Speech

Speech by SFST at Shanghai-Hong Kong Development Lecture

(English only)

Friday, December 4, 2015

Following is the speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, at the Shanghai-Hong Kong Development Lecture hosted by the Shanghai-Hong Kong Development Institute today (December 4):

Professor Sung, distinguished guests, ladies and gentlemen,

Good evening. I'm very glad to see such a large audience here at the Chinese University of Hong Kong on a Friday evening. I'd also like to thank the Shanghai-Hong Kong Development Institute for inviting me to give the Shanghai-Hong Kong Development Lecture this year, bringing back my fond memory of lecturing to a class. You have indeed invited me at a time when I am most eager to speak on Shanghai and Hong Kong.

This is no coincidence. The ties between Shanghai and Hong Kong have never been closer in recent years. Through an unprecedented direct link between the two stock exchanges under the Shanghai-Hong Kong Stock Connect, investors may invest in the other market through their home brokers and accounts. Further to say is the Mutual Recognition of Funds (MRF) arrangement, implemented in July, which will allow Hong Kong investors direct access to approved fund products from the Mainland and vice versa.

The Stock Connect and the MRF are important milestones on the Mainland's march towards bilateral opening of its capital markets. They are implemented against a backdrop of separate yet rapid developments in Hong Kong and Shanghai as the Mainland reformed and opened in the past three decades.

Hong Kong has always been an open market where funds and information flow in and out freely. Financial institutions from all over the world are welcome to set up shop here, and in this process, we have been competing and co-operating with other financial centres such as New York, London, Tokyo and Singapore.

The continued reform and opening of the Mainland has brought Hong Kong new opportunities and the two economies have been growing closer and closer ever since. Capital market links were added to trading and commercial ones in 1993 when the first Mainland H-share IPO was issued in Hong Kong. The H-share market has been growing rapidly since then. At the end of October, there was a total of 927 Mainland enterprises trading in the Hong Kong Stock Exchange, with a total market capitalisation of over HK$15 trillion. Hong Kong is at the same time the world's seventh and Asia's third largest stock market by capitalisation. In terms of IPO funds raised, we were first in the world during the first 10 months of 2015, and have been among the top five since 2002.

At the same time, the offshore Renminbi (RMB) market was born here in 2004 when Hong Kong banks started to offer RMB deposits, exchange, remittance and credit card services to personal customers. This was followed by the issuance of the first offshore RMB bond in 2007, the launch of RMB cross-border trade settlement arrangement in 2009 and the introduction of the RMB Qualified Foreign Institutional Investor (RQFII) scheme in 2011. During the process, Hong Kong has played the role as a unique testing ground for various policies designed to increase the use of RMB offshore.

Standing at about RMB1 trillion at the end of October, Hong Kong's pool of offshore RMB liquidity was the largest in the world. At the same time, outstanding RMB loans stood at RMB294 billion and a total volume of over RMB660 billion of RMB bonds was issued on an accumulative basis. During the first 10 months of 2015, RMB5,700 billion worth of cross-border RMB trades were handled by Hong Kong banks, with 217 banks participating in our RMB clearing platform.

Hong Kong is also an offshore RMB asset management centre, with 79 fund companies granted RQFII quotas and 95 listed and unlisted funds managing over RMB60 billion. The daily volume of RMB handled by our RTGS (Real Time Gross Settlement) passed the RMB1,000 billion mark for the first time in July, surpassing the daily HKD amount settled.

In September, RMB was the fifth most used payment currency in the world according to the Society for Worldwide Interbank Financial

Telecommunication (SWIFT), and 70 per cent of the RMB settlements are conducted in Hong Kong. After two years of smooth operation here, the RQFII scheme is now expanded to 13 markets in the rest of the world. We have also grown into the largest and most efficient offshore RMB centre during the process.

All this time Shanghai has not been sitting on the sidelines. In fact, the rapid growth of Shanghai's capital markets is no less spectacular, playing a crucial role in the reform process of the Mainland's capital market. In 1990, the State Council announced the development of the Pudong New District and the Lujiazui Financial Zone. At the end of the same year, the Shanghai Stock Exchange was established with 25 members and eight listed companies issuing 30 types of securities. At the end of October, the Shanghai market was already the world's fourth largest by market capitalisation, with 1,071 listed companies that were worth a total of RMB27,850 billion. The Shanghai Composite Index, too, has also grown from a base of 100 to 3,456 points on Monday, witnessing the exponential growth of the Mainland economy and capital markets.

Besides being an equities stronghold, Shanghai is also a trading centre for metals and agricultural commodities futures. Founded in 1999, the Shanghai Futures Exchange offers trading services for 14 futures contracts with more than 200 members and is one of the major futures exchanges in the Mainland.

In 2013, the China (Shanghai) Free Trade Zone was established to speed up innovation in financial regulations, capital account opening, interest rate liberalisation, exchange controls and ownership. The setup of the Free Trade Zone clearly demonstrates the new leadership's commitment to reforms and opening, as well as the role Shanghai is playing in supporting the real economy through financial reforms.

It is only with this background in mind that we can fully appreciate the significance of the Shanghai-Hong Kong Stock Connect launched last year. Through direct connection between the two exchanges in the same time zone, the Stock Connect allows direct access between two markets in a risk-managed manner. With a total market capitalisation of US$7,624 billion at the end of October, the combined market was the second largest in the world.

Through regulatory co-operation between the China Securities Regulatory Commission and the Hong Kong Securities and Futures Commission, the Stock Connect arrangement allows each market to reserve their respective rules and regulations, laying the foundation for further co-operation in other areas. The launch of the Stock Connect is the boldest step yet in China's push towards full opening of its capital markets - a pledge made at the Third Plenum in 2013.

