

**Speech by SFST at 5th Annual Hedge Funds Conference
(English only)**

Tuesday, December 11, 2007

Following is a speech by the Secretary for Financial Services and the Treasury, Professor K C Chan, at the 5th Annual Hedge Funds Conference today (December 11):

Hong Kong: Hedge Fund Hub of Asia

Christophe (Lee), distinguished guests, ladies and gentlemen:

Good afternoon. It gives me great pleasure to join you today at the 5th Annual Hedge Funds Conference hosted by the Alternative Investment Management Association (AIMA) Hong Kong Chapter. The conference has been a great success in the past four years and I would like to express my gratitude to AIMA for staging this event, which provides a very good opportunity for industry players to exchange views on the development of the hedge fund industry in Hong Kong.

A decade ago, it would have been rather controversial to talk about hedge funds, given the Asian economies were hard hit by a severe financial crisis widely believed to be triggered by a group of aggressive hedge funds at that time. Today, the hedge fund industry has become an important driving force in the global financial markets. At present, there are about 10,000 hedge funds around the world with assets under management (AUM) amounting to US\$2.5 trillion. It is believed that hedge funds now account for about 40% of the turnover of major stock exchanges in the world, or a quarter of the derivatives turnover. These statistics suggest that the hedge fund industry has become an important pillar of the world's financial markets.

Hong Kong has been proactive in promoting the development of the fund management industry. We have adopted various measures to attract new funds, including hedge funds, that meet the relevant requirements to set up in Hong Kong. Let me give you a brief overview of the development of our hedge fund industry, our strengths as a hedge fund hub in Asia and what we have done to promote the further development of the industry.

Hong Kong as a Hedge Fund Hub of Asia

In recent years, many hedge fund houses from the US and Europe have sought to establish their presence in Asia to pursue Asian-focused strategies. The attraction of the Asian markets mainly lies in the vibrant economic growth, high liquidity and liberalisation of the capital markets in the region. The influx of the US and European capital has driven the growth of the Asian hedge fund industry, with the number of hedge funds in Asia increased substantially from 160 in 2001 to about 1,240 in the first half of 2007. The total AUM has also increased by nine times, from US\$16 billion to about US\$167 billion during the same period.

As an international financial centre known for its economic freedom and sound regulation, Hong Kong's development as a hedge fund hub in Asia has been very encouraging. We are now one of the largest hedge fund centres in Asia. According to AsiaHedge, Hong Kong got the largest number of new Asia Pacific hedge funds launched in 2006 as well as in the first half of 2007, ahead of Singapore, Japan and Australia. A survey conducted by the Securities and Futures Commission (SFC) revealed that the aggregate AUM of hedge funds in Hong Kong amounted to US\$33.5 billion as at end March 2006, representing an increase of 268% over the amount as at end March 2004. The number of hedge fund managers also increased significantly, from 58 to 118 during the same period.

Several facts about the hedge fund industry in Hong Kong are noteworthy. First, most of the hedge funds managed in Hong Kong serve institutional investors, both local and overseas. Second, among the top 20 hedge fund managers as at end March 2006, 13 of them were affiliates of hedge fund managers from the US, the UK and Japan, while the rest were local start-ups. This suggests that our hedge fund market has a cluster of both international and local hedge fund managers. Third, Hong Kong is one of the first few jurisdictions in the world to allow the sale of hedge funds to the retail public. Currently, there are 14 retail hedge funds in Hong Kong. Their total net asset size amounted to US\$1.67 billion as at end September 2007. The retail hedge funds have created a domestic investor community for our hedge fund industry, hence diversifying the client base of our hedge fund industry.

Hong Kong's Strengths as the Hedge Fund Hub of Asia

So what are the strengths of Hong Kong as the hedge fund hub of Asia? Overseas hedge fund managers, especially the larger ones, prefer setting up in Hong Kong because of our proximity to Mainland China and Northern Asia. Situated at the heart of Asia and as the gateway to Mainland China, Hong Kong serves as an ideal place to access those markets. We also have a number of fundamental strengths conducive to the development of the hedge fund industry, which include -

- * the rule of law, supported by an independent judiciary;
- * a low and simple tax regime;
- * a stable currency with no foreign exchange control; and
- * a free economy.

Indeed, Hong Kong was rated by the Heritage Foundation as the world's freest economy for the 13th consecutive year earlier this year. Apart from the strengths that I just mentioned, the Foundation commented that our business regulation is simple; investment in Hong Kong is wide open with virtually no restrictions on foreign capital; and the labour market is highly flexible. These have given fund managers much flexibility and convenience.

Another competitive edge of Hong Kong is our rich pool of high quality financial professionals. A research conducted by the SFC last year revealed that Hong Kong ranked 1st among 13 major Asian economies in terms of the availability of competent senior managers and their international experience. Market practitioners also responded that they were satisfied with the quality of our professional services, including legal, accounting and consulting services. They also commented that Hong Kong has a strong market infrastructure for the establishment of fund management businesses, such as custodians, administrators, prime brokers, etc. Such infrastructure and human capital have given Hong Kong an edge to attract quality fund managers from around the world to set up operation in the territory.

