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AN ANALYSIS OF THE FUNCTIONS OF THE
SECURITIES AND FUTURES COMMISSION
ORDINANCE AS A DEVICE FOR ENSURING THE
PROTECTION OF INVESTORS IN HONG KONG

by

KO Sai Hong

A Master's Thesis

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for the award of

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ABSTRACT

The present study is concerned with the analysis of a piece of economic legislation - the Securities and Futures Commission Ordinance (SFC) of Hong Kong - within the theoretical framework of the theories of economic regulation, testing the legislation's stated objective of investor protection for the securities industry.

Principally two sets of theories attempt to explain the impact of economic regulations. They are the "Public Interest Theory" and the "Capture Theory". The former is largely of a normative nature. It stipulates that in case of market inefficiency economic regulations are enacted for protecting the interest of the general public. The Capture Theory states that economic regulations are enacted for interest groups rather than for the protection of the interest of the general public against the defects and inefficiencies of the market economy. George J. Stigler is the pioneer of the latter theory. Over the years his Capture Theory Model has been subject to rigorous analysis and expanded upon by economists such as C. Friedland, S. Peltzman, W. Gordan, R. Jackson etc. Stigler's original pessimistic stance that economic legislation is inefficient and ineffective in protecting the general public is

gradually being modified and refined by J. Hirshleifer, L. Edwards and F Edwards, P. Spiller, J. Kalt and M. Zupan, D. Haddock and J. Macey and D. T. Llewellyn. A multi-relationship model which consists of players like regulators, legislators, consumers and manufacturers gradually emerges.

With both the central planned economies and market economies practising deregulation over the last decade, the Capture Theory Model is being further challenged because it could not explain fully regulation and at the same time, deregulation or re-regulation. D. T. Llewellyn points out that the usual Capture Model premise of "legislative versus legislative-free" environment does not hold for the UK Financial Services industries. The Capture Model which ignores the forces of the market intermediaries and professionals, may, therefore, not be an appropriate model for industries which the above mentioned interest groups play an important part in the regulatory process. K. J. Button, in examining the deregulation of the UK bus industry, suggests that Sharkey's "Winning Coalition" model which is based on the theory of cooperative games, may provide a more appropriate framework for analysis.

In ascertaining the effectiveness of the SFC Ordinance in protecting the public interest the present researcher

employs the survey research method for collecting data from interest groups of the securities industry as well as from the general public. The collected data are used for testing three hypotheses. Each hypothesis tests the effectiveness of the SFC in discharging one of its major functions. Binary Choice Models are employed for ascertaining the likelihood that the general public is being protected by the legislation. The chi-square analysis is also employed for ascertaining the degree of confidence and the other characteristics of the collected data.

The findings indicate that benefits of the SFC legislation, an economic legislation, are not all the time accrued to interest groups, as predicted by the Capture Theory. The general public does occasionally derive benefits from this legislation. However, it is also not correct to state that this economic legislation only bestows benefits on the general public, as predicted by the Public Interest theory. Interest groups also, at times, derive benefits from it. Both the Public Interest Theory and the Capture Theory are unable to explain fully the findings. It is further observed that the general public does behave like an interest group. The general public bids for the benefit of an economic legislation as though it is an interest group but, unlike an interest group, it offers negative "considerations" such as "not raising a public uproar" or

"refrain from supporting the other party". The regulator, the SFC, also behaves like an interest group. On the one hand it maximises support from the general public which would guarantee its future funding from the public but on the other it also solicits rewards from interest groups. The results also demonstrate that, when mutual interest prevails, interest groups (including the SFC and the general public) may join hands in bidding for legislative benefits.

The results support neither the Public Interest Theory nor the Capture Theory. Both of them cannot fully explain the interaction among interest groups. As observed, it is more appropriate to consider each interest group as a player in a corporate game of manoeuvre. Players of this corporate game of manoeuvre are each holding stakes of a different nature and value. Sharkey's "winning coalition" model which is based on the theory of cooperative games seems to be providing a viable framework for such an analysis. These two sets of theory, however, do provide a useful framework from which the conduct of interest groups are analysed. Regulators and legislators, except for their occasional "shirking" behaviour, do act like any other interest group. In future, a corporate game model within which all parties to an economic legislation are players could be a more insightful way of looking at the behaviour of the general public, legislators, regulators and corporate bodies.

CHAPTER 1

INTRODUCTION

Statement of the problem

The present study is concerned with the analysis of the SECURITIES AND FUTURES COMMISSION ORDINANCE of Hong Kong (Chapter 24 of the Laws of Hong Kong), within the theoretical framework of the theories of economic regulation, testing the legislation's stated objective of investor protection for the securities industry.

Research of this nature is uncommon outside the USA and UK legislature and is unique in the Hong Kong environment. A variety of theories and hypotheses touch upon and are concerned with economic regulations. These theories are often advocating conflicting concepts and no consensus has yet emerged. However, 'the most widely adopted theories of regulation can usefully be divided into two broad groupings'¹. First is the Public Interest Theory. This theory is composed of normative values devoid of rigorous analysis. It has dominated the thinking of economists for generations and there are still keen advocates of this theory today.

¹p.489, The Antitrust Bulletin, Fall 1989, 'Economic theories of regulation and the regulation of the United Kingdom's bus industry', Kenneth J Button.

The theory simply asserts that economic regulations are enacted for the protection of the 'general public'. It says that benefits from economic regulations would accrue to the general public and not to private individuals or groups. The second and more recent theory is the Capture Theory propounded by economist and Nobel laureate George J. Stigler. This theory asserts that economic regulations are 'supplied' to economic groups simply as a form of commodity and that benefits derived from such economic regulations would be captured by them.

The researcher, using primary data, attempts to test the hypothesis that the benefits from the Securities and Futures Commission Ordinance, an economic legislation, are captured by the general public. The alternative hypothesis is, of course, that legislative benefits are not captured by the general public. If such were the case, the researcher will attempt to ascertain whether benefits are captured exclusively by interest groups, as predicted under the Capture Theory or shared, either among interest groups or among interest groups and the general public.

The importance of the study

The research involves an analysis of the Securities and Futures Commission (SFC), an independent agency set up under

the Securities And Futures Commission Ordinance. The analysis focuses on the ability and effectiveness of the SFC in protecting private securities investors. The Public Interest theory and the Capture Theory are adopted as the guiding theories of this analysis. Primary data relating to the effectiveness of the Securities and Futures Commission are collected through original empirical research. As the Public Interest Theory and the Capture Theory are advocating different concepts, at the conclusion of the analysis the acceptance of one may lead to the rejection of the other. However, there is a possibility that both theories are being rejected by empirical evidence i.e. the legislation provides benefits to interest groups and the public alike or it bestows benefits to none. The Capture Theory does not exclude the possibility that benefits of legislation are being shared among interest groups.

The Capture Theory has been subject to rigorous analysis in the United States of America, based upon legislation of individual states. Only in a few instances are these theories applied to a non-USA legislature ¹, and none to a non-USA and non-European legislature, such as the one conducted by the present researcher. The present

1. Professor K J Button has written a paper on the 'Economic theory of regulation and the regulation of the United Kingdom's bus industry', The Antitrust Bulletin, Fall 1989.

analysis advances the understanding of the theories of economic regulation and tests their applicability in the present Hong Kong legislative and social environment. Findings from this research may be useful to economists, lawyers and legislators in understanding the nature of economic legislation in Hong Kong. Further, as Hong Kong will undergo dramatic political changes in 1997 when its sovereignty reverts back to China, research of this nature could form the base of comparative research in political economy.

A critical evaluation of the present research problem

Not every problem is appropriate for empirical studies, and not every human behaviour can be guided by knowledge obtained using scientific methods. A research problem, such as the present one, in addition to being empirically grounded, should also be clearly and specifically articulated. An appropriate research problem should possess these attributes ¹:

1. the problem is defined properly, is labelled and described accurately;
2. the problem is posed in testable terms;
3. the problem is connected logically to the environment

1.p.19 Research Methodology & Business Decisions, John W. Buckley and others, National Association of Accountants, 1976.

from which it is drawn - and the solution can be applied within that environment;

4. the problem has been screened against the existing body of knowledge to assure of its uniqueness, i.e., it has not been solved previously;

5. the solution to the problem must be viewed as making a potential contribution to the body of knowledge, i.e., the problem must be material.

The present research problem is able to fulfil the above five conditions. It has been properly defined, is solvable, is connected with the environment, has not been solved previously and its findings would make a contribution to the existing body of knowledge.

Reasons for using the Securities and Futures Commission Ordinance for this research

Most of Hong Kong's legislation is economic in nature. However, a piece of economic legislation, if adopted for use in the present research, should exhibit all or most of the following characteristics :

a) The legislation must be an economic legislation having material effects on clearly defined economic activities of Hong Kong. A piece of insignificant economic legislation would not attract the attention of interest groups.

b) It is desirable for the chosen legislation to create or

formulate a regulatory system which exhibits some degree of similarity with that of the USA. The Capture Theory is developed by Stigler using the USA regulatory models and the Public Interest Theory is rooted in the western economic system. The investigation of a regulatory system using theories developed from a completely different economic and legislative environment may yield interesting results but may, at the same time, render comparison and generalization difficult and the conclusions inconclusive. Some degree of commonality is desirable.

c) The Hong Kong regulatory agency created by the legislation must be generally known by both the public and interest groups. An unknown or relatively obscure regulatory agency may present difficulties to a researcher in collecting useful data.

d) The legislation must have, as one of its main objectives, the protection of the interest of the general public.

Having considered the above characteristics which should be exhibited by the targeted legislation the researcher is of the opinion that the Securities and Futures Commission Ordinance is the most appropriate legislation for the present analysis. The researcher forms the above opinion after considering the following.

a) The Hong Kong stock market, with a market capitalization of HK\$ 2,240,547 millions in June 1994, is second in Asia after the Tokyo exchange. The SFC Ordinance is an important legislation affecting the Hong Kong securities industry. There is no doubt that this legislation has a material economic impact on Hong Kong as well as for other financial centres in the South East Asia region.

b) Among the economic legislation of Hong Kong the SFC Ordinance is both unique and pioneering. For the first time in Hong Kong's regulatory history an independent agency (away from the government bureaucracy) is being set up for regulating economic activities. No other independent agency of this nature is currently being established in Hong Kong. The setting up of this independent agency, the Securities and Futures Commission, has brought the regulatory system of Hong Kong closer to those of the USA, the UK and other industrialized countries.

c) Representations from 21 associations, 64 companies, 26 individuals and 4 government departments were received before the securities review report was compiled. The subsequently drafted legislation had undergone full consultation with all market participants before it became

law ¹. The intent, purposes and effects of the SFC Ordinance were well publicized to the people affected, i.e. the various interest groups and private investors. No other Hong Kong economic legislation has received such public attention.

d) As mentioned before in subsection C the SFC Ordinance was drawn up following closely the recommendations of the Report of the Securities Review Committee of 1988. Members of the Securities Review Committee were appointed with the terms of reference of reviewing the work of the securities industry and specifically "to recommend what changes are desirable to ensure the integrity of the markets and to protect investors" ². The SFC Ordinance is one of the few Ordinances in Hong Kong which specifically states as one of its objectives the protection of the public interest. Section 4 (e) of the Ordinance states that the SFC Commission is "to take all reasonable steps to safeguard the interests of persons dealing in securities or trading in futures contracts or entering into property investment arrangements". The unambiguous investor protection objective in the SFC Ordinance has rendered this piece of

1. Appendix 3, The Report of the Securities Review Committee, 1988.

2. p.8 the Report of the Securities Review Commission, Hong Kong Government Press, 1988.

legislation the most appropriate law to be used in the present analysis.

The research method employed

After defining the research problem and identifying the economic legislation to be used the other equally important task for the researcher is to select an appropriate research method. Within the social science discipline, researchers are known to employ one of the three research methods - the archival research, survey research and experiments.

Archival research is the systematic investigation of recorded information relating to a research problem with a view to acquiring insights, discovering relationships or forming opinion. Recorded information can be obtained from original documents or official files and records. A researcher who uses this information for his analysis is conducting a primary archival research. Alternatively a researcher may employ data which was previously collected and developed by other investigators. This is called secondary archival research ¹.

Survey research is the process of obtaining information

1.p.8 Business Research : Concepts and Practices, Robert F. Murdick, International Textbook Company Penn., 1966.

from a population or a sample of a population with a view to describing the characteristics, evaluating the effects of an action or obtaining explanations of certain behaviour of a population. Personal interviews and questionnaire responses are tools which are commonly employed for this research method. Most surveys have a central thesis of finding relationships among variables or the determination of the existence of patterns of relationships among variables ¹. Empirical data collected through surveys should either provide grounds for accepting or rejecting hypotheses originally set for the survey or provide insights for research problems.

An experiment based on social phenomena is not unlike any other experiment based on natural phenomena. The purpose of an experiment is to study a specific reaction or effect ². It is the production of an effect which is the experiment and the object of the experiment is to determine what (if any) effect can be identified in the dependent variables as due to the treatment of the independent variables. One of the major differences between experiments of natural scientists and those of social scientists is that social scientists must interact with their subjects while

1.p.2 Survey and Opinion Research

2.p.201 Survey and Opinion Research

natural scientists need not do so.

As discussed in the foregoing paragraphs, three methods are commonly employed by researchers of social science for collecting data --- experiments, archival research and survey research. Each method is evaluated in the coming paragraphs to ascertain their appropriateness for the present analysis.

Experimentation is being used increasingly in social science researches. It is so because social science researchers are beginning to realize that under certain circumstances experimentation is most effective in obtaining dependable knowledge about social intervention ¹. This research method is frequently employed by public sector researchers who wish to determine the potential effect of public policies. In the private sector marketing researchers also frequently employ this research method. In a social science experiment "one or more treatments (programs) are administered to some set of persons (or other units) drawn at random from a specified population; and that observations (or measurements) are made to learn how some relevant aspect of their behaviour following treatment differs from like behaviour on the part of an untreated or

1.p. 24 Social Experimentation, H W Riecken & R F Boruch, Academic Press, Inc., 1974.

control group also drawn at random from the same population"

¹. An important aspect of a social science experiment is that of the 'programme' which is to be administered to the randomly selected group. A researcher could not employ this research method if he is constrained by his research environment from designing an effective programme. The second aspect of a successful experiment is that of the quality of the personnel administering the programme. Staff involved in the programme should be specially selected and trained ². Further, the high cost of administering a social science experiment may also deter many researchers from using this technique. In the present analysis, the researcher is not adopting the experimentation method because :

a) An effective programme is almost impossible to devise. Basically the effect of an SFC action on the securities industry cannot be duplicated in a laboratory environment. Alternatively if field experimentation is used, it is difficult to isolate the effect of an SFC action from the control group.

b) Because of the limited resources available to the researcher it is doubtful whether he could employ competent

1.p.3 Social Experimentation, edited by H W Riecken & R F Borouch; Academic Press Inc., 1974.

2.p.18 Social Experimentation, H W Riecken & R F Borouch, Academic Press, Inc., 1974.

and highly trained personnel for carrying out the experimentation.

c) The cost of carrying out such an experiment may be so inhibitive that it is not reasonable for it to be funded by a private researcher who has limited support.

For the second research method, the archival research, the researcher is of the opinion that this method cannot be employed; or, if being employed, this method will not produce unbiased and complete results. The researcher takes the following observations into consideration when arriving at this conclusion:

a) The SFC Ordinance has only been in place since May 1989. Only limited data are available because of the short history of this legislation.

b) The SFC Ordinance regulates financial services, the effectiveness of which could not be easily quantified or measured in monetary or physical terms, unlike similar analyses in the USA for utilities industries.

c) Previous archival research in this area was mainly carried out by researchers in the USA. These researchers had the advantage of comparing data collected from States which are with and without a certain piece of economic legislation. Researchers from other countries, however, are not in such an advantageous position. Hong Kong is small and it has a homogeneous legislature. It would not be

possible to adopt a similar archival research method.

The last research method, the survey method, is the most appropriate one to be employed for the present analysis given the present constraints. The researcher takes the following into consideration when he comes to this conclusion:

a) The population relating to the securities industry has a high literacy rate, is receptive to answering questionnaires and is usually not afraid of giving honest opinion, if the research is conducted by a respectable body or person and anonymity is assured.

b) This research method is more cost effective than other methods, given the resource constraint.

The Survey

Three surveys, each on an identified group, are conducted. The groups identified for the present analysis are a) private investors, b) professional investors and c) stock brokers. Private investors represent the interest of the investing public while the latter two are interest groups ¹. The securities industry has other interest groups

1. Haddock and Macey treat the general stockholders as an interest group, albeit weak interest group, in their analysis of insider trading laws, Regulation on Demand: A Private Interest Model, with an Application to Insider Trading Regulation, vol. XXX(2) Journal of Law and Economics, Oct. 1987.

which are equally affected by the SFC Ordinance. However, for testing the effect of the legislation in investor protection it is only necessary to study the effect of the law on the general public and major interest groups. It is not necessary to repeat the analysis for all interest groups affected by the SFC Ordinance. The essential task for the researcher is to identify major interest groups which possess diverse interests, but not necessarily conflicting interests, in the legislation and to investigate the effectiveness of each in capturing legislative benefits. The present researcher is not alone in the selection of such groups for study. George A. Jarrell of the Securities and Exchange Commission of the USA had used similar group types for his analysis of the deregulation of the New York Stock Exchange ¹. Haddock and Macey (1987) also used such groups in their analysis of insider trading regulation of the USA ².

The interest of the general public is represented by the interest of individual private investors who deal in securities for their own accounts. They are members of the

1.Changes at the Exchange : The Causes and Effects of Deregulation; George A Jarrell, Journal of Law and Economics, vol.XXVII (October 1984).

2.Regulation on Demand : A Private Interest Model, With an application to Insider Trading Regulation; Haddock & Macey, vol.XXX(2), Journal of Law and Economics, October 1987.

`general public'. As observed by the Securities Review Commission, these investors are not especially risk averse.

¹ They seldom possess the expert knowledge or the efficiency of professional investors and, as a group, are cohesively weak, with diffuse interests and, with the exception of a few consumer groups, are not likely to form themselves into an interest group for the bargaining of legislative benefits. Under the Capture Theory, private investors, as a group, lose out on capturing legislative benefits. However, under the Public Interest Theory, private investors (the general public) should always be the winners in capturing legislative benefits.

Professional investors are firms or individuals (unlikely) who manage unit trusts, funds or portfolios of securities for fees and commissions. One of their most important duties is to "acquire information about a firm, an industry, or a group of firms or industries and to develop skills for evaluating the information they obtain" ². In Hong Kong there are only about 35 firms of professional investors managing 497 unit trusts and funds which in total

1.p.36 Report of the Securities Review Commission 1988.

2.p.318 Journal of Law and Economics, October 1987, Regulation on Demand: A Private Interest Model, With an Application to Insider Trading Regulation, Haddock & Macey.

command an asset value of US\$ 21,835 millions ¹. Most of the assets of these trusts and funds, however, are not invested in Hong Kong. Professional investors, as a group, are extremely cohesive because of their small number. They possess a strong mutual interest of having a tightly regulated and highly efficient securities industry. They are, in general, risk averse and dislike surprises. They are likely to form themselves into a group for the bargaining of legislative benefits. The managers of unit trusts in Hong Kong have formed an association, the Hong Kong Unit Trust Association. In 1986, members of this association had accounted for 80% of the total turnover value in the Unified Exchange ², leaving a mere 20% for local investors. This figure may have changed because of the passage of time but the economic bargaining power of this association is demonstrated. This association had made representation to the Securities Review Committee in 1988 ³. Under the Capture Theory, the benefits of the SFC Ordinance should be captured by this interest group. There are only 24 active professional investors (fund managers) dealing in the Hong Kong market. Because of the small

1.p.4 The Hong Kong Unit Trust Yearbook 1992, The Hong Kong Unit Trust Association, published by Longman Group (Far East) Limited.

2.p.6 Journal of the Chinese Manufacturers' Association, 1987 second issue.

3.Appendix 3, Report of the Securities Review Committee, 1988.

population size, their survey returns may not be statistically significant. However, because of their enormous importance in the Hong Kong securities market they are included as an interest group.

Stock brokers are traders of securities dealing in the Unified Exchange. The Unified Exchange is the only authorized stock exchange in Hong Kong ¹. It is operated by the Stock Exchange of Hong Kong Limited (the Exchange Company) for its stock broker members. Members of the Exchange Company are a formidable group. They lobby actively for political and legislative benefits. There were 520 members (stock brokers) in the Exchange Company in 1989 and their number has grown to 854 by June 1994 ². The number of stock brokers, as compared with the number of professional investors, is much larger. Their association, the Hong Kong Stock Brokers Association Limited, is in theory less cohesive than the Hong Kong Unit Trust Association due to the larger population size of the former. The Hong Kong Stockbrokers Association Limited has also attempted to influence the legislative process by making representation to the Securities Review Committee in 1988 ³.

1.s.27 Stock Exchange Unification Ordinance Cap.361.

2.Member List, The Stock Exchange of Hong Kong Limited, September 1989, and 1994.

3.Appendix 3, Report of the Securities Review Committee, 1988.

This group favours an unhindered market, lax legislative control and an unfettered trading environment.

Objectives of the surveys

Three surveys were conducted, each of an interest group. The central thesis of the three surveys is to evaluate the impacts of the SFC Ordinance on the three interest groups of professional investors, private investors and stock brokers. Dictated by its functions ¹ the SFC Ordinance should have considerable impact on the following aspects of the securities industry :

- a) the enactment and enforcement of law relating to securities for the protection of investors;
- b) the supervision of market intermediaries (eg. stock brokers) and self regulated bodies (eg. the stock exchange), for the purpose of protecting investors ;
- c) the ensuring of the integrity of securities and securities dealings for the protection of investors.

The Securities and Futures Commission (SFC) is an independent agency created by the Securities and Futures Commission Ordinance for discharging the function of investor protection. The effectiveness of the SFC Ordinance in protecting investors is reflected in the effectiveness of

1. Section 4, SFC Ordinance.

the SFC, the independent agency. The effectiveness of the SFC is reflected in the ways in which it discharges its duty and exercises its powers. The three hypotheses are formulated so as to test the effectiveness of the SFC from a wide spectrum. In order to ensure that the present findings reflect accurately the effectiveness of the SFC all major functions of the SFC are within the scope of the present analysis.

Arising out of the three functions are the three hypotheses formulated by the researcher to be tested in the present analysis:

Hypothesis 1 : That the Securities and Futures Commission has caused the making and enforcement of appropriate law and regulations for protecting the interest of the general public, i.e. private investors.

Hypothesis 2 : That the Securities and Futures Commission has adequately supervised the stock exchange, a self regulated body, for protecting the interest of the general public, i.e. private investors.

Hypothesis 3 : That the Securities and Futures Commission has adequately supervised listed companies and their management for protecting the interest of the general public, i.e. private investors.

Sampling methods

Three surveys are conducted, each on an interest group, i.e. the private investor group which represents the interest of the general public, the professional investor group which represents the interest of funds operators and the stock broker group which represents the interest of securities dealers. Due to the difference in group size, different sampling methods are employed for each. For the private investor group, because of its very large group size the random sampling method is used. In order to avoid bias in the random sampling process, a good random sample should be drawn "either entirely at random, or at random subject to restrictions which, while improving the accuracy, are of such a nature that they do not introduce bias into the results" ¹. In the present analysis, the sample is not selected at random from the population of Hong Kong because of the likely low response rate. Instead, the researcher requests 60 stock brokers each of whom to send five questionnaires to five of their clients. The stock brokers are asked specifically to send the questionnaires to the first five of their personal clients who they deal with on the day which they receive the questionnaires. They are the first five personal clients who come to or call the brokers' office for deals irrespective of their background or the

1.p.10 Sampling Methods for Censuses and Surveys, 3rd Edition, Frank Yates, Charles Griffin & company Limited, 1971.

nature of their deals. A total of 300 questionnaires were sent.

For the professional investor group, due to its small group size, the researcher is able to send questionnaires to all of them who maintain an office in Hong Kong. Those who do not maintain an office in Hong Kong are unlikely to be active in the Hong Kong securities market or to have a good understanding of the Hong Kong legislation affecting securities. A total of twenty four questionnaires were sent. The mailing list was compiled from the "Hong Kong Unit Trust Yearbook 1988" published by the Hong Kong Unit Trust Association.

For the stock broker group, because its group size is not as small as the professional investor group or as large as the private investor group the researcher decides to use the systematic sampling method. Systematic sampling "consists of selecting every kth individual after the original individual is selected at random" ¹. In this case the member list of the Unified Stock Exchange 1989 is used. Every second member on the list is selected, starting from the first member. Members who hold two or more seats are only sent questionnaires once. A total of 250

1.p.348, Statistics in Political and Behavioral Science, D. J. Palumbo, Meredith corporation 1969.

questionnaires were sent. Dormant members are not excluded from the mailing list. Their dormant status cannot create any bias in their responses to this questionnaire.

Limitation due to population size

Out of the three interest groups targeted for the present analysis, both the private investor group and the stock broker group have viable population size from which representative samples could be drawn. For the professional investor group, although it is included as an interest group due to its importance to the industry, the population size of this group (24 companies) is too small for sampling. Thus, all members of this group are sent questionnaires. Unless all or a substantial number of them responded to the questionnaire, the data from this group of investors should be treated with caution. Throughout this research, data collected from professional investors are treated with caution and are regarded as of persuasive importance only (i.e. of a supportive nature). The analysis is being carried out with stronger reference to the stock broker group representing an interest group and the private investor group representing the interest of the general public.

End of Chapter

CHAPTER 2

LITERATURE REVIEW ON THEORIES OF ECONOMIC REGULATIONS

In this chapter the economic theories of regulation are reviewed. Economic regulations may be in the form of legislation or rules. Legislation is written law enacted by the state. It is highly compulsory. Those in breach of the legislation may have to suffer punishments from the state. Rules are usually less compulsive. They are usually set by quasi-governmental bodies exercising the power vested upon them through legislation. Self-regulated bodies may also set informal codes of conduct which are more coercive by nature but are still compulsory for members of the industry regulated. However, both types of regulation may have important economic impact on society in general and the industries regulated in particular.

Many generations of economists have studied the general economic impact of regulations. Theories explaining the rationale of regulation are, at times, philosophical arguments. In the late fifties and early sixties economists began to adopt an analytical approach to the study of the economic impact of regulation. This new approach gives rise to some unexpected findings which prompt economists to find new ways of explaining the impact of economic regulations.

The early theory adopts the 'public interest' argument. It says that economic regulations are enacted for the protection of the interest of the general public. Later, Stigler challenged this theory and put forward his Capture Theory. The Capture Theory, in essence, says that economic regulations are there to protect the interest of politically cohesive groups which in most cases are the industries themselves. Stigler published his paper, the "Theory of Economic Regulation", in 1971 ¹.

Before Stigler's publication in 1971, there were already several important publications on the empirical studies of the economic impact of regulations. These studies were mostly conducted by economists from the United States of America analyzing the economic impact of state economic legislation. These analyses are difficult to duplicate in other countries because the United States of America is one of the few countries in the world which is economically homogeneous but legislatively diverse.

THE PUBLIC INTEREST THEORY

The Public Interest Theory is derived from the concept of natural justice and natural law. These in turn are

1. The Theory of Economic regulation. George J. Stigler, Bell Journal of Economics and Management science, V.3 1971.

derived partly from the 'concept of nature' of the Renaissance and partly from religious background ¹. This set of highly conceptual moral standards has manifested itself in positive law because a set of natural laws would only consist of legal concepts devoid of any content. A set of derived positive law would, of course, embody in it the normative value of natural right and natural justice or simply - public interest.

The concept of public interest is extremely vague. Bonbright says that "One is tempted to say that the so called standard of public interest is not a real standard at all; that, instead, it is a mere form of words of highly emotional content, invoked as an instrument of persuasion by people who have at heart much more immediate interests ..."

² However, he says that dismissing the concept of public interest or social welfare out of hand because of its undeterminable nature would go too far. He gives the following reasons for adopting the Public Interest Theory when writing his 'public utility rate theory' ³. These reasons can equally be applied in the present analysis when

1.p.179 Max Weber, edited by J E H Eldridge, printed by Thomas Nelson and Sons Ltd. 1971.

2.p.29 Principles of Public Utility Rates, J C Bonbright, Columbia University Press, 1961.

3.p.29 ibid

adopting the Public Interest Theory ¹:

1. "Public utility economics may usefully accept as "given" those basic conceptions of social welfare that prevail in the country and in the time period under review. At least in Western Europe and in the United States, this would mean, among other things, the identification of the public interest with the welfare of the people in the community or nation, the state being regarded merely as an instrument for the attainment of this welfare.

2. The public utility economist is justified in going a long way toward the acceptance, as final for his restricted assignment, of widely held goals of economic policy that a social scientist or social philosopher might properly regard as subjects for intensive and critical analysis. An economist is under no obligation to present either an elaborate defense or an elaborate critique of the standard."

The Public Interest Theory is given further support by a group of modern political scientists who collectively are called 'modern' or 'analytical' pluralists for they scientifically and analytically study the economic and

1.p.29 Principles of Public Utility rates, J C Bonbright, Columbia University Press, 1961.

political action of interest groups in society ¹.

Arthur F Bently, one of the most important modern pluralists, writes that group interests in society are the most basic elements for analysis. He thinks that only group interests would be an issue and individual interests are fictitious. The gains and losses to a single individual are immaterial. Groups would have a degree of power or pressure more or less equal to the number of members in that group. The larger, more general interest would defeat the smaller, more narrowly defined and more intense interest ². He concedes that legislatures may at times work imperfectly favouring the more intense interest but eventually the more general interest would win out.

Posner relegates the modern pluralists to the Capture Theory camp because they propose that regulation would only serve group interests ³. However, as stated in the previous paragraphs, these theorists also conclude that eventually the weaker larger interest will prevail over the smaller though more intense interest. Their thesis predicts

1.p.118 The Logic of Collective Action, Olson M., Harvard University Press, 1965.

2.p.121 The Logic of Collective Action, Olson M., Harvard University Press, 1965.

3.p.341 Bell Journal of Economics and Management Science, 1974
V5. Theories of Economic Regulation, R A Posner.

that ultimately the public interest will be served. Conceptually the modern pluralists should belong to the Capture group but their ultimate conclusion (public interest will ultimately be served) put them squarely in the Public Interest group.

The Public Interest Theory of regulation has been held by a succession of economists from the late nineteenth century to the present day. This theory is largely of a normative nature. The theory says that markets may fail to operate efficiently. Such market failures may be caused by many factors such as monopoly, imperfect information, high set-up costs, etc. The departure from the socially ideal outcome has provided the rationale for legal intervention ¹. Law in general and statute in particular are regarded by economists as being enacted for the correction of market imperfections. These imperfections are usually attributed to the market structure or the product nature of the industry. However, regulatory agencies now appreciate that market imperfections are industry unique. For example, market imperfections in the financial services industry are basically not caused by its market structure or its product nature but caused mainly by the inadequate and asymmetric

1. Theory of Economic Regulation, R A Posner, Bell Journal of Economics and Management Science, 1974 V5.

information about its products, the potential principal-agent relationship and issues relating to conflict of interest and the fiduciary role of the financial institutions. With such diversity in market imperfections among industries it is now appreciated that legislative interventions for correcting these imperfections could, and should, come in many forms and guises.

CAPTURE THEORY

The Capture Theory states that economic regulations are there for the promotion of group interest rather than for the protection of the interest of the general public against the defects and inefficiencies of the market economy. In the words of George J. Stigler, "...as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefits."¹ Marxists are early supporters of this theory, arguing that capitalists capture all the benefits of economic regulations. The modern pluralists are more moderate in their stance, emphasizing the influence of interest groups when formulating government policies or enacting economic statutes. Some political scientists are more specific. They state that "Over time regulatory agencies come to be dominated by the industries regulated"

1.p.3 Bell Journal of Economics and Management Science, 1971, V3, George J. Stigler.

1.

Stigler and Friedland, building on earlier work by political economists, published their paper which gave an account of the effects of regulations on the United States' electricity utility industry from 1907 to 1937. By 1937 the majority of states in the USA already had regulating agencies for electrical utilities ². Data from unregulated states beyond 1937, they say, could not be used with confidence because by that time the threat of regulation was already latent in the unregulated states. They use the following model for their analysis :

$$\log p = a + b \log U + c \log P_f + dH + e \log Y + fR,$$

where

p = average revenue per KWH, in cents;

U = population in cities over 25,000 (in thousands);

Pr = price of fuel (in dollars per BTU equivalent ton of bituminous coal);

H = proportion of power from hydroelectric sources;

Y = per capita state income, in dollars;

R = dummy variable, 0 if an unregulated state, 1 a regulated

1.p.341 Bell Journal of Economics and Management Science 1974, V5. Theories of Economic Regulation, Richard A Posner.

2.p.1 - 16 The Journal of Law and Economics, V 5 1962, What can Regulators regulate? The Case of Electricity, George J. Stigler and Claire Friedland.

state.

The model is put to rigorous analysis aiming at finding out the regression coefficient of the dummy variable representing regulation or by the difference in the coefficient of multiple determination including and excluding regulation. The results show that regulation can only provide explanation for about 2 % of the changes of average revenue per KWH and 1 % of the changes in output in 1922. Similar results are obtained for the other years under study. They conclude that no effect of regulation can be found in the average level of rates paid by users of electrical utilities.

Secondly, they examine the rate structure for finding out the possible influence of regulation. They expect that the numerous small consumers would be given lower rates than bulk consumers due to the political popularity of this policy (public interest theory ?). However, they discover that the rate structure for domestic consumers seems to be independent and not regulation-related. They further test the average ratio of charges per KWH to domestic users as compared to charges to industrial users for the 1917 to 1937 period. Again they could not find any economic effect of regulation for domestic users. However, commercial and industrial users seem to be enjoying slightly lower rate

levels during the period.

Thirdly, they examine the effects of regulation on the return to stockholders. They find that there is a slight, though statistically insignificant, effect of regulation on market values of stocks of the utilities companies under investigation.

Stigler and Friedland conclude that they are unable to find any significant regulatory effects on the electrical utilities industry of the United States during the period of study. They postulate that the ineffectiveness of regulation may be caused by two circumstances, the first being that the individual utility system had not been in possession of any large amount of long run monopoly power, and, the second being that the regulatory body was incapable (not unwilling) of forcing the utility to operate at a specified combination of output, price, and cost.

Using the Stigler and Friedland technique, Raymond Jackson discovers that the data from the electrical utilities industry in the United States for the years 1940 and 1950 are in line with the Stigler and Friedland findings. However his analysis reveals that in 1960, both consumer users and commercial and industrial users were having lower average rates with regulation than without it

These studies indicate that regulation confers no short or medium term economic benefits to ordinary household consumers of electricity in the United States of America. However, industrial and commercial consumers do enjoy some benefits, in terms of lower rates, through regulation. Only after 45 years of regulation does economic regulation for electrical utilities show any appreciable effect of lowering rates paid by ordinary household consumers ².

Other studies by economists on the telephone service in Michigan and local gas distributions in Baltimore also reveal that regulations for these industries do not lower rates for the general consumers. Regulations also fail to decrease the power of natural monopoly in these industries and may even have increased it ³. Moore uses a different technique in analyzing the price paid by consumers of electricity from 1952 to 1962. He calculates the estimated monopoly prices of the firms and compares them with actual prices for electricity paid by residential consumers. He

1.p.156 The Journal of Law and Economics, 1972, Producer Protection and Government Regulation, William A Jordan.

2.p.156 The Journal of Law and Economics, 1972, Producer Protection and Government Regulation, William A Gordan.

3.p.160 - 163, the Journal of Law and Economics, 1972, Producer Protection and Government Regulation, William A Jordan.

concludes that regulation has reduced the prices of privately-owned electrical utilities by less than 5%. He is of the opinion that regulation has no or very little effect on price ¹.

The analyses of the impact of economic regulations mentioned earlier do cast doubt upon the validity of the Public Interest Theory. However, these analyses do not in themselves propose or put forward any workable alternative hypothesis.

In 1971, Stigler published his paper 'the Theory of Economic Regulation'. It is regarded by some economists as a pathbreaking article ². The central thesis of his paper is that, as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit. Stigler says that those regulations, which are undoubtedly onerous on the industries, can also be explained by the same hypothesis which explains beneficial legislations.

The first insight put forward by Stigler is that the state is a provider of economic benefits. These benefits

1.p.156 the Journal of Law and Economics, 1972, Producer Protection and Government Regulation, William A Jordan.

2.p.343 Bell Journal of Economics and Management Science, 1974 V5, Theories of Economic Regulation, R A Posner.

may only be provided upon the payment of prices. The price paid by the industry is in the form of votes and resources. Votes are for the continuing success of the politicians and their party and resources are for the reward of the persons who administer the party.

The second insight is that, in general, industries would have a positive demand price (schedule) for the services of government.

According to Stigler there are four types of benefits which a government may supply (at the right price) to the bidders of legislation. The direct provision of money subsidy is the first and the most obvious type of benefit. However, industries usually do not seek this favour unless the list of beneficiaries can be limited by an acceptable device.

The second type of benefit which a government may confer upon an industry is the barrier of entry to the industry. Stigler proposes that every industry or occupation which has enough political power to utilize the government will seek to, through legislation or otherwise, control entry to its industry. Further, the regulatory policy will often be so fashioned as to retard the rate of growth of new firms.

The third type of benefits are those measures which affect substitutes and complements. For example, the butter producers would seek measures from the government to suppress margarine producers and encourage the production of bread.

The fourth type of benefit is the fixing of prices for the products of the industry. Where there are no diseconomies of large scale for firms of the industry, price control is essential to achieve more than a competitive rate of return. For example, the prohibition of interest on demand deposits is one form of price fixing.

In providing empirical evidence for his hypothesis Stigler analyses the economic effects of the regulation of the motor trucking industry in the United States during the thirties. The railroad industry was, at the time, the main competitor of motor trucking. One of the methods by which motor trucking was combatted during the period was the enactment of adverse state legislation against the motor trucking industry. He finds that the regulations on weight of trucks at that period were less onerous, the larger the truck population in farming, the less competitive were the trucks to railroads, and the better was the highway system.

Stigler recognizes that not every industry will have a significant demand for the service of the government. It is possible that for some industry the fortunes of its members would not be significantly enhanced even upon the enactment of favourable legislation. However, in general, he postulates that "most industries will have a positive demand price (schedule) for the services of government" ¹.

Stigler says that the nature of the political system enables an industry to employ the political machinery to its own ends. Political decisions are made by representatives who, once in office, will have ample discretion of action, regardless of the interests of their constituents. Unlike a market decision, which involves only interested members of the society, a political decision, in theory, should involve all members of the community, irrespective of their interest in a certain issue. However, most issues concern a sector of the community only and the rest of the community is participating in a passive mode. In order to make a correct decision voters should acquire full knowledge for each issue; knowledge being a costly thing for the voters, most of them would have little incentive to acquire it. Most of the time voters are not as well informed as consumers in the

1.p.10 Bell Journal of Economics and Management Science, 1971 V3,
The Theory of Economic Regulation, George J Stigler.

market system because consumers in the market are being offered good monetary incentives for acquiring information. Due to the participation of uninformed or ill-informed voters the expressions of preferences in voting will be less precise than the expressions of preferences in the market place. That does not mean that legislators or voters' representatives will be able to supply to industries or interest groups any piece of legislation bidden for. There may be political issues which are of such importance to the general voters that the supply of legislation opposing such interest will put the representatives' political career in jeopardy. In such cases the representatives will have no benefits to supply to the bidders. This explains why some industries are not regulated. However it does not explain why some legislations are clearly onerous to the industry regulated.

Stigler says that the bidders of regulations must be prepared to pay for the regulations in two ways, votes and resources. Votes to be rallied by the bidders to support the re-election of the representatives and resources to reward the politicians. Stigler suggests that much of the compensation to the legislative leaders takes the form of extra-political payments or simply bribes.

In the paper Stigler uses the term 'cost of obtaining regulation' when referring to votes and resources

paid by bidders of state legislation to legislators or political parties. This concept of 'cost' may be extended to embrace the meaning of 'consideration' in the common law. 'Consideration' as defined in law is "Some right, interest, profit or benefit accruing to the party, or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other" ¹. Consideration in this sense includes not just benefits received but also loss or forbearance to be undertaken by the bidders of regulation. Voters who refrain from causing an uproar or refrain from voting for other candidates are giving consideration to the legislator or politician. From this concept one may argue that for every law-making session there are at least two bidders ². The first bid is from the general voters (some members of the industry to be regulated may also be general voters) and the other bid is from the industry to be regulated or some other interest group. Consideration from the general voters to the legislators is the 'prevention of voting for the other party or candidates' or 'prevention of a public uproar' or even 'public admiration of the legislators' righteousness'.

1. Currie v. Misa (1875)

2. Peltzman has already envisaged the multi-bidders situation and Peltzman and Stigler share the opinion that regulatory agencies will not exclusively serve one economic interest. Peltzman : Toward a More General Theory of Regulation, Journal of Law and Economics, 1976.

Consideration from the industry, of course, will be votes and resources. If the consideration provided for by the general voters (general public) is sufficiently attractive, the industry will not be awarded any beneficial legislation and sometimes onerous legislations on the industry may even be enacted favouring the general voters.

This very slight extension of Stigler's theory (by the present researcher) comfortably explains why many legislations are clearly onerous or harmful to the industry regulated. However the concerted effort of industries regulated and the sufficiently large number of uninformed or misinformed general voters render onerous legislations on industries a rarity. Stigler is pessimistic in his paper and writes in the concluding paragraph: "Until the basic logic of political life is developed, reformers will be ill-equipped to use the state for their reforms, and victims of the pervasive use of the state's support of special groups will be helpless to protect themselves."¹

At about the same time, in 1972, William A. Jordan published his paper, 'Producer Protection, Prior Market Structure and the Effects of Government Regulation'. In the paper Jordan surveys the then existing literature on the

1.p.18, Bell Journal of Economics & Management Science, 1971, V3, George J. Stigler.

economic impact of regulation. After assessing most of the available empirical evidence from various industries he concludes that "Overall, remarkably little of the available evidence suggests that consumers are protected by regulation. In contrast, the producer-protection hypothesis yields implications that, by and large, are consistent with what is found to have occurred as a result of regulation."¹ His conclusion is similar to Stigler's findings.

Sam Peltzman, in his article published in 1976, adopts Stigler's Theory of Economic Regulation and subjects it to rigorous analysis ². He uses the following model :

$$M = n.f - (N - n).h$$

where

n = number of potential voters in the beneficiary group

f = (net) probability that a beneficiary will grant support

N = total number of potential voters

h = (net) probability that he who is taxed (every non-n) opposes.

Peltzman's analysis yields the following findings :

1. Even if a single economic interest receives all the

 1.p.151 the Journal of Law and Economics, 1972, Producer Protection, Prior Market Structure and the Effects of Government Regulation, William A. Jordan.

2.p.211 The Journal of Law and Economics, 1976 VXIX(2) Aug., Toward a More General Theory of Regulation, Sam Peltzman.

benefits of regulation, it must be less than a perfect broker would obtain. The best organized cartel will yield less to the membership if the government organizes it than if it were organized privately. This is in line with Stigler's suggestion that the political process automatically admits powerful outsiders to the industry's councils. The regulatory agencies will not exclusively serve a single economic interest.

2. Regulation will tend to be more heavily weighted towards "producer protection" in depressions and towards "consumer protection" in expansions.

3. Government intervention and regulation are both normal goods. The income elasticity of producer protection ought to be less than that of consumer protection which makes for an increased consumer share of the total surplus as demand (income) increases.

4. The tendency of regulation to change prices infrequently, sometimes called "regulatory lag," ought to be stronger when demand changes than when costs change.

5. In a growing, technologically progressive industry, producer protection ought to yield to consumer protection over time, even if, on average, there is no effect.

6. Elastic demand and economies of scale create a bias favourable to consumers.

7. Regulation should reduce conventional measures of owner risk. By buffering the firm against demand and cost

changes, the variability of profits (and stock prices) should be lower than otherwise. To the extent that the cost and demand changes are economy-wide, regulation should reduce systematic as well as diversified risk.

Jack Hirshleifer, in his comment on Peltzman's paper ¹ points out that there are two things wrong with taking the regulator's goal as majority maximization. Firstly, the regulators themselves constitute an interest group. They should, therefore, also be aiming at wealth maximization. If wealth is the ultimate goal, majority maximization can only be an instrumental and partial aim. The politician should be willing to accept some risk of defeat in exchange for a sufficient direct or indirect monetary payment. He also points out that Peltzman's identification of the regulator with the elected politicians is too radical a simplification.

Secondly, Peltzman's economic approach to politics naturally tends to assume constitutionality, ie a set of prearranged rules to be adhered to by players. However, Hirshleifer points out that the highest and biggest game of all is non-constitutional politics. This biggest game of

1.p.241 The Journal of Law and Economics, 1976 V XIX(2) Aug, Comment on Toward a More General Theory of Regulation, Jack Hirshleifer.

social interaction is subject only to the law of nature. In this game there are no property rights, and the ultimate arbiter is the physical force of individuals or of the coalitions they can form.

PUBLIC INTEREST THEORY REVISITED

All is not lost for the Public Interest Theory. In 1974, Edwards and Edwards publish their paper on the 'Measuring the Effectiveness of Regulation: The Case of Bank Entry Regulation'. In their paper, they discuss two problems. These problems are generally ignored in studies of the impact of economic regulation but often undermine their results. They are: (1) the failure to take complete account of the indirect effects of regulation; and (2) the oversimplified treatment of the behaviour of regulators ¹. The earlier study by Peltzman of bank entry regulation is reviewed. Peltzman uses the following model:

$$E_t = f(P_{t-1}, Z_t) - kR_t$$

where:

E_t = the rate of formation of new banks in period t ;

P_{t-1} = the expected rate of return on invested capital in banking (adjusted for risk) in period $t-1$;

1.p.445 Journal of Law and Economics, V XVII (2) Oct. 1974, Measuring the Effectiveness of Regulation: The case of Bank Entry Regulation, Linda N. Edwards and Franklin R. Edwards.

Z_t = all variables (other than regulation and lagged expected profits) that determine entry (or capital formation) in period t ;

R_t = a dummy variable which takes the value of 0 in the unregulated period (1921 to 1935), and the value 1 in the regulated period (1936 to 1962).

Peltzman estimates the value of k in this equation to be .57 which means that the rate of entry during the period of regulation is only about half as large as it would have been had there been no regulation.

Edwards and Edwards argue that the value of k as estimated by Peltzman is erroneous. Firstly, the restriction on entry based upon the integrity of the financial statements will cause firms to report higher profits. This is one of the indirect effects. Given exactly the same economic performance for the industry during the two periods, the profit rate used in the equation during the period of entry restriction will be higher than the period of free entry. As a consequence, the model predicts too great a desired rate of bank formation during the period of regulation and causes the overestimation of k , the coefficient of the dummy variable. By ignoring the indirect effects of regulation on profit rate, Edwards and Edwards estimate that Peltzman has overstated the

restrictive effect of regulation by almost 45%.

Secondly, Edwards and Edwards propose that bank regulators are themselves a group and are associated with maximization of their personal welfare. They incorporate this behaviour element to Peltzman's model and find out that this enhanced model causes an adjustment of Peltzman's results by 12%. Oversimplification of regulators' behaviour has again caused an overestimation of the effects of regulation.

In conclusion they state that, by taking into account the indirect effects and the behaviour of regulators, the Public Interest Theory of regulation better explains the behaviour of bank regulators than does the Capture Theory of regulation. Their findings suggest that bank regulators permit more entry when the profits of existing banks rise which is consistent with the enhancement of the welfare of the public.

