

# **The Hong Kong Advantage: Building a Global Market**

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Good afternoon ladies and gentlemen. It is an honour to be attending this year's Legal Services Forum being held in Guangzhou.

Guangzhou is a thriving city, isn't it? On my way here this morning I saw people rushing about, cars filling the roadways, shops opened, tourists snapping photos, and the general sounds of a great city on a typical working day. So anytime I get to visit Guangzhou, I always try to do so.

Like Guangzhou, Hong Kong sits in the Pearl River Delta region, which is one of the most dynamic economic regions in the world. Indeed, within five to six hours flying time we can reach about two-thirds of the world's population and some of the fastest growing economies.

We are blessed with our geographic location, but Hong Kong's success lies in much more than that: it lies in our institutions, our laws, and in a much broader sense, our "system".

I know many of you here today run your own business, work as lawyers or corporate counsel, represent various levels of government, or do business in China. I want to share with you Hong Kong's experience in building a global market, and what we can offer to companies in the Mainland and around the world who are looking to raise funds in a well-regulated and transparent market.

## **Hong Kong's Story**

Like the Mainland, Hong Kong has faced a long development curve. We were once a fishing enclave before manufacturing took off in the 1970s and 1980s. We became a service economy in the 1990s and at the turn of the millennium, became one of the top and most comprehensive financial centres in the world.

The success of a city is not the result of a single policy, location, or leader. Rather, it is the culmination of a series of decisions made over time and with foresight. This includes policy changes, talent recruitment, building institutions and more.

Let's look at the HKEx as an example. Back in early 80's, we were essentially a local Exchange, a local capital market with most of the companies listed being local companies. The market capitalisation of companies listed in Hong Kong back in 1980 was \$210 billion Hong Kong dollars, which became \$2 trillion dollars by the early 90's. In 1990, our GDP was \$598.8 billion Hong Kong dollars. When I joined the HKEx Board in 2006, our GDP had grown to about \$1.5 trillion Hong Kong dollars. Preliminary figures released for 2011 show this has grown further to about \$1.9 trillion dollars. The growth of our financial market has had a profound influence in

the growth of our GDP. Today, the financial services industry is more than 15% of Hong Kong's GDP.

Today's market capitalization of all the companies listed in Hong Kong is over 20 trillion Hong Kong dollars. I believe we are the only international financial centre, where the market capitalization of companies on HKEx is some 10 times of its GDP. The total market cap of companies on the New York Stock Exchange is about equal to the GDP of the United States of America, i.e. US\$14 trillion or HK\$110 trillion. We hardly produce or manufacture anything. We are a very small territory with 7 million people, but we have two important assets, our people and our physical, legal and market infrastructures.

### Hong Kong's Advantages

Hong Kong boasts a fully international and established financial market. In 2011, we topped the global IPO fundraising table for the third consecutive year, raising US\$36.1 billion despite a challenging economic environment. Furthermore, we've been in the top five globally in terms of IPO funds raised for 10 years, the only exchange to share this distinction is the New York Stock Exchange. In December last year, the World Economic Forum named Hong Kong number 1 in its financial development index, beating New York and London. We are the first city in Asia to win top spot in the rankings. Hong Kong was also ranked the world's freest economy by the Heritage Foundation for the 18th consecutive year in January 2012.

In March this year, London, New York and Hong Kong ranked as the Top 3 in the 11th Global Financial Centres Index compiled by Zyen, the City of London's leading commercial think tank. The three cities were also the Top 3 in 2010 and have been at or near the top of the rankings since the first GFCI.

Hong Kong is also China's number 1 international capital formation centre. Since the early 1990s, Mainland enterprises have raised US\$500 billion on our market in IPO and secondary offerings. But while China has played a major role in our success, we are also home to an increasing number of overseas companies that want to tap the Asian market.

But despite our tremendous success, we can't be complacent. We are at the dawn of a new era. As many of you are aware, we recently announced the acquisition of the London Metal Exchange. The deal is expected to close in the fourth quarter of this year. With the LME, we are getting a world leader in commodities that instantly opens up an entirely new line of business for HKEx. We expect to help the LME access the China and Asian markets over time. This will open up a vast new market for commodities traders and HKEx. We also intend to introduce RMB-denominated contracts on the LME.

Our plan going forward is simple: to be a vertically and horizontally integrated exchange with comprehensive product depth. In terms of product depth, we already excel in our equities market, derivatives, and we continue to build our index market. In fact, we recently launched a joint-venture company with the Shanghai and Shenzhen exchanges to develop cross-market equity indexes. In terms of vertical

integration, we offer exchange-traded products, clearing, and will soon launch OTC clearing post-trade services.

Finally, in terms of horizontal integration, we are already offering equities, and are expanding into fixed income, currency, and commodities.

The results of our integrated exchange model means Hong Kong is no longer just a place for companies to raise funds – we are a comprehensive financial services centre.

### Legal and Regulatory Environment

So where does our competitive advantage come from? Hong Kong is a Special Administrative Region of China so a listing there is an excellent way for a company to gain exposure and establish a presence in the world's fastest-growing major economy. Hong Kong's many strengths include a free-market economy with no restrictions on capital flows, low taxes and full currency convertibility. It also has a strong, independent, well-established and respected legal system and judiciary. Our financial markets are subject to a robust, reasonable and fair regulatory regime with international standards and best practices.

Most of the world's largest banks and financial institutions have a presence in Hong Kong. One of the key factors is Hong Kong's large and diverse pool of accountants, analysts, investment bankers and lawyers with proven financial expertise from different parts of the world who continue to define and refine our markets. These individuals are indispensable to our progress and are a part of what makes Hong Kong one of the most open, efficient, fair and free markets in the world. We also have a deep liquidity pool that comes from a range of investors. In fact, 46 percent of total market turnover value comes from overseas investors, and 10 per cent of those come from Mainland China.

### Corporate Governance

We also take Corporate Governance very seriously. The Hong Kong Stock Exchange first introduced a basic corporate governance code in 1993. Our recently retired Chief Executive of the HKSAR Government, Mr Donald Tsang decided in 2001 when he was our Financial Secretary to turn Hong Kong into 'a paragon of corporate governance in the region'.

A Corporate Governance Action Plan followed in 2003 to coordinate various streams of work on corporate governance by the Exchange, Hong Kong's