



SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

The 11th Annual Hedge Funds World Asia 2008

**Regulatory keynote address:
Hong Kong as a QDII Platform**

11 September 2008

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Outline

- I. Growth of the Mainland Market**
- II. Hong Kong – the Bridge between Mainland and the World**
- III. Our Facilitating Approach for Hedge Funds to Capture Mainland Market**



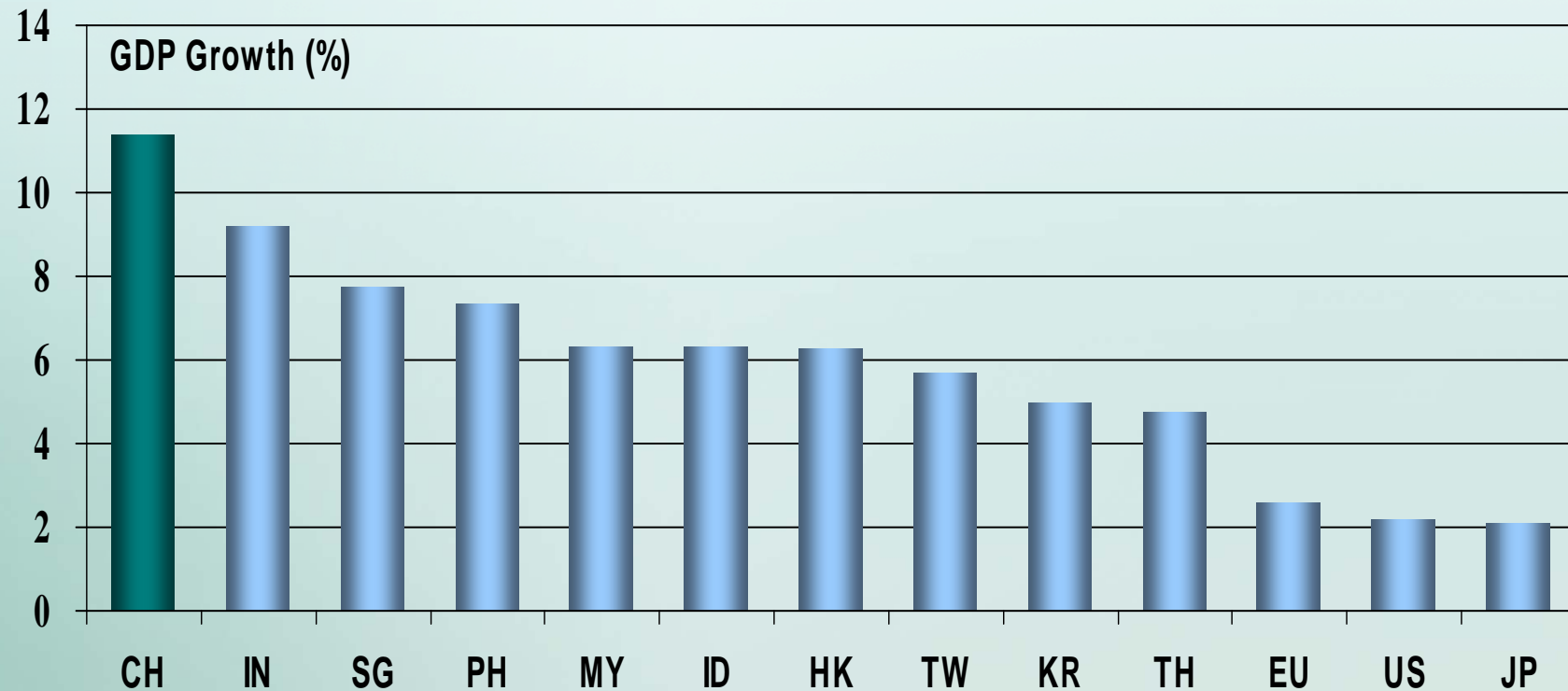


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I. Growth of Mainland Market

Strong Economic Growth of China and Asian Economies

- China will be the 3rd largest economy in the world in 2008 (after US & Japan)
- Double-digit growth for the **5th consecutive year**
- Real GDP per capita: **US\$2,604** in 2007



Source: IMF World Economic Outlook Database April 2008

Potential of Mainland Securities Market

- **Given exponential economic growth, Mainland companies will increasingly turn to capital markets for fund-raising**
 - Government is keen to develop capital market to facilitate direct financing, thus reducing heavy reliance on banks
 - High domestic savings can be used to deleverage Mainland companies
- **Total no. of listed firms in the Mainland: 1,614 with a market cap of US\$2,658.2 bn as of end Jul 2008 (80% of 2007's GDP)**
 - Total no. of IPOs in 2007: 126 (nearly 2 times of 2006)
 - Funds raised through IPO in 2007: US\$63.4b (3.6 times of 2006)
- **China's entry to WTO:**
 - deepen reforms in the securities markets
 - greater access to the Mainland market



China's Economy: Where to Go post Olympic Games

- **China's economy will continue to benefit from the Olympic impact and enjoy good prospects in the long run**
 - three major drivers of growth -- investment, consumption and exports
 - risks of a sudden and drastic fall-off largely reduced

- **Mainland Government will seek a balance between fighting inflation and boosting economic growth to ensure steady and fast development**

- **With robust investment and proper macro controls, China is expected to maintain 7- 8% growth, or even higher for coming years**