Spiller, in his recent paper, ¹ has given the regulators a special role in the 'interest group' theory of regulation. He proposes that the Capture Theory has

1.p.65 Journal of Law and Economics, VXXXIII (1) Apr. 1990, Politicians, Interest Groups, and Regulators: A Multiple-Principals Agency Theory of Regulation, or "Let Them Be Bribed", Pablo T. Spiller.

oversimplified the relationship between politicians and regulators. The assumption that there is no necessary divergence between politicians' optimal policies (as responses to interest groups' demands) and their implementation may not be valid. Policies are seldom implemented by politicians themselves. Instead, they are delegated to regulators. The two may not have a convergence of interest. On many occasions the interests and wishes of the politicians may not be in line with those of the regulators. At times, both politicians and interest groups may have to compete for the regulators' favour, who themselves are maximizers of "interest". The politicians reward the regulators by increasing the budgets of the agencies while interest groups reward the regulators by giving favourable appointments to regulators after the regulators leave the agencies.

Spiller presents an agency model in his paper, which Congress, the interest group and the regulator are the parties. In the model, Congress tries to influence the regulator through the regulator's budget. The budget for the regulator will be increased (a reward) for favours done to the politicians. The interest group also attempts to influence the regulator, in this case, through direct transfer of benefits, such as patronage appointment of the regulator after he is de-commissioned. The model is tested

by analyzing the determinants of the career path of bureaucrats. Thus, the probability of going to work (directly or indirectly) for the industry should correlate with the agency's budget during the regulator's last period at the agency.

Spiller's model is tested against the data set composed of the career path of regulators for the Interstate Commerce Commission, Civil Aeronautical Board and Federal Communications Commission and a measure of discretionary budgets. Among other things the results suggest that discretionary budgets and postagency employment at the regulated industry are negatively correlated. Increases in discretionary budgets seem to reduce the probability of going to work for the regulated industry after leaving the agency. The assumption that both Congress and the interest group are bidding for favours from regulators is apparently being given some support.

The Public Interest Theory receives renewed attention with the publication of a number of recent studies which report that the personal ideologies of legislators matter a great deal in explaining particular cases of economic legislation and that the capture model does not do well in

these circumstances ¹. Kalt and Zupan in their model about the ideological behaviour of legislators, test the hypothesis that ideology is just another good : as the price of "shirking" falls, shirking increases. Here, shirking means the deviating from the mandate of a politician's constituency by a politician for putting forward his viewpoints in a public issue. Kalt and Zupan try to trace the demand curve for shirking and, if it exists, to find out whether it is negatively sloped.

Kalt and Zupan use the ADA (Americans for Democratic Action) rating, which reflect legislators' ideological leanings, to isolate the on-the-job ideological consumption by senators (the ideology residual). The ADA rating is thought to reflect the following :

$$\text{ADA rating} = f(\text{Constituents' Demographic-Economic Characteristics and Ideological Preferences}) + \text{Error}$$
$$= \text{Fitted Rating} + \text{Senator-Specific Residual}$$

The senators' ADA ratings are broken down into two parts, a fitted part reflecting underlying constituents' interests and a senator-specific residual. The residual is a measure of the distance between a senator's actual positioning (voting) on a bundle of issues faced while in office and

1.p.103 the Journal of Law and Economics V XXXIII(1) Apr. 1990, The Apparent Ideological Behavior of Legislators: Testing For Principal-Agent Slack in Political Institutions, Joseph P. Kalt and Mark A. Zupan.

where his constituents would like to have him be (prefer him to vote). They represent the problem of on-the-job consumption by senators in a marginal cost-benefit framework. The marginal cost of shirking (MCS) is dependent upon the following : the costs of monitoring and retaliation of the constituent (M), the barrier to entry (B) and alternative sources of support of the senator (A).

$MCS = MCS(M, B, A, S)$ where S = level of senator's shirking. Increases in M , B and S will lower a senator's marginal cost of shirking. Rational politicians will equate marginal cost of shirking (MCS) to marginal benefit of shirking (MBS). Solving implicitly for the inverse of MBS yields a demand for shirking in term of MCS :

$$S = S(MCS, I)$$

where I = the intensity of a senator's ideological preference.

$$S = S(M, B, A, I)$$

The hypotheses to be tested are S_M, S_B, S_A , and $S_I > 0$

The ADA senatorial ratings in the ninety-fifth Congress (1977-78) are applied to the model. All the variables have signs that are consistent with the hypothesis that senators are rational ideological shirkers. Senators take more on-the-job ideology when they are not subject to a re-election constraint; the higher is their committee power; the greater is their brandname capital; the more heterogeneous is their

electorate etc.

This paper has attempted to illustrate the downward-sloping demand curve for shirking and has collected empirical results supporting the hypothesis that politicians (legislators) do engage in on-the-job shirking. Such activities are not relevant to the wish or desire of their constituents (including interest groups) but are dependent on the legislators' personal ideological preferences. In other words, ideology matters and at times may surpass the interest of interest groups. This and other research in this area does cast doubt about the universal adaptability of the Capture Theory.

In the UK the regulation of the financial services industry lends support to the public interest theory. In the last two decades, banks and building societies in the UK are under increasing legislative pressures. These legislative interventions are tilted in favour of consumers. Hall observes that in the UK "Support for the capture, as opposed to the public interest, theory of regulation is less easy to find in banking and building society regulation."¹

First, to the dismay of banks, the UK clearing banks'

1.p.169, Surveys in Monetary Economics, V.2, edited by C J Green & D T Llewellyn, "Financial Regulation in the UK: Deregulation or Regulation", by M J B Hall, Basil Blackwell Ltd., UK, 1991.

interest rate cartel was abolished in 1971. It was followed by further legislative interventions in the financial services industry aiming at formalizing supervision in the industry. In 1982 a deposit protection scheme was forced upon the unwilling banking industry. A similar deposit protection system was forced upon the building societies in 1987 which, at that time, was already operating a voluntary scheme. Moreover, in general, the UK banking and financial services industry has become more tightly regulated since. It is fair to conclude that for the UK financial services industry substantial legislative benefits have been bestowed on the general public through legislative interventions in recent years and that the Public Interest Theory apparently has, in this instance, been given support.¹

ECONOMIC LEGISLATION ON FINANCIAL SERVICES INDUSTRY

Most of the early analyses of economic regulation relate to utility industries. In the seventies and eighties several papers were published applying the theories of economic regulation to the financial services industry. Edwards and Edwards published their paper "Measuring the Effectiveness of Regulation : the Case of Bank Entry

1.p.170, Surveys in Monetary Economics, V.2, edited by C J Green & D T Llewellyn, "Financial Regulation in the UK: Regulation or Reregulation?", by M J B Hall, Basil Blackwell Ltd., 1991.

Regulation"¹ in 1974. The content of this paper has already been discussed in previous paragraphs when Peltzman's model is discussed. Jarrell published a paper on "Change at the Exchange: The Cause and Effects of Deregulation" ². The content of this paper will be discussed in the coming paragraphs when deregulation is discussed. In 1987, Haddock and Macey published a paper on "Regulation on Demand: A Private Interest Model, with an Application to Insider Trading Regulation" ³. They argue that "...while sanctions against some sorts of insider trading may be desirable, the insider trading laws are not motivated primarily by concerns for efficiency, nor are they mistaken" ⁴. They believe that the proper mode of analysis is to adopt the private interest model in a form elaborated by Peltzman for analyzing the action of the Securities and Exchange Commission (SEC) of the United States of America.

In their analysis they recognize that two interest groups, insiders and stock market professionals, are

1.vol.XVII(2) Journal of Law and Economics (Oct. 1974)

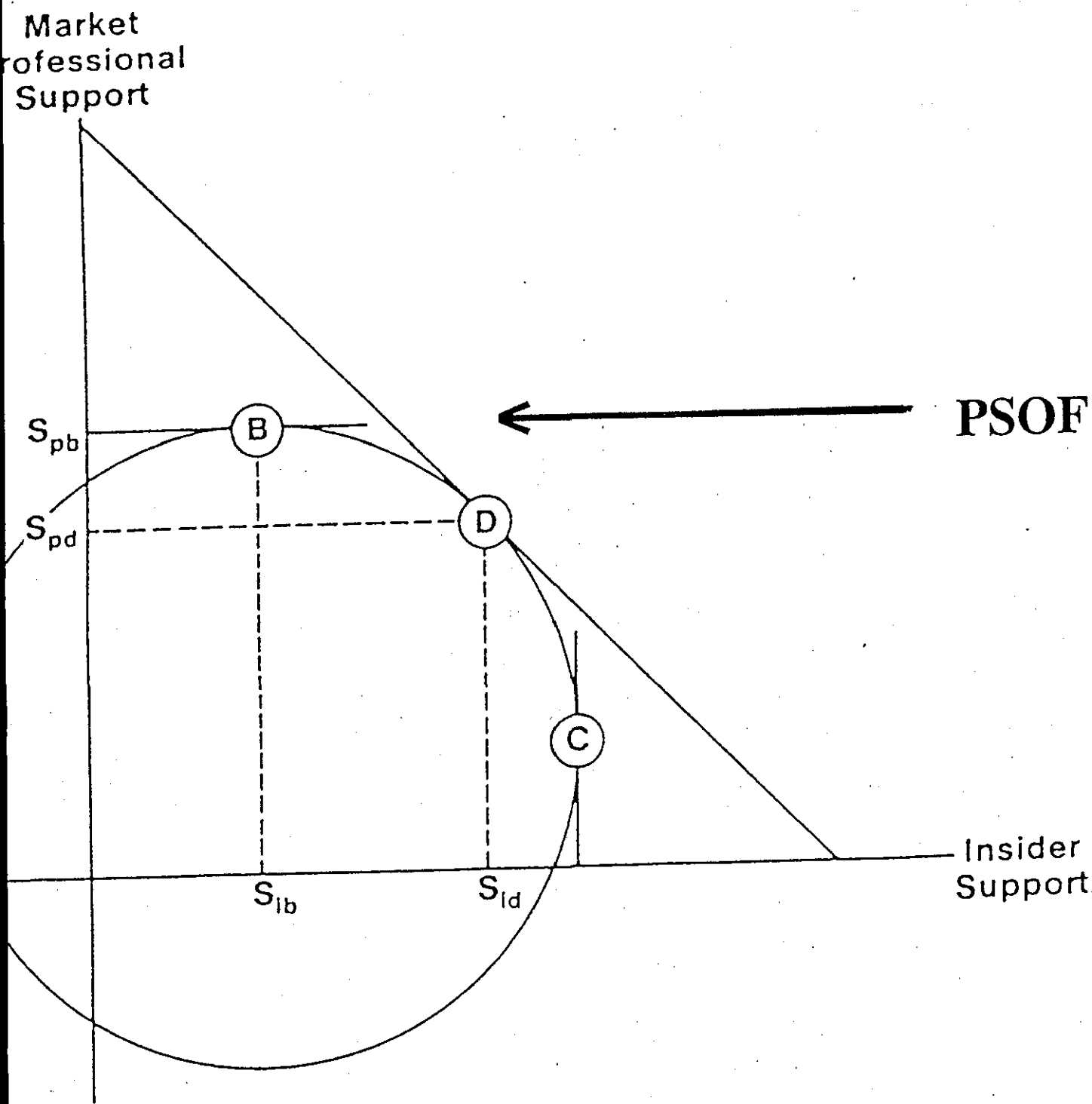
2.Change at the Exchange: The causes and Effects of Deregulation, Gregg A. Jarrell, The Journal of Law and Economics, October 1984.

3.Regulation on Demand: A private Interest Model, with an Application to Insider Trading Regulation, by David D Haddock and Jonathan R. Macey, Journal of Law and Economics, October 1987.

4.ibid.

rivalling for insider trading profits. Insider trading laws are a reflection of the heterogeneous interests of these diverse groups. According to the relative cohesiveness of interest groups, the profits of insider trading laws are sometimes reaped by insiders, sometimes by market professionals, rarely by stockholders and never by the general public. The policy options of the SEC can be represented by a curve called the "Policy selection opportunity" curve where every position of the SEC in this curve generates positive support and negative support from interest groups. The larger the potential benefits to be reaped by the agency's action the more an interest group can be expected to invest in influencing the agency. The curve may be in many dimensions and in various shapes. However, for the sake of simplicity, Haddock and Macey demonstrate the curve in a two dimensions round or oval shape manner. The SEC would not take a position inside the boundary of the curve because such a position would not maximize the benefits of both interest groups and it follows that the SEC would not be maximizing its political support. The SEC will select a point in the boundary where a tangent line can be drawn (point D in the diagram). In the case of a round curve, it will be at the point where the slope of the opportunity curve is minus forty-five degrees. At this point one more unit of support from one group is gained only by sacrificing a unit from another. At any other point the

To maximize its support, SEC uses its discretion to pick point D at the PSOF line. At D, another unit of support from one group is gained only by sacrificing a unit from the other.



Policy Selection Opportunity Frontier (PSOF)

SFC is not acting rationally as it is sacrificing more units of support than it is gaining. It follows that neither group is fully satisfied and both groups would have some complaints about the agency's action. The boundary curve may move outward if the cost for each group to generate support for the SEC decreases. The curve may also be flattened. Such instances would provide an opportunity for the SEC to give favours to one group which could give it more political support than it would have lost to the other rivaling group.

Haddock and Macey use the model to explain the effect of the Chiarella Decision ¹. The court decided that there is no obligation to "disclose where the person who has traded on inside information was not [the corporation's] agent...was not a fiduciary, [or] was not a person in whom the sellers [of the securities] had placed their trust and confidence."² A portion of the "policy selecting opportunity" curve is truncated by the court in favour of market professionals by the aforementioned decision. The SEC has to realign its position to maximize its political support. The model predicts and explains two phenomena. First, there is an increased willingness of the exchange to

1. Chiarella v. United States, 100 S. Ct. 1108 (1980).

2. ibid

cooperate with the SEC to bring prosecution of insider trading. Indeed, more prosecutions of insiders have been brought. Second, after Chiarella, market professionals have reasons to lobby Congress for higher penalties against insider trading violations. This they obtained by joining the forces of market professionals and the more active private traders. The Insider Trading Sanctions Act was enacted on 1984. However, the more active traders would not agree that market professionals be immunized from insider trading penalties.

Haddock and Macey contend that a Peltzmanian political support model is "an insightful way to examine the tradeoffs facing the SEC" and that the analysis accounts for the recent upsurge of activities against insiders and the passage of new legislation providing more onerous penalties for offending insiders.

One noteworthy insight provided by Haddock and Macey is that interest groups may join together if they possess compelling mutual interest. This joining of hands is not the same as the merger of interest groups. These interest groups remain as separate entities and continue to exercise restraints against each other, as in the case of preventing market professionals from obtaining immunity from insider trading. This concept is similar to the concept of 'winning

coalition' put forward by Sharkey, which is discussed more fully later on in this chapter.

CAPTURE THEORY IN RELATION TO THE FINANCIAL SERVICES INDUSTRY

As stated earlier Capture Theory apparently fails to explain fully the impact of an economic legislation on interest groups of the financial services industry. This failure may be attributable to the following factors. First, market imperfections of the financial services industry are unlike those of the utilities industry. In the utilities industry market imperfections are generally caused by the monopolistic or oligopolistic structure of the industry. These imperfections are manifested in the less than competitive product prices of the utilities. In the financial services industry, market imperfections are mainly caused by the sophisticated nature of its services and products. These imperfections are manifested in the problem of inadequate consumer information, the problem of asymmetric information, the difficulty of ascertaining the quality of financial contracts at the point of purchase, the imprecise definition of products and contracts, the under-investment in information by consumers, agency costs and potential principal-agent problems, issues related to conflict of

interest, etc.¹ The major concern for consumers of financial services industry is, therefore, not with the prices of products and services but with the imprudent acts of the service providers.² While consumers of the utilities industry demand to be protected against monopolistic or oligopolistic product prices, consumers of the financial services industry demand to be protected against the imprudent acts or sub-standard services of service providers. With different consumer demands and market imperfections, the legislation and regulatory framework for each industry could well be different. Therefore, the correlative relationship between interest groups and legislative benefits, which the "Capture Theorists" observed in the utilities and the trucking industry, may not be found in the financial services industry.

Second, "Capture Theorists" generally follow a polarized "legislative versus legislative-free (self-regulatory)" model. The model adopts the premise that legislative intervention is the usual method for correcting market imperfections. The model does not entertain the

1.p.2, Journal of Financial Regulation and Compliance, Spring 1995, Regulation of Retail Investment Services, David T. Llewellyn.

2.p.45, Journal of Financial Regulation and Compliance, Vol. 3 No.1, Consumer Protection in Retail Investment Services: Protection Against What?, David T. Llewellyn.

eventuality that an industry is regulated partially by legislation and partially by practitioners (self-regulated) with built-in safeguards preventing interest groups (apart from the general public) from capturing legislative benefits. A polarized Capture Theory model could well be an appropriate model for the utilities industry which has few producers and no market intermediaries and practitioners. However, there are many firms and market intermediaries and practitioners in the financial services industry. The Capture Theory model, which ignores the forces of the market intermediaries and professionals, may, therefore, not be an adequate model for the financial services industry. Further, It is recognized that in the financial services industry "It is never a question of either 'legislative regulation' (with no practitioner input) or exclusively self-regulation in the absence of any legislative framework. These are polar cases at the extremes of a spectrum and neither polar case is tenable. Always and everywhere regulation of financial services is a mix of legislation, and elements of practitioner-based regulation."¹ Devoid of the premise of polarization one may not be able to apply the Capture Theory model to the financial services industry to its fullest extent.

1.p.4, Journal of financial Regulation and Compliance, Spring 1995, Regulation of Retail Investment Services, David T. Llewellyn.

Third, the premise of competition among interest groups and the general public for legislative benefits - a basic premise of the Capture Theory model - may not be a correct premise for the financial services industry. Regulation of an industry may enhance the efficiency of the industry regulated. These extra benefits may come from a) the correction of market imperfections which reduce consumer welfare; b) the economies of scale which come from the collective authorisation and monitoring of firms by a single regulatory agency; and c) the confidence in minimum standards in the industry which reduces or eliminates the phenomenon associated with the "Akerlof's Lemons Paradigm".¹ In some instances these benefits may be higher than the accounting costs due to regulation. Under the conditions that there are net legislative benefits and that interest groups and the general public are not worse-off due to regulation, interest groups and the general public could be sharing rather than competing for legislative benefits. If such were the case for the financial services industry the Capture Theory model, which assumes a competitive environment where each group is vying for the full share of the legislative benefits, may not be a satisfactory model.

1.p.3, Journal of Financial Regulation and Compliance, Spring 1995, "Regulation of Retail Investment Services, David T. Llewellyn.

APPLICATION OF THE ECONOMIC THEORIES TO DEREGULATION

Both the Capture theory and the Public Interest theory attempt to explain the rationales behind economic regulations. However, from the seventies, there is an increasing trend of deregulation in many industries. Such a trend is more observable in the utilities industries and the financial services sector.

Theorists generally suggest that deregulation would enhance efficiency. First, inefficiency generated from the imperfect competition of firms in the industry regulated would be curtailed. Second, dynamic inefficiencies such as low productivity growth, slow technological innovation, and the poor quality of management would also be reduced due to a more responsive environment. However, some writers, while recognizing inefficiency created by regulation, argued that deregulation would not create first-best outcomes because of the presence of the diseconomies of density, as in railroads and telecommunications.

Jarrell, in his paper ¹, using the political support

1.Changes at the Exchange: the Causes and Effects of Deregulation, Journal of Law and Economics, vol.XXVII(2) Oct. 1984.

model of Stigler and Peltzman, tries to explain the phenomenon of deregulation in the US securities industry. Jarrell contends that the principles underlying the political support model explain regulation as well as deregulation. An agency, in this case the SEC, would abandon rate and entry regulation when the maximum political support generated from the upholding of the regulation falls below the potential support which would be generated by deregulation. Using the model Jarrell shows that the emergence of low-cost alternatives to block trading on the New York Stock Exchange and backward integration by institutional traders into brokerage business prove to be the forces behind deregulation. The model predicts that these two changes reduce the net demand for redistribution, in the form of regulation. The SEC responded by completely deregulating rates in 1975.

However, the political support theory of Stigler and Peltzman apparently cannot provide convincing theoretical support for some instances of deregulation. K J Button examines the deregulation of the United Kingdom's Bus Industry in the current theories of economic regulation. This industry is selected because it has undergone a full cycle of legislative interference, from no regulation to regulation to deregulation.

The UK bus industry is characterized by monopolistic competition and until the late seventies was under strict legislative control. In 1978, major legislative reforms took place to liberalize both entry and fare control. Unlike the US securities industry, the UK bus industry has undergone no major changes in the nature of its market. The technology relating to the bus industry is unprogressive. The supply side of the industry remains unchanged while there may be a decline in the demand. The public interest theory does not seem to be able to explain the full regulation cycle experienced. The Capture Theory can do no better. Although deregulation in the seventies does benefit the operators afterwards, initially the operators opposed the reform and actively campaigned against it.

The UK banking and financial services industry is another case in point. It has undergone a cycle of regulation, deregulation and reregulation.¹ However, unlike the UK bus industry the banking and financial services industry were subjected to substantial pressures before the start of the deregulation process. These pressures were "largely a response to competitive pressures and financial innovations rather than dramatic policy changes designed to

1.p.168 Surveys in Monetary Economics, V.2, Edited by J Green & D T Llewellyn, "Financial Regulation in the UK: Deregulation or Reregulation?", by M J B Hall, Basil Blackwell Ltd., 1991.

force the pace of change".¹ Using Jarrell's argument, the deregulation of the UK banking and financial services industries should be the outcome of a structural change of the market which, in turn, reduces the political support for regulations. However, Hall observes that, at the time of the deregulation, "new limits were placed on societies' (building societies) ability to diversify into new markets and to undertake new activities, and a new formalized supervisory framework was established".² Hall calls this a "reregulation" of the industry. One is confronted with a dilemma when deregulation and reregulation take place at the same time. Jarrell's argument, which explains deregulation due to the lack of political supports for regulation, is unable to explain the concurrent occurrence of the deregulation and reregulation process of the financial services industry.

An alternative theory which can more completely explain both regulation and deregulation, and perhaps, reregulation, under this condition is required. Button suggests that the 'winning coalition' theory of Sharkey does provide a more

1.p.223, Surveys in Monetary Economics, V.2, edited by C J G Green & D T Llewellyn, "Structural Changes in the British Financial system, by D T Llewellyn, Basil Blackwell Ltd., 1991.

2.p.166, Surveys in Monetary Economics, edited by C J Green & D T Llewellyn, "Financial Regulation in the UK: Deregulation or Reregulation?", by M J B Hall, Basil Blackwell Ltd., 1991.

complete explanation ¹. Sharkey's 'winning coalition' model is based on the theory of cooperative games. Given a set of players, a set of winning coalitions and a set of regulations, the game demonstrates the characteristics of the model. The model predicts that regulation is likely to occur in a condition in which the unregulated market can no longer be supported by a coalition which supports the status quo. The same applies to deregulation. The theory further predicts that consumers or other players who are temporary members of a coalition with the producers or firms may defect to another coalition excluding the producers or firms. This theory seems to be able to explain both public interest regulations and capture regulations.

While regulatory reforms are still evolving and theorists are still arguing about the impetus behind the phenomenon of deregulation C Winston, using data from previous studies², conducts a comprehensive assessment of deregulation generally in the USA. In his paper he compares the quantitative predictions of previous regulatory reforms with the actual economic outcomes. His analysis reveals

1. Outline of a Positive Theory of Regulation, W W Sharkey, Proceedings from the Tenth Annual Telecommunication Policy Research Conference, edited by Gandy & others, Ablex Publishing Corporation, N.J., USA, 1983.

2. Winston, C., "Economic Deregulation Days of Reckoning for Microeconomists", Journal of Economic Literature Vol. XXXI (September 1993), pp.1263 - 1289.

that the predictions that deregulation leads to lower prices and significant welfare gains to consumers is generally correct. However, these benefits are not derived from the exploitation of labour or the sacrificing of profit from producers, as predicted by theorists. In fact producers usually gain from deregulation. These gains may come from the return of profits which had previously been dissipated due to regulation or because the deregulation process has entailed higher efficiency. Both of these gains may more than compensate for the loss of the producers to consumers in the deregulation process. Winston estimates that there may be a 7 to 9 percent improvement of the GNP of the USA due to regulatory reforms. While Winston's analysis does not specifically address the theoretical divergence of the Public Interest Theory and Capture theory, it does confirm that deregulation bestows economic benefits to the public. Whether these benefits come from the producers or are due to higher efficiency accrued to the deregulation process is unclear.

SUMMARY OF THE THEORIES

The theory of economic regulation has undergone a thirty year development, from the early sixties when doubt was first cast upon the traditional public interest theory to the present. Using empirical findings from utilities,

financial and transport industries, Stigler and Peltzman derive their political support model. This model does provide a good explanation for the pro-producer economic legislation. However, soon after the development of the Stigler-Peltzman model researchers started to doubt the universal applicability of the model. The hypothesis that regulatory agencies, at times, seemed to have a life of their own, practicing ideological shirking at the expense of their supporters has been given some support. The model, however, cannot explain why economic regulation is only found in some sectors of the economy and not others. If the model applies, then, pro-producers legislation should be found evenly over the whole economy. Also, the model cannot adequately explain some obviously public-spirited legislation, especially the environmental protection legislation which sprang up in the eighties. With the current trend of deregulation and, perhaps, reregulation in many western economies, the model seems to be hopelessly inadequate. While the model can be stretched to explain some deregulation, in other instances, like the deregulation of the UK Bus industry and the deregulation and reregulation of the UK Financial Services Industry, the model fails. The "failure" of the Stigler-Peltzman model does not mean the demise of the Capture Theory or that the Public Interest Theory should be automatically accepted. Theorists are now trying hard to find a theory which can explain both the

public interest elements and the capture elements in economic legislation. The Winning Coalition theory of Sharkey which internalized interest groups seems to be providing a bridge.

End of Chapter

CHAPTER 3

THE SECURITIES LEGISLATION OF HONG KONG

HISTORICAL BACKGROUND OF LEGISLATIVE PROTECTION OF INVESTORS

The securities industry of Hong Kong is regulated by common law and legislation. In recent years the investing public has demanded more and more securities legislation for their protection. This is due partly to the globalization of securities trading and partly to the growth in fraud-related activities in securities.

Investor protection has long been a policy of the Hong Kong government. In April 1962, the Companies Law Revision Committee for reviewing the law relating to corporations was given, *inter alia*, the following terms of reference :

"To consider and make recommendations as to the revision of the Company Legislation of Hong Kong, and in particular to recommend as soon as possible whether legislation for prevention of fraud in relation to investments is required and if so, the form which it should take."

The report, which was submitted in June 1971, recommended that dealers of securities and their

representatives be licensed, the separation of clients' and dealers' money, the regulation and supervision of stock exchanges, the introduction of compensation funds, the control of the publication of prospectuses inviting public subscription, the suppression of insider dealings, etc. This report was instrumental in the enactment of the first legislation regulating the securities industry - the Securities Ordinance of 1974. A new department in the Government, the Securities Commission, was duly set up for enforcing the new legislation and overseeing the activities of stock exchanges. The part of the Companies Ordinance which was concerned with the issuance of prospectuses in public offers was substantially amended.

In 1981, anticipating that Hong Kong would be one of the world's centres for securities dealings, the Stock Exchange Unification Ordinance was enacted. This ordinance provided for the establishment of a single, unified stock exchange, replacing the four exchanges which were then operating independently of each other. The four exchanges were : Hong Kong Stock Exchange, Kam Ngan Stock Exchange, Far East Stock Exchange and the Kowloon Stock Exchange. In June 1986 the trading floors of the four exchanges were abolished. Instead, a new company, the Stock Exchange of Hong Kong Limited, was set up by members of the four exchanges for running a unified exchange in one single

premises. The four old exchange companies were subsequently wound up voluntarily. One year after the setting up of the Unified Exchange, a major worldwide financial crisis rocked the foundations of the securities industry of Hong Kong and elsewhere.

THE DAVISON REPORT

On 19 October, 1987, the New York stock market plunged a massive 22.6%. Other major markets followed suit. In Hong Kong, after a 11.3% fall on 19 October, both the stock exchange and the futures exchange were closed for 4 days by the management of these Exchanges. When the markets reopened on 26 October, the stock market dropped a massive 33%. The event did not stop at the stock exchange. The futures exchange, which traded mainly in stock index futures (Hang Seng index), was the hardest hit. Many futures brokers were in default - unable to meet their obligations to their clients and fellow brokers.

In order to maintain the confidence of investors in Hong Kong and/or possibly bowing to pressure from futures traders, the government decided to put together a rescue package which altogether amounted to HK\$4 billion. All futures contracts were honoured either by the futures brokers or, if they were in default, by the rescue fund.

There was no massive default on the stock exchange; only a few brokers, who were also futures brokers, stopped trading.

After the crisis, the integrity of the professionals in the securities industry and the modus operandi of the exchanges were called into question. In November 1987, the Governor of Hong Kong appointed a committee for carrying out a review of the securities industry. The committee was headed by I. H. Davison. The committee submitted its report in May 1988. The following is an analysis of the report.

SALIENT POINTS OF THE REPORT

1. Objectives of the Hong Kong securities markets

The Report discussed at length the objectives of the securities markets of Hong Kong. It stated that "if Hong Kong harbours ambitions to be a regional or international market, it is necessary to go further by ensuring that its system caters for overseas investors and intermediaries, that its regulatory regime broadly satisfies prevailing international standards and that its markets develop in scope and depth." ¹ "We believe that Hong Kong should aim to be the primary capital market for the south East Asian

1.p.18 the report

region...". "In doing this, we adopted as our starting point the needs of Hong Kong as an international financial centre"¹. This premise of aspiring to be the major, if not the first, regional financial centre is important as most of the recommendations found in the Report are with this undertone. The appropriateness of this basic assumption will be explored in later paragraphs.

2. Summary of Findings

a. The committee formed the view that the October market crash in Hong Kong was triggered by falls elsewhere. "Moreover, anecdotal evidence suggests that overseas investors were amongst the largest sellers in October. We accept that becoming a corner of the so-called "global marketplace" carries risks, but we believe October demonstrates that these probably cannot be avoided in any case."² Moreover, the futures market, which exacerbated the crisis, was exonerated. "We formed the view that, while the futures market had weaknesses which went beyond the lack of risk management controls, it could not be blamed for the crash, although it did undoubtedly severely complicate its

1. p.13 the report

2.p.25 The report

course because of the extraordinary level of defaults" ¹.

b. The committee observed that the concept of self-regulation and market self-discipline has failed to develop in Hong Kong. But it stated that "there is no alternative to practitioner-based regulation." "We do so because we wish above all to avoid the danger of straight-jacketing the securities markets by a strict statutory regime which might all too easily lead to insensitive or heavy handed over-regulation." ² However, the Report promulgated checks and balances at every level of the system. There should be a two-tier system of supervision, with one single authority on top, as an ultimate regulator; and the exchanges, regulating their own affairs, keeping a watching brief over market participants. Against this background, the Report warned that regulatory controls can all too easily reach a state where they hamper rather than facilitate an efficient market. It urged regulators to be vigilant in keeping a proper balance between the benefits and costs of regulating.

c. The committee further observed that an inside group has treated the stock exchange as a private club rather than a public utility. It formed the view that the executive

1.p.159 the Report

2.p32 the Report

staff of the HKSE were ineffective, lacking adequate knowledge and experience. The Report recommended that independent members be admitted to the governing board of the exchanges and the recruitment of independent, well-paid and qualified staff for the exchanges ¹. It recommended that the SEHK be restructured, with membership tightened and that existing members be immediately retrained.

d. Although prohibited by statute the committee noted that some forms of short selling were practiced in Hong Kong. The pros and cons of short selling were discussed, comparing it with similar activities in other major markets. The Report proposed that, with the necessary safeguards and regulations, short selling should be permitted ².

e. The committee observed that the stock settlement system, based upon a 24-hour cycle, had failed to function properly. It proposed a rolling "T+3" system ³. The Report stated that Hong Kong should take active steps for developing a central clearing and settlement system, built on a system of uncertificated book-entry transfers ⁴.

1.p.35 the Report

2.p.83 the Report

3.p.111 the Report

4.p.117, 123 the Report

f. The committee noted serious shortcomings in the listing arrangements. Responsibilities for vetting an application for listing were split among the exchange, the Securities Commission and the Registrar General. The Report proposed that the SEHK listing department be given the sole responsibility for vetting applications for listing provided that it is able to discharge such duties impartially and effectively. The Listing Department of the SEHK should be strengthened within 12 months of the publication of the Report. The exchange should review its policies towards the pricing of new shares and the practice of "listing through the back door" - the acquisition of non-active listed companies by unlisted companies to circumvent the listing requirements ¹.

g. The committee observed that the surveillance of members of the SEHK was cursory. The exchange management had not introduced proper management and regulatory arrangements for monitoring its members. The Report stated that there is an urgent need for improving the SEHK surveillance activities towards its members. It recommended a system of tendering monthly returns, paying periodic inspection visits, early warning signals, large exposures

1.p.88 - 90 the Report

reporting and exception trading reporting. It proposed that the regulatory authority should review the development of SEHK's surveillance arrangements within 12 months of its establishment.

h. The committee observed that the tripartite structure of the futures trading system (ie the futures exchange, clearing house and guarantee corporation) had obstructed the development of an adequate risk management system. It stated that Hong Kong's unique experience of the October collapse was due to poor risk management and lax credit controls in the futures market at every level. It stated that the collapse was caused by an ineffective system rather than the inherent features of the HSI futures contract ¹. The HSI contract should not be dropped on regulatory grounds provided that sufficient safeguards and risk management controls are in place to prevent a recurrence of the crash of 1987. The whole system of futures trading should be revamped.

i. The committee observed that the Securities Commission was passive, inactive and without direction. The office of the Commissioner of Securities had become "too

1.p.158 the Report

much of a registry and too little of a watchdog" ¹.

GENERAL COMMENT ON FINDINGS AND RECOMMENDATIONS OF THE REPORT

1. The Report has an underlying assumption that the Hong Kong securities market is aiming at becoming a regional or international market. Recommendations in the Report are being made with this basic premise in mind. While this is a perfectly logical and admirable aim, the Report has ignored the harsh political reality.

After the signing of the "Joint Declarations" by the British and Chinese Governments in 1981, Hong Kong is destined to succumb to Chinese rule after 1997. Since the "Declaration", Hong Kong is suffering from a series of confidence crises. The crisis was further aggravated by the "Tien An Mun massacre" of June of 1989. Local interest in the securities market has been seriously undermined by the uncertainties in the political scene. In 1983, local pension funds invested 38% of their money in the Hong Kong securities market. In 1989, only 23% of the funds were invested in Hong Kong. As a common precaution, Hong Kong funds are now appointing emergency or alternative trustees.

1.p.228 the Report

These are legal entities located offshore, which would, when the need arises, replace the Hong Kong-based trustees taking full responsibility of trust schemes ¹.

Many financial institutions are now making preparations for moving all or a substantial portion of their operations from Hong Kong to other financial centres in the region. Such moves are prompted partly by the high cost of experienced personnel due to the mass exodus of experienced professionals to other countries and partly due to political risk. "Hong Kong's attraction as a regional financial centre is under serious threat and many banks have taken steps to reduce their reliance on the territory in case the political situation deteriorates". This is a statement made by the Chairman of the Foreign Bank Representatives' Association ².

With the above scenario in place, it is unrealistic to assume that significant advancement could be made in internationalizing the Hong Kong securities market without at the same time improvement of the political atmosphere. The present aim, in the short and medium term, should be to retain and to revitalize the investment interest of the

1. SCMP and Oriental Daily, 5/4/90

2. SCMP 9/4/90

local populace; the majority of them are going to stay with Hong Kong for good or bad.

For the longer term, say 10 years hence, since Hong Kong will become a part of China in 1997, it is essential to take steps in establishing Hong Kong as the leading financial centre of China. The Report had made a one sentence statement about this issue, "It might also be important to Hong Kong's role vis-a -vis China as it could fill a gap in China's financial infrastructure." ¹ China's economy must improve in the coming years, either due to a change of government or due to the natural gyration of economic cycles. On a longer term basis, Hong Kong should be preparing to take on a leading role as the leading financial centre of China and also of the South East Asia region. Hong Kong is not without competitors. Already, Shenzhen Special Economic Zone (just north of the Hong Kong border) has established a securities market alongside one in Shanghai. The necessary legislation has already been enacted ². Without firm policy from the government, Hong Kong may very well lose out in the long run.

Of course Hong Kong should not shy away from the

1.p.24 the Report

2.March 1990, the Securities Journal, The Stock Exchange of Hong Kong Limited.

inevitable globalization of securities markets. Internationalization of investments cannot be resisted. However, the policy-makers should set as their primary goal the establishment of Hong Kong as the most important financial centre of China.

2. The Report recognized the importance of free enterprising spirit in ensuring the success of Hong Kong as a financial centre ¹. The Report further recognized the importance of self-regulated bodies in the securities system and believed that "there is no alternative to practitioner-based regulation" ². The Report also recognized that self-regulation and market self-discipline had failed to develop in Hong Kong. With such importance attached to self-regulation in the securities industry, the Report, however, devoted only a page in discussing this issue. It proposed that "On the development of codes of conduct for the protection of investors, ...trade associations such as the Hong Kong Stockbrokers Association should play a leading role." ³ Apart from such general comments, the Report failed to make any specific recommendations for the future development of these self-regulated bodies or to propose

1.p.6 the Report

2.p.32 the Report

3.p.327 the Report

plans for these SR bodies to take over some of the regulating activities from regulators, now or in the future.

Without a concerted effort from both the industry and the regulator, the further development of self-regulated bodies as supervising mechanisms may not take place. Definite policy regarding this issue must be stated and even law established to prompt the development of a practitioner-based system. Without the simultaneous development of self-regulation in the securities industry, the new regulatory body could not properly take on its role as a "watchdog"; and instead, must be contented with the role of a "blood hound".

3. The Report criticized the Office of the Commissioner of Securities for having "became too much of a registry and too little of a watchdog at a time when the reverse was needed."

¹ The Report further stated that the Commission was poorly funded, inadequately managed and not effective. The Report recommends the establishment of a new statutory body outside the civil service staffed with full-time professional staff to watch over the securities industry. The new regulating body, which will be assisted by an advisory committee, will be directly accountable to both the Governor and the

1.p.228 the Report

Legislative Council. The government should not be represented on the board of this new body or its advisory committee. The new body will have a high degree of autonomy for its operation, with only a yearly sanction by the Legislative Council when it presents its budget for approval.

Since this new body is vested with all the statutory power of regulation, it is important for it to steer a proper course. The Report stated that "Recent events in Hong Kong have in our view demonstrated beyond doubt that checks and balances are imperative at every level of the system. This fundamental principle underlies the structure we propose." ¹ The Report stated that "If absolutely necessary it (the government) can overrule the SC (new body) - if need be by direction but preferably by sheer political authority." ² While recognizing the importance of maintaining checks and balances at all levels, the Report, however, did not address the issue of checks and balances for the new regulator. The new regulator will be at the apex of the regulatory hierarchy. Leaving this powerful body, which can exert enormous influence on the securities industry, without external checks and balances is wholly

1.p.34 the Report

2.p.241 the Report

unsatisfactory. Political sanctions, if any, which may be exerted upon the new body, may be too weak, and come too late.

SPECIFIC COMMENTS ON THE REPORT

1. The first set of recommendations relates to the restructuring of the governing bodies of the stock exchange. The Report recommends that membership of the governing council of SEHK allows corporate representations. A small number of independent members from the public should be invited to be members of the council of SEHK for providing checks and balances to other members of the council. The number of such appointments is to be decided. A full-time, well paid chief executive should be appointed and the Chairman of the Council should devote a substantial proportion of his time to SEHK affairs.

These recommendations are long overdue. Before the crash in 1987, the governing council of the SEHK did not allow corporate representatives to sit on its committee. As corporate members of the SEHK account for a growing portion of the trading volume in the exchange, it is unreasonable to bar them from managing the exchanges.

The Chairman of the Council is recommended to devote a substantial portion of his time to the management of SEHK. However, he will not be paid for his effort. This is unrealistic. The Chairman should also be remunerated for his effort if he is expected to take up full-time duties.

2. The second set of recommendations relates to the management of the stock exchange and the training of its members. The Report recommends that the regulatory body screens and approves appointments of key management personnel. The duty of the chairman of the council should be externally orientated while the paid chief executive takes care of internal matters. The Listing Committee, Investigations Committee and Disciplinary Committee should all include non-SEHK members for ensuring public protection. Immediate steps should be taken to train members.

These recommendations again provide checks and balances for the exchange. However, it is important that these checks and balances should not be indiscriminately exercised or unnecessarily onerous. In order that the exchange be able to properly discharge its function, either as a forum for raising capital or as a self-regulated body, it is important that interference by the regulators should be kept to a reasonable level.

3. The third set of recommendations relates to the operation of the stock market. The Report recommends that, with the necessary safeguards, short selling of stock and shares should be allowed. Listing procedures should be improved. Non-active listings should be delisted.

These are overdue recommendations. Short selling of stocks and shares should already be allowed when the futures exchange launched its Hang Seng Index futures contracts in May 1986. Only in 1993 was "limited selling" allowed for the first time in the exchange. Disallowing short selling in the cash market while permitting "long" positions in the Heng Seng Index Futures is an anomaly.

4. The fourth set of recommendations relates to the dealing system of the stock exchange. The Report recommends a T+3 system for the settlement of scripts. The maximum period for completion of share transfers should be reduced to 14 days or less before the central clearing system is introduced. Active steps should be taken to develop a central clearing and settlement system, building on a system of uncertificated book-entry transfers. This system should be supported by a central risk-taker. A guarantee should be provided by the clearing house substituting itself as a counterparty to broker trades.

These recommendations, in short, create a mega corporation, entrusting it with the functions of clearing, registration and the provision of credits.

At present, the costs of clearing and settlement are borne by individual brokers who pass these costs on to customers in the form of commissions and charges. However, by world standards, commissions and charges relating to the dealing of securities in Hong Kong are comparatively low. One finds that the clearing and settlement procedures under the present system are efficient in terms of money cost. To establish a new mega corporation which embraces all clearing activities will involve economic as well as social costs:- the economic costs of setting up and running this corporation and the social cost of allowing a monopoly situation to develop. Furthermore, unlike other overseas markets, most brokerage houses in Hong Kong are located within a walking distance of each other, in the Central District.

The present recommendation of establishing a central clearing system is made without a careful analysis of the costs and benefits. The Report did not approach the issue with a sufficiently analytical approach. Without sufficient cost justifications, these recommendations are groundless and unconvincing unless the reduction of risk of default to

traders is paramount.

5. The fifth set of recommendations relates to the restructuring of the HK Futures Exchange and the enhancement of its management. The Report recommends that the governing Board of the HKFE should be broadly based with independent members. The chief executive of the futures exchange should be of a high calibre. All dealers of the futures exchange should be rescreened.

In view of the fact that the crisis in October 1987 was caused mainly by a defective trading system of the futures exchange, these are exceptionally mild recommendations. Since futures trading has high inherent risk it is reasonable for the authority to exercise a vigilant control over activities of the futures market to ensure the integrity of the market and its intermediaries. If the authority is incapable or unable to implement a system for reducing the risk of counterparty default by brokers and traders, futures trading should be discontinued.

6. The sixth set of recommendations relates to the management of risks in the trading of futures. The Report recommends that the clearing house of the futures market should be a counterparty to every trade. Business risks of the clearing house should be assumed by a fund made up of

deposits from clearing members (risk creators). Further, this risk should be transferred externally to a banking syndicate or an insurance conglomerate or both. The clearing house should be allowed to call in extra funds from clearing members as the need arises.

These recommendations are probably made bearing in mind the massive default of futures brokers during October 1987. The clearing house has the duty of ensuring that the proposed risk management system of the futures exchange could, at least, withstand a market crash (or upswing) of a magnitude similar to the one in October 1987. This is not an unreasonable requirement given the present political situation in Hong Kong.

7. The seventh set of recommendations relates to the restructuring of the futures clearing house and the enhancement of dealing practices. The Report recommends the reviewing of the membership hierarchy of the Clearing House. A high confidence factor in setting margin levels should be adopted by the clearing house. Intra-day settlement should be introduced if volumes and open positions build up again. Brokers should be obliged to collect a "good faith" deposit before executing orders. The HKFE and its clearing house should set limits on gross open positions.

These are reasonable recommendations.

8. The eighth set of recommendations relates to the supervision of futures firms. The Report recommends that the financial positions of each firm should be evaluated by the clearing house and HKFE every trading day. Large traders should be identified by name. An early warning system about the integrity of futures brokers should be implemented. Speculative position limits should be introduced.

None of these recommendations are unduly burdensome in view of the risks associated with futures trading.

9. The ninth set of recommendations relates to the creation of a new securities commission, its objectives and mode of operation. The Report recommends that a statutory body, apart from the civil services, should be established. This new body should be empowered with complete authority over the regulating of the securities industries and matters relating to investments. It will have authority to investigate and bring summary proceedings for statutory offences. It will have the responsibility of reporting annually to the Governor and submitting its annual budget to the Finance Committee of the Legislative Council.

In view of the previous failure of the government to regulate the securities industry, it is only a matter of common sense that a new body, apart from the government, should be set up for taking over the duty of supervision of the securities industry. However, the Report fails to address the issue of checks and balances for this new body. This issue has been discussed in the foregoing paragraphs under General Comments.

10. The tenth set of recommendations relates to the regulation of intermediaries. The Report recommends the revision of the registration process of market intermediaries. The minimum capital requirements of dealers should be reviewed with a view to adequately reflecting risk-related capital needs. An early warning system of capital inadequacy should be introduced. Business conduct rules or codes should be developed to combat malpractice.

Relating the capital of market intermediaries to their business (ie risk) is, in principle, a suggestion in the right direction. However, the volume of trade in securities markets varies greatly from day to day and from month to month. It is, therefore, difficult to come out with a workable formula for estimating the capital requirements for each market intermediary. Before one accepts the recommendation of developing an elaborate system of

calculating capital requirements, one should first examine the failure rates of market intermediaries, the adequacy of the present compensation funds and the viability of broker insurance. All these issues have not been adequately addressed in the Report.

It is doubtful how far a business code, not supported by law, could improve the trading practices of intermediaries. Without the authority of the law the effectiveness of such a code depends, to a large extent, on the authority of the self regulated bodies enforcing its code. Already the committee has observed that Hong Kong has failed to develop authoritative self regulating bodies.

11. The eleventh set of recommendations relates to the marketing and listing of securities. The Report recommends that all current legislation which touches upon and is concerned with the marketing of securities should be consolidated and rationalized. The vetting of prospectuses should be the sole responsibility of the SEHK.

At present, prospectuses are scrutinized by no less than three bodies, i.e. the Company Registrar, the Office of the Commissioner of Securities and the listing department of the stock exchange. Such duplication of duties is totally unnecessary and wasteful. These are reasonable

recommendations.

12. The twelfth set of recommendations relates to the continuing obligations of listed companies. The Report recommends that listed companies should be encouraged to disclose additional information besides that required under statutes. Material shareholdings should be disclosed. Directors dealing in shares of their own companies should be monitored and controlled.

These are reasonable recommendations. However, one should note that the Companies Ordinance is at present under review.

13. The last set of recommendations relates to miscellaneous issues. The Report recommends the revision of the Codes on Takeovers and Mergers. Margin trading should be regulated. The concept of insurance coverage for market intermediaries should be pursued further by both the exchanges and the new regulatory body. Steps should be taken to develop an effective debt market. SEHK and HKFE should be more closely coordinated for the exchange of information.

For margin trading, the present practice of allowing each broker to make his own rule and accept his own risk

seems to work well. As long as the financial positions of intermediaries are properly monitored it may not be wise to implement rules which may hinder rather than facilitate business activities.

OVERVIEW OF THE SECURITIES AND FUTURES COMMISSION ORDINANCE (SFC)

The Davison Report was published in May 1988. After the Report was published a year long consultation period ensued. The subsequently drafted legislation had undergone full consultation with all market participants. The intent, purposes and effects of the SFC Ordinance are well publicized among the people affected, i.e. the various interest groups and private investors. No other economic legislation in Hong Kong had received such publicity.

