Speech

Speech by SFST at Hong Kong Investment Funds Association 9th Annual Conference (English only)

Friday, October 30, 2015

Following is the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, at the Hong Kong Investment Funds Association (HKIFA) 9th Annual Conference "The Hong Kong fund management industry - moving to the next stage" today (October 30):

Terry (Pan), distinguished guests, ladies and gentlemen,

Good morning. I am very pleased to join you all today at the HKIFA Annual Conference. The Conference has been a highlight on the event calendar of the industry since it was first organised nine years ago. And today I am very happy to see so many old friends and new faces as well.

Hong Kong's asset and wealth management industry is on a very sound footing. According to the Securities and Futures Commission (SFC)'s survey, the total combined fund management business has more than doubled in the past five years, growing from HK$8.5 trillion in 2009 to HK$17.6 trillion in 2014. The number of corporations licensed for asset management under the SFC grew by 8.5 per cent year on year to 1,031 corporations, with overseas investors accounting for over 70 per cent of our business.

The expansion of the industry is driven by a number of factors. Asia is expected to contribute a large share of growth worldwide and capital continues to come to this region to take advantage of the investment opportunities. Combining the location and superb connectivity, Hong Kong is the ideal location for these investors to base their business.

At the same time, we also benefit from the growth and sustained reforms in the Mainland. As the world's second largest economy and the largest trading nation, gone were the days when the Mainland was considered just a destination for foreign investment. After years of growth, Chinese companies and individuals are keen to invest their accumulated capital outside of their homeland. Hong Kong is often their first stop on their way to "go global". With a track record of cross-border regulatory co-operation, Hong Kong is also the ideal platform for successive opening measures including the RQFII (Renminbi Qualified Foreign Institutional Investor) scheme, the Shanghai-Hong Kong Stock Connect and, more recently, the mutual recognition of funds (MRF) arrangement.

At home, we are taking on a few legislative initiatives to help the industry capture these opportunities. First of all, we are preparing a legislative proposal to introduce the open-ended fund company as a fund vehicle. By giving the industry an alternative to the unit trust form, we seek to attract more funds to domicile here and develop Hong Kong into a comprehensive fund service centre. To attract more private equity funds to expand their business in Hong Kong, we have also extended the profits tax exemption for offshore funds to the private equity sector. This will in turn drive demand for other relevant professional services.

First introduced in Hong Kong in 2011, the RQFII scheme has become a major channel for offshore Renminbi (RMB) investors to access the Mainland capital market. The arrangement is playing a central role in the development of the RMB as an international investment currency.

As of September, there are already 79 Hong Kong financial institutions qualified under the scheme, with the approved quota reaching RMB270 billion. Out of these 22 are RQFII ETFs (exchange traded funds) with a total of RMB31.6 billion under management. These are complemented by 72 unlisted retail funds utilising the RQFII or Renminbi Stock Connect scheme, managing another RMB22 billion. RQFII products are now an indispensable part of our asset management industry.

Meanwhile, the mutual recognition of funds arrangement is the first such scheme between the Mainland and a market outside the Mainland. Implemented on July 1, 2015, the arrangement allows qualified Mainland and Hong Kong funds to offer directly to retail investors in each other's market after obtaining authorisation or approval under streamlined procedures.

The SFC received 14 applications for authorisation on the first day, and more applications subsequently. Meanwhile, the CSRC (China Securities Regulatory Commission) has received 17 applications so far. With the close co-operation of both regulators, we hope to see the first recognised fund under the MRF to be offered in the markets soon.

The MRF will allow Hong Kong and international investors to access the Mainland's diverse pool of public funds. On the other hand, many asset managers are already getting themselves ready for distribution in the Mainland by strengthening their Hong Kong operation, establishing distribution networks and getting familiar with the Mainland markets. More funds will come to domicile in Hong Kong and help strengthen our fund manufacturing capabilities. This will complement our existing fund distribution network and help develop Hong Kong into a full fund service centre.

From a broader perspective, the MRF will also help the Mainland and Hong Kong regulators to develop a shared set of regulatory standards and broaden cross-border investment channels. It will also help promote the use of the RMB as an investment currency and reinforce Hong Kong's position as the preeminent offshore RMB centre.

As a transparent, liquid and low-cost product, the ETF is useful for investors who are investing in new markets or asset classes for the first time. As financial integration continues to deepen in Asia, the role of the ETF as a tool to facilitate cross-border fund flows will continue to grow. To help promote the ETF industry, we have waived all stamp duty on the transfer of ETFs this year.