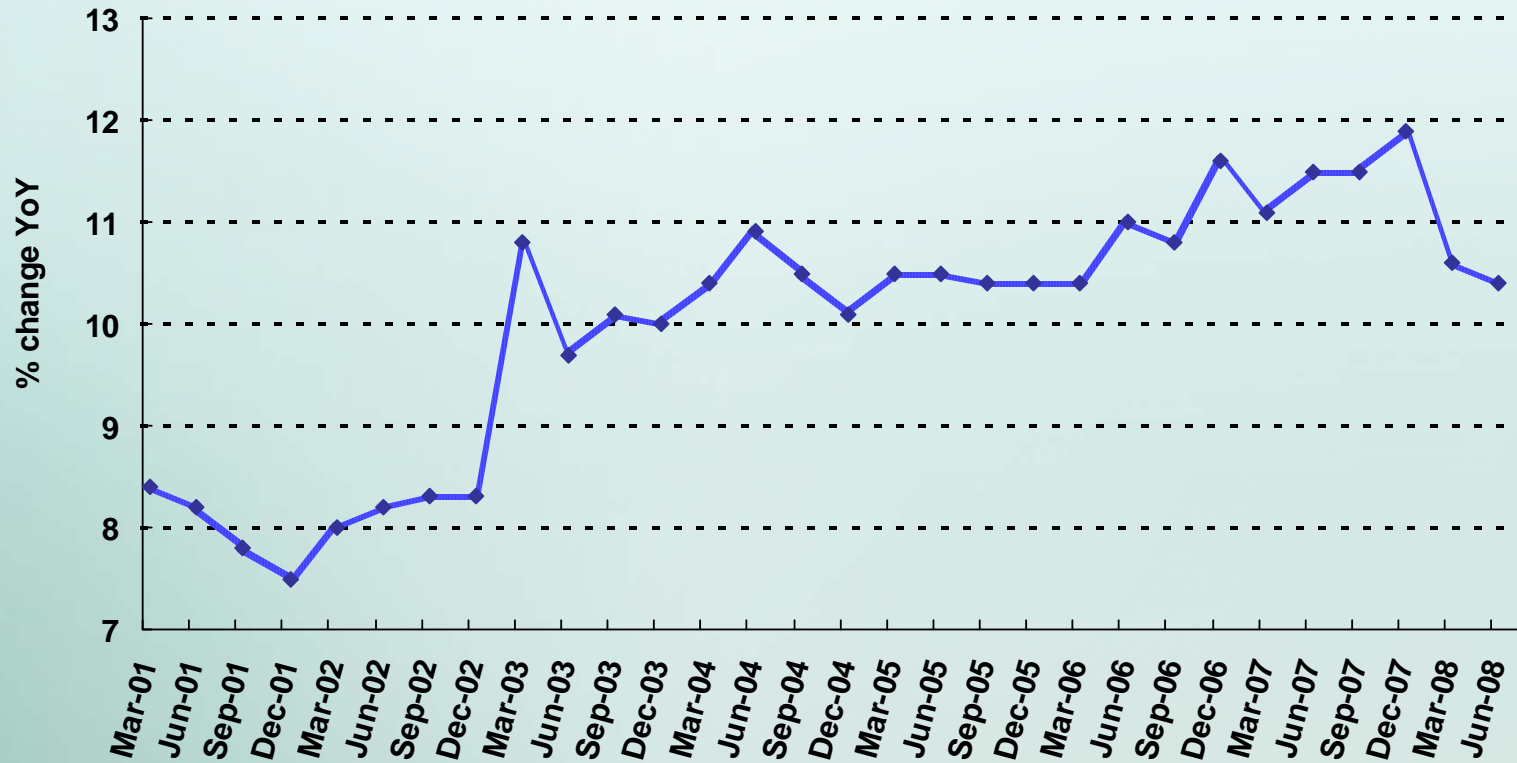
- **... challenges remain**
 - global slowdown and slack export demands
 - inflationary pressures
 - individual investors of stock and real estate markets were discouraged



China's GDP Growth Moderated in 2008 1H

Slower GDP growth of 10.1% in Q2 08 (10.6% in Q1 08 Q1)

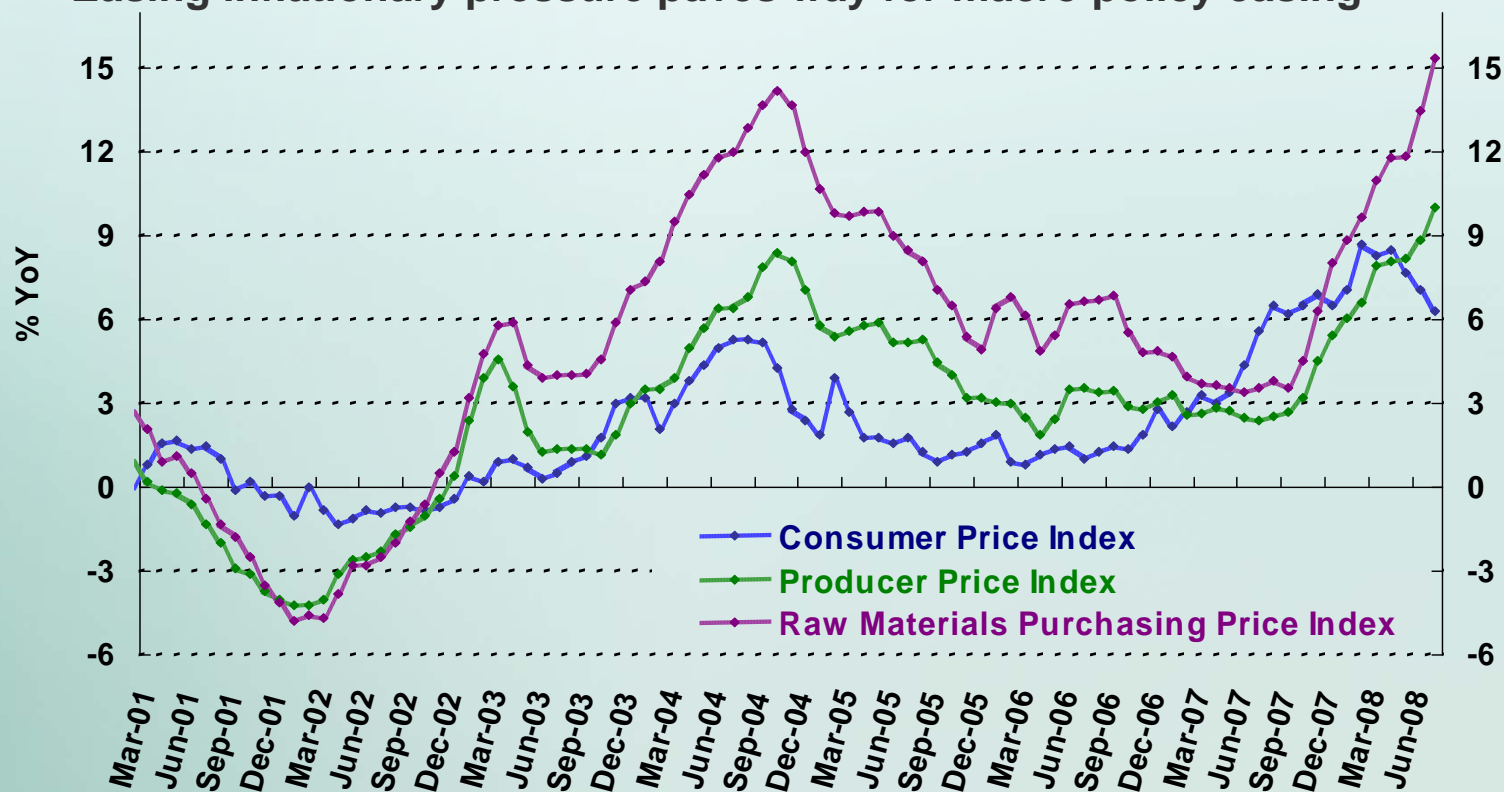
... as external demand softens and tight policy stance limits investment



