

Speech

Speech by PSFS at Hong Kong Investment Funds Association 3rd Annual Conference (English only)

Following is the speech by the Permanent Secretary for Financial Services and the Treasury (Financial Services), Miss Au King-chi, at the Hong Kong Investment Funds Association 3rd Annual Conference today (September 29):

Positioning Hong Kong as an International Financial Centre

Desmond (Chairman), distinguished guests, ladies and gentlemen,

Good morning and welcome. It's a great pleasure to see you all here today.

I would particularly like to thank the Hong Kong Investment Funds Association for inviting me to this event. It gives me an opportunity to share with you some of our thoughts on positioning Hong Kong as an international financial centre, particularly with regard to Mainland China.

Hong Kong's Fundamentals

To start with, let me briefly survey our position in global terms, and the impact of the international financial crisis on our market.

Hong Kong has remained as a major asset management centre in Asia and an international financial centre. Our combined fund management business amounted to HK\$5.8 trillion (US\$750 billion) in 2008, over 60 per cent of which was sourced overseas. We have maintained our position as the Asia's third largest

international banking centre, and the world's 15th largest. Our stock market ranked 7th in the world and 3rd in Asia in terms of market capitalisation, amounting to about HK\$ 15 trillion (about US\$2 trillion).

The competitiveness of Hong Kong as an international financial centre has been recognised worldwide. In the Global Competitiveness Report published by the World Economic Forum earlier this month, Hong Kong continued to rank 1st out of 133 economies in the financial market pillar.

A survey by the City of London Corporation Global Financial Centres Index released last week ranks Hong Kong as the third global financial centre in the world, after London and New York.

What is it about Hong Kong that attracts investors and financial institutions to this city? The answer lies in our fundamental strengths. These include our simple and low taxes; high-quality services; free flow of capital with no foreign exchange controls, and a stable, fully convertible currency; as well as a free economy buttressed by the rule of law and an independent judiciary. Our regulatory regime is on par with international standards; and our regulators are tasked to ensure a fair, transparent and orderly market.

Impact of the Global Financial Crisis

A year ago however, despite our resilience and sound fundamentals, some people thought the roof might cave in. Today, following concerted international effort, the global financial crisis has receded and there are signs that an economic recovery is beginning to get underway, though most analysts would agree that we are not completely out of the woods yet.

We expect negative growth for our economy this year of between minus 3.5 and minus 4.5 per cent.

However, compared to many economies, Hong Kong has weathered the storm relatively well. The Government acted swiftly, reassuring the industry and the public that the necessary measures would be taken to mitigate the crisis.

Our financial system has remained relatively stable. The stock market stays robust. Our clearing and settlement system remains smooth and efficient. Key performance indicators suggest that our banking sector remains healthy and well capitalised.

Positioning Hong Kong vis-à-vis Developments in Mainland China

There is however no room for complacency. Together with the industry, we must capitalise on our strengths, seize all the development opportunities and prepare ourselves for the challenges ahead.

The IMF forecasts that China's GDP will continue growing between 7.5 and 10.7 per cent annually in the next five years. Our country is currently the third largest economy in the world and the largest trading partner in the region, and is likely to continue rising in the ranks.

With China's GDP rising to over RMB30 trillion last year and its ongoing economic liberalisation efforts, together with a large and increasingly affluent population and a high savings rate, there are undoubtedly vast opportunities for Hong Kong.

Stable and harmonious cross-Strait relations would also be conducive to the economic activities on both sides of the Strait. We are well-positioned for enterprises in the Mainland and Taiwan to make full use of our financial services.

Against such developments, we can sharpen our edge and position ourselves as first, the capital formation hub; second, the offshore RMB centre; and third, the wealth management centre, to serve the Greater China Area and China's Global Market. These would in turn reinforce Hong Kong's position as the Mainland's premier international financial centre.

I would like to focus on these three areas, and float some questions on what more we can do to attract new users, liquidity and products to our market. In considering any financial liberalisation initiatives concerning the Mainland, we have to bear in mind two overarching principles: first, any liberalisation initiatives should complement the overall development of our country and be mutually beneficial to both the Mainland and Hong Kong; and second, they should not compromise the "financial security" of our country.

Capital Formation Hub

First, Hong Kong as an international capital formation hub for China.

Domestic consumption in the Mainland is growing, as witnessed by the establishment of more overseas and Mainland companies. To fund their growth, Mainland companies increasingly turn to the capital markets. Hong Kong plays an instrumental role here.

Today, Hong Kong is the largest source of overseas direct investment in the Mainland. At end 2008, about 45 per cent of overseas-funded projects registered in the Mainland were tied to Hong Kong interests.

Since 1993 when the first H-share was listed, Mainland firms have raised over HK\$2.2 trillion (US\$290 billion) on the Stock Exchange of Hong Kong. Hong Kong is the largest source of international capital for Mainland enterprises. After last year's drop in IPO activities, we have already seen a pick-up in fund-raising in our market, mostly by Mainland enterprises, and expect the pipeline to continue in foreseeable future.