As of September, there are 26 ETF issuers and a total of 131 ETFs listed in Hong Kong, growing from just 24 in 2008. Tracking more than 100 different investment benchmarks, ETFs in Hong Kong had a total market capitalisation of HK$340 billion in March. They contribute to some 8 per cent of the stock exchange's cash market turnover, compared with about 10 per cent and 25 per cent in Europe and the US respectively.

However, ETF transactions in Hong Kong were highly concentrated, with the top five funds accounting for over 95 per cent of the average daily turnover in March. Similarly, the top five funds represented more than 70 per cent of all ETF assets. Investors' interest in funds tracking non-Hong Kong and non-China A-shares indices remains very limited. Retail investors, in particular, are not familiar with the use of ETFs as a cost-effective way to diversify and manage risks.

While investors in many markets demonstrate a certain degree of home bias, it is important for the investing public to appreciate the need to diversify in order to better manage risks in the long run. I trust and I hope the industry will continue to develop suitable products and educate investors about their benefits. Looking further ahead, ETFs are also good candidates to be included under the Stock Connect scheme, so that Mainland investors could also diversify across different markets using ETFs listed in Hong Kong.

Distribution is, in fact, a challenge shared by the entire asset management industry. Compared to more mature markets such as the US and Australia, Hong Kong investors have generally underutilised investment funds as a tool to invest and save for retirement. There is perhaps something we can learn from other markets where new platforms and technologies are used to help investors make better use of investment funds.

For example, the Australian Stock Exchange has introduced the mFund platform to provide order routing, settlement and custody services for unlisted fund products. Launched last year, the electronic platform allows investors to buy and sell a broad range of fund products from multiple fund providers through their brokers. There are already 125 funds from 35 asset managers available on the platform, covering equities, fixed income, currencies, commodities and real estate.

In Korea, the web-based Fund Supermarket Korea was launched last year to allow investors direct access to a variety of products offered by multiple fund houses. Collectively owned by the industry, the platform has resulted in management fees as low as a third of the cost of funds sold elsewhere. We understand that the SFC is in the early stage of discussion with our stock exchange about the possibility of similar exchange-based platforms for retail investors in Hong Kong and will also look at other similar platforms with the fund industry.

The SFC has also identified the need for more guidance on our approach to suitability and "know your clients" (KYC) requirements as a prerequisite to the more widespread use of electronic fund distribution platforms. Regulators facing similar challenges have turned to new technologies for solutions. The Securities and Exchange Board of India, for example, launched a central KYC registration system to streamline the due diligence process. As a centralised pool of investor details, clients would go through the due diligence process just once and all market intermediaries would be able to access the results. This will also help regulators perform AML (anti-money laundering) supervision.

Lastly, I want to turn to another favourite subject of mine, the Mandatory Provident Fund (MPF) scheme. With more than 2.5 million participants and HK$620 billion under management in June, the MPF scheme is an integral part of our asset management industry. In order to simplify the decision-making process for scheme members, we are going to introduce a legislative proposal to mandate a standardised default investment strategy, dubbed the "core fund", across all MPF schemes, with the management fee capped at 0.75 per cent per annum. The goal is to provide scheme members with a simple investment approach fit for long-term retirement savings objectives.

The "core fund" with a fee cap will help address the public's concerns over the high fees and complexity of MPF schemes. I believe this new arrangement is not only good for the MPF scheme, but also the investment fund industry. With greater confidence in the system, employers and employees will be more willing to make voluntary contributions and make better use of the system as an investment and retirement saving tool.

Finally, human resource is the fundamental driver behind the growth of the asset management industry. However, we understand from the industry that students and graduates are often not aware of the full range of functional posts and career prospects within the sector. As a result, it is often challenging to attract new talents to join those relatively technical functions such as risk management, compliance and operations.

To help tackle the problem, the Government is planning to allocate $100 million to enhance training for the asset and wealth management industry as well as the insurance sector, subject to approval of the LegCo. It's a matter of timing. We will reach out to university students to showcase the variety of roles within the front, middle and back offices of the industry. There will also be sponsorship for summer internships at Hong Kong asset and wealth management institutions. We are also going to put in place a financial incentive scheme for professional training to help in-service professionals beef up their skills and knowledge through further training.

Ladies and gentlemen, there are great opportunities ahead of us as Mainland China continues to move forward with its opening up and reform policies. Today's programme is packed with speeches by industry experts and leaders, and I trust that you would make the most out of the Annual Conference. As we move on to the next stage, we look forward to working closely with the industry to capture opportunities arising from increased competition and opening.

Thank you.

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