Source: National Bureau of Statistics of China

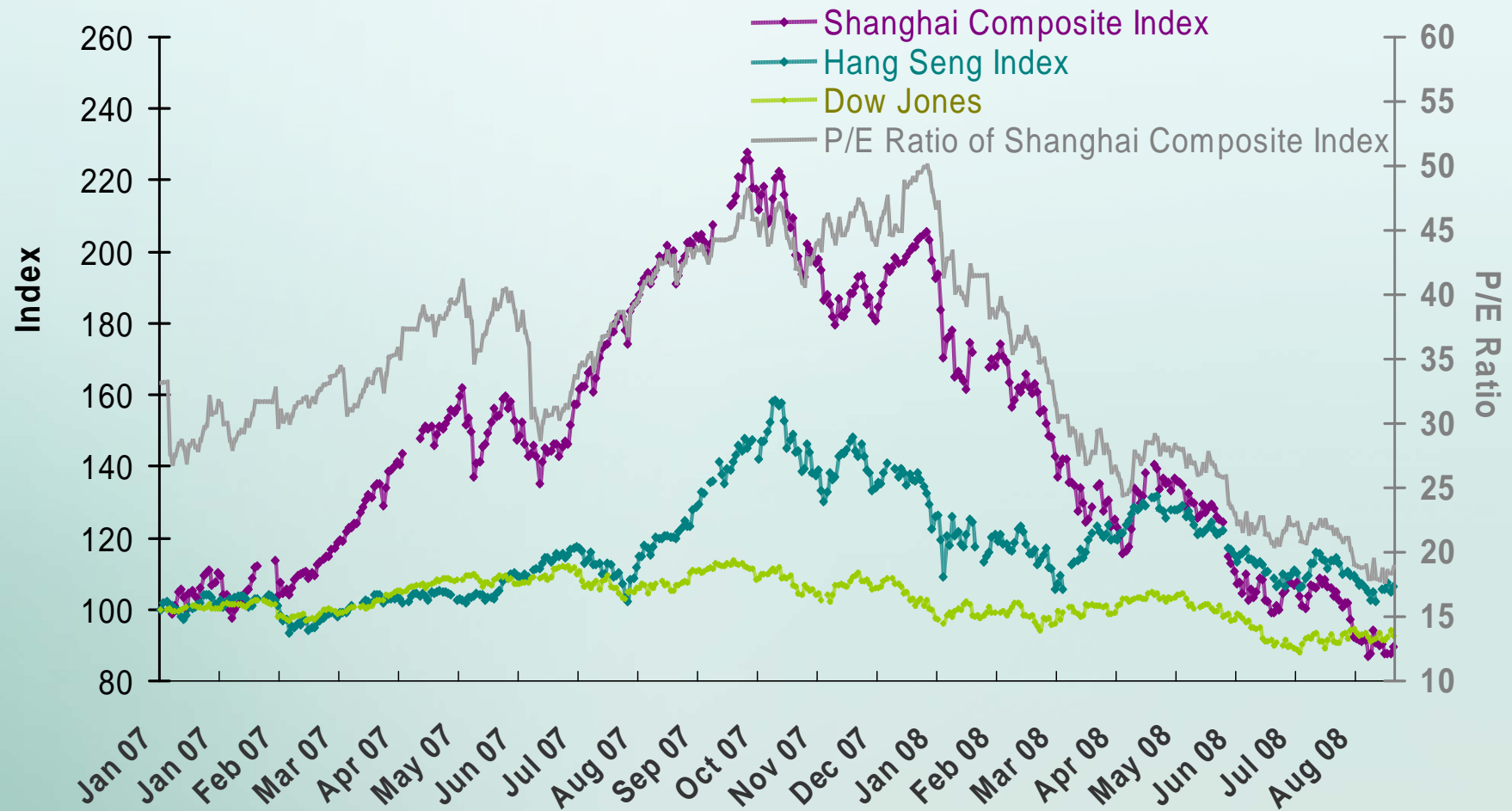
Consumer Inflation Eases, PPI Inflation to Peak and Ease Gradually as Commodities Prices Soften

- **CPI fell to 6.3% in July 2008 (from the peak of 8.7% in Feb 08)**
 - tightening monetary policies
 - expected to ease further in remainder of the year
- **PPI at a 10-year high, may ease amid recent falls in oil and commodity prices**
- **Easing inflationary pressure paves way for macro policy easing**



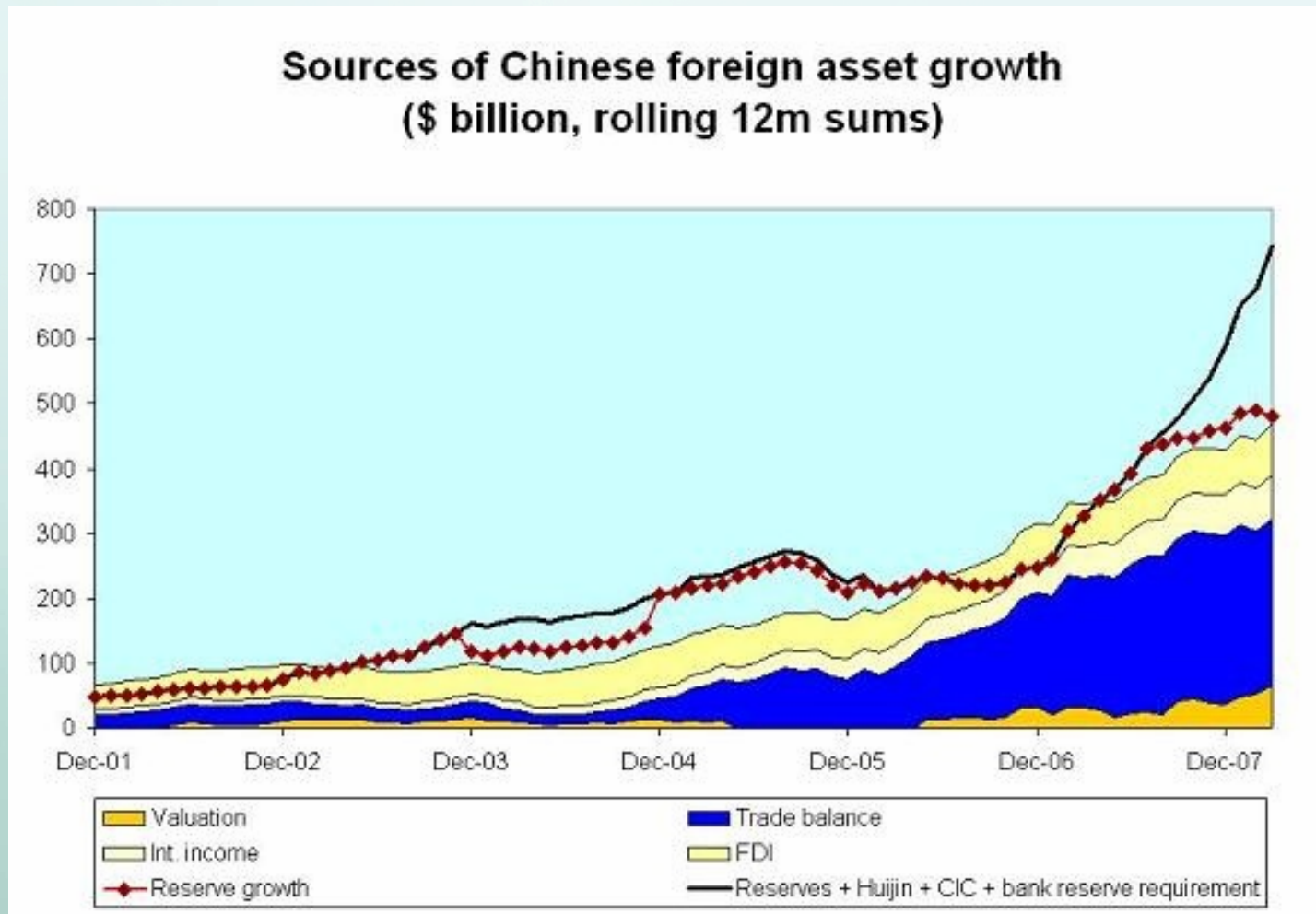
Source: National Bureau of Statistics of China

Recent Fall of Shanghai Stock Market vs. Performance of US and HK Stock Markets



Remark: P/E ratio prior to Aug 1996 was not available.
Sources: CEIC and Bloomberg

