

Enhancement of the Financial Infrastructure in Hong Kong

“An eFrastructure for a Leading eEconomy”

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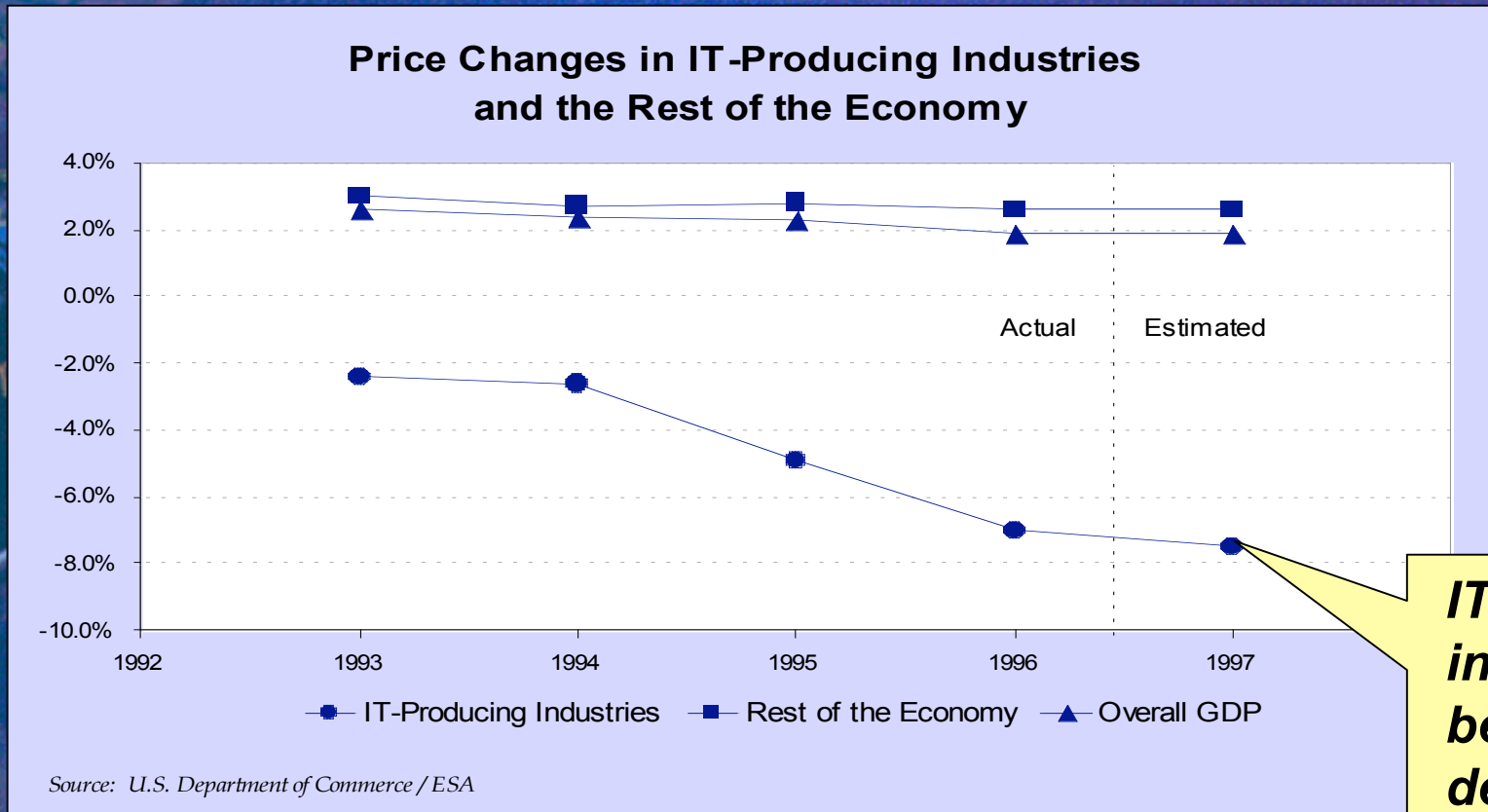
- The SCEFI study
- Embracing market challenges & opportunities
- Vision for success
- The eFrastructure
- Journey to the future

