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Speech

Fostering Future-ready Capital Markets in a New Era of Uncertainty

Keynote remarks at OSC Dialogue[1]

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Ladies and gentlemen, it is a pleasure for me to stand before you today and speak about navigating global capital market challenges in a new era of uncertainty.

First of all, it is a truly remarkable experience for me to visit Toronto again after some 15 years, to see for myself the exciting progress the leading Canadian financial centre has made. This also reminds me how much Hong Kong and Ontario markets share in common, much more than many assume. Both are highly developed yet fast-evolving in many critical areas such as Fintech, wealth management and sustainable finance.

This year's OSC Dialogue is taking place at a critical juncture for the global economy, and its theme "Future Ready" can't be more timely and pertinent. We are standing witness to shocks to the world trade order as we have known it since World War II, and this order has underpinned decades of global prosperity and peace. Now that the escalating trade war has obscured the global economic outlook and roiled both equity and debt markets, the biggest question for capital market regulators like myself is: how can we ensure the resilience and robustness of our markets and prepare our financial institutions for a future of uncertainty?

Harnessing the disruptive forces of our times

This may not be an easy feat, but we have had our "practice" since the outbreak of the pandemic in 2020. The trade war is the latest in a series of disruptive forces at play today. Because of the conflation of these forces, or megatrends if you so prefer, visibility for the future of our financial markets has dimmed, but for one thing, volatility is almost guaranteed. So, my ***first message for you today is we must harness the disruptive forces of our times into positive agents of change to drive market progress.***

Geopolitical tension is undoubtedly one of these forces. When supply chains were first disrupted well before COVID, many worried about deglobalisation. But then, supply chains were reconfigured, boosting intra-Asia trades and investments. In other words, manufacturers simply adapted and diversified from single sources of supply. Now, with the US' latest move, global supply chains are poised to undergo more drastic reconfiguration, and amid widespread unpredictability and uncertainties, global trade and investments would suffer; world GDP growth would slow, and confidence in financial markets, both established and emerging, is being shaken.

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

[1] OSC refers to Ontario Securities Commission, Canada.

Another force of change is the rise of new technologies including blockchain and generative artificial intelligence (GenAI). But with innovation come new risks. The rise of digital assets, for example, has posed tremendous challenges to investor protection, anti-money laundering efforts and market integrity. Yet, if the risks are mitigated, a regulated stablecoin leveraging blockchain can boost efficiency in cross-border trade settlement. Similarly, the tokenisation of traditional assets such as bonds and money market funds can reduce operational costs and improve clearing and settlement efficiency.

As for GenAI, the rapid emergence of large language models is opening up a new horizon of business opportunities in scaling up applications, while lowering the bar for users. Even before this, financial institutions already used machine learning and AI in surveillance, portfolio construction and algo trading for more than a decade, leading to unforeseen levels of interconnectedness and transaction volume in global markets. With GenAI, many of the associated risks are not new, such as model, data privacy and data governance risks, but the biggest risk lies in hallucination, that is, its ability to make up "answers" that it doesn't readily have. Yet, it is no denying that GenAI can be a great tool to enhance business efficiency if hallucination risk is well managed.

Added to this cocktail of complexities is climate risk. It is more of a slow-burning crisis but can equally challenge capital market stability.

With these mega-forces in play, we know what has occurred most recently and over the past few years is no aberration but, instead, a new world order. I always like to quote the old Chinese saying, "in every risk lies an opportunity". If we harness change well, it can prove to be the necessary force of transformation for our capital markets. If not, such change could put many businesses out of existence and shake investor confidence, which we can't afford to lose as it is the very foundation of our markets.

A clear and consistent plan to navigate challenges

Now, to reinforce my first message about mega-forces at play, ***here I come to my second message, which is about the SFC's strategies to harness changing tides to ensure the resilience and competitiveness of our markets.***

The first prong of our strategies is about bolstering resilience. Hong Kong has a completely open capital market with free flows of capital guaranteed by the city's own mini-constitution. Our equity market capitalisation is more than 10 times our GDP. Being a top three international financial centre globally also means Hong Kong is highly exposed to massive capital inflows and outflows.

I would say resilience is in our DNA. The SFC was born out of a crisis 36 years ago in the aftermath of "Black Monday". A decade later, the Asian financial crisis broke out, hitting many regional markets including Hong Kong's as foreign capital fled and carry trades unwound. Since then, the SFC has built a market surveillance system for on-market trading, which we extended to the over-the-counter (OTC) derivatives market after the Global Financial Crisis. In recent years, we also implemented an investor ID system that allows us to see through transactions at the entity level. We can therefore observe anomalies or concentrated buildup of positions, as well as the interplay across different market segments and asset classes.

At the same time, we have bolstered the resilience of our stock exchange, its central counterparties and regulated financial firms by rigorous stress testing and requiring adequate liquid capital to withstand crunches even in the “perfect storm”.

To take the most recent example, on 7 April, our benchmark index experienced the worst single day fall in almost three decades amid a global selloff. Daily turnover spiked to HK$620 billion (about US$80 billion), which was more than double the average daily turnover year-to-date. But our markets showed hallmark resilience against unexpected shocks: intraday margin calls were met on time; bid-ask spreads were tight, suggesting an orderly market with good two-way flows. Short selling positions were normal and spread out.