Accumulating Foreign Exchange Assets in China



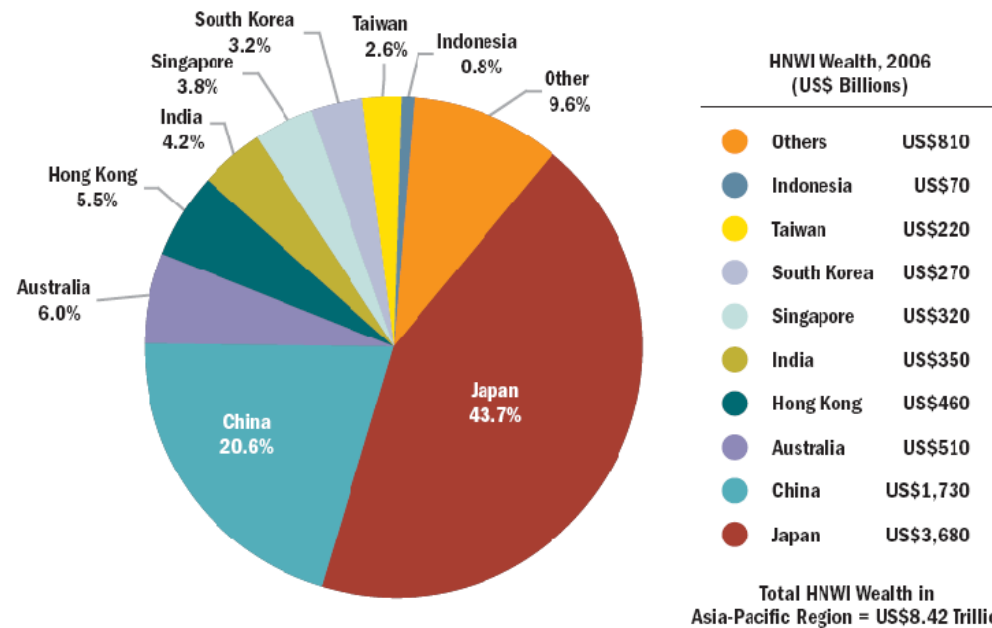
Source : Research Report of Peking University

Wealth Building and Importance of Asset Management

- **Wealth building in Mainland China**
 - Savings deposits: US\$2.3 trillion
 - Mounting trade surplus: US\$262 billion in 2007
 - Forex reserves: US\$1.53 trillion by end 2007

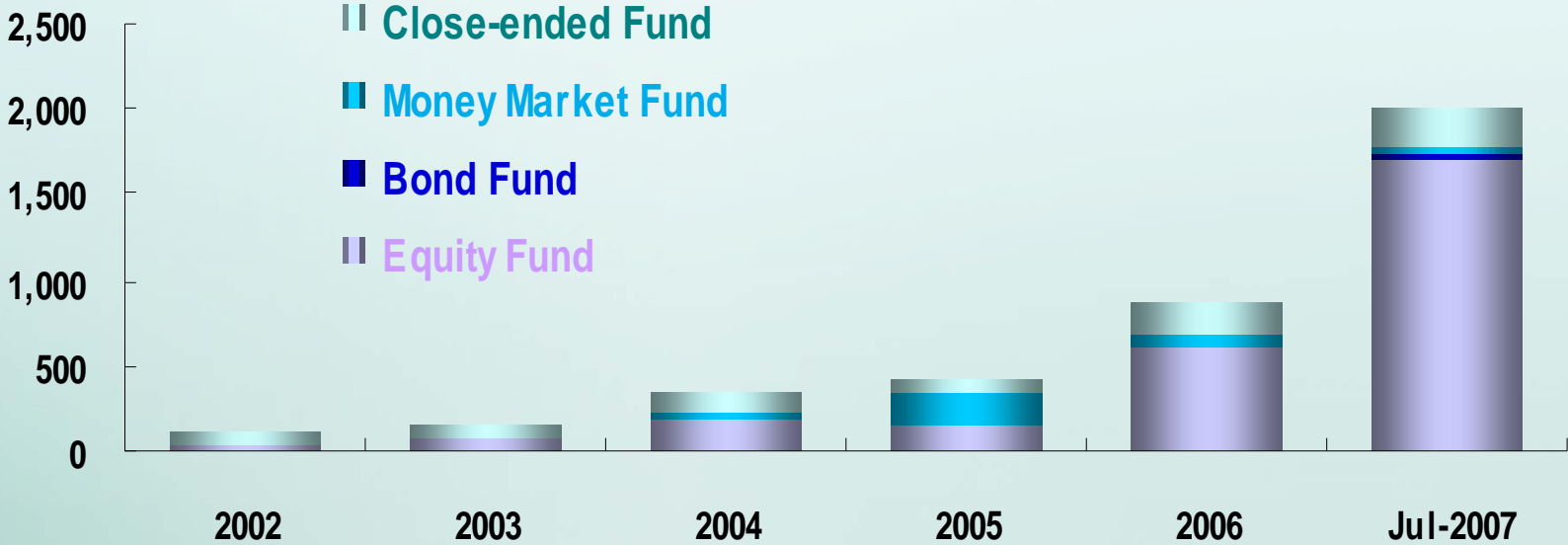
- **In 2007, McKinsey published a report on personal financial services for Mainland households**
 - 1.5 million individuals earn more than US\$50,000 per annum
 - High income group will continue to grow at 15% per annum
 - Aging population will fuel the demand for retirement planning services and products

**Asia-Pacific HNWI Wealth
Distribution
(by Market, 2006)**



Growth of Mainland Asset Management Industry

(RMB billion)



- Excess liquidity but limited choice – need to look for opportunities in alternative investments



Source : CSRC



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II. Hong Kong – the Bridge between Mainland and the World

What Lies Ahead for Hong Kong in China's Economic Development? – Be a Two-way Bridge

- **Hong Kong as an ideal platform for overseas investors to gain access to Mainland China**
- **Hong Kong to channel Mainland capital overseas and as a gateway for Mainland investors to access overseas markets or products**



Hong Kong as an Ideal Gateway to Access Mainland China

- **HK's unique position as a developed market within China**
- **Internationally recognised financial market and regulatory framework**
- **Transparent and reliable legal system**
- **Well-established financial infrastructure**
- **Stable currency with no foreign exchange control**
- **Low and simple tax regime**
- **Strong pool of market talents and investors from all over the world**
- **Free and efficient flow of capital and market intelligence**
- **Wide range of financial products and risk management tools**



Presence of Mainland Companies in HK

- Significant presence of Mainland companies (H-shares and red chips) in HK stock market

	2007		% of Total
	Mainland Companies	Total	
No. of listed companies	239	1,241	19
Market capitalisation (HK\$bn)	10,605	20,698	51
Market turnover (HK\$bn)	10,509	21,669	48
IPO funds raised (HK\$bn)	124	295	43

- **HK as a major fund raising centre for the Mainland**
 - During 2007, the total amount of funds raised in HK was **US\$75.6 bn (HK\$590.4 bn)**, the 5th largest fund-raising centre in the world (2nd in Asia); the total amount of funds raised through IPO in HK was **US\$37.5 bn (HK\$292.4 bn)**, the 4th largest IPO centre in the world (2nd in Asia)
 - During 2007, the amount of funds raised by Mainland companies directly and indirectly through HK was **US\$26.0 bn (HK\$202.8 bn)** during the period (34% of the total); the amount of funds raised by Mainland companies through IPO amounted to **US\$15.9 bn (HK\$124.4 bn)** during the period (43% of the total)