The Mutual Recognition of Funds arrangement implemented in July is another exemplification of the Central Government's commitment to open the Mainland's capital markets. As the first such scheme between the Mainland and a market outside the Mainland, the MRF 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.

With capital flows managed by professional asset managers, the MRF will expand mutual capital market access between the Mainland and Hong Kong in an orderly manner and raise the participation of institutional investors in the Mainland. The scheme will allow Hong Kong and international investors to access the Mainland's diverse pool of public funds. At the same time, many asset managers are already getting themselves ready for distribution in the Mainland by upgrading their Hong Kong operations and building distribution networks. As more funds will be domiciled in Hong Kong, the scheme will help strengthen our fund manufacturing capabilities and 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 jointly develop a shared set of regulatory standards for fund products. A shared standard will help promote integration of the Asian asset management industry and facilitate the transfer of Asian savings into cross-border investments in the region. 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.

The successful launch of the Stock Connect and the MRF is not only a manifestation of the Central Government's commitment to reform and opening; it also exemplifies the complementary nature between Shanghai's and Hong Kong's markets. An efficient and developed capital market will help companies of all sizes in China to raise the much needed capital. Such a market will also serve the society by allowing individuals and corporations to grow their wealth and allow individuals to plan for their retirement.

Going forward, Hong Kong will continue to consolidate our role as China's international financial centre by capturing the opportunities brought about by the Mainland's continued reform and opening under the 13th Five-Year Plan. We will also take advantage of the continuing capital market opening, especially the improved flows between the offshore and onshore markets, to improve the breadth and depth of our RMB markets, so funds may be raised and transactions may be executed more cheaply and efficiently.

This is of utmost importance as the RMB was included by the International Monetary Fund (IMF) into its Special Drawing Rights (SDR) currency basket this week. The IMF's decision is a key milestone in RMB internationalisation. In the past decade, the RMB has made significant progress in its use as a trading currency and investment currency. The addition of the RMB to the SDR basket will establish its use as a reserve currency.

Joining the US dollar, Euro, pound sterling and Japanese yen, the RMB will have a weight of 10.92 per cent in the basket. The demand for RMB will hugely increase as the addition takes effect next October. The increase in RMB holdings by central banks in the world is estimated to be in the order of thousands of billions of RMB, along with enormous demand for RMB-denominated assets. The global RMB market will see increases in the needs for derivatives and other risk management tools. As the largest offshore RMB centre with close ties with the Mainland, Hong Kong will seize this historic opportunity to strengthen our RMB infrastructure and product offerings.

The IMF decision is also a timely one as China adopts the "Belt and Road" development strategy and the Asian Infrastructure Investment Bank is being set up. Financial integration has been a hot topic among Asian officials and the industry in recent years. Financial reform and opening is seen by many as a means to promote economic growth and integration. However, I believe financial integration is impossible without true openness in trade and investment flows. In other words, financial integration cannot precede economic and trade integration.

We have seen a lot of progress towards liberalising trade and investment flows in the past years. And in this regard, China's "Belt and Road" initiative is going to play an important role in the future. It is a blueprint to integrate China with the rest of the world. It is also a vision to help Asian economies integrate more closely together.

Infrastructure investments along the Belt-Road will promote cross-border investment flows. It is with this vision in mind that the Asian Infrastructure Investment Bank, or AIIB, was set up to raise capital for such investments. The bank is expected to be in operation this month and we look forward to seeing the resulting investment flows between the countries.

The ultimate goal of financial integration is to channel Asian savings in Asian investments to support sustainable economic growth in the region. Hong Kong, as an international financial centre, will also benefit from financial and economic integration.

Under "one country, two systems", Hong Kong maintains our own institutions while being part of China. We are in the front seat to witness and help promote China's economic and financial reforms. As I mentioned before, financial integration does not happen in a vacuum; it follows real trades, investment flows and people connections. As such, Hong Kong is in the best position to provide the business facilitation and financial intermediation in connecting the rest of the world with China.

During this process, Hong Kong's role as an international financial centre will continue to evolve in response to market demands. Due to market restrictions in the past, Hong Kong and Shanghai were de facto financial hubs for the offshore and onshore markets respectively, but with little connection between the two. As the Mainland markets continue to open, the division of labour between Shanghai and Hong Kong will continue to change.

The Shanghai markets will gradually become more international, and the RMB will eventually be freely convertible. These developments will open Hong Kong to opportunities that were not available before. And at the same time, the division between the offshore and onshore markets will be blurred, and the two markets will be more intertwined with each other. It does not mean that Hong Kong will lose our offshore market advantage. Rather, our offshore market should not be built on the basis of a closed China market. We should make full use of the opening of China's capital market, and the increasing linkage between the offshore and onshore markets, to build an international financial centre that serves the increasing appetite of the world for Chinese currency and investment assets.

This process will be a dynamic one and may take a while, subject to the external environment and pace of reform in the Mainland. There will not be a charted course for us to follow. However, we have learnt from past experience that the energy and opportunities unleashed from new reform will benefit all parties involved.

As such, Hong Kong will continue to position ourselves as China's international financial centre. We will continue to embrace a nationality-neutral policy and to maintain low tax rates and a simple tax regime. We will also preserve our multiculturalism through setting a level playing field, and welcome individuals and companies from all over the world to set up here. The financial industry should also stay competitive and alert of the many changes that are occurring every day. By taking full advantage of opportunities arising from the Stock Connect, Mutual Recognition of Funds, "Belt and Road" and the 13th Five-Year Plan, Shanghai and Hong Kong will be able to play their respective roles and contribute to China's reform and development.

Thank you.

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