

Finsia Luncheon on 6 March 2007

Mr Martin Wheatley's speech on "Opportunities in Hong Kong and China"

Ladies and Gentlemen,

Thank you for inviting me to your luncheon meeting today to talk about investment management opportunities in Hong Kong and China. Perhaps if I can start with Hong Kong, I will run down just some of the attributes that make Hong Kong such a superb place for investment management opportunities. For those who are Hong Kong "old hands", do excuse me for stating the obvious.

Hong Kong Attributes

A new comer to Hong Kong will be awed by the seemingly endless energy of the people that deliver world-class performance standards. In addition to boundless energy, we have

- Rule of law supported by an independent judiciary;
- A well established financial infrastructure, our banking system, the exchanges and the related clearing houses are equal to the best in the world;
- A robust and effective but fair regulatory regime;
- A rich pool of talents;
- A low and simple tax regime; and
- Geographically close to Mainland China.

We are also fortunate to have a Government that is fully committed to providing a conducive environment to attract overseas foreign investment. For instance, the Government has abolished estate duty and introduced profit tax exemption for offshore funds. Such measures substantially enhance our competitiveness in comparison with other major financial centers.

With such attributes, it is not surprising to note that for four consecutive years, Hong Kong has been ranked by the World Investment Report published by the United Nations as the second most preferred destination for foreign direct investment in Asia, after Mainland China.

Hong Kong's capital market

Today, Hong Kong is the premier fund raising centre for Mainland enterprises. In terms of market capitalization, Hong Kong's stock market is the 6th largest in the world and the 2nd largest in Asia after Japan. The IPO fund raising for the 2006 amounted to US\$43 billion. In IPO terms, HK ranked second in the world after London, and ahead of New York.

On the asset management side, perhaps if we can begin with some numbers so that you will have some idea about how big is the industry. In 2005, Hong Kong's combined asset management business, which included asset management, advisory business, other private banking business, and REITs management, amounted to US\$580 billion. To give you an indication, the size of Hong Kong's combined fund

management business as at the end of 2005 was equivalent to 55% of Hong Kong's stock market capitalization.

A recent Retail Investor Survey found that investment funds were Hong Kong retail investors' second most popular investment, with a participation rate that has doubled in two years to 18.1% in 2005. As of December 2006, the SFC has authorized nearly 2,000 unit trusts and mutual funds for offering to the public.

Hong Kong continues to be a leading financial centre with a strong international flavour. Most of fund management business comes from overseas. Capitalizing on Hong Kong's position as a magnet for overseas funds, companies continue to select Hong Kong as one of their key strategic markets to conduct asset management business.

Growth of Hong Kong's hedge funds market

Hong Kong is not only a leading asset management centre for traditional funds but also for hedge funds. AsiaHedge reported that Hong Kong has got the largest number of new Asian hedge funds within Asia in 2005 and 2006. In respect of aggregate asset size of these start-ups, Hong Kong also ranked first within Asia in both 2005 and 2006.

We also did a survey on the operations of hedge fund managers licensed by the SFC. According to SFC's survey, the total hedge funds' assets under management in Hong Kong also increased by a staggering 268% during the period from March 2004 to March 2006 to US\$33.5 billion, and the number of hedge fund managers doubled to 118 as of March 2006. Now, we have about 140 licensed hedge fund managers / advisors in Hong Kong. There are now 14 retail hedge funds authorized by the SFC with a total net asset value of over US\$1.66 billion at the end of 2006. Although the size of authorized hedge funds is relatively small in the context of the whole hedge fund universe, the introduction of retail hedge funds does provide investors with an access to a wider range of investment choices.

Opportunities in China

I now turn to the investment management opportunity in China. Without doubt, the spotlight is now on China and the Mainland has become the focal point for good reason as the Mainland's economy is expanding rapidly, with the world's biggest saving pools (US\$2 trillion according to market sources) and the world's largest foreign currency reserve of over US\$1 trillion. Such liquidity brings significant opportunities for both investors and asset managers. To avail to this investment opportunity, I would like to talk about 3 possible channels.

First, through Hong Kong Securities Market

As at the end of Dec 2006, there were a total of 1,173 companies listed here with a total market capitalization of about US\$1,710 billion. Of these, about 31% were Mainland enterprises and their aggregate market capitalization came to about US\$860 billion (or 50% of our total market capitalization).

Moreover, some of the world's largest IPOs have taken place in Hong Kong. Mainland's largest bank, Industrial and Commercial Bank of China (ICBC), listed on the Hong Kong Stock Exchange in 2006. This was not only Hong Kong's largest IPO ever but also the world's largest ever. In addition, Bank of China and China Construction Bank, which were listed in the past two years, also ranked among the top 10 largest global IPOs ever.