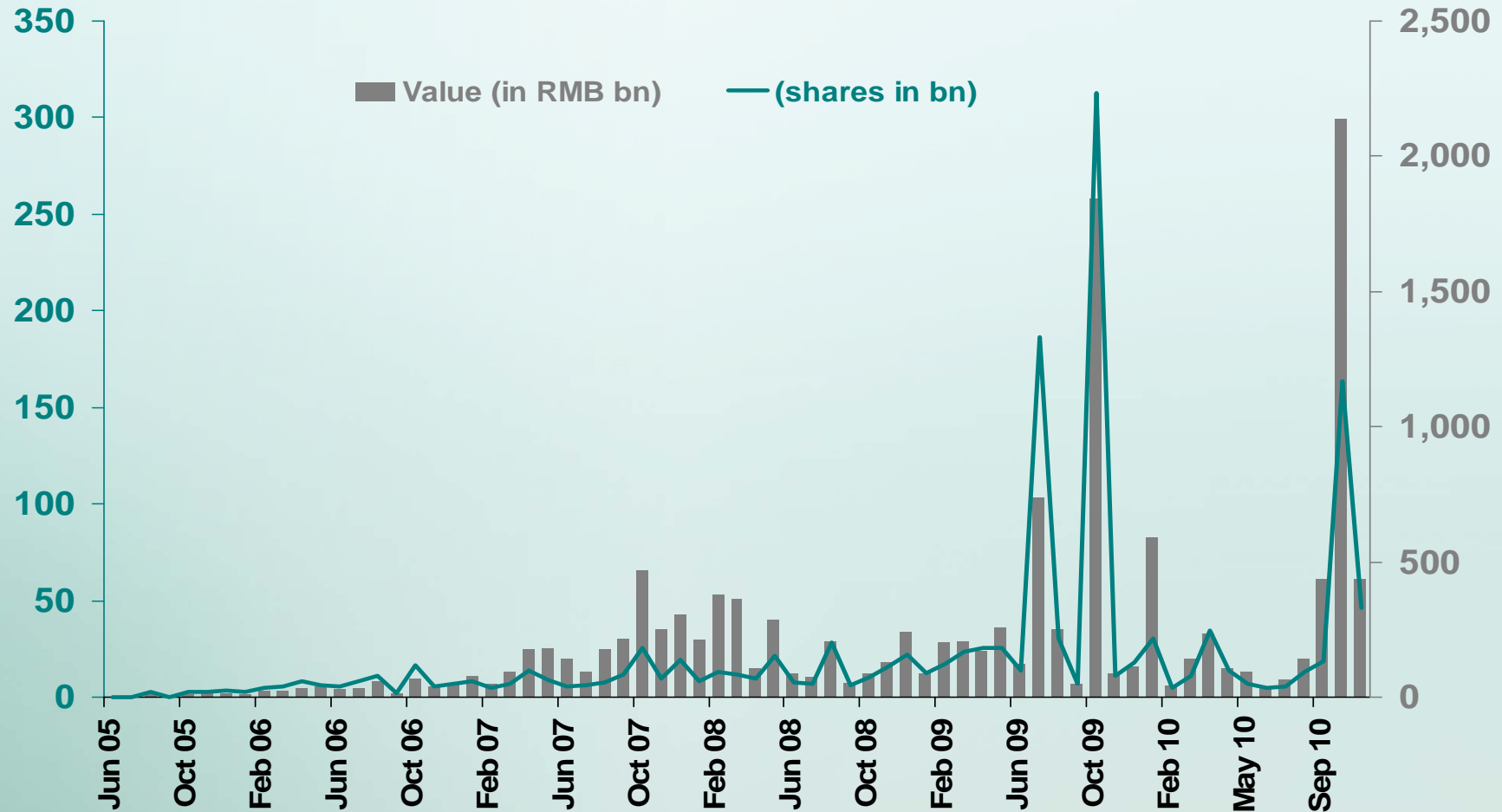
Source: HKEx

Access to Mainland Market

- **Foreign investors can access Mainland market through QFII (Qualified Foreign Institutional Investors) scheme in HK**
- **QFII Scheme**
 - Launched in Dec 2002
 - Open the door for foreign investors to invest in A-shares
 - **56** foreign companies have obtained QFII licenses
 - Aggregate investment quota granted to QFIIs is over **US\$10 bn**
- **HK has been offering more and more China-focused QFII funds:**
 - iShares FTSE/Xinhua A50 China Tracker – the **first ETF tracking the performance of A-share markets**
 - W.I.S.E. – CSI 300 China Tracker – another ETF launched last year tracking the performance of A-share markets
 - The first open-ended fund investing directly and substantially in Mainland's A share markets using QFII quota
 - The first closed-end fund investing in Mainland's A-share markets using the QFII quota
 - SFC has also authorized 15 funds which indicated that they will invest/have invested substantially in Mainland's A-share markets



