

**Speech at the Hong Kong Securities Institute Luncheon
by Mr Eddy Fong
Chairman, Securities and Futures Commission
“Positioning Hong Kong in a Competitive Global Marketplace”
19 March 2007**

Good afternoon Ladies and Gentlemen,

1. First of all, thank you very much for inviting me today. I am particularly pleased to be here. As you know, the SFC and HKSI have a close and long working relationship. My colleagues sit on HKSI’s Board and some of its committees. Both organisations share the objective of raising the standards and professional knowledge of our market participants. We hold constant dialogue on the development of industry-related courses and training programmes. This is important in today’s ever-changing marketplace where practitioners must keep abreast of developments in their field if they are to provide a proper service to their clients.
2. Well, it has been five months since I took up my role as Chairman of the Securities and Futures Commission. As non-executive Chairman, my main responsibility is to lead the Commission Board in setting the overall direction and policies. So what I thought I would do today is share with you my thoughts on the most important strategic issue facing Hong Kong as a leading international financial centre, i.e. how do we position Hong Kong in an increasingly competitive marketplace, and what specific role the SFC would play in this.

The need for positioning

3. Now, you may ask: Why is it important for the SFC to look at this issue? Is it not the role of the SFC to just regulate the market, set rules and regulations, and take action against those who breach the rules?
4. If you have read our past annual reports, you will have noticed that the SFC’s key roles include not only regulation and enforcement, but also market facilitation and investor education. We see each of these roles as equally important. SFC is not just here to regulate and police the financial market, but also to actively help enhance its quality and status. This is also reflected in our core mission, which is to provide a regulatory environment that is conducive to both market development and market regulation. Issues like positioning and competitiveness are therefore highly relevant to us.
5. In fact, governments around the world have been concerned with these issues recently. Globalisation and technology have revolutionised the marketplace and empowered the individual investor as never before. At the same time, the rise of emerging markets – particularly China – has focused much of the financial world’s attention to investment in this part of the world. Together, these developments have had a significant impact on the competitiveness of markets around the world. Even the largest markets – such as New York and London – find it necessary to reassess their position on the global stage.

6. Back in November 2005, the City of London conducted a study of global financial centres and how London ranked among them. The study concluded that London and New York were the only two genuinely global financial centres. However, it also cautioned against complacency. The study identified 14 most important competitive factors for financial centres. The top three are the availability of skilled personnel, the nature of the regulatory environment, and access to international financial markets, i.e. how easy it is for intermediaries to trade financial products in other jurisdictions.
7. Just last week, the City of London published another report on 46 financial centres worldwide. It confirms London and New York as the two leading global financial centres, and to our delight puts Hong Kong in the third place. The report says Hong Kong performs well in all the key areas, especially in regulation – which was also rated by respondents to its survey as a major component in considering the competitiveness of a market. The report concludes that Hong Kong is a real contender to become a genuinely global financial centre. It is interesting to note also that while there was no clear leader among the Asian centres in the 2005 report, the latest analysis suggests that Hong Kong leads the way from Singapore and is well ahead of other Asian centres including Tokyo.
8. In the City of New York, Mayor Michael Bloomberg last year commissioned a study to identify the specific variables that are negatively impacting its financial services industry, and recommend an action plan to correct them. The report was issued in January. It confirmed that the US's and New York's historically strong position in financial services is under threat from both external and internal challenges. The report also identified three main competitive factors: these are skilled workers, the legal environment and regulatory balance.
9. It is telling, though perhaps not surprising, that the world's two largest and leading markets should consider it necessary to review their competitiveness. If anything, this only confirms that Hong Kong too – despite its many achievements in recent years – cannot afford to be complacent.
10. It is also noteworthy that all these studies highlighted the existence of an appropriate regulatory regime as being a key factor in competitiveness. It also highlights the importance of striking a proper balance between regulating markets effectively and allowing them to develop in line with market needs. I hasten to say that while we endeavour to find that right balance, the optimal result is not always easy to come by. I would seek to knit together some of the more inter-related elements and outline how the SFC may help maintain the competitiveness of the Hong Kong financial market.
11. A thorough analysis of this subject involves many complicated issues, and I would focus on two aspects which, in my view, can make the most difference. The two areas are:
 - First, capitalise and build on the Mainland connection, and on Hong Kong's unique ability to serve as a bridge between the Mainland and the rest of the world; and
 - Second, reinforce its competitive edge by constantly reviewing and enhancing the quality of the market.

12. These are two of Hong Kong's greatest strengths, and each serves to reinforce the other. Our international characteristics enable us to serve as a bridge between the Mainland and the rest of the world. At the same time, our deeply rooted Mainland connection makes us an attractive platform for international players to invest in the Mainland. And the SFC has an important role to play in enhancing these aspects. Let me explain.

Enhancing the Mainland connection

13. The Mainland's economic transformation over the last two decades has provided many opportunities for partnership and co-operation between the two places, particularly in financial services. This partnership has been facilitated by the fact that we enjoy a close relationship with the Mainland, and that we are familiar with the languages, culture, practices and systems there. But, more importantly, by the fact that our strengths and needs are complementary.