- FS announced market reform to enhance the financial infrastructure in Hong Kong
- SCEFI was appointed to study:
 - Single clearing arrangement
 - Straight-through processing (STP)
 - Scripless securities market
 - Technology structure, legal/regulatory implications
- Examined international standards, best practices, emerging trends, and input of User & Technology Working Groups
- Proposed target infrastructure & recommended initiatives

Market competition is relentless...

- Meeting competition through technology excellence
- Advent of eEconomy spurs eCommerce & eTrading
- Strategic alliances dominate in the global marketplace
- Enhancing financial infrastructure to win

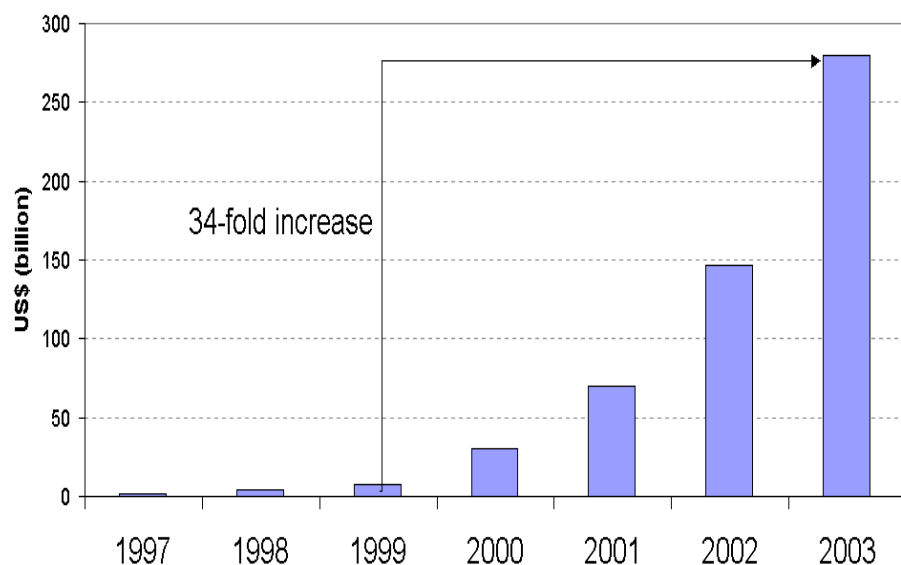
Recent developments in the U.S. demonstrate how relentless improvements in technology can compensate for high cost.



IT-producing industries have become a GDP deflator

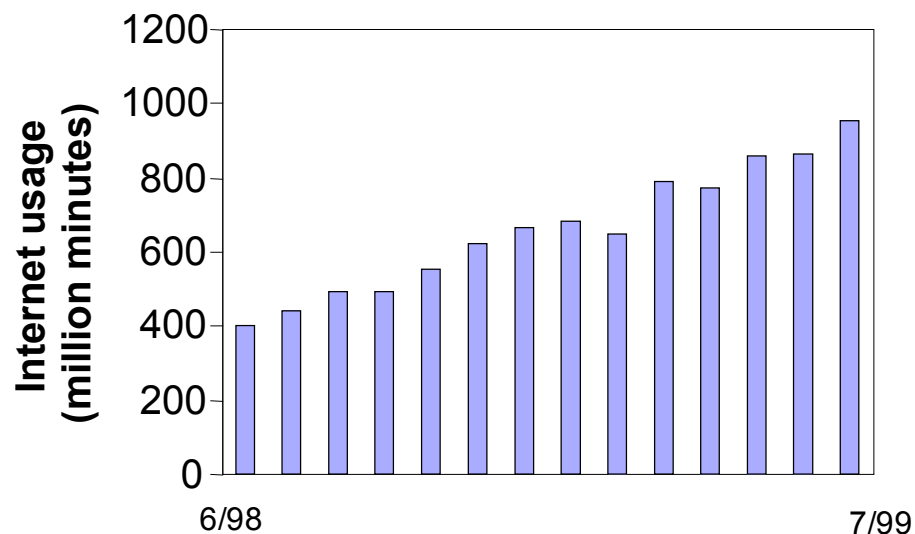
Hong Kong has experienced robust growth in Internet usage; and would continue to thrive under the explosion of Asia Pacific eCommerce.

