

Hong Kong Securities Institute

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“Positioning Hong Kong as an Asset Management Hub”

Mrs Alexa Lam
Executive Director
Intermediaries and Investment Products

Good afternoon ladies and gentlemen, and a Happy New Year to you all!

I would like to thank the Hong Kong Securities Institute for this opportunity to share with you my thoughts on positioning Hong Kong as an asset management hub in Asia.

A lot has been said about the size and prospects of the Hong Kong asset management business. I will invite you to look at a few numbers which will paint the landscape vividly. More importantly, I will share my personal view on the prospects of this business, the opportunities and risks that we face, and how we should position for growth.

Landscape of Hong Kong’s asset management industry

Asset management is an important constituent of the financial sector of Hong Kong. The total combined assets under management in HK according to our Fund Management Activity Survey (FMAS) as at end of 2006 (the latest available FMAS results) stood at US\$789 billion, representing 4 times HK’s GDP for that year. For context, the NAV of mutual funds in the US amounted to 79% of the country’s GDP. In the UK, the NAV of mutual funds amounted to 31% of the country’s GDP. The comparisons here are not quite like with like, but they do give you a broad idea of the strength and importance of our asset management industry in our economy and financial market.

Over the years, industry participants have devoted energy and resources to broaden their expertise and range of asset management services, whether in terms of product range, geographical exposure and asset class. Hong Kong is a matured market, yet our FMAS

2006 showed an impressive double-digit growth of 36% from 2005, and a growth of 70% from year 2004.

Asset management is essentially a global business. Investment money will flow to the market where there is a critical mass of management talents and market expertise, supported by an efficient platform and information system, and a fair and transparent regulatory environment. Our survey seeks to find out the aggregate size of assets that are managed here in Hong Kong, whether they are managed for retail or institutional investors. While the managers and advisors (including banks) provide the services here, the assets do not all originate from Hong Kong (over the years about 60% of the assets managed here come from outside Hong Kong). Nor are the assets all invested in Hong Kong. In fact, I would argue that for a small place like Hong Kong, our asset management industry's ability to attract funds from outside Hong Kong and to invest them in markets all over the world is both a prerequisite to and a testimony of our success.

At this point, the survey has not included players in the insurance industry, yet this sector is an important part of and a potent source of growth in the asset management business, as investors increasingly recognise the importance of insurance products as part of their financial planning and investment. For a more complete landscape of the asset management industry here, we are closely working with the Insurance Authority with an aim that through the Insurance Authority, the Commission can incorporate data on asset management business in the insurance sector in the coming FMAS exercise.

Developments of the HK retail funds market

Other than looking at our asset management industry from the perspective of the value of assets managed by our intermediaries in Hong Kong, we also need to analyse the industry from the perspective of the breadth and depth of our SFC-authorized retail funds market. That market has similarly recorded stellar growth in recent years. According to data recently released by the Hong Kong Investment Funds Association, the total subscription of retail funds for the 11 months ended November 2007 amounted to US\$43.1 billion, representing a 95% growth as compared to 2006.

As at end of 2007, there were 2,040 SFC-authorized retail funds. The total NAV of SFC-authorized funds as at end of 2006 (again the latest available public data) amounted to US\$910 billion. The significant size of these funds not only reflects the growth in

investment capital, but also underscores the breadth and depth of our retail product market, our industry's commitment to product innovation and our commitment to facilitate growth. Underlying this commitment is our belief that to best serve the market and our investors, we must maintain an open architecture so that a diversity of fund products managed by qualified managers from different backgrounds and with different skills could be offered to the retail public.

Let me just name a few of the newer products that we have seen brought to market in the last few years:

- In 2002, Hong Kong became one of the first jurisdictions to allow the offering of retail hedge fund. Currently, there are 14 authorised hedged funds with total NAV of US\$1.57 billion as of June 2007.
- In 2004, we authorised the first ETF tracking the performance of a closed market - A share market.
- In 2005, the first Real Estate Investment Trust (REIT) - the Link REIT and the ETF tracking the performance of Asian bond market were authorised and listed.
- In 2006, there were a number of firsts - the first open-end fund investing directly in China A share markets; the first ETF tracking the performance of the Indian market in 2006; and the first open-ended fund that provides dedicated exposure to Vietnam. Through these funds, retail investors could gain access to these emerging but restricted markets in the region.
- In 2007, the SFC authorised the first ETF that tracks an index on commodities futures, the first listed "close-end fund" for investing in A shares and our first 130/30 UCITS funds.

