

**Speech by SFST at luncheon hosted by Carnegie Endowment**

**for International Peace**

**(English only)**

Thursday, May 15, 2008

Following is the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, at a luncheon hosted by the Carnegie Endowment for International Peace in Washington, DC, on May 14 (Washington, DC, time):

Distinguished guests, ladies and gentlemen:

I hear that lunch at the Carnegie Endowment for International Peace is delicious. I wonder if your lunch has anything to do with a very famous expression now sweeping across much of China. Let me tell you a little story that tells us a lot about the new world order. Two weeks before I left Hong Kong to come here, I turned on the TV and there was a smart looking Chinese CEO talking about his business operations on the Mainland. That in itself was unremarkable. What was remarkable was a phrase that rolled off his tongue. It immediately caught my attention. This was what he said in Mandarin: "There is no such thing as a free lunch." Ten years ago, that expression would never have been heard on the Mainland. But American concepts and expressions have followed the global economy deep into the Chinese hinterland. A sociologist would tell you that language reflects social change and perhaps a new social order. Words like "bear market" or "bull market" are now on the lips of practically every money-minded person in China.

International pundits have been talking about the emergence of a new economic order. I will leave it up to you to decide if in fact there is a new economic or even political order. If there is, then surely China, the world's fastest growing large economy, is very much part of it. Its wealth creation is phenomenal. China's domestic savings has reached US\$2.8 trillion, and its economy continues to grow by double digits, five years in a row, reaching 11.9% in 2007. With massive capital inflows over the past two or three decades, China now has the largest foreign reserves assets in the world.

This tremendous growth and accumulation of wealth have created massive opportunities in China and other Asian financial markets. I understand that Carnegie has also established its presence in Beijing since 2004. You may wonder what Hong Kong's role is in the midst of all these mouth-watering opportunities. That's what I am here for—to explain to you how you can use the splendid Hong Kong platform to dive into the splashing pool of opportunities in China.

### Hong Kong as an International Financial Centre

We never tire of telling you that Hong Kong is situated in the heart of Asia and on the doorstep of China. This may sound clichéd, but the opportunities are eye-popping or jaw-dropping, depending on which part of your face reacts to the rich offerings you see when you land there. Like China, Hong Kong has been registering continuous growth, though not by the same magnitude. Let me play the boastful guest for a moment. Our stock market is now the seventh largest in the world, and the third largest in Asia in terms of market capitalisation. We rank in the world's top five when it comes to fund-raising capability. And Hong Kong is a banking paradise, with about 70 of the world's 100 largest banks operating in our city, making it one of the largest asset management and banking centres in Asia.

Make no mistake. Hong Kong is not called a money-making paradise for nothing. We place third worldwide, just behind London and New York in terms of financial centre competitiveness. This is not my ranking. This is the ranking according to the Global Financial Centres Index published by the City of London in March of this year.

So what precisely is Hong Kong's magic, and what goodies do we offer as an international financial centre?

Please remember that we are a small place with no natural resources. All our resources are in one basket: our people, hardworking, educated and always alert for opportunities. We stand out in Asia as a city that enjoys total freedom of information and freedom of the press, the impartial rule of law upheld by an independent judiciary, a freely convertible currency pegged to the US dollar, a low and simple tax system, a squeaky-clean and highly efficient government, streets that are ultra-safe, markets that are well-regulated but not over-regulated. For the 14th consecutive year, Hong Kong was rated by the Heritage Foundation as the world's freest economy. We are English-speaking and money-making activists.

You see, Hong Kong is not hard to sell at all.

What makes it even easier to sell is that our special relationship with the Mainland offers us limitless opportunities. Hong Kong is now part of China, but we exist under a principle that is unique in the world, the so-called “One Country Two Systems” concept. This gives us special advantages and privileges not enjoyed by Mainland cities and provinces. But first let us talk about the mouth-watering opportunities that break our way. As I said earlier, the Mainland’s continued high growth has resulted in quick and massive accumulation of wealth. This translated into a huge demand for high-end and sophisticated financial products not yet available on the Mainland. At the same time, Mainland enterprises in droves are scouring for funds to grow their businesses. Spectacular growth on the Mainland means buckets of business opportunities for Hong Kong.