Business-to-business eCommerce in Asia Pacific



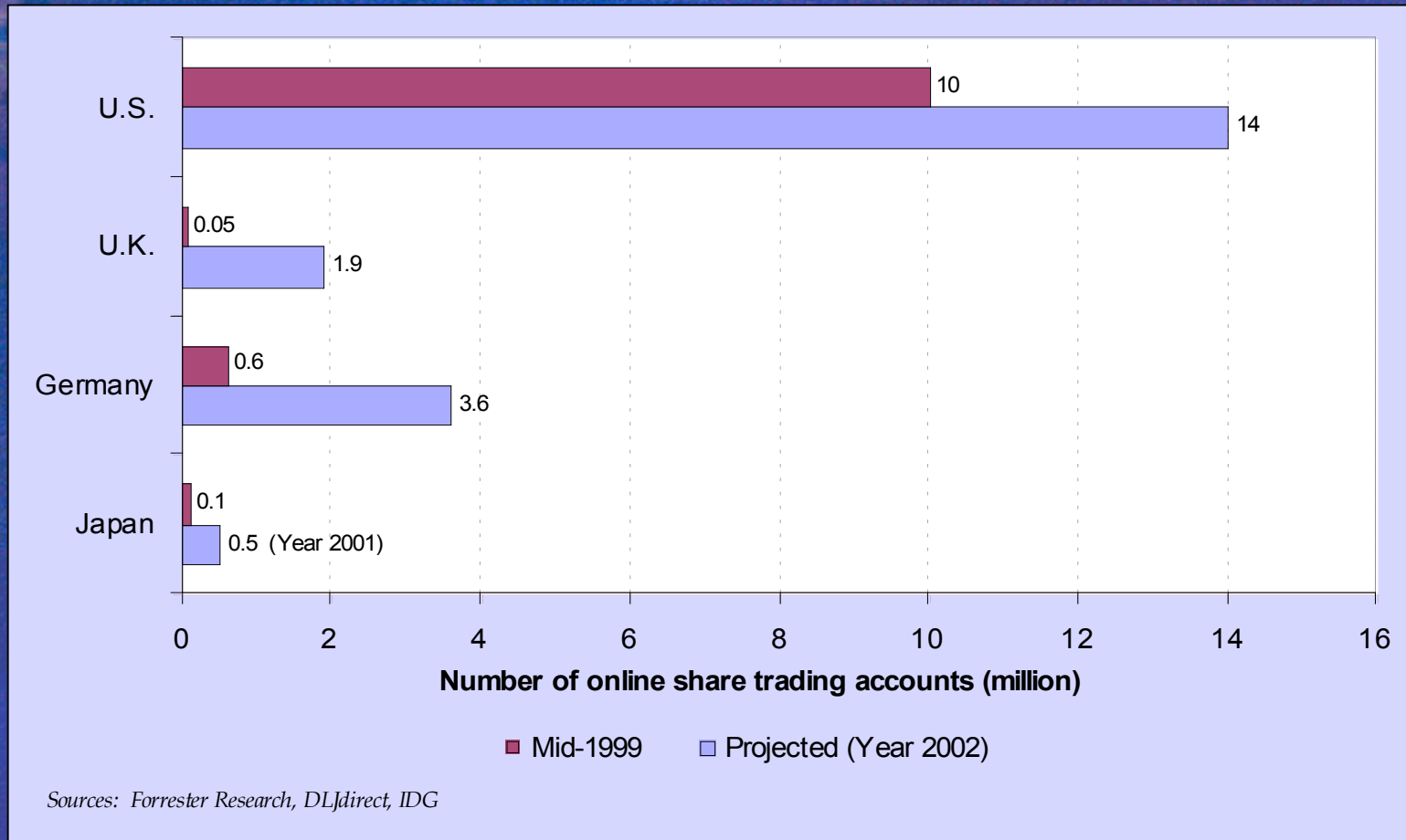
Source: Gartner Group

Hong Kong's Internet usage



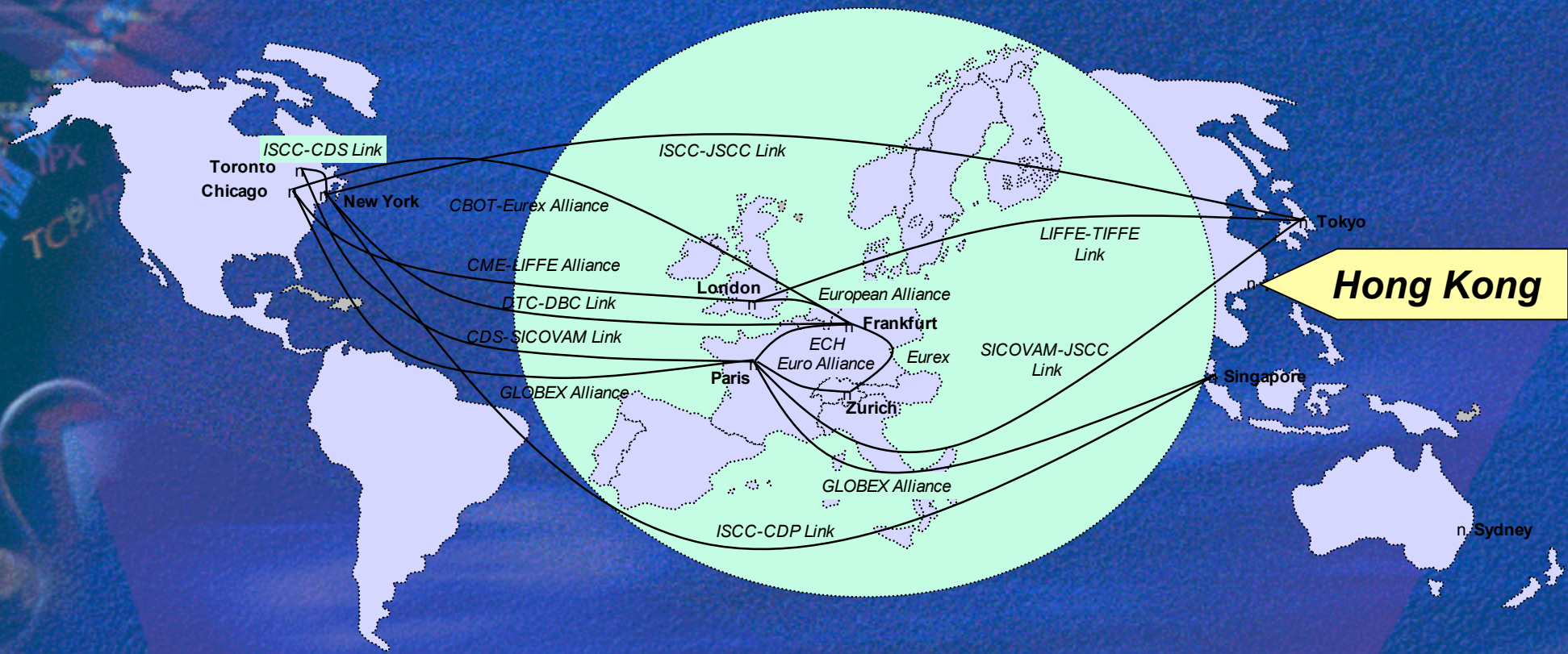
Source : Office of the Telecommunications Authority, Hong Kong

By 1999, nine of the ECNs account for about 25% of the total equity trade volume in the U.S.



