Speech

Speech by SFST at Conference on Development of ETFs and Other Index Products (English only)

Friday, May 13, 2011

The following is speech entitled "Latest Trends in Hong Kong's Securities Market - Renminbi Products and ETFs" by the Secretary for Financial Services and the Treasury, Professor K C Chan, at the Conference on Development of ETFs and Other Index Products organised by Hong Kong Exchange and Clearing Limited and Shanghai Stock Exchange today (May 13)：

Chairman Arculli, President Zhang, ladies and gentlemen,

I am very glad today to participate in this conference jointly organised by two of the fastest-growing exchanges in Asia, namely the Hong Kong Exchanges and Clearing Limited (HKEx) and the Shanghai Stock Exchange (SSE). Both Exchanges have achieved significant developments in the past couple of years in many areas, like in the amount of funds raised for companies from different sectors and product types.

Today, I want to talk about some of the opportunities and challenges faced by our markets. My main message is that there are great opportunities before us, but there is also work for us to do in order to take advantage of those opportunities.

<u>Hong Kong-Mainland financial co-operation</u>

One of the most important tasks for our two markets is that we should continue our efforts to strengthen the links between our two markets and explore and exploit opportunities for co-operation for mutual benefit.

The case for Hong Kong-Mainland financial co-operation is an obvious one. President Zhang and Chairman Arculli talked about the importance of this co-operation. Closer financial co-operation between the two sides will assist in promoting the modernisation of the Mainland's financial system, particularly the internationalisation of the Renminbi, and the increased convertibility of the Mainland's capital account in a gradual and orderly manner. In this process, I'm sure we will create a win-win situation for the two markets and allow the exchanges to offer a broader range of products and services to both markets, to our issuers and our investors.

In January last year, my bureau signed with the Shanghai Municipal Government Financial Services Office the Memorandum of Understanding Concerning Advancing Hong Kong-Shanghai Financial Co-operation. Actually, before that, HKEx and SSE had already signed their Closer Cooperation Agreement in January 2009. With this agreement, the two sides have been putting much effort into strengthening exchanges and cooperation in regulation, information sharing, training, information technology and so on. I am very glad to see that this conference has been jointly organised, which demonstrates the close partnership of the two exchanges and the two markets.

The history of Hong Kong-Mainland financial co-operation tells the story of how an offshore market, like Hong Kong, can work well with an onshore Mainland market. The H-share and A-share markets have been astounding successes, providing capital to many Chinese enterprises and giving them access to an international capital market.

The recent case of Renminbi internationalisation is another one. Hong Kong and Shanghai will leverage our respective advantages and play the roles of offshore and onshore Renminbi business centres. An offshore Renminbi market will inevitably lead to more opening up of the onshore Renminbi market. The feedback loop between the offshore and onshore markets will allow them to naturally interact, stimulate and complement each other.

Development of Renminbi offshore products is crucial to the development of offshore Renminbi business. Therefore, one should not be surprised that HKEx is working on offering equity products denominated in Renminbi.

Renminbi products in Hong Kong

In fact, in recent years Hong Kong has seen a rapid increase in the size of the Renminbi liquidity pool in the market. At the end of March this year, the total outstanding Renminbi deposits in Hong Kong amounted to about 450 billion Renminbi. This has led to an exciting development of the Renminbi bond market. Entities making use of the Hong Kong platform to issue Renminbi bonds are growing and becoming more diversified, ranging from local entities to international ones.

Hong Kong is also gearing up for the listing of Renminbi equity products. Last month, we saw the listing of Hong Kong's first Renminbi REIT, the first of its kind outside the Mainland. It represents a milestone in our Renminbi listing market.

ETF market in Hong Kong

We will also leverage our financial co-operation with the Mainland and unique role as a Renminbi offshore business centre to further develop our ETF market, which is the theme of this conference.

Hong Kong's ETF market, as Chairman Arculli mentioned earlier, has continued to flourish in recent years. There has been an average annual growth of 113% in the turnover value of ETFs in the past five years. In 2010, our turnover in ETFs, at US$78 billion, made us come first in the Asia-Pacific region. We now have 72 ETFs listed in Hong Kong. Our ETF issuers continue to launch new classes of ETFs, allowing investors to diversify in different sectors. From January 2010 to March 2011, we have had four new ETFs tracking Hong Kong stocks, 16 new ETFs tracking the Mainland A-shares market, one new ETF tracking gold, one new ETF tracking the Greater China Region, and seven new ETFs tracking overseas stocks. In addition, two options on ETFs were introduced in 2010.