Apart from capital formation, Hong Kong continues to provide a platform for Mainland companies to develop their corporate branding and enhance their international recognition. Our professional services can also help Mainland companies manage the risks involved in opening up to international financial markets.

For Mainland enterprises interested in raising foreign capital or gaining exposure to international standards and practices, we would like to think Hong Kong would be their preferred choice. To strengthen ourselves as the capital hub for continued IPO and post-IPO activities from Mainland enterprises as well as overseas enterprises, especially those with businesses in the Mainland, the Hong Kong Exchanges and Clearing Limited (HKEx) are strengthening their offerings and services.

For instance, HKEx have launched a strategic review of the Listing Rules with the aim of streamlining the listing process. They are also reviewing the Listing Rules applicable to mining and resources companies to facilitate their fund-raising and will consult the market on related proposals.

We have benefited from the Closer Economic Partnership Arrangement - CEPA as it is known for short. For example, Mainland brokerage firms can set up branch offices in Hong Kong, while qualified Mainland and Hong Kong securities companies will soon be able to set up joint venture securities investment advisory companies in Guangdong. To date, HKEx have about 30 Exchange Participants in the cash market and 18 in the derivatives market coming from the Mainland. No doubt we welcome more to our trading platform.

The challenge ahead is how we may enrich our repertoire of products and services while ensuring our market quality, in order to best meet market users' needs. There are a host of possibilities that Government and the industry can jointly explore. For instance, how could we develop more Mainland-related products, including Mainland-related derivatives, in cooperation with the Mainland authorities? What are the pre-requisites for the listing and trading of products denominated in Renminbi (RMB) on our Exchange?

Offshore RMB Centre

Second, Hong Kong as an offshore RMB centre.

The rise and liberalisation of RMB business continues to offer new opportunities and reinforces our position as the Mainland's leading offshore RMB centre. Given our cultural affinities, robust risk management systems, and close economic ties with the Mainland, Hong Kong is best placed to serve as a testing ground for the development of RMB business outside the Mainland. Developing RMB business in Hong Kong helps the Mainland promote the settlement and

circulation of RMB in neighbouring countries and the Region, hence enhancing the international status of RMB.

RMB banking was first introduced here in 2004 and has since expanded to include a comprehensive range of services including deposits, remittances, cheques and currency exchange. At end July this year, the total amount of outstanding deposits was about RMB 56 billion (US\$8 billion).

Yesterday, the city was abuzz as the Central Government issued RMB 6 billion (US\$878.5 million) worth of sovereign bonds in Hong Kong. This is the first time the Central Government has issued such bonds outside the Mainland. It lends further weight to our RMB bond market, which was introduced here in 2007. As of today seven Mainland financial institutions have already issued RMB bonds in Hong Kong.

The announcement in April that Mainland subsidiaries of Hong Kong banks could issue RMB-denominated bonds has provided a great boost to the local banking industry. This measure widens the sources of RMB capital of Hong Kong banks, and enhances their capacity to provide services in the Mainland. It also broadens the scope of RMB bond issuers in Hong Kong, provides investors with more choices, and promotes the further development of the local bond market. So far two Mainland subsidiaries of Hong Kong banks have issued RMB bonds. We look forward to seeing more coming to Hong Kong.

In July the RMB trade settlement service was launched in Hong Kong – the first major step towards promoting RMB as a regional and an international currency. Mainland exports to Hong Kong last year amounted to close to US\$200 billion. Even if a small proportion of this is settled in RMB, it will expand such financial activities locally and enlarge the RMB deposit base in Hong Kong.

Indeed, further progress in RMB capital account liberalisation brings new opportunities. Subject to the two overarching principles that I have outlined earlier, we should bounce ideas outside-the-box on how to attract more liquidity and develop new RMB products and services in Hong Kong, so as to anchor our position as Mainland's offshore RMB centre. For example, what are the prerequisites for us to develop and trade RMB-denominated investment products such as futures, ETFs and other derivatives in Hong Kong? What kind of RMB-related services should we offer in the course of capital account liberalisation? Going forward, how we may encourage Mainland and overseas enterprises to issue RMB bonds here? And how we may embrace more market participants in the process?

We expect RMB to become a major currency in the Region and the world in the future. Hong Kong as the Mainland's offshore RMB centre will bring a win-win situation to both the Mainland and Hong Kong: we would serve as a reliable and effective testing ground for China's continuous liberalisation efforts, while gaining considerable market development opportunities in the process.

Wealth Management Centre

Third, Hong Kong as a wealth management centre for China.

The Mainland's large and increasingly affluent population renders Hong Kong as an ideal – and logical – wealth management centre for Mainland individuals and institutions. Hong Kong is best placed to serve as an effective channel for orderly capital outflows from the Mainland, and Mainland financial institutions can manage their overseas investments through Hong Kong.

With the Mainland authorities gradually allowing more savings to be invested overseas, we have already witnessed fund flows being facilitated by the QDII programme, with over US\$50 billion in approved quotas. Recently we also noted that SAFE was planning for an increase in QFII limits for individual institutions' quota from US\$800 million to US\$1 billion.