The second prong is to keep our markets efficient and competitive. Two years ago, Hong Kong’s market liquidity was a far cry from the current level, as global interest rates soared from 0% to 5% in 2023. This was when the Hong Kong market suffered from both a drought of initial public offerings (IPOs) and a dearth of liquidity. Average daily turnover in 2023 was less than half of this year’s level at HK$240 billion (about US$31 billion)[2].

That has prompted a review of the microstructure of our stock market to enhance liquidity. The SFC is working hand in hand with the stock exchange to improve the liquidity and efficiency of our listed securities market. We are conducting a comprehensive review to reduce transaction costs and raise capital efficiency, while staying laser-focused on investor protection.

The stock exchange has recently set out measures to minimise the price spreads for stock trading in a phased approach starting mid-2025. Last year, it also worked with the SFC to enhance the corporate governance standards for listed companies to keep up with global best practices.

In addition, we stay agile in making adjustments to facilitate market development. We have sped up our IPO vetting timeframe and, over the years, introduced broad-ranging enhancements to attract new economy stocks to our stock exchange. These include the regimes for weighted voting rights, biotech, SPAC[3] and specialist technology companies. These days, new economy stocks comprise about 35% of Hong Kong’s total market capitalisation. On the asset management front, we also support the listing of alternative funds that invest in private equity, in response to rising investor demand for diversifying portfolios.

For the third prong, we are further broadening and deepening our markets. As you may be aware, Hong Kong has introduced several Connect schemes to enable overseas investors to participate in the Mainland’s stock market, bond market as well as OTC swap market. We strive to further diversify our investor base and forge closer bilateral links with overseas markets to promote mutual benefits. We are strengthening connectivity with both new markets such as the Middle East and Southeast Asia, as well as traditional markets including Canada.

This journey will take time but we have made key steps forward in the past year. Two Hong Kong exchange-traded funds (ETFs) are now cross-listed on the Saudi exchange – the biggest on the ETF market there. This reciprocates the late 2023 listing of a Saudi Arabian

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[2] Average daily turnover was about HK$100 billion (US$13 billion) in 2023.
[3] Special purpose acquisition companies.

ETF in Hong Kong. And of course, the city has also expanded its connectivity with the fast-growing Mainland Chinese capital market, which is now the world's second largest.

The fourth prong of our strategies is about harnessing innovative technology to future-proof our financial markets. One of our core initiatives is setting out a comprehensive, competitive regulatory framework for Hong Kong's virtual asset market focused on investor protection. Therefore, we recently published our so-called "ASPIRe"[4] roadmap to enhance the security, innovation and growth of our market under a five-pillar framework.

Our roadmap is a calibrated response to the emerging challenges in the global virtual asset market, aiming to drive innovation within guardrails. With a strong focus on risk mitigation and investor protection, we aspire to attract global liquidity, and also to leverage blockchain to promote infrastructure upgrades and efficiency gains for our financial system. In the meantime, we are expanding virtual asset product and service offerings, while also developing new frameworks to regulate more related activities.

Importance of international regulatory collaboration in a new age

For these strategies to succeed, we very much rely on international regulatory cooperation, which is my third and last message for you today. Cross-border collaboration is especially important in today's fragmented world. Trade barriers can be erected overnight to impede trade flows, but capital, like water, flows around obstacles. In the increasingly digital and interconnected global capital markets, we need more collaboration, not less, to mitigate cross-border financial risks, combat crime, as well as scale up and buttress our markets against external shocks.

IOSCO[5] is where both the SFC and OSC have worked in solidarity with united purpose for many years. Earlier this week, an IOSCO board-level committee met in Washington DC to discuss the latest market turmoil and coordinate a global response to common issues and emerging risks, especially in times of stress. As seen during the pandemic, our open communication channels are vital to ensure a rapid and consistent regulatory reaction to maintain market resilience.

I recall back in 2018 when crypto was still a novel topic and when terminology such as "ICOs" was still in fashion, the OSC chaired IOSCO Committee 2 on the regulation of secondary markets, and the SFC was a member. Together, we prepared one of the first IOSCO reports on crypto-asset related risks, specifically on crypto trading platforms. This definitive report has served as the foundation for both IOSCO's further work and also the development of local crypto regulation, such as that in Hong Kong. The report was indeed an early template which has inspired the SFC's evolving regulatory framework over the past five years.

I also recall working with Grant[6] and his team in the early days of our regulatory exploration into sustainable finance, including preparation of IOSCO recommendations on related practices, policies and disclosures for asset managers. While approaches continue to

[4] "ASPIRe" refers to Access, Safeguards, Products, Infrastructure and Relationships.

[5] The International Organization of Securities Commissions.

[6] Mr Grant Vingoe, Chief Executive Officer of OSC.

diverge around the world, the initial international conversation and IOSCO reports helped to lay down the core principles that inform local regulatory frameworks.

Closing: collaboration as the way forward

Ladies and gentlemen, the old international order has been shaken, but a new one has yet to take shape. During this transition, it is even more important to champion the regulatory principles and collaborative spirit that have long underpinned our capital market resilience and sustainability. While Hong Kong does not share a physical border with Ontario, the SFC and OSC do share the same cooperative mindset, mutual respect and commitment to market principles that transcend borders. In this new era of uncertainty, we will stand with our trusted, like-minded partners to ensure our capital markets remain resilient and robust.

Thank you.