Serving as the premier fund raising centre for Mainland enterprises

14. Since the early 1990s, Hong Kong has been serving as the premier overseas fund raising centre for Mainland enterprises – in other words, a conduit for bringing international capital into the Mainland. This partnership has brought substantial benefits for both places – and will continue to do so in the future. The numbers speak for themselves.
15. Our stock market is the 6th largest in the world in terms of market capitalisation and the 2nd largest in Asia. Close to 50% of this market cap and turnover is attributable to Mainland enterprises.
16. In addition, Hong Kong last year ranked 2nd worldwide (after only London) in terms of total funds raised through IPOs, and Mainland enterprises accounted for almost 90% of the funds raised. Some of these IPOs, qualified as among the world's largest, are well known to you – such as China Construction Bank, Bank of China, China Merchants Bank, and the record breaking ICBC.
17. The Mainland has also benefited from this cross-border fund-raising, and some of these benefits have a significant impact on the longer-term development of its economy and capital markets. In particular, a Hong Kong listing helps raise the regulatory and corporate governance standards of a Mainland enterprise. Over time, international standards will become the norm for Mainland companies, and eventually the Mainland market as a whole. International investors are keen to invest in Mainland companies with high growth potential and good corporate governance.
18. A word of caution though. With the success in the A share reform and the re-launch of the IPOs in the Mainland since April 2006, confidence has returned to the markets in the Mainland. We have witnessed an upsurge both in volume and prices to very high level in the Mainland exchanges. The market capitalisation of the shares listed in the Shanghai exchange had risen from RMB2,700 billion in April 2006 to RMB7,200 billion at the end of the year. Similarly, the average P/E of shares listed in Shanghai had also risen from 19.4 to 33.3. This robust environment has raised concerns among many stakeholders as to the long term future of the Hong Kong market. With the

abundance of capital and the attraction of higher P/Es, many cast doubts as to whether Mainland enterprises will continue to list in Hong Kong. Contrary to such concerns, I hold the view that, with the fundamentals just described and others that I am to mention later, Hong Kong will remain as an attractive place for Mainland enterprises (privately or state owned) to list.

Serving as an investment platform for Mainland investors

19. Hong Kong has at the same time served as an investment platform for Mainland investors looking overseas – in other words, as a conduit for channelling the Mainland’s huge savings to the international market.
20. In recent years, China has made significant changes to gradually relax restrictions on overseas investments and cross-border capital flows. Examples include the QFII and the QDII schemes. These have opened up channels for international investors to invest in the Mainland, and for Mainland investors to invest overseas. This, in turn, has created new business opportunities.
21. Hong Kong is ideally suited to capture these opportunities for the following reasons:
22. We offer a broad range of investment products ranging from low risk funds (such as bond or money market funds) to more sophisticated and specialised products (such as REITs, exchange-traded funds and hedge funds).
23. We are a leading fund management centre in the region. The total asset size of the fund management business in Hong Kong was US\$580 billion at the end of 2005.
24. Our fund management industry has a very strong international and offshore nature. Around 60% of our investment funds are sourced from outside Hong Kong and the majority of assets are invested outside Hong Kong.
25. Our financial intermediaries also have much to offer. Large international firms who focus on institutional investors already have an established network to international capital markets and sophisticated products and services. A good example is that last November, the National Council for Social Security Fund appointed a number of international institutions to manage a substantial part of its fund that is allocated for investment outside of the Mainland, and many of these managers have a significant presence here or have strong ties with Hong Kong. I am sure you are also familiar with most of the names.
26. Hong Kong therefore has much to offer in terms of skills, experience, products and services, and can play a key role in helping Mainland institutions that are seeking to invest overseas.

SFC’s role in fostering development with the Mainland

27. So far, I have talked about Hong Kong serving as the premier fund raising centre and as an investment platform for Mainland investors. Now I would like to turn to the question of the specific role of the SFC in this regard.

28. I believe our role is essentially two-fold. First – and this is perhaps the more obvious role – putting in place appropriate regulation of world-class standards that would facilitate market development. Second, developing closer regulatory co-operation with the Mainland authorities. This co-operative relationship is unique between the Mainland and Hong Kong, and I would like to elaborate a little on this.

SFC's role in strengthening regulatory co-operation

29. The SFC has long enjoyed a constructive and mutually respectful relationship with the China Securities Regulatory Commission (CSRC). Well back in 1993, the CSRC, the SFC and the three exchanges in Hong Kong, Shanghai and Shenzhen entered into a Memorandum of Regulatory Co-operation in recognition of the increasingly close relationship between the two markets. Over the years, this relationship has been further strengthened through consultation, co-operation, and exchange of personnel. Both the CSRC and SFC are members of the IOSCO, or the International Organization of Securities Commissions. We work closely together on many international regulatory issues.
30. Elsewhere, the SFC and CSRC have also worked closely to implement CEPA where it applies to the securities and futures industry. In particular, we have agreed to mutually recognise each other's securities and futures market qualification for practitioners. This offers a simplified alternative route for professionals from both jurisdictions to work across the border. It also facilitates the flow of qualified personnel and expertise, thus contributing to the further development and competitiveness of both markets.
31. Regulatory co-operation between the SFC and the CSRC is, in my view, critical. Both sides recognise this, and the dialogue will continue.
32. So that covers my first point about capitalising and building on our Mainland connection. I turn now to my second point, which is on reinforcing our position by constantly upgrading the quality of the market.

