

Keynote address at Deacons 7th Annual Investment Products and Regulatory Forum

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21 May 2015

Mr Ashley Alder, Chief Executive Officer of the Securities and Futures Commission (SFC), delivered the keynote address at the Deacons 7th Annual Investment Products and Regulatory Forum on 21 May.

In the address, Mr Alder outlined the main factors which are turning Hong Kong into an unrivalled Asian fund management centre. Already, increasing connectivity between the Mainland and Hong Kong financial markets has transformed Hong Kong's role as an international financial centre and has also affected other key financial markets globally, he noted. The result is that Hong Kong is fast becoming a "superconnector" between the Mainland and the rest of the world.

The Mainland's opening of its capital account has been a key driver of these developments, Mr Alder continued. Connections between Hong Kong and Mainland markets have multiplied over the past two decades, but since 2011 the pace of change has accelerated significantly. Most recently, the Stock Connect pilot programme and the imminent Mutual Recognition of Funds (MRF) scheme are real game changers for the fund industry.

Stock Connect

Since its launch in late 2014, Shanghai-Hong Kong Stock Connect has acted as a catalyst for major shifts in capital flows, Mr Alder said. Despite subdued trading at the start of the programme, market performance and turnover have gained momentum—trading volumes on the Shanghai and Hong Kong stock exchanges have more than doubled, and southbound trading reached its quota limit twice in April. This was attributable to many factors, but the proximate trigger was the China Securities Regulatory Commission's policy support for funds to invest southbound.

Nevertheless, Mr Alder pointed out, some speedbumps still need to be overcome, including daily trading quotas and foreign ownership limits. Some fixes are already being put in place to address issues around beneficial ownership and pre-trade checking. Finally, further work needs to be done in relation to trade execution as well as short selling and exchange-listed derivatives.

Looking ahead, the mooted launch of Shenzhen-Hong Kong Stock Connect and the possible inclusion of A shares in the MSCI will be major influences on future flows. It is likely that more stocks will be available for trading in both markets, and this will be accompanied by increased quotas and the broadening of the Stock Connect programme to include exchange-traded funds.



Renminbi internationalisation

The driver behind these developments is renminbi internationalisation, which has created a virtuous cycle of stimulating cross-border capital flows to and from the Mainland, in Mr Alder's view. In a drive to rebalance its economy from an investment-driven model to one that is consumption-driven, the Mainland is understandably concerned about inbound and outbound hot money flows. Renminbi is now the fifth top global payments currency by value, up from 20th in 2011. The direction of travel is clear, Mr Alder said. Inbound institutional investment enables the volatile, retail-dominated A-share market to grow up fast, whilst outbound institutional and retail investment diversifies the deployment of savings. This is what the new Qualified Domestic Institutional Investor scheme¹ is all about.

Ultimately, Mr Alder emphasised, market-based finance will increasingly fund efficient domestic investment on the Mainland, thereby reducing the dependence on credit. This should lead to more accurate, market-based pricing of risks without implicit state guarantees, which in turn will allow long-term capital to fuel the Mainland's growth.

Mutual Recognition of Funds

Turning to MRF, Mr Alder explained that it will help transform Hong Kong into a major Mainland-Hong Kong asset management centre and ultimately the leading Asia-Pacific asset management centre. Once implemented, the scheme will allow overseas retail fund investors to access the enormous Mainland market.

Regulation

By way of background, Mr Alder presented a brief overview of current global debates about the funds industry. These include the question of whether global policy makers should apply the G-SIFI² designation to some big funds and asset managers which are identified as potential sources of systemic risk. The SFC is heavily involved in the global debate on G-SIFI designation, Mr Alder said, and while this may have implications locally, the SFC's basic stance is that asset managers and funds should not be regulated like banks.

Other issues of concern relate to the funds industry's business model, and potential conflicts of interest arising in particular from commissions and bundling arrangements. Moreover, Mr Alder emphasised, the growth of Hong Kong as an asset management centre will go hand in hand with world-class investor protection.

Mr Alder concluded his address by quoting PwC's survey findings, which reveal that Hong Kong is expected to emerge as a financial centre rivalling London and New York in the years through 2020—narrowly beating out other Asian financial markets in the survey.

¹ Also known as the QDII 2 scheme.

² Global systemically important financial institutions.