Strategic alliances dominate in the global marketplace

Exchanges and clearing houses are establishing strategic alliances to enable better development of cross-market products and realize economies of scale on technological investments.



Despite existing strengths and recent achievements, Hong Kong cannot afford to become complacent.

Strengths and Achievements in Hong Kong:

- CCASS (1992)
- AMS (1993)
- RTGS (1996)
- Digital 21 strategy (1998)
- AMS/3 (2000)

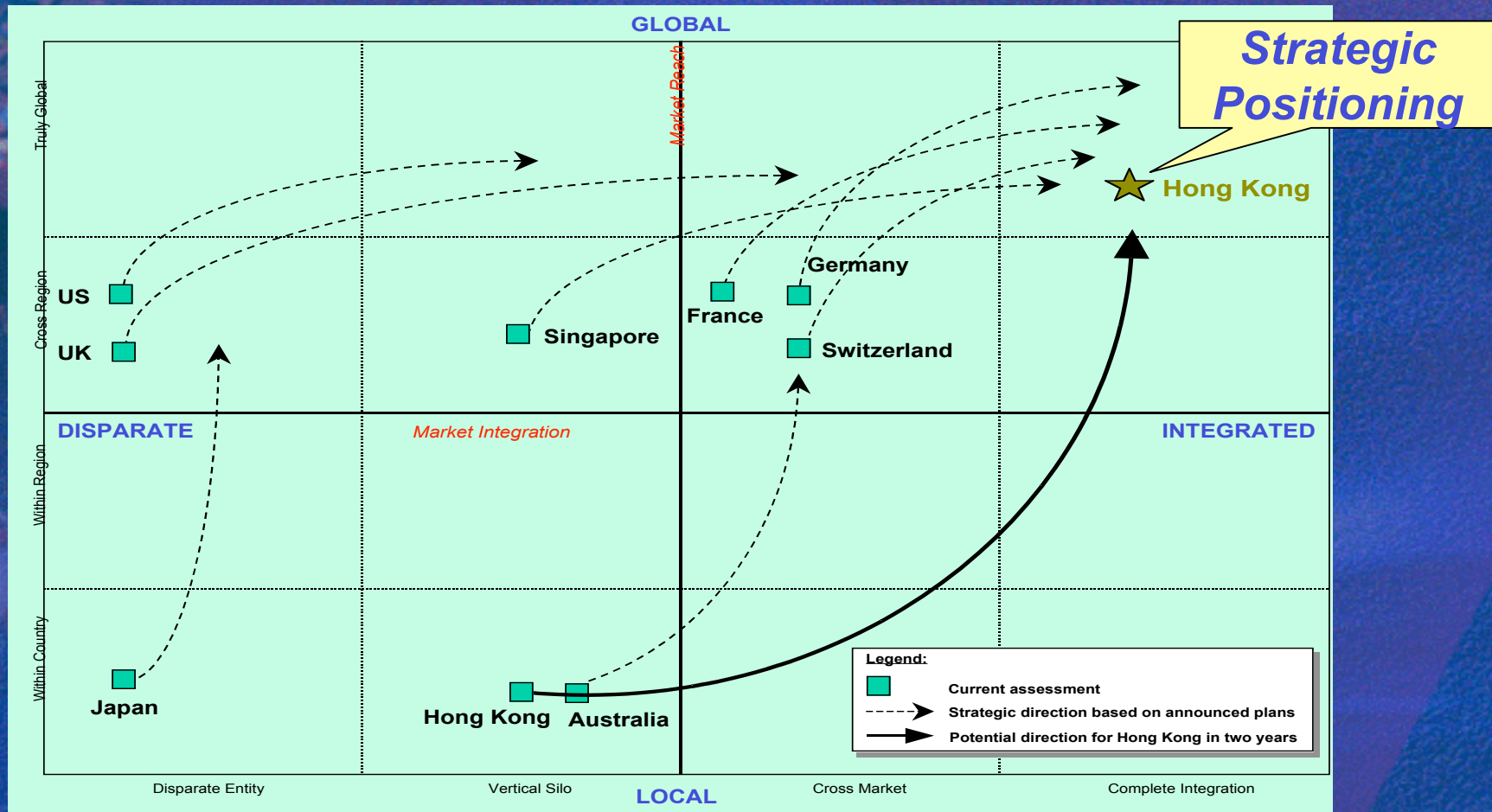
Initiatives taken by other countries in Asia:

- CNAPS (China)
- Korean Information Highway (Korea)
- MSC (Malaysia)
- SingaporeONE (Singapore)

Strategic objective:

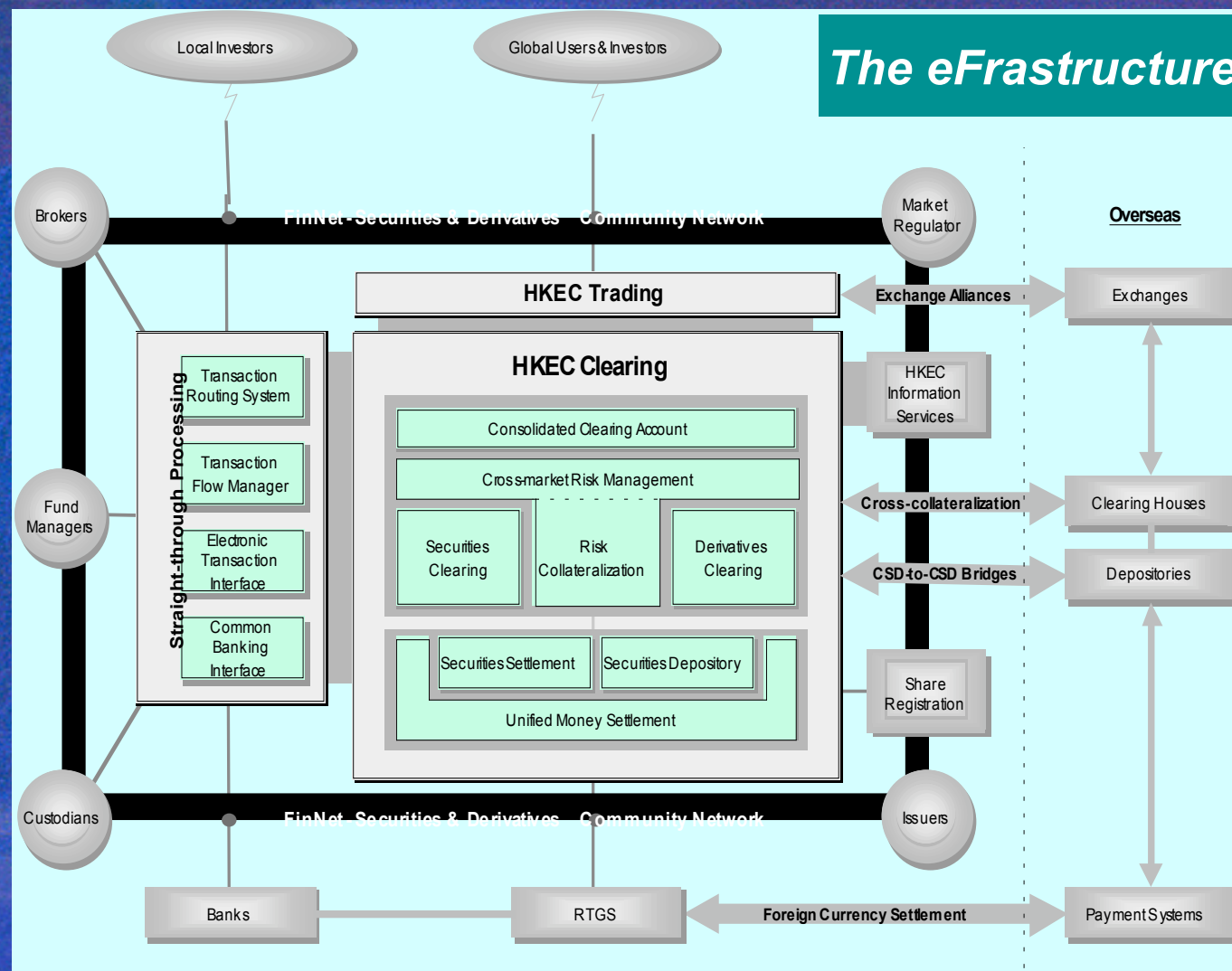
To embrace state-of-the-art technology to remain in the premier league of world financial centers and enhance the competitiveness of Hong Kong in terms of risk mitigation, efficiency improvement, and costs reduction.