The Securities And Futures Commission Ordinance [Cap. 24] was enacted in May 1989. The short title of the Securities And Futures Commission Ordinance declares that the SFC Ordinance is to "establish the Securities And Futures Commission and to amend the law relating to dealing in securities and trading in futures contracts...". The Ordinance has, of course, to fulfil this aim. However, besides establishing the Securities And Futures Commission, the Securities And Futures Commission Ordinance also provides for additional registration requirements for

registered persons, regulation of registered persons' business and special provisions relating to exchange companies and clearing houses.

The Securities And Futures Commission Ordinance is the immediate outcome of the Davison Report. Chapter 9 of the Report together with Appendix 26 have laid down the exact form and power of the new statutory body. Other recommendations of the Davison Report, unless they are incidental to the establishment of the SFC, are not the immediate concern of the new legislation. The Ordinance is but a small step towards the full implementation of the Report.

Part 2 of the SFC Ordinance provides for the establishment of the SFC Commission as suggested by the Report. Unfortunately the statute also took on the shortcomings of the Report. By design, the Commission is directly accountable to the Governor and indirectly accountable to the Finance committee of the Legislative Council - for the purpose of its annual funding. That being the case, the Commission is an autonomous body whose activities are largely unchecked, by either the civil services or by the general public. The Financial Secretary may, to some extent, influence the Commission by asking the

Commission to explain to him its policy ¹. However, such influence may be too weak or too late. If, as suggested by the Report, the outgoings of the Commission are to be met mostly from levies on securities transactions, the control over the Commission by the Finance Committee may also turn out to be weak and ineffective.

Part 3 provides for the establishment of a Securities And Futures Appeals Panel. This panel is empowered to deal with matters relating to the refusal, forfeiture, revocation or suspension of registration of registered persons. Other matters, such as the inappropriate exercise of power or the non exercise of power by the SFC, are not appealable.

The jurisdiction of the Appeals Panel should be extended to embrace matters arising out of the exercise, or the non exercise of the power of the Commission.

Part 4 stipulates additional registration requirements for registered persons and their agents. The onus of proving that a person is a proper person to be registered or continue to be registered as a registered person lies with the applicant or the registered person as the case may be rather than with the SFC, as in the past.

1.s. 13 SFC Ordinance

Further, after prior consultation with the Financial Secretary, the Commission is empowered to lay down additional financial requirements for registered persons. This power of the SFC gives rise to uncertainties for registered persons because they could not be certain of the financial resources required for staying in the securities business. Given the contentious nature of this issue the financial resources requirements for registered persons should be stipulated in subsidiary legislation which, when changed, would invoke some form of legislative scrutiny.

Part 5 is concerned with the supervision of registered persons. Under Part 5 the SFC is empowered to enter and seize records of a registered person without a court order. Further, SFC personnel may compel a person to answer questions relating to securities transactions. This power of demanding information has exceeded the power normally enjoyed by the civil services and is arousing concern from human right groups. The SFC has, so far, not been able to show causes for needing this power. Even if such power is granted to the SFC the exercise of such should be subject to external checks and balances. This part of the legislation should be amended to take away the sections offensive to human rights unless there are strong arguments for behaving otherwise. However, it is noted that similar powers are

held by supervisory authorities elsewhere, notably in United Kingdom (ie. in the Serious Fraud Office).

Under Part 5, the SFC is required to supervise the activities of registered persons. However, if a registered person is at the same time a member of the exchange he will be under dual supervision, from both the SFC and the exchange. The supervision activities of these two bodies are more likely than not to overlap. Valuable resources are wasted and such duplication of supervisory activities may even cause unnecessary disruptions to the business activities of registered persons. The legislation should make clear the duties of both the SFC and the exchange in supervising registered persons.

Part 6 is concerned with the delegation of some of the duties of the SFC to the exchange. If the delegation of duties is properly performed the problems of overlapping supervisory activities may have been solved. Besides the delegation of duties the SFC may, under this section, regulate the management and operation of the exchange and the clearing houses. The SFC may even issue an order suspending some or all of the functions of the governing bodies of the exchanges and clearing houses. It is not expected that this power of the SFC will ever be used but the mere possession of such power will "persuade" the

exchanges and the clearing houses to be more co-operative than in the past. Before the October stock crash there were frequent allegations from corporate members of the exchanges that the senior management of the exchanges treat the exchanges as their own private club without regard to the interest of the public. These accusations may have arisen out of the conflict of interest among the factions in the exchanges. However, with the SFC acting now as a "watchdog", equipped with proper teeth, the exchanges should now more likely than not function like a public body more than in the past.

Section 7 is concerned with the financing of the SFC. Although it is intended that the outgoings of the SFC be met by levies on securities transactions, the Ordinance still provides for the financing of the SFC from the general revenue of the Government. In Hong Kong charges incidental to securities dealings are still low in international terms. However, this competitive advantage may soon be eroded if there are no controls over the imposition of market levies. It is unrealistic to require the SFC to "earn" its own living but the Finance Committee of the Legislative Council should be allowed to restrict or impose conditions on the SFC for raising revenue through levies.

Part 8 is concerned with minor issues of enforcing the

various provisions of the Ordinance and immunity from legal responsibilities for persons acting under the relevant Ordinance.

SECURITIES AND FUTURES COMMISSION ORDINANCE BY SECTIONS

The following paragraphs give a section by section analysis of the Securities And Futures Commission Ordinance.

Part 1

Section 1 : It contains the short title of the Ordinance. Sub-clause (2) states that the Ordinance will come into operation on a day to be appointed. The day appointed was 13 April, 1989.

Section 2 : It contains the interpretations of certain words and expressions used in the Ordinance. Should the meanings of words not defined under this clause be called into question the Interpretation and General Clauses Ordinance may provide guidance. If the definitions contained in this Ordinance are in conflict with those provided by the Interpretation and General Clauses Ordinance, the definitions provided by this Ordinance shall prevail.

Part 2

Section 3 : It provides for the establishment of a body corporate known as the Securities And Futures Commission. This body is a legal entity capable of suing and of being sued and possesses a common seal. It is a legal person apart from the Government.

This is to implement the recommendations found in paragraph 9.35 of the Report which requests the establishment of a new statutory body to assume the roles of the three regulatory bodies: the Securities Commission, the Commodities Trading Commission and the Office of the Commission of Securities. The Report observes that the remunerations offered under the civil services are unattractive to qualified professionals and there are constraints under the Government system.

Section 4 : This section states the functions of the Commission. The Commission is to uphold all law relating to securities, to report insider dealings to the Financial Secretary, to supervise investors in securities and properties, to promote integrity in the securities industry, to encourage the development of the futures market, to promote the development of self-regulatory bodies etc. Furthermore the Commission has the functions of protecting investors in other areas of investments as long as they are within the ambit of "property investment arrangement".

These provisions are the outcome of the recommendations in paragraph 9.66 of the Report.

Section 5 : This section stipulates the constitution of the Commission and, in addition, covers matters such as appointment, resignation and removal of directors of the Commission.

The constitution of the Commission follows the recommendations in paragraphs 9.37 - 9.41 and 9.55 of the Report. All appointments and removals of directors of the Commission are to be made by the Governor. This is in line with the underlying principle that the Commission should be highly autonomous and not be accountable to the civil service.

Section 6 : This section provides for the establishment of committees to assist the Commission in the discharge of its duties.

Section 7 : This section allows the SFC to recruit staff on such terms and conditions as it may deem fit.

This is to implement the suggestions in paragraphs 9.42 - 9.48 of the Report.

Section 8 : This section provides the SFC with the general power of holding land, to make contracts, to receive and expend moneys, to borrow money (with the consent of the Financial Secretary), to publish etc.

Section 9 : This section provides for the delegation and sub-delegation of the Commission's functions.

Section 10 : This section provides for the establishment of an Advisory Committee. This Committee does not possess any executive function and is purely of an advisory nature, advising the Commission on any matter of policy.

Members of the Committee are appointed by the Governor after consultation with the Commission. Two executive directors of the Commission may sit on the Committee. The Committee is not totally independent from the Commission and one may harbour doubts about the effectiveness of its advice to the Commission.

Section 11 : This section enables the Governor to give policy directions to the Commission. This is in line with the recommendation made in paragraph 9.55 of the Report.

Directors of the Commission are appointed by the Governor and he also has the power of issuing directives to

the Commission. This is an important check and balance mechanism for the Commission. As one would expect the Governor's intervention will be infrequent. There are other indirect check and balance mechanisms such as the yearly funding exercise and the Financial Secretary's indirect intervention. These are provided for in other sections.

Section 12 : This section requires the Commission to prepare a yearly report on its activities and have the report sent to the Financial Secretary who will table it in the Legislative Council. This follows the recommendation made in paragraph 9.55 of the Report.

This is another check and balance mechanism, albeit indirect and always belated. If the Council is not pleased with the work of the Commission, the most it could do is to withhold public funding. However, it is possible that a substantial part of the funding of the SFC could come from market levies.

Section 13 : This section requires the Commission to furnish to the Financial Secretary information on its policies as required. This check and balance mechanism is not found in the Report but is incorporated for the better accountability of the Commission. However, the SFC is only obliged to answer if asked. The effectiveness of this

section as a check and balance mechanism is relying very much on the vigilance of the Financial Secretary.

Sections 14 - 16 : These sections require the Commission to keep accounting records, audit the accounts and submit to the Governor for his approval a yearly budget which shall be tabled before the Legislative Council. The recommendation made in paragraph 9.58 of the Report stated "we recommend that the new SC Chairman should develop and submit its annual budget to the Finance Committee of the Legislative Council".

Section 17 : This section allows the Commission to invest surplus funds in a manner approved of by the Financial Secretary.

Part 3

Section 18 : This section provides for the establishment of an Appeals Panel. The panel consists of independent members appointed by the Governor. The Report suggests that "the new SC's determinations may need to be subject to appeal, although we would restrict this to really important matters (such as licence revocation) and would prefer that appeals

should be on procedures and not on merit" ¹. This provision implements the suggestion.

However, the Ordinance does go further than the Report. Section 22 provides that the Tribunal hearing an appeal may, by way of a case stated, refer it to the Court of Appeal, for the Court's opinion on any question of law relating to the appeal. However, on the question of facts, there are no appellate procedures. In order to appeal to the High Court the appellant must obtain leave from the Tribunal. Section 22 was not on the original bill. It was added because the public was concerned with the exercise of the power by the Commission ².

Sections 19 - 21 : These provisions deal with matters in relation to appealable issues, the hearing of appeals and proceedings regarding appeals.

Section 22 : This provision provides for appeals as discussed in section 18.

Part 4

1.p.251 the Report

2.The bill was gazetted on 13 January, 1989

Sections 23 - 24 : These sections introduce additional provisions relating to applications for registration and the furnishing of information under the Securities Ordinance and the Commodities Trading Ordinance. These sections implement paragraph 10.18 of the Report which suggests that applicants should demonstrate to the satisfaction of the authority that they are "fit and proper persons" to be registered.

In the Securities Ordinance, it is up to the authority to demonstrate that an applicant is not a fit and proper person to be registered. An applicant will be automatically registered unless he is shown to be not "a fit and proper person". Under sections 23 - 24, the onus is shifted to the applicant. He is to prove himself to be a "fit and proper person".

Section 25 : This section provides that persons registered under the Securities Ordinance and Commodities Trading Ordinance will continue to be so registered until revoked or suspended. This dispenses with the requirement of yearly renewal of registration. It implements the recommendations in paragraphs 10.25 and 10.26 of the Report.

Section 26 : This section enables the Commission, when making enquiry about the misconduct of registered persons, to apply the criteria in section 23 (fit and proper etc.)

Section 27 : This section requires registered persons to notify the Commission of the whereabouts of records legally required to be kept. The Commission may request the registered person to use an alternative venue for keeping records if a location is found unsuitable.

For the purposes of investors' protection and revenue collection the Securities Ordinance requires registered persons to keep various records relating to their business. This section makes further requirements for the location of these records.

Sections 28 - 29 : These sections enable the Commission, after consultation with the Financial Secretary, to make rules requiring registered persons to maintain specified financial resources. The Commission may, if requested by any person to whom such rules apply, by direction adapt the rules to the circumstances of that person or his business.

Paragraphs 10.42 - 10.64 of the Report discussed the financial requirements of registered persons. While the Report recognizes that the net worth requirements and the liquidity requirements of registered persons are not unreasonable when compared with other centres, they "do not

adequately reflect risk-related capital needs"¹. In this respect, it recommends that the minimum capital requirements should be reviewed at an early stage and that the Commission should consider introducing a system of early notification for capital inadequacy. This section empowers the Commission to implement these recommendations.

Part 5

Section 30 : This section enables the Commission to exercise certain supervisory powers over registered persons for the purpose of ascertaining whether the various ordinances relating to securities are being complied with. The powers include the power to enter business premises and the power to inspect and make copies of records and the power to require the production of documents.

This section implements Paragraphs 9.100 - 9.104 of the Report. The Report proposes that the "Initial investigations should be carried out by expert SC staff vested with appropriate powers". "The general duties of inspectors will include examining papers, documents and accounts and interviewing officers of the companies and others. If the facts of the case merit it, the inspectors

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may prepare evidence for subsequent prosecution or call for a further more closely focused investigation."¹

Section 30 aims at giving sufficient power to the Commission for carrying out investigations. This is one of the controversial sections in the Ordinance. In investigating complaints, investigators are vested with the power of entering premises of registered persons where records are kept without going through any judicial process. Normally a law enforcement agent may only enter and search premises after obtaining a search warrant from a magistrate. The legislators are making an exception for crimes committed under the SFC Ordinance or related ordinances.

Sections 31 - 32 : These sections enable the Commission to obtain information relating to the acquisition, disposal etc of securities and futures contracts. The information so demanded includes names and addresses of persons acquiring or disposing of securities. A person who, without cause, fails to comply with the disclosure order will commit an offence of contempt of court.

The power provided by this section assists investigators. Without this provision, a person is not duty

1.p.253 the Report

bound to divulge information concerning their clients or beneficiaries.

Section 33 : This section enables the Commission to conduct investigations concerning certain activities which are not in the interest of the investing public and are in breach of the SFC and other relating ordinances. Where an investigation is conducted, the person investigating is given powers to require certain persons to produce documents, to require from them explanations as regarding records and to require them to attend and truthfully answer questions relating to the matters. A person must answer questions put before him but is afforded protection in relation to self incrimination as the answers could not be used against him in legal proceedings.

The kind of power which should be given to the Commission in relation to investigation is not specifically discussed in the Report. In the absence of specific recommendations, the legislators have armed the Commission with very extensive investigating powers. The right of maintaining silence is taken away from the investigatees. This is, of course, another controversial issue. With a few exceptions, the law of Hong Kong generally respects the right of an individual to maintain silence in the face of accusations or incriminating evidence. Faced with the

public's concern over this issue, the legislators amended the bill, allowing legal representation for the investigatees when attending investigations.

When a person is convicted on a prosecution instituted as a result of an investigation under this section, the court may order that person to pay the whole or part of the costs or expenses of the investigation. This is altogether unusual for Hong Kong law. If the SFC mounts an all out investigation which results in a conviction for an offence of a technical nature, eg. the non-registration of a dealer who deals in Hong Kong on overseas securities for overseas clients, the accused may be asked to pay millions of dollars in investigation fees because of the complicated nature of the business, although the fine for the offence may only amount to a few hundred dollars.

Section 34 : This section enables the Commission to make rules requiring any registered person to make annual returns to the Commission.

Section 35 : This section enables the Commission to request parties concerned to produce computerized information in a legible form.

Section 36 : This section enables a magistrate to issue a

warrant authorizing investigators to gain entry to premises for investigation under this Ordinance. The warrant may confer authority for searching, seizing and removing of any record or document. This section affects registered persons as well as non-registered persons.

Section 30, which enables investigators from the SFC to enter and search premises without a warrant, only applies to business premises of registered persons. Section 36 applies generally to other premises and business premises of non-registered persons.

Section 37 : This section makes it an offence to destroy or conceal any record relevant to an investigation.

Section 38 : This section provides that the powers conferred by sections 39, 40 or 41 are exercisable only where it appears to the Commission that the exercise of such power is desirable in the interest of the investing public, or that the registered person concerned is not a fit and proper person.

Sections 39, 40 and 41 : These sections enable the Commission, by notice in writing to a registered person, to restrict the registered person's business activities, restrict the registered person's ability in dealing with his

assets and require the registered person to maintain his assets.

Sections 42, 43 and 44 : These sections provide for the issuance, withdrawal, substitution and appeal etc of the prohibiting notice under sections 39, 40 or 41.

Sections 45 - 46 : These sections enable the Commission to petition the High Court for a receiving order or for the winding up of a registered person.

Part 6

Section 47 : This section enables the Commission to request the Governor in Council to make transfer orders transferring certain functions of the Commission to the exchange company. These are functions relating to the registration and supervision of registered persons.

Section 48 : This section enables the Commission, the exchange companies and clearing houses to supply information to each other and empowers the Commission to require an exchange company or a clearing house to provide it with information. The supply of information under this section is protected against legal liability.

This section is to implement the recommendations in paragraph 13.57 of the Report which states that the senior management and surveillance staff of the two Exchanges and their respective clearing agencies should co-operate fully and there should not be any obstacles to a proper and full exchange of information.

Section 49 : This section instructs the exchanges to serve written notice on the Commission for their intention to close or reopen the exchanges other than in the ordinary course of business.

No doubt, such a requirement for the exchanges originates from the much disputed closures of both exchanges in October 1987. At that time the Commissioner had no legal power to demand the reopening of the exchanges. The Commission's power to open or close the exchanges is now made available by section 50.

Paragraphs 9.97 - 10.00 of the Report deal with this matter. It says, "It should be better to place the Exchanges under an obligation to give the new SC prior notice of any intention to close (or reopen) a market. We would hope that, if it queried or disagreed with the proposed action, the new SC or the Administration would be able to use its authority to bring about a pause or

reversal".¹

Section 50 : This section empowered the Commission, after prior consultation with the Financial Secretary and a prior request had been made to the institution concerned, to serve a restriction notice in the following circumstances :

a) to require an Exchange Company or Clearing House to amend, withdraw or revoke its memorandum or articles or association in a manner specified by the Commission or to take a course of action regarding the management, conduct or operation of its business; and

b) to prohibit certain acts by an Exchange Company or Clearing House as regards such management or operation.

This power is to implement the comment on paragraphs 9.95 - 9.96 of the Report which says, "Most important are the powers the new SC will have to regulate the management and operation of the Exchanges and the Clearing House ... the watchdog (new SC) has to be able to act swiftly, decisively and, where necessary, with great force if problems develop in the Exchanges or with their members."²

Suggested powers for the Commission are listed in Appendix

1.p.252 - 253 the Report

2.p.251 - 252 the Report

26 of the Report.

Section 51 : This section empowers the commission to make suspension orders regarding the exercise of the functions of a Board of Directors or governing body of an exchange company or a clearing house, the functions of the members of such Board or body or a committee established by it, or the functions of the chief executive officer of an exchange company or a clearing house.

This is an extension of the power under section 50. Instead of making an prohibition order, the Commission may issue a suspension order instead.

Part 7

Section 52 : This section enables the Commission to impose a levy on every purchase or sale of securities recorded on the Unified Exchange or notified to it under its rules. The rate of the levy is specified by order of the Governor in Council as a percentage of the consideration.

This section implements the recommendation in paragraphs 9.56 - 9.58 of the Report which says, "Linked to accountability is funding. We believe that the new SC

should be funded to a significant degree by the market". ¹

Section 53 : This section provides for the financing of the operations of the Commission out of the general revenue of the government.

This section makes provision for furtherance of the recommendations mentioned in section 52.

Section 54 : This section enables the Commission to make rules providing for the payment to the Commission of fees and other charges. Fees and charges may be fixed at levels sufficient to effect the recovery of expenditure incurred, or likely to be incurred, by the Commission.

This section makes provision for furtherance of the recommendations mentioned in section 52.

Part 8

Section 55 : This section enables the Commission to apply to the High Court for an injunction order to restrain a registered person from breaching any of the rules or orders made under section 28 or 29 or under Part 5 of the

1.p.239 the Report

Ordinance.

Section 56 : This section provides immunity from legal responsibilities for persons acting under the relevant Ordinances.

Section 57 : This section imposes legal liability to company directors who consent to a corporation committing an offence under the SFC Ordinance.

Sections 58 - 59 : These sections are concerned with the evidence and the preservation of secrecy relating to the enforcement of this Ordinance.

End of Chapter

CHAPTER 4

RESEARCH METHODOLOGY

In this chapter the research technique, the design of the present analysis and the method of carrying out the analysis are discussed.

Reasons are provided in Chapter 1 ,the Introduction Chapter, for employing the survey research method for this research out of the three commonly used research methods, the experiment, the archival research and the survey research. Reasons have also been provided for conducting the survey with the three interest groups - the private investors, the professional investors and the stock brokers of the Unified Exchange.

Selection of the Information-collecting technique

The researcher is now required to make a decision as to which information-collecting technique is to be employed, the face-to-face interview method or the mail questionnaire technique.

A review of past research in Public Interest Theory and Capture Theory is conducted with a view to finding helpful precedents which may help the researcher in deciding which

information-collecting technique is to be employed. However, the researcher is unable to find any precedent after an exhaustive study.

After reviewing the constraints, inter alia the time and funding problems, faced by the researcher he is of the opinion that the mail questionnaire technique would be more appropriate for the present analysis. When employing the mail questionnaire technique: a) the time taken for conducting the survey would be shorter as all questionnaires are sent out at the same time; b) the manpower needs would be smaller as interviewers are not required; c) certain personal and financial questions, such as those requested in section 1 of the questionnaire, may be more accurately answered because of the anonymous nature of the responses; and d) data collected could be more reliable because respondents would have ample time to give considered responses.

The mail questionnaire technique for collecting information is often regarded as possessing certain drawbacks, among them the low response rate. However, when efficiency is defined as overall response rate and

completeness of response per unit, Backrack and Scobe ¹ are of the opinion that a properly administered mail questionnaire could be as efficient as personal interviews in studies where the researchers believe, on reasonable grounds, that the universe they desire to sample is skewed away from the normal adult population distribution in the direction of higher social status/or higher income. In the present analysis, the recipients of the questionnaires are investors and stock brokers. Most of them should be in the higher income group and/or be of a higher social status.

Another drawback for using the mail questionnaire technique is that only literate persons could respond. And even among literate persons, some, for example, white-collar workers, are more likely to reply than others. This issue would not cause difficulties for the present survey. Questionnaires are sent to investors and stock brokers. They are literate members of Hong Kong society.

The Design of the Questionnaire

The questionnaire was designed after an exhaustive study of the following materials --- literature relating to

1. Stanley Backrack and Mary Scobe, "Mail Questionnaire Efficiency : Controlled Reduction of Non-responses." Public Opinion Quarterly, Vol. 31, Summer 1967, p.266.

economic regulations, the Report of the Hong Kong Companies Law Revision Committee 1971, the Report of the Securities Review Committee 1988, previous economic research questionnaires, and the SFC ordinance (Cap. 24).

Personal interviews with market participants of the securities industry were also conducted to assist in the design of the questionnaire. The researcher conducted informal personal interviews with 5 private investors, 5 stock brokers and 2 securities analysts for ascertaining the issues which might be helpful in solving the particular problem at hand. The materials assembled and opinions collected were studied carefully to determine the items which would be of the most importance and relevance. Questions were constructed with reference to these observations.

The type, format and length of each question and of the questionnaire were given careful consideration. It was considered unwise to construct a questionnaire requiring more than 15 minutes to fill in or covering 10 or more pages¹. The questionnaire was designed with these constraints in mind. Only short and simple sentences were used in the questionnaire. Questions which were too difficult for a

1. Keith Howard and John A Sharp, The management of a Student Research Project, Hants: Gower, 1983, p.138.

person possessing a minimum education ¹ were discarded. Questions requiring considerable thinking or expert knowledge were also avoided.

The design and pretesting of the questionnaire took several months. During that period, the researcher solicited and obtained an approval from the Hong Kong Polytechnic for sending the questionnaires under its name. The researcher hoped that the response rate would be higher if the name of an established institution was used. Apart from this the Hong Kong Polytechnic played no part in the research.

The resultant questionnaire contained 6 sections, with 35 questions covering 6 pages. The Likert scaling was used in Q.7 to Q.20 and Q.23 to Q.33, a total of 25 questions out of the 35 questions in the questionnaire. This scaling method is commonly used by researchers in questionnaires for measuring the attitude of respondents. A Likert scale requires respondents to indicate a degree of agreement or disagreement with the statement set by the surveyor ². For the 25 questions using this scaling method, a five-point

1.Hong Kong has adopted a system of providing a minimum of 9 years' of compulsory education to each person of schooling age.

2.Aker, D.A.& Days G.S., Marketing Research, 3rd edition, John Wiley & Son Inc., 1986, p.218.

scale was used. The respondents were asked to choose one among the "strongly agree", "agree", "neutral", "disagree" and "strongly disagree" headings.

The Contents of the Questionnaire

The main objective of the questionnaire is to ascertain the effectiveness of the SFC Ordinance in protecting the general public. An independent agency, the Securities and Futures Commission (SFC), is incorporated by the SFC Ordinance for discharging the functions found in the legislation. The following are the functions of the SFC Ordinance to be discharged by the SFC.

1. Law Making and Enforcing -- The SFC is required to consider and suggest reforms of the laws relating to securities, futures contracts and property investment arrangement ¹. Further, it has the responsibility of ensuring compliance with the relevant Ordinances so far as they relate to securities, futures contracts and property investment arrangements ².

2. Promotion of Self Regulation -- The SFC is to promote

1.s.4(1)(f) SFC Ordinance.

2.s.4(1)(b) SFC Ordinance.

and develop self-regulation by market bodies in securities and futures industries ¹.

3. Regulation of the Stock Exchange and the Clearing Houses

: The SFC is to be responsible for supervising and monitoring the activities of the Exchange Companies and Clearing Houses ².

4. Regulation of Market intermediaries -- The SFC is to promote and to ensure that the integrity of registered persons (stock brokers and their representatives) is maintained and to regulate registered persons' business ³.

5. Guarding the Interests of investors : The SFC is to take all reasonable steps to safeguard the interests of persons dealing in securities or trading in futures contracts or entering into property investment arrangements ⁴.

6. Regulation of Dealing Activities -- The SFC is to suppress illegal, dishonest and improper practices in

1.s.4(1)(k) SFC Ordinance.

2.s.4 (1)(d) SFC Ordinance.

3.s.4(1)(h) SFC Ordinance; Part IV and V of SFC Ordinance.

4.s.4(1)(e) SFC Ordinance.

securities, futures trading, property arrangements, and the provision of investment advice or other services relating to securities, futures contracts and property investment arrangements ¹.

The questions in the questionnaire were designed to ascertain the effectiveness of the legislation in protecting the interest of the general public and of the interest groups. Effectiveness is measured by the level of satisfaction or dissatisfaction accruing to each interest group due to the discharging of the functions stated in the SFC Ordinance. The researcher assumes that the higher the level of satisfaction enjoyed by an interest group, the more benefits it has enjoyed and vice versa.

The Questionnaire -- the final version

The final version of the questionnaire has a total of 35 questions printed on 6 pages. Questions are grouped in six sections. Except for the GENERAL INFORMATION section, which deals with general background matters, other sections are designed to each cover a major function of the SFC. These sections are :

1. GENERAL INFORMATION

2. LAW AND REGULATIONS FOR THE SECURITIES INDUSTRY

1.s.4(1)(g) SFC Ordinance.

3. THE STOCK EXCHANGE OF HONG KONG
4. STOCK BROKERS AND OTHER INTERMEDIARIES
5. LISTED COMPANIES
6. SECURITIES DEALINGS

Section 1 -- GENERAL INFORMATION

This section aims at obtaining background information from respondents. Respondents are asked about the locality of their activities, local or both local and overseas (Q. 1), years of experience (Q. 2), frequency of activities (Q. 4), level of activities (Q. 5) and purpose of investment (Q. 6). Question 3 is a control question. Respondents are asked in question 3 for whom they are investing in Hong Kong. Their responses should match the characteristics of the interest group they are belonging to. For example, if professional investors replied that they are investing for themselves only (not for their company) their questionnaire would be discarded.

Section 2 -- LAW AND REGULATIONS FOR THE SECURITIES INDUSTRY

This section aims at ascertaining the level of satisfaction accruing to each interest group relating to the law making and enforcement activities of the SFC. There are altogether 4 questions in this section. All questions in this section carry a 1 to 5 scale to be checked off by

respondents. A "1" represents a strong agreement with the statement while a "5" represents a strong disagreement. In between are the various levels of satisfaction or dissatisfaction. Questions relating to the law governing the securities industry (Q. 7), vigilance in the enforcement of such law (Q. 8), the role which should be played by professional bodies in making rules and regulations for the securities industry (Q. 9, Q. 10) are all incorporated.

Section 3 : THE STOCK EXCHANGE OF HONG KONG

This section aims at ascertaining the level of satisfaction accruing to respondents regarding the supervision of the Exchange (Q. 12, Q. 17), the activities of the Exchange regarding new listings (Q. 14, Q. 15, Q. 16) and the insuring of stock brokers against their financial defaults (Q. 13). The activities of the Exchange are now under the strict guidance of the SFC ¹.

Section 4 -- STOCK BROKERS AND OTHER INTERMEDIARIES

This section aims at ascertaining the level of satisfaction accruing to respondents relating to the regulation of stock brokers and other market intermediaries by the SFC. Capital adequacy of stock brokers is a cause of

1. Part VI, SFC Ordinance.

concern among professional investors ¹. A question on the capital adequacy of stock brokers is included (Q. 20). Two questions (Q. 21, Q. 19) about malpractice of stock brokers and two questions (Q. 18, Q. 19) about the services rendered by stock brokers are included in this section.

Section 5 -- LISTED COMPANIES

This section aims at ascertaining the level of satisfaction accruing to respondents in relation to the SFC's activities in supervising listed companies. Interests of investors are vested in listed companies. Seven questions about listed companies are incorporated. Four questions about disclosure of information by listed companies (Q. 23 - 26), one question about the discharge of duties by directors of listed companies (Q. 27), one question about the power of shareholders in approving major transactions (Q. 28) and one question about take-over activities are included.

Section 6 -- SECURITIES DEALINGS

This section aims at ascertaining the level of satisfaction accruing to respondents in relation to the suppression by the SFC of illegal, dishonourable or improper conduct in securities dealing. One question about margin

1.p.275 the Report of the Securities Review Committee, 1988

trading (Q. 30), one about short selling (Q. 32), and two about commissions and charges are included (Q. 33, Q.34). The last two questions (Q. 34, Q. 35) are general questions asking for the respondents' general comments.

Pretesting the Questionnaire

The final version of the questionnaire was pretested before the bulk printing of the questionnaire. Five private investors and 40 securities professionals ¹ were asked to respond to the questionnaire. Of the 40 securities professionals, about three quarters of them are stock brokers and the rest executives in investment companies -- professional investors. Forty of the pretesters had a tertiary education while the rest were secondary school leavers. All respondents were able to complete the questionnaire within the time limit of 15 minutes. As a result of the pretesting, some questions were replaced and some rephrased.

Statistical Analysis employed

After the collection of data, the next important task is to subject the data to analysis using statistical methods

1. The researcher was, at the time, a lecturer and subject leader of an educational programme jointly organised by the Stock Exchange of Hong Kong Ltd. and Hong Kong Polytechnic.

to estimate some property of the population that is sampled and to test the three formulated hypotheses. It is necessary to employ statistical methods because a survey conducted with a sample involves incomplete information about the population and, therefore, it is necessary for the researcher to ascertain the degree of confidence for the data collected.

The researcher uses two unrelated statistical techniques for analyzing his empirical data. The first and more important technique, binary choice modelling, is employed to test the three hypotheses stipulated in chapter one. The second technique, the chi-square statistical method, is employed to find out the other characteristics of the data collected.

Binary choice modelling

`Binary-choice models assume that individuals are faced with a choice between two alternatives and that the choice they make depends on the characteristics of the individuals'¹.

Assuming one has the information from a representative

1.p.274 Econometric Models and Economic forecasts, Second Edition, R S Pindyck & D L Rubinfeld, McGraw-Hill Book Company 1981.

group of persons about the choice made by each person of the group and the attributes which affect each in the making of their choices, then one could estimate an equation which could make prediction about the behaviour of an individual not in the group. The usual regression analysis technique is employed. In the present analysis the researcher is building a model which estimates the 'supportiveness' of the SFC by private investors and interest groups.

Binary models of the same nature are employed in testing all the hypotheses. Each hypothesis has a group of questions in the questionnaire for testing the effectiveness of the SFC in discharging one of its major functions. Most of the responses to the questions in the questionnaire are in fact dichotomous in nature. The responses can be simplified into 'yes' or 'no' categories, or following the terms used in the questionnaire, 'agree' or 'disagree'. A 'Yes' indicates support for the SFC and a 'No' no support for the SFC. When a variable is dichotomous in nature one may represent it as the dummy variable or the dependent variable in the binary-choice model. The attributes, the independent variables, are not required to be dichotomous in nature. The objective of the model is to estimate the likelihood that an individual will support or not support the SFC. Once the equation is estimated and the coefficients of the independent variables are calculated,

the likelihood of a person supporting the SFC can be estimated. In the present analysis, a fictitious respondent who is the 'Mr. Average' is invented. This 'Mr. Average' takes on averages of all the responses of that sample as his responses. These 'averages' are fed into the model to estimate the likelihood of 'Mr. Average' supporting the SFC, expressing it in a probability ratio of between 0 and 1. The probability of 'Mr. Average' for the private investors group may be compared with the probability of 'Mr. Average' for interest groups and the group which has the higher likelihood of supporting the SFC will be the group deriving higher satisfaction from the SFC.

For models involving dichotomous response variables, there are three commonly used approaches for formulating such models ¹. These are :

1. The linear probability model,
2. The logit model (non-linear),
3. The probit model (non-linear).

It is vital for the researcher in any statistical analysis to specify the correct model. Statistical inference made from an analysis would be doubtful or even

1.p.468, Basic Econometrics, Second Edition, D N Gujarati, McGraw Hill, 1988.

meaningless if an incorrect model is specified. There are two different aspects to specifications ¹. The first concerns the specification of the correct set of variables in the model and the correct ascertainment of their interdependency. This is done from the outset when reviewing the literature and designing the research. The second, which is the more immediate concern of this section, is to decide whether to use linear or non-linear probability modelling. The problem with the linear probability model is that the independent variables in the function are used to approximate a probability number. For the case of dichotomous dependent or dummy variables in the model the assumption of linear relationship may be incorrect. If the linear probability model is used the dependent variable, which is calculated as a probability of an event happening, may exceed 1 or be less than 0. Probabilities not satisfying the 0 to 1 constraint cause difficulty in interpretation. Such an anomaly occurs because while the dependent variable is assumed to be dichotomous the independent variables are assumed to be continuous. For the present analysis, the dependent variables are dichotomous in nature while the independent variables are assumed to be continuous, although following a Likert Scale of 5. Because of the foregoing reasons non-linear logit and probit

1.p.31, Linear Probability, Logit, and Probit Models, J H Aldrich & F D Nelson, Sage Publications 1984.

probability models are used instead of the linear probability model.

The Probit and Logit Models

To overcome the difficulties mentioned in the previous paragraph, it is necessary to translate the values of the independent variables, which may range from 1 to 5 in the present analysis, to a probability which ranges in value from 0 to 1. The use of the cumulative distributive function (CDF) will provide such a transformation ¹. The CDFs which are commonly chosen to represent the 0 - 1 response model are (1) the logistic and (2) the normal, the former giving rise to the LOGIT and the latter to the PROBIT (or normit) model. In the case of the Logit model, the original regression form of the linear probability model of :

$$P_i = \text{Beta}_1 + \text{Beta}_2 X_i$$

where X_i = value of the independent variable

$P_i = 0$ or 1 , 0 for support of the SFC while 1 for non-support is now transformed to the following, using the cumulative probability function :

$$P_i = 1 / 1 + e^{-(\text{Beta}_1 + \text{Beta}_2 X_i)}$$

1.p.280 Econometric Models and Economic forecasts, R S Pindyck & D L Rubinfeld, McGraw Hill Book Company, 1981.

or $P_i = 1 / 1 + e^{-Z_i}$

and the odds ratio of $P = P_i / 1 - P_i$

$$= 1 + e^{Z_i} / 1 + e^{-Z_i} = e^{Z_i}$$

and taking the natural log of the above formula one has

$$L_i = \ln (P_i / 1 - P_i) = Z_i$$

$$= \text{Beta}_1 + \text{Beta}_2 X_i$$

L is the Logit and hence the Logit model.

The Logit model exhibits the following features¹ :

1. As P goes from 0 to 1, the Logit goes from -infinity to +infinity. Although the probabilities lie between 0 and 1, the logits are not so bound.

2. Although L is linear in X, the probabilities themselves are not. This is in contrast with the Linear Probability Model where the probability increases linearly with X.

3. Beta_2 , the slope, measures the change in L for a unit change in X; in the present analysis, it tells how the log-odds in favour of supporting the SFC change as the independent variable changes by a unit. The intercept Beta_1 , is the value of the log-odds in favour of supporting the SFC if the independent variable is zero. The value of the intercept has no meaning for the present analysis

1.p.482 Basic Econometrics, 2nd Edition, D N Gujarati, McGraw-Hill Book Company, N.Y. 1988.

because the independent variable has at least a value of 1 in the 1 to 5 Likert Scale.

4. Once the intercept (Beta_1) and the coefficients (Beta_2 , Beta_3 ...) are estimated, the probability of supporting or not supporting the SFC by a certain person, who expresses his opinions through the values of the independent variables, can be calculated. The same principles apply to a group of persons who express opinions as one.

In the Probit Specification, instead of the logistic CDF in the Logit model, the normal CDF is used. The estimating model which emerges from the normal CDF is called the Probit model. Aside from the different definition of the dependent variables and a different formula for the variances, the reciprocals of which are to be used as weights, the analysis proceeds exactly as that of the logit formulation ¹. The interpretation of the Probit model is the same as that of the Logit model. Except for a slight difference in magnitude, the coefficients for both the Logit and Probit models exhibit the same sign and direction and the probability estimations (P_i) of both are the same.

1.p.71 Linear Probability, Logit, and Probit Models, J H Aldrich & F D Nelson, Sage Publications, USA 1984.

Model Specifications

For testing the first hypothesis "That the Securities and Futures Commission has caused the making and enforcement of appropriate law and regulations for protecting the interest of the general public i.e. private investors" the following model is used for the Logit and Probit analysis :

$$Y = C + B_1X_1 + B_2X_2 + B_3X_3$$

where

$Y = 0$ or 1 , 0 for agreeing that law enforcement is adequate for protecting investors, 1 for not

C = a constant

B_i = coefficients

X_1 = opinion on the adequacy of the present law

X_2 = opinion on whether or not Self Regulated Bodies should make rules for protecting investors

X_3 = opinion as to the legalizing of rules of Self Regulated Bodies

For testing the second hypothesis "That the Securities and Futures Commission has adequately supervised the stock exchange, a self regulated body, for protecting the interest of the general public, i.e. private investors" the following model is used for the Logit and Probit analysis :

$$Y = C + B_1X_1 + B_2X_2 + B_3X_3$$

where

$Y = 0$ or 1 , 0 for agreeing that exchange has made adequate effort to protect investors, 1 for not

C = a constant

B_i = coefficients

X_1 = opinion on the question of closer supervision of the exchange by the SFC

X_2 = opinion on the suggestion that the exchange be given a role in determining the initial subscription price

X_3 = opinion on whether or not listed companies have already been properly scrutinized by the exchange

For testing the third hypothesis "That the Securities and Futures Commission has adequately supervised listed companies and their management for protecting the interest of the general public, i.e. private investors" the following model is used for the Logit and Probit analysis :

$$Y = C + B_1X_1 + B_2X_2$$

where $Y = 0$ or 1 , 0 for prompt disclosure of sensitive information to investors, 1 for not

C = a constant

B_i = coefficients

X_1 = opinion on whether or not directors of listed companies have properly discharged their duties towards investors

X_2 = opinion on whether or not in takeovers and mergers the interest of shareholders is protected.

Chi-square analysis

The researcher intends to employ the chi-square analysis to ascertain the degree of confidence and the other characteristics for the collected data. This statistical method was devised by an English statistician Karl Pearson who used the Greek letter chi for an index of variation. Since the index is commonly used as a square, it is generally known as chi-square, symbolized by χ^2 . Chi-square analysis is suitable for solving multiple classification problems and testing hypotheses on a normal distribution ¹. The chi-square can also be used to solve classes of correlation problems for counting variables.

The analysis assumes that there is a finite number, denoted by k , of possible outcomes of an experiment. These possible outcomes are represented by k cells. The experiment is performed n times, and the results are expressed by recording the observed frequencies of outcomes in the corresponding cells. The problem then is to determine whether the frequencies are compatible with those expected from some postulated theory. The general method

1.p.269 Basic Statistics for business and Economics, Paul G. Hoel and Raymond J. Jessen, John Wiley & Sons, inc., 1971.

for testing compatibility is based on a measure of the extent to which the observed and expected frequencies agree. This measure, called chi-square, is defined by the formula :

$$x^2 =$$

where o_i and e_i denote the observed and expected frequency, respectively, for the i th cell, and k denotes the number of cells. Thus, increasingly large values of x^2 may be thought of as corresponding to poor experimental agreement ¹.

The present research analysis is concerned with multiple classification problems. The reliability of the findings depends upon the probability distribution of the observed frequency and the expected frequency of a null hypothesis that "the observed frequencies are compatible with the frequencies expected of evenly distributed replies". The chi-square distributions for returns of each category are calculated. The researcher, observing generally accepted norms in statistical analysis of this nature, is using a confidence level of 90% for analyzing the collected data.

End of Chapter

1.p.269 - 271, Basic Statistics for Business and Economics, Paul G. Hoel and Raymond J. Jessen, John Wiley & Sons Inc., 1971.

CHAPTER 5

RESULTS OF THE EMPIRICAL STUDY

Chapters one and two describe the research method and the research technique employed for collecting the data needed in testing the effectiveness of the Securities and Futures Commission in investor protection. The survey was conducted in December 1989 and the results of that survey are presented in this chapter.

This chapter is divided into 5 sections. The first section presents the findings relating to the background of the respondents. Data about the level of experience, the frequency of dealing, for whom the deal is done, the percentage of Hong Kong securities in their portfolio and the reasons for investing in Hong Kong securities are presented.

The second section presents the findings relating to the adequacy and enforcement of law and regulations relating to securities. Data about the adequacy of the law, the level of vigilance in enforcing the law and the role of self regulated bodies are presented.

The third section presents the findings relating to the regulatory function of the SFC in the stock exchange. Data about the adequacy of protection of investors by the

exchange, the adequacy of supervision of the exchange by the Securities and Futures Commission, the insuring of stock brokers, the power of limiting new listings, the role of the exchange in the determination of share subscription prices of new listings, the scrutinizing of new listings and the closure of the stock market in time of turmoil are presented.

The fourth section presents the findings relating to the regulating of market intermediaries by the SFC. Data about the adequacy of financial information from professionals for the general public, the training of market intermediaries, the capital adequacy of stock brokers and sharp practices and methods of curbing sharp practices are presented.

The fifth section presents the findings relating to the supervision of listed companies and the management of listed companies for investor protection. Data about the disclosure of information by listed companies, the competence of listed company directors, the power of shareholders in approving major transactions and the protection of investors in take-over situations are presented.

The sixth section encompasses miscellaneous issues

which were mentioned in the Report of the Securities Review Committee of 1988 but which have not been dealt with in other sections. These items of interest, although not directly related to the present analysis, are important for understanding the issue at hand. Data about margin trading, short selling, brokerage and charges, the cost of supervising the industry and the methods of ensuring an orderly market are presented.

Besides submitting the findings in a written form they are also presented in the form of BAR CHARTS and TABLES. In order to avoid repeating the same information time and time again, only charts are incorporated in the text. Tables are separately placed in attachment B.

SECTION ONE

GENERAL BACKGROUND INFORMATION ON THE RESPONDENTS RELATING TO SECURITIES DEALINGS

There are altogether six questions in this part of the questionnaire. The following paragraphs present the data and their findings :

Investment Activities - Most private investors invest only in the Hong Kong market while most brokers invest both in the Hong Kong and overseas markets. All responding fund managers engage in both the Hong Kong and overseas markets. International fund operators are

becoming active in the Hong Kong market and it could now be regarded as an integrated component of the world financial system. If this status is to be maintained the financial activities in and the supervision of the Hong Kong securities market should be of international standards.

Experience - One generally expects that fund managers are more experienced than private investors. However, data from the survey paint a different picture. At the time of the survey most fund managers have less than five years of experience with the local market. This may be caused by the short history of the Hong Kong market as an international market. Most brokers and private investors have more than 10 years of experience with the local market. The findings of a share ownership survey conducted by the Stock Exchange of Hong Kong Limited ¹ corroborate the above observations. The Stock Exchange survey reveals that only 19% of Hong Kong share owners are novices while the remaining 81% of them have more than two years of experience in the stock market, out of whom 40% came into the market 10 years or more ago.

Frequency of dealing - Brokers are found to have the highest frequency in dealing. This is not altogether

1.P.18 Shareownership Survey in Hong Kong 1989, Summary and Comparison, The Stock Exchange of Hong Kong Limited, 1990.

unusual as dealing is their business. However, the findings reveal that only 47.6% of them deal everyday. This is not expected because they are supposed to deal on each working day. Further investigation reveals that out of the 679 stock brokers in the exchange, 162 of them (23.8%) are dormant members ¹. Dormant members are those members of the exchange who have stopped trading in the exchange.

Proportion of HK securities in portfolio - Private investors have a higher proportion of their securities portfolio in Hong Kong securities than fund managers and brokers. However, among private investors, 40% of them have less than 50% of their portfolio in Hong Kong securities. Likewise only 15% of fund managers invest more than 50% of their portfolio in Hong Kong securities. This finding is in line with the finding of the stock exchange survey mentioned earlier which revealed that only 14% of the share owners place more than half of their total investment (including real property, precious metals, currencies etc) in local stocks ². Perhaps this phenomenon is explained by the higher than normal political risk associated with

1. 'Members List', The Stock Exchange of Hong Kong Limited, January 1990.

2.p.15 Shareownership Survey in Hong Kong 1989, Summary and Comparison, The Stock Exchange of Hong Kong Ltd, 1990.

investment in Hong Kong.

