FS's speech at luncheon of Asian Financial Forum (English only)

Following is the speech by the Financial Secretary, Mr John C Tsang, at the luncheon of the Asian Financial Forum this afternoon (September 21):

Your Excellencies, Distinguished Guests, Ladies and Gentlemen,

Good afternoon.

It is my great pleasure to be among so many esteemed figures in world finance. I would like to add my own warm welcome to you all for joining us today.

The Asian Financial Forum is a timely and significant event. The Chief Executive has outlined this morning exactly why this forum is so important in terms of the financial services sector throughout Asia and the world.

I would like to take this opportunity to explain Hong Kong's role within the global financial community. In particular, I intend to focus on our position as China's global financial centre. It is an important role not just for Hong Kong and the Mainland. It also has implications for all of Asia, and beyond.

Looking back, it is difficult to believe that it was only a decade ago that the Hong Kong Special Administrative Region was born. If we had been able to look into a crystal ball in 1997, we probably would not have believed the ride we were about to go on.

Since Reunification, we have faced severe challenges – and overcome them. Many of those challenges were unexpected. Some of the biggest hurdles, such as SARS, avian influenza, the Asian financial crisis, and the 9-11 attack in the US came out of the blue. That in itself is ample evidence that no matter how hard we plan, there will inevitably be bumps and potholes along the way that can slow our progress, or throw us off course for a while. But as long as we have a sound plan, and have a clear goal in mind, the gyroscope of self-interest will bring us back on track.

With those challenges behind us, Hong Kong is now embracing remarkable opportunities. We do have a plan and a goal, and that is to develop our role as China's global financial centre.

Today, Hong Kong – and I am pleased to say, much of Asia also – is stronger, wiser and more prosperous for the experiences of the past 10 years.

Here in Hong Kong, the stock market is trading at record levels, and our economy is enjoying its best period of sustained growth since the late 1980s. Significantly, we have a much deeper and broader relationship with the Mainland.

These days you cannot talk about global finance without talking about China. China is the world's fastest growing large economy, has the world's largest population, and is increasingly becoming more open and accessible to international business.

There are also a growing number of investors in the Mainland with a considerable appetite for making money. Many of these investors are looking further afield, many to Hong Kong, for the tools to make their next investment.

Importantly, Hong Kong is already a global financial centre. We already have the institutional software, the market infrastructure, the knowledge bank, and the entrepreneurial flair to operate effectively on a local, regional and international level.

One example is our banking sector. Hong Kong has been a magnet for bankers for many years, and is now home to some 70 of the world's 100 largest banks. A high standard of transparency and disclosure, and zero tolerance towards corruption, are high on the list of reasons why banks like Hong Kong.

It is not just international banks that have a fondness for this city. Mainland banks have been hitting the headlines recently with some high-profile listings on our stock market. These include the Bank of China, the Bank of Communications and Industrial and Commercial Bank of China. They have tapped Hong Kong's market for capital and know-how. They are predominantly domestic banks now. They may well become global banks in the future.

The Mainland's rise as a major global force means that it needs a financial centre of global significance.

A centre that would provide the necessary linkage to the outside world. A centre that could manage the risks that will inevitably come with increased interaction with the rest of the world. And, a centre that already has decades of experience bringing international capital and best-practice to the Mainland market.

The unique ‘One Country, Two Systems’ concept which forms the basis for Hong Kong’s Reunification with the Mainland can also be regarded as ‘One Country, Two Financial Systems’. Marrying these two financial systems is a challenge because each has its own distinct identity. But, as in any successful relationship, the whole is greater than the sum of its parts. Together, we can achieve much more than if we do it alone.

Our advantage as a global financial centre for China is two-fold. On the one hand, we are a city in China with traditions, values and a culture that resonate across and beyond our physical boundary.

On the other hand, Hong Kong is a city with a distinctly international flavour. English remains the lingua franca of our business community; more than 3,800 international firms have regional operations in Hong Kong. We are a relatively small city that relies heavily on the outside world to make a living.

Our plus points in this regard include a tried and trusted legal system, our well-established access to both foreign and domestic capital markets, the free flow of money and information, the efficient distribution of goods and services, a level playing field for business, a clean administration, and a highly skilled and flexible workforce. And, when it comes to financial transactions with the Mainland, it is best to conduct them in the same time zone to avoid payment and settlement risks.

Our role as China’s global financial centre has also been confirmed in our country’s latest economic blueprint, the 11th Five-Year Plan. This plan clearly spells out Hong Kong’s role as an international financial center, serving the interests of the Mainland, and the rest of the world doing business in Asia. It is a two-way street, serving both inflows to, and outflows from, China and the region.

Premier Wen Jiabao said last year that there was a need to develop a “mutually-assisting, complementary and inter-active relationship” between our two financial systems.

Let me outline our strategy for developing such a relationship in five broad areas.

First, we need to expand the presence of our financial institutions in the Mainland. China’s rapid economic growth, combined with a savings rate of some 45 per cent of

GDP, has created a huge demand for financial services. Our financial institutions are strong, efficient and well received across the boundary.

Our free trade pact with the Mainland, what we call our Closer Economic Partnership Arrangement, or CEPA, can help us do that. At the moment, CEPA covers 27 services sectors and will be expanded to 38 services sectors from January 1 next year. CEPA provides WTO- plus access in these services sectors, which include accounting, banking, insurance, legal and securities and futures. Other services sectors, of course, will also require access to certain financial services in the course of their business.

One good example of how CEPA works is in banking, where, among other things, the asset threshold for Hong Kong incorporated banks has been lowered from US$20 billion to US$6 billion. So, CEPA enhances the opportunities for Hong Kong incorporated businesses. And because we have a nationality neutral policy, it applies equally to the Hong Kong incorporated entities of foreign owned or controlled corporations.

This brings me to my second point. We need to increase our role in the outward mobility of funds from the Mainland. You only have to look at the bullish Mainland stock market to see the depth of domestic liquidity. And the gradual liberalization of Mainland’s closed capital account will allow investors there to access investment opportunities offshore. A pilot scheme was announced last month that will allow individuals in the Mainland to directly buy Hong Kong stocks. Though the final implementation details have still to be completed, this is no doubt a positive development for Hong Kong. Hong Kong’s capital markets offer a wide range of investment instruments. Many are already familiar to Mainland investors. So, I do believe that our stock market could become an effective channel for the orderly outflow of funds from the Mainland.

Progress has also been made on expanding the Qualified Domestic Institutional Investor scheme, or QDII. This enables more Mainland banks, securities and insurance companies, which meet the required standards, to invest in Hong Kong and overseas. According to releases by the State Administration of Foreign Exchange (SAFE), it had approved as of early September this year the applicable QDII quotas for 21 banks, and two fund management companies, totalling US16.1 billion and US$2.5 billion respectively.

Thirdly, Hong Kong financial instruments could be offered in the Mainland. These could take various forms. But, there is a red flag here. Our exchanges operate on different systems. There are large differentials between the share prices of the same company listed in Hong Kong and the Mainland. Issuing exchange-traded funds together with an arbitrage mechanism could be an answer. With stronger interface, the overall size and the breadth and depth of the two markets will increase, and that would help to enhance intermediation efficiency and limit price volatility. Although there will inevitably be difficulties in the closer interfacing of our two financial systems, the hurdles do not appear to be overly difficult to overcome. We will continue to discuss the various options with the Mainland authorities.

The fourth part of our strategy involves currency. As China's global economic stature grows, so will the importance of the Renminbi as an international currency. It is important for Hong Kong to continue to develop its handling of Renminbi-denominated transactions. This process began back in 2004 and has been picking up steam since then. There are currently 38 banks offering Renminbi services to their customers under the Renminbi Business scheme in Hong Kong. As of the end of July, Renminbi deposits amounted to 27.9 billion yuan.

Another important recent development is that, since June this year, Hong Kong has become the first, and only, place outside the Mainland to operate a Renminbi bond market. Within a short period of three months, we have already seen three Renminbi bond issues, offered by the China Development Bank, the Export-Import Bank of China and the Bank of China, totalling 10 billion yuan, and were all over-subscribed by investors. Several Mainland financial institutions have also indicated an interest to issue Renminbi bonds in Hong Kong and we look forward to seeing them soon.

Finally there is more room to dovetail the infrastructure of our two financial systems. Hong Kong has a world-class multi-currency system. So one area we are looking at is encouraging the Mainland to settle its foreign currency transactions through Hong Kong. Looking ahead, to cater for the increasing flows of funds and instruments between Hong Kong and the Mainland, there is also a need to develop new links. And we are actually making preparations to provide for different possibilities.

Ladies and Gentlemen, I am confident that this five-pronged strategy will strengthen Hong Kong's role as a global financial centre for China as a whole. But, it is not the whole picture.

While we will be working hard at how to boost our interface with the Mainland's developing market and systems, we will also be reaching further afield to promote our financial services to the rest of the world. It is important that we explore business opportunities in other economies as well as the Mainland market. This we will earnestly do. And this, too, will help enhance our access to international investment opportunities.

For Hong Kong to develop as China's global financial centre is a new and exciting challenge. It is also a case of history repeating itself. Let me take you back to the 1980s when China was emerging as a global trading giant. Back then, Hong Kong played an important role in bridging the Mainland with the world trade market.

Today, there is an historic opportunity for Hong Kong to help bridge the Mainland with the global financial market. We also aspire to be a model for our neighbours in the region in terms of market development, regulation and corporate governance. Ladies and Gentlemen, as you can see, Hong Kong is entering an exciting new stage of development as an international financial centre. And from where I sit, the future looks pretty good.

Thank you very much.