

Asset management in an evolving landscape

Annual PwC Asset and Wealth Management Conference

Tim Lui

Chairman

25 November 2019

It was just about a year ago when I took up the role of Chairman of the Securities and Futures Commission. Today, I want to give you an update on what the SFC has been doing to help Hong Kong develop as an asset and wealth management centre.

There is no doubt that this is a time of rapid change. Financial markets are now much more complex and interconnected than they were 10 or 20 years ago. New technologies have changed how people communicate with one another, how they do their banking and how they make investments.

Staying on top of new developments is a priority for every industry, but asset managers face unprecedented challenges. The behaviour of investors has changed. Disruptive technologies have come online. A host of new regulations have been introduced. These trends have transformed the industry landscape like never before. It is now more urgent than ever that asset managers keep on top of emerging challenges in order to stay competitive.

A rapidly changing environment

Today, a top priority for asset managers is how to transform their businesses and operating models to keep up with the changing demands of investors and also provide a better customer experience.

More and more customers are demanding instant service. This is true regardless of what generation they are part of. The younger generations prefer to go online to find investment advice and they expect quick execution around the clock. Many will shop around to find the lowest minimum initial investment. But even older and more experienced investors now like to use online investment accounts. They too want easy access to professional advice.

The industry also has to cater to institutional investors, who have different concerns. These include portfolio transparency, tailored investment solutions and access to global products.

Note: This is the text of the speech as drafted, which may differ from the delivered version.

So focusing on what investors want is more important than ever. Another big issue for the industry is margin compression. Keeping costs low and boosting profit margins will remain key challenges.

Regulatory enhancements

Hong Kong: an onshore fund management hub

With these issues in mind, the SFC has been working closely with the Government and other local regulators on a variety of market development initiatives. Our overarching goal is to promote Hong Kong as an onshore fund management hub and a preferred domicile for investment funds.

Some of these efforts have already borne fruit. An example is the new unified tax regime that came into effect in April. This allows profits tax exemptions for private funds, as long as certain conditions are satisfied. The tax exemptions will apply regardless of the structure of the fund or its size, or where its central management is located.

Other initiatives which we are studying include establishing a limited partnership regime for funds and tax arrangements to attract private equity funds to Hong Kong. The aim is to encourage funds to set up domiciles locally. This would strengthen Hong Kong's role as a centre for private capital in the Greater Bay Area and the wider Asian region.

We also keep in close contact with the alternative investment management industry. Most recently, we have been talking to them about the licensing requirements for private equity firms and the factors determining the type of licences applicable to them, which include the scope of business in Hong Kong and the managers' discretionary powers.

Another important initiative is our effort to sign agreements with other jurisdictions for the mutual recognition of funds, or MRF. Our MRF arrangement with the Mainland has now been in place for four years. This expanded market access by allowing qualified public funds in Hong Kong to be sold across the boundary, and vice versa. Since then, we concluded similar arrangements with other jurisdictions. Our MRF network now covers Switzerland, France, the UK, Luxembourg and the Netherlands.

Currently, our focus is on how to enhance these mutual recognition arrangements. For example, we have been talking with the Mainland authorities about the delegation of investment functions outside of Hong Kong as well as relaxing the requirement that the value of shares sold to Hong Kong investors be no more than 50% of the total.

Offshore fund centre: economic substance laws

Looking at today's conference agenda, I saw that there will be a session titled "offshore – comply or exit" that will discuss the offshore economic substance laws that recently took effect in some overseas jurisdictions. This is one more example of the kinds of rule changes firms need to cope with.

Those of you from private equity firms and hedge funds may have companies in Bermuda, the Cayman Islands and British Virgin Islands in your structures. I am sure you have been following this issue very closely. With the new economic substance requirements in these jurisdictions, most offshore fund managers are looking at how to restructure to comply with the new regulations.

One of the most realistic options for Asia-based private equity firms is to relocate their fund management functions to Hong Kong. There are a number of reasons for this.

First is Hong Kong's prime location. It connects East and West and is close to the Mainland. We have a large pool of professionals. Businesses benefit from a simple tax regime. Our active stock market provides exit options for private equity funds.

We continue to build out our market infrastructure. For example, in July last year, Hong Kong introduced an open-ended fund companies regime. Hong Kong-domiciled open-ended investment funds can now be structured in a corporate form. This is in addition to the traditional unit trust form.

Keeping ahead of innovation

Another area where we have done a lot of work is addressing the challenges posed by new financial technologies, or Fintech. The firms we regulate are introducing more innovative new businesses and operational models. Traditional asset managers are acquiring robo-advisers to help them deliver their wealth advisory services. New analytics capabilities have been introduced to design more customised portfolios as well as to digitise customer services.