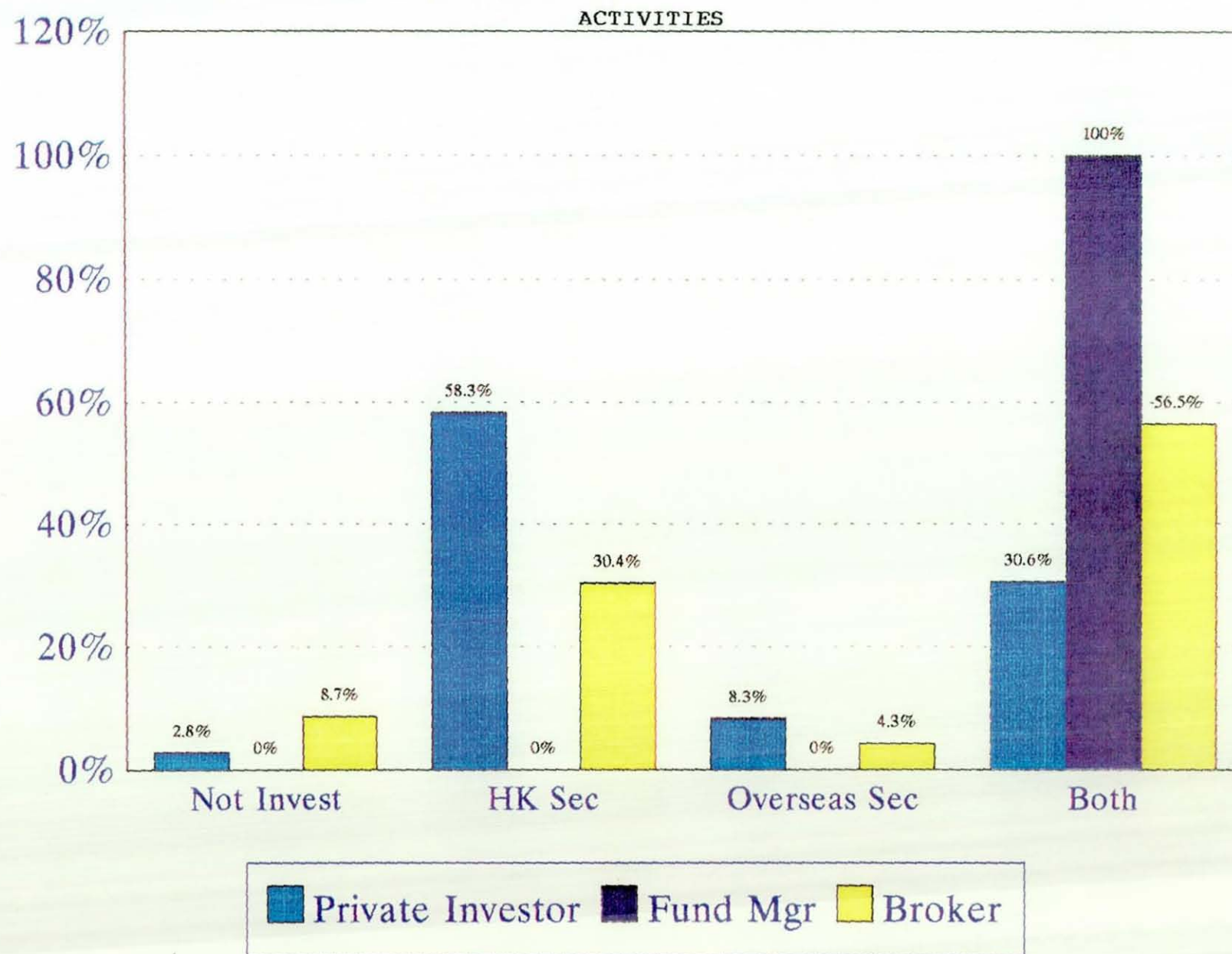
Reasons for investing in HK securities - Most of the investors in Hong Kong, including fund managers or private investors, choose capital appreciation as their dominant reason for investing in Hong Kong securities. As Hong Kong does not subscribe to double taxation and dividend is paid free of any local tax encumbrance, this investor mentality is perhaps partly explained by the speculative nature of the market and partly by the lack of long term commitment by investors. This finding is again corroborated by the findings of the earlier mentioned stock exchange survey. The stock exchange survey reveals that good company prospects, gain in stock price and good capital growth are the first, second and third foremost reasons for investing in local stocks. Good dividend yield ranks only tenth in their survey.

The diversification of investment activities (Chart 5.1; Table 5.1)

Question ONE aims at ascertaining from respondents their investment activities.

For private investors (PI), 58% of them invest only in the Hong Kong market while 30% invest both in Hong Kong and

CHART 5.1
THE DIVERSATION OF INVESTMENT



overseas markets. For stock brokers (SB), the situation is reversed, 30% of them invest only in the Hong Kong market while 56.5% invest both in Hong Kong and overseas. For professional investors (PRO), all of them invest in both local and overseas markets.

The level of local experience (Chart 5.2; Table 5.2)

Question 2 aims at ascertaining from respondents their local investment experience. For PI, 19.4% of them have less than 5 years of experience in Hong Kong, 80.6% of them have 5 years or more and 50% have more than 10 years.

For SB, 90.4% of them have 5 years or more of local experience while 71.4% have more than 10 years. For PRO, the majority of them (57.1%) have less than 5 years of local experience while only 1 has more than 10 years.

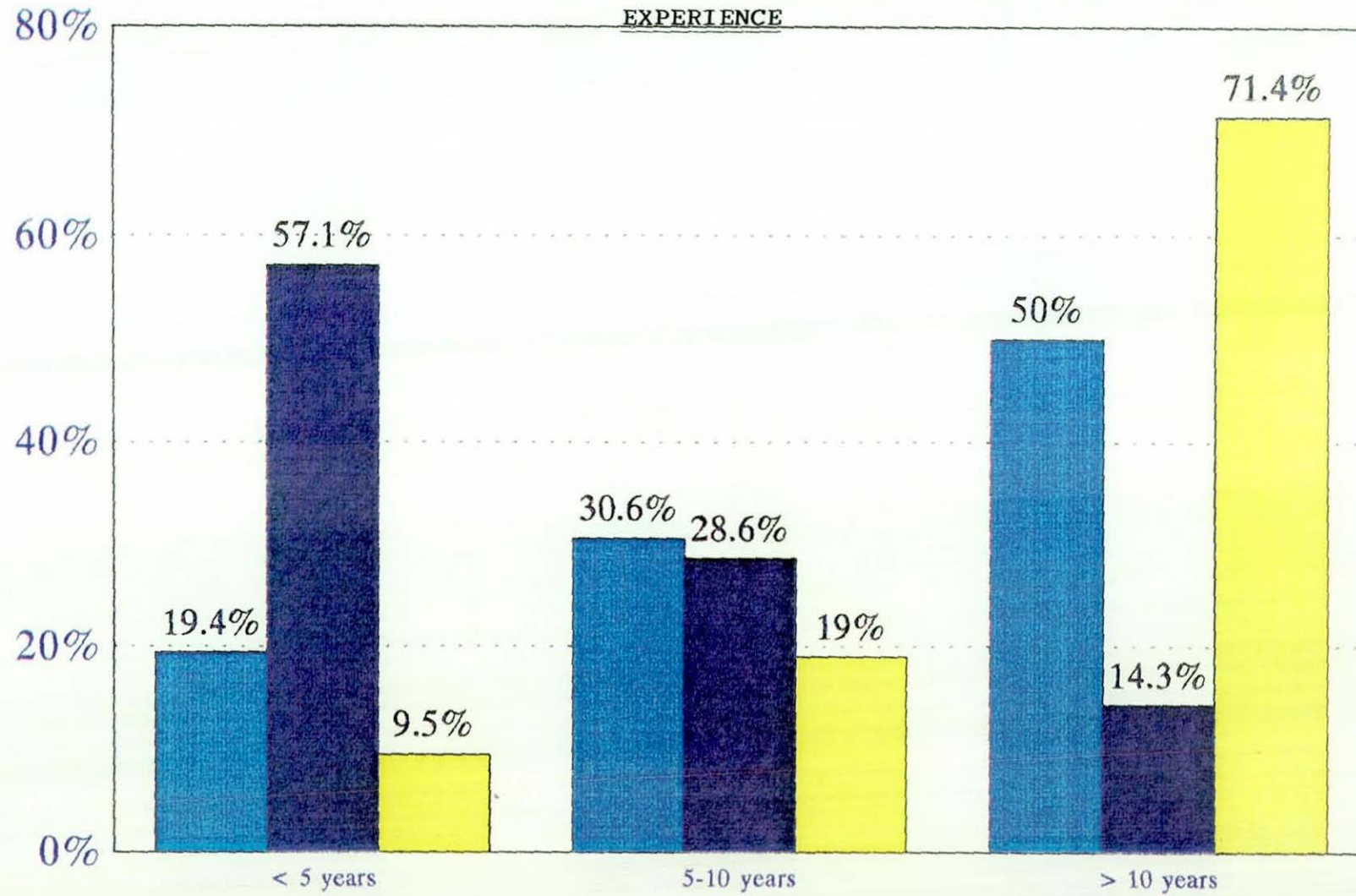
For whom the respondents are investing (Chart 5.3; Table 5.3)

Question 3 requests the respondents to state for whom they are investing.

For PI, most of them (75%) invest for themselves, friends and relatives. Nine PI respondents (25%) state that they invest both for themselves and for their company. None of the PI state that they invest for their company only.

For SB, 42.9% of them invest both for themselves and for their friends and relatives, 47.6% invest both for the

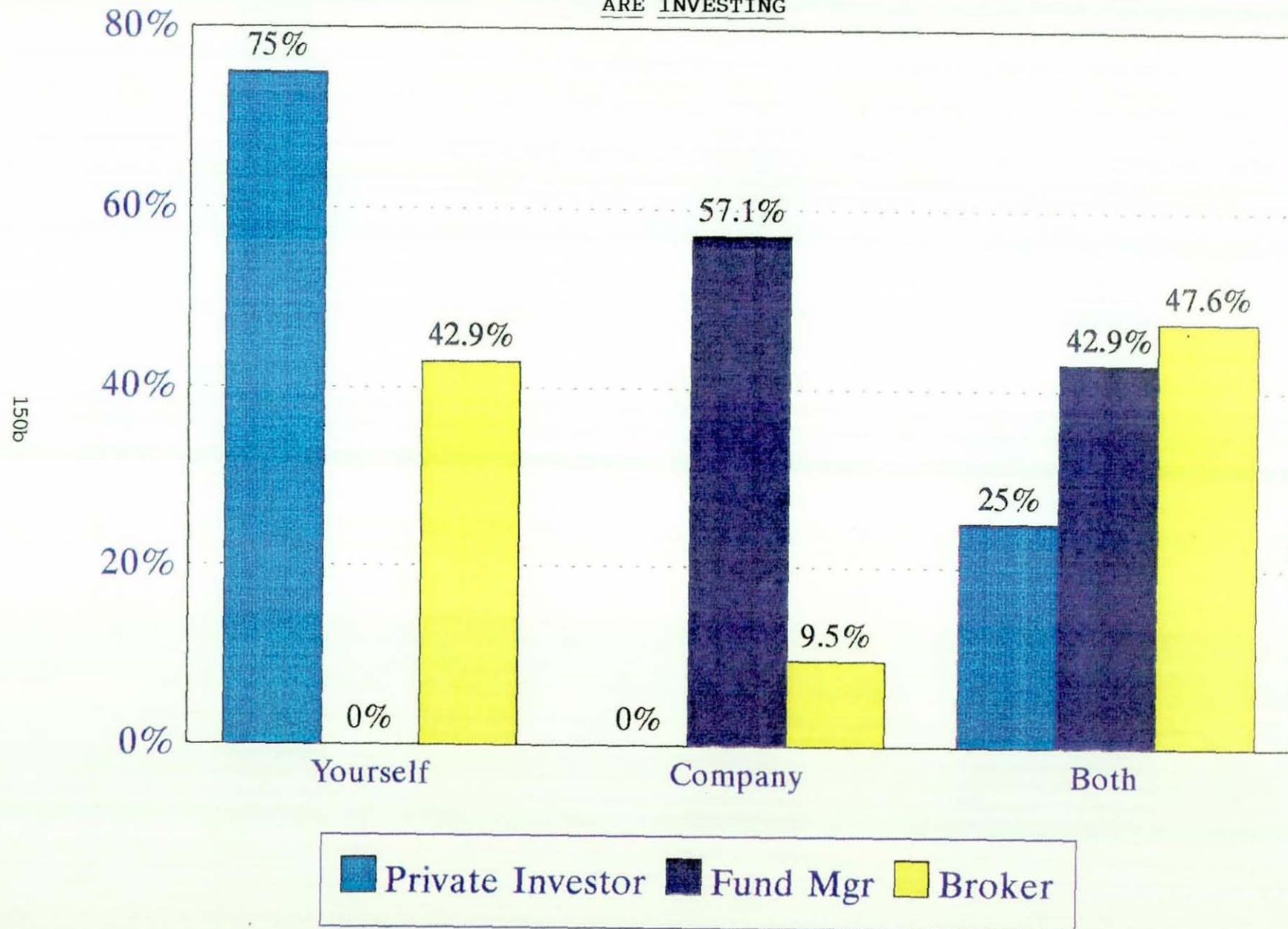
THE LEVEL OF LOCAL
EXPERIENCE



■ Private Investor ■ Fund Mgr ■ Broker

CHART 5.3

FOR WHOM THE RESPONDENTS
ARE INVESTING



company and themselves while 9.5% for the company only.

For PRO, all of them either invest for their company or both for their company and themselves. None of them invest only for themselves.

Frequency of activities in the stock market (Chart 5.4; Table 5.4)

Question 4 aims at finding out from respondents their frequency of activity in the local market.

For PI, 44.4% of them deal infrequently (less than monthly), and 66.6% or 2/3 deal every month or frequently. Only 19.4% of them deal everyday.

For SB, 19% of them deal infrequently (less than monthly). 81% deal every month or frequently. Only 47.6% deal every working day.

For PRO, 40% of them deal everyday while 60% deal every week. The level of activity for PRO is higher than that of PI and SB.

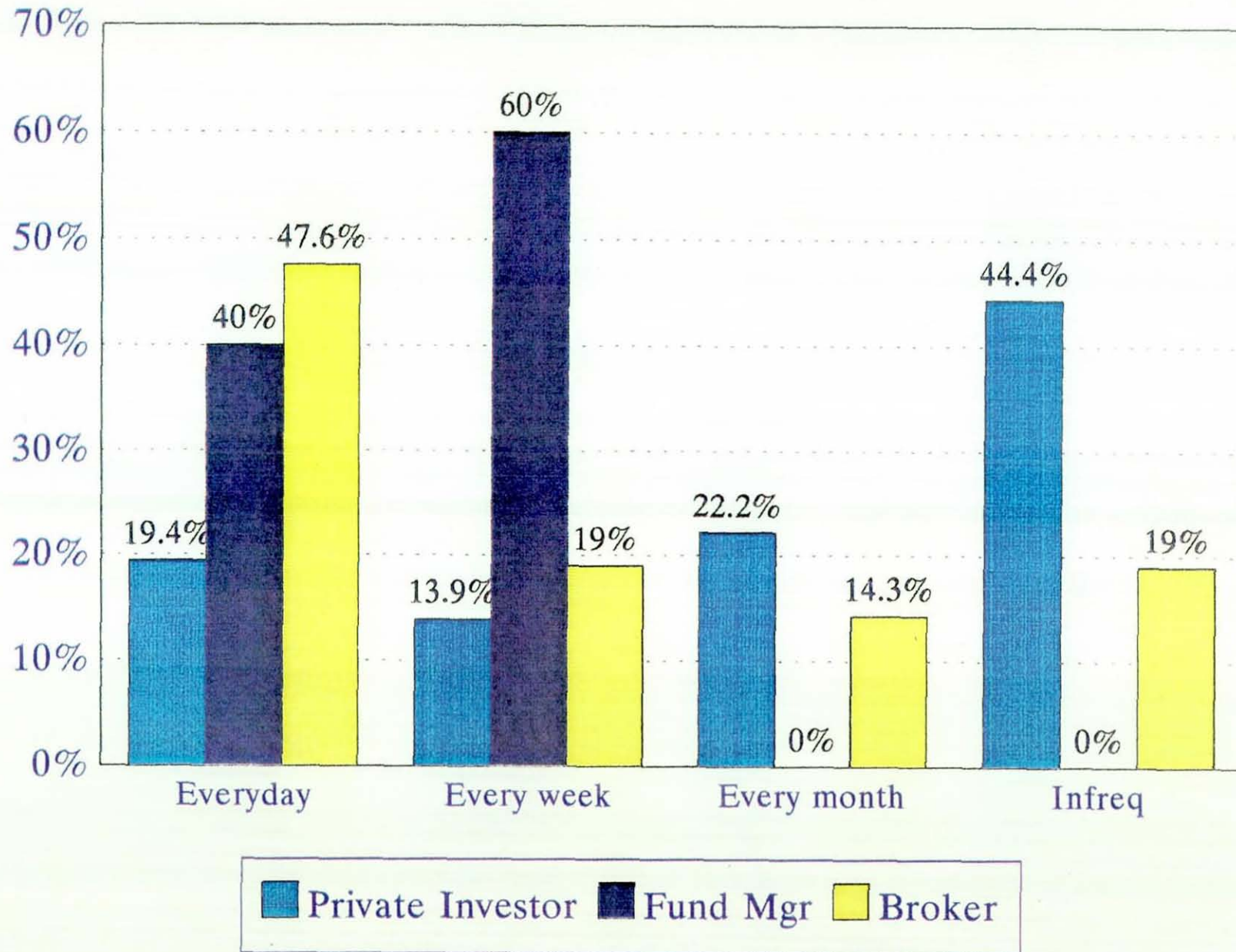
The amount of Hong Kong securities under control (Chart 5.5; Table 5.5)

Question 5 aims at finding out from respondents the proportion of Hong Kong securities in their portfolios.

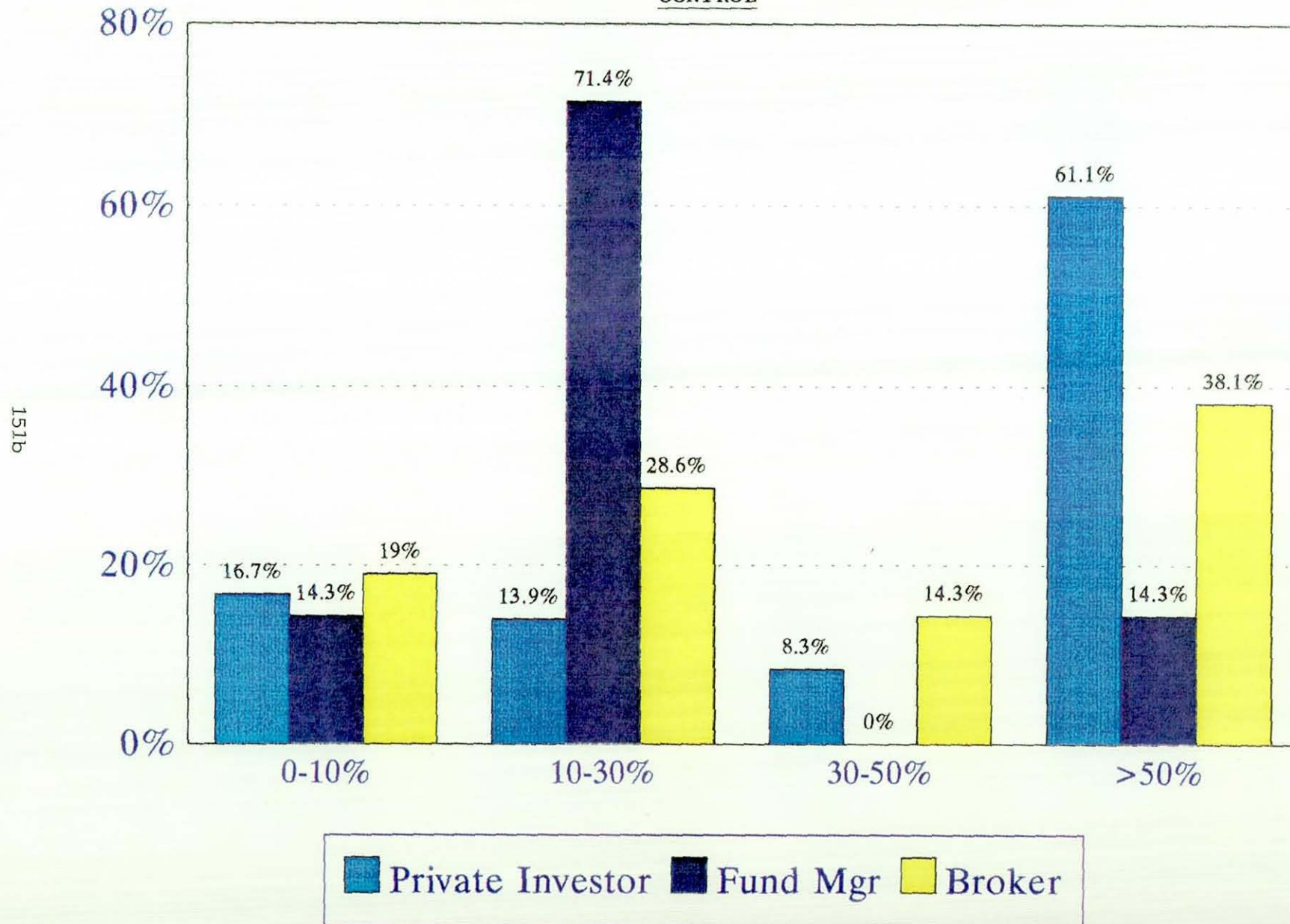
For PI, 61.1% of them have more than half of their securities portfolios (securities only, excluding other investments) in Hong Kong securities. This is corroborated with the findings from question 1 which reveal that 58% of

CHART 5.4

Q.4

FREQUENCY OF ACTIVITIES IN STOCK MARKET

THE AMOUNT OF HONG KONG SECURITIES UNDER CONTROL



the PI respondents invest only in Hong Kong.

For SB, 38.1% of them have more than half of their securities portfolios in Hong Kong securities. Again this is in line with the findings in question 1 which reveal that 30% of the SB invest only in Hong Kong.

For PRO, only 14.3% of them have more than half of their securities in Hong Kong securities. 71.4% of the PRO have only 10 - 30% of their securities in Hong Kong securities.

Reasons for investing in Hong Kong Securities (Chart 5.6; Table 5.6)

Questions 6 aims at finding out from respondents their reasons for investing in Hong Kong securities.

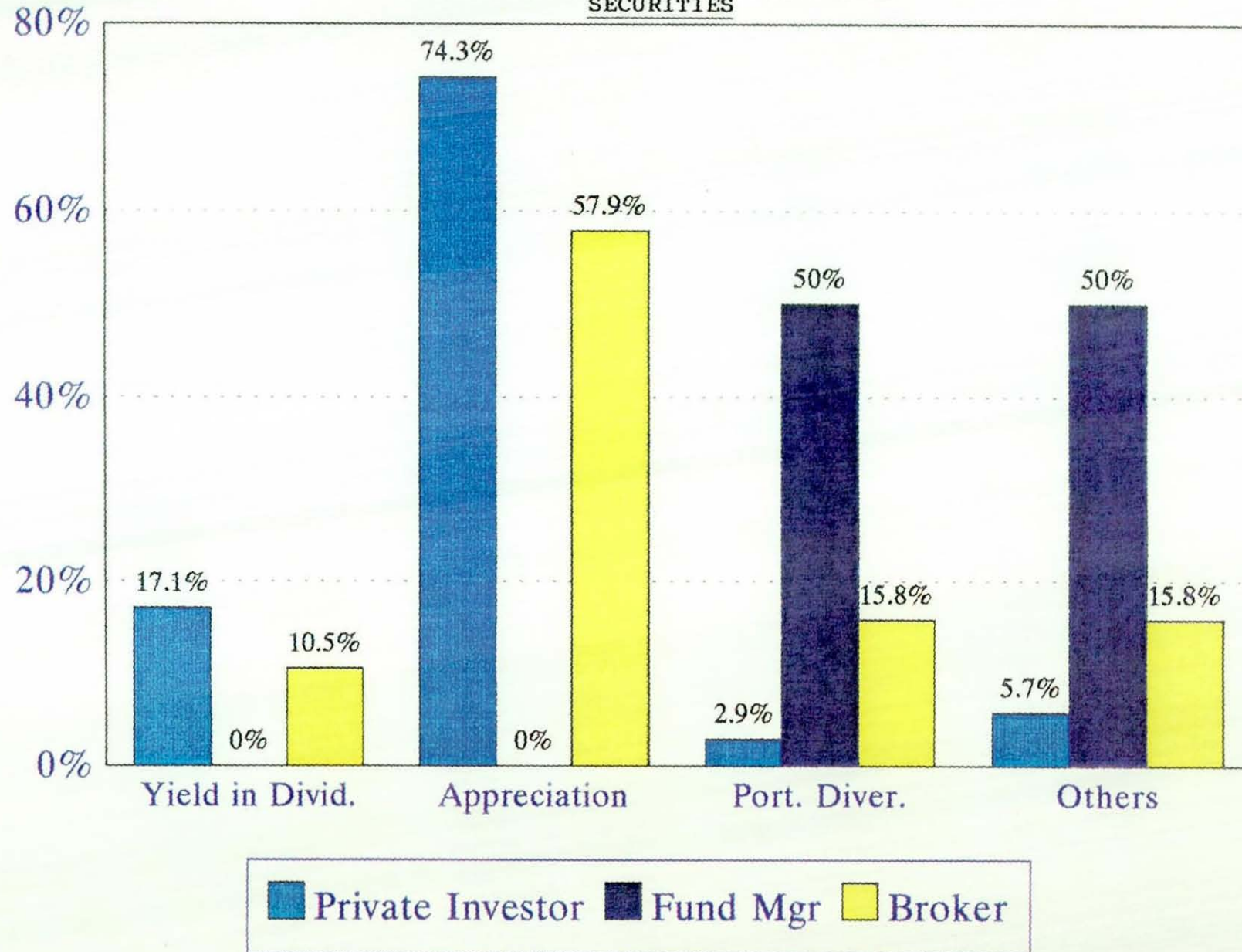
For PI, 74.3% of them invest in Hong Kong securities because of capital appreciation.

For SB, 57.9 of them invest in Hong Kong securities because of capital appreciation.

For PRO, most of them give multiple reasons¹. However, capital appreciation (5 indications out of a total of 16 indications) and portfolio diversification (6 out of a total

1. multiple reasons returns could not be captured by the computer programme and all the forms under this category were manually tabulated.

CHART 5.6

REASONS FOR INVESTING IN HONG KONG
SECURITIES

of 16) are among the favoured reasons. Yield in dividend (2 out of 16) is the least favoured.

SECTION TWO

LAW MAKING AND ENFORCEMENT

There are altogether four questions (Q.7 - Q.10) in this section. Questions 7 and 8 are key questions for testing the first hypothesis. Question 7 attempts to find out from respondents the adequacy of the present law while question 8 the adequacy of law enforcement. The other questions in this section refer to rules and regulations of self regulated bodies. The following are the observations from the findings :

Adequacy of the Law - Under the Capture Theory, benefits of economic legislation are captured by interest groups. As such one expects to find from the results that the fund managers group, a most cohesive group, is most satisfied with securities legislation while the stock brokers group, a less cohesive interest group, less satisfied and lastly, the private investors group dissatisfied. The findings, however, do not support this supposition. Instead, one finds that the fund managers group is dissatisfied with the present law governing the securities industry. The private

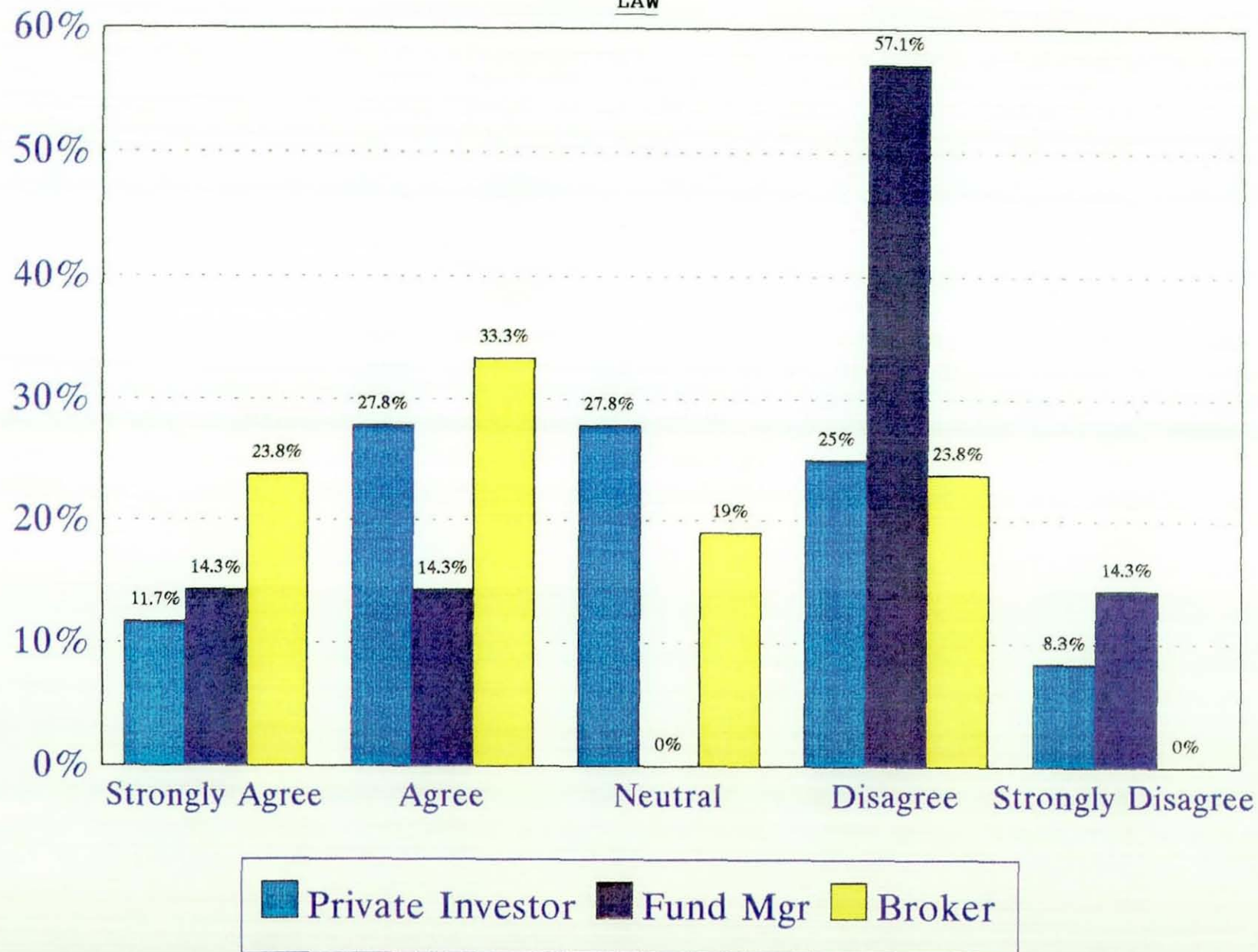
investors group is divided in its opinion whereas the stock brokers group is rather satisfied with the existing law. Securities legislation seems to have conferred a lot of benefits on stock brokers, some on private investors and none on fund managers. On the enforcement of law a similar pattern is observed. Fund managers show a high level of dissatisfaction while stock brokers and private investors are generally satisfied. These observations illustrate that producers and consumers are dividing up the legislative benefits between themselves.

On the issue of professional bodies acting as self regulated bodies for protecting investors, all three groups are in favour of this suggestion. However, fund managers are against the idea of having the force of law backing the investor protection function of self regulated bodies. This outcome cannot be explained by the Capture Theory since under the theory self regulated bodies, as interested bodies, should welcome economic legislation which would be for their benefits.

Adequacy of the present law (Chart 5.7; Table 5.7)

Question 7 aims at finding out from respondents their opinion about the adequacy of the current law governing the securities industry.

CHART 5.7

ADEQUACY OF THE PRESENT
LAW

For PI, their opinion is divided. There are as many respondents agreeing as there are disagreeing that the present law is adequate.

For SB, there are more respondents (57.1%) agreeing than disagreeing (23.8%) that the present law is adequate. 23.8% of them strongly agree while none strongly disagree.

For PRO, there are more respondents (71.4%) disagreeing than agreeing (28.6%) that the present law is adequate.

Adequacy of law enforcement (Chart 5.8; Table 5.8)

Question 8 aims at finding out from respondents their opinion about the adequacy of enforcing the securities law.

For PI, 50% of them agree that law enforcement is adequate while 33.4% disagree.

For SB, 47.8% of them agree that the enforcement is adequate while 23.8% disagree.

For, PRO, 14.3% of them agree that the enforcement of the law is adequate while 57.2% disagree. Dissatisfaction with law enforcement comes mainly from PRO.

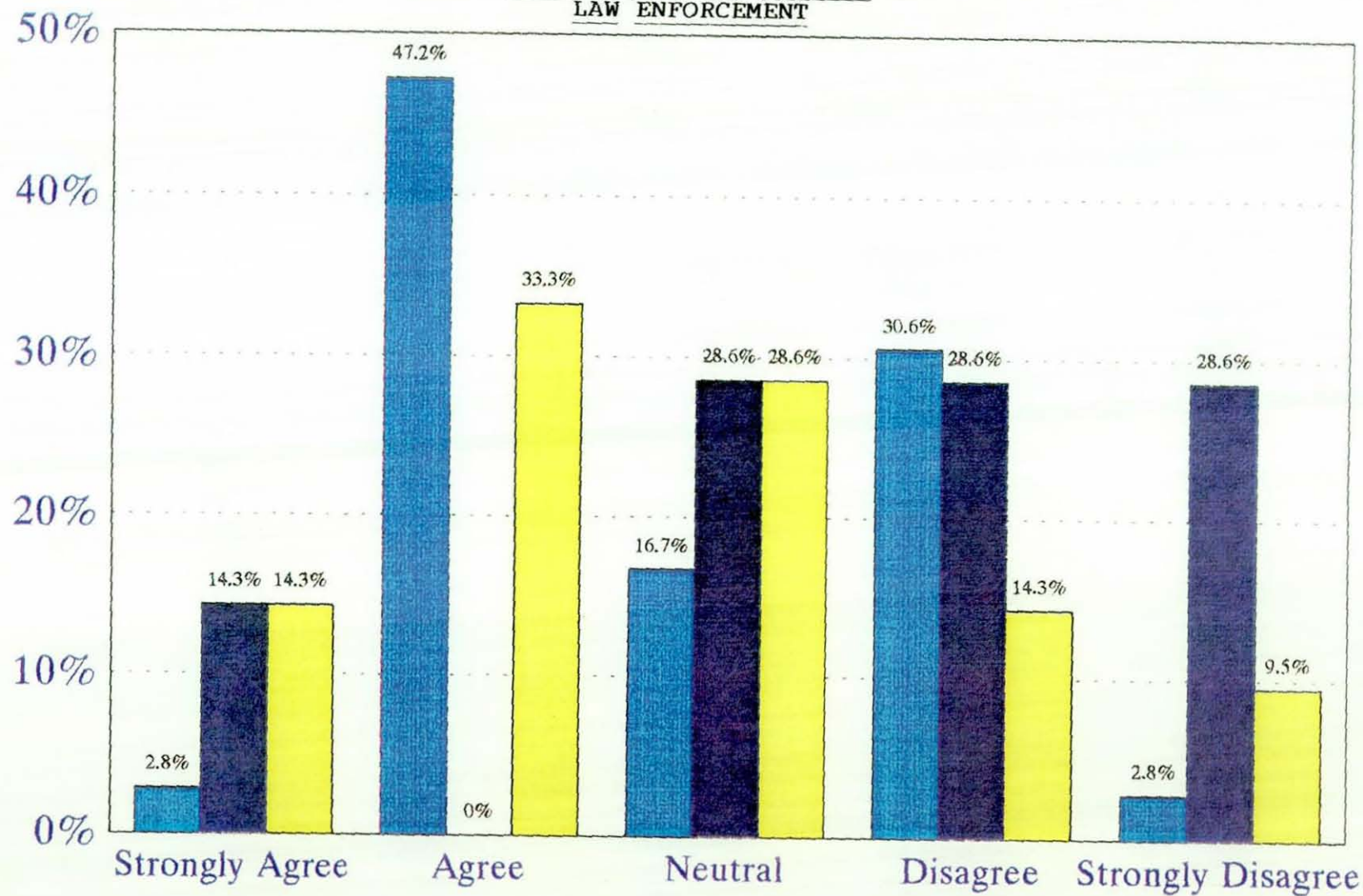
Role of professional bodies in protecting investors (Chart 5.9; Table 5.9)

Question 9 aims at finding out whether professional bodies such as the Stock Brokers Association or the Unit Trusts Association should play a role in making rules and

CHART 5.8

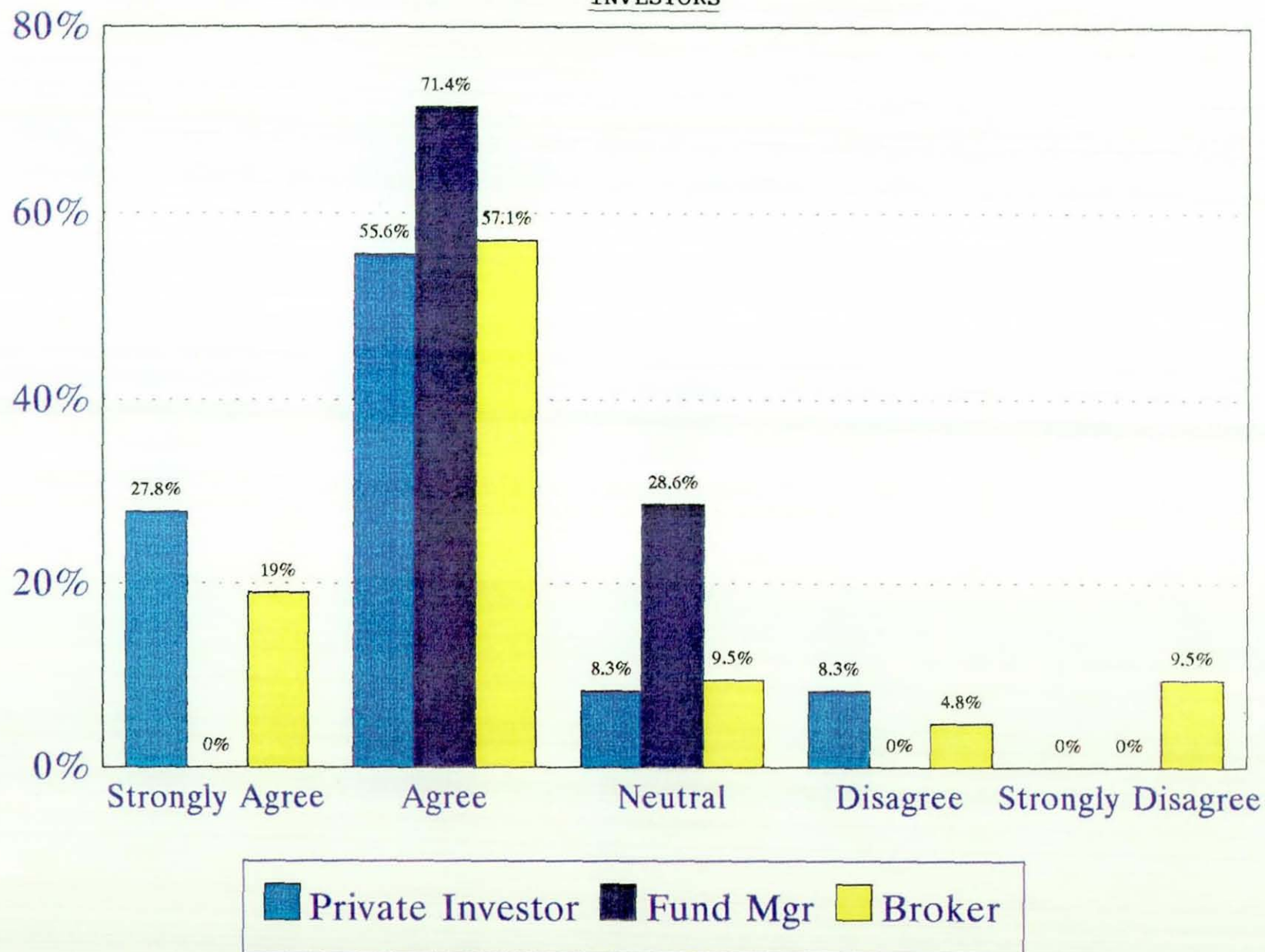
Q.8

ADEQUACY OF THE PRESENT
LAW ENFORCEMENT



■ Private Investor ■ Fund Mgr ■ Broker

CHART 5.9

ROLE OF PROFESSIONAL BODIES IN PROTECTING INVESTORS

regulations governing their members for protecting investors.

For PI, 83.4% of them agree that professional bodies should play a role while only 8.3% disagree.

For SB, 76.1% of them agree that professional bodies should play a role while only 14.3% disagree.

For PRO, 71.4% of them agree that professional bodies should play a role while none disagree.

All 3 categories of respondents join force on this issue.

Professional rules to be backed up by law (Chart 5.10; Table 5.10)

Question 10 aims at ascertaining whether rules and regulations relating to securities made by professional bodies should have the force of law behind them.

For PI 80% of them agree that such rules and regulations should be backed up by law while only 8.6% disagree.

For SB, 65% of them agree that such rules and regulations should be backed up by law while 25% disagree.

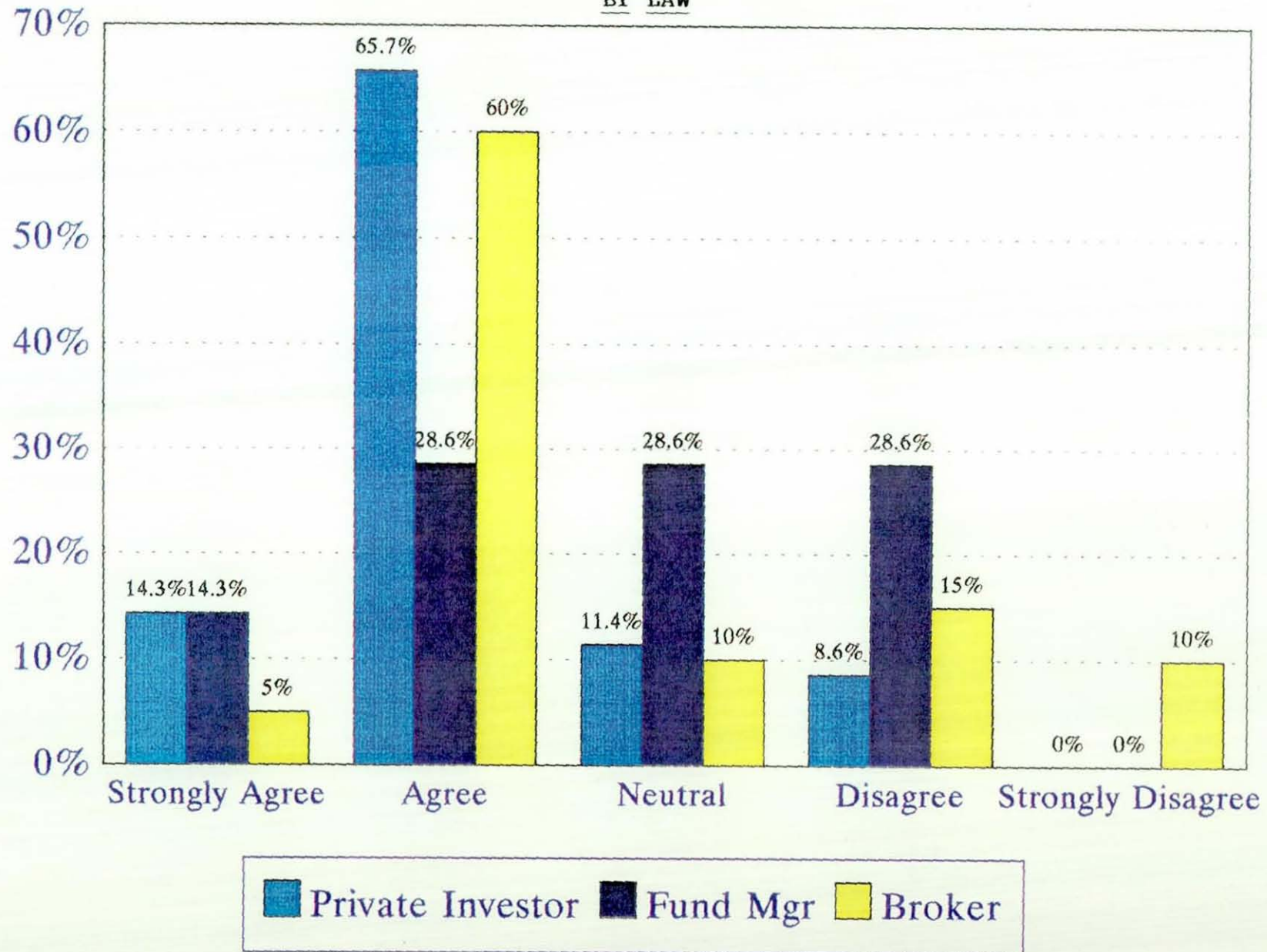
For PRO, 42.8% of them agree that such rules and regulations should be backed up by law while 28.6% disagree.

All 3 categories of respondents join force on this issue with PI showing the strongest desire to have these rules and regulations by professional bodies legally enforceable.

CHART 5.10

Q.10

PROFESSIONAL RULES TO BE BACK UP
BY LAW



SECTION THREE

THE STOCK EXCHANGE OF HONG KONG

There are altogether seven questions in this section. (Q.11 - Q.17). Questions 11 and 12 are key questions for testing the second hypothesis while other questions relate generally to other activities of the stock exchange. From the findings the following observations are made :

The Adequacy of the Stock Exchange - The findings show that the issue of "the adequacy of the Exchange in discharging its function of investor protection" does not generate much diverse response from respondents. Responses are evenly distributed in the middle columns of "Agree", "Neutral" and "Not Agree". Generally the stock brokers are more satisfied with the working and supervision of the Exchange than private investors or fund managers. However, the disparities among interest groups are not significant.

Closer supervision of the Exchange by the SFC - From the data it seems that the SFC has earned for itself a certain amount of goodwill. All three categories of respondents believe that the closer supervision of the Exchange by the SFC would enhance investor protection. Perhaps all three interest groups have derived benefits from the SFC before.

Role of the Exchange - There is a general feeling among

investors that stock brokers should insure themselves against the risk of their own financial defaults. This demonstrates the apprehension and distrust from investors towards the Compensation Fund which is currently run by the Exchange. Even among stock brokers more of them than not are in favour of insuring themselves. However, in general, investors are not dissatisfied with the work of the Exchange. On the issue of the monitoring of listed companies most investors are satisfied with the work of the Exchange.

Adequacy of the stock exchange (Chart 5.11; Table 5.11)

Question 11 aims at finding out from respondents their opinion about the adequacy of the stock exchange in protecting investors.

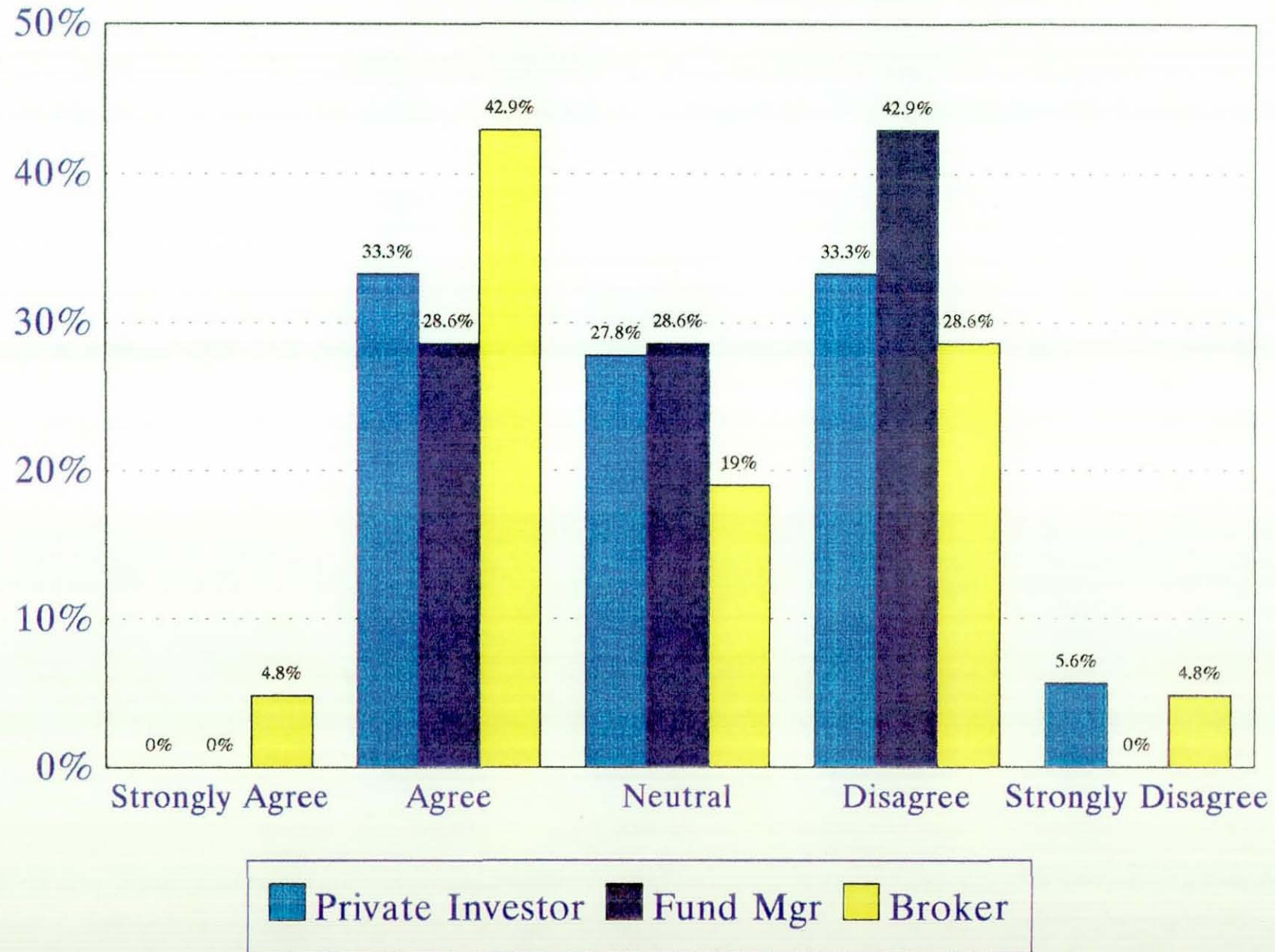
For PI, 61.1% of them agree that the Stock Exchange has already made adequate efforts to protect investors while 35.9% disagree.

