

## Speech

### Speech by SFST at the 9th Hong Kong Forum (English Only)

Friday, October 31, 2008

Following is the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, at the 9th Hong Kong Forum today (October 31):

Good morning Mr (Barry) Macdonald, Fred (Lam), ladies & gentlemen,

#### Introduction

It gives me great pleasure to speak to you at this annual event. A special welcome goes to our overseas guests who have travelled a long way to be with us today. It is our pride that you all choose to maintain such close ties with Hong Kong.

I am happy to brief you on how the markets in Hong Kong are performing, our strengths and opportunities, our recent challenges and how the Government is reacting to the financial turmoil.

#### Impressive performance of Hong Kong's financial services sector

I am pleased to report that Hong Kong has done well in the financial services arena:

\* As at end August 2008, our stock market was the sixth largest in the world and the second largest in Asia in terms of market capitalisation.

\* Hong Kong is ranked first in both derivatives warrants turnover and Asia's stock options markets, second in the exchange traded fund (ETF), and fifth in total equity raised for our stock market. In 2007, we were voted the Derivatives Exchange of the Year by Asia Risk.

\* Hong Kong has become one of the largest asset management centres in Asia.

\* We are one of the world's largest banking and insurance centres.

## Hong Kong's strengths

Hong Kong's success as an international financial centre is premised on our core values and fundamental strengths. These include our heritage of rule of law underpinned by an independent judiciary, a clean and efficient government, low and simple tax regime, a regulatory framework that is on a par with international standards. Our Securities and Futures Commission is recognised as a leading and efficient regulator. Hong Kong Exchanges and Clearing Limited is a worthy companion to this regulatory structure.

We also cherish our freedoms including a free and unfettered media and a free flow of ideas and information. Our freely convertible currency has been pegged to the US dollar since 1983 and our economy has for the past 14 years been ranked as the freest in the world by the US-based think-tank, the Heritage Foundation.

Added to our financial credentials are our political stability, highly cost-effective business environment, a critical mass of international investors and large pool of experienced financial professionals.

Situated mid-way between London and New York, our location makes us the bridge for trading activities to be carried out around the clock and around the world. In its January 28th edition, TIME Magazine coined a new term "Nylonkong". The lead article placed Hong Kong alongside London and New York as examples of globalisation, including globalisation of the capital markets.

## Gateway to Mainland China

What sets Hong Kong apart from our rivals is the unique role we play in the economic life of Mainland China. As an international financial centre located at the heart of Asia with strong global linkages, Hong Kong provides a premium capital formation and global investment platform for enterprises worldwide. Most important of all, being both a city in China and Asia's world city, Hong Kong is at the best strategic location for being a gateway to

Mainland China.

On the other hand, many Mainland companies have set up regional headquarters or offices in Hong Kong as a first step to establish their presence in an international financial market.

Our China story is more than purely location driven. For a long time, we have acted as the facilitator of inward investment of foreign funds into China. Most recently, we are a centre for Chinese IPOs. As the Mainland's continuous high growth in the past few years has resulted in quick and massive accumulation of wealth, Mainland authorities have progressively allowed its financial institutions to invest overseas. Hong Kong has been the major beneficiary of the outflow of capital as we are a market that the Mainlanders know, culturally, linguistically and financially.

Hong Kong remains the only jurisdiction outside the Mainland in which banks may transact business using the renminbi (RMB). We also became the first place outside the Mainland to operate a RMB bond market. All of the above shows that Hong Kong is capable of offering unique market opportunities for overseas investors and Mainland issuers.

Challenges and outlook

Financial turmoil

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In the past months, the global financial markets have been deeply affected by a weakening of market confidence in the soundness and capability of financial systems to effectively respond to the aftermath of the subprime crisis. The financial tsunami we now face is a global crisis. It hits all major markets, and there is no exception for Hong Kong.

In fact, immediately after the Asian financial crisis a decade ago, we have been shoring up our regulatory regime, in particular strengthening our risk management. For example, Hong Kong is among the first jurisdictions to adopt the risk-based capital adequacy standards for the banking industry enshrined in Basel II starting from January 2007. Over the years, our financial sector has become more resilient to shocks when compared to the Asian

financial crisis. As a result, although our financial markets are unavoidably affected by the repercussions of the subprime crisis and the adverse sentiments arising from them, our financial system has remained stable and has displayed resilience in coping with the challenges.

The collapse of Lehman Brothers has resulted in many investors who bought Lehman Brothers' related products to suffer investment losses. The Government, realising that the Lehman Brothers' minibonds still have value, immediately co-ordinated efforts of the regulators, the trustee and the distributors to assist the minibonds investors. We have also pledged to undertake a full and comprehensive systemic review and to consider, on a policy level, what can be done to further improve our regulatory regime and to enhance investor protection and education.

#### Improving market quality

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We announced in the Policy Agenda 2008-09 earlier this month that we will launch new initiatives this year to strengthen our financial regulatory regime. We will work towards strengthening the supervisory framework for authorised institutions (AI) in the banking industry in order to ensure their resilience to withstand severe market stress and to reinforce Hong Kong's role as an international financial centre. Emphasis will be put on the management and enhancement of capital treatment for structured credit and securitisation activities, improvement to liquidity risk management and enhancement of risk management capabilities of AIs.

Confidence in financial institutions worldwide has been shaken up in the recent financial turmoil. It has been announced recently that the Exchange Fund will be used, on a special and time-limited basis, to guarantee the repayment of all customer deposits held with all AIs in Hong Kong till the end of 2010. The Hong Kong Deposit Protection Board will continue to review the coverage and protection limit of the Deposit Protection Scheme and provide feasible long-term proposals to enhance protection of depositors.

In order to sustain a conducive environment in fostering the growth of legitimate business and investment in Hong Kong, we will embark on a review of our financial systems and the relevant preventive measures with a view to

strengthening the anti-money laundering and counter financing of terrorism regime in Hong Kong.

We believe that these are important steps to bolster the confidence of depositors and investors in our financial system and to consolidate our leading position as an international financial centre in the region.

#### Market development

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Moreover, we will press ahead with on-going efforts to promote market development. Considerable progress has been made in the past year to promote the development of Islamic finance and to advance financial services co-operation with Mainland China. In the coming year, we will continue to vigorously implement market development initiatives to capitalise on the new opportunities in the region and around the world.

We have been continuing to advance financial co-operation with the Mainland at different levels. In the past year, we have worked towards expanding the presence of Hong Kong financial institutions, such as banks, fund management and insurance companies, on the Mainland under the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA). We have also encouraged Mainland funds, investors and financial institutions to go overseas through Hong Kong by way of the Qualified Domestic Institutional Investors (QDII) Scheme. The implementation of the Mainland QDII Scheme in 2007 brought about tremendous business opportunities for the fund management industry. The first QDII fund was launched in September 2007, and so far, Hong Kong has been one of the preferred investment markets for QDII funds.

RMB business in Hong Kong has developed steadily since its launch in 2004. We will continue to ensure the smooth operation of RMB business and pursue further expansion of the scheme. In this regard, discussion with the relevant Mainland authorities on a proposal for Hong Kong importers to settle import trade from the Mainland in RMB is in progress.

#### Concluding remarks

I hope you have enjoyed my portrait of our markets, our strengths, our recent challenges and how the Government is geared up for developing a broader, deeper and higher quality market.

Thank you.