Time is of the essence. Hong Kong must act fast aggressively to clinch its lead position.



Components of eFrastructure:

- Single clearing arrangement
- STP
- Scripless securities market
- Open, robust, and scalable technology structure



Building blocks:

- Consolidated clearing account structure
- Real-time position creation & management
- Unified money settlement through interbank RTGS
- Portfolio-based risk management & collateralization
- Synchronized processing of consolidated clearing

Key Benefits:

- Improve risk management across markets
- Reduce settlement risks and improve efficiency
- Enhance market liquidity

Building blocks:

- Transaction flow manager (TFM)
- Transaction routing system
- Electronic transaction interface
- Common banking interface
- CSD-to-CSD bridges (multiple bilateral links)

Key Benefits:

- Reduce pre-settlement risks and operating cost
- Shorten the settlement cycle to achieve T+1 settlement
- Increase settlement accuracy/efficiency

Building blocks:

- Electronic & instantaneous share registration
- CSD-to-registrars links
- Comprehensive investor participation for direct settlement
- CSD/registrars' infrastructure upgrade
- Fine-tune the legal & regulatory framework

Key Benefits:

- Ensure instantaneous legal certainty of share transfers
- Enable real-time DvP and registration
- Through STP, increase efficiency and reduce cost

Building blocks:

- Unified, open & global **access** through various channels and complying to standards (e.g., Web, APIs, SWIFT, ISO)
- Secure, high performance & resilient community **network**; scalable, flexible & interoperable with the financial conduit “FinNet”
- Reliable **gateway** for message-based/interactive connections
- Integrated global leading league’s **services** for alliance readiness

Key Benefits:

- Pave the way for FinNet implementation
- Provide an integrated platform for risk management and STP initiatives

Single clearing arrangement:

- Recognition of the merged clearing house by the SFC
- Cross-market participation rights
- Insolvency protection & cross-market risk management

Straight-through processing:

- New legal / contractual relationships
- Principal-to-principal relationship for exchange trades
- Electronic Transactions Bill

Scriptless securities market:

- Changes to statutory provisions that pre-suppose scrip & papers
- Legal title & ownership, security interests & the roles of CSD
- Legislative changes of domicile countries requiring scrip

Quick Wins

- 1. Implement Consolidated Account Reporting**
- 2. Implement Electronic Filing for Intermediaries on FinNet**
- 3. Implement Appropriate Risk Management Quick Wins**

Core eFrastructure Initiatives (within 2 Years)

- 4. Build Securities & Derivatives Community Network (FinNet for securities clearing first)**
- 5. Upgrade Securities Clearing to Open Architecture Ready**
- 6. Achieve Single Clearing Arrangement**
- 7. Enable Straight-through Processing**
- 8. Consolidate Derivatives Clearing onto Single Platform**
- 9. Realize Scripless Securities Market**

Re-assess then Act

- Integrate Other Exchanges & Clearing Networks into the SDNet**
- Unify Access for Trading & Clearing for Securities & Derivatives Markets**
- Further Upgrade Securities Clearing System (if appropriate)**

Key success factors:

- Commitment & determination
- Continuous learning from the market
- Strategic partnerships with global players
- Program management of the enhancements
- Availability of needed skills & resources
- Effective market communications & acceptance
- Complementary business strategy