You may ask why the NAV of SFC-authorised funds (totalling US\$910 billion) is different from the amount of combined asset management business of US\$789 billion reported in the FMAS over the same period. Let me clarify this apparent inconsistency. Currently a vast majority of the retail funds authorised by the SFC are domiciled and managed by managers located in overseas jurisdictions like the US, the UK, Luxembourg, Ireland etc with whom the Commission has signed MOUs. These retail funds are

marketed not only in Hong Kong but also in other jurisdictions where they have obtained regulatory approval. Regardless of the location of the managers of these SFC-authorized funds, their asset size comprises the investment capital raised by the managers of the funds in all the relevant jurisdictions. In contrast, the FMAS only collates information on assets managed or advised by asset managers located in Hong Kong, although the assets in this case also include overseas funds raised by these Hong Kong managers outside HK.

Given the above background, the size of SFC-authorized funds represents a very broad and dynamic universe of funds, made possible by our regulatory philosophy that we not only allow funds managed by Hong Kong fund managers to be offered to the retail public, but also funds managed by fund managers that operate in such overseas jurisdictions that provide comparable safeguards and the Commission has signed MOUs with the securities regulators there for information exchange and co-operation. This model has played a crucial role in the development of Hong Kong's asset management business. It constructs a causeway for retail investors to access a truly global range of products, investments and managers under a regime that has built in adequate disclosure requirements and core structural safeguards that can embrace qualified retail products from different parts of the world. In essence, it gives Hong Kong the ability to showcase itself as a premier fund supermarket. That in turn attracts more players, products, investors, and capital seeking investment opportunities.

Not only this, the offering of overseas managed funds here has provided local asset managers easy access to overseas expertise, skills and practices. More importantly, local managers have the opportunity to co-operate and compete with the best of international fund houses. This has offered local talents fertile opportunities to grow and mature, and to operate by the best of international standards. Today, some of our local names have become significant regional or even global players in their own rights.

Where to next?

You may ask, given that Hong Kong is already a matured market, where is the growth going forward? What will take Hong Kong's asset management industry to the next stage of growth? I believe the answer lies in Mainland China.

As you all know, a major breakthrough for the industry last year was the wide scale implementation of the Mainland QDII Scheme. So far, a total of US\$52.7 billion QDII

quota has been granted by the SAFE (State Administration of Foreign Exchange), namely US\$16.6 billion to 21 Mainland commercial banks, US\$29.5 billion to six fund management companies and one securities firm, and US\$6.6 billion to 14 insurance companies.

Apart from the insurance QDIIs which have different investor profiles, many if not most of the retail QDII products launched so far have a significant component that invests in the Hong Kong equities market or stocks of Chinese companies listed in HK. Anecdotally, this has provided some of the liquidity that drove the Hong Kong market in the last quarter of 2007. The press has recently played up the story of how some of the QDII funds have fallen in value during the last quarter of 2007. It is probably a little unfair to zero in only on these funds, as the world markets have also fallen during the last quarter of 2007. In any event, fund investments should be for the longer term and the importance of short-term performances should not be overplayed.

The US\$52.7 billion QDII quota granted has exceeded by a very significant margin the ultimate US\$30 billion QFII quota that SAFE has promised. The Mainland will in all likelihood continue the policy of channelling excess liquidity overseas. Indeed many market practitioners believe that the Mainland authorities will continue to grant very sizable QDII quotas in the coming year, and that a proportion of them will continue to invest in the Hong Kong market.

While Hong Kong has enjoyed the first influx of QDII fund flows into our market and will probably continue to do so, one must recognise that capital from the Mainland, given its size and the natural need for diversification, will look for a broad spectrum of investment opportunities, both in geographical exposure and product range. The objective of QDII scheme is not just for channelling excess capital overseas. It is the first major step for the “going out” of Mainland intermediaries and investors to gain exposure and experience and ultimately to master world class investment techniques, expertise and standards, which could then be used at home to deepen and broaden their capital market and product pool. In the Mainland’s grander scheme of opening its capital market and growing it into a deep and matured market, therefore, Hong Kong should seek to play a wider and more proactive role, and not just that of a recipient of Mainland funds.