For SB, 47.7% of them agree that the Stock Exchange has already made adequate effort while 33.4% disagree.

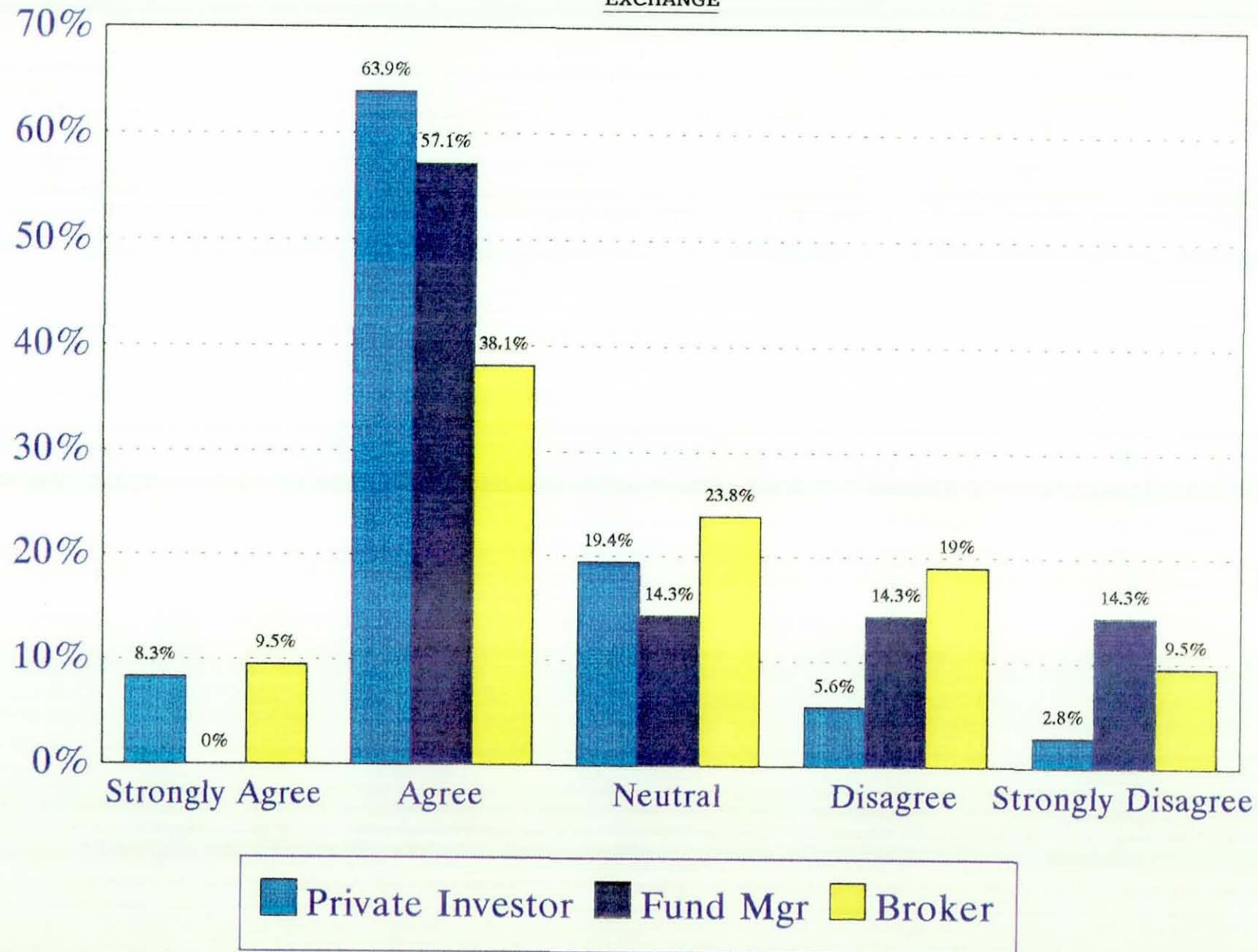
For PRO, 28.6% of them agree that the Stock Exchange has already made adequate effort while 42.9% disagree.

Closer supervision of the Stock Exchange (Chart 5.12; Table 5.12)

CHART 5.11

ADEQUACY OF THE STOCK EXCHANGE

CLOSER SUPERVISION OF THE STOCK
EXCHANGE



Question 12 aims at finding out from respondents their opinions about closer supervision of the Stock Exchange by the SFC and the government for protecting investors.

For PI, 72.2% of them agree that closer supervision of the Stock Exchange should give better protection to investors while only 8.4% disagree.

For SB, 47.6% of them agree that closer supervision of the Stock Exchange should give better protection while 28.5% disagree.

For PRO, 57.1% of them agree that closer supervision of the Stock Exchange should give better protection while 28.6% disagree.

All three interest groups join forces on this issue.

Insurance against financial default (Chart 5.13; Table 5.13)

Question 13 aims at finding out whether the Exchange should request their members (stock brokers) to take out insurance against their possible financial default towards investors.

For PI, 72.3% of them agree that stock brokers should take out insurance while only 2.8% disagree.

For SB, 42.8% of them agree while 33.4% disagree.

For PRO, 71.4% of them agree while 28.6% disagree.

All three interest groups join forces on this issue.

Limiting the number of new listings (Chart 5.14; Table 5.14)

CHART 5.13

Q.13

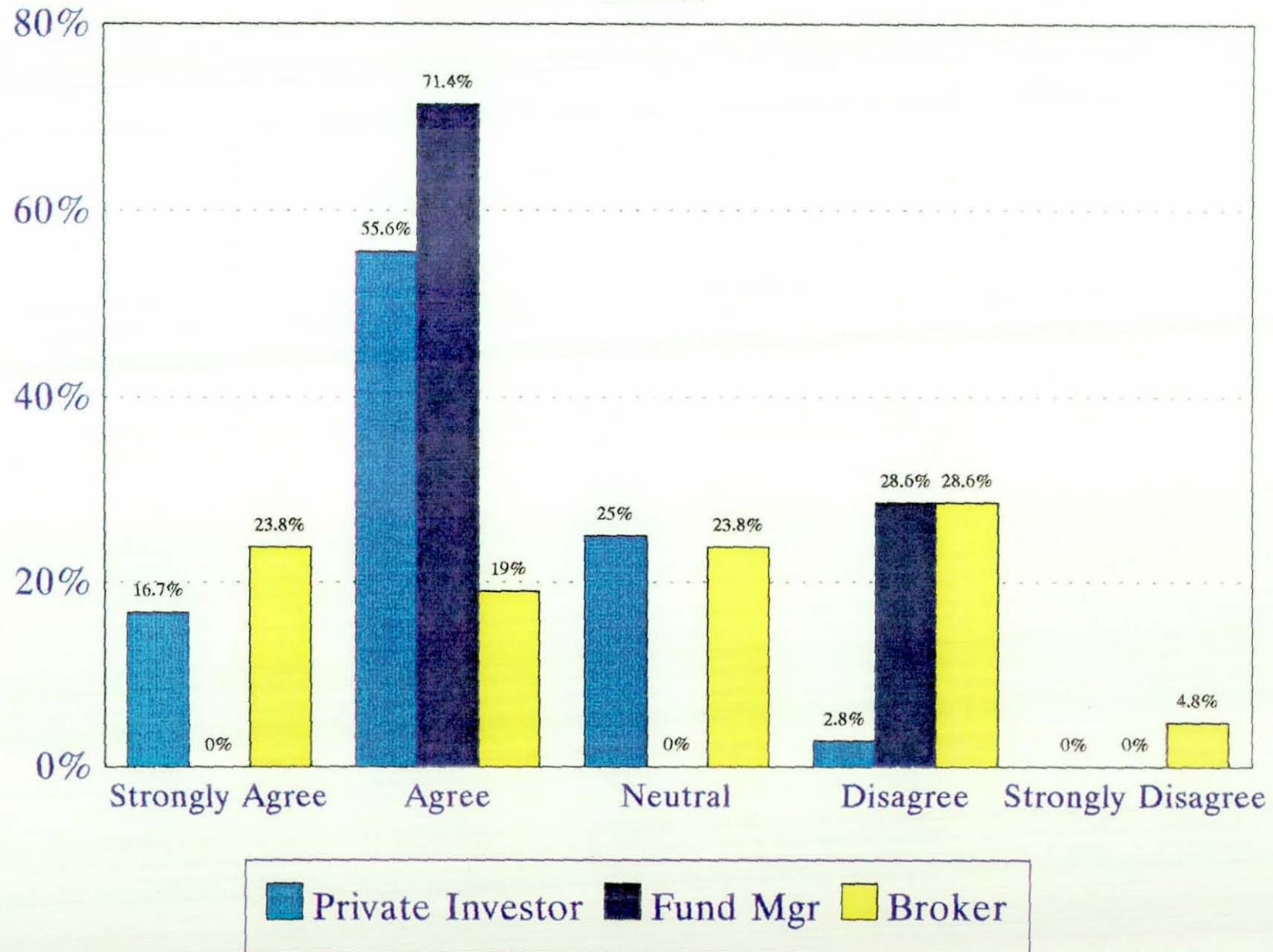
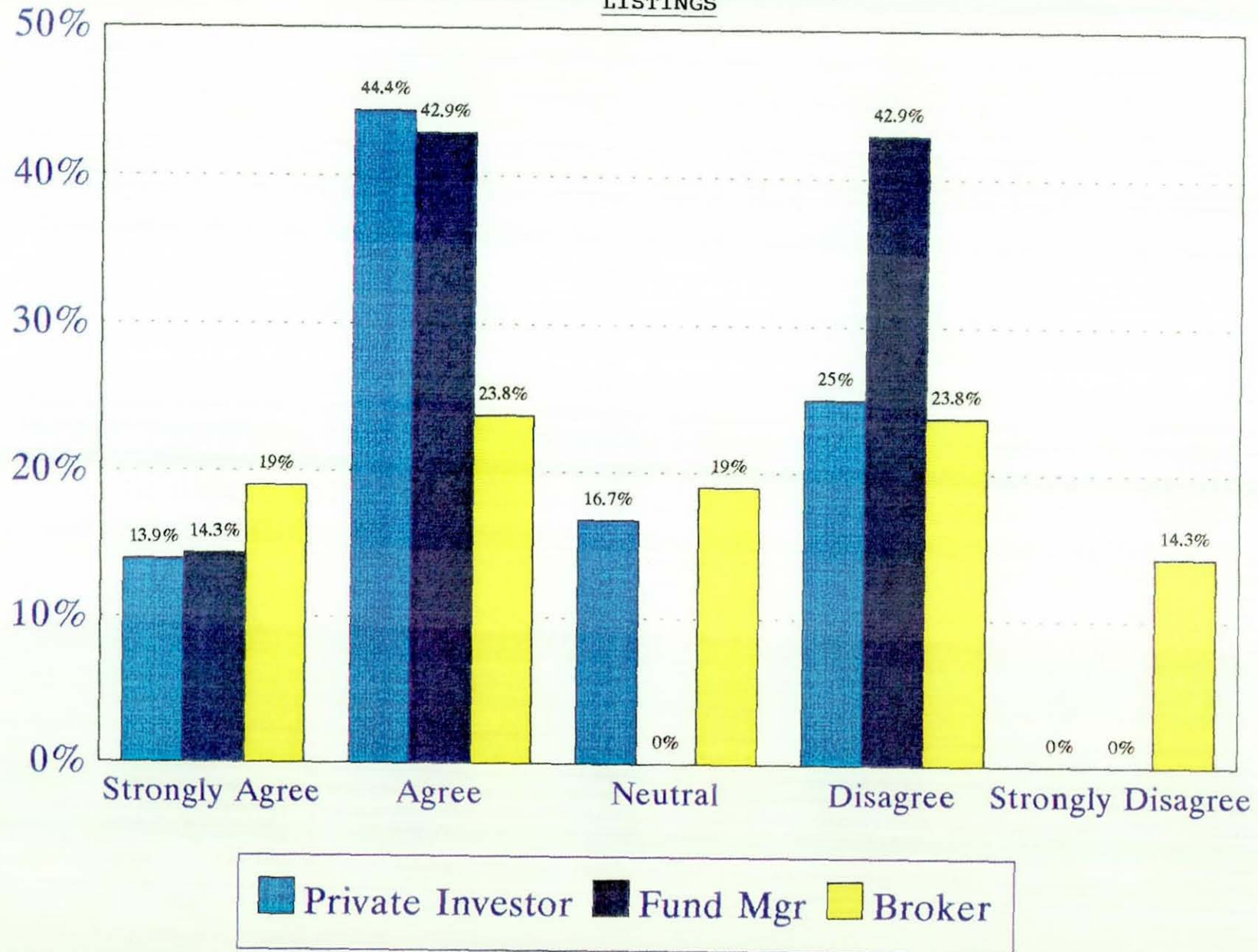
INSURANCE AGAINST FINANCIAL
DEFAULT

CHART 5.14

Q.14

LIMITING THE NUMBER OF NEW LISTINGS



Question 14 aims at finding out whether the Exchange should be given the power of limiting the number of new listings and placements for the market in any given period.

For PI, 58.3% of them agree that the Stock Exchange should have such power while 25% disagree.

For SB, 42.8% of them agree while 38.1% disagree.

For PRO, 57.1% of them agree while 42.9% disagree.

All 3 three interest groups join forces on this issue.

Determination of share subscription price (Chart 5.15; Table 5.15)

Question 15 aims at finding out whether the Exchange should be given a role in determining share subscription prices of new listings in conjunction with the applicants and their advisers.

For PI, 62.9% of them agree that the Stock Exchange should be given such a role while 17.1% disagree.

For SB, 47.6% of them agree while 28.5% disagree.

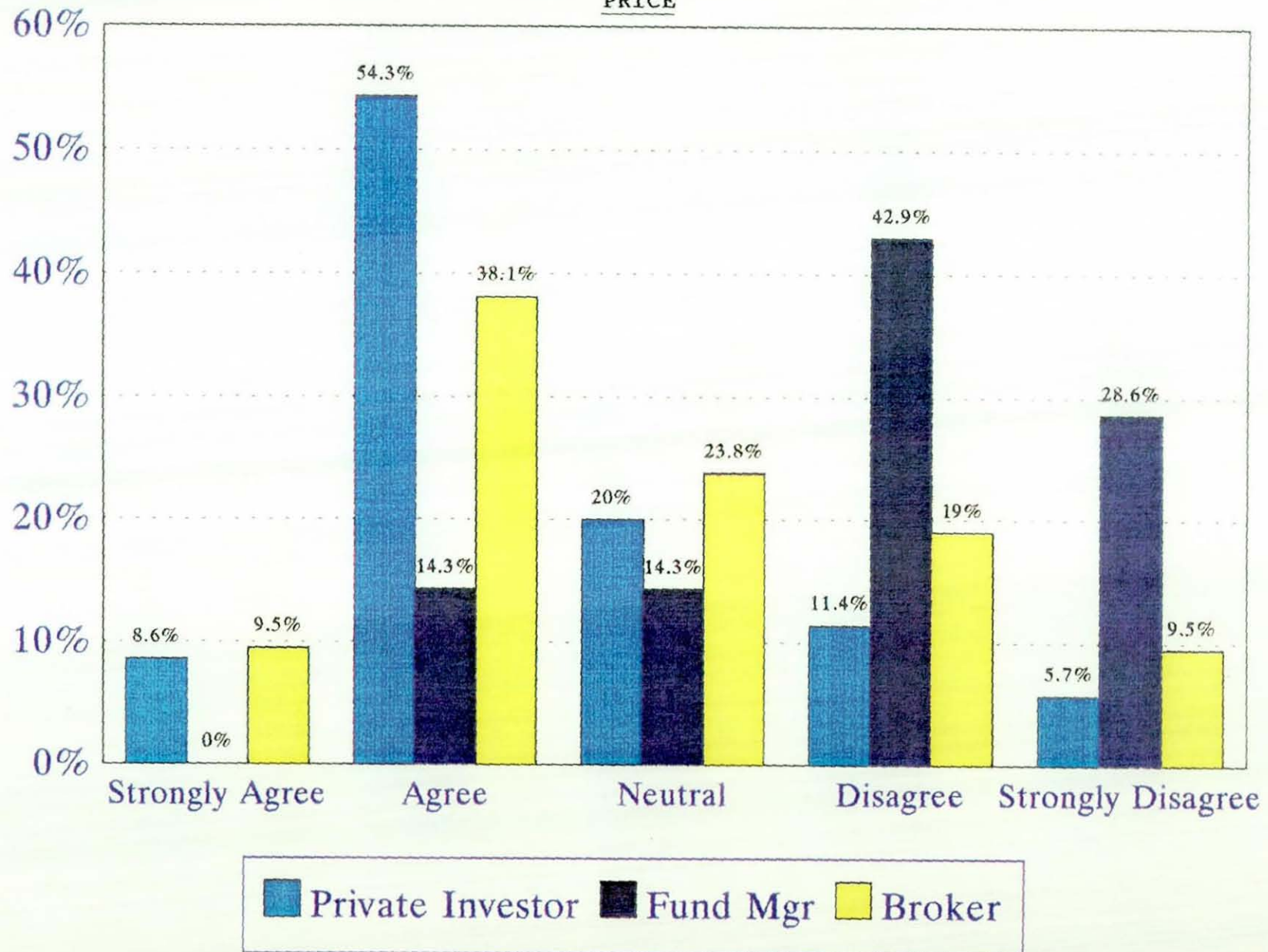
For PRO, 28.6% of them agree while 76.5% disagree.

Scrutinizing of Prospective Listed Companies by the Exchange before approval (Chart 5.16; Table 5.16)

Question 16 aims at finding out whether companies applying to be listed are always properly scrutinized by the Exchange before their applications are approved.

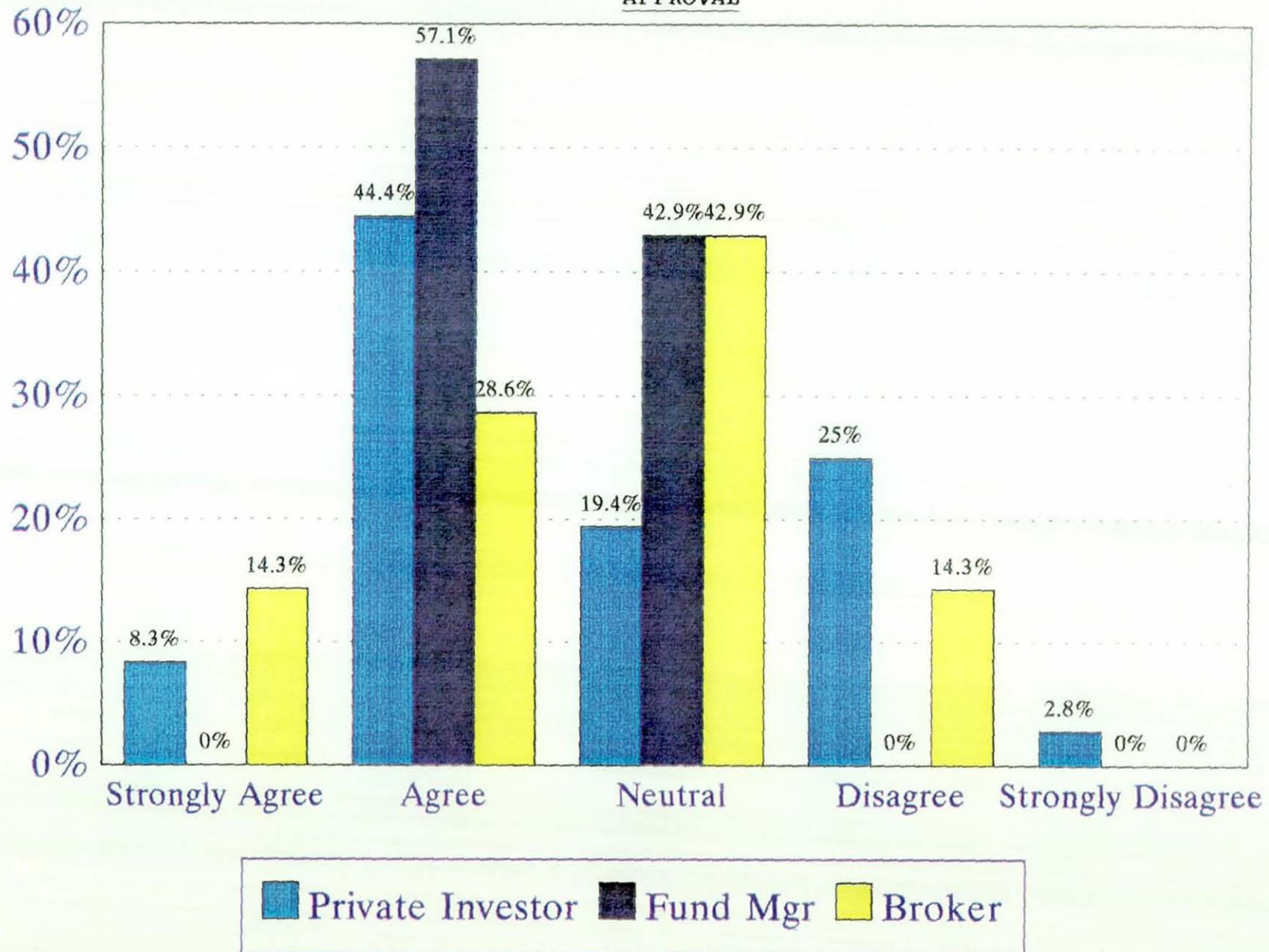
CHART 5.15

DETERMINATION OF SHARE SUBSCRIPTION
PRICE



SCRUTINIZING BY EXCHANGE BEFORE
APPROVAL

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For PI, 52.7% of them agree that companies are always properly scrutinized by the Exchange before their listings are approved while 27.8% disagree.

For SB, 42.9% of them agree while 14.3% disagree.

For PRO, 57.1% of them agree while none disagree.

Temporary closure of Exchange in financial turmoil (Chart 5.17; Table 5.17)

Question 17 aims to find out whether in time of exceptional financial turmoil the Stock Exchange should be temporarily closed for protecting investors.

For PI, 16.7% of them agree that in time of exceptional financial turmoil the Exchange should be temporarily closed while 58.3% disagree.

For SB, 23.8% of them agree while 57.1% disagree.

For PRO, 100% of them disagree.

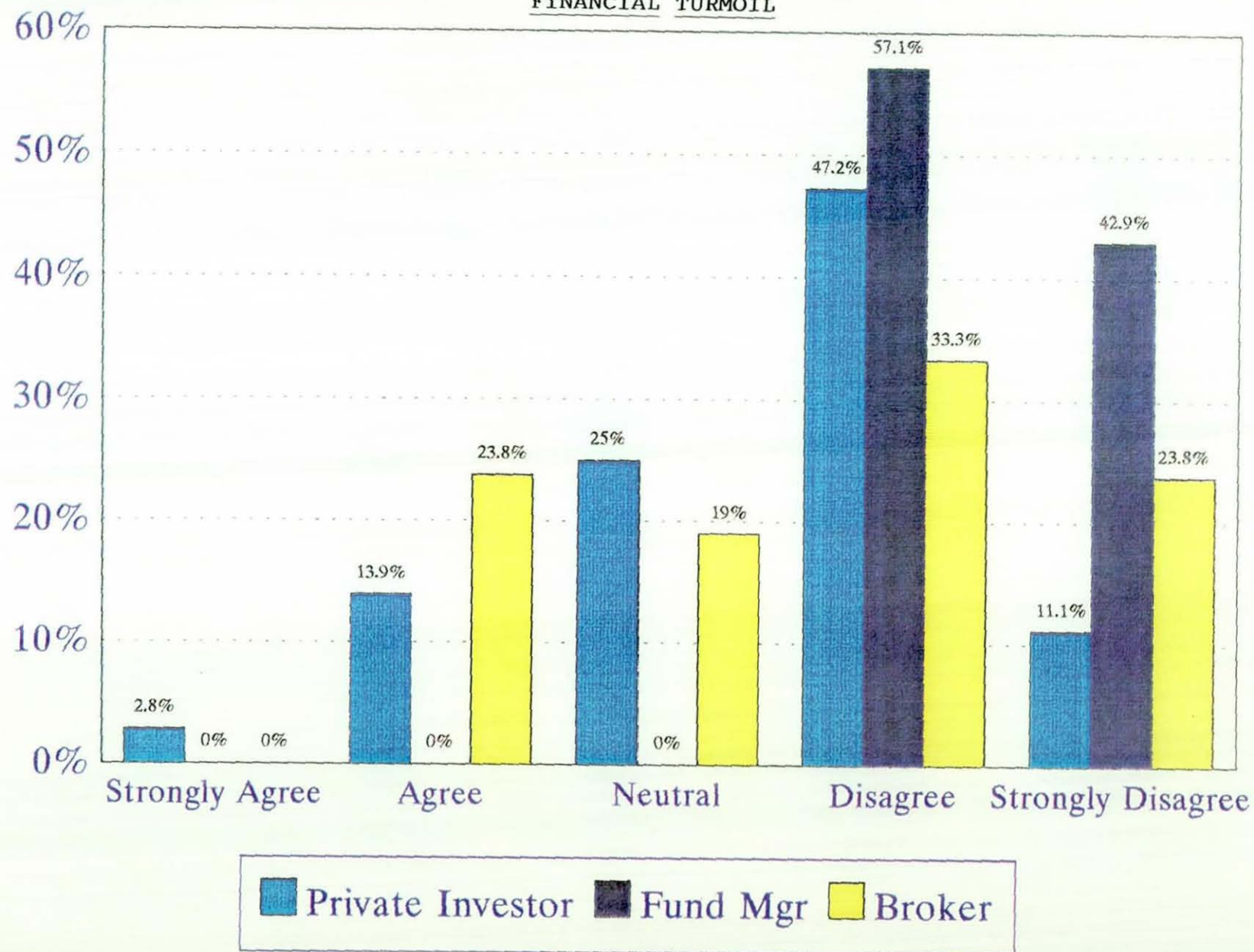
SECTION FOUR

STOCK BROKERS AND OTHER INTERMEDIARIES

Section four aims at providing information relating to the supervision of stock brokers by the Securities and Futures Commission. There are altogether five questions in this section (Q.18 - Q.22). From the results the following observations are made :

Services Provided by Financial Intermediaries - There

CHART 5.17

TEMPORARY CLOSURE OF EXCHANGE IN
FINANCIAL TURMOIL

is a general consensus among respondents that services provided by financial intermediaries are inadequate. The survey reveals that half of the private investors and most of the fund managers know of dishonest or sharp practices by stock brokers. In past years, stock brokers or floor dealers were not required to undergo formal training before they were allowed to practise stock broking. Further, there is no continuing education or training of the market intermediaries during their career. This deficiency has been duly noted and addressed in the Davison Report (para. 4.89). In combatting the dishonest or sharp practices by market intermediaries respondents overwhelmingly endorse the use of the law. Brokers, understandably, prefer to submit to the jurisdiction of the Exchange in sharp practice cases.

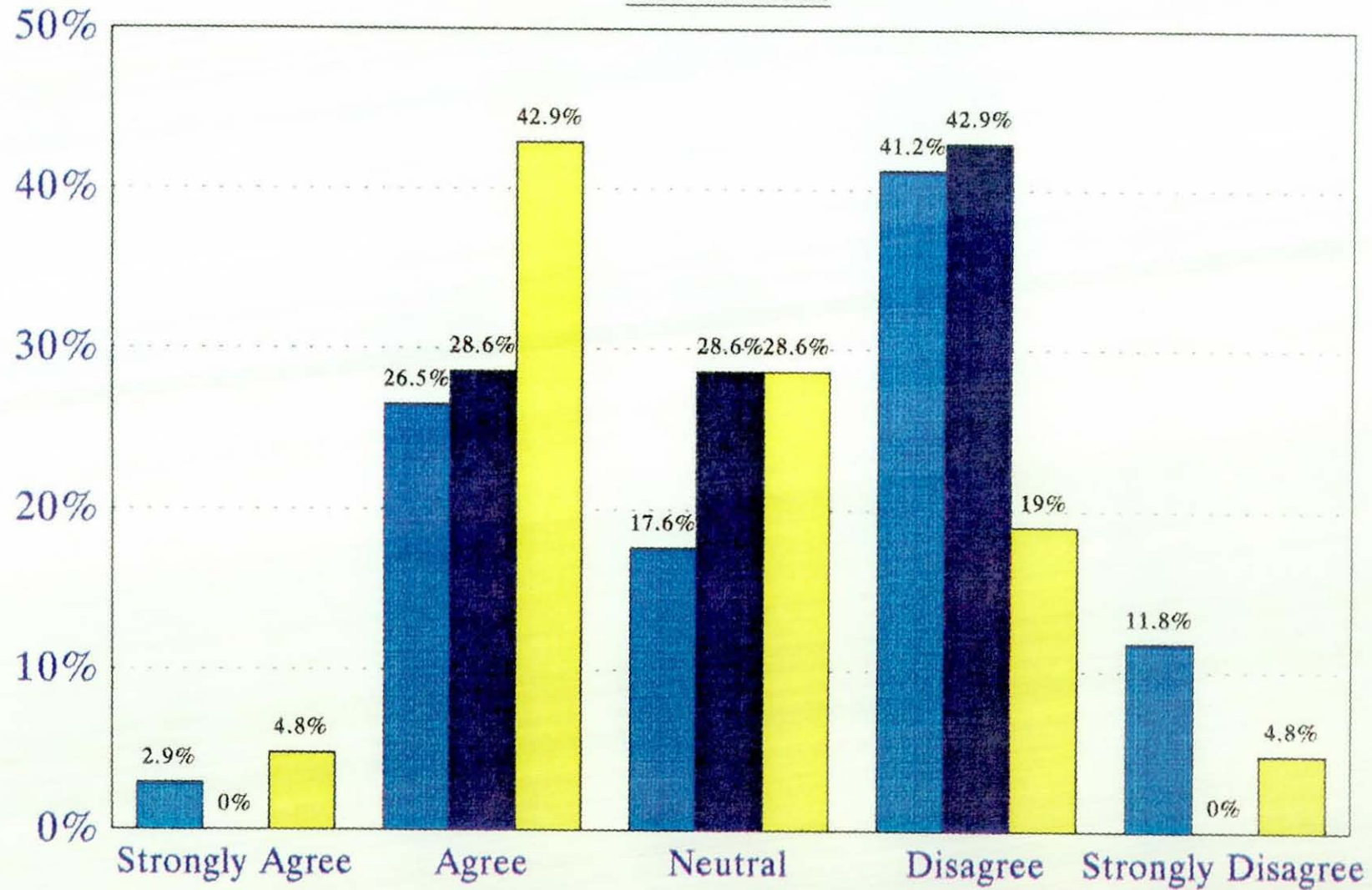
Financial information from professionals (Chart 5.18; Table 5.18)

Question 18 aims to find out whether investors have already received an adequate supply of financial information from stock brokers, investment advisers and other market intermediaries.

For PI, 29.4% of them agree that they have already received an adequate supply of financial information from

CHART 5.18

Q.18

FINANCIAL INFORMATION FROM
PROFESSIONALS

■ Private Investor ■ Fund Mgr ■ Broker

stock brokers, investment advisers and other intermediaries while 53% disagree.

For SB, 47.7% of them agree while 23.8% disagree.

For PRO, 28.6% of them agree while 42.9% disagree.

Training of the professionals (Chart 5.19; Table 5.19)

This question aims to find out whether stock brokers, investment advisers and others in securities dealings are adequately trained.

For PI, 28.6% of them agree that these professionals are adequately trained while 45.7% disagree.

For SB, 42.9% of them agree while 42.8% disagree.

For PRO, none agree while 42.9% disagree.

Capital requirements of brokers (Chart 5.20; Table 5.20)

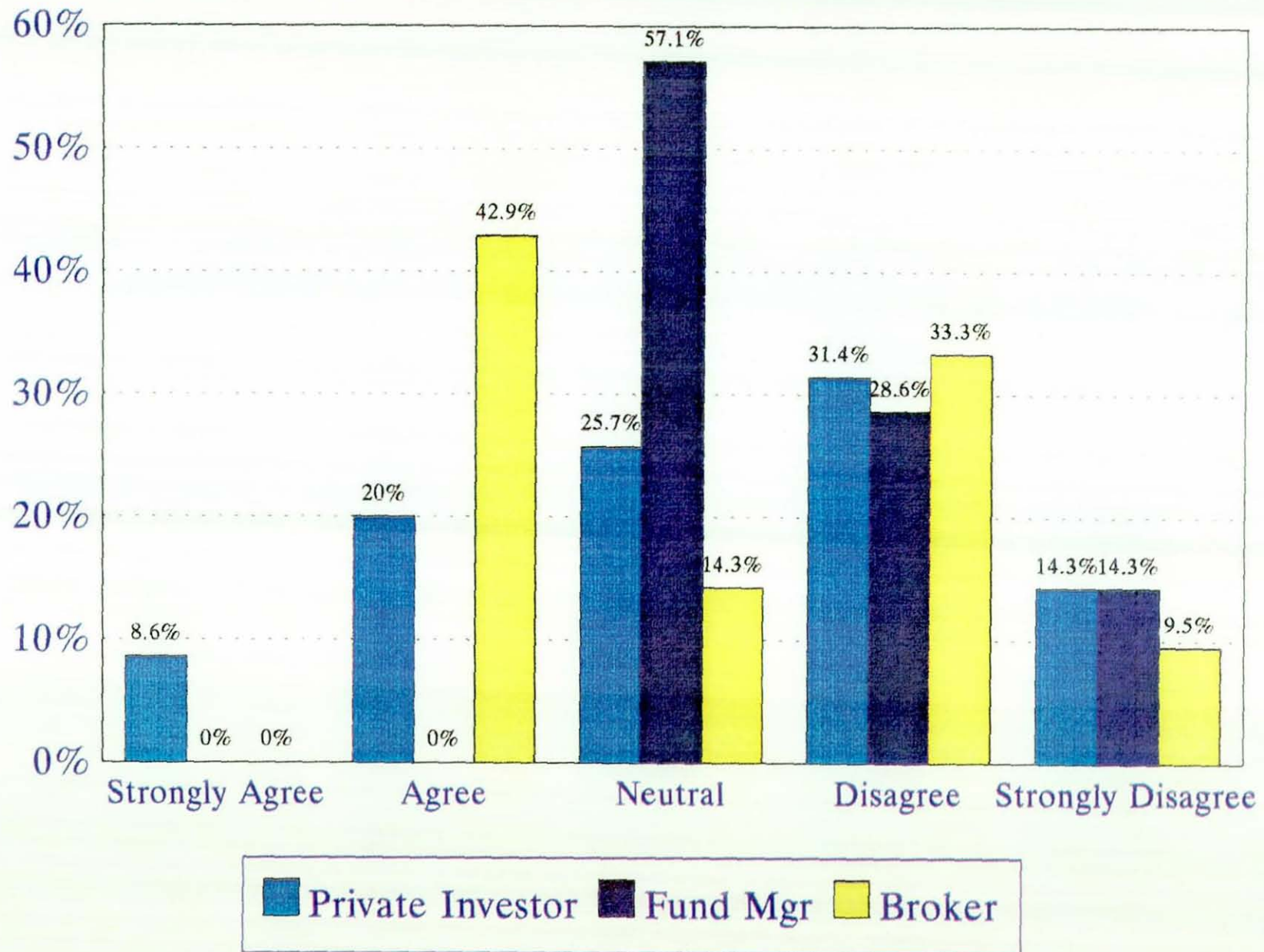
Question 20 aims to find out whether the capital requirements of stock brokers are adequate, from the point of view of investors and the brokers' dealing counterpart (HK\$1 million for personal brokers and HK\$5 million for corporate brokers irrespective of turnover).

For PI, 37.1% of them agree that the capital requirements of stock brokers are adequate while 28.6% disagree.

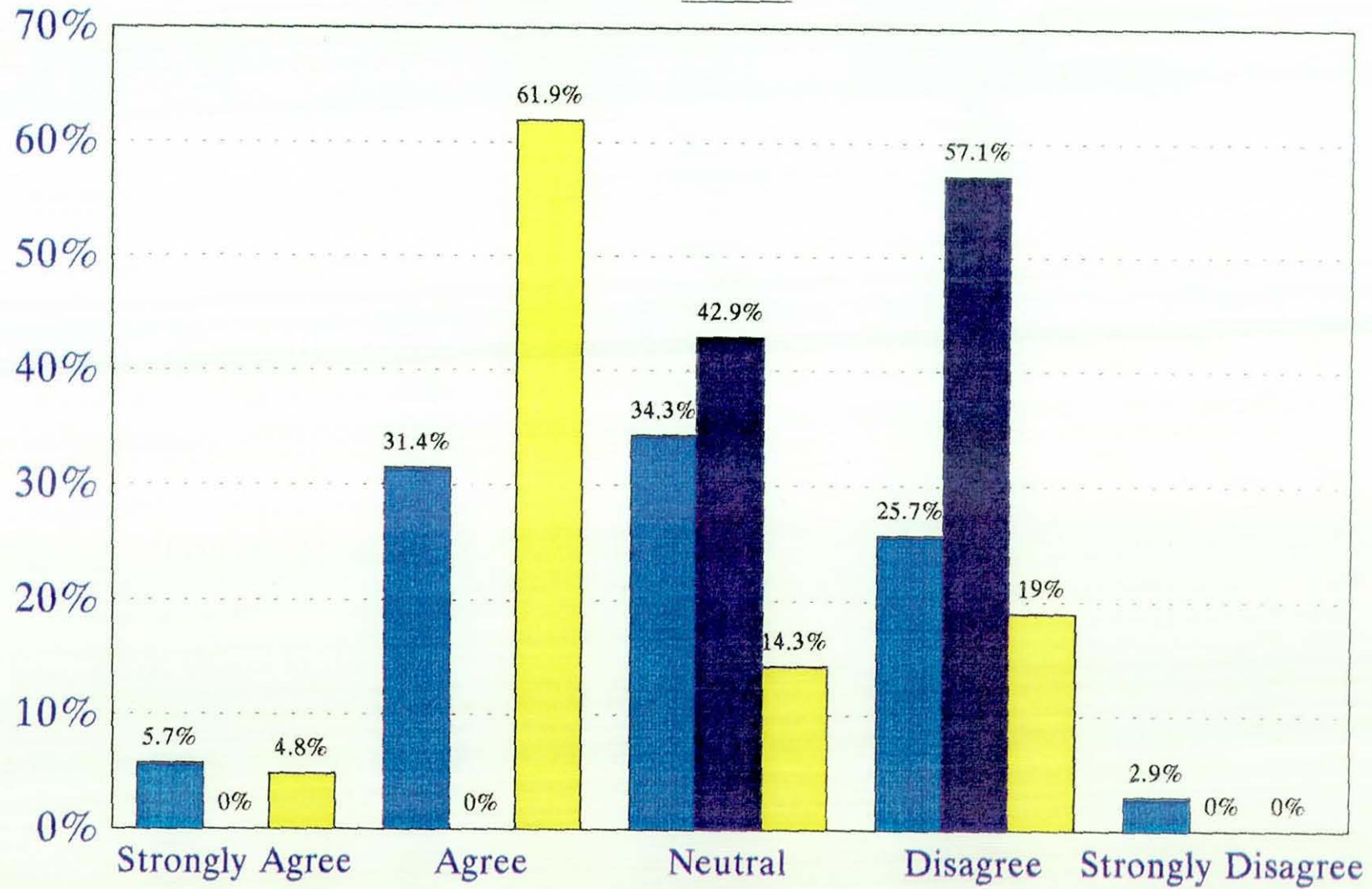
For SB, 66.7% of them agree while 19% disagree.

For PRO, none agree while 57.1% disagree.

CHART 5.19

TRAINING OF THE PROFESSIONALS

CAPITAL REQUIREMENTS OF STOCK
BROKERS



■ Private Investor ■ Fund Mgr ■ Broker

Dishonest or sharp practice (Chart 5.21; Table 5.21)

Question 21 asks respondents whether they know of any dishonest or sharp practices by stock brokers and market intermediaries which are against the interests of their clients.

For PI, 42.9% of them say that they know of such practices by stock brokers and market intermediaries while 57.1% say that they do not know of such practices.

For SB, 42.9% of them know of such practices while 57.1% do not know of such practices.

For PRO, 83.3% of them know of such practices while 16.7% do not know of such practices.

Curbing dishonest or sharp practices (Chart 5.22; Table 5.22)

Question 22 asks respondents to choose the best method for combating dishonest or sharp practices of brokers and market intermediaries : enacting law, sanctions by the stock exchange, sanctions by their respective trade association, sanction by quasi-governmental bodies or others.

For PI, 65.7% of them favour enacting law while 28.6% favour sanction by the stock exchange.

For SB, 25% of them favour enacting law while 65% favour sanction by the exchange.

For PRO, 85.7% of them favour enacting law while 14.3% favour sanction by the exchange.

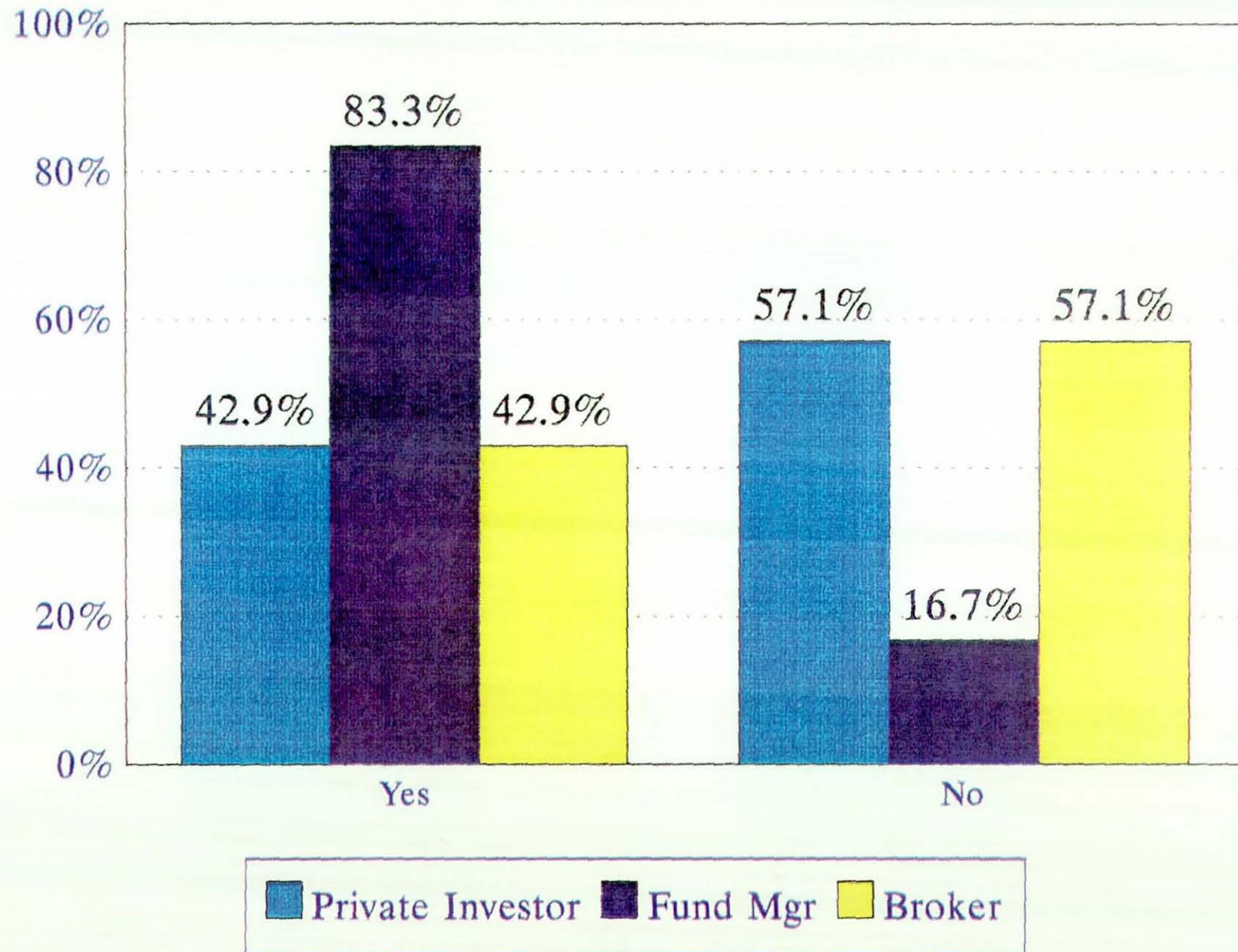
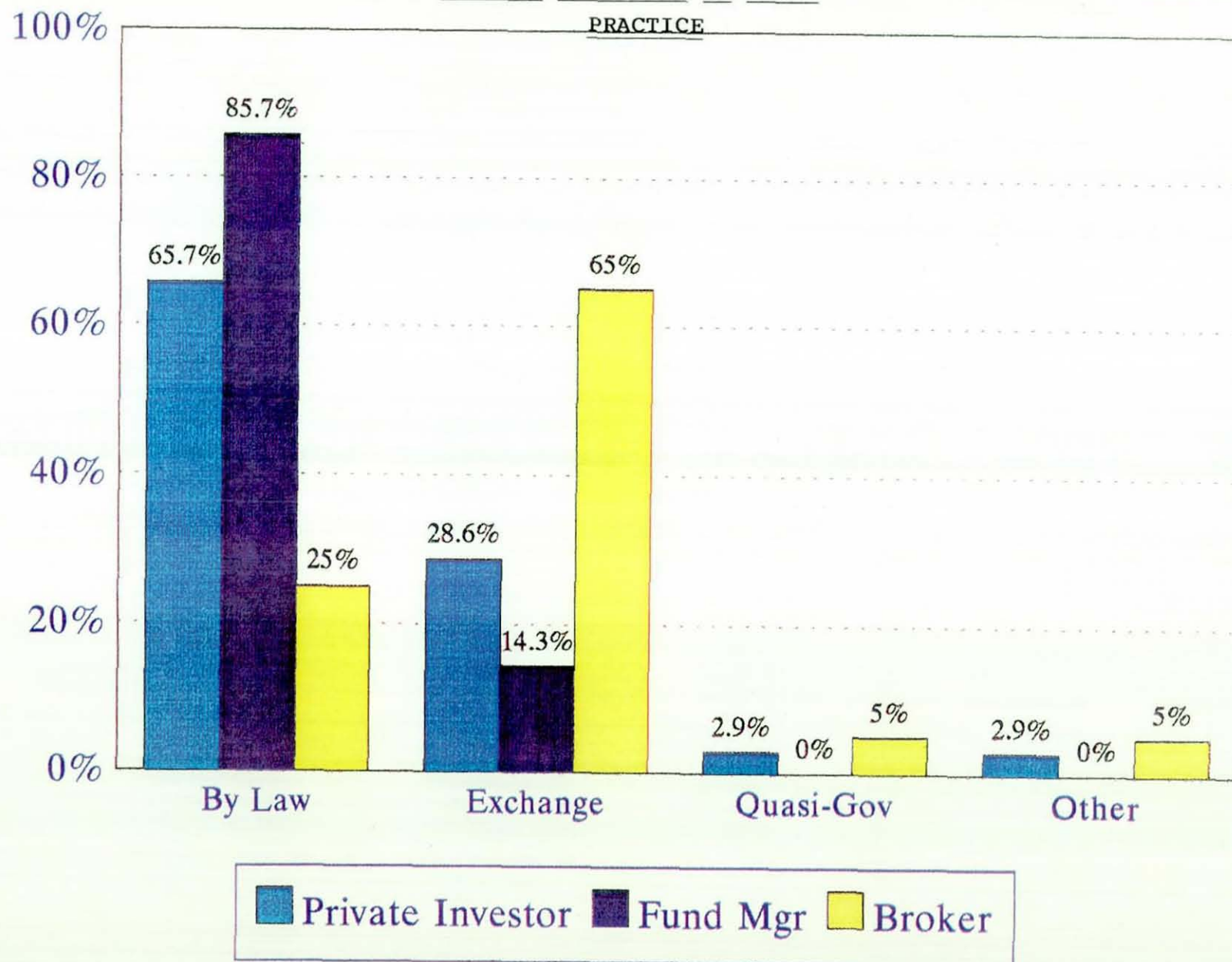
DISHONEST OR SHARP PRACTICE

CHART 5.22

CURBING DISHONEST OR SHARP
PRACTICE



SECTION FIVE

LISTED COMPANIES

Section five aims at testing the third hypothesis. There are seven questions in this section (Q.23 - Q.29). Questions 23, 24 and 29 are key questions for testing the hypothesis. From the results the following observations are made :

Behaviour of Listed Companies - The results indicate that almost all respondents are dissatisfied with listed companies in respect of the amount of information disclosed to investors and the promptness of their disclosures. Brokers and private investors exhibit similar levels of dissatisfaction while fund managers are more aggravated. From the results it is strongly indicated that investors desire to possess more vetting power in listed companies, especially during merger or take-over situations. This points to the inadequacy of the SFC in upholding the interest of the general public and also of the interest groups under study. An explanation for this general dissatisfaction from respondents is that listed

companies are acting as and behaving like an interest group. In other major world markets listed companies are in their thousands. Because of the large number of listed companies it may be difficult for them to undertake group action bidding for legislative benefits. However, with only about 400 companies listed in Hong Kong, it is possible that they are compact enough for behaving like an interest group.

