Tricor Seminar 2010
Corporate Governance and Regulatory Updates
The further development of Mainland China's capital market – Hong Kong's continuing role

Eddy Fong
Chairman
Securities and Futures Commission

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Ladies and gentlemen,

Introduction

The development of the Mainland capital market and Hong Kong's role in this development has spanned more than 30 years. The integration of Mainland China with global financial markets through Hong Kong is quite unique. It has brought huge benefits to both the Mainland and Hong Kong, and provided the opportunity for investors around the world to gain some exposure to China's growth story.

Before I talk about the continuing role of Hong Kong in the further development of the Mainland's capital market, allow me to quickly recall how Hong Kong's role has evolved over the years to meet the changing needs of Mainland China's economy as it transformed, the strengths of Hong Kong and the role of the Securities and Futures Commission (SFC).

Hong Kong's role in China's capital market development

Hong Kong has played a major role as a test bed for China's integration with international financial markets.

- In the 1980s, Hong Kong provided a platform for the introduction of foreign direct investment into the Mainland as it opened up its economy. Funds raised were mainly for the manufacturing sector along the coastal provinces. This not only helped to boost the Mainland's export drive but also spearheaded the transformation of Hong Kong's economy to that of a service driven one.
- In the 1990s, as the Mainland saw the need to develop its capital market for its state-owned enterprises (SOEs), the Hong Kong market became the preferred choice of fund raising as the financial infrastructure within the Mainland was not ready at the time. Many will remember the first H-share listed in Hong Kong was Tsingtao Brewery.
- In the noughties, the capital raising activities through Hong Kong continued but with increasing focus on state-owned banks and insurers following financial reform in these sectors, as well as capital raising by privately-owned enterprises or the "minyings".
- In more recent years, given the Mainland's prominence in the global economy, Hong Kong's contribution has expanded to include providing the services of a finance centre

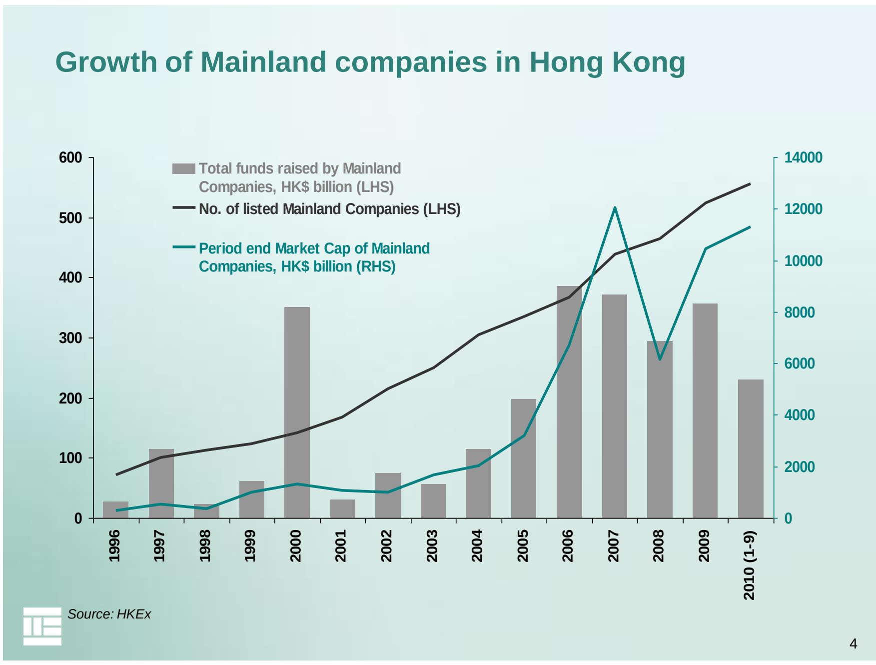
for Mainland enterprises to invest their savings outside the Mainland. The Mainland's recent initiative to gradually internationalise the renminbi (RMB) as a move to further integrate with international financial markets, Hong Kong again became the obvious choice as the pilot offshore centre. I shall elaborate on this initiative later in my remarks.