As a market regulator, we recognise that there are many benefits of innovation. At the same time, some Fintech may give rise to risks for investors, and we have to be prepared to tackle them. This means keeping a close eye on our regulatory framework to make sure it stays aligned with international standards. We also need to foster healthy market development.

We have done quite a bit of work over the past few years to adapt our rules to the increasing use of technology in asset management. This is part of a broader effort to develop Hong Kong as one of the world's leading full-service asset and wealth management centres. To this end, we need to provide useful, detailed guidance on the use of innovative technology at the same time as we apply consistent principles of investor protection.

So far, we have provided guidance on a wide range of issues. Our aim is to promote the growth of online platforms to give investors more choice, convenience and flexibility. We now have specific guidelines on automated or robo-advice and how suitability assessments can be applied in the online environment. Other recent guidance included an online approach to onboarding overseas clients and verifying client identities. We also set out guidelines on taking client orders through instant messaging.

Earlier this month, we announced a new regulatory framework for virtual asset trading platforms. Those that operate in Hong Kong and offer trading of at least one security token may now apply to be licensed by the SFC.



By providing a path for compliance for firms willing to adhere to a high level of standards and practices, we believe it will help investors tell the difference between these firms and those that do not seek a licence.

In October, we also published guidance on licensing conditions for firms that manage portfolios that invest in virtual assets.

Finally, in view of the growing need for Fintech firms to hire specialists to oversee their operations, we announced that we would consider specialised expertise as relevant industry experience in our licensing assessments.

Our efforts in this area have been supported by many stakeholders in the Fintech industry. We have a dedicated communications channel – our Fintech Contact Point – as well as a Fintech Advisory Group made up of industry leaders.

Applying technology in supervision

When we introduce new regulations, we are always mindful of the impact they may have on asset managers and the wider industry. Compliance is undoubtedly a key area but it is also important for compliance measures to be cost-efficient.

A growing trend is for firms to adopt innovative solutions to manage their risk and compliance functions using new technologies. This could be to optimise post-trade compliance, improve data management and automation, or compile and monitor regulatory data in more efficient and economical ways.

Inside the SFC, we have already introduced some changes to deploy new technologies such as these. They help us manage the significant growth in the volume and complexity of trading data. We also leverage technology in our inspections to identify irregularities, systemic control deficiencies and material compliance issues that would otherwise go undetected.

We have also started to deploy data analytics. Order lifecycles are a core part of the data we need for our supervisory work, so we are developing common industry standards to prescribe the content and format of trading-related data that firms will need to retain and submit to the SFC. We will also provide an easy way for the data to be submitted to us online.

Another priority is to update our data collection and analytical framework for our prudential risk assessments. We run an automated stock alert and stress test system to identify thinly-capitalised brokers. This requires more data. To collect it, we made changes to the Business and Risk Management Questionnaire and will soon revamp the financial returns submitted at regular intervals under the financial resources rules.



Green funds

Technology aside, sustainability is another key theme on the global policy-making agenda. Investors increasingly recognise that strong environmental, social and governance (ESG) standards are a reflection of overall management quality.

With these trends in mind, the SFC has been looking closely at global developments in green finance and what they may imply for Hong Kong.

Asset management is a major focus for us in this area. First, we are working to improve public investors' knowledge of green finance.

Second, we are examining asset managers' integration of ESG factors into their own investment processes. Asset owners are becoming more vocal in asking ESG-related questions when they hire or retain asset managers. It is no longer enough for asset managers to simply claim that they take ESG factors into account, without disclosing a robust methodology to investors.

Another step forward is that major markets are now developing consistent disclosure guidelines for green investment products. Earlier this year, we published guidance on disclosures by green funds which should help make them more comparable. There are currently about 25 SFC-authorized funds which focus on climate, green, environmental or sustainable development, and new applications keep coming.

Conclusion

To conclude, I just want to say that the pace of change and innovation in financial services is tremendous and is only going to accelerate.

One of our important mandates at the SFC is to promote the development of healthy, high-quality markets. Today I told you a bit about our efforts to build up Hong Kong as an asset management centre and to make sure our regulations keep pace with market developments and the industry's business needs. This includes our efforts to help asset managers respond to investors' growing demand for opportunities to invest in virtual assets and green investment products.

In these challenging times, we all have to be ready to adapt to changing circumstances and make the changes needed to protect our markets and safeguard the interests of investors. I am confident that working together we can achieve great things in the years to come.

Thank you.