Disclosure of information by listed companies (Chart 5.23; Table 5.23)

Question 23 aims to find out whether listed companies have adequately disclosed information to their shareholders.

For PI, 22.9% of them agree that the amount of information disclosed by listed companies to their shareholders is adequate while 48.5% disagree.

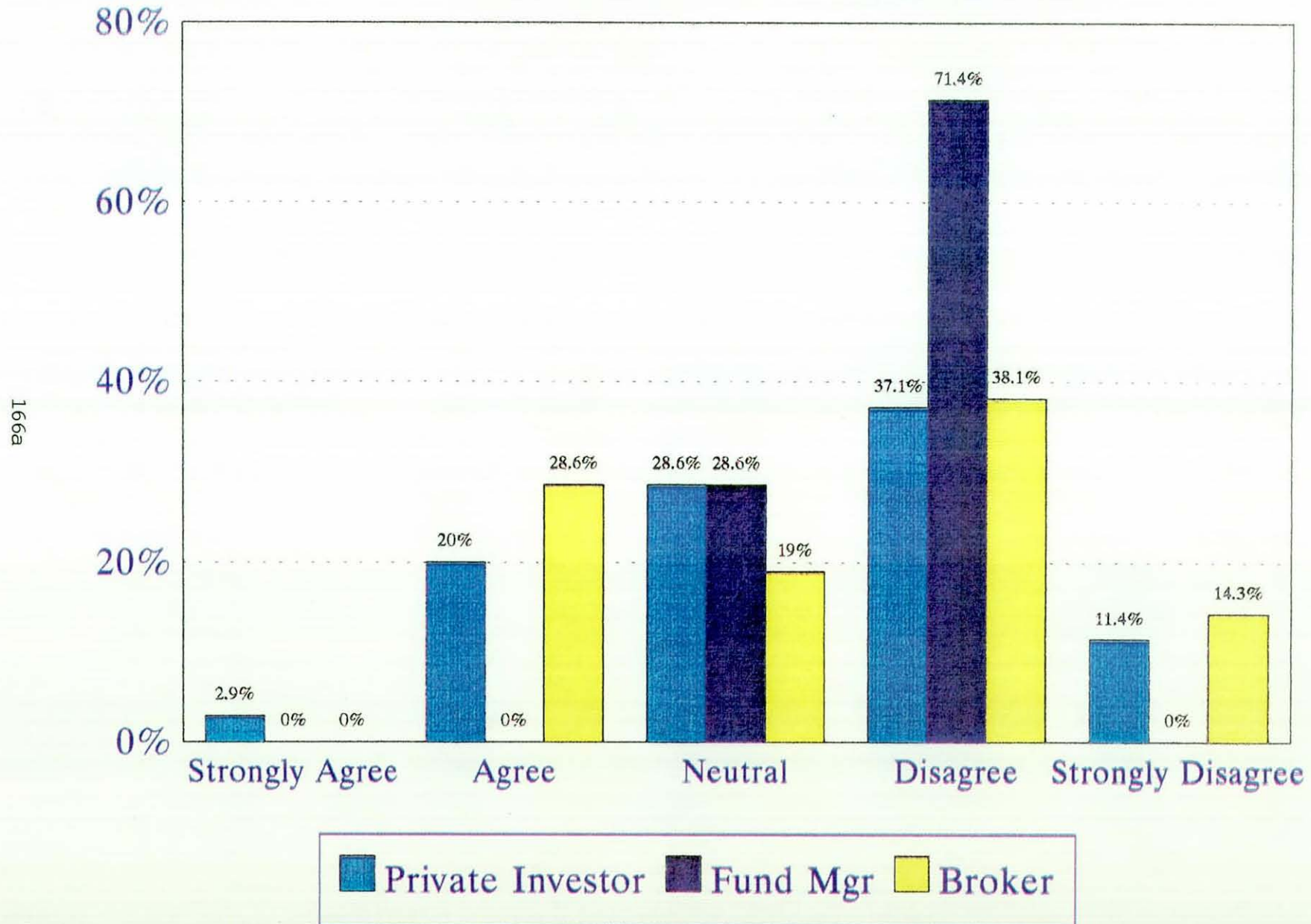
For SB, 28.6% of them agree while 52.4% disagree.

For PRO, none agree while 71.4% disagree.

Prompt in disclosing sensitive information (Chart 5.24; Table 5.24)

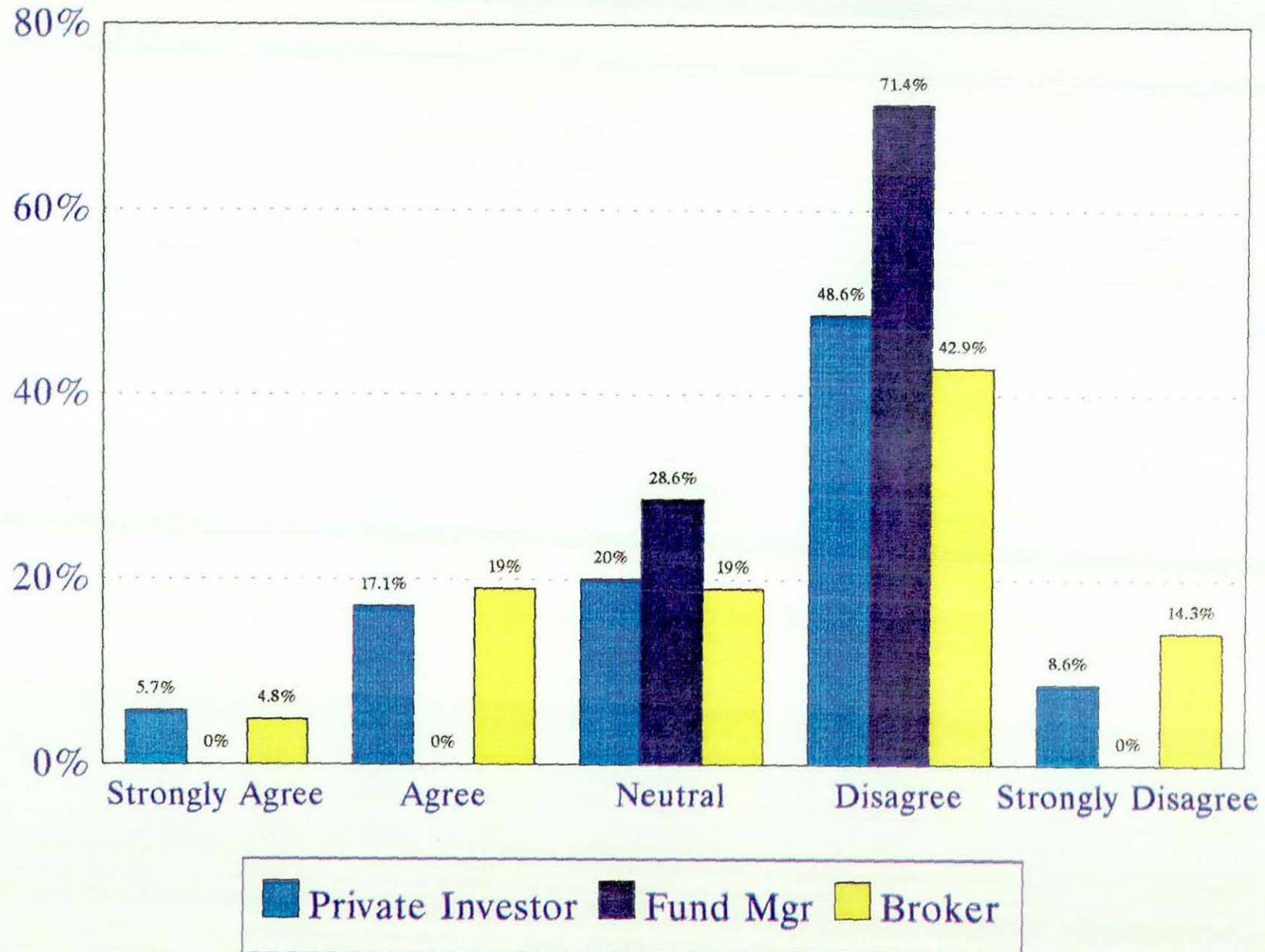
Question 24 aims to find out whether listed companies are prompt in disclosing sensitive information to the public.

For PI, 22.8% of them agree that listed companies are

DISCLOSURE OF INFORMATION BY LISTED COMPANIES

PROMPT IN DISCLOSING SENSITIVE INFORMATION

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prompt in disclosing sensitive information to the public while 57.2% disagree.

For SB, 23.8% of them agree while 57.2% disagree.

For PRO, none agree while 71.4% disagree.

Listing discouraged due to information disclosure (Chart 5.25; Table 5.25)

Question 25 aims to find out whether private companies would be discouraged from seeking listings if they were compelled by law to disclose more information to the public.

For PI, 45.7% of them agree that private companies would be discouraged while 40% disagree.

For SB, 33.3% of them agree while 52.4% disagree.

For PRO, 57.1% of them agree while 14.3% disagree.

Disclosure of shareholding above five percent (Chart 5.26; Table 5.26)

Question 26 aims to find out whether the law should require the disclosure of listed company shareholdings above 5%.

For PI, 54.3% of them agree that the law should require such disclosure while 14.3% disagree.

For SB, 47.6% of them agree while 23.8% disagree.

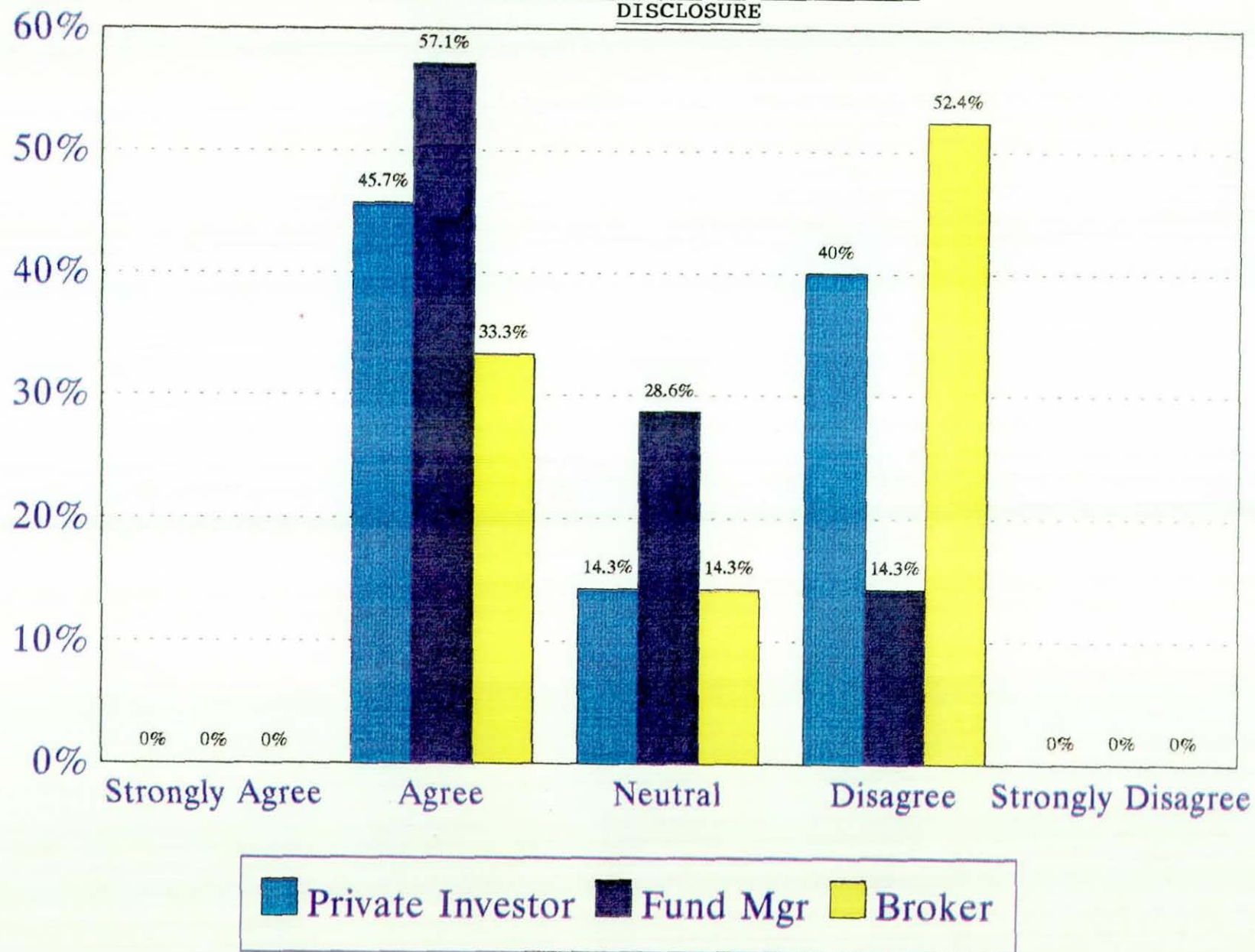
For PRO, 57.2% of them agree while 28.6% disagree.

Directors discharge of duties (Chart 5.27; Table 5.27)

CHART 5.25

Q.25

LISTING DISCOURAGED DUE TO INFORMATION DISCLOSURE



DISCLOSURE OF SHAREHOLDING ABOVE FIVE PERCENT

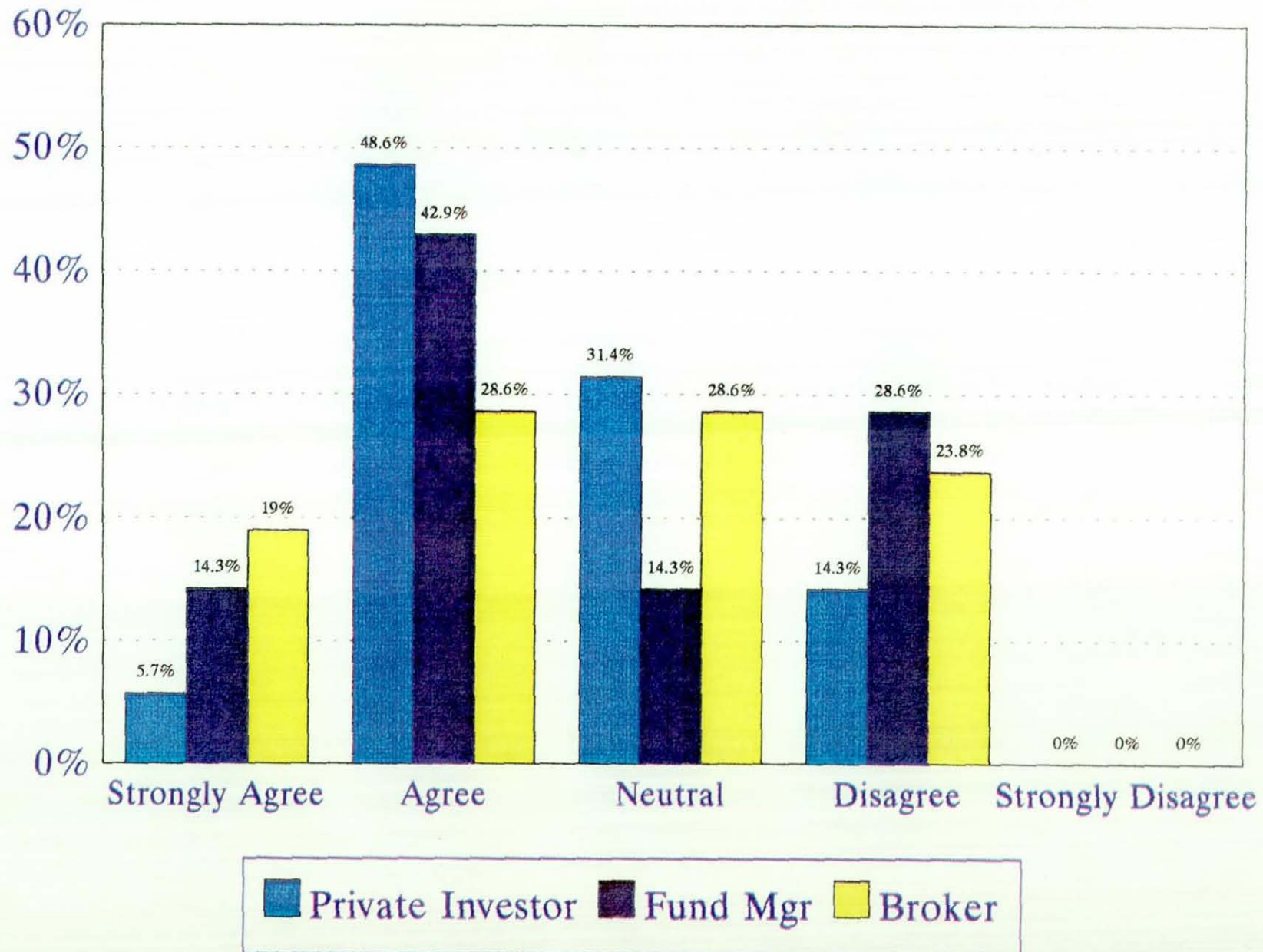
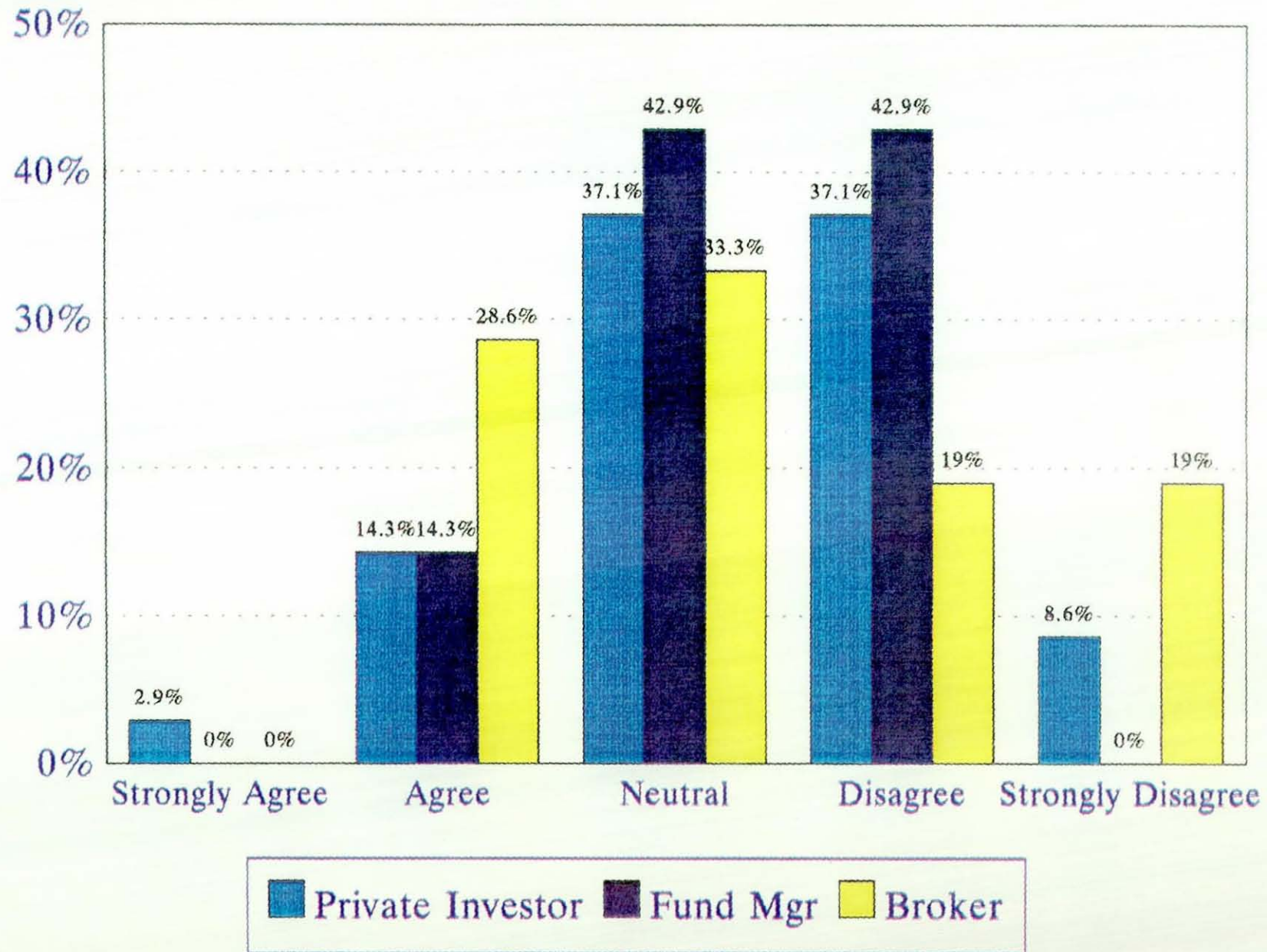


CHART 5.27
DIRECTOS DISCHARGE DUTIES



Question 27 aims to find out whether directors of listed companies in HK have adequately discharged their duties towards investors.

For PI, 17.2% of them agree that directors of listed companies in HK have adequately discharged their duties towards investors while 45.7% disagree.

For SB, 28.6% of them agree while 38% disagree.

For PRO, 14.3% of them agree while 42.9% disagree.

More power for shareholders to approve transactions (Chart 5.28; Table 5.28)

Question 28 aims to find out whether shareholders of listed companies should be given more power to approve major transactions of their companies.

For PI, 57.2% of them agree that shareholders of listed companies should be given more power to approve major transactions of their companies while 2.9% disagree.

for SB, 47.6% of them agree while 23.8% disagree.

For PRO, 71.4% of them agree while none disagree.

Protection of investors in take-overs (Chart 5.29; Table 5.29)

Question 29 aims to find out whether in take-over situations the interests of investors are always being protected.

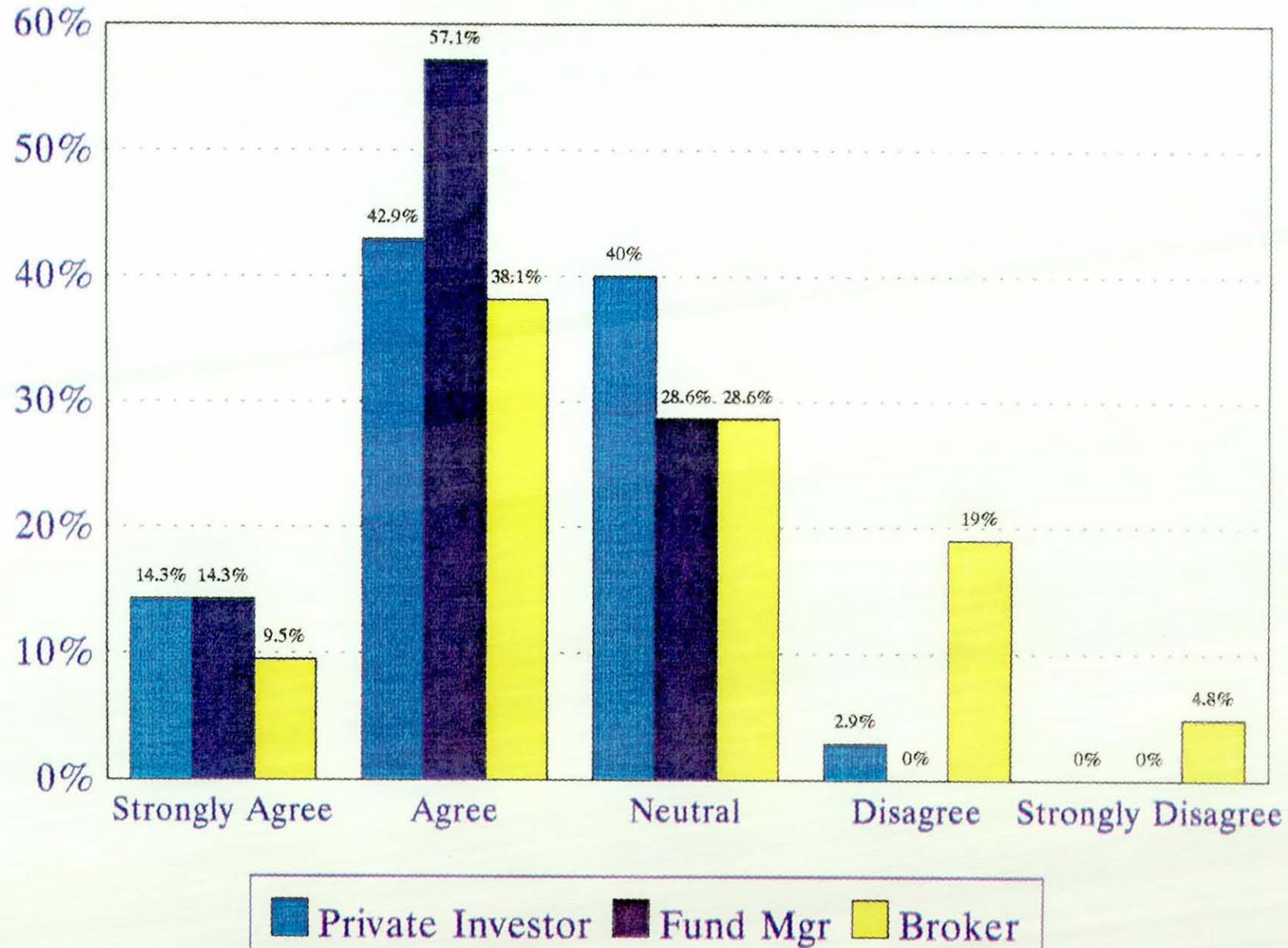
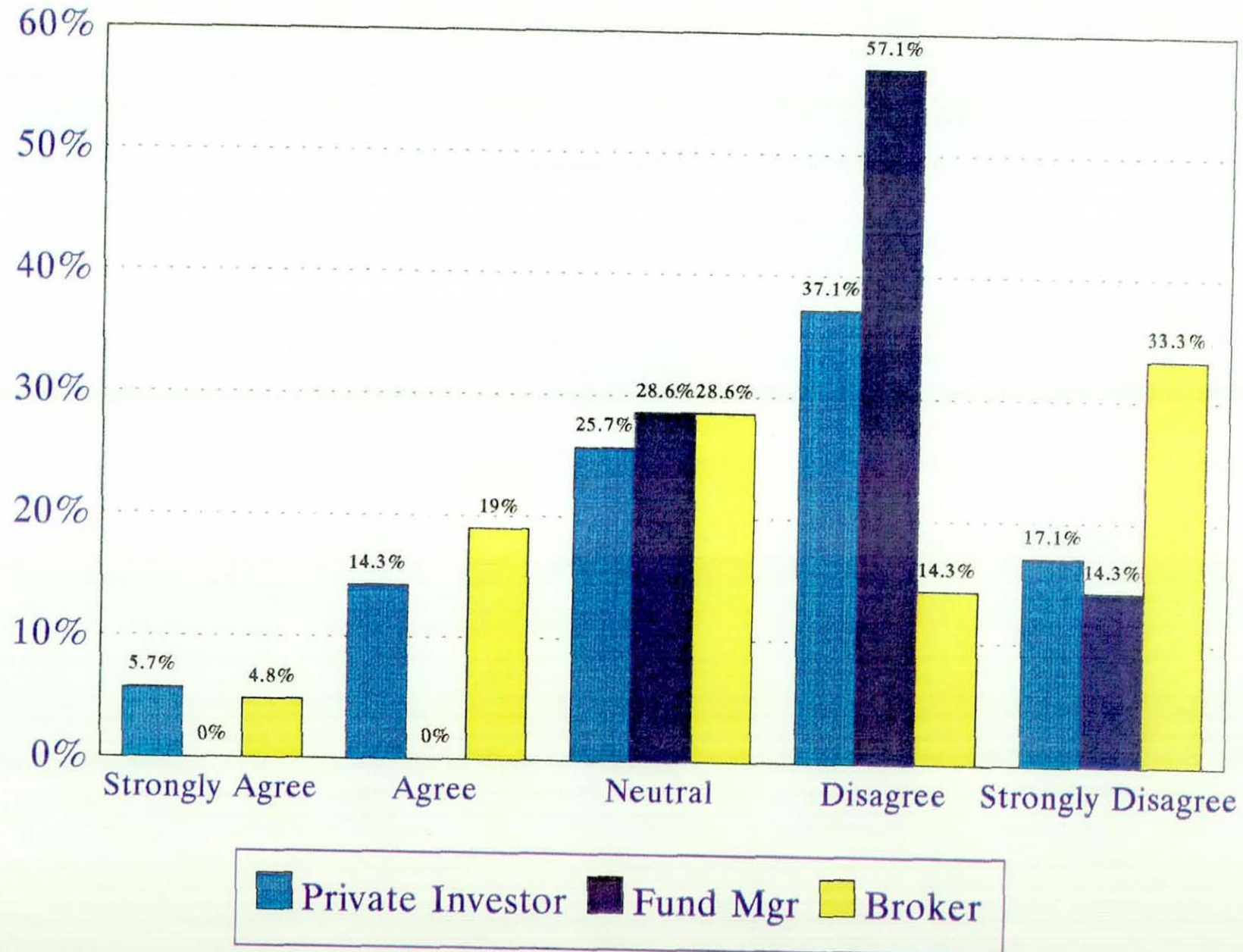
MORE POWER FOR SHAREHOLDERS TO APPROVE TRANSACTION

CHART 5.29

Q.29

PROTECTION OF INVESTORS IN TAKE-OVERS

For PI, 20% of them agree that in the take-over situations the interests of investors are always being protected while 54.2% disagree.

For SB, 23.8% of them agree while 47.6% disagree.

For PRO, none agree while 71.4% disagree.

SECTION SIX

SECURITIES DEALINGS

This sections aims at finding out from respondents their opinions about various subsidiary issues such as trading on margin, short selling, level of charges, cost of supervision and the means of ensuring a fair market. There are altogether five questions in this section (Q.30 - Q.34). From the results the following observations are made :

Margin Trading - In Hong Kong it is common for investors to trade on margin accounts. However, this form of investment activity may give rise to problems for investor protection. In a falling market situation an investor's securities portfolio pledged with a broker under a margin trading agreement may be the target for abuse. Under the margin trading agreement a broker may dispose of stock and shares pledged by customers at any bargain price. In a rising market situation, it is not unheard of that some less than honest brokers "borrow" without consent shares from

customers' portfolios for the purpose of covering their short positions. Most respondents, including brokers, agree that some form of legislative control on margin trading is needed.

Short Selling - Short selling of stock and shares has long been prohibited by law in Hong Kong. It was once thought that short selling was a form of wagering activity which should not be allowed. However, with the introduction of the "Hang Seng Index Futures" contracts in the Futures Exchange in 1986 short selling of stock and shares could now be a genuine form of hedging activity for those who have taken up the "call" option of the HS Index futures contracts. Accordingly respondents to the questionnaires, irrespective of their groupings, disagree that the present law prohibiting short selling helps in protecting investors. The SFC has long been urged to rationalize the present law regarding short selling. The SFC, however, has reservations about allowing unsanctioned short selling activities which, in times of financial turmoil, may accelerate the fall of the market. There is a need to maintain balance between rationalizing short selling and the concern for market stability.

Regulating Market Activities - The results show that respondents generally favour the use of the law for ensuring an orderly market. In line with the Public

Interest Theory investors do think that legislation is enacted for their benefits.

Control over trading on margin (Chart 5.30; Table 5.30)

Question 30 aims to find out whether trading on margin should be under some form of control for the sake of an orderly market.

For PI, 60% of them agree that trading on margin should be under some form of control for the sake of an orderly market while 11.5% disagree.

For SB, 60.6% of them agree while 14.3% disagree.

For PRO, 85.7% of them agree while none disagree.

Prohibit short selling (Chart 5.31; Table 5.31)

Question 31 aims to find out whether prohibiting short selling of stock and shares helps to protect investors.

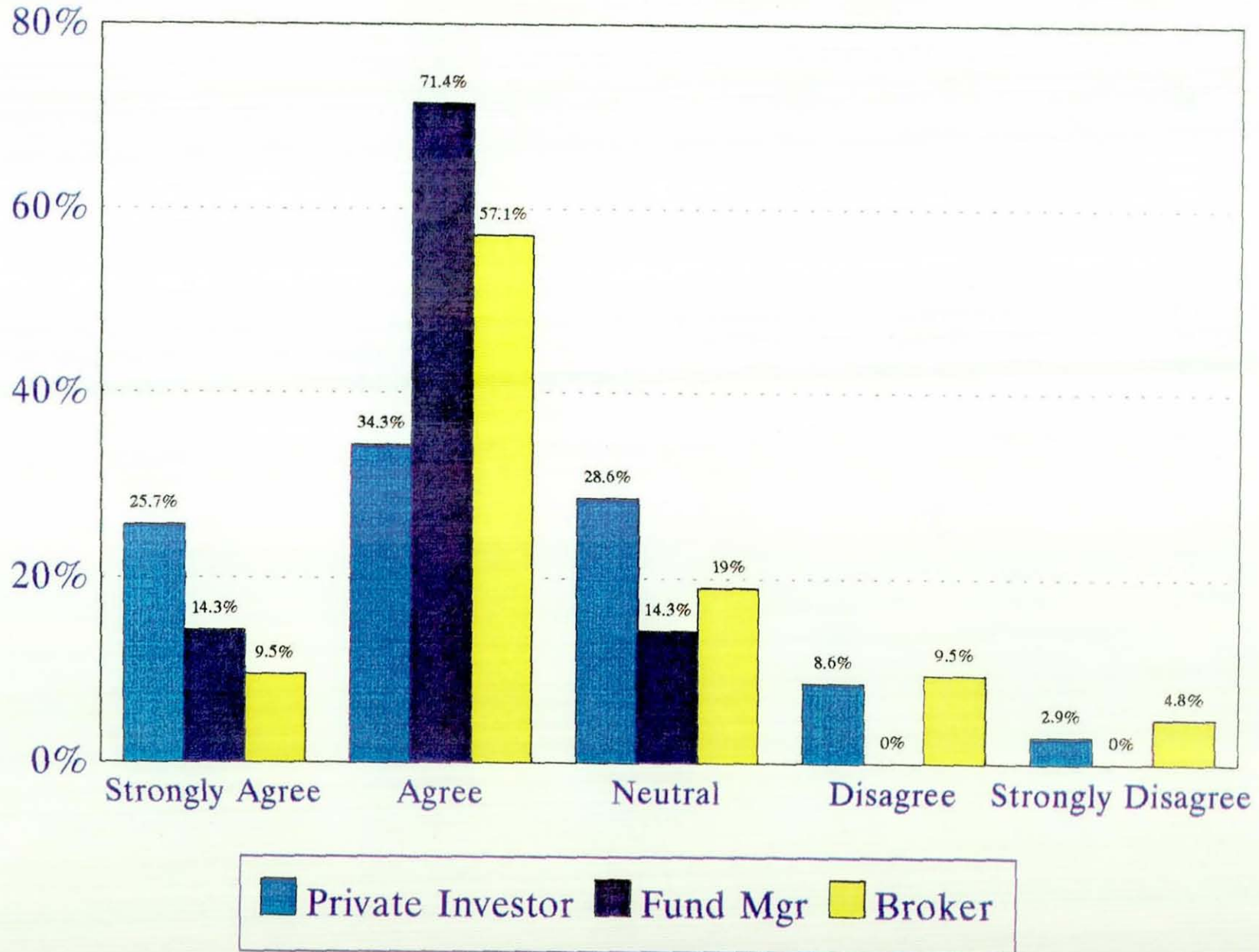
For PI, 30.6% of them agree that prohibiting short selling of stock and shares helps to protect investors while 55.6% disagree.

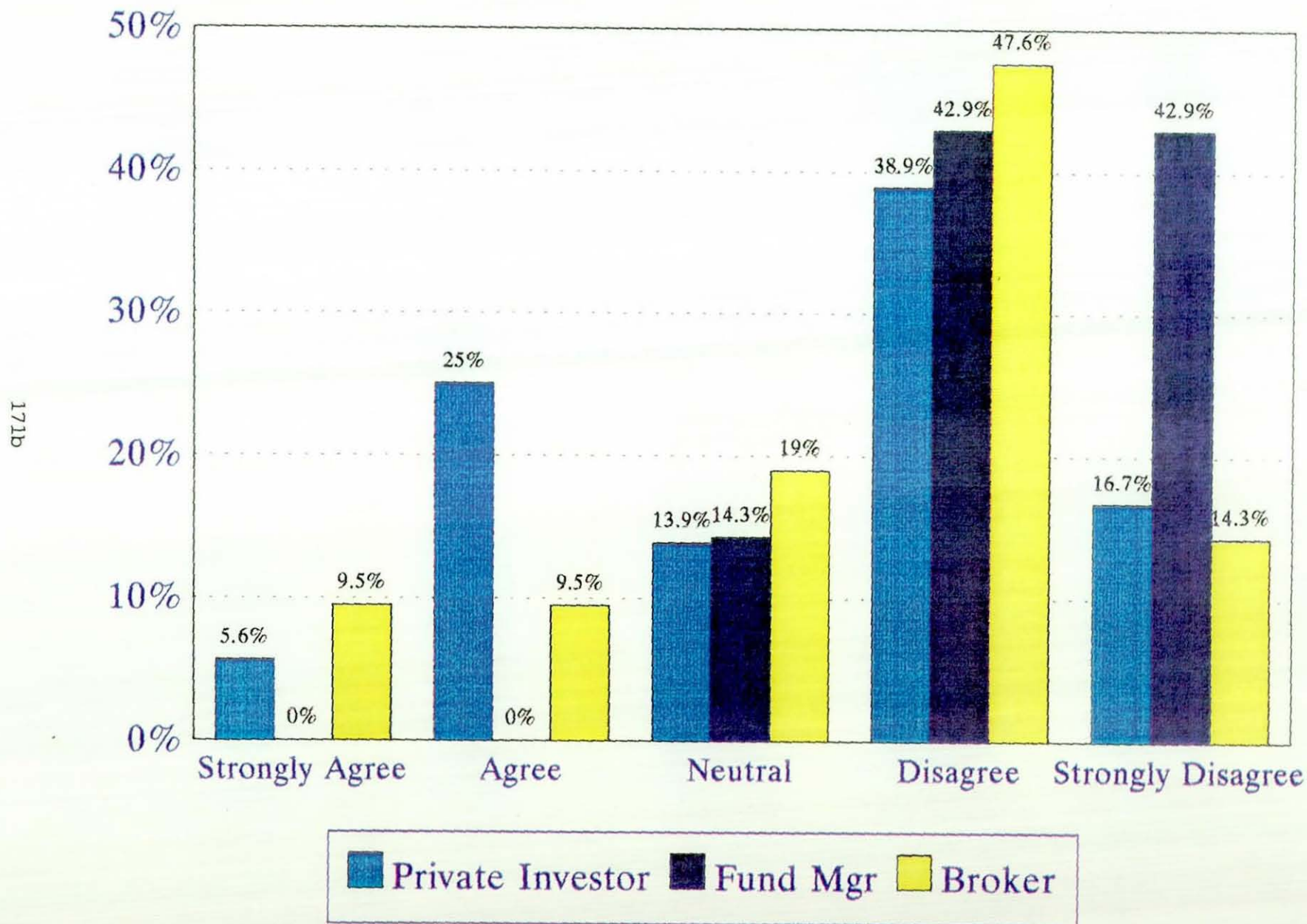
For SB, 19% of them agree while 61.9% disagree.

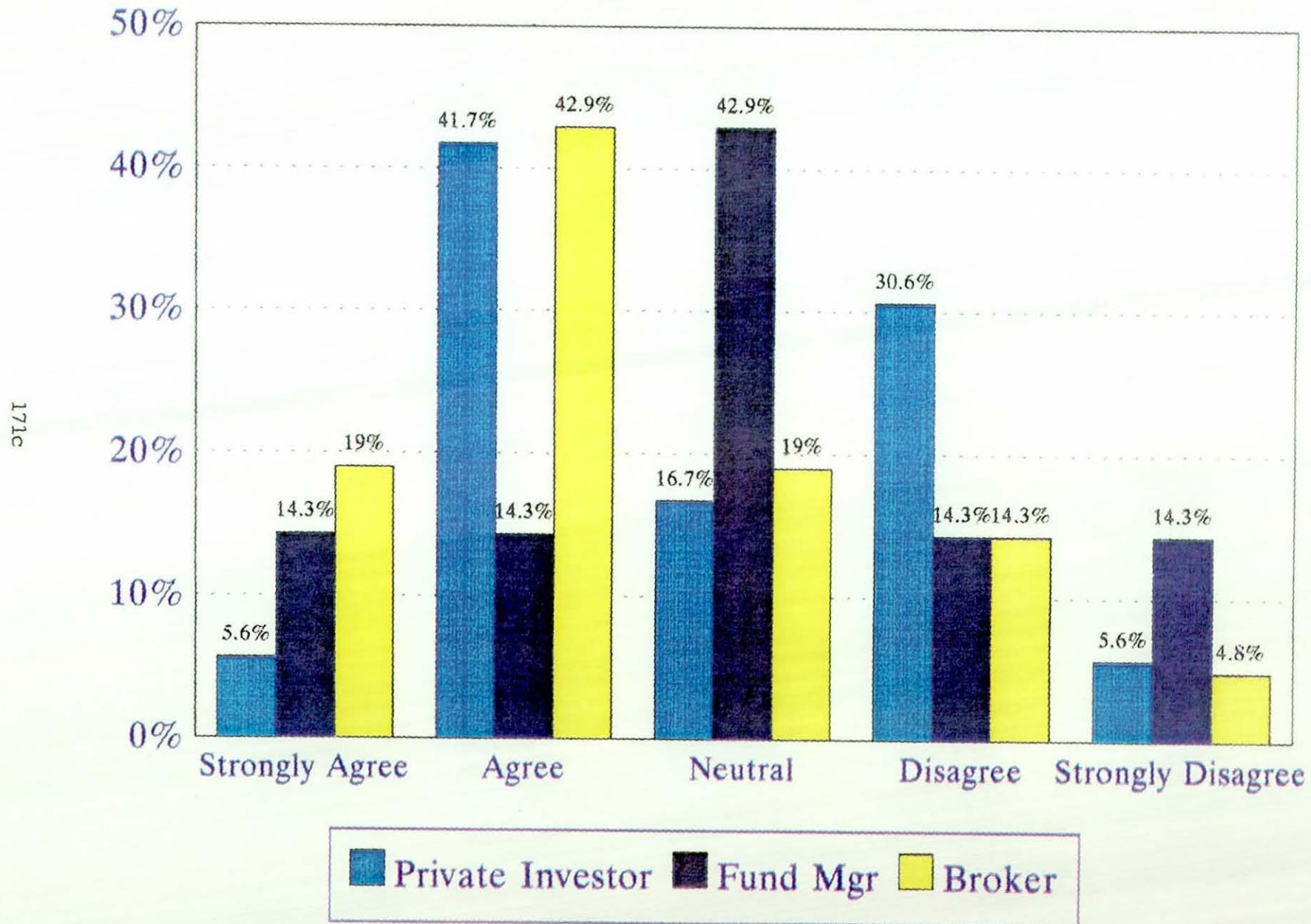
For PRO, none agree while 85.8% disagree.

Low brokerage and incidental charges (Chart 5.32; Table 5.32)

Question 32 aims to find out whether the brokerage and

CONTROL OVER TRADING ON MARGIN

PROHIBIT SHORT SELLING

LOW BROKERAGE AND INCIDENTAL CHARGES

incidental charges on the buying of securities in HK are low.

For PI, 47.3% of them agree that the brokerage and incidental charges on the buying of securities in HK are low while 36.2% disagree.

For SB, 61.6% of them agree while 19.1% disagree.

For PRO, 28.6% of them agree while 28.6% disagree.

Costs paid by investors (Chart 5.33; Table 5.33)

Question 33 aims to find out whether the cost of supervising the securities industry should be mostly paid for by investors.

For PI, 30.6% of them agree that the cost of supervising the securities industry should be mostly paid for by investors while 50% disagree.