Offloading of Non-tradable Shares will be Higher in 2009 and Peak in 2010

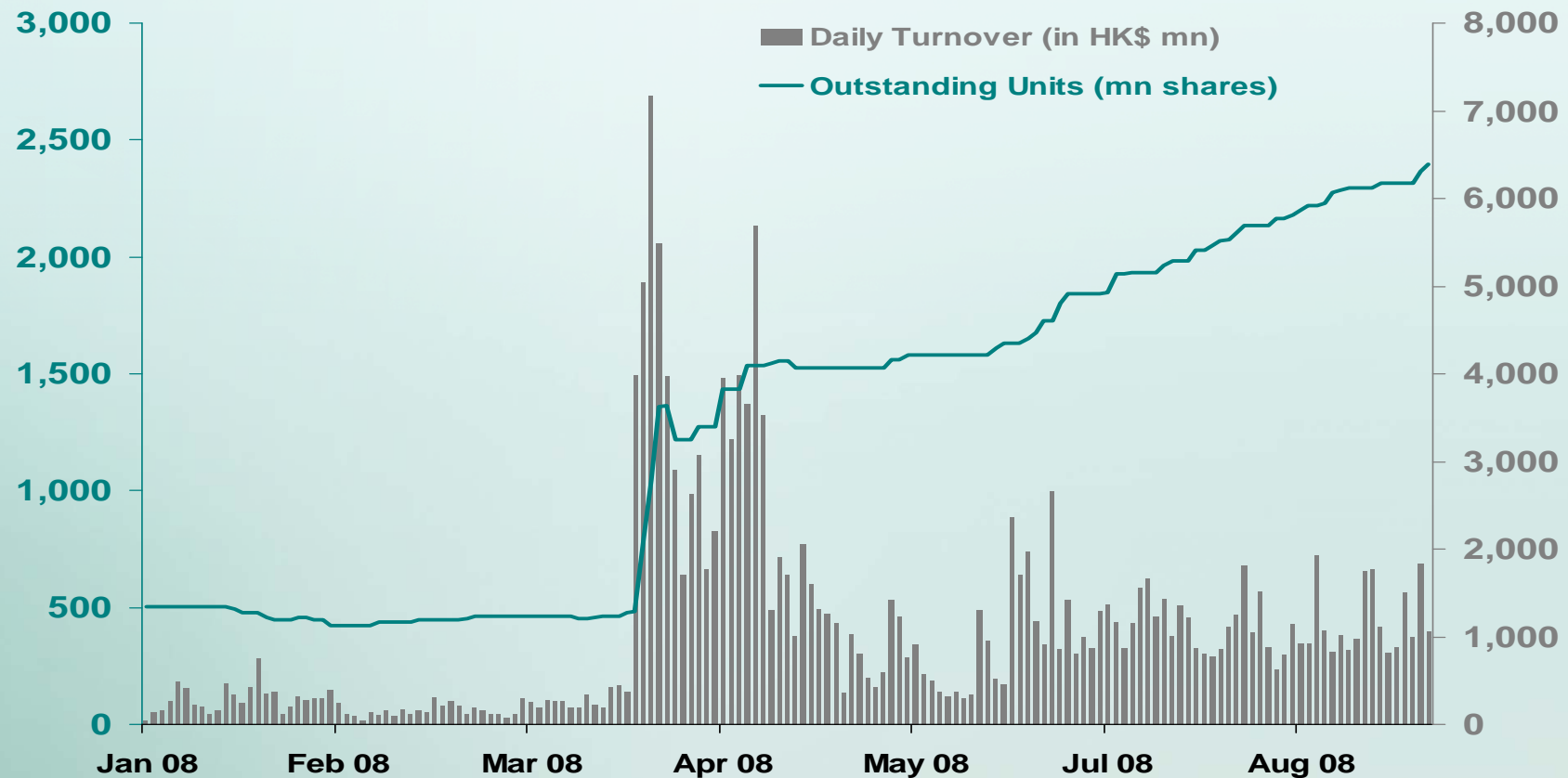


Source : Wind



Huge Local and Overseas Demand for A50

- Local and overseas investors currently gain exposure in the Mainland A-shares market through A50 China Tracker



iShares FTSE/Xinhua A50 China Tracker

Source : Bloomberg



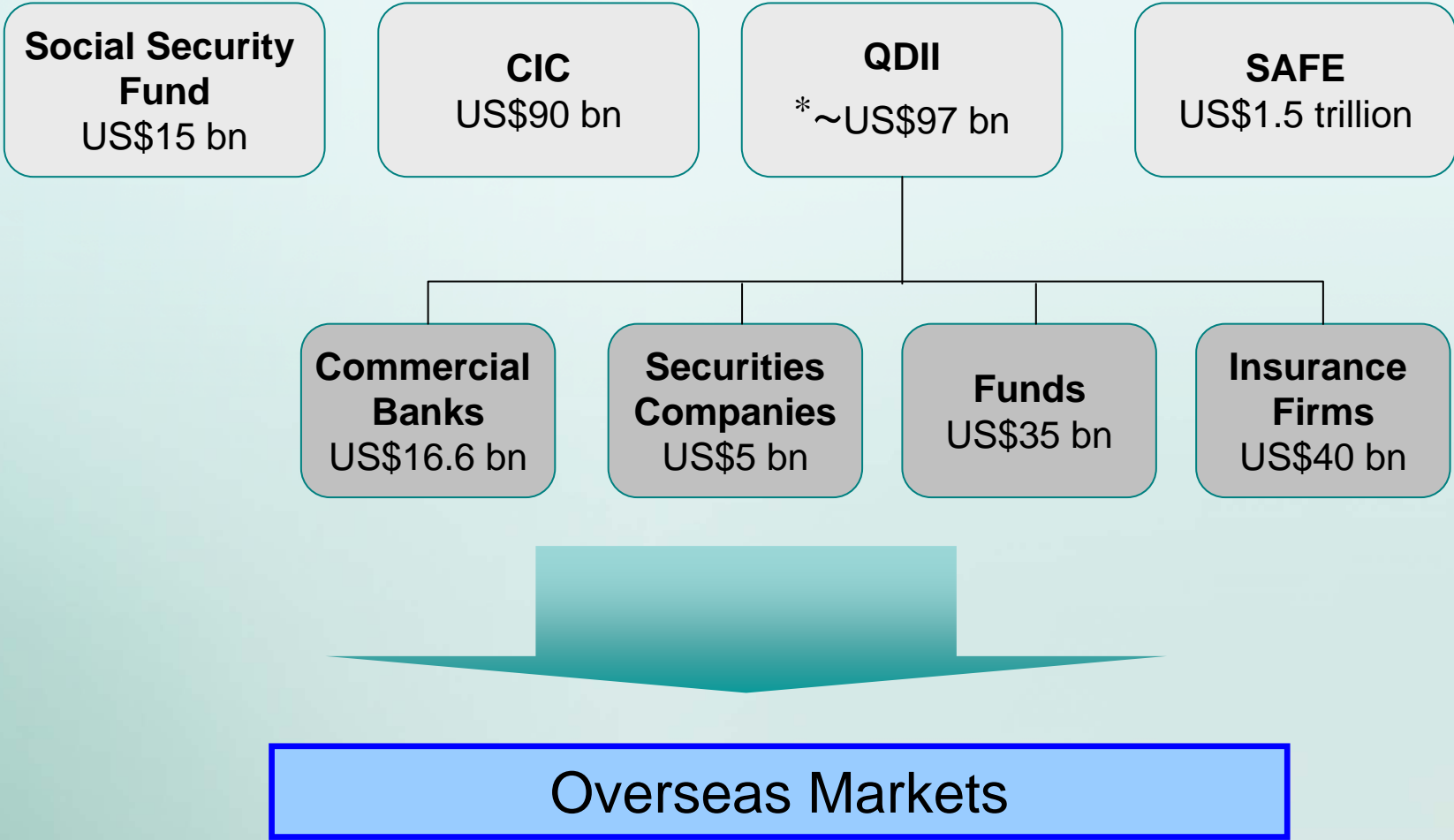
Channel Mainland Capital to Overseas

Qualified Domestic Institutional Investor (QDII)

- **Lay the groundwork for Mainland funds to take full advantage of HK market to invest overseas**
- **Provide an additional source of inflow for the fund management business in HK**
- **Absorb excess liquidity from Mainland market**
 - HK\$130 billion of assets sourced from Mainland QDII in 2007
 - Mainland institutional funds actively looking for foreign alternative investments
 - CIC, National Social Security Fund
 - retail clients
 - commercial banks, fund management companies and securities firms, insurance companies
- **Widen the investment scope of Mainland investors (including institutions)**
- **Allow Mainland firms to learn international market practices**
- **Hong Kong SFC authorised funds can be sold through QDIIs to Mainland investors**



Mainland Capital to be Invested on Overseas Markets



Remarks: * Investment quota approved by SAFE

HK as a Wealth Management Centre for Mainland Investors

- **HK has been a platform for Mainland enterprises to raise funds when China lacked capital. Now, China is flooded with capital – HK is the platform for the overseas investment**
- **HK has strengths at retail and wholesale levels**
- **Customized wealth management services and products to Mainland investors**
 - SFC authorised funds can be sold through QDIIs to Mainland investors
 - Introduction of innovative products to Mainland markets
- **Platform for Mainland fund managers to access international markets and practices**
 - Mainland fund managers are allowed to set up operation in HK