Some research analysts have estimated that the GDP of the Mainland will continue to grow at a rate of 10% and reach US\$3.8 trillion in 2008 and the Mainland is poised to

overtake Germany as the third largest economy in the world this year. It has US\$1.5 trillion in forex reserves and savings of over US\$2 trillion. As its population continues to build wealth, the pressure to properly manage that wealth and to provide for aging and retirement will multiply. As at July 2007, the size of the AUM of Mainland's asset management industry was US\$400 billion, about half of that of Hong Kong as at end of 2006. This highlights both the scope for growth, and the urgency for the Mainland's asset management industry to quickly build critical mass of skill and expertise in the discipline of capital markets, international finance and asset management. I believe this is where Hong Kong could give value and play a meaningful role, a role that one would argue is naturally Hong Kong's, given that it is part of China and therefore enjoys the trust of the country and its people, and our proven success so far in working with the Mainland authorities to allow their companies come to market to raise funds and learn international best practice in governance. Today, the new imperatives are to work with the Mainland so that their financial intermediaries could, through our market, our players and our rules learn the skills necessary for managing and growing the Mainland's wealth.

Under the CEPA IV arrangements signed last year, Mainland fund managers can come to Hong Kong to establish subsidiaries to engage in asset management business. In my view, we should welcome Mainland managers here, not just to play a role in managing and supporting their QDII products, but also to use Hong Kong as a platform to gain familiarity with internationally-renowned standards, up-to-date investment practices and best regulatory and compliance requirements. We should encourage them to build connections with overseas industry practitioners, gain real-time access to global information, and learn to master investment techniques. This will ensure that they become integral and long term players in our market and that eventually they could, just like any of the asset managers licensed here, manage SFC authorised funds and accept investment mandates from overseas investors.

The Mainland managers will in turn bring to our market their catchment of investors and investments assets. As well, they could provide our own industry players with hands-on experience in dealing with Mainland investment rules and regulations, as well as serving the investment needs of the Mainland. Such knowledge is fundamental to Hong Kong's success in playing a meaningful role in the development of investment management business in the Mainland. In short, for Hong Kong to be truly global and competitive in the new economic order, we need to build a critical mass of Mainland financial

intermediaries and players here, using our platform to invest their clients' assets all over the world.

To this end, the Commission will continue to streamline our processes, remove unnecessary regulatory impediments, and at the same time ensure that the regulatory standards in Hong Kong are on a par with international best practice, and that we continue to regulate one and all applying the same set of principles and standards fairly, firmly and transparently.

On this, let me just spend a few minutes to take stock of some of the work we did last year facilitating the industry:

- In March 2007, we further facilitated the processing of UCITS III funds with special features, such as guaranteed and index funds by the issue of further streamlined measures to the industry.
- In September 2007, we organised a very high level seminar for the delegation led by the vice chairman Gui Minjie of CSRC with senior management of the top Mainland fund management and securities companies to kick start the implementation of the QDII scheme for Mainland fund managers and securities houses. In this connection, I would like to thank the HKIFA and the industry for their support of the event.
- Starting October 2007, we allow the managers of our authorised funds to delegate their investment management functions to their related local affiliates located in non-AIR jurisdictions. This enables our retail fund managers to tap a wider spectrum of investment expertise.
- Finally, for recent months, we have worked closely with the industry Work Group that we set up to explore ways to streamline the pre-vetting requirement of ads and notices of our authorised funds and to enhance the standards in our advertising guidelines. This will facilitate the roll out of the marketing of retail products and reduce the lead-time to market. The proposal will be put out for public consultation soon.

Concluding remarks

Hong Kong has worked hard to build its asset management business. The challenge we face going forward is to continue to grow this business in face of stiff competition. Liquidity is mobile at the touch of a button. Other markets beckon with an array of competitive initiatives. Hong Kong's strength is that it is both a market for Mainland China and an international market. We have been dealt a strong hand because the Mainland is opening up in search of investment channels and expertise. We should play this hand to the mutual benefit of the Mainland and Hong Kong. In this, we all need to work in close partnership, you to bring in the skills and innovation, and we to keep the market clean and the rules clear and simple, and together we could scale new highs.

Thank you.