Our key strength, in addition to those attributes I mentioned earlier, is that we are ideally positioned to act as a bridge between the Mainland and the rest of the world. We enjoy close relations and proximity to the Mainland, and are also familiar with the languages, culture, practices and systems on the Mainland. The combination of these qualities make us an ideal partner choice for both Mainland enterprises looking to raise funds outside the Mainland and international investors looking to tap into the growing Mainland economy.

For their part, international investors looking to tap into the growing China market can look to a single platform for access to good quality Mainland companies with high growth potential. They can also take comfort in knowing that Mainland companies listed in Hong Kong have met rules and regulations, which are on a par with international standards, and will continue to be subject to them.

Second, through QFII

In 2006, the Mainland's domestic A-share market surged 130% and domestic mutual funds topped US\$100 billion. This increase of the size of the domestic mutual funds was largely driven by two factors – a big shift in investments from money market funds (investing in short-dated bonds) to equity products as well as the sizeable jump in China's domestic A share market.

The asset management industry in China is also enjoying rapid growth – there has been a 10 times increase in total assets under management within six years between 2001 and 2006. In one year alone, total AUM jumped by 84% (from US\$59 billion in 2005 to US\$107 billion at the end of December 2006).

The sheer volume of Mainland investor money hungry for investing opportunities is a well documented phenomenon. As an example, a new Mainland joint venture fund management company between Harvest Fund Management Co. Ltd. and Deutsche Bank saw a bumper fund launch in the final quarter of 2006. One of their new funds was able to receive US\$5 billion in subscription money in just one day.

So, the question now, is how does one tap into the lucrative Mainland market? Although the market is opening up at an unprecedented rate, restrictions abound. Foreign access to domestic China securities is possible through the QFII (Qualified Foreign Institutional Investors which are allowed to invest in Mainland securities) scheme. By obtaining QFII status, asset management companies can directly play the China securities market. As at the end of December 2006, there were 52 approved QFII with a total quota of US\$9 billion for investing in the Mainland securities market. We have seen some of these QFII quotas used to package retail fund products in Hong Kong. An example is the FTSE/Xinhua A50 China Tracker, which seeks to track the performance of the FTSE/Xinhua China A50 index. The Fund, which is listed on the Hong Kong Stock Exchange, is currently performing well and derivative

warrants on the A50 China Tracker, will soon be issued and listed on the Exchange. We also have the first retail China A share fund in Hong Kong launched last year that invest directly in the Mainland securities market via the fund manager's QFII quota.

Through QDII

The Mainland's recently announced QDII scheme – Qualified Domestic Institutional Investor scheme – is another example of the barriers to capital flow being relaxed. The scheme will open up channels for Mainland investors to invest abroad, and to convert RMB into foreign exchange for this purpose.

Under the scheme, banks, fund management companies, securities operating institutions (i.e. brokers) and insurance companies are permitted to invest in overseas markets and in certain types of financial products. Such investments may be made on behalf of clients or themselves. Although QDII products offer notable investment opportunities for Mainland investors, the take up rate has been slow. At the end of December 2006, US\$13.4 billion quota was granted to 15 bank QDIIs. However, the actual investment in QDII products totaled less than US\$400 million, a rather low utilization amount.

Bank QDII products are not doing as well probably due to (i) lack of product diversification and low return from fixed income due to restrictions in the current bank QDII rules to bonds and fixed income products; (ii) anticipated continued appreciation of RMB exchange rate; and (iii) pick up of China's stock market which made buying A shares more attractive.

To address these issues, the first joint working group meeting of CBRC (China Bank Regulatory Commission), SAFE, SFC and HKMA concerning QDII was held in November 2006 in Hong Kong. The working group recognized the importance of widening the scope of permissible investment of QDII banks and discussed the possibility of expanding the scope by taking a gradual step-by-step approach.

CEPA

It would be amiss of me not to mention about CEPA, which stands for Closer Economic Partnership Arrangement between Hong Kong and the Chinese mainland. It's a free trade agreement under the WTO rules. It gives preferential access to mainland market for Hong Kong companies. The arrangement came into effect from 1 January 2004. Under this arrangement, Mainland brokers are establishing presence in HK. Currently, Mainland securities or futures brokers control over 20 Hong Kong licensed corporations. At the same time, Hong Kong brokers and fund managers are establishing joint ventures in the Mainland for brokerage and fund management business. There are about 7 joint venture securities brokers and 23 joint venture fund management companies in the Mainland. Most of the foreign partners of these joint ventures have a Hong Kong connection. These cross-border activities will bring along substantial business opportunities from providing investment and asset management services to Mainland investors.

Conclusion

To conclude, Hong Kong being the premier fund raising centre for Mainland enterprises, and its significant capital market acting as conduit for funds investing both in and out of China all serve to indicate Hong Kong should be the prime consideration for both investors and investment managers.