With funds, an obvious question is do we have a wide enough range of products for our investors?

I have referred to RMB products just now. I have also floated to you some questions on developing new products. As you all know, we are pressing ahead with a HK\$100 billion Government Bond Programme, to promote the development of the local bond market. The Programme will help our fund managers to match their long-term HK-dollar liabilities. It will also help broaden and deepen our bond market, which will in turn give both fund-raisers and investors another option during any future times of financial stress.

At the same time, Hong Kong has a well-developed exchange traded fund (ETF) market. Our ETF market was the largest in the Asia-Pacific Region last year in terms of turnover value.

We are continuing to add to our ETF offering. This is illustrated by the cross-listing of ETFs in Hong Kong and Taiwan recently. Three Hong Kong ETFs were successfully listed on the Taiwan Stock Exchange in mid-August, and are proved to be very popular among Taiwanese investors. One of these Hong Kong ETFs (W.I.S.E. CSI 300 China Tracker) was the second largest ETF in Taiwan, and in terms of number of units turnover, it was the highest among all Taiwan ETFs. The first Taiwan ETF was also listed on the Stock Exchange of Hong Kong last month. These are encouraging opportunities for the wealth management industry.

We are also working with the Mainland exchanges to facilitate mutual ETF listings, and there is no reason why such cross-listings could not be extended to other exchanges in the region.

To expand our product range as a wealth management centre, we are establishing a platform for Islamic finance. We look forward to sharing with the industry our draft legislation to amend and clarify our taxation arrangement in order to level the playing field for Islamic financial products vis-a-vis other conventional ones.

Though we now offer an extensive range of wealth management tools, this is not enough.

We shall continue to work with the industry to identify ways to create an even more conducive environment for our wealth management business. Further to the abolition of estate duty and exemption of offshore funds from profits tax in 2006, we are now modernising our trust law, which would facilitate more trusts to be created and administered here in Hong Kong. Public consultation has just completed and we are taking forward the market views in refining the proposals.

Maintaining investor confidence and enhancing market quality is paramount to our status as a major wealth management centre. We are working together with our regulators and the Exchange on a continuum of protection measures for investors at their various stages of investment.

Understandably some of you may be concerned about the challenges arising from enhanced regulation. However I believe together we would be able to strike

a reasonable balance between encouraging innovation and protecting investors, for us to weather economic ups and downs in future.

Here I would like to highlight a few regulatory initiatives which would require market inputs.

On preventive measures. We propose increasing the financial literacy of the investing public by setting up an Investor Education Council. This council may seek to work with different public and private sector organisations to establish an integrated approach to investor protection in Hong Kong. In this regard, we aim to launch a public consultation by year end on the proposed scope of work and the institutional set-up of this council.

On regulatory measures. The regulators have formulated a number of measures to strengthen both product and conduct regulation. Some measures have been implemented by the HKMA earlier in the year. The SFC has just launched a consultation on a number of regulatory initiatives last Friday. They cover authorisation of investment products and the regulation of intermediary conduct and selling practices.

Moreover, we are working on improved remedial measures as “things may go wrong”. These may include a financial dispute resolution mechanism, commonly called a Financial Services Ombudsman in other jurisdictions, to help investors settle their disputes through a simple and quick resolution mechanism. These may also include empowering the regulators to compel investor compensation. We aim to consult the public by the end of the year.

Another key initiative to improve market transparency is the codification of certain listing requirements for the disclosure of price sensitive information in the

statute. With experience from past market engagement, we are identifying ways to first, enhance the legal certainty of the disclosure requirements for giving “peace of mind” to our market practitioners; and second, devise proportionate sanctions, be they supervisory, civil or criminal, to promote a continuous disclosure culture among our issuers. Again we aim at consulting the public by year end.

Industry Inputs Essential

The global financial crisis has sparked a worldwide review of regulatory arrangements for the financial markets. Around the globe, economies are trying to strike a balance between financial innovation and effective regulation. Hong Kong is no exception. To maintain our status as an international financial centre, we will take into account our unique market needs, as well as global trends, in improving our financial regulatory regime.

It would be grossly inadequate for Government to work on these initiatives on our own. We must listen to the views of the industry in shaping the proposals to improve the regulation and promote development of our financial markets. I therefore encourage all of you, the market experts, to get involved in these consultation exercises.

Concluding Remarks

Ladies and gentlemen, this year’s experience is particularly important, coming as we all are recovering from the global financial crisis. In better positioning Hong Kong, we need to work together with the industry to continue to attract more

liquidity to our capital platform, widen and deepen our RMB business, and sharpen our edges in wealth management.

The Government is fully committed to efforts in facilitating market development. But the best way to enhance our competitiveness as the premier international financial centre for the Greater China Area and China's Global Market is through you – the talented, innovative and hardworking individuals who make it happen.

I trust with all our endeavours, Hong Kong can come out stronger as an international financial centre.

Finally, I would like to say “thank you” to the Hong Kong Investment Funds Association for your valuable contributions over the years in raising industry standards and promoting Hong Kong as a wealth management centre.

Let me wish you all a fruitful conference.

Thank you.