Hong Kong's Listed Products Provide Access to a Variety of Markets

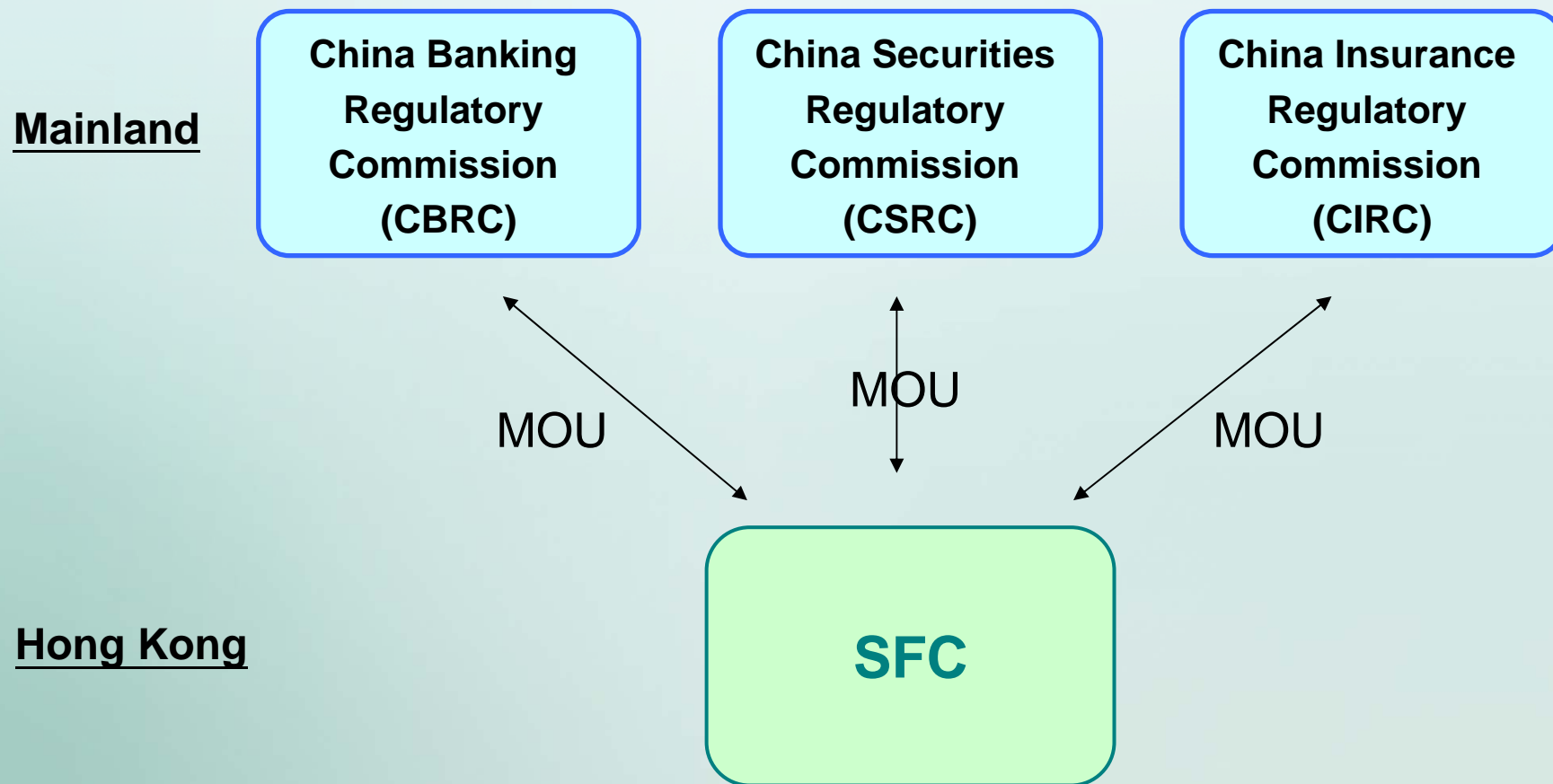
<i>Year</i>	<i>Products</i>
1999	Listing of the 1 st ETF – The Tracker Fund
2004	The first ETF tracking the performance of A-share markets
2005	The first ETF tracking the index of Asian bonds
2006	The first ETF tracking the performance of India's securities market
2007	The first ETF tracking the commodities futures index
2008	The first Gold ETF

- Hong Kong is the largest ETF market in Asia (ex-Japan)
- The total market capitalization of ETFs (ex Gold ETF) as at Aug 08 was US\$16 billion with average daily turnover of US\$240 million in Aug 08
- Hong Kong has 24 ETFs covering equity, bond, commodities futures and gold markets with diversified geographic exposure (e.g. US, Europe, Mainland, Japan, Taiwan and other Asian countries)



Sole Privilege of HK's Regulatory Cooperation with the Mainland

HK is the only market to have regulatory cooperative agreements with the 3 major financial regulators in Mainland



Latest Development of the QDII Scheme

	CSRC	CBRC
MOU signed with SFC on	July 2007	April 2007
QDII licenses approved	<ul style="list-style-type: none"> ▪ 25 fund management companies ▪ 9 securities firms 	<ul style="list-style-type: none"> ▪ 23 banks
Investment quota approved by SAFE	<ul style="list-style-type: none"> ▪ US\$35.0 billion to 10 fund management companies ▪ US\$5.0 billion to 1 securities firm (China International Capital Corporation) 	<ul style="list-style-type: none"> ▪ US\$16.6 billion to 21 banks
QDII products launched	<ul style="list-style-type: none"> ▪ 10 QDII funds launched ▪ HK being the most preferred investing market 	<ul style="list-style-type: none"> ▪ Over 80 bank QDII products ▪ Over 20 products were linked to or directly invested in HK listed securities or HK funds



Latest Development of the QDII Scheme (Cont'd)

- **Signed MoU with CIRC in March 2008**
 - SFC became CIRC's first regulatory partner in this regard
 - Hong Kong became the first destination for Mainland insurance funds to invest overseas
- **A number of Mainland insurance companies have been granted QDII licences and ready to issue their products or to invest**
- **International experience shows that institutions like pensions and insurance companies would seek alternative investments for long term investment opportunities**



Investment of QDII Funds and Challenges Ahead

- **Many QDII funds mainly invested in equities, bonds, money markets etc.**
- **HK remains to be the most sought-after investment destination**
- **Challenges:**
 - QDII funds reported gloomy performance due to the volatile global markets
 - QDII fund managers have to compete with more experienced international market players
 - Different market operations and regulatory requirements in the international environment
 - Complexity of investment products
 - Operational risks e.g. valuation and settlement
- **QDII remains the solid route for Mainland Money going overseas**



HK as an International Platform for Mainland Financial Intermediaries

- **HK– a real IFC with the presence of Mainland participants**
- **By leveraging on CEPA, many Mainland securities and futures brokers have established operations in HK**
 - As of June 2008, 30 Mainland related groups operating in HK are managed by 9 Mainland securities firms and 6 Mainland futures companies
- **CEPA IV permits asset managers from the Mainland to set up subsidiaries in HK**
 - In May, CSRC published "Implementation Rules for Mainland Fund Management Companies to Set Up Operations in HK"
 - 6 Mainland asset managers approached us on licensing related matters
 - China Southern Fund, E-Fund and Harvest Fund have obtained approval from the Mainland regulators to set up operations in HK
- **A broadened base of market professionals and talents will likely attract more overseas investors and capital flowing into HK**





