Financial Innovations- Prospects for the asset management industry
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Alexa Lam
Deputy Chief Executive Officer,
Executive Director
Investment Products, International and China

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Financial innovation is the cornerstone of the Hong Kong market. Innovation is certainly a strength of players in the Hong Kong asset management industry. Before I begin, I would like to thank the Hong Kong Investment Funds Association (HKIFA) for inviting me here today, giving me an opportunity to share our thoughts on how industry participants and regulators have worked together in the past, and where our joint efforts can take us going forward.

Introduction

In recent years, renminbi (RMB) and Mainland-related business has been the source of excitement in our financial market. We see new types of RMB product introduced into the market one after another. Some of them were the first of their kind in the world.

Hong Kong's asset management sector has enjoyed a history of success, delivering benefits that are widely felt in the industry and across the broader economy.

The asset management industry has now grown to a significant size. The combined fund management business in Hong Kong has attained year-on-year growth of 27% to achieve a record high of HK$16 trillion as at the end of 2013. Overseas investors are strongly attracted to Hong Kong as an investment platform; they contributed over 70% of our total fund management business in 2013. This exceeds the percentage share recorded in any of the previous 14 years.

Hong Kong was the first offshore market to launch RMB business. We started in 2004. Today, we are the world's largest offshore RMB centre. As at the end of August 2014, RMB customer deposits and outstanding RMB certificates of deposits totalled RMB1.13 trillion; this represents a 7% growth from RMB1.05 trillion at the end of 2013.

None of this was accomplished overnight. It took years of commitment towards building relationships, developing solutions and innovation to get us to the position we are at today.

Competition among financial centres has always been fierce. Today every aspiring offshore RMB centre wishes to replicate Hong Kong's success. Indeed, other markets may replicate Hong Kong's hard-won solutions and methodology. As such, Hong Kong must keep up the momentum to transform and innovate; to ensure that our asset management platform is robust and attractive and that there is sufficient expertise to enable financial, infrastructure and product innovation to continue to flourish.

As a regulator, we have to move with the times. We continuously seek new frontiers to enable you, as market participants, to capture new opportunities. It is these opportunities that have galvanised the industry into taking positive action to innovate and improve in terms of products, processes and infrastructure.

Mutual recognition of funds between the Mainland and Hong Kong

Real breakthroughs are few and far in between in financial markets. The mutual recognition of funds between the Mainland and Hong Kong (MRF) is what I would consider the next breakthrough for the asset management industry in Hong Kong. This is because MRF will be the first mutual recognition of funds arrangement between the Mainland and an overseas market. Hong Kong's financial market has been waiting in anticipation for this industry game changer.

During the HKIFA Conference last year, the China Securities Regulatory Commission (CSRC) shared with the audience the latest development of the Mainland capital markets, including the MRF. I was frequently asked during public events about MRF's launch timetable. Recently, I have heard rumours that the industry is beginning to cast doubts as to the likelihood of the launch of MRF.

The facts are this. For quite some time, we have urged the industry to start preparing for the MRF. It was never a question of "whether or not to launch MRF", but more a question of "when MRF is going to be launched".

I can tell you that after the Shanghai-Hong Kong Stock Connect is launched, the MRF will follow.

On a number of occasions, we have explained that for a fund to qualify under this initiative, it must be a SFC-authorized Hong Kong-domiciled fund, managed by a SFC-licensed fund manager in Hong Kong. The aim is to ensure that there is an effective regulatory handle over the qualified funds and their managers. Also, only simple fund products would be covered at the initial stage.

Indeed, since we first unveiled to the public our discussion with the Mainland authorities about the MRF, we have been seeing an increasing number of SFC-authorized funds domiciled in Hong Kong. We have also received proposals from various fund managers about re-domiciling their funds to Hong Kong. In fact, during the past two years, 48 SFC-authorized funds were re-domiciled to Hong Kong. Clearly, these funds wish to position themselves to get ready for the launch of the MRF.

Need for cooperation between regulators and the industry

While much emphasis has been placed on the launch date of the MRF, the future path and development of the Hong Kong asset management landscape depends heavily on the joint efforts of both industry players and regulators.

The long term success of an international financial centre cannot simply rest on new government policies. As well, the success of a regulatory initiative cannot rest solely upon whether it offers exciting new opportunities, or on the rules and requirements governing the framework. Appropriate business infrastructures, expertise and products must go hand-in-hand.

While the future development of the asset management landscape is premised on a sound and robust regulatory framework, it requires the collaboration of every stakeholder in the ecosystem in order to make this a success.

We, as the regulator, will continue to authorize publicly offered investment products and their offering documents in a prudent manner. Whether they are Hong Kong-domiciled funds, or foreign funds that enter Hong Kong through different recognition schemes – and that will include Mainland funds once the MRF is launched, these funds need our authorization. We require proper disclosure, and appropriate governance structure, for investor protection. Our authorization, however, is not an assurance of the success or performance of an investment product. Distributors and investors should also play their part. Distributors must perform proper product due diligence and know-your-client procedures to ensure the suitability of the products they recommend to their clients. Investors, on the other hand, should review the key features and risks associated with products in light of their needs and risk appetite before making investment decisions. We must work together towards the common goal of building investor confidence.

RQFII

Let me now turn to a more specific innovation idea that I wish to invite you to consider – that is, you have used up your Hong Kong RQFII quota, and how you could get new quotas so that you can continue to create new RMB products.

The RQFII is an original idea that Hong Kong could proudly claim was its creation. This initiative enables our asset managers to use the Hong Kong platform to create new RMB products for investors worldwide to invest in RMB in the onshore market.

Since its landmark launch in 2011, the RQFII regime has been a great success in Hong Kong. As of the end of September 2014, there were 70 SFC-authorized RQFII products, including 53 RQFII unlisted funds, 15 RQFII A-share ETFs and 2 RQFII Mainland treasury bonds ETFs, with a total asset under management of US$15.2 billion. One of the most popular category of RMB products in Hong Kong, the RQFII ETFs have attained remarkable market share. At a combined market capitalisation of US$10.6 billion as of 30 September 2014, these RQFII ETFs represent 24% of the total market capitalisation of all ETFs in Hong Kong (excluding SPDR Gold Trust). The average daily turnover of these RQFII ETFs grew to US$304.1 million as of 30 September 2014, accounting for some 39% of the average daily turnover of the Hong Kong ETF market. Among the five most actively traded ETFs listed in Hong Kong, two are RQFII A-share ETFs.

What RQFII has accomplished not only underscores the strong appeal of the RMB and the attraction of the Mainland market to investors, it also testifies to the expert skill and creativity of our market participants.

Next stage of growth

Hong Kong has been granted an aggregate RQFII quota of RMB 270 billion. This quota has now been fully utilised. Some of this quota was used by our managers to create and launch RMB products in other markets, notably New York and London. We supported this innovative use of the Hong Kong RQFII quota by our managers, and our Mainland regulatory counterparts were fully behind our decision. After all, the role of offshore RMB centres is to create a healthy velocity of RMB transactions on a global scale. To do so, they must expand the scope of offshore RMB business and assets worldwide. That means that they should work in partnership to fully utilise the RQFII quota that the Mainland has granted to different markets. In other words, a RQFII quota granted to an institution in one jurisdiction is not limited to use within only that jurisdiction.

Cross utilisation of quota will allow firms to pool their expertise and quotas to bring RMB products to a global investor audience. In doing so, we could make the RQFII work on a global scale, and give investors a bigger opportunity to enjoy the benefits of a new international currency.

I understand that some of you have been lobbying the Mainland authorities to further expand the Hong Kong RQFII quota. While the process for quota expansion for Hong Kong is underway, the industry should start looking into how it could work with players in other markets that still have plenty of quota.

As you all know, the RQFII scheme has been expanded to other markets. Together, Taiwan, Singapore, United Kingdom, France, Germany and South Korea have been granted an aggregate RQFII quota of RMB470 billion. So far, less than 3% of that aggregate quota has been used in these markets.

I would therefore encourage you to partner with firms in other RQFII markets. By pooling RMB product expertise and available RQFII quota, you could bring new products to the markets of Hong Kong and beyond. We have discussed this idea with our Mainland counterparts. They are most supportive; they would like to see the total RQFII quota fully utilised. This means that the option of using the RQFII quota from other jurisdictions is open to you. I hope I have provided you with some interesting food for thought.

Closing remarks

As the market regulator, we are happy to work with you to further the development of RMB investment products in Hong Kong. Our door is always open. You should feel free to discuss new ideas with us. Let us continue to work on ground breaking initiatives to enhance Hong Kong's position as a global asset management centre.

Thank you and I wish you all a successful conference.