Speech

Speech by SFST at Lujiazui Forum 2010 in Shanghai

Saturday, June 26, 2010

Following is the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, at the Plenary Session III: "Shanghai in 2020 and the Evolving Landscape of Global Financial Centres" of Lujiazui Forum 2010 in Shanghai today (June 26):

Distinguished Panelists, ladies and gentlemen,

Good afternoon. It is my great pleasure to be invited to the 'Structural Adjustment and Financial Reform after the Crisis' Forum. The US Senate has passed legislation on financial regulatory reform on May 20, 2010. Across the Atlantic, the EU is also contemplating similar financial reform. World advanced economies are on the verge of implementing changes to the financial systems to correct "market excesses" that many consider have caused the recent financial crisis. This is an opportune moment for me to share with you my thoughts on, as the title of the Plenary Session suggests, the evolving landscape of global financial centres, and how Shanghai and Hong Kong could position themselves to contend as China's financial centres.

Hong Kong and Shanghai will be facing some exciting challenges and opportunities in the coming years. Hong Kong will build on its strength as a leading financial market in Asia. Shanghai will face an even more exciting challenge. The State Council endorsed in March 2009 that by 2020 Shanghai will be developed into an international financial centre that is basically commensurate with the economic strength of China and the international status of RMB. Hong Kong supports the further development of Shanghai into an international financial centre, as this will help improve Shanghai's regulatory framework, market infrastructure and financial intermediation.

<u>Evolving regulatory landscape</u>

Let me first speak on Hong Kong's response to changes in the regulatory landscape. As an international financial centre, Hong Kong confronted shock waves of the financial crisis rippled from overseas. Financial crisis is no stranger to Hong Kong's regulatory regime. We have weathered many financial storms and upheavals in the past decades. During the recent global financial crisis, there was no major disruption to the markets in the financial crisis. The banking system remained sound and resilient. Clearing and settlement were smooth and efficient despite surge in trading volume. There was no temporary closure in the stock market amid price volatility. There were no changes in short-selling rules. There was no significant distress in our financial institutions, given the sharp correction in asset price. Our seasoned regulatory regime has once again served us well in the current financial crisis.

Rising to the challenges of the financial crisis has not only confirmed the robustness of Hong Kong’s regulatory regime. Most importantly, it has not, in contrast to overseas jurisdictions, eventuated in call for wholesale regulatory changes. Certainty and predictability, the treasured cornerstone of all financial transactions and capital markets, remain solidly in place. The certainty and robustness of our regulation will continue to be the cornerstone of our market, even as the international regulatory landscape evolves.

Details of the US and EU financial reform proposals have not been finalised yet, though they seem to cover wide areas including monitoring of systemic risk, restrictions on banks, resolution regime for failing financial company, trading of derivatives and oversight on hedge funds. Many of these changes are warranted, but we should bear in mind, that in the long term, the proposals could restrain capital flows and slow down the pace of financial innovations.

International financial centres worldwide are inter-linked and the regulatory regime in Hong Kong will align with that of the counterpart, while ensuring our regulation will serve the needs of our market. Our challenge is to balance the flourishing of innovation in financial intermediation and maintaining stability of the financial system as an entirety. A tight leash only suffocates innovation but unchecked innovation could derail our course, as evident in the recent financial crisis.

In view of the market development needs for Asia, it will be a challenge to us to recognise what innovations are good for our economy, and what innovations can bring about financial instability. But on balance, I think a slower pace of financial innovations will not have a negative effect on our market development. Hong Kong's success has been due to our ability to meet the needs for Chinese companies raising international capital and improving their corporate governance. And in the coming years, this mission of serving the real economy will continue to be important.

