

Speech at Asian Financial Forum
“Hong Kong as a leading fund management centre in Asia”

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Good afternoon ladies and gentlemen

1. I would like to thank the Government and the Trade Development Council for this opportunity to let me share with you my thoughts on Hong Kong’s position as a leading fund management centre in Asia.

What can we learn from others?

2. Recently, considerable coverage has been given to the suggestion that London has overtaken New York as the most important financial centre in the world. Let’s see what we can learn from the stories of London and New York.
3. You all know that London beat New York in landing the 2012 Olympic Games. It was reported that when the British Prime Minister Gordon Brown rose to declare victory, he also drew many comparisons between the two cities. He said, “Today, over 40% of the world’s foreign equities are traded in London, more than New York. Over 30% of the world’s currency exchanges take place here, more than New York and Tokyo combined. While New York

and Tokyo are reliant mainly on their large American and Asian domestic markets, 80% of London's business is international.”

4. Facing the challenges, Mayor Michael Bloomberg in New York commissioned a study last year to identify specific variables that are negatively impacting the financial services industry in the U.S. The report was issued earlier this year, confirming that the U.S.'s and New York's historically strong position in financial services is under threat from both external and internal challenges, including too much litigation and heavy-handed regulation.
5. Debates are going on as many people criticise that the Sarbanes-Oxley Act and the other post-Enron financial regulations have severely hampered the competitiveness of the U.S. Increased compliance costs (that far exceed the benefits of the heightened regulations) have been a controversial issue since the implementation of the Act in 2002.
6. On the other hand, we see that the U.K. regulators have put in place a new, lighter, and altogether more flexible principles-based regulatory approach, that makes it easier to do business in their country.
7. The importance of regulatory balance should be obvious to everyone. Governments around the world are concerned with the issues of positioning and competitiveness. In Washington, Treasury Secretary Henry Paulson is calling for changes to strengthen the competitiveness of U.S. capital markets, and Christopher Cox, chairman of the SEC, is talking about the need for the SEC to rethink the way it works.

8. Turning to Hong Kong, we as regulators realise that having a balanced regulatory regime is a critical factor of success. We clearly understand our role is not just to regulate or police the financial market, but also to actively help enhance its quality and status.

Hong Kong as a leading fund management centre in Asia

9. Earlier this year, the City of London published a report on the competitiveness of 46 financial centres worldwide. It confirms London and New York as the top leading global financial centres, and to our delight, it puts Hong Kong in the third place, saying that Hong Kong has performed well in all key areas including skilled workers, free market access, regulatory balance and strong market infrastructure. The report also concludes that Hong Kong is a real contender to be a true global financial centre and is well ahead of other Asian centres including Singapore and Tokyo.
10. According to our annual fund management activities survey, Hong Kong's combined fund management business amounted to HK\$6,154 billion (or US\$789 billion) as at end of 2006. It represented a staggering growth of 36% over 2005, and an accumulated growth of 70% over 2004. According to market statistics, Hong Kong was ranked first in Asia in terms of net assets of mutual funds in 2006.
11. As a leading fund management centre in Asia, over 60% of the funds under management in Hong Kong are sourced from outside Hong Kong and the majority of assets are invested outside Hong

Kong. This reflects the fact that Hong Kong's fund management business has a strong international favour, as opposed to a domestic focus like Japan. We expect that the growth of non-Hong Kong sourced funds is likely to increase further, given the relaxation of the QDII scheme that will prompt an influx of investment capital from the Mainland.

12. In 2006, 47 corporations were newly granted with an asset management licence by the SFC. This year, we have already processed 45 asset management licence applications, representing 96% of the total number granted last year. More than half of the applicants are hedge fund managers (mainly focused on equity long-short and multi-strategies). Of the top 50 largest fund managers in the world, 37 already have operations and are licensed in Hong Kong. Among the top 25 largest hedge fund managers headquartered in Asia, 10 are based in Hong Kong.
13. According to our survey conducted in 2006, the hedge fund management market in Hong Kong has recorded a remarkable growth. The number of hedge fund managers doubled from 58 as at end of March 2005 to 118 as at end of March 2006. The total hedge fund AUM in Hong Kong of these respondents increased by a staggering 268% to US\$33.5 billion over the same two-year period. The findings show that Hong Kong's hedge fund market has grown substantially and confirm Hong Kong's position as a leading hedge fund management centre in Asia.
14. Just during the first 8 months of 2007, we have already encountered over 10 new international fund groups seeking to launch their retail funds to the Hong Kong public, representing

120% of the total of 2006. Also, in these 8 months, we have handled around 260 new fund applications, representing 100% of the total of 2006.

