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Speech

Keynote address at WFC Global Conference of Central Securities Depositories 2017

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Good Morning,

First of all, I would like to thank Hong Kong Exchanges and Clearing Limited, the organisers and hosts of the WFC[1] for inviting me to be a keynote speaker today. I understand we have a whole range of stakeholders at this conference such as regulators, exchanges, clearing houses, central securities depositories (CSDs), custodians and financial firms from many different countries. It seems only fitting then for a world forum such as this one to be hosted in Hong Kong, a world-class city and one of the world's leading international financial centres.

Hong Kong's role as an international financial centre

Hong Kong's unique value proposition as an international financial centre is that it connects the Mainland with the rest of the world, and facilitates international participation in China's growth and economic transformation under the framework of "one country, two systems". The Mainland's evolution into the world's second largest economy creates significant new opportunities for both Hong Kong and the rest of the world.

Where CSDs and other market infrastructures can link or span across different markets, there are potential benefits to be realised as well as risks to be managed. One crucial element for managing this balance successfully is strong coordination between the relevant authorities. Without a doubt, this has been the experience of Hong Kong, where the SFC has very good cross-boundary cooperation with the China Securities Regulatory Commission. Indeed, both parties view cooperation as a critical prerequisite for the continued linkage of our markets, which for Hong Kong is an important dimension for the further development of the Hong Kong market and in enhancing Hong Kong's role as a leading international financial centre.

In what follows, I would like to share with you some thoughts on two major cross-boundary market developments in Hong Kong that are relevant to the CSD industry—Stock Connect and Bond Connect.

Note: This is a drafted version and may differ from the one delivered.

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[1] World Forum of Central Securities Depositories

Stock Connect

We are about to celebrate the third anniversary of Stock Connect. We have gone through a number of encouraging developments since the start of the programme. Let me recap some of these milestones.

Stock Connect, launched between Shanghai and Hong Kong in November 2014, provides a unique opportunity for Hong Kong and Mainland investors to trade eligible stocks in each other's market. The programme opens up the vast onshore Mainland equity market to the rest of the world and enables a huge pool of Mainland investors to diversify portfolios outside their home markets.

Initially, both daily and aggregate quotas were in place to manage two-way equity market flows. The aggregate quota under Shanghai Stock Connect was abolished in August 2016, allowing investors to conduct trading with higher flexibility. This is considered a strong signal from the Mainland market that it is ready to open two-way investment flows on a large scale.

In December 2016, the scope of the programme was widened to include more eligible stocks in Hong Kong and a new market in Shenzhen, with a new pool of small cap but possibly fast-growing stocks. Stock Connect now covers some 1,500 Mainland stocks and 440 Hong Kong stocks, representing over 80% of market cap of both markets.

Despite a slow start at the initial launch, trading volumes have been gathering momentum. The share of Hong Kong market turnover attributable to Stock Connect is significant and growing. On average, the daily southbound trading has reached 6% of trading in the Hong Kong market so far this year, doubling that of 3% last year. Northbound trading has been relatively stable at 1% of the Mainland market total. The operations of Stock Connect have been smooth and the clearing and settlement systems have been able to accommodate the rapidly increasing flows without any hiccup.

The developments in Stock Connect have been particularly welcomed by international investors who have been demanding global index companies to consider greater inclusion of A-shares in global investment benchmarks. In this regard, MSCI has decided to include Mainland A-shares into its Emerging Markets (EM) Index through Stock Connect in two stages, beginning in May and August 2018. We would expect possible inclusion of Mainland stocks into other international indices and further increases in index weightings over time, given the Mainland's strategy for further opening up, the growing size of its equity markets, and its increasing importance in the global economy.

We are looking forward to further enhancements to Stock Connect. Considerations will be given to expanding the quota and the range of stocks and financial products available for trading. This will further add to the breadth and depth of the programme and its attraction to both Mainland and international investors.

Stock Connect links the Mainland and Hong Kong stock exchanges, making them the second largest equity market in the world taken as a whole, with a combined market capitalisation in excess of US$12 trillion. With further growth and expansion over time, Stock Connect will bring the Mainland and Hong Kong markets closer together, and speed up the Mainland's integration into the global capital market. In essence, Hong Kong will continue to thrive as the key point of connection between global capital and the Mainland for many years to come.

Bond Connect

Bond Connect is a more recent development but no less important to financial integration between the Mainland and the global capital market.

At present, China has the world's third largest bond market behind the US and Japan, with a market size of US$10 trillion.

On 16 May 2017, the People's Bank of China (PBoC) and the Hong Kong Monetary Authority (HKMA) informed the market that they had approved the establishment of Bond Connect. Bond Connect is an arrangement that will enable Mainland and overseas investors to trade bonds in the Mainland and Hong Kong bond markets through connection between the bond clearing houses in the Mainland and Hong Kong. In the initial phase, overseas investors from Hong Kong and other countries will be permitted to invest in the China Interbank Bond Market (CIBM) (Northbound trading), and Mainland investors will be able to invest in the Hong Kong bond market through Bond Connect (Southbound trading) at a later stage.

Northbound trading under Bond Connect was successfully launched on 3 July 2017.

The settlement and custody of bonds traded by eligible offshore investors on the CIBM via Bond Connect are conducted through a settlement link established between the Hong Kong Monetary Authority's Central Moneymarkets Unit (CMU) and each of the Mainland's two bond clearing houses, Chinabond and the Shanghai Clearing House. The CMU also provides services to facilitate cross-border payments for trades executed via Bond Connect.

The PFMI and future directions

As a regulator, let me conclude with a few remarks about global regulatory developments on financial market infrastructures (FMIs) and future directions.

Five years ago, in 2012, CPMI (the Committee on Payments and Market Infrastructures) and IOSCO (the International Organisation of Securities Commissions) released the Principles for Financial Market Infrastructures (PFMI). This was a groundbreaking effort to define international standards for market infrastructures and promote orderly market and financial stability.

During the consultation stage for the PFMI, the WFC itself expressed a recommendation that the new principles "should become a true global standard". From the perspective of 2017, I think it is fair to say that that statement is now true.

The PFMI is the global standard to enhance the safety and efficiency of FMIs and, more broadly, to reduce systemic risks and promote transparency and financial stability. It serves as the core of the modern regulatory framework for more resilient market infrastructure.
In Hong Kong, all locally regulated FMIs are required to meet the PFMI. And when Hong Kong FMIs interact with overseas regulators, for example, in Europe or the US, the overseas regulators also expect compliance with the PFMI.

The PFMI is an important milestone but more work still remains. CPMI-IOSCO continues to work in areas such as recovery planning and cybersecurity. In Hong Kong, just this past July, the legal framework of the resolution regime for financial institutions and FMIs, the Financial Institutions (Resolution) Ordinance (FIRO) came into effect. This is an important step in empowering the various resolution authorities in Hong Kong, including the SFC, with strong and effective tools for ensuring financial stability and the continuity of critical FMI functions.

The drive for more resilient markets is a continuous process that requires close coordination among all stakeholders, including regulators and the industries. As a regulator, the SFC considers industry bodies like the WFC important partners in building better markets. On behalf of the SFC, I thank you for your contributions to these efforts.