



Hong Kong has seen a host of Mainland listings, and these have allowed international investors to access one of the most dynamic and fastest growing economies in the world.



Of course, the factors I just mentioned will have limited relevance to Hong Kong unless Hong Kong can take full advantage of them. This is where the SFC and our local industry come into play.

Diversifying and extending our reach in the value chain

The one idea that you have probably heard from my colleagues at the SFC, the Government products and service offerings, and extend its reach in the value chain.

So where are we now?

Asset management covers a wide range of investment services and activities ranging from pooled investment services such as traditional public or mutual funds management and private funds management, to discretionary management accounts for institutional clients like pension funds, endowment and family offices, to investment advisory, private banking or wealth management services by private banks and insurance companies.

According to our annual Fund Management Activities Survey (FMAS), the combined fund management business in Hong Kong (covering mainly the asset management business of SFC-licensed firms, banks and insurance companies, private banking business of banks and fund advisory business of SFC-licensed firms) has almost doubled from US\$1.2 trillion to US\$2.2 trillion in the last five years.

been and still remains a key fund distribution centre in terms of industry profile of personnel engaged in the business. Many of the staff in the industry work in product distribution or related services. Our FMAS consistently shows that of the over 34,000 industry staff, 70% or more are involved in sales and marketing.

No doubt, product distribution is an important segment of our asset management industry. But we need something more to sustain the next stage of growth.

One reason is size. Hong Kong is a relatively small market with a limited customer base. We are an open market and we have an amazing ability to attract capital from the Mainland and overseas. This explains why about two-thirds of the assets managed in Hong Kong are from overseas. However, most investors still prefer to invest through intermediaries in their home markets, which they may be more familiar with and have more confidence in. As for our local investors, the Hong Kong market is already quite saturated.

This is why we believe our next stage of growth will only come if we can extend our reach along the value chain and diversify the types of services that we can provide to the industry, to portfolio management, fund domicile, administration, transfer agent, valuation, accounting and other related professional services. Each link within the value chain has its own appeal. For example, port

added. On the other hand, back office activities such as fund domicile, administration and accounting generate a stable stream of income and are less affected by the vicissitudes of the market and the economy. Last but not least, many of these activities are highly scalable and their growth is not constrained by the size of the local market. We have recently seen some shifts in industry staff profile as a result of the growth of Hong Kong-domiciled funds



and the further opening up of Mainland markets as a result of the Stock Connect and Mainland-Hong Kong MRF initiatives.

Fund management and fund domicile in Hong Kong

We have been encouraging fund managers to come to set up and manage their funds in Hong Kong for some time. And we have made good progress. The number of asset management licenses granted by the SFC has been increasing over the past few years, exceeding 1,200 by the end of September 2016. The number of Hong Kong-domiciled SFC-authorized funds has been growing quite rapidly too, from less than 400 in 2011 to close to 700 now. The size of these funds also almost doubled during the period.

The growth in the past few years has largely been driven by the demand on the part of Hong Kong and international investors for Mainland and renminbi investment opportunities and the growth of Hong Kong as a pre-eminent offshore renminbi centre, and Hong Kong has a strong competitive edge in these areas.

In addition, we have successfully secured policy support that facilitates the development of our Mainland and renminbi investment products. For example, in 2011, the Central
fied Foreign Institutional Investor (RQFII) scheme was first launched in Hong Kong, allowing overseas investors to invest renminbi in the Mainland bond and equity markets. Hong Kong managers were the first to receive approval and quotas to participate in the RQFII scheme, and Hong Kong has the largest quotas among all overseas markets. Stock Connect, a new cross-border scheme with which you are all familiar, has been in operation since the end of 2014 and will soon be expanded to cover Shenzhen. The scheme allows international investors to invest in the Mainland through Hong Kong. This was another shot in the arm as we continue to build up our asset management business.

Mutual recognition of funds

Notwithstanding our appeal and the headway that we have made, the factors that have
issue, most notably the relatively small size of our market.

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and overhead costs across a larger pool of assets under management brings down the expenses ratio of a fund, making it more attractive to investors. This is particularly true for passive funds, which are becoming increasingly popular. Passive funds tracking the same index have more or less the same underlying portfolio. Cost has thus become the key factor which determines how they perform relative to each other. But cost aside, scale confers some additional advantages. It allows the fund manager to develop expertise and capability in specific market segments and also to build infrastructure, such as trading and execution facilities.

A few years ago, we started expanding the markets for our funds, by more actively pursuing mutual recognition arrangements with overseas markets. Over the past ten years we have entered into a number of mutual recognition arrangements with various overseas markets.

Mutual recognition arrangements have an intuitive appeal. Different markets are good at different types of products and may have products on offer that are not otherwise available in the other market. By allowing cross-distribution of funds between different markets, investors



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Unfortunately, events in the past few years have cast doubt over whether the asset



In Europe, some regulators are studying so-called closet trackers, which are funds that pose as active funds, charge a high fee, but in fact invest according to some major indices. Authorities are mulling over what they should do about these funds.