15. All these demonstrate that Hong Kong has been very attractive to global fund management players. Many factors have contributed to this success. These include:
 - a well-established market infrastructure that allows for the efficient conduct of international financial transactions;
 - a robust regulatory regime that is on a par with international standards;
 - a fair and just legal system;
 - a responsive and efficient government;
 - a rich pool of experienced professionals and the presence of established multinational financial institutions;
 - a business and investor-friendly tax system; and
 - proximity to major markets – the Mainland China in particular.

16. I will not go through with you each of these points, except two points relating to the Government's initiatives to exempt offshore funds from profits tax and abolish the estate duty.

Exemption of offshore funds from profits tax

17. From March 2006 onwards, offshore funds are exempted from tax for profits derived from specified transactions in Hong Kong. It brings us into line with major financial centres such as New York and London as well as Singapore, which all exempt offshore funds from taxation. This would help attract new offshore funds to Hong

Kong and encourage existing offshore funds to continue to invest in Hong Kong.

Abolition of estate duty

18. The legislation for implementing the abolition of estate duty commenced operation on February 11, 2006. The abolition of estate duty would encourage people, including overseas investors, to hold assets in Hong Kong through a Hong Kong corporate vehicle or trust. It would also encourage those who make various arrangements to avoid estate duty, such as overseas investments, to transfer these back to Hong Kong. More overseas companies and professionals will come here, and this will facilitate the further development of our asset management services.

How do we meet the challenges?

19. As regulators, we always put investor protection and market integrity as our utmost priority. However, we try not to impose a one-size-fits-all framework in regulating the market. Instead, we adopt a pragmatic and flexible approach to better regulate and assist with market development and products innovation. Let's look at a few examples demonstrating our efforts in this respect.

Licensing

20. In June, we issued a circular to announce a set of initiatives to streamline and simplify the licensing processes, in particular for overseas fund managers interested in setting up businesses in Hong Kong. Firms that are already licensed or registered in the U.S. /

U.K. as investment managers or advisers and which only serve professional investors will benefit from an expedited licensing process. Upon receipt of their applications, we will commence a streamlined review process focusing principally on key areas of operations such as risk management, valuation, internal controls and management of conflicts of interest. Furthermore, persons nominated to be the responsible officers of hedge fund managers, who fulfil the necessary criteria, can be exempted from the local regulatory examination. A broader range of relevant industry experience will also be recognised as satisfying the competence requirements for the purposes of licensing.

Products innovation

21. We adopt an open architecture and are receptive to new products. In fact, we have been striving to facilitate more product types to the market. For example, Hong Kong is one of the first jurisdictions in the world to allow the sale of hedge funds to the retail public since May 2002. To date, there are 14 authorised hedge funds with a total NAV of US\$1.57 billion as of June 2007.

22. We are also the first regulator in Asia to issue local guidelines to facilitate the authorisation of UCITS III funds. We made it clear that the guiding principles in authorising UCITS III funds are that the funds should possess sufficient disclosure and suitable risk management and control systems in view of the significantly expanded investment scope and tools now permissible under the UCITS III regime, such as 100% investments in financial derivative instruments. We issued various circulars to provide guidance to the industry regarding, for example, expected risk

management processes. To date, we have authorised various UCITS III funds of different features including funds of funds, guaranteed funds, index funds and, recently, the first retail 130/30 fund offered in Hong Kong. We are receptive to overseas products. Over 70% of our authorised funds are domiciled overseas.

23. In June 2005, we revised the Code on Real Estate Investment Trusts (REITs) to allow investments in overseas properties. To date, seven REITs, offering a wide choice of properties ranging from retail shopping malls, Grade A offices, hotels to properties in the Mainland China, are listed on the HKEx, with a market capitalisation of US\$8 billion as of August 2007.
24. With the unique characteristics of Hong Kong and its close relationship with the Mainland market, we have worked closely with the industry to successfully launch a wide range of China A-share products to meet the needs and appetites of different investors including both local and international investors.
25. In 2004, we authorised the first exchange traded fund (ETF) that tracks a China A-share index offering non-Mainland investors access to the A-share market which was otherwise off-limits to the public.
26. In June 2006, we authorised the first open-ended fund in the world investing directly in A-shares through the fund manager's own QFII (Qualified Foreign Institutional Investors) quota.
27. Recently, we have also authorised the first listed close-ended fund in Hong Kong for investing in A-shares. This close-ended fund

was oversubscribed 28 times by retail investors at its IPO. Traditionally, all of the retail funds should be able to provide ongoing subscription and redemption facility (open-ended structure) as they invest in liquid securities. Given the special features of the A-share market and having discussed with the fund manager and realising a strong investor demand for the product in the market, we have considered the alternative liquidity provided to investors via trading on the stock exchange acceptable in granting our authorisation to the fund.