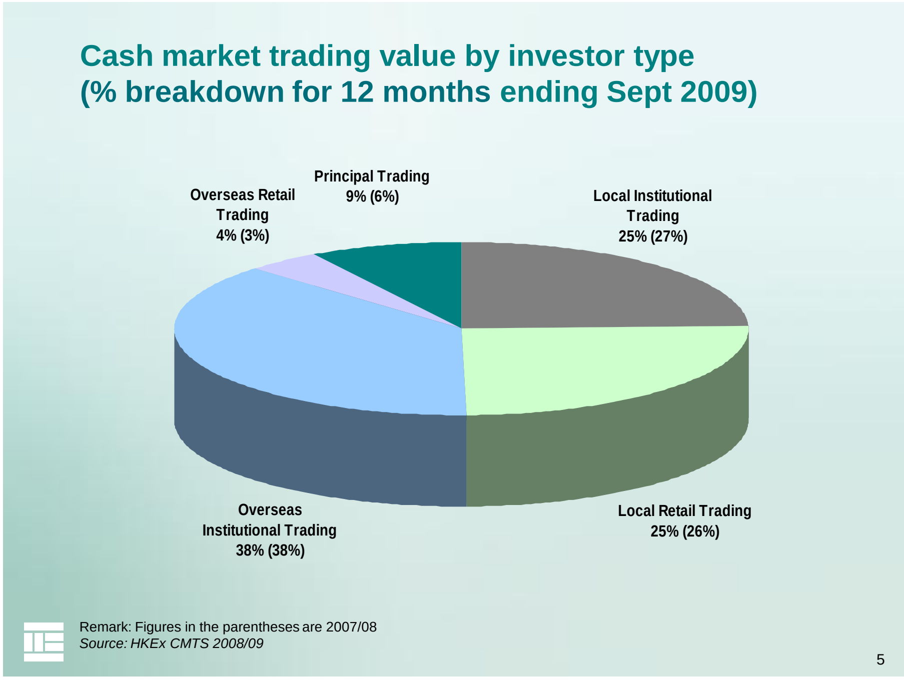
Factors for Hong Kong's success

Firstly, Hong Kong's branding has made it a successful international financial centre (IFC).

- We are the world's "freest economy".
- Hong Kong has a robust institutional structure that protects property rights and a legal system which is backed by Common Law.
- Hong Kong is well known for its business-friendly environment and its deep talent pool of professionals from around the world.

Secondly, "one country, two systems" has placed Hong Kong in a unique position to be a test bed for the Mainland for many of its initiatives. Hong Kong had and will play a pivotal role in the Mainland's opening up of its capital market in a gradual and cautious manner. As the charts below show, this experiment has successfully won the trust of Mainland authorities on one hand, and the confidence of international investors, on the other hand, that has enabled a fast growing number of Mainland enterprises (first the SOEs, then the private enterprises) to list in Hong Kong.





Thirdly, the commitment by the Central Government to support and strengthen Hong Kong as an IFC is enshrined in the Basic Law.

With Hong Kong's proven track record and our understanding of Mainland policies and concerns, Hong Kong is well-placed to assist the Mainland to make the RMB an international currency.

The part played by the SFC

It goes without saying that a robust regulatory and supervisory regime is the pillar to uphold market integrity, protect investors, and maintain market stability. Under the Securities and Futures Ordinance (SFO), the objectives and functions of the SFC can be summed up as follows:

- Regulate and enforce to protect investors and maintain market integrity and stability.
- Facilitate market development and innovation so as to maintain a competitive securities industry and Hong Kong's status as an IFC.
- Educate investors.

I would like to add that the special role entrusted to the SFC to facilitate market development so as to maintain Hong Kong's status as an IFC is quite unusual. Section 6 of the SFO provides that in the performance of its functions, the SFC shall have regard to:

- the desirability of maintaining the status of Hong Kong as a competitive international financial centre;
- the desirability of facilitating innovation; and
- the principle that competition should not be impeded unnecessarily.