Reviewing and enhancing the quality of the market

33. The position of Hong Kong as an international financial centre has contributed significantly to Hong Kong's renown today as a world-class city. Many factors have helped to establish Hong Kong's status as an IFC of global significance. These include –
- a well-established market infrastructure that allows for the efficient conduct of international financial transactions
 - a robust, effective and fair regulatory regime that is on a par with international standards
 - proximity to major markets – and particularly the Mainland market
 - a rich pool of experienced professionals and the presence of established intermediaries with a global presence
 - a business and investor-friendly tax regime
34. As the securities market regulator, we can help enhance some of these factors by implementing appropriate policies and practices. In particular, we can play an active

role in enhancing our market infrastructure and regulatory regime so that they are in keeping with global developments. By doing so, we improve the quality, and hence attractiveness, of our market.

35. Perhaps I can share with you some of the policies and measures that we have implemented over the last few years – and some that we are currently working on.
36. First, we have implemented measures to enhance the regulation, and hence quality of our listed companies. Our measures include putting in place the dual filing system, a corporate governance code and a code for sponsors. We will continue to improve corporate governance with the proposal to give statutory backing to important listing requirements.
37. Second, we have been working closely with the Exchange and other market participants to widen and improve our product base, upgrade the trading environment and reduce transaction costs.
38. Third, we have also worked on ensuring that our enforcement powers are adequate and our actions are transparent. Our philosophy is to encourage compliance, rather than enforcement.
39. In addition, some of the initiatives that we are actively engaged in, together with the industry and stakeholders, are:
 - facilitating the listing of companies from more overseas jurisdictions;
 - promoting Hong Kong as an offshore RMB centre;
 - coordinating various issues relating to dual listing of H and A shares; and
 - studying the potential of setting up a commodity futures market in Hong Kong.
40. As you can see, our efforts are in line with the proposals under the financial services Action Agenda of the Report on Economic Summit in response to China's 11th Five-Year Plan, announced by the Hong Kong SAR Government in January.
41. Going forward, in order for the SFC to continue to play a key role in enhancing the quality of the market, we must review the way we carry out our functions, such as by adopting a pro-business approach, further streamlining our processes, having more frequent dialogue with the industry, and ensuring our frontline staff are well equipped to handle matters raised by market participants.

Providing adequate and appropriate investor education

42. As we discuss the positioning of the Hong Kong market, we must not lose sight of the importance of investor education. Let me explain.
43. Our financial markets will become increasingly complex. The products and services offered will also become increasingly sophisticated and diverse. It is vital therefore that regulators, financial intermediaries and investors have a good understanding of the benefits and risks involved so that they can play their part in the market properly.
 - Regulators need to understand new products and services before they can determine how best to regulate them.

- Exchanges, intermediaries and professional service providers need to understand new products and services before they can promote them to investors or give advice.
 - Investors need to understand new products and services before they can determine whether these are suitable for them.
44. A more diverse product range and an active market have attracted new investors and will likely attract more – some of whom may not only be new to our markets or the specific products, but new to investing altogether. Investors have different levels of experience and it is important that our investor education efforts are able to serve these different needs.
45. To that end, we have a continuously updated investor education programme targeting different products and risks. Our theme for 2007 is “Know your risk” .
46. In his recent Budget speech, the Financial Secretary announced that the SFC would explore ways of using part of its levy income to enhance investor protection and education. To that end, the SFC has proposed establishing an investor education body to improve investor education across the financial services sectors. We have received initial support from the Government and other financial regulators. We are forming a working group to take the proposal forward.

Conclusion

47. So that covers what I wanted to share with you today. To sum up:
48. We need to recognise that despite Hong Kong’s success in recent years, there is no room for complacency in the face of increasing competition.
49. That we need to focus on the two main drivers: Hong Kong’s connection with the Mainland and a quality market. The SFC has a clear role to play in both respects.
50. At the same time, we must also ensure that our investor education efforts meet the varying needs of our bigger and more diverse investor base.
51. At the end of the day, maintaining Hong Kong’s competitiveness is a shared responsibility. The SFC will continue to work with its stakeholders – including the Government, fellow regulators, the Exchange, market professionals and participants, and of course, the Mainland authorities - to achieve this goal. I am confident that, with our combined efforts and given its fundamental strengths, the Hong Kong market is ready to meet the challenges and embrace the opportunities.
52. Thank you.