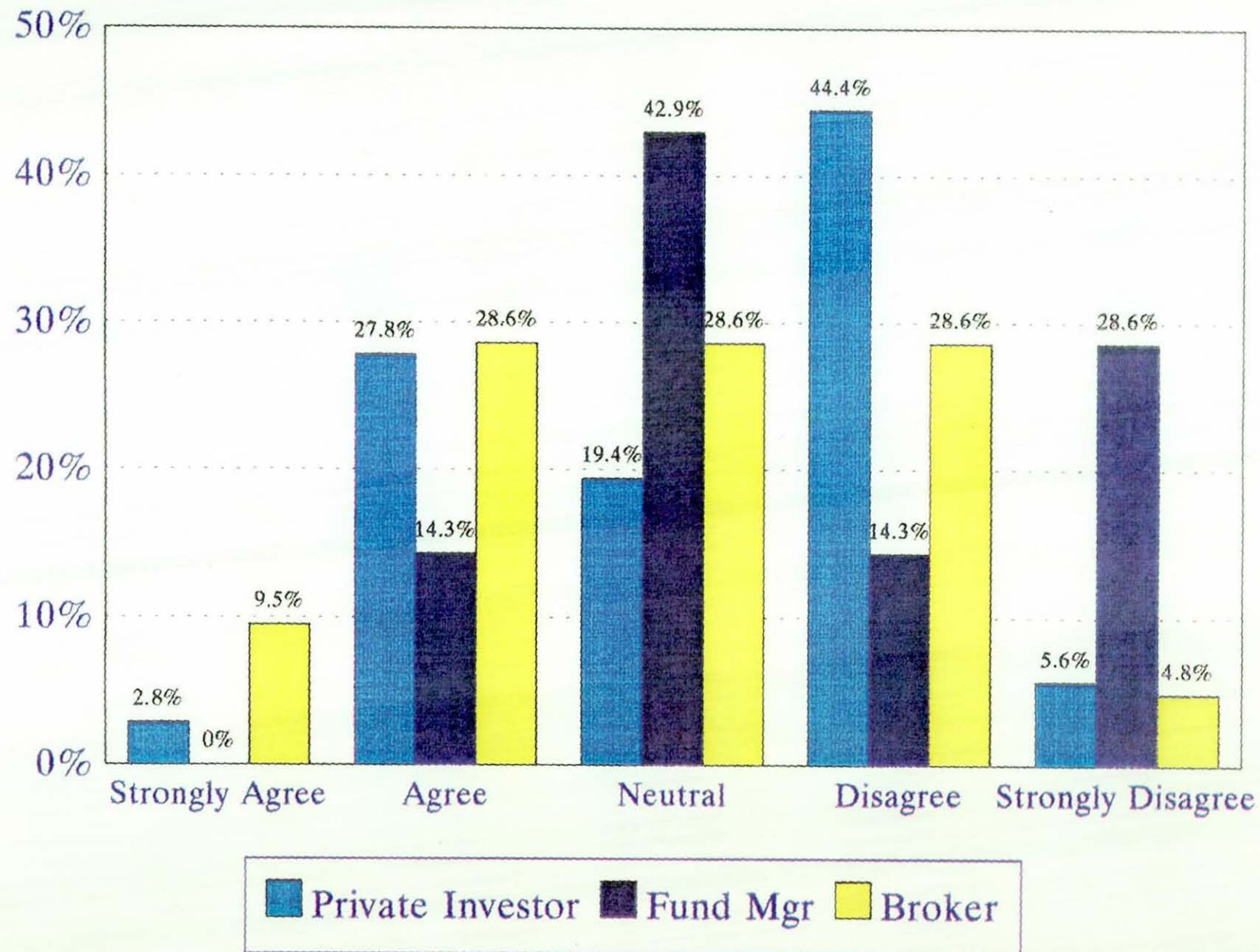
For SB, 38.1% of them agree while 33.4% disagree.

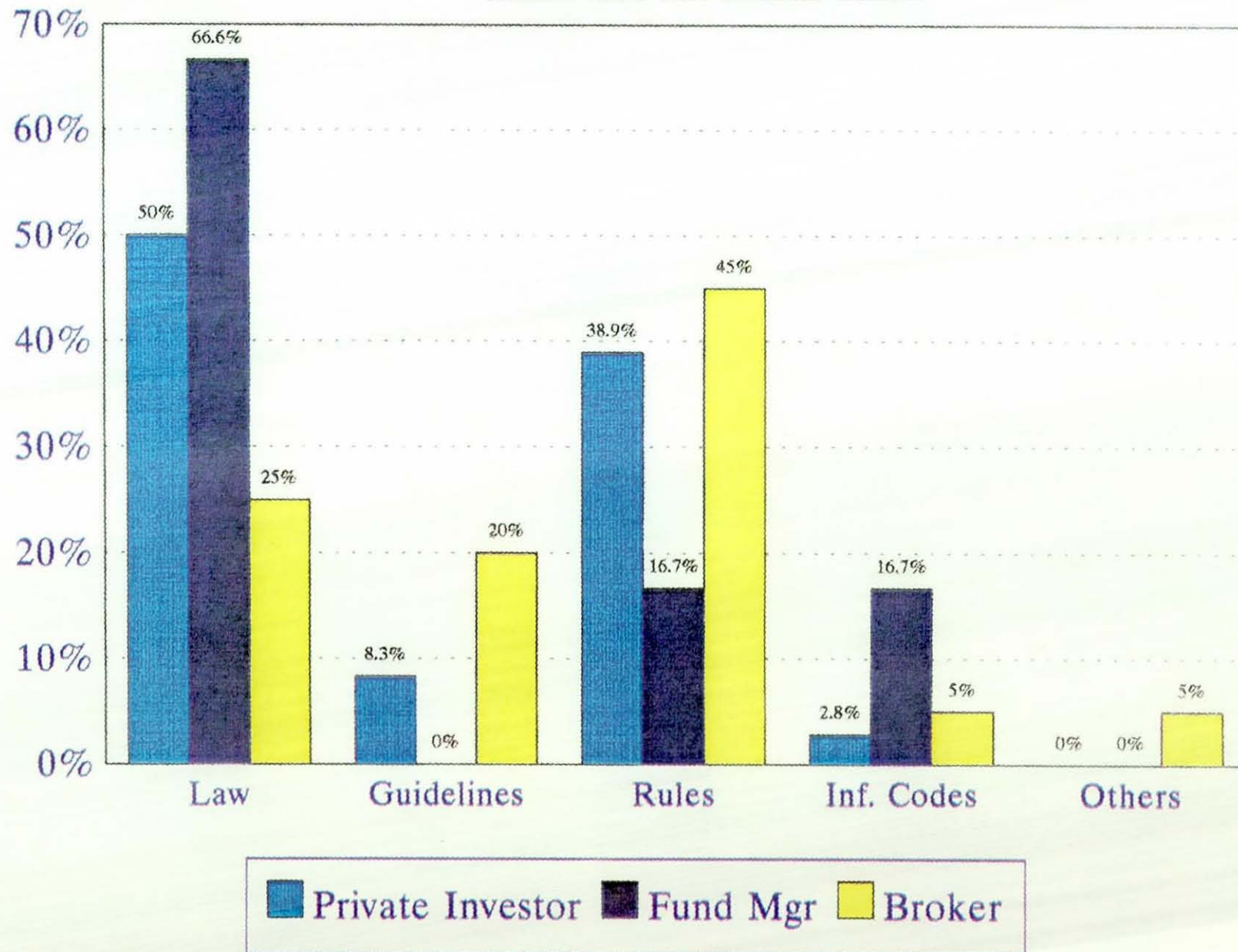
For PRO, 14.3% of them agree while 42.9% disagree.

Ensure fair and orderly market (Chart 5.34; Table 5.34)

Question 34 asks respondents to choose from a list the best method for ensuring an orderly and fair market: law, informal guidelines by the authority, rules by the stock exchange, informal codes similar to the codes of takeovers and mergers, practice rules by trade associations or any other suggestions.

For PI, 50% of them choose law, 38.9% choose rules by

COST PAID BY INVESTORS

ENSURE FAIR AND ORDERLY MARKET

stock exchange.

For SB, 45% of them choose rules by stock exchange, 25% choose law and 20% choose informal guidelines by the authority.

For PRO, 66.7% of them choose law, 16.7% choose rules by the exchange and 16.7% choose informal codes similar to the codes of takeovers and mergers.

End of Chapter

CHAPTER 6

HYPOTHESIS TESTING AND CONCLUSIONS

After the collection of data, the next most important task is to subject the data to analysis using statistical methods to estimate some property of the population that was sampled and to test the three formulated hypotheses. It is necessary to employ statistical methods because a survey based on a sample involves incomplete information about the population and it is, therefore, necessary to ascertain the degree of confidence for the data collected and subsequently on the inferences drawn and hypotheses tested.

The present researcher proposes to use two separate and unrelated statistical techniques to analyze the data collected. The first and the more important technique, **binary choice modeling**, is employed to test the three hypotheses stipulated in chapter one. The second technique, the chi-square statistical method, is employed for the purpose of finding out the other characteristics of the collected data.

The following three hypotheses are to be tested :

Hypothesis 1 : That the Securities and Futures Commission has caused the making and enforcement of appropriate law and regulations for protecting the interest

of the general public, i.e. private investors.

Hypothesis 2 : That the Securities and Futures Commission has adequately supervised the stock exchange, a self regulated body, for protecting the interest of the general public, i.e. private investors.

Hypothesis 3 : That the Securities and Futures Commission has adequately supervised listed companies and their management for protecting the interest of the general public, i.e. private investors.

The researcher is following a three step routine in applying the model. These steps are :

- a) Apply the data to the model to calculate the constant and the coefficients of the independent variables.
- b) Calculate the averages of the independent variables.
- c) Input the averages back to the models to calculate the Logit and Probit figures.

The above three steps are repeated for each of the hypotheses and for each of the two groups - the private investor group and the stock broker group. The results of the analysis are presented in Chapter Five. The findings and conclusions derived from these results are presented in the following paragraphs.

FINDINGS FROM TESTING OF HYPOTHESES USING BINARY CHOICE MODELING

The data from section 2 of the questionnaire is used to test the **first hypothesis** "That the Securities and Futures Commission has caused the making and enforcement of appropriate law and regulations for protecting the interest of the general public, i.e. private investors." The SFC has the function of considering and proposing reforms of the securities legislation and is required to ensure that securities legislation is complied with.

Data from section two of the questionnaire is applied to the first binary choice model for estimating the formula. Averages of the two groups are input to the model to find out the likelihood of each supporting the SFC. **The model predicts that** for private investors, the probability of a private investor supporting the SFC is 0.68 while for stock brokers the probability is 0.76. There is a two thirds chance in one that a private investor supports the SFC. For a stock broker the chance is even higher. From the foregoing findings the first hypothesis "That the Securities and Futures Commission has caused the making and enforcement of appropriate law and regulations for protecting the interest of the general public, i.e. private investors." is accepted. Although private investors are satisfied, if the probability of the private investor group is compared with

the probability of the stock broker group, it is observed that a stock broker is more likely to support the SFC.

Observation of charts 5.7, 5.8, 5.9 and 5.10 lends support to the above finding. Chart 5.7 shows the results of question 7. Question 7 asks respondents if they agree that the present law governing the securities industry is already adequate for the protection of investors. Chart 5.8 shows the results of question 8. Question 8 asks respondents if they agree that the authorities have already exercised adequate vigilance in the enforcement of the law relating to securities for the protection of investors. From both charts one observes that private investors and stock brokers are satisfied with the present law although the phenomenon is more pronounced in stock brokers than private investors. Charts 5.9 and 5.10 relate to questions 9 and 10 both of which are concerned with the role of self regulating bodies in protecting investors. Results show that all three groups agree that self regulating bodies should play a role in investor protection. Further, from chart 5.10 it is observed that respondents support the legalization of rules and regulations made by self regulating bodies for investor protection.

Section three aims at testing the second hypothesis of Chapter one. The **second hypothesis** states "that the

Securities and Futures Commission has adequately supervised the stock exchange, a self regulated body, for protecting the interest of the general public, i.e. private investors". The SFC has the function of supervising and monitoring the activities of the stock exchange.

Data from this section is applied to the second binary choice model of chapter four to arrive at a formula. The averages are then input into the model to arrive at the probabilities of supporting the SFC. **The model predicts that** for a private investor, there is a probability of 0.62 or approximately a two thirds chance in one that he supports the SFC while for stock brokers the probability is 0.63. There is only a slight difference of one percentage point between the two groups. For both private investors and stock brokers there is approximately a two thirds chance in one of supporting the SFC. From the foregoing findings the second hypothesis "that the Securities and Futures Commission has adequately supervised the stock exchange, a self regulated body, for protecting the interest of the general public, i.e. private investors" is accepted. From the results one finds that stock brokers are deriving from SFC the same level of satisfaction as private investors.

Observation of charts 5.12, 5.15 and 5.16 also lends support to the above finding. These charts relate

respectively to questions 12, 15 and 16 of the questionnaire. Question 12 asks if closer supervision of the Exchange by the SFC will give better protection to investors. The chart shows that all three groups agree to closer supervision. Question 15 relates to the determination of share subscription prices of new listings. Most private investors and stock brokers agree that the stock exchange should be given a role. Question 16 relates to the Exchange's function of scrutinizing new listings. On this issue all three groups are satisfied with the work of the Exchange.

Section five aims at testing the **third hypothesis** "that the Securities and Futures Commission has adequately supervised listed companies and their management for protecting the interest of the general public, i.e. private investors".

Data from this section is used in the third binary choice model for estimating the formula. The averages are then calculated and input into the model to arrive at the probabilities of being satisfied and supportive of the SFC. **The model predicts that** for a private investor, there is only a probability of 0.27 or approximately a one quarter chance in one that he is satisfied and supportive of the SFC. For a stock broker exactly the same probability of

0.27 is arrived at. Neither private investors nor stock brokers are satisfied with or supportive of the SFC. It follows that both stock brokers and private investors are not deriving benefits from the SFC on this issue. From the foregoing findings the third hypothesis "That the Securities and Futures Commission has adequately supervised listed companies and their management for protecting the interest of the general public, i.e. private investors" is rejected. Benefits relating to this matter should have been appropriated to parties other than the general public, stock brokers or fund managers.

Observation of charts 5.24, 5.27 and 5.29 lends support to the above finding. Chart 5.24 relates to the promptness of listed companies in disclosing sensitive information to the public. Most respondents are dissatisfied with the current practice. Chart 5.27 relates to the proper discharge of duties by listed company directors towards investors. Respondents are disappointed with listed company directors on this matter. Question 5.29 relates to investor protection in take-over and merger situations. Most respondents believe that their interests are not being protected.

CONCLUSIONS

The following conclusions are drawn from the findings.

- a) The benefits of the Securities and Futures

Commission Ordinance, an economic legislation, do not always accrue to interest groups, as predicted by the "Capture Theory". The general public does occasionally derive benefits from this legislation, although it is not correct to state that most of the benefits go to the general public, as stated under the "Public Interest" theory. Interest groups also derive benefits from the legislation. Both the Public Interest Theory and the Capture Theory are, at least in this analysis, unable to explain fully the findings observed.

b) Private investors, i.e. the general public, do behave like an interest group and it should be so treated. In the present analysis, private investors, as an interest group, win legislative support for regulating the stock exchange but lose legislative benefits to listed companies (eg: on the issue of disclosing price sensitive information by listed companies) which could also be regarded as an interest group. This phenomenon lends support to this researcher's postulation that for every economic legislation there are at least two bidders. The first bid is offered by the general public offering a negative price consideration while the other bid comes from an interest group or groups. The negative price consideration includes the "not creating a public uproar" or "not orchestrating a public outcry".

c) There is no support for the hypothesis that the smaller an interest group the more cohesive it is and the easier for it to bid for economic benefits from legislators and regulators. The general public, as an interest group, is neither small in size nor cohesive in nature. However, it does successfully bid for legislative benefits.

d) The present analysis lends support to the view expressed by Haddock and Macey that interest groups may join together when they possess compelling mutual interests. In the present analysis, private investors, as an interest group, and the stock brokers interest group are both interested in the enactment of law and regulation for the proper supervision of the stock exchange. This they got. There, apparently, are grounds for supporting the view that interest groups sometimes join hands in bidding for legislative benefits.

e) The present researcher observes that the Securities and Futures Commission does behave like a profit maximizing entity. On the one hand the SFC is maximizing support from the general public which will guarantee its future funding from the public purse. On the other hand the SFC is soliciting rewards from interest groups, most notably from listed companies. Again, if the general public is regarded as an interest

group, the SFC is driving a course which would bring to it maximum benefits or minimum detriments, taking the interest of all parties into consideration. The SFC will pursue this "corporate policy" irrespective of the legal provisions in the Securities and Futures Commission Ordinance as long as the SFC is bestowed the power of discretion in key issues by legislators. In general the SFC, as a regulator, is following a profit maximizing function. This function is represented by :

$$f(x) = p + g_1 + g_2 + \dots g_n$$

where x are the "profits" to the SFC

p is consideration given by the general public

g₁ is consideration given by interest group 1

g₂ is consideration given by interest group 2

etc...

Consideration in this case includes negative consideration of "detriments and public outcries". Acting like a profit maximizing interest group, the SFC seeks to maximize its profits (x), within the legal framework, in every course of action it takes or will take.

FINDINGS FROM CHI-SQUARE ANALYSIS

The CQ statistical analysis is performed on the data of

all three groups. However, because of the small number of replies from professional investors, it is not statistically sound to rely on the data collected ¹. As such, data from the professional investor group is not used for comparative purposes nor for the purpose of drawing conclusions about interest groups except for section one which deals with the background of the three groups.

The results of the CQ statistical analysis are presented in chapter five. Findings from the statistical analysis are given below.

For section one there are altogether six questions. The findings of this section suggest that investors in Hong Kong are sophisticated. A significant number of private investors (30%) are investing in both local and overseas markets. However, many of them are only moderately experienced in the local market. More than half of the professional investors have less than five years of local experience while half of the private investors have less than ten years of local market experience. Except for professional investors, most private investors are not active participants. Private investors tend to put a substantial portion of their share investments locally while professional investors tend to diversify into other markets.

1.p.274 Basic Statistics for Business and Economics, Paul G. Hoel and Raymond J Jessen, John Wiley and Sons, Inc., 1971.

Local investors are not risk averse. They regard capital gain as the prime motive for participating in the local market. Private investors give a low priority to dividend gained from investment.

For section two there are altogether four questions (Q.7 - Q.10). Questions 7 and 8 are key questions. Question 7 attempts to find out the adequacy of the present law while question 8 the adequacy of the law enforcement. Other questions in this section refer to rules and regulations of self regulated bodies.

Question 7 investigates the adequacy of the present law. The opinions from private investors and stock brokers are evenly distributed. The null hypothesis "that there is no appreciable statistical difference in the sample population regarding the adequacy of the present securities law" is accepted by both groups. No definite conclusion could be drawn from the data.

Question 8 deals with the adequacy of the enforcement of the present securities law. The null hypothesis "that there is no appreciable statistical difference in the sample population regarding the enforcement of the present securities law" is accepted by the stock broker group and rejected by the private investor group. It could be

concluded that private investors are happy with the present law enforcement whereas stock brokers do not give a clear indication.

Opinion on the other 2 questions of this section indicates that both private investors and stock brokers are favouring a more prominent role for self regulated bodies in making rules and regulations for the protection of investors.

For section three there are seven questions (Q.11 - Q.17). Questions 11 and 12 are key questions. For question 11, the null hypothesis "that there is no appreciable statistical difference in the sample population regarding the adequacy of the Exchange in protecting investors" is rejected by both the private investor group and stock broker group, indicating a definite opinion on this issue. More than 60% of private investors agree that the exchange has made an adequate effort in protecting investors while only 47% of stock brokers agree. Both private investors and stock brokers are satisfied with the present arrangement while the former show a higher satisfaction.

For question 12, the null hypothesis "that there is no appreciable difference in the sample population regarding closer supervision of the Exchange by the SFC" is rejected

by the private investors group. 72% of private investors agree that closer supervision of the exchange by the SFC would give better protection to investors, indicating a definite trusting attitude towards the agency. In the case of stock brokers the null hypothesis is accepted for this question which indicates a rather divided attitude towards the SFC.

From the response to the above two key questions, the researcher is of the opinion that private investors are more satisfied with the stock exchange in protecting investors and are more willing to subject the exchange to the supervision of the SFC than stock brokers. For private investors, supervision of the stock exchange is effective. Although stock brokers are less positive than private investors towards the running and supervision of the exchange, on a number count the majority of them are still satisfied.

Other questions in this sections refer to the other activities of the stock exchange. Responses to these questions reinforced and corroborated the earlier findings that private investors are more satisfied with the working and supervision of the stock exchange than other groups.

Section four aims at providing information relating to

the adequacy of the SFC in supervising stock brokers.

There are five questions in this section (Q.18 - Q.22). Question 18 requests the respondents to express opinion about the adequacy of information supplied by market intermediaries. The majority of private investors and professional investors are of the opinion that market intermediaries are not supplying to them adequate financial information. Question 19 requests the respondents to express opinions about the adequacy of training of market intermediaries. Again, the majority of private investors and professional investors express dissatisfaction. Question 20 asks the respondents to express their opinions about the adequacy of capital requirements for stock brokers. The SFC, by virtue of the power vested upon it by legislation, sets the capital requirements for stock brokers. The majority of private investors express satisfaction while the majority of professional investors are dissatisfied. Question 21 asks the respondents if they know of any dishonest or sharp practices by stock brokers and market intermediaries against the interest of clients. For private investors, 42% say that they know of such practices while 57% reply that they do not know of such practices. For professional investors, a majority of them say that they know of such practices while only 16% reply that they do not know of such practices. Most of them wish

that these practices be stopped by the operation of law.

The overall conclusion from the replies is that both private investors and professional investors are dissatisfied with the supervision of and services provided by market intermediaries. However, professional investors are more critical of market intermediaries' professional conduct.

For section five there are seven questions (Q.23 - Q.29). Q.23, 24 and 29 are key questions for testing the third hypothesis. Q.23 asks the respondents if they agree that the amount of information disclosed by listed companies to their shareholders is adequate. The null hypothesis "that there is no appreciable difference in the sample population regarding the adequacy of the disclosure by listed companies" is rejected by the private investor group. For the stock broker group the null hypothesis is accepted. While both the private investors group and the stock brokers group agree that listed companies do not provide adequate information, the opinion of private investors is more pronounced (the null hypothesis rejected).

Q.24 asks the respondents if listed companies are prompt in disclosing sensitive information to the investing public. The null hypothesis "that there is no appreciable

difference for the sample population regarding the promptness in disclosing sensitive information by listed companies" is rejected by both the private investor and stock broker group. Both groups disagree that listed companies are prompt in disclosing sensitive information to the investing public.

Q.29 asks the respondents if the interests of shareholders are always protected in take-over situations. The null hypothesis "that there is no appreciable difference in the sample population regarding the protection of investors in take-over situations" is rejected by the private investor group and accepted by the stock brokers group. Both private investors and stock brokers disagree that investors' interests are protected in take-over situations but stock brokers exhibit a more balanced opinion.

Findings from other questions of this section further support the view that both groups are dissatisfied with the SFC on the supervising of listed companies. However, private investors, as compared with stock brokers, are more dissatisfied.

Section six deals with general issues.

On margin trading the majority of the three groups

agree that it should be under some form of control to ensure an orderly market.

On prohibiting short selling the majority of the three groups agree that prohibiting short selling will not help protect investors.

On brokerage and incidental charges on securities transactions the majority of private investors and stock brokers agree that brokerage and charges in Hong Kong are low while professional investors are indecisive.

On the cost of supervising the securities industry the majority of private investors and professional investors do not agree that investors should bear the cost while most of the stock brokers agree that it should be borne by investors. This divergence of opinion basically arises from their divergence of interest.

For the methods of supervision both private investors and stock brokers choose law as the most favoured means while stock brokers, understandingly, choose the less formal method of supervision by the stock exchange. Only a few respondents of each group prefer informal mechanisms for supervision.

SUMMARY

The data is subject to two analyses i.e. Binary Choice

Modelling and Chi Square Analysis. The three hypotheses are tested using binary choice models. Results indicate that neither the Capture Theory nor the Public Interest Theory can explain in full the behaviour of interest groups and the general public. Rather, it would be more realistic to regard both the regulator and the general public as two distinct interest groups. These two interest groups, together with the other more traditionally defined interest groups, such as the stock broker group, would engage in open competition for legislative benefits. Benefits, as defined by the present researcher, could be tangible benefits, such as votes or money, or intangible benefits such as "not raising a public outcry against the regulator".

Flowing from the above insight one is tempted to take a fresh look at the two "newly defined", "always present" interest groups - the regulator and the general public. The regulator should no longer be regarded as only a distributor of legislative benefits nor the general public only a passive player in the legislative game. There is every reason to believe that the game is feverishly played and ardently participated in by all parties concerned.

It is logical to conclude that the Capture Theory, which was derived from analysing a particular group of industries in the United States of America, is only

applicable to industries adopting the "legislative versus legislative-free (self regulation)" model.¹ These polar situations, as observed by some theorists, do not have universal applications. The UK financial services industry is a case in point. A substantial number of industries are now being regulated by a mix of legislation and elements of practitioner-based regulation with appropriate safeguards against industry capture. This modified Public Interest model - i.e. a Public Interest model with interest groups, including the general public interest group, internalized - seems to work well in quite a number of economies and it could be a "winning" model for regulating businesses and industries in the twenty-first century.

Understanding more the underlying reasons for the modus operandi of all interest groups, including the general public, will allow legislators to enact legislation and to devise regulatory frameworks which would comply more with the original design and purposes of their enactment. Further, understanding more the behaviour of the major players in the economy will provide economists and state planners with better insights into the distribution of resources in society. Hopefully, in future, state planners may be able to devise a more effective regulatory system for

1.see Chapter 2.

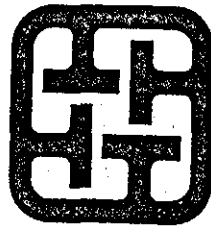
the economy aiming at modifying market imperfections.

End of Chapter

Hong Kong Polytechnic

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Questionnaire



Department of Business Studies
December 1989

QUESTIONNAIRE ABOUT THE IMPROVEMENT OF THE SECURITIES INDUSTRY AND THE PROTECTION OF SECURITIES INVESTORS OF HONG KONG

IN THE FOLLOWING, THE TERM SECURITIES MEANS STOCKS, SHARES, BONDS, AND UNIT TRUSTS INVESTING IN STOCKS, SHARES OR BONDS.

GENERAL INFORMATION

1. Do you invest in securities markets?

1. ☐ I do not invest in securities
(if you tick the above please ignore the rest of this questionnaires and send back this form to us)
2. ☐ I invest in HK securities only
3. ☐ I invest in overseas securities only
4. ☐ I invest in both HK and overseas securities

2. How long have you been investing in the Hong Kong securities market?

1. ☐ never
2. ☐ less than 5 years
3. ☐ between 5 — 10 years
4. ☐ more than 10 years

3. For whom are you investing in the HK securities?

1. ☐ for yourself only (including friends and relations)
2. ☐ for your company only
3. ☐ for both yourself and your company

4. Frequency of your activities in the HK securities market

1. ☐ deal in the market every day
2. ☐ deal in the market every week
3. ☐ deal in the market every month
4. ☐ only infrequently

5. The amount of HK securities you have or under your control is

1. less than 10% of all your securities investments
2. between 10% — 30% of all your securities investments
3. between 30% — 50% of all your securities investments
4. more than 50% of all your securities investments

6. You invest in HK securities for ...

1. the high yield in dividend and interest
2. the high appreciation of capital value
3. the necessary portfolio diversification
4. other such as _____

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LAW AND REGULATIONS FOR THE SECURITIES INDUSTRY

7. Do you agree that the present law governing the securities industry are already adequate for the protection of investors such as yourself?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

8. Do you agree that the authorities already exercise adequate vigilance in the enforcement of law relating to securities for the protection of investors?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

9. Do you agree that professional bodies such as Stock Brokers Association, Unit Trusts Association, HK Society of Accountants etc. should play a role in making rules and regulations governing their members for the protection of investors?

- strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

10. Do you agree that such rules and regulations made by professional bodies relating to securities industry should have the force of law behind them?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

THE STOCK EXCHANGE OF HONG KONG

11. Do you agree that the Stock Exchange has already made adequate effort for the protection of investors?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

12. Do you agree that closer supervision of the Stock Exchange by the Securities and Futures Commission and the government could give better protection to investors?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

13. Do you agree that the Stock Exchange should request their members (stock brokers) to take out insurance against their possible financial default towards investors?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

14. Do you agree that the Stock Exchange should have the power to limit the number of new listings and placements to the market in any given period?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

15. Do you agree that the Stock Exchange should be given a role in the determination of share subscription prices of new listings in conjunction with the company applying to be listed and their advisors?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

16. Do you agree that companies which apply to be listed are always properly scrutinized by the Stock Exchange before their requests for listing are approved?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

17. Do you agree that in time of exceptional financial turmoil the Stock Exchange should be temporarily closed for the protection of investors?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

STOCK BROKERS AND OTHER INTERMEDIARIES

18. Do you agree that investors already receive an adequate supply of financial information from stock brokers, investment advisors and various professionals of the securities industry?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

19. Do you agree that stock brokers, investment advisors and other professionals in securities dealings are adequately trained?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

20. Do you agree that the capital requirements of stock brokers are adequate, from the point of view of investors and the brokers' dealing counterpart? (HK\$1 million for personal brokers and HK\$5 million for corporate brokers irrespective of turnover)

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

21. Do you know of any dishonest or sharp practices by stock brokers and market intermediaries which are against the interest of their clients?

1. ____ yes

2. ____ no

22. What do you think is the best way of curbing dishonest or sharp practices of brokers and market intermediaries? (Tick one only)

1. ____ by enacting law

2. ____ sanction by the Stock Exchange

3. ____ sanction by their respective trade associations

4. ____ sanction by quasi-government bodies, such as the Consumers' Council

5. ____ other, such as _____

LISTED COMPANIES

23. Do you agree that the amount of information disclosed by listed companies to their shareholders is adequate?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

24. Do you agree that listed companies are prompt in disclosing sensitive information to the investing public?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

25. Do you agree that if listed companies are compelled by law to disclose more information to the public, some private companies may be discouraged from seeking a listing?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

26. Do you agree that the law should require disclosure of listed company shareholding above 5%?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

27. Do you agree that directors of listed companies in HK adequately discharge their duties towards the investors?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

28. Do you agree that shareholders of listed companies should be given more power to approve major transactions of their companies?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

29. Do you agree that in the take-over of one listed company by another company, the interest of shareholders are always protected?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

SECURITIES DEALINGS

30. Do you agree that trading on margin should be under some form of control for the sake of an orderly market?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

31. Do you agree that prohibiting short selling of stock and shares helps to protect investors?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

32. Do you agree that the brokerage and incidental charges on the buying of securities in HK are low?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

33. Do you agree that the cost of supervising the securities industry should be mostly paid for by investors?

strongly agree	agree	neutral	disagree	strongly disagree
1	2	3	4	5

34. Indicate below which methods you considered the best for ensuring an orderly and fair market?
(Tick one only)

1. ____ law
2. ____ informal guidelines by the authority
3. ____ rules by the Stock Exchange of Hong Kong Limited
4. ____ informal codes similar to the codes of takeovers and mergers
5. ____ practice rules by trade associations
6. ____ others such as _____

35. Please state below any comments which you wish to make on the subject of the protection of investors trading in securities

THANK YOU

ATTACHMENT B

Table 5.1a

INVEST IN SECURITIES MARKET BY PRIVATE INVESTORS (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
NOT INVEST	1	1	2.7	2.8	2.8
HK SECUR	2	21	56.8	58.3	61.1
OVERSEA SECUR	3	3	8.1	8.3	69.4
BOTH	4	11	29.7	30.6	100.0
		.	1	2.7	MISSING
TOTAL		37	100.0	100.0	

Table 5.1b : INVEST IN SECURITIES MARKET BY STOCK BROKERS (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
NOT INVEST	1	2	8.7	8.7	8.7
HK SECUR	2	7	30.4	30.4	39.1
OVERSEA SECUR	3	1	4.3	4.3	43.5
BOTH	4	13	56.5	56.5	100.0
TOTAL		23	100.0	100.0	

Table 5.1c : INVEST IN SECURITIES MARKET BY PROF. INVESTORS (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
BOTH	4	7	100.0	100.0	100.0
TOTAL		7	100.0	100.0	

Table 5.2a : HOW LONG IN HK SECURITIES MKT (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
LESS THAN 5 YRS	2	7	18.9	19.4	19.4
5-10 YRS	3	11	29.7	30.6	50.0
MORE THAN 10 YRS	4	18	48.6	50.0	100.0
	.	1	2.7	MISSING	
TOTAL		37	100.0	100.0	

Table 5.2b : HOW LONG IN HK SECURITIES MKT (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
LESS THAN 5 YRS	2	2	8.7	9.5	9.5
5-10 YRS	3	4	17.4	19.0	28.6
MORE THAN 10 YRS	4	15	65.2	71.4	100.0
.	.	2	8.7	MISSING	
		-----	-----	-----	
TOTAL		23	100.0	100.0	

Table 5.2c : HOW LONG IN HK SECURITIES MKT (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
LESS THAN 5 YRS	2	4	57.1	57.1	57.1
5-10 YRS	3	2	28.6	28.6	85.7
MORE THAN 10 YRS	4	1	14.3	14.3	100.0
		-----	-----	-----	
TOTAL		7	100.0	100.0	

Table 5.3a : FOR WHOM INVESTING IN HK SECUR MKT (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
YOURSELF	1	27	73.0	75.0	75.0
BOTH	3	9	24.3	25.0	100.0
.	.	1	2.7	MISSING	
		-----	-----	-----	
TOTAL		37	100.0	100.0	

Table 5.3b : FOR WHOM INVESTING IN HK SECUR MKT (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
YOURSELF	1	9	39.1	42.9	42.9
COMPANY	2	2	8.7	9.5	52.4
BOTH	3	10	43.5	47.6	100.0
.	.	2	8.7	MISSING	
		-----	-----	-----	
TOTAL		23	100.0	100.0	

Table 5.3c : FOR WHOM INVESTING IN HK SECUR MKT (PRO)

Value Label	Value	Frequency	Percent	valid Percent	Cum Percent
COMPANY	2	4	57.1	57.1	57.1
BOTH	3	3	42.9	42.9	100.0
		-----	-----	-----	

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TOTAL	7	100.0	100.0
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Table 5.4a : FREQUENCY IN HK SECUR MKT (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
EVERYDAY	1	7	18.9	19.4	19.4
EVERYWEEK	2	5	13.5	13.9	33.3
EVERYMONTH	3	8	21.6	22.2	55.6
INFREQ	4	16	43.2	44.4	100.0
	.	1	2.7	MISSING	
TOTAL		37	100.0	100.0	

Table 5.4b : FREQUENCY IN HK SECUR MKT (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
EVERYDAY	1	10	43.5	47.6	47.6
EVERYWEEK	2	4	17.4	19.0	66.7
EVERYMONTH	3	3	13.0	14.3	81.0
INFREQ	4	4	17.4	19.0	100.0
	.	2	8.7	MISSING	
TOTAL		23	100.0	100.0	

Table 5.4c : FREQUENCY IN HK SECUR MKT (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
EVERYDAY	1	2	28.6	40.0	40.0
EVERYWEEK	2	3	42.9	60.0	100.0
	.	2	28.6	MISSING	
TOTAL		7	100.0	100.0	

Table 5.5a : AMT HK SECU UNDER CONTROL (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
0-10%	1	6	16.2	16.7	16.7
10-30%	2	5	13.5	13.9	30.6
30-50%	3	3	8.1	8.3	38.9
MORE THAN 50%	4	22	59.5	61.1	100.0

	1	2.7	MISSING
TOTAL	37	100.0	100.0

Table 5.5b : AMT HK SECU UNDER CONTROL (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
0-10%	1	4	17.4	19.0	19.0
10-30%	2	6	26.1	28.6	47.6
30-50%	3	3	13.0	14.3	61.9
MORE THAN 50%	4	8	34.8	38.1	100.0
	.	2	8.7	MISSING	
TOTAL		23	100.0	100.0	

Table 5.5c : AMT HK SECU UNDER CONTROL (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
0-10%	1	1	14.3	14.3	14.3
10-30%	2	5	71.4	71.4	85.7
MORE THAN 50%	4	1	14.3	14.3	100.0
TOTAL		7	100.0	100.0	

Table 5.6a : REASON FOR INVESTING HK SECU (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
YIELD IN DIVIDEND	1	6	16.2	17.1	17.1
APPRECIATION	2	26	70.3	74.3	91.4
PORTFOLIO DIVERS	3	1	2.7	2.9	94.3
OTHER	4	2	5.4	5.7	100.0
	.	2	5.4	MISSING	
TOTAL		37	100.0	100.0	

Table 5.6b : REASON FOR INVESTING HK SECU (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
YIELD IN DIVIDEND	1	2	8.7	10.5	10.5
APPRECIATION	2	11	47.8	57.9	68.4

PORTFOLIO DIVERS	3	3	13.0	15.8	84.2
OTHER	4	3	13.0	15.8	100.0
.		4	17.4	MISSING	
		-----	-----	-----	
TOTAL		23	100.0	100.0	

Table 5.6c : REASON FOR INVESTING HK SECU (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
PORTFOLIO DIVERS	3	1	14.3	50.0	50.0
OTHER	4	1	14.3	50.0	100.0
.		5	71.4	MISSING	
		-----	-----	-----	
TOTAL		7	100.0	100.0	

Table 5.7a : OPINION ON LAW PROTECTION (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	4	10.8	11.1	11.1
AGREE	2	10	27.0	27.8	38.9
NEUTRAL	3	10	27.0	27.8	66.7
DISAGREE	4	9	24.3	25.0	91.7
STRONGLY DISAGREE	5	3	8.1	8.3	100.0
.		1	2.7	MISSING	
		-----	-----	-----	
TOTAL		37	100.0	100.0	

Table 5.7b : OPINION ON LAW PROTECTION (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	5	21.7	23.8	23.8
AGREE	2	7	30.4	33.3	57.1
NEUTRAL	3	4	17.4	19.0	76.2
DISAGREE	4	5	21.7	23.8	100.0
.		2	8.7	MISSING	
		-----	-----	-----	
TOTAL		23	100.0	100.0	

Table 5.7c : OPINION ON LAW PROTECTION (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	14.3	14.3	14.3

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AGREE	2	1	14.3	14.3	28.6
DISAGREE	4	4	57.1	57.1	85.7
STRONGLY DISAGREE	5	1	14.3	14.3	100.0
		-----	-----	-----	
TOTAL		7	100.0	100.0	

Table 5.8a : AUTHORITIES ENFORCE LAW (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	2.7	2.8	2.8
AGREE	2	17	45.9	47.2	50.0
NEUTRAL	3	6	16.2	16.7	66.7
DISAGREE	4	11	29.7	30.6	97.2
STRONGLY DISAGREE	5	1	2.7	2.8	100.0
.		1	2.7	MISSING	
		-----	-----	-----	
TOTAL		37	100.0	100.0	

Table 5.8b : AUTHORITIES ENFORCE LAW (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	3	13.0	14.3	14.3
AGREE	2	7	30.4	33.3	47.6
NEUTRAL	3	6	26.1	28.6	76.2
DISAGREE	4	3	13.0	14.3	90.5
STRONGLY DISAGREE	5	2	8.7	9.5	100.0
.		2	8.7	MISSING	
		-----	-----	-----	
TOTAL		23	100.0	100.0	

Table 5.8c : AUTHORITIES ENFORCE LAW (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	14.3	14.3	14.3
NEUTRAL	3	2	28.6	28.6	42.9
DISAGREE	4	2	28.6	28.6	71.4
STRONGLY DISAGREE	5	2	28.6	28.6	100.0
		-----	-----	-----	
TOTAL		7	100.0	100.0	

Table 5.9a : PROFESSIONAL BODIES TO PROTECT (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	10	27.0	27.8	27.8
AGREE	2	20	54.1	55.6	83.3
NEUTRAL	3	3	8.1	8.3	91.7
DISAGREE	4	3	8.1	8.3	100.0
.	.	1	2.7	MISSING	
TOTAL		37	100.0	100.0	

Table 5.9b : PROFESSIONAL BODIES TO PROTECT (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	4	17.4	19.0	19.0
AGREE	2	12	52.2	57.1	76.2
NEUTRAL	3	2	8.7	9.5	85.7
DISAGREE	4	1	4.3	4.8	90.5
STRONGLY DISAGREE	5	2	8.7	9.5	100.0
.	.	2	8.7	MISSING	
TOTAL		23	100.0	100.0	

Table 6.9c : PROFESSIONAL BODIES TO PROTECT (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
AGREE	2	5	71.4	71.4	71.4
NEUTRAL	3	2	28.6	28.6	100.0
TOTAL		7	100.0	100.0	

Table 5.10a : RULES BACKED UP BY LAW (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	5	13.5	14.3	14.3
AGREE	2	23	62.2	65.7	80.0
NEUTRAL	3	4	10.8	11.4	91.4
DISAGREE	4	3	8.1	8.6	100.0
.	.	2	5.4	MISSING	

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TOTAL	37	100.0	100.0
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Table 5.10b : RULES BACKED UP BY LAW (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	4.3	5.0	5.0
AGREE	2	12	52.2	60.0	65.0
NEUTRAL	3	2	8.7	10.0	75.0
DISAGREE	4	3	13.0	15.0	90.0
STRONGLY DISAGREE	5	2	8.7	10.0	100.0
.	.	3	13.0	MISSING	
TOTAL		23	100.0	100.0	

Table 5.10c : RULES BACKED UP BY LAW (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	14.3	14.3	14.3
AGREE	2	2	28.6	28.6	42.9
NEUTRAL	3	2	28.6	28.6	71.4
DISAGREE	4	2	28.6	28.6	100.0
TOTAL		7	100.0	100.0	

Table 5.11a : OPINION ON STOCK EXCHANGE PROTECTION (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
AGREE	2	12	32.4	33.3	33.3
NEUTRAL	3	10	27.0	27.8	61.1
DISAGREE	4	12	32.4	33.3	94.4
STRONGLY DISAGREE	5	2	5.4	5.6	100.0
.	.	1	2.7	MISSING	
TOTAL		37	100.0	100.0	

Table 5.11b : OPINION ON STOCK EXCHANGE PROTECTION (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
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STRONGLY AGREE	1	1	4.3	4.8	4.8
AGREE	2	9	39.1	42.9	47.6
NEUTRAL	3	4	17.4	19.0	66.7
DISAGREE	4	6	26.1	28.6	95.2
STRONGLY DISAGREE	5	1	4.3	4.8	100.0
.	.	2	8.7	MISSING	
TOTAL		23	100.0	100.0	

Table 5.11c OPINION ON STOCK EXCHANGE PROTECTION (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
AGREE	2	2	28.6	28.6	28.6
NEUTRAL	3	2	28.6	28.6	57.1
DISAGREE	4	3	42.9	42.9	100.0
TOTAL		7	100.0	100.0	

Table 5.12a : CLOSER SUPERVISION (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	3	8.1	8.3	8.3
AGREE	2	23	62.2	63.9	72.2
NEUTRAL	3	7	18.9	19.4	91.7
DISAGREE	4	2	5.4	5.6	97.2
STRONGLY DISAGREE	5	1	2.7	2.8	100.0
.	.	1	2.7	MISSING	
TOTAL		37	100.0	100.0	

Table 5.12b : CLOSER SUPERVISION (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	2	8.7	9.5	9.5
AGREE	2	8	34.8	38.1	47.6
NEUTRAL	3	5	21.7	23.8	71.4
DISAGREE	4	4	17.4	19.0	90.5
STRONGLY DISAGREE	5	2	8.7	9.5	100.0
.	.	2	8.7	MISSING	
TOTAL		23	100.0	100.0	

Table 5.12c : CLOSER SUPERVISION (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
AGREE	2	4	57.1	57.1	57.1
NEUTRAL	3	1	14.3	14.3	71.4
DISAGREE	4	1	14.3	14.3	85.7
STRONGLY DISAGREE	5	1	14.3	14.3	100.0
		-----	-----	-----	
	TOTAL	7	100.0	100.0	

Table 5.13a : INSURANCE AGAINST FIN DEFAULT (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	6	16.2	16.7	16.7
AGREE	2	20	54.1	55.6	72.2
NEUTRAL	3	9	24.3	25.0	97.2
DISAGREE	4	1	2.7	2.8	100.0
	.	1	2.7	MISSING	
		-----	-----	-----	
	TOTAL	37	100.0	100.0	

Table 5.13b : INSURANCE AGAINST FIN DEFAULT (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	5	21.7	23.8	23.8
AGREE	2	4	17.4	19.0	42.9
NEUTRAL	3	5	21.7	23.8	66.7
DISAGREE	4	6	26.1	28.6	95.2
STRONGLY DISAGREE	5	1	4.3	4.8	100.0
	.	2	8.7	MISSING	
		-----	-----	-----	
	TOTAL	23	100.0	100.0	

Table 5.13c : INSURANCE AGAINST FIN DEFAULT (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
AGREE	2	5	71.4	71.4	71.4
DISAGREE	4	2	28.6	28.6	100.0
		-----	-----	-----	
	TOTAL	7	100.0	100.0	

Table 5.14a : LIMITING THE NO OF NEW LISTINGS (PI)

Valid Cum

Value Label	Value	Frequency	Percent	Percent	Percent
STRONGLY AGREE	1	5	13.5	13.9	13.9
AGREE	2	16	43.2	44.4	58.3
NEUTRAL	3	6	16.2	16.7	75.0
DISAGREE	4	9	24.3	25.0	100.0
.	.	1	2.7	MISSING	
		-----	-----	-----	
	TOTAL	37	100.0	100.0	

Table 5.14b : LIMITING THE NO OF NEW LISTINGS (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	4	17.4	19.0	19.0
AGREE	2	5	21.7	23.8	42.9
NEUTRAL	3	4	17.4	19.0	61.9
DISAGREE	4	5	21.7	23.8	85.7
STRONGLY DISAGREE	5	3	13.0	14.3	100.0
.	.	2	8.7	MISSING	
		-----	-----	-----	
	TOTAL	23	100.0	100.0	

Table 5.14c : LIMITING THE NO OF NEW LISTINGS (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	14.3	14.3	14.3
AGREE	2	3	42.9	42.9	57.1
DISAGREE	4	3	42.9	42.9	100.0
		-----	-----	-----	
	TOTAL	7	100.0	100.0	

Table 5.15a : DETERMINATION OF SHARE SUBSCRIPTION PRICE (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	3	8.1	8.6	8.6
AGREE	2	19	51.4	54.3	62.9
NEUTRAL	3	7	18.9	20.0	82.9
DISAGREE	4	4	10.8	11.4	94.3
STRONGLY DISAGREE	5	2	5.4	5.7	100.0
.	.	2	5.4	MISSING	
		-----	-----	-----	
	TOTAL	37	100.0	100.0	

Table 5.15b : DETERMINATION OF SHARE SUBSCRIPTION PRICE (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	2	8.7	9.5	9.5
AGREE	2	8	34.8	38.1	47.6
NEUTRAL	3	5	21.7	23.8	71.4
DISAGREE	4	4	17.4	19.0	90.5
STRONGLY DISAGREE	5	2	8.7	9.5	100.0
.	.	2	8.7	MISSING	
TOTAL		23	100.0	100.0	

Table 5.15c : DETERMINATION OF SHARE SUBSCRIPTION PRICE (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
AGREE	2	1	14.3	14.3	14.3
NEUTRAL	3	1	14.3	14.3	28.6
DISAGREE	4	3	42.9	42.9	71.4
STRONGLY DISAGREE	5	2	28.6	28.6	100.0
TOTAL		7	100.0	100.0	

Table 5.16a : SCRUTINIZING BY EXCHANGE BEFORE APPROVAL (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	3	8.1	8.3	8.3
AGREE	2	16	43.2	44.4	52.8
NEUTRAL	3	7	18.9	19.4	72.2
DISAGREE	4	9	24.3	25.0	97.2
STRONGLY DISAGREE	5	1	2.7	2.8	100.0
.	.	1	2.7	MISSING	
TOTAL		37	100.0	100.0	

Table 5.16b : SCRUTINIZING BY EXCHANGE BEFORE APPROVAL (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	3	13.0	14.3	14.3
AGREE	2	6	26.1	28.6	42.9
NEUTRAL	3	9	39.1	42.9	85.7
DISAGREE	4	3	13.0	14.3	100.0
.	.	2	8.7	MISSING	
TOTAL		23	100.0	100.0	

Table 5.16c : SCRUTINIZING BY EXCHANGE BEFORE APPROVAL (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
AGREE	2	4	57.1	57.1	57.1
NEUTRAL	3	3	42.9	42.9	100.0
		-----	-----	-----	
TOTAL		7	100.0	100.0	

Table 5.17a : TEMPORARY CLOSURE OF EXCHANGE IN FINANCIAL TURMOIL (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	2.7	2.8	2.8
AGREE	2	5	13.5	13.9	16.7
NEUTRAL	3	9	24.3	25.0	41.7
DISAGREE	4	17	45.9	47.2	88.9
STRONGLY DISAGREE	5	4	10.8	11.1	100.0
.	.	1	2.7	MISSING	
		-----	-----	-----	
TOTAL		37	100.0	100.0	