Hong Kong has become the darling of Mainland enterprises for listing in another jurisdiction. Just to give you an idea, since 1993, the year when the first Mainland company got listed on our stock exchange, over 440 Mainland enterprises have done so, raising a total of over US\$240 billion. They now represent almost 60% of our total market capitalisation.

Hong Kong has not just become a darling, she has become a trusted relative to manage the Mainland money. In recent years, Mainland authorities have been progressively allowing its banks, securities and fund management companies and insurance companies to invest overseas through a scheme with a name that is quite a mouthful. It is called Qualified Domestic Institutional Investors, or QDII for short. This is considered an orderly outflow for Mainland funds. Hong Kong is likely to be the principal beneficiary of this scheme, as we are a market mainlanders know well, both culturally and financially. Other developments are also leaning towards Hong Kong’s advantage. For example, in March this year, for the very first time, the China Insurance Regulatory Commission signed a regulatory agreement with Hong Kong’s securities regulator, our Securities and Futures Commission, better known locally as the SFC. This agreement will make possible the use of Mainland insurance funds outside the Mainland, making Hong Kong the first destination for Mainland insurance funds seeking to invest overseas.

What is plain for all to see is this: Whenever Mainland authorities wish to explore or experiment with untried ways of financial transactions with the outside world, Hong Kong is favoured to be the first outlet for such purposes, for all the wonderful reasons I have mentioned, plus our cultural and linguistic affinities. This gives Hong Kong an enormous early advantage. In the West, you might call this “the early bird gets the worm”. In Hong Kong we prefer to call it “getting the first sip of the soup” which is supposed to be the most nourishing. So I urge you to come and take your first sip. You will be like Oliver Twist asking for more soup. I guarantee it.

### Hong Kong as the Window of Opportunity on the Mainland

Hong Kong has been the biggest beneficiary of China’s skyrocketing prosperity. Since opening up to the world in the late 1970’s, China’s GDP has soared an astounding 60 times or more. In 2007, its GDP reached US\$3.3 trillion, making her the world’s fourth largest economy and Asia’s No 1 destination for foreign direct investment.

So how can Hong Kong help you to tap this rich vein of opportunities on the Mainland?

Well, the people who can help you are the smart financial professionals, and we have these in abundance. Our financial talents not only possess business acumen, they have an intimate knowledge of the Mainland market. Most important of all, they are Mainland networking specialists who can help you avoid costly mistakes and make the right moves.

Mainland intermediaries such as banks, insurance companies, securities and futures broker dealers etc are also establishing operations in Hong Kong, and we expect to see Mainland fund managers set up their operations in our city later this year.

At the same time, foreign enterprises are also keen to partner with Hong Kong enterprises to do business on the Mainland. In 2007, nearly 3,900 overseas companies had regional headquarters or offices in Hong Kong, among them 891 are from the US. Last year, the World Investment Report released by the United Nations declared Hong Kong as the second most preferred destination for foreign direct investment in Asia, for five years in a row.

If you are keen to access opportunities in Asia, and especially in China, Hong Kong can help in a number of ways.

First, investors can capitalise on the growth of the Mainland economy by investing in Chinese enterprises' shares listed on the Hong Kong Stock Exchange. There are some 440 such enterprises for you to choose from, ranging from financial institutions, telecommunications, coal and gold mining, oil, gas, car manufacturing to supermarkets. They represent about one-third of our total listings and 70% of our daily equity turnover. We have a very welcoming financial infrastructure and favourable tax regime - with no capital gains tax, no dividend tax, no estate duty. Since 2006, offshore funds have been exempted from profits tax, all to make our market more attractive.