As a regulator, the SFC has to remain vigilant in responding to developments in the market environment, internationally and locally. For example, following the Lehman episode, the SFC has taken steps to strengthen our regulatory regime regarding the sale of investment products to retail investors and to better protect the interests of investors. As an example:

- We strengthened the requirements for product transparency and disclosure of product risks.
- We stepped up requirements for intermediaries to enhance selling practices relating to the sale of investment products.
- We also closely monitor the global financial reform initiatives led by G20 countries.

Going forward – Hong Kong's role in further developing the Mainland market

The success of the Mainland's strategy to use Hong Kong as the launch pad for various capital market initiatives (A- and H-shares, Qualified Domestic Institutional Investor (QDII) and Qualified Foreign Institutional Investor (QFII)) has laid a strong foundation for further development and integration of the Mainland capital market.

The successful experience and good co-operation would provide the confidence to strengthen the unique symbiotic relationship between the Mainland and Hong Kong, particularly as the Mainland embarks on the next milestone of its "going out" strategy to integrate its financial markets with the rest of the world.

First and foremost, the SFC must continue to work closely with Hong Kong and Mainland authorities to maintain Hong Kong as a major overseas fund-raising centre for Mainland companies. Hong Kong was the largest Initial Public Offer (IPO) centre in the world in 2009, raising a total of US$32 billion, of which 83% was raised for Mainland enterprises. For the first nine months of this year, Mainland companies raised US$16 billion or 78% of total IPOs in Hong Kong.

The plan to experiment the launch of small scale QFII would open up opportunities for investors to directly invest in Mainland instruments.

We will continue to co-operate and work with the Mainland in various areas:

- build and expand on Closer Economic Partnership Arrangement (CEPA) opportunities;
- facilitate the "going out" of Mainland capital as the Mainland integrates with global capital markets;
- co-operate and assist the Mainland, e.g. in product and market development;
- co-operate with regulators in the Mainland in its capacity building in human resources/talent, facilities and regulatory systems; and
- strengthen the financial linkages by enhancing the market infrastructure of the two markets.

Secondly, I view the recent relaxation by the Central Government to internationalise the RMB as the next ground breaking opportunity for Hong Kong to demonstrate that it is worthy of this unique opportunity to be the pilot offshore financial centre for the RMB.

The launch of pilot scheme to allow cross-border trade settlement in July last year marked the beginning to make the RMB more widely used internationally.

Further new policies were introduced in July and August this year to make the offshore RMB market in Hong Kong truly viable:

- Allowing the transfer of funds between RMB accounts in Hong Kong without any restrictions.
- Allowing non-individuals to open RMB accounts in Hong Kong for any purpose.
- Allowing RMB to flow back to the Mainland through qualified institutions for investing in the interbank bond market.
- Setting up RMB swap lines with central banks and monetary authorities.

These measures would present enormous opportunities for RMB investment products to be structured and offered in Hong Kong. As the RMB is allowed to change hands through trading of financial instruments and borrowing and lending, this would allow the pool of offshore RMB to grow much faster and create the necessary liquidity for a viable offshore RMB market.

Other supporting infrastructure to facilitate the trading of RMB listed products will require intermediaries, such as brokers, to ensure that the necessary arrangements for RMB fund transfers between investors and brokers are put in place.

Conclusion

To conclude, the choice of Hong Kong as a pilot offshore RMB centre is a unique opportunity and an honour for Hong Kong and we should do our best to make it a success. To achieve this, Hong Kong has to be vigilant to preserve its brand and safeguard the interests of investors and the integrity of our financial markets. On the part of the SFC, we will conduct investor education campaigns as appropriate to help investors to understand the new opportunities and risks of RMB-related investment products.

The success of this experiment would give confidence to the Mainland to proceed with its gradual opening up of its capital account and its integration with global financial markets. Success would bring benefits to the Mainland, Hong Kong, and investors and market participants around the world, as it would provide another window to gain exposure to the China growth story. Success could also lead to a wider field for the offshore RMB market to operate beyond Hong Kong.

There are many exciting opportunities ahead, and the SFC is ready and willing to work with market participants and regulators in Hong Kong and the Mainland to make this new initiative a great success.

On this note, I will end my remarks and wish you all a successful seminar.

Thank you.