Table 5.17b : TEMPORARY CLOSURE OF EXCHANGE IN FINANCIAL TURMOIL (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
AGREE	2	5	21.7	23.8	23.8
NEUTRAL	3	4	17.4	19.0	42.9
DISAGREE	4	7	30.4	33.3	76.2
STRONGLY DISAGREE	5	5	21.7	23.8	100.0
.	.	2	8.7	MISSING	
		-----	-----	-----	
TOTAL		23	100.0	100.0	

Table 5.17c : TEMPORARY CLOSURE OF EXCHANGE IN FINANCIAL TURMOIL (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
DISAGREE	4	4	57.1	57.1	57.1
STRONGLY DISAGREE	5	3	42.9	42.9	100.0
		-----	-----	-----	
TOTAL		7	100.0	100.0	

Table 5.18a : FINANCIAL INFORMATION FROM PROFESSIONALS (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	2.7	2.9	2.9
AGREE	2	9	24.3	26.5	29.4
NEUTRAL	3	6	16.2	17.6	47.1
DISAGREE	4	14	37.8	41.2	88.2
STRONGLY DISAGREE		4	10.8	11.8	100.0
.		3	8.1	MISSING	
		-----	-----	-----	
TOTAL		37	100.0	100.0	

Table 5.18b : FINANCIAL INFORMATION FROM PROFESSIONALS (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	4.3	4.8	4.8
AGREE	2	9	39.1	42.9	47.6
NEUTRAL	3	6	26.1	28.6	76.2
DISAGREE	4	4	17.4	19.0	95.2
STRONGLY DISAGREE	5	1	4.3	4.8	100.0
.		2	8.7	MISSING	
		-----	-----	-----	
TOTAL		23	100.0	100.0	

Table 5.18c : FINANCIAL INFORMATION FROM PROFESSIONALS (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
AGREE	2	2	28.6	28.6	28.6
NEUTRAL	3	2	28.6	28.6	57.1
DISAGREE	4	3	42.9	42.9	100.0
		-----	-----	-----	
TOTAL		7	100.0	100.0	

Table 5.19a : TRAINING OF THE PROFESSIONALS (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	3	8.1	8.6	8.6
AGREE	2	7	18.9	20.0	28.6
NEUTRAL	3	9	24.3	25.7	54.3
DISAGREE	4	11	29.7	31.4	85.7
STRONGLY DISAGREE	5	5	13.5	14.3	100.0
.		2	5.4	MISSING	
		-----	-----	-----	

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TOTAL	37	100.0	100.0
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Table 5.19b : TRAINING OF THE PROFESSIONALS (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
AGREE	2	9	39.1	42.9	42.9
NEUTRAL	3	3	13.0	14.3	57.1
DISAGREE	4	7	30.4	33.3	90.5
STRONGLY DISAGREE	5	2	8.7	9.5	100.0
.	.	2	8.7	MISSING	
TOTAL		23	100.0	100.0	

Table 5.19c : TRAINING OF THE PROFESSIONALS (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
NEUTRAL	3	4	57.1	57.1	57.1
DISAGREE	4	2	28.6	28.6	85.7
STRONGLY DISAGREE	5	1	14.3	14.3	100.0
TOTAL		7	100.0	100.0	

Table 5.20a : CAPITAL REQUIREMENT OF BROKERS (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	2	5.4	5.7	5.7
AGREE	2	11	29.7	31.4	37.1
NEUTRAL	3	12	32.4	34.3	71.4
DISAGREE	4	9	24.3	25.7	97.1
STRONGLY DISAGREE	5	1	2.7	2.9	100.0
.	.	2	5.4	MISSING	
TOTAL		37	100.0	100.0	

Table 5.20b : CAPITAL REQUIREMENT OF BROKERS (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	4.3	4.8	4.8
AGREE	2	13	56.5	61.9	66.7
NEUTRAL	3	3	13.0	14.3	81.0
DISAGREE	4	4	17.4	19.0	100.0
.	.	2	8.7	MISSING	

TOTAL	23	100.0	100.0
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Table 5.20c : CAPITAL REQUIREMENT OF BROKERS (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
NEUTRAL	3	3	42.9	42.9	42.9
DISAGREE	4	4	57.1	57.1	100.0
TOTAL		7	100.0	100.0	

Table 5.21a : DISHONEST OR SHARP PRACTICES (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
YES	1	15	40.5	42.9	42.9
NO	2	20	54.1	57.1	100.0
	.	2	5.4	MISSING	
TOTAL		37	100.0	100.0	

Table 5.21b : DISHONEST OR SHARP PRACTICES (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
YES	1	9	39.1	42.9	42.9
NO	2	12	52.2	57.1	100.0
	.	2	8.7	MISSING	
TOTAL		23	100.0	100.0	

Table 5.21c : DISHONEST OR SHARP PRACTICES (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
YES	1	5	71.4	83.3	83.3
NO	2	1	14.3	16.7	100.0
	.	1	14.3	MISSING	
TOTAL		7	100.0	100.0	

Table 5.22a : CURBING DISHONEST OR SHARP PRACTICES (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
BY LAW	1	23	62.2	65.7	65.7
STOCK EXCHANGE	2	10	27.0	28.6	94.3
QUASI-GOVT BODIES	4	1	2.7	2.9	97.1
OTHER	5	1	2.7	2.9	100.0
	.	2	5.4	MISSING	
		-----	-----	-----	
TOTAL		37	100.0	100.0	

Table 5.22b : CURBING DISHONEST OR SHARP PRACTICES (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
BY LAW	1	5	21.7	25.0	25.0
STOCK EXCHANGE	2	13	56.5	65.0	90.0
TRADE ASS	3	1	4.3	5.0	95.0
OTHER	5	1	4.3	5.0	100.0
	.	3	13.0	MISSING	
		-----	-----	-----	
TOTAL		23	100.0	100.0	

Table 5.22c : CURBING DISHONEST OR SHARP PRACTICES (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
BY LAW	1	6	85.7	85.7	85.7
STOCK EXCHANGE	2	1	14.3	14.3	100.0
		-----	-----	-----	
TOTAL		7	100.0	100.0	

Table 5.23a : DISCLOSURE OF INFORMATION BY LISTED COMPANIES (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	2.7	2.9	2.9
AGREE	2	7	18.9	20.0	22.9
NEUTRAL	3	10	27.0	28.6	51.4
DISAGREE	4	13	35.1	37.1	88.6
STRONGLY DISAGREE	5	4	10.8	11.4	100.0
	.	2	5.4	MISSING	
		-----	-----	-----	
TOTAL		37	100.0	100.0	

Table 5.23b : DISCLOSURE OF INFORMATION BY LISTED COMPANIES (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
AGREE	2	6	26.1	28.6	28.6
NEUTRAL	3	4	17.4	19.0	47.6
DISAGREE	4	8	34.8	38.1	85.7
STRONGLY DISAGREE	5	3	13.0	14.3	100.0
.	.	2	8.7	MISSING	
		-----	-----	-----	
TOTAL		23	100.0	100.0	

Table 5.23c : DISCLOSURE OF INFORMATION BY LISTED COMPANIES (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
NEUTRAL	3	2	28.6	28.6	28.6
DISAGREE	4	5	71.4	71.4	100.0
		-----	-----	-----	
TOTAL		7	100.0	100.0	

Table 5.24a : PROMPT IN DISCLOSING SENSITIVE INFORMATION (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	2	5.4	5.7	5.7
AGREE	2	6	16.2	17.1	22.9
NEUTRAL	3	7	18.9	20.0	42.9
DISAGREE	4	17	45.9	48.6	91.4
STRONGLY DISAGREE	5	3	8.1	8.6	100.0
.	.	2	5.4	MISSING	
		-----	-----	-----	
TOTAL		37	100.0	100.0	

Table 5.24b : PROMPT IN DISCLOSING SENSITIVE INFORMATION (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	4.3	4.8	4.8
AGREE	2	4	17.4	19.0	23.8
NEUTRAL	3	4	17.4	19.0	42.9
DISAGREE	4	9	39.1	42.9	85.7
STRONGLY DISAGREE	5	3	13.0	14.3	100.0
.	.	2	8.7	MISSING	
		-----	-----	-----	
TOTAL		23	100.0	100.0	

Table 5.26a : DISCLOSURE OF SHAREHOLDING ABOVE FIVE PERCENT (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	2	5.4	5.7	5.7
AGREE	2	17	45.9	48.6	54.3
NEUTRAL	3	11	29.7	31.4	85.7
DISAGREE	4	5	13.5	14.3	100.0
	.	2	5.4	MISSING	
		-----	-----	-----	
TOTAL		37	100.0	100.0	

Table 5.26b DISCLOSURE OF SHAREHOLDING ABOVE FIVE PERCENT (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	4	17.4	19.0	19.0
AGREE	2	6	26.1	28.6	47.6
NEUTRAL	3	6	26.1	28.6	76.2
DISAGREE	4	5	21.7	23.8	100.0
	.	2	8.7	MISSING	
		-----	-----	-----	
TOTAL		23	100.0	100.0	

Table 5.26c : DISCLOSURE OF SHAREHOLDING ABOVE FIVE PERCENT (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	14.3	14.3	14.3
AGREE	2	3	42.9	42.9	57.1
NEUTRAL	3	1	14.3	14.3	71.4
DISAGREE	4	2	28.6	28.6	100.0
		-----	-----	-----	
TOTAL		7	100.0	100.0	

Table 5.27a : DIRECTORS DISCHARGE DUTIES (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	2.7	2.9	2.9
AGREE	2	5	13.5	14.3	17.1
NEUTRAL	3	13	35.1	37.1	54.3
DISAGREE	4	13	35.1	37.1	91.4
STRONGLY DISAGREE	5	3	8.1	8.6	100.0
	.	2	5.4	MISSING	
		-----	-----	-----	

TOTAL 37 100.0 100.0

Table 5.27b : DIRECTORS DISCHARGE DUTIES (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
AGREE	2	6	26.1	28.6	28.6
NEUTRAL	3	7	30.4	33.3	61.9
DISAGREE	4	4	17.4	19.0	81.0
STRONGLY DISAGREE	5	4	17.4	19.0	100.0
.	.	2	8.7	MISSING	
TOTAL		23	100.0	100.0	

Table 5.27c : DIRECTORS DISCHARGE DUTIES (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
AGREE	2	1	14.3	14.3	14.3
NEUTRAL	3	3	42.9	42.9	57.1
DISAGREE	4	3	42.9	42.9	100.0
TOTAL		7	100.0	100.0	

Table 5.28a : SHAREHOLDERS MORE POWER TO APPROVE TRANSACTIONS (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	5	13.5	14.3	14.3
AGREE	2	15	40.5	42.9	57.1
NEUTRAL	3	14	37.8	40.0	97.1
DISAGREE	4	1	2.7	2.9	100.0
.	.	2	5.4	MISSING	
TOTAL		37	100.0	100.0	

Table 5.28b : SHAREHOLDERS MORE POWER TO APPROVE TRANSACTIONS (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	2	8.7	9.5	9.5
AGREE	2	8	34.8	38.1	47.6

NEUTRAL	3	6	26.1	28.6	76.2
DISAGREE	4	4	17.4	19.0	95.2
STRONGLY DISAGREE	5	1	4.3	4.8	100.0
.	.	2	8.7	MISSING	
TOTAL		23	100.0	100.0	

Table 5.28c : SHAREHOLDERS MORE POWER TO APPROVE TRANSACTIONS (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	14.3	14.3	14.3
AGREE	2	4	57.1	57.1	71.4
NEUTRAL	3	2	28.6	28.6	100.0
TOTAL		7	100.0	100.0	

Table 5.29a : PROTECTION IN THE TAKEOVER (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	2	5.4	5.7	5.7
AGREE	2	5	13.5	14.3	20.0
NEUTRAL	3	9	24.3	25.7	45.7
DISAGREE	4	13	35.1	37.1	82.9
STRONGLY DISAGREE	5	6	16.2	17.1	100.0
.	.	2	5.4	MISSING	
TOTAL		37	100.0	100.0	

Table 5.29b : PROTECTION IN THE TAKEOVER (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	4.3	4.8	4.8
AGREE	2	4	17.4	19.0	23.8
NEUTRAL	3	6	26.1	28.6	52.4
DISAGREE	4	3	13.0	14.3	66.7
STRONGLY DISAGREE	5	7	30.4	33.3	100.0
.	.	2	8.7	MISSING	
TOTAL		23	100.0	100.0	

Table 5.29c : PROTECTION IN THE TAKEOVER (PRO)

Valid Cum

Value Label	Value	Frequency	Percent	Percent	Percent
NEUTRAL	3	2	28.6	28.6	28.6
DISAGREE	4	4	57.1	57.1	85.7
STRONGLY DISAGREE	5	1	14.3	14.3	100.0
		-----	-----	-----	
TOTAL		7	100.0	100.0	

Table 5.30a : CONTROL OVER TRADING ON MARGIN (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	9	24.3	25.7	25.7
AGREE	2	12	32.4	34.3	60.0
NEUTRAL	3	10	27.0	28.6	88.6
DISAGREE	4	3	8.1	8.6	97.1
STRONGLY DISAGREE	5	1	2.7	2.9	100.0
.		2	5.4	MISSING	
		-----	-----	-----	
TOTAL		37	100.0	100.0	

Table 5.30b : CONTROL OVER TRADING ON MARGIN (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	2	8.7	9.5	9.5
AGREE	2	12	52.2	57.1	66.7
NEUTRAL	3	4	17.4	19.0	85.7
DISAGREE	4	2	8.7	9.5	95.2
STRONGLY DISAGREE	5	1	4.3	4.8	100.0
.		2	8.7	MISSING	
		-----	-----	-----	
TOTAL		23	100.0	100.0	

Table 5.30c : CONTROL OVER TRADING ON MARGIN (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	14.3	14.3	14.3
AGREE	2	5	71.4	71.4	85.7
NEUTRAL	3	1	14.3	14.3	100.0
		-----	-----	-----	
TOTAL		7	100.0	100.0	

Table 5.31a : PROHIBIT SHORT SELLING (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	2	5.4	5.6	5.6
AGREE	2	9	24.3	25.0	30.6
NEUTRAL	3	5	13.5	13.9	44.4
DISAGREE	4	14	37.8	38.9	83.3
STRONGLY DISAGREE	5	6	16.2	16.7	100.0
.	.	1	2.7	MISSING	
		-----	-----	-----	
TOTAL		37	100.0	100.0	

Table 6.31b : PROHIBIT SHORT SELLING (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	2	8.7	9.5	9.5
AGREE	2	2	8.7	9.5	19.0
NEUTRAL	3	4	17.4	19.0	38.1
DISAGREE	4	10	43.5	47.6	85.7
STRONGLY DISAGREE	5	3	13.0	14.3	100.0
.	.	2	8.7	MISSING	
		-----	-----	-----	
TOTAL		23	100.0	100.0	

Table 5.31c : PROHIBIT SHORT SELLING (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
NEUTRAL	3	1	14.3	14.3	14.3
DISAGREE	4	3	42.9	42.9	57.1
STRONGLY DISAGREE	5	3	42.9	42.9	100.0
		-----	-----	-----	
TOTAL		7	100.0	100.0	

Table 5.32a : LOW BROKERAGE AND INCIDENTAL CHARGES (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	2	5.4	5.6	5.6
AGREE	2	15	40.5	41.7	47.2
NEUTRAL	3	6	16.2	16.7	63.9
DISAGREE	4	11	29.7	30.6	94.4
STRONGLY DISAGREE	5	2	5.4	5.6	100.0
.	.	1	2.7	MISSING	
		-----	-----	-----	
TOTAL		37	100.0	100.0	

Table 6.32b : LOW BROKERAGE AND INCIDENTAL CHARGES (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	4	17.4	19.0	19.0
AGREE	2	9	39.1	42.9	61.9
NEUTRAL	3	4	17.4	19.0	81.0
DISAGREE	4	3	13.0	14.3	95.2
STRONGLY DISAGREE	5	1	4.3	4.8	100.0
.	.	2	8.7	MISSING	
TOTAL		23	100.0	100.0	

Table 5.32c : LOW BROKERAGE AND INCIDENTAL CHARGES (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	14.3	14.3	14.3
AGREE	2	1	14.3	14.3	28.6
NEUTRAL	3	3	42.9	42.9	71.4
DISAGREE	4	1	14.3	14.3	85.7
STRONGLY DISAGREE	5	1	14.3	14.3	100.0
TOTAL		7	100.0	100.0	

Table 5.33a : COST PAID BY INVESTORS (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	1	2.7	2.8	2.8
AGREE	2	10	27.0	27.8	30.6
NEUTRAL	3	7	18.9	19.4	50.0
DISAGREE	4	16	43.2	44.4	94.4
STRONGLY DISAGREE	5	2	5.4	5.6	100.0
.	.	1	2.7	MISSING	
TOTAL		37	100.0	100.0	

Table 5.33b : COST PAID BY INVESTORS (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
STRONGLY AGREE	1	2	8.7	9.5	9.5

AGREE	2	6	26.1	28.6	38.1
NEUTRAL	3	6	26.1	28.6	66.7
DISAGREE	4	6	26.1	28.6	95.2
STRONGLY DISAGREE	5	1	4.3	4.8	100.0
.	.	2	8.7	MISSING	
TOTAL		23	100.0	100.0	

Table 5.33c : COST PAID BY INVESTORS (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
AGREE	2	1	14.3	14.3	14.3
NEUTRAL	3	3	42.9	42.9	57.1
DISAGREE	4	1	14.3	14.3	71.4
STRONGLY DISAGREE	5	2	28.6	28.6	100.0
TOTAL		7	100.0	100.0	

Table 5.34a : ENSURE FAIR AND ORDERLY MKT (PI)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
LAW	1	18	48.6	50.0	50.0
INFORMAL GUIDELINES	2	3	8.1	8.3	58.3
RULES	3	14	37.8	38.9	97.2
PRACTICE RULES	5	1	2.7	2.8	100.0
.	.	1	2.7	MISSING	
TOTAL		37	100.0	100.0	

Table 5.34b : ENSURE FAIR AND ORDERLY MKT (SB)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
LAW	1	5	21.7	25.0	25.0
INFORMAL GUIDELINES	2	4	17.4	20.0	45.0
RULES	3	9	39.1	45.0	90.0
INFORMAL CODES	4	1	4.3	5.0	95.0
OTHERS	6	1	4.3	5.0	100.0
.	.	3	13.0	MISSING	
TOTAL		23	100.0	100.0	

Table 5.34c : ENSURE FAIR AND ORDERLY MKT (PRO)

Value Label	Value	Frequency	Percent	Valid Percent	Cum Percent
-------------	-------	-----------	---------	---------------	-------------

LAW	1	4	57.1	66.7	66.7
RULES	3	1	14.3	16.7	83.3
INFORMAL CODES	4	1	14.3	16.7	100.0
.		1	14.3	MISSING	
	-----		-----	-----	
TOTAL		7	100.0	100.0	

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RATS Version 3.11. 08/01/90

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open data ko3.dat

allocate 0 22

data(org=obs,length = 255) 1 22 q1 q2 q3 q4 q5 q6 q7 q8 q9 q10 \$

q11 q12 q13 q14 q15 q16 q17 q18 q19 q20 q21 q22 q23 q24 q25 \$

q26 q27 q28 q29 q30 q31 q32 q33 q34 q35

set dvar 1 21 = q8(T)>=4

print 1 22 dvar q7 q9 q10

ERROR DATA 22 SERIES DVAR (36)

**WARNING 7 Using Possibly Undefined Entry of Series. Ignore if set

ENTRY	DVAR	36	Q7	7	Q9	9	Q10
1	1.000000		4.000000		2.000000		2.000000
2	.000000		1.000000		1.000000		2.000000
3	.000000		2.000000		2.000000		3.000000
4	1.000000		1.000000		5.000000		2.000000
5	.000000		2.000000		2.000000		2.000000
6	.000000		1.000000		1.000000		5.000000
7	.000000		2.000000		2.000000		4.000000
8	.000000		2.000000		3.000000		2.000000
9	.000000		2.000000		1.000000		1.000000
10	.000000		2.000000		2.000000		2.000000
11	.000000		4.000000		5.000000		5.000000
12	.000000		3.000000		3.000000		4.000000
13	1.000000		4.000000		2.000000		2.000000
14	.000000		1.000000		2.000000		4.000000
15	.000000		3.000000		2.000000		2.000000
16	1.000000		4.000000		2.000000		3.000000
17	.000000		3.000000		4.000000		2.000000
18	1.000000		4.000000		2.000000		2.000000
19	.000000		3.000000		2.000000		2.000000
20	.000000		1.000000		1.000000		3.000000
21	.000000		2.000000		2.000000		2.000000
22	NA		3.000000		1.95230		2.1428

*

lgt dvar 1 21

constant q7 q9 q10

CONVERGENCE REACHED ON ITERATION 7

DEPENDENT VARIABLE	36	DVAR	
OBSERVATIONS	21	CASES CORRECT	18
LOG LIKELIHOOD	-6.7342522	AVG. LIKELIHOOD	.72565639
NO. LABEL	VAR LAG	COEFFICIENT	STAND. ERROR
			T-STATISTI

```

***          *****          ***          ***          *****          *****          *****
1      CONSTANT      0      0      -5.181759      3.227067      -1.605718
2      Q7            7      0      1.984527      .9793879      2.026293
3      Q9            9      0      1.121543      .8666253      1.294150
4      Q10           10      0      -1.904027      1.192503      -1.596665

```

```

smpl 22 22
prj predict 22 22
set predict = exp(predict(t))/(1+exp(predict(t)))
print / predict

```

```

ENTRY          PREDICT 37
22             .246282

```

```

*
prb dvar 1 21
# constant q7 q9 q10

```

CONVERGENCE REACHED ON ITERATION 7

DEPENDENT VARIABLE		36	DVAR			
OBSERVATIONS		21	CASES CORRECT		18	
LOG LIKELIHOOD		-6.6700855	AVG. LIKELIHOOD		.72787706	
NO.	LABEL	VAR	LAG	COEFFICIENT	STAND. ERROR	T-STATISTI
***	*****	***	***	*****	*****	*****
1	CONSTANT	0	0	-3.085155	1.868588	-1.651062
2	Q7	7	0	1.178247	.5517158	2.135605
3	Q9	9	0	.6717767	.4457748	1.506987
4	Q10	10	0	-1.139177	.6667401	-1.708578

```

smpl 22 22
prj(cdf=predict)
print / predict

```

```

ENTRY          PREDICT 37
22             .246282

```

```

set dvar 1 21 = q11(T)>=4
print 1 22 dvar q12 q15 q16
ERROR DATA 22' SERIES DVAR ( 36)
**WARNING 7 Using Possibly Undefined Entry of Series. Ignore if set

```

ENTRY	DVAR	36	Q12	12	Q15	15	Q16
1	.000000		2.00000		3.00000		3.0000
2	.000000		2.00000		2.00000		2.0000
3	.000000		3.00000		2.00000		3.0000
4	1.00000		5.00000		5.00000		3.0000
5	.000000		3.00000		2.00000		2.0000
6	.000000		5.00000		2.00000		1.0000
7	.000000		1.00000		5.00000		3.0000
8	.000000		3.00000		1.00000		4.0000
9	1.00000		2.00000		1.00000		1.0000
10	.000000		4.00000		4.00000		3.0000
11	1.00000		2.00000		3.00000		3.0000
12	.000000		4.00000		4.00000		3.0000
13	1.00000		1.00000		3.00000		4.0000
14	.000000		4.00000		2.00000		2.0000
15	1.00000		3.00000		3.00000		1.0000
16	1.00000		2.00000		3.00000		4.0000
17	.000000		4.00000		2.00000		3.0000
18	.000000		2.00000		2.00000		2.0000
19	.000000		2.00000		2.00000		2.0000
20	1.00000		2.00000		4.00000		2.0000
21	.000000		3.00000		4.00000		3.0000
22	NA		2.23800		2.71420		2.5714

```

*
lgt dvar 1 21
# constant q12 q15 q16

```

```

CONVERGENCE REACHED ON ITERATION      5

```

DEPENDENT VARIABLE		36	DVAR				
OBSERVATIONS		21	CASES CORRECT		14		
LOG LIKELIHOOD		-12.081135	AVG. LIKELIHOOD		.56254050		
NO.	LABEL	VAR	LAG	COEFFICIENT	STAND. ERROR	T-STATISTI	
***	*****	***	***	*****	*****	*****	
1	CONSTANT	0	0	.1371773	2.120261	.6469831E-01	
2	Q12	12	0	-.5579688	.4703685	-1.186238	
3	Q15	15	0	.5462734	.5071797	1.077081	
4	Q16	16	0	-.3450373	.6180775	-.5582427	

```

smp1 22 22
prj predict 22 22
set predict = exp(predict(t))/(1+exp(predict(t)))
print / predict

```

```

ENTRY      PREDICT 37
22          .373767

```

```
*
prb dvar 1 21
# constant q12 q15 q16
```

CONVERGENCE REACHED ON ITERATION 5

232

DEPENDENT VARIABLE		36	DVAR				
OBSERVATIONS		21	CASES CORRECT		14		
LOG LIKELIHOOD		-12.037268		AVG. LIKELIHOOD		.56371682	
NO.	LABEL	VAR	LAG	COEFFICIENT	STAND. ERROR	T-STATISTI	
***	*****	***	***	*****	*****	*****	
1	CONSTANT	0	0	.5694921E-01	1.238637	.4597733E-01	
2	Q12	12	0	-.3365026	.2662535	-1.263843	
3	Q15	15	0	.3322897	.2840749	1.169725	
4	Q16	16	0	-.2111065	.3639192	-.5800916	

```
smp1 22 22
prj(cdf=predict)
print / predict
```

```
ENTRY          PREDICT 37
22             .373767
```

```
set dvar 1 21 = q24(T)>=4
print 1 22 dvar q27 q29
ERROR DATA      22 SERIES      DVAR      (      36)
**WARNING 7 Using Possibly Undefined Entry of Series. Ignore if set
```

ENTRY	DVAR	36	Q27	27	Q29	29
1	.000000		4.00000		5.00000	
2	.000000		2.00000		2.00000	
3	.000000		3.00000		2.00000	
4	1.00000		5.00000		4.00000	
5	1.00000		3.00000		1.00000	
6	.000000		2.00000		3.00000	
7	1.00000		3.00000		3.00000	
8	1.00000		5.00000		5.00000	
9	1.00000		4.00000		5.00000	
10	1.00000		3.00000		3.00000	
11	.000000		2.00000		5.00000	
12	.000000		3.00000		3.00000	
13	1.00000		5.00000		5.00000	
14	1.00000		4.00000		4.00000	
15	1.00000		3.00000		3.00000	
16	.000000		4.00000		4.00000	

17	1.00000	2.00000	2.00000
18	.000000	2.00000	5.00000
19	.000000	2.00000	2.00000
20	1.00000	5.00000	5.00000
21	1.00000	3.00000	3.00000
22	NA	3.42850	3.57140

*
 lgt dvar 1 21
 # constant q27 q29

CONVERGENCE REACHED ON ITERATION 6

DEPENDENT VARIABLE		36	DVAR			
OBSERVATIONS		21	CASES CORRECT		16	
LOG LIKELIHOOD		-10.334857		AVG. LIKELIHOOD		.61131920
NO.	LABEL	VAR	LAG	COEFFICIENT	STAND. ERROR	T-STATISTI
***	*****	***	***	*****	*****	*****
1	CONSTANT	0	0	-2.898953	2.007880	-1.443788
2	Q27	27	0	1.959073	.9987888	1.961449
3	Q29	29	0	-.9153415	.7717743	-1.186022

smpl 22 22
 prj predict 22 22
 set predict = exp(predict(t))/(1+exp(predict(t)))
 print / predict

ENTRY	PREDICT	37
22	.633829	

*
 prb dvar 1 21
 # constant q27 q29

CONVERGENCE REACHED ON ITERATION 6

DEPENDENT VARIABLE		36	DVAR			
OBSERVATIONS		21	CASES CORRECT		16	
LOG LIKELIHOOD		-10.243120		AVG. LIKELIHOOD		.61399552
NO.	LABEL	VAR	LAG	COEFFICIENT	STAND. ERROR	T-STATISTI
***	*****	***	***	*****	*****	*****
1	CONSTANT	0	0	-1.805020	1.187480	-1.520042
2	Q27	27	0	1.192732	.5661915	2.106587
3	Q29	29	0	-.5476381	.4376282	-1.251378

```
smpl 22 22  
prj(cdf=predict)  
print / predict
```

```
ENTRY          PREDICT 37  
22             .633829
```

```
end
```

```
NORMAL COMPLETION OF JOB  
HALT AT 0  
0 ERRORS
```

3 WARNINGS

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Portions (c) 1988-90 by Doan Associates

open data kol.dat

allocate 0 37

data(org=obs,length=255) 1 37 q1 q2 q3 q4 q5 q6 q7 q8 q9 q10 \$

q11 q12 q13 q14 q15 q16 q17 q18 q19 q20 q21 q22 q23 q24 q25 \$

q26 q27 q28 q29 q30 q31 q32 q33 q34 q35

set dvar 1 36 = q8(T)>=4

print 1 37 dvar q7 q9 q10

ERROR DATA 37 SERIES DVAR (36)

**WARNING 7 Using Possibly Undefined Entry of Series. Ignore if set

ENTRY	DVAR	36	Q7	7	Q9	9	Q10
1	1.000000		2.000000		2.000000		2.0000
2	.000000		5.000000		2.000000		2.0000
3	1.000000		4.000000		2.000000		4.0000
4	.000000		2.000000		1.000000		2.0000
5	.000000		4.000000		2.000000		2.0000
6	.000000		3.000000		2.000000		2.0000
7	.000000		3.000000		2.000000		2.0000
8	1.000000		4.000000		1.000000		1.0000
9	.000000		4.000000		1.000000		2.0000
10	1.000000		4.000000		1.000000		1.0000
11	.000000		3.000000		3.000000		2.0000
12	.000000		3.000000		2.000000		1.0000
13	1.000000		1.000000		3.000000		4.0000
14	.000000		3.000000		3.000000		2.0000
15	1.000000		2.000000		2.000000		2.0000
16	.000000		2.000000		2.000000		1.0000
17	.000000		1.000000		1.000000		4.0000
18	.000000		4.000000		1.000000		2.0000
19	1.000000		2.000000		2.000000		2.0000
20	.000000		4.000000		4.000000		3.0000
21	.000000		3.000000		2.000000		2.0000
22	.000000		2.000000		2.000000		1.0000
23	.000000		5.000000		2.000000		3.0000
24	.000000		2.000000		1.000000		3.0000
25	1.000000		4.000000		2.000000		2.0000
26	1.000000		3.000000		2.000000		2.0000
27	1.000000		3.000000		1.000000		2.0000
28	.000000		5.000000		4.000000		2.0000
29	.000000		3.000000		1.000000		2.0000
30	.000000		2.000000		2.000000		3.0000
31	.000000		2.000000		1.000000		2.0000
32	1.000000		3.000000		2.000000		2.0000
33	.000000		2.000000		4.000000		2.0000
34	.000000		1.000000		2.000000		2.0000
35	.000000		1.000000		2.000000		2.0000
36	1.000000		4.000000		2.000000		3.0000
37	NA		2.91660		1.97220		2.1666

*
lgt dvar 1 36
constant q7 q9 q10

236

CONVERGENCE REACHED ON ITERATION 4

DEPENDENT VARIABLE		36	DVAR			
OBSERVATIONS		36	CASES CORRECT		24	
LOG LIKELIHOOD		-22.394671		AVG. LIKELIHOOD		.53682979
NO.	LABEL	VAR	LAG	COEFFICIENT	STAND. ERROR	T-STATISTI
***	*****	***	***	*****	*****	*****
1	CONSTANT	0	0	-1.034022	1.638391	-.6311206
2	Q7	7	0	.1437543	.3187033	.4510601
3	Q9	9	0	-.3722597	.4592762	-.8105356
4	Q10	10	0	.2921455	.4716324	.6194348

```
smpl 37 37
prj predict 37 37
set predict = exp(predict(t))/(1+exp(predict(t)))
print / predict
```

ENTRY PREDICT 37
 37 .328284

*
prb dvar 1 36
constant q7 q9 q10

CONVERGENCE REACHED ON ITERATION 4

DEPENDENT VARIABLE		36	DVAR			
OBSERVATIONS		36	CASES CORRECT		24	
LOG LIKELIHOOD		-22.365458		AVG. LIKELIHOOD		.53726559
NO.	LABEL	VAR	LAG	COEFFICIENT	STAND. ERROR	T-STATISTI
***	*****	***	***	*****	*****	*****
1	CONSTANT	0	0	-.6307433	1.016149	-.6207191
2	Q7	7	0	.8671535E-01	.1962759	.4418033
3	Q9	9	0	-.2428917	.2869000	-.8466076
4	Q10	10	0	.1896657	.2889298	.6564422

```
smpl 37 37
prj(cdf=predict)
```

print / predict

ENTRY PREDICT 37
 37 .328284

237

set dvar 1 36 = q11(T)>=4

print 1 37 dvar q12 q15 q16

ERROR DATA 37 SERIES DVAR (36)

**WARNING 7 Using Possibly Undefined Entry of Series. Ignore if set

ENTRY	DVAR	36	Q12	12	Q15	15	Q16
1	.000000		2.00000		4.00000		4.0000
2	.000000		2.00000		5.00000		2.0000
3	1.00000		2.00000		2.00000		2.0000
4	.000000		2.00000		3.00000		1.0000
5	.000000		2.00000		2.00000		3.0000
6	.000000		2.00000		1.00000		1.0000
7	1.00000		3.00000		2.00000		2.0000
8	1.00000		2.00000		2.00000		2.0000
9	1.00000		2.00000		3.00000		4.0000
10	1.00000		2.00000		4.00000		2.0000
11	.000000		3.00000		4.00000		4.0000
12	.000000		1.00000		2.00000		4.0000
13	1.00000		2.00000		2.00000		2.0000
14	.000000		2.00000		2.00000		2.0000
15	1.00000		2.00000		5.00000		5.0000
16	.000000		3.00000		2.00000		2.0000
17	.000000		2.00000		3.00000		3.0000
18	.000000		2.00000		2.00000		3.0000
19	.000000		2.00000		2.00000		2.0000
20	1.00000		4.00000		2.00000		4.0000
21	.000000		3.00000		3.00000		2.0000
22	.000000		2.00000		1.00000		3.0000
23	1.00000		1.00000		2.00000		4.0000
24	.000000		4.00000		3.00000		2.0000
25	1.00000		2.00000		2.00000		4.0000
26	.000000		2.00000		2.00000		4.0000
27	1.00000		2.00000		3.00000		2.0000
28	1.00000		5.00000		3.00000		2.0000
29	.000000		3.00000		1.00000		2.0000
30	.000000		1.00000		2.00000		2.0000
31	.000000		3.00000		2.00000		3.0000
32	1.00000		2.00000		3.00000		2.0000
33	.000000		3.00000		4.00000		1.0000
34	.000000		2.00000		2.00000		3.0000
35	.000000		2.00000		2.00000		3.0000
36	1.00000		2.00000		2.00000		4.0000
37	NA		2.30550		2.52770		2.6944

```
*
lgt dvar 1 36
# constant q12 q15 q16
```

CONVERGENCE REACHED ON ITERATION 4

278

DEPENDENT VARIABLE		36	DVAR			
OBSERVATIONS		36	CASES CORRECT		23	
LOG LIKELIHOOD		-23.241770		AVG. LIKELIHOOD		.52434536
NO.	LABEL	VAR	LAG	COEFFICIENT	STAND. ERROR	T-STATISTI
***	*****	***	***	*****	*****	*****
1	CONSTANT	0	0	-2.353019	1.730248	-1.359932
2	Q12	12	0	.2076240	.4361860	.4759989
3	Q15	15	0	.1371903	.3613131	.3796992
4	Q16	16	0	.3924534	.3559603	1.102520

```
smpl 37 37
prj predict 37 37
set predict = exp(predict(t))/(1+exp(predict(t)))
print / predict
```

```
ENTRY          PREDICT 37
37             .384583
```

```
*
prb dvar 1 36
# constant q12 q15 q16
```

CONVERGENCE REACHED ON ITERATION 4

DEPENDENT VARIABLE		36	DVAR			
OBSERVATIONS		36	CASES CORRECT		23	
LOG LIKELIHOOD		-23.238342		AVG. LIKELIHOOD		.52439529
NO.	LABEL	VAR	LAG	COEFFICIENT	STAND. ERROR	T-STATISTI
***	*****	***	***	*****	*****	*****
1	CONSTANT	0	0	-1.462399	1.061940	-1.377101
2	Q12	12	0	.1264333	.2719961	.4648349
3	Q15	15	0	.8860896E-01	.2264973	.3912143
4	Q16	16	0	.2436751	.2205096	1.105054

```
smpl 37 37
prj(cdf=predict)
print / predict
```

ENTRY PREDICT 37
 37 .384583

239

set dvar 1 36 = q24(T)>=4

print 1 37 dvar q27 q29

ERROR DATA 37 SERIES DVAR (36)

**WARNING 7 Using Possibly Undefined Entry of Series. Ignore if set

ENTRY	DVAR	36	Q27	27	Q29	29
1	1.00000		4.00000		4.00000	
2	1.00000		5.00000		5.00000	
3	1.00000		3.00000		4.00000	
4	.000000		2.00000		4.00000	
5	1.00000		4.00000		4.00000	
6	.000000		1.00000		2.00000	
7	.000000		2.00000		2.00000	
8	1.00000		4.00000		3.00000	
9	1.00000		3.00000		4.00000	
10	.000000		3.00000		3.00000	
11	.000000		3.00000		4.00000	
12	1.00000		4.00000		5.00000	
13	1.00000		5.00000		5.00000	
14	1.00000		4.00000		3.00000	
15	1.00000		4.00000		4.00000	
16	.000000		3.00000		3.00000	
17	.000000		3.00000		3.00000	
18	1.00000		4.00000		4.00000	
19	1.00000		4.00000		2.00000	
20	.000000		4.00000		4.00000	
21	1.00000		3.00000		3.00000	
22	1.00000		4.00000		1.00000	
23	1.00000		4.00000		5.00000	
24	1.00000		4.00000		4.00000	
25	1.00000		4.00000		4.00000	
26	1.00000		2.00000		5.00000	
27	.000000		2.00000		3.00000	
28	.000000		3.00000		3.00000	
29	.000000		3.00000		4.00000	
30	.000000		3.00000		1.00000	
31	1.00000		3.00000		4.00000	
32	.000000		2.00000		2.00000	
33	.000000		3.00000		2.00000	
34	.000000		3.00000		3.00000	
35	.000000		3.00000		3.00000	
36	1.00000		5.00000		5.00000	
37	NA		3.33330		3.44440	

*
 lgt dvar 1 36

constant q27 q29

CONVERGENCE REACHED ON ITERATION 7

242

DEPENDENT VARIABLE		36	DVAR			
OBSERVATIONS		36	CASES CORRECT		30	
LOG LIKELIHOOD		-13.497900		AVG. LIKELIHOOD		.68732938
NO.	LABEL	VAR	LAG	COEFFICIENT	STAND. ERROR	T-STATISTI
***	*****	***	***	*****	*****	*****
1	CONSTANT	0	0	-11.43250	4.060289	-2.815688
2	Q27	27	0	2.541667	.9399845	2.703946
3	Q29	29	0	1.015328	.5510966	1.842377

smpl 37 37
prj predict 37 37
set predict = exp(predict(t))/(1+exp(predict(t)))
print / predict

ENTRY PREDICT 37
37 .631074

*
prb dvar 1 36
constant q27 q29

CONVERGENCE REACHED ON ITERATION 6

DEPENDENT VARIABLE		36	DVAR			
OBSERVATIONS		36	CASES CORRECT		30	
LOG LIKELIHOOD		-13.539090		AVG. LIKELIHOOD		.68654341
NO.	LABEL	VAR	LAG	COEFFICIENT	STAND. ERROR	T-STATISTI
***	*****	***	***	*****	*****	*****
1	CONSTANT	0	0	-6.440337	2.050409	-3.141001
2	Q27	27	0	1.418655	.4684072	3.028679
3	Q29	29	0	.5748208	.2977749	1.930387

smpl 37 37
prj(cdf=predict)
print / predict

ENTRY PREDICT 37
37 .631074

end

241

NORMAL COMPLETION OF JOB
HALT AT 0
0 ERRORS

3 WARNINGS

202

ATTACHMENT E

RESULTS OF CHI-SQUARE ANALYSIS FOR PRIVATE INVESTORS

QUESTION

CHI-SQ

DEGREE OF
FREEDOM

SIGNIF

NULL
HYPO

SECTION 1

Q1. invest in sec mkt	27.556	3	.000	reject
Q2. how long in HK mkt	5.167	2	.076	reject
Q3. for whom invest in mkt	9.000	1	.003	reject
Q4. frequency in HK mkt	7.778	3	.051	reject
Q5. amt HK sec control	25.556	3	.000	reject
Q6. reason invest in HK	46.943	3	.000	reject

SECTION 2

Q7. law protection	6.5	4	.165	accept
Q8. authority enforce law	26.222	4	.000	reject
Q9. SRB to protect	21.556	3	.000	reject
Q10. rules back by law	31.117	3	.000	reject

SECTION 3

Q11. exchange protection	7.556	3	.056	reject
Q12. closer Ex. monitor	46.222	4	.000	reject
Q13. broker insurance	21.556	3	.000	reject
Q14. new listing	8.222	3	.042	reject
Q15. new share offer price	27.714	4	.000	reject
Q16. check new listings	19.000	4	.001	reject
Q17. close of exchange	21.222	4	.000	reject

SECTION 4

Q18. broker supply info	14.529	4	.006	reject
Q19. training of broker etc	5.714	4	.222	accept
Q20. broker finance	15.143	4	.004	reject
Q21. dishonest practices	.714	1	.398	accept
Q22. curb dishonest pract.	37.114	3	.000	reject

LISTED COMPANIES

Q23. company disclosures	12.857	4	.012	reject
Q24. prompt disclosures	20.286	4	.000	reject
Q25. more disclosures	5.886	2	.053	reject
Q26. 5% disclosure	15.171	3	.002	reject
Q27. director's duty	18.286	4	.001	reject
Q28. approve tran.	16.086	3	.001	reject
Q29. takeovers	10.000	4	.040	reject

SECURITIES DEALINGS

Q30. margin trading	12.857	4	.012	reject
Q31. short selling	11.500	4	.021	reject
Q32. brokerage fees etc	18.167	4	.001	reject
Q33. cost paid by invts.	20.944	4	.000	reject
Q34. ensure fair mkt	22.889	3	.000	reject

ATTACHMENT F

RESULTS OF CHI-SQUARE ANALYSIS FOR STOCK BROKERS

QUESTION	CHI-SQ	DEGREE OF FREEDOM	SIGNIF	NULL HYPOTH
----------	--------	-------------------	--------	-------------

SECTION 1

Q1. invest in sec mkt	15.783	3	.001	reject
Q2. how long in HK mkt	14.000	2	.001	reject
Q3. for whom invest in mkt	5.429	2	.066	reject
Q4. frequency in HK mkt	5.857	3	.119	accept
Q5. amt HK sec control	2.810	3	.422	accept
Q6. reason invest in HK	11.105	3	.011	reject

SECTION 2

Q7. law protection	.905	3	.824	accept
Q8. authority enforce law	4.476	4	.345	accept
Q9. SRB to protect	19.238	4	.001	reject
Q10. rules back by law	20.500	4	.000	reject

SECTION 3

Q11. exchange protection	11.143	4	.025	reject
Q12. closer Ex. monitor	5.905	4	.206	accept
Q13. broker insurance	3.524	4	.474	accept
Q14. new listing	.667	4	.955	accept
Q15. new share offer price	5.905	4	.206	accept
Q16. check new listings	4.714	3	.194	accept
Q17. close of exchange	.905	3	.824	accept

SECTION 4

Q18. broker supply info	11.143	4	.025	reject
Q19. training of broker etc	6.238	3	.101	accept
Q20. broker finance	16.143	3	.001	reject
Q21. dishonest practices	.429	1	.513	accept
Q22. curb dishonest pract.	19.200	3	.000	reject

LISTED COMPANIES

Q23. company disclosures	2.810	3	.422	accept
Q24. prompt disclosures	8.286	4	.082	reject
Q25. more disclosures	4.571	2	.102	accept
Q26. 5% disclosure	.524	3	.914	accept
Q27. director's duty	1.286	3	.733	accept
Q28. approve tran.	7.810	4	.099	reject
Q29. takeovers	5.429	4	.246	accept

SECURITIES DEALINGS

Q30. margin trading	19.238	4	.001	reject
Q31. short selling	10.667	4	.031	reject
Q32. brokerage fees etc	8.286	4	.082	reject
Q33. cost paid by invts.	5.905	4	.206	accept
Q34. ensure fair mkt	11.000	4	.027	reject

ATTACHMENT G

RESULTS OF CHI-SQUARE ANALYSIS FOR FUND MANAGERS

QUESTION	CHI-SQ	DEGREE OF FREEDOM	SIGNIF	NULL HYPOTH
----------	--------	-------------------	--------	-------------

SECTION 1

Q1. invest in sec mkt	n/a	n/a	n/a	-
Q2. how long in HK mkt	2.000	2	.368	accept
Q3. for whom invest in mkt	.667	1	.414	accept
Q4. frequency in HK mkt	.200	1	.655	accept
Q5. amt HK sec control	4.571	2	.102	accept
Q6. reason invest in HK	.000	1	1.000	accept

SECTION 2

Q7. law protection	3.857	3	.277	accept
Q8. authority enforce law	.429	3	.934	accept
Q9. SRB to protect	1.286	1	.257	accept
Q10. rules back by law	.429	3	.934	accept

SECTION 3

Q11. exchange protection	.286	2	.867	accept
Q12. closer Ex. monitor	3.857	3	.277	accept
Q13. broker insurance	1.286	1	.857	accept
Q14. new listing	1.143	2	.565	accept
Q15. new share offer price	1.571	3	.666	accept
Q16. check new listings	.143	1	.705	accept
Q17. close of exchange	.143	1	.705	accept

SECTION 4

Q18. broker supply info	.286	2	.867	accept
Q19. training of broker etc	2.000	2	.368	accept
Q20. broker finance	.143	1	.705	accept
Q21. dishonest practices	2.667	1	.102	accept
Q22. curb dishonest pract.	3.571	1	.059	reject

LISTED COMPANIES

Q23. company disclosures	1.286	1	.257	accept
Q24. prompt disclosures	1.286	1	.257	accept
Q25. more disclosures	2.000	2	.368	accept
Q26. 5% disclosure	1.571	3	.666	accept
Q27. director's duty	1.143	2	.565	accept
Q28. approve tran.	2.000	2	.368	accept
Q29. takeovers	2.000	2	.368	accept

SECURITIES DEALINGS

Q30. margin trading	4.571	2	.102	accept
Q31. short selling	1.143	2	.565	accept
Q32. brokerage fees etc	2.286	4	.683	accept
Q33. cost paid by invts.	1.571	3	.666	accept
Q34. ensure fair mkt	3.000	2	.223	accept



Hong Kong
Polytechnic

The Manager
Securities Department

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Hong Kong
Telephone 766 5111
Cable Polytechd
Telex 38964 Polyx Hx
Fax (852) 764 3374

date 9 December 1989

our ref.

your ref.

Director
Professor John L. Clark, JP

Dear Sir/Madam,

The Department of Business Studies of Hong Kong Polytechnic is now conducting a survey on the improvement of the securities industry and the protection of securities investors of Hong Kong. Questionnaires about these topics are being sent to leading members of society to find out their views on these issues. Findings from this survey will be sent to interested parties, including the various professional associations and government or quasi governmental agencies, for their consideration. It is a meaningful exercise and it will not be fruitful unless members of the public assist us.

A questionnaire is enclosed. We hope you will spare a few minutes of your time to answer the questions. It is an anonymous survey so there is no need to disclose your identity. However, if you wish to receive a summary of the findings of this survey, please return this questionnaire with your calling card. Should you have any query please do not hesitate to call me. My telephone number is K-638344 extension 626.

Thank you for your help in advance.

With Seasonal Greetings,

Yours sincerely,

S. H. Ko
Senior Lecturer
Department of Business Studies

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