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III. Our Facilitating Approach for Hedge Funds to Capture Mainland Market

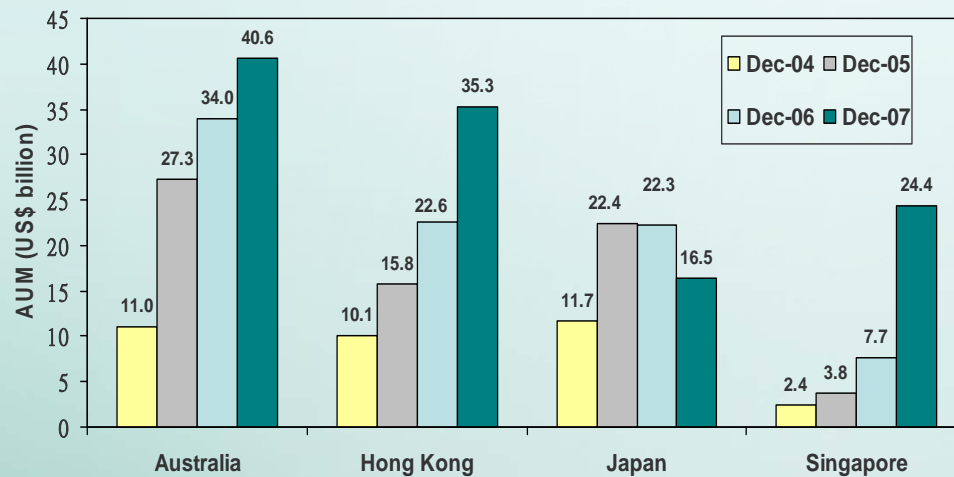
Mainland Opportunities for Hedge Fund

- **QDIIs not yet allowed to invest in hedge funds, but relevant studies now underway**
- **Some Mainland institutions showed interests in hedge funds**
 - Bank of China acquires 30% of Switzerland's Heritage Fund Management
 - Institutional funds actively looking for foreign alternative investments including overseas hedge funds
- **Hedge fund manager can provide investment expertise to Mainland especially in the volatile markets**
- **Investment channels for global hedge funds**
 - QFIIs can invest in A-shares
 - invest in stocks of Mainland-related companies listed on overseas markets
 - Global hedge fund managers are eyeing to the private equity investment in China



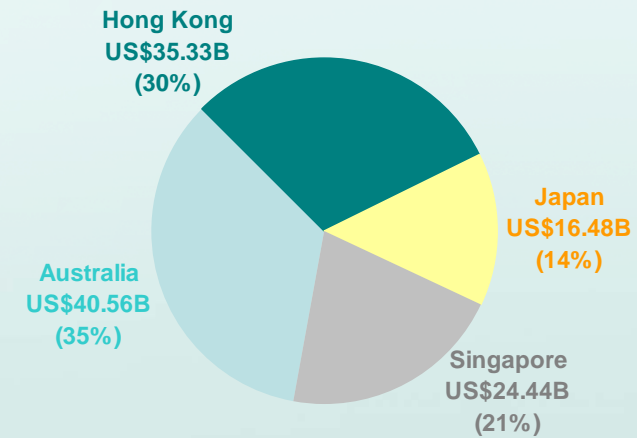
HK as a Major Hedge Fund Centre in Asia

Asia Pacific hedge fund assets by location of hedge fund managers in major Asian markets



Source: AsiaHedge

AUM by Location of Hedge Fund Managers in Major Asian Markets (as of Dec 2007)



- The AUM of Asia Pacific based hedge funds in HK was US\$35.33 billion as of Dec 2007
- The number of our licensed hedge fund managers/ advisers grew by 61% from March 2006 to end of 2007
 - Overseas hedge fund groups (~40%)
 - Local start-ups (~60%)



New Asia-Pacific Hedge Funds

HK ranks first in terms of number of new Asia-Pacific hedge funds launched in 2006, 2007 and the first half of 2008

	No. of new hedge funds launched in		
	IH 2008	2007	2006
Hong Kong	14	25	29
Singapore	12	25	20
Japan	0	10	19
Australia	3	14	8

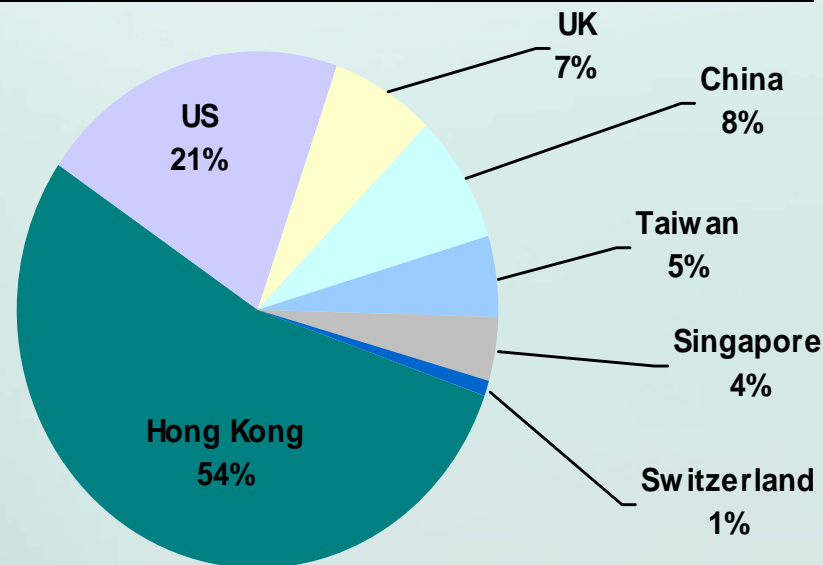


Source: AsiaHedge

HK is a Location of Choice for Hedge Fund Managers Targeting Mainland

- AsiaHedge: 87 China-focused hedge funds with total AUM of US\$12.6 billion as of end 2007, increased by 113% from US\$5.9 billion in 2006
- Number of China-focused hedge funds grew by 71% from 51 in 2006 to 87 in 2007
- Most of these China-focused hedge funds had a fund size of US\$100 million - US\$500 million

Headquarter base by AUM as at December 2007



Source: AsiaHedge

Regulate and Facilitate the Hedge Fund Industry

- **Objective**

- Maintain market's regulatory standards while facilitating market development and encouraging product innovation

- **Approach**

- No direct regulation over hedge funds unless they are offered to the public, but they are still subject to our law against fraud, insider dealing and market misconduct

- **Cross-border cooperation**

- MoUs with Mainland regulators on regulatory cooperation (CSRC, CBRC, CIRC)
- International co-operation through participation at the IOSCO

- **Facilitation**

- We are the 1st jurisdiction to allow retail hedge fund
- Streamlining licensing process



Conclusion

- **Mainland’s fast growing economy and huge capital provide tremendous opportunities to Hong Kong fund management industry, including hedge funds**
- **Hong Kong is a platform for foreign investors “going into” and domestic investors “going out” of Mainland**
- **QDII has moved on from its original remit of fixed income products and now embraces equity, mutual fund products and financial derivatives – substantial opportunities**
- **As a regulator, we provide a balanced regulatory environment to fostering the growth of the hedge fund industry in Hong Kong while protecting investor’s interest and minimizing systemic risks**



Thank You