Indeed, our strengths as an international financial centre are recognised worldwide. The Global Financial Centres Index published by the City of London Corporation in September this year ranked Hong Kong as the 3rd major world financial centre, following London and New York. The report commented that Hong Kong has a strong regulatory environment and performs well in all of the key competitiveness areas.

Government Initiatives

Although Hong Kong is doing well in our fund management business, we cannot afford to be complacent and must continue to enhance the competitiveness of our fund management industry. In this regard, the Government and the SFC have been adopting a number of measures to promote the fund management industry in Hong Kong. To begin with, our regulators place great emphasis on the facilitation of market development. In June this year, the SFC announced a set of initiatives to streamline the licensing procedures for overseas fund managers, including hedge fund managers. These include expediting the licensing process for firms that are already registered as investment managers or advisors in specified overseas countries; and simplifying the licensing process for overseas fund firms wishing to operate in Hong Kong. We have received positive feedback from the industry on the streamlined procedures. Many fund management companies can now obtain their licences within a few weeks. We will continue to review our regulatory process to ensure that it is responsive to market development and needs.

Secondly, we have adopted various tax measures to promote the growth of the industry. Since 2006, offshore funds have been exempted from profits tax. This brings us in line with other major financial centres such as New York and London. More importantly, the measure helps attract new offshore funds to come to Hong Kong and encourages existing offshore funds to continue to invest in Hong Kong. We have also abolished estate duty since last year to encourage local and overseas investors to invest in Hong Kong. To further enhance our competitiveness, the Chief Executive announced in his Policy Address in October this year that our profits tax will be reduced from 17.5% to 16.5% in 2008-09. Given our already low and simple tax regime, these measures will further enhance our attractiveness to overseas fund managers.

Thirdly, we have embarked on a series of overseas visits to promote our strengths as an international financial centre and as Asia's major asset management centre. In the past year, we visited a number of countries and cities in the Middle East, Asia and North America to promote our financial services. InvestHK has also proactively conducted visits to targeted fund management firms located overseas and in the Mainland to promote our fund management industry. Looking ahead, we will continue to lead financial services delegations to selected cities in the Mainland and in Asia to let more overseas investors understand the strengths of our business environment and our policy towards the fund management industry.

A well-established fund management business is beneficial to our economy. It forms a high-value added services chain with other professional services, such as legal, accounting, corporate consulting etc, and as a result strengthens our role as an international financial centre. In particular, hedge funds play a critical role in the development of our fund management business. Hedge funds improve the pricing efficiency of financial markets and act as an important source of liquidity, risk transferring and diversification. It is therefore important to continue to promote our fund management business and attract hedge funds to set up in Hong Kong. This would help attract foreign capital and bring about innovations, efficiency and liquidity to our markets.

While we are committed to facilitating the fund management industry in Hong Kong, adopting proper regulation is equally important. Under the current regulatory regime, all hedge fund managers operating in Hong Kong are required to be licensed regardless of whether the related fund is private or publicly offered. In addition, the SFC has been working closely with leading industry bodies to safeguard investor interests, market integrity and the reputation of Hong Kong's financial market. Our goal is to facilitate the development of the fund management industry as far as practicable without compromising investors' interests. In this regard, I would like to thank AIMA for its contribution in promoting investor education, transparency, due diligence and sound practices among the industry over the years. Your efforts in promoting the understanding of alternative investments both here and overseas are highly appreciated.

Prospects of the Fund Management Industry

The potential of the growth of the fund management business in Asia is substantial, thanks to the robust economic growth and the acceleration of wealth creation in Asia in recent years. According to the World Wealth Report 2007 published by Merrill Lynch and Capgemini, the number of high net worth individuals grew by 8.6% to 2.6 million in the Asia-Pacific Region in 2006. Their combined wealth is expected to grow from US\$ 8.4 trillion in 2006 to US\$12.7 trillion in 2011. This will certainly fuel the growth of the hedge fund industry. Market sources estimated that the Asian hedge fund industry could be worth as much as US\$250 billion by the end of the decade.

Furthermore, our country's rapid development and the opening up of its financial services sector have presented unprecedented opportunities for Hong Kong. In the past few months, the Mainland authorities have relaxed the Qualified Domestic Institutional Investor (QDII) Scheme to allow Mainland commercial banks, securities firms, fund management companies and insurance companies to invest in Hong Kong stocks and other specified securities. Against the backdrop of the potential growth in the Asian markets, coupled with our proximity, linguistic and cultural affinities, and increasingly close economic co-operation with the Mainland, Hong Kong is best placed to capture the tremendous opportunities under these measures.

Concluding Remarks

Ladies and gentlemen, the prospect for our hedge fund industry is promising. The Government will continue to spare no efforts in promoting the development of the industry. I look forward to working with you to reinforce Hong Kong's position as a Hedge Fund Hub in Asia.

Thank you.

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