Cross-border ETFs are not new to Hong Kong. In August 2009, three Hong Kong ETFs and the first Taiwan ETF were listed in Taiwan and Hong Kong respectively. We will continue to push forward cross-border ETFs. CEPA Supplement VI signed in May 2009 and CEPA Supplement VII signed in May 2010 announced the measure to introduce ETFs on Hong Kong stocks in the Mainland. We have been closely liaising with relevant Mainland authorities on the launch of such cross-border ETFs.

On the other hand, our issuers are already using synthetic replication to create ETFs tracking the Mainland market. Such ETFs have become one of the most popular ETF classes in Hong Kong. We need to ensure there is proper regulation of ETFs, particularly with regard to product transparency. In November last year, HKEx and the Securities and Futures Commission (SFC) introduced new measures to raise investors' awareness of synthetic ETFs by adding a marker at the beginning of the stock short names of synthetic ETFs. This assists investors in distinguishing between traditional ETFs and synthetic ETFs and better enables investors to make informed investment decisions.

Risks associated with ETFs do not simply involve disclosure issues. There are also potential systemic risks. The Financial Stability Board (FSB) has recently issued a note discussing the potential financial stability issues arising from recent trends in ETFs. This is an area that deserves the attention of regulators and exchange operators as we further develop our ETF market.

Listing platform competitiveness

Despite the exciting developments that I have outlined above, I would like to point out an obvious challenge facing us all. No matter how well we are doing, we need to continuously improve the competitiveness of our markets in the face of global competition.

Let me turn to the listing platform in Hong Kong for an example. It is the core business of our exchange, and undoubtedly the strength of Hong Kong's financial market. Indeed, we are a global equity funding leader. Two years in a row, Hong Kong raised more than any other exchange in the world.

On top of our success in attracting listings from the local and Mainland markets, Hong Kong has become increasingly attractive as a destination for international companies seeking listing.

These companies have picked Hong Kong as their listing platform of choice for a variety of reasons. Some want to tap into the growing Asian investor base; some have business connections in Asia, in particular in Mainland China; some simply see value in being branded as "Listed in Hong Kong".

The success so far is due to the strong policy support from Government, and the joint efforts of the regulator and the exchange.

Despite the current success, which is remarkable and significant and attracts lots of attention from all over the world, if we are honest with ourselves we will find that our existing regulation is not what you would call most enabling for international listings.

The framework for accepting listings from overseas jurisdictions was designed at a time before we had actual experience of listing overseas companies. For example, we found that the corporate governance rules in some developed foreign jurisdictions may not fall squarely within our prescribed rules. To its credit, HKEx has been pragmatic in accommodating these foreign companies by granting waivers where applicable without sacrificing our shareholders' protection.

To achieve the Government's policy objectives of supporting international listings and improving the competitiveness of our listing platform, we have asked the regulator and the exchange to review the framework. The exchange and the regulator are now working on a holistic review of the policy and procedures governing listings from overseas jurisdictions.

I want to thank them for their efforts, and I am confident about the improvements they will make. We cannot afford to be complacent, and what I can promise you is our commitment to continuously review our listing regime. Good regulations by definition never stand still.

Our range of listed products is another area under review. We are determined to make available on our stock exchange products that satisfy market needs.

Let me give you an example. Under the current economic situation, business trust is something that makes sense to certain issuers and a segment of investors that is looking for distribution out of cash flows. This is a test of how we should respond to new market needs. I am glad about the pragmatic position taken by the exchange and the regulator -- they will study the feasibility of such a product. It is Government policy, as well as the consensus among us, the regulators and the exchange, that we should strive to be competitive. We should compete on the strength of our market, the robustness of our regulation and our market-friendly attitude toward development.

Ladies and gentlemen, I have talked about the common opportunities presented to our two exchanges. Realising the potential of our promising future requires co-operation between our two markets. The 12th five-year plan of our country has set out a framework for our co-operation and a goal for us to achieve.

I hope I have also impressed upon you the need for each of us to strive to be competitive in our own markets. Success in each of our markets depends critically on the collective efforts between government, the regulator and the exchange. I believe this is the formula for success in Hong Kong. Thank you.

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