Speech

Speech by SFST at HFR Industry Summit: Asia 2010

(English only)

Thursday, September 16, 2010

Following is the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, at the HFR Industry Summit: Asia 2010 today (September 16):

Distinguished guests, ladies and gentlemen,

Good afternoon. It gives me great pleasure to join you today at the HFR Industry Summit. This conference brings together the hedge fund industry's most influential hedge fund managers and its most sophisticated investors. It is a great opportunity for the players in the hedge fund sphere to exchange views on the development of the industry and the markets. It also allows me to share with you my thoughts on Hong Kong's role as a hedge fund hub in Asia and how regulation in this area is developing internationally and locally.

Shifting of financial centre of gravity from the West to the East

I understand that this is the first time the HFR has chosen an Asian venue to hold its summit.

Your choice of Hong Kong as the venue is testimony that, in the wake of the global financial crisis, Asia presents exciting opportunities for the financial services industry.

A key feature in the Asian financial market scene is the economic growth of China, the opening up of its financial market, and the liberalisation of the RMB.

Asset managers should be attracted to China like bees to honey. It possesses the two major factors that would allow the industry to propel forward - (1) a country with increasing wealth to invest abroad, and (2) investment opportunities in its fast expanding market.

Hong Kong is lucky to be sitting in the nucleus of the latest explotion of financial activities in Asia. We have a long history of hosting international liquidity.

We are open to all investors, international and domestic, with no restrictions on capital flows. Our regulatory structure is designed to facilitate this intermediation. As shown by our long experience in meeting the challenges of many financial crises, we are also good at managing the risks posed by these liquidity flows.

Hong Kong's strengths as the hedge fund hub of Asia

To understand the strength of Hong Kong's financial market, I should emphasise the concept of "One Country, Two Systems" regarding Hong Kong's relationship with Mainland China.

Under this principle, in the context of our financial market, Hong Kong shares the economic opportunities of our nation, China. At the same time, we retain our own unique characteristics. We have our own legal system and our own financial system as well as a highly internationalised financial market to serve as a financial gateway to China.

Hong Kong's financial market has shown its resilience in the face of the financial crisis.

Indeed, we have weathered many financial storms and upheavals in the past decades and learned new lessons each time.

During the recent global financial crisis, there was no major disruption to our markets. The banking system remained sound and resilient. Clearing and settlement were smooth and efficient despite the surge in trading volume. I am also happy to note, to this hedge fund audience, that there were no changes to our short-selling rules during the crisis. Our seasoned regulatory regime has once again served us well in the current financial crisis. Rising to the challenges of the financial crisis has confirmed the robustness of Hong Kong's regulatory regime. There are no calls for wholesale regulatory changes.

Certainty and predictability, the treasured cornerstone of all financial transactions and capital markets, remain firmly in place.

Our financial market regulators are well known worldwide for their professionalism, transparency and effectiveness.

Regulatory approach

Our regulatory system is a key factor behind the high quality of our financial market. We are sensitive to the fact that good regulations need to evolve side by side with the latest market needs and be attuned to new sources of risk. By definition, good regulations can never stand still.

The regulatory landscape of the world is changing fast in the wake of the global financial crisis. Reform measures coming out of the US and EU cover wide areas including monitoring systemic risk, restrictions on banks, a resolution regime for failing financial companies, trading of derivatives and oversight on hedge funds.

Many of these changes are warranted, but we should bear in mind that in the short term, these reform proposals can create uncertainties in regulation and increase the costs of capital.

The hedge fund industry is a prime example of a business that has enjoyed exponential growth in the past decade. To ensure that there is a level playing field in this new industry and that investors are adequately protected, we support greater transparency and closer surveillance, as well as the licensing of hedge fund managers in order to reduce financial stability risk.

International

Regulation and oversight of the hedge fund industry have tightened globally since the financial crisis.

US

The US has required investment advisers to private funds (i.e. hedge funds and private equity funds) above US$150 million in assets under management to register with the Securities and Exchange Commission.

It also requires private funds to report systemically relevant data in the interests of a broader financial stability assessment.

The Volcker Rule restricts banks' proprietary trading and investments in hedge funds and private equity funds.

Europe

In Europe, the Alternative Investment Fund Managers (AIFM) Directive will eventually restrict non-EU managers to provide their services in the EU, unless these funds can fulfil the same requirements as their EU counterparts and the countries of the funds' domicile have in place EU-equivalent regulatory and supervisory standards.

There are uncertainties as to whether the existing private placement regime will continue to govern marketing activities in each of the EU member states.

The various EU proposals also envision some sort of cooperative arrangements between competent authorities in EU and home regulators of the third country managers.

Hong Kong

Hedge fund managers carrying on business in Hong Kong are subject to the Securities and Futures Commission regulatory regime and are required to be licensed.

We cannot design our own rules without regard to how the rest of the world is regulating their hedge funds.

In today's global economy, monies are often moved across borders to be managed, and could end up being invested in completely different parts of the world. Regulations, particularly in the financial sector, cannot be expected to have a local effect only. Developments in the EU and the US relating to regulation of hedge funds will inevitably have a huge impact on the international asset management industry.

We believe any regulations coming out of the EU should not discriminate against non-EU managers. We are supportive of cooperative arrangements between the authorities but they should be in line with international standards. Regulations should also be predictable and consistent.

In Hong Kong, the hedge fund industry manages a total of US$55.3 billion in assets, of which about 40% are funded by European investors.

It is therefore of critical importance that our hedge funds can continue to service their European clients.

We are committed to designing regulations that are suitable for our needs and our markets. We need to strike a balance between the goal of having a quality market and maintaining a forward-looking market friendly approach.

Offshore renminbi business centre

Turning now to new opportunities in our market, Hong Kong is well positioned to become an offshore market in RMB. As the pace of RMB internationalisation continues, this development will provide a new growth driver to our market.

The latest development in this area is exciting. Take the issue of RMB bonds for example. Last September, the Central Government launched its inaugural renminbi sovereign bond issue, totalling RMB6 billion, in Hong Kong. A number of Chinese banks have issued RMB bonds in the past three years, raising RMB32 billion. The RMB deposits in the local banking sector have grown to 1 trillion, from a level of about 630 billion at the end of 2009.

Hong Kong and foreign companies are also allowed to issue renminbi bonds in Hong Kong, which has made us the only offshore renminbi bond market in the world.

There has also been rapid growth in RMB trade settlement and the provision of corresponding banking services. Through the extended renminbi trade settlement scheme commenced in June this year, Hong Kong and foreign companies can now settle trade transactions with eligible enterprises on the Mainland in RMB.

This can be done through the efficient clearing facilities in Hong Kong. Since mid-July, all companies, including financial institutions, can open renminbi accounts at banks in Hong Kong.

The restrictions on renminbi interbank transfers between personal accounts and corporate accounts have also been removed. Banks in Hong Kong can now also provide renminbi conversion services to corporate customers for purposes other than for trade settlement.

All these new measures have greatly enlarged the scope of renminbi banking services and financial products in Hong Kong. We are already seeing a rapid growth of RMB savings products in our market. More investment products, wealth management products denominated in RMB will be offered in our market as the RMB liquidity pool grows in Hong Kong.

Our stock exchange is also making preparations for RMB denominated products to be offered on its trading platform.

Concluding remarks

Ladies and gentlemen, the prospect of the asset management business has never looked brighter. Hong Kong will continue its efforts to create a conducive environment for you - whether you are a fund manager or an investor. We invite you to join us in seizing the massive opportunities that we are enjoying in Asia, and particularly those that are coming out of China.

Thank you very much.

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