28. Furthermore, we have seen growing interest in fund houses to launch ETFs in Hong Kong, given the liquidity of the market. In 1999, we authorised the first ETF, the Tracker Fund. In 2007 so far, we have authorized 8 new ETFs listed on the Hong Kong Stock Exchange, including the first ETF that tracks an index on commodities futures and the second ETF in Hong Kong that tracks an “A” share index. Currently, there are 17 SFC-authorized ETFs, with a total market capitalization of HK\$86 billion (US\$11 billion), making Hong Kong the largest ETF market in Asia Pacific (ex-Japan) in terms of market capitalization.

Opportunities from the Mainland China

29. Among the tremendous opportunities from the Mainland China, today I would like to focus on two: CEPA (i.e. the Mainland and Hong Kong Closer Economic Partnership Arrangement) and QDII (i.e. the Mainland’s scheme on Qualified Domestic Institutional Investors).

30. CEPA IV, for the first time, permits asset managers from the Mainland to set up subsidiaries in Hong Kong. With the arrival of these Mainland professionals, this will make Hong Kong even stronger as an international asset management hub with experienced managers from all major markets. The increased participation of Mainland fund managers will not only bring in PRC expertise including their knowledge about the PRC market and investor demands, it will also bring in connections and capital. A broadened base of market professionals and talents will likely attract more overseas investors and capital flowing into Hong Kong.
31. The Chinese regulatory authorities have announced a series of measures to allow approved banks, asset management/securities firms and insurance companies to invest in overseas capital markets. QDII funds will flow to overseas markets through both equity investments and a variety of fund products. A wide variety of bank QDII products have been created with a number of them linked to/invested in Hong Kong stocks and SFC-authorized funds.
32. The economy of the Mainland has been growing rapidly, with the world's biggest saving pool (US\$2 trillion according to market sources) and the world's largest foreign currency reserve of over US\$1 trillion. Such liquidity brings significant opportunities for both investors and asset managers.
33. According to market source, the utilised amount for the QDII quota as of June 2007 was US\$7.29 billion, representing only 36% of the total quota granted. The investment potential in this area is therefore tremendous. As you may be aware, the first QDII fund recently launched under the CSRC's QDII rules was reportedly

very well received by the Mainland market. It attracted about RMB50 billion in subscriptions in just one day (compared to its permissible limit of RMB15 billion). In fact, many new fund groups have already approached us indicating their interests in bringing their overseas funds to Hong Kong in order to seize the QDII opportunities. A number of existing fund groups in Hong Kong are also planning to launch more new products for QDII.

34. Last week, representatives of around 30 of Mainland's largest fund and securities houses led by the CSRC's vice chairman, Mr Gui Minjie, came to Hong Kong to attend a high level seminar, to exchange views on market development issues with major international fund and securities houses, banks and law firms operating in Hong Kong. The seminar was the first such event held in Hong Kong for leading practitioners in the Mainland and Hong Kong to exchange views on their respective operating environment and opportunities. Mr Gui remarked that in order to boost the development of the Hong Kong market, the CSRC would, when considering QDII product applications, guide the companies involved to make Hong Kong the key investment market.

Conclusions

35. Hong Kong is clearly ahead of other Asian markets as a leading fund management centre. Amongst the various advantages of Hong Kong, its international characteristics that enable it to serve as a bridge between the Mainland and the rest of the world are noteworthy. Our close connection with the Mainland and familiarity with the Chinese culture make us a unique and

attractive platform for international players looking to invest in the Mainland.

36. As regulators, we will continue to maintain an appropriate regulatory balance by adopting a pragmatic and flexible approach and provide an environment that is conducive to both business development and market regulation. You are very welcome to approach the SFC to discuss your plans for setting up fund management businesses here or bringing new products to Hong Kong.

37. Thank you.