Second, fund managers can leverage on Hong Kong's unique strengths to tap the huge domestic savings of China. We are already Asia's leading wealth management centre with 80 fund management houses currently operating in Hong Kong, including firms from the US, the UK and Switzerland, among others. In 2006, our combined fund management business exceeded US\$789 billion, of which 60% were sourcing from overseas investors, a clear indication of how attractive we are to overseas fund managers to conduct asset management business.

Third, the renminbi business in Hong Kong has grown steadily since its launch in 2004. Hong Kong is the first place outside the Mainland with a renminbi bond market. So far, there have been three successful renminbi bond issues in Hong Kong worth a total of RMB10 billion yuan. The development of renminbi business in Hong Kong has further deepened economic integration between Hong Kong and the Mainland, providing valuable opportunities for investors who wish to gain exposure to this strengthening currency.

### Challenges and Outlook

Present success does not blind us to the challenges of the future. We are aware that as the China economy becomes more and more liberalised, its needs are changing. Hong Kong needs to continuously upgrade our services to meet these needs.

We need to continue to integrate and strengthen financial co-operation with the Mainland economy. China is unique in having two financial systems within its borders, one in Hong Kong, and one on the Mainland. We are developing a complementary and interactive relationship with the financial system on the Mainland by the following measures:

- \* Encouraging Hong Kong financial institutions to expand their presence on the Mainland;
- \* Encouraging Mainland funds, investors and financial institutions to go overseas through Hong Kong;
- \* Strengthening the links between the financial markets in Hong Kong and the Mainland;
- \* Getting Hong Kong financial instruments to be traded on the Mainland, and continuing to expand the renminbi business in Hong Kong; and
- \* Strengthening the financial infrastructural links between Hong Kong and the Mainland.

While racing to take advantage of our Mainland economic relationship, we do not forget to internationalise to give our financial services industry a well-rounded development. We prepare for this diversification by upgrading our market infrastructure, promoting financial intermediation, encouraging financial reform and launching new financial products to attract more overseas enterprises to list in our market.

As announced by our Chief Executive in his 2007 Policy Address, we are energetically putting in place a platform for Islamic finance, including the Islamic bond (or sukuk) market, to match the huge investment needs of the Middle East to the capital needs for development on the Mainland. This initiative has been well received by financial market players. The first retail Islamic fund was launched by a major bank in Hong Kong in November 2007. The fund is an index tracking one that tracks the Dow Jones Islamic Market China/Hong Kong Titans Index. Its fund size reached US\$ 51 million as at end March 2008, up by more than 10 times since its launch. Just last month, the first sukuk offering Islamic investors exposure to China's growth via Hong Kong-listed shares was listed on the Labuan Stock Exchange in Malaysia, as well as on our own exchange. Expect to see more innovative products in the market to meet this demand.

We will continue to review our regulatory model to ensure that it will not hamper financial innovation nor stifle further development of Hong Kong's financial services industry. In June last year, for example, the SFC announced a set of initiatives to streamline the licensing procedures for overseas fund managers wishing to operate in Hong Kong. Firms that are already licensed or registered in the US as investment managers or advisers, and which only serve professional investors and have good compliance records, will enjoy an expedited licensing process. Also, persons nominated to be the Responsible Officers of hedge fund managers, who fulfill the necessary criteria, can be exempted from our local regulatory examination. The result is that some of the fund management companies can now obtain their licences within four weeks. Such moves have been welcomed by industry players.

Hong Kong business people have always considered our city an entrepreneur's paradise. Our reunification with the Mainland has brought us a huge economic bonanza, with a growing wealth of opportunities to those lucky enough to be located in our city. We invite you to come and share a piece of the pie. You will find no better place than Hong Kong to secure a foothold in the huge Chinese market, and no better time to come than this Olympic year when we will be co-hosting the Olympic and Paralympic Equestrian events. Come and hear it from the horses' mouth: that Hong Kong is the fast track to Mainland business opportunities. You may even get a free lunch from me. Thank you.

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