The job for serving the real economy is even more important for markets within China. Improvement in financial intermediation is badly needed to facilitate the growth of the real economy. Development in banking products, fund management products, and improvement in the capital market are important priorities in supporting the development of the real economy. The key player of improving the domestic financial market intermediation will not be Hong Kong, but it has to be Shanghai, as well as other cities in China. Of course Hong Kong's experiences may not apply in its entirety to financial centres in China. I would however argue that having a robust, market friendly regulation, is the key to building the financial market. And the priorities in this regulation should be in building financial institutions that serve the needs of the real economy in China.

Shifting of financial centre of gravity to the east

A key feature in the emerging global financial order is the economic growth of China. There is going to be a shift of the financial centre gravity to the East. The internationalisation of RMB would add momentum to this movement.

Shanghai and Hong Kong will play very important roles in the new centre of gravity. As I have said, as the domestic liquidity grows along with the real economy, Shanghai has the most important task of fulfilling the financial intermediation role in the domestic economy. Hong Kong, however, has a long history of playing host to international liquidity – and managing risks arising. Hong Kong is open to all investors, international and domestic, with no restrictions on capital flows. We are open to all issuers raising capital in Hong Kong, in equity and other forms of financing. Our regulatory structure is designed to facilitate this intermediation. Hong Kong will play a strong role in meeting international financial needs of Chinese investors and companies. The anchoring and management of risks in Hong Kong would provide a stable monetary and financial condition for continuous economic growth of our nation. In other words, China can have the best of two possible worlds: a gradual liberalisation of the capital account to fulfil balance of payments needs yet achieving stable economic growth.

Shanghai in turn will develop the domestic financial sector to support a stable growth of the domestic economy. The fast increase in domestic liquidity needs to be managed through continuous development of a domestic financial market, supporting the capital funding needs of Chinese companies. The important national strategy of growth rebalancing so that domestic consumption will contribute to stable economic growth requires commensurate development of financial institutions.

Internationalisation of RMB

The internationalisation of RMB is part of the new financial order for this region. This will provide a new impetus for the growth of China's financial market. Connectivity with trading partners, investors and financial institutions overseas will increase the demand for international financial services in China and access to the Chinese capital market. Shanghai's financial market will become more and more open, more and more international, as a natural part of the process of the internationalisation of RMB. The pace of the development of Shanghai as an international financial centre will be linked to the pace of the internationalisation of RMB. As I have said earlier about Hong Kong's experience, a sound regulatory framework is required for building a quality market. And this is all the more important to meet international investors' demand for transparency and certainty of regulation. With increased mobility of capital, prudential regulation of financial institutions will become more important. Thus the development of the financial infrastructure and regulation to facilitate an increasingly open market is a priority in building Shanghai as an international financial centre. As usual, Hong Kong is ready to share its experience.

As part of the process of the internationalisation of RMB, it is inevitable there will be a growth for offshore RMB financial services. This is partly due to the non-opening of the capital account, but that is not the only reason. Offshore financial activities take place in all major currencies of the world, a feature of our globalised market. The role that Hong Kong plays in this development will again illustrate the unique status of Hong Kong and how it complements the internationalisation of the China economy.

An offshore RMB market anchored in Hong Kong will facilitate the internationalisation process of the RMB. This process will inevitably lead to more opening in the on-shore capital market. The offshore market will naturally complement the onshore market as there must be a feedback loop between the two for the market as a whole to function. Shanghai and Hong Kong are the twin engines on the airplane, propelling the process of RMB internationalisation.

Conclusion

I have been asked many times for my views on the competition between Shanghai and Hong Kong. My answer is simple. The two cities have unique roles to play in the development of our nation. Shanghai is in a unique position to support the development of the real economy in China. From Hong Kong's perspective, that perfectly complements its functions as a global financial centre. In the process of RMB internationalisation, we will work even more closely. Collaboration between Hong Kong and Shanghai, in sharing our experiences and building the linkages between our markets will help each other. On January 19, 2010, Hong Kong and Shanghai signed a Memorandum of Understanding Concerning Advancing Hong Kong - Shanghai Financial Cooperation. We look forward to working with Shanghai to contribute to the financial security and stable economic growth of our country.

Thank you.

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