Developing Financial Markets in Changing Times

Speech at Law Society's Forum

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Chairman

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Honorary guests, ladies and gentlemen, good afternoon. Today I want to speak to you as a market regulator about how the SFC steers the development of financial markets to ensure Hong Kong remains a leading capital raising centre and investment hub.

The SFC's primary commitment is to build quality markets through world-class regulation and instil investor confidence in our markets. This is key to strengthen Hong Kong's status as a premier global financial hub connecting China and overseas markets, as well as a preferred fund domicile in the region.

Hong Kong as international financial centre

As you well know, Hong Kong has a mature financial services industry which includes the largest and best-known global and Mainland firms. The total market capitalisation of the Hong Kong stock market is over US$4 trillion. Our unique connections with Mainland markets help attract overseas investment and provide fund-raising opportunities for a wide variety of Mainland enterprises.

Despite a challenging macro landscape, we have seen progress on many fronts over the past three years. The number of listed companies increased more than 5% and the number of Hong Kong-domiciled funds rose 20%. And just in the past year, the number of corporations licensed by the SFC has grown by 5%.

Agile regulation to support growth

To help maintain this momentum, the SFC adopts an agile regulatory approach to help ensure sustainable market development during changing times. Agility is especially important in times of high interest rates, monetary tightening and heightened geopolitical tensions.

Mainland enterprises now account for 80% of Hong Kong's equity market by capitalisation, and one of our main strategies has been to adapt our listing regime to facilitate the listing of new economy companies from Greater China. These companies now account for about 40% of market capitalisation, providing attractive opportunities to investors looking to tap into the high-growth sectors of the Chinese economy. Specifically, we introduced new regimes for weighted voting rights, biotech and specialist technology companies and the "homecoming" of overseas-listed Chinese firms.

While the changes we made accommodate some pre-profit or pre-revenue companies, we remain steadfast to protect investors and ensure an orderly market. In the case of the specialist technology listing regime, we have put in place various guardrails, such as

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minimum ratios for R&D expenditure before IPO, minimum investments from sophisticated independent investors and longer post-IPO lock-up periods for controlling shareholders.

Our new licensing regime for virtual asset trading platforms is an example of how we have both kept pace with emerging market trends and embraced innovation, such as Web3 and blockchain. We recognise that, if responsibly used, technologies can drive efficiency and reduce costs. This new regime, the first of its kind anywhere, was designed to allow retail access to virtual asset services, but with investor protection as the key focus. Our requirements include client suitability when onboarding, good governance, enhanced token due diligence, the segregation and safe custody of client assets and cybersecurity.

Hong Kong as the premier China gateway

Secondly, we will continue to strengthen Hong Kong's role as the premier gateway to Mainland China markets.

Since the launch of Connect in 2014, our mutual market access programmes have been a great success. They now cover stocks, bonds, unlisted retail funds, ETFs, swaps and wealth management products. Connect serves as an efficient channel for investors to access Mainland and Hong Kong markets and strategically diversify allocation and risks when tapping into China's growth story. Cumulative net inflows since launch total RMB2.3 trillion southbound and RMB1.9 trillion northbound.

Mutual market access is a key part of our long-term strategy and we have been working with our local and Mainland counterparts to strengthen the Connect programmes. We recently took steps to include foreign companies listed in Hong Kong and Mainland-listed small and medium enterprises in Stock Connect. Enhancements to the Greater Bay Area Wealth Management Connect and the Mainland-Hong Kong Mutual Recognition of Funds scheme are also in the works.

Over the past 20 years, Hong Kong has developed into the top offshore renminbi hub in the world and we are making sure the city continues to lead in this area. Just last month, the Stock Exchange introduced the dual counter model to promote stock trading in renminbi. This will encourage more investors to use renminbi in their offshore investments and promote the expansion of listed renminbi products. Under this model, the dual counter market making programme brings in market makers to ensure liquidity and minimise HKD-RMB share price gaps. Besides, to expand our offshore risk management toolkit for investors, Swap Connect was launched in May to enable investors to hedge investment risks through Mainland and Hong Kong derivative markets.

Building market resilience and managing systemic risks

Thirdly, the SFC is committed to building market resilience and managing systemic risks to ensure a healthy market in the long run. To guard against instability, our day-to-day work revolves around supervision and monitoring of markets and market participants, including exchanges, clearing houses, brokers and funds.

To pre-empt systemic threats, we closely watch the operations of Hong Kong's markets, which are open and globalised, and we monitor capital flows on a daily basis. Our stock market recorded inflows in the first four months of 2023 but we stay alert to any signs of reversal. Following major risk events such as bank collapse and war, we conduct timely assessments of market risks and their impact on market players.

Our surveillance extends from the spot exchange market to derivatives, futures and over-the-counter markets, as we monitor the build-up of short positions and watch for any signs of concentration of positions in OTC derivatives. The Hong Kong Investor Identification Regime now provides us with real-time investor identity information behind each trade. This facilitates our enforcement action by helping us spot irregularities and deters misconduct.

The SFC also supervises Hong Kong Exchanges and Clearing Limited. Our top priority is to ensure its risk management can withstand extreme market shocks. We also closely supervise licensed brokers' risk management and prevent over-leverage. We monitor their margin lending risks and stress-test their capital adequacy. And for SFC-authorised funds, we monitor their liquidity especially during market volatility and stay in touch with major fund managers. These efforts can help protect the markets against unforeseen instability.

Driving efficiency for markets

Fourthly, promoting market efficiency is another key focus for the SFC, and we believe technology and digitalisation are instrumental. One of our main objectives in launching the new licensing regime for virtual asset trading platforms is to promote innovation and technology and help develop Hong Kong into a Fintech hub. Technology should help deliver efficiency gains by streamlining processes and the settlement cycle for investment products.

The SFC has fully digitalised its licensing platform since April 2022 and the efficiency gains are pronounced. For corporate licence applications, the average processing time has been shortened by 20% year-on-year and the long outstanding application number reduced by half. To extend our efforts, we are working on a new online platform to process retail investment product applications. We are also aiming to introduce a paperless securities market for mid-2025, which will make the holding and transfer of stock ownership more efficient and eco-friendly while saving costs for issuers.

Cross-border collaboration to enhance market integrity

Fifthly, we work with global and Mainland regulators and authorities to set standards for capital markets and drive their development. International collaboration is essential to help maintain Hong Kong's high regulatory standards. At the International Organization of Securities Commissions (IOSCO), the SFC's senior executives play important roles in different taskforces and workstreams to lead discussions on wide-ranging topics such as risk management, sustainable finance, virtual assets and enforcement collaboration.

The SFC also works closely with China Securities Regulatory Commission (CSRC) on cross-boundary supervision and enforcement, mutual market access and renminbi internationalisation. In March, we met with the CSRC chairman Yi Huiman and PBoC governor Yi Gang to exchange views on markets. Just in June, the top management of the CSRC and the SFC met again in Hong Kong and reached broad consensus on a number of initiatives.

Closing

To wrap up, the SFC's vision for our financial markets can be summed up in just a few words: agile, connected, resilient and efficient. The ultimate aim of our regulatory work is to enable sustainable market development which serves the needs of the real economy and society at large. And we hope you all share this vision.

Thank you very much.