Some market participants protest that regulators should not intervene in how much they charge, as long as the charges are clearly disclosed. This argument misses the point. Accusations of high fees, low returns, and asset managers benefiting at the expense of

interests ahead of its own, investors will find alternatives be they low-cost trackers or some fintech offerings, for example. This would undermine the sustainability of the industry. It is important that we all deal with these issues head on, by putting investors' interests first.

Improving the local market

Much of what I just said concerns principles and measures to ensure the longer-term health and development of the asset management industry. I would like to move onto talking about some of the more concrete initiatives we have been working on, which fall under three broad areas: product diversity, product distribution and market infrastructure.

Product diversity

Division. We strongly believe in providing a broad range of investment products to the investing public in Hong Kong subject to structural and disclosure requirements which provide an appropriate degree of investor protection. In the past two years, we have begun authorizing more innovative products for public offering in Hong Kong, to enhance the product selection in our market and to give investors more choices in this low-interest rate environment.

In April 2016, we authorized the first commodity futures ETFs, tracking the performance of the oil market. In February, we released a circular setting out our requirements for authorizing leveraged and inverse products and we authorized the first of these products in June. As of today, a total of 12 have been authorized, tracking markets in Asia and North America.

Right now, we are allowing leverage and inverse products tracking only non-Hong Kong indices. The intention is to first observe the trading and operation of these products, as well as the

universe. So far, the products have been running much as we thought they would. Their turnover and size have been relatively small, making up less than 1% of the market. But considering the novelty of these products and the fact that the products launched so far all track foreign indices, we believe this was to be expected. As we said in our February circular, we would conduct a review six months after the launch of the first leveraged and inverse products to consider opening them up for other underlying indices, including Hong Kong equity indices. We are now preparing for such a review.

Product distribution

Quite often, asset managers, and particularly the niche players and the newer entrants, tell us that the biggest challenge they face is in securing a distribution outlet for their funds. This is hardly surprising. Compared to other markets worldwide, Hong Kong has a concentrated



fund distribution market. Banks have an estimated 78% share³, which is mainly captured by four major banks. This puts banks in Hong Kong in a strong negotiating position, allowing them to charge high up-front subscription fees and ongoing trailer fees. Cost aside, the outlets for asset managers.

We are acutely aware of the consequences of such concentration in product distribution. We are working to clarify the existing suitability requirement in the context of interactive communications between intermediaries and clients, as well as how the suitability requirement should be implemented across different business models (such as in the context of exchange and online fund distribution platforms and robo-advice, as well as in the more

We hope that by clarifying the relevant regulatory regime in relation to online funds distribution and advisory platforms, we could encourage the use of new channels for fund distribution, such as electronic and online platforms, and also broaden the channels through which products would be made available to investors.

Market infrastructure

The third prong that we have been working on is market infrastructure.

The SFC and the Government are doing a lot in this area, including working on the introduction of -
busy preparing the draft subsidiary legislation and a related code for public consultation.

Another area that is now particularly relevant is the training and expertise of our financial

Government launched the Pilot Programme to Enhance Talent Training for the Asset and Wealth Management Sector, which provides financial subsidies for industry practitioners to attend training courses to enhance their professional knowledge and competency. The SFC, together with organisations such as the HKSI, also organise training programmes to enhance the regulatory regime, as well as seminars

Market development and regulation

however, is relevant to every aspect of my speech. Our vision of developing Hong Kong into a global financial hub, and for this the quality of our regulation is a key factor.

Our plan to secure mutual recognition arrangements with more overseas markets also depends on our ability to demonstrate that Hong Kong has a robust regulatory regime and

based in Hong Kong or abroad. While we are open to consider authorizing new products and opening up new product distribution channels, our first priority has always been to make sure

³ Risk-focused Industry Meeting Series - Asset Management: Looking Forward, SFC (January 2015)



behind, for example, the requirements that we imposed on leveraged and inverse products before we started considering them for public offering in Hong Kong.

In respect of new regulations, on 23 November we launched a consultation on our proposals to enhance the regulation of the asset management industry in Hong Kong. The proposals were formulated following a review of major international regulatory developments, and taking into account observations and views of industry stakeholders.

The proposals cover topics including commissions and independent advice, securities lending and repurchase agreements, safe custody of fund assets and liquidity management, and where needed we have proposed amendments to the Fund Manager Code of Conduct and certain Code of Conduct provisions. In particular, we propose to enhance disclosure of on-going commissions that may be received by intermediaries from product issuers (eg, the trailer fees fund managers typically pay to sales agents from their management fees) at the point of sale. Also, we are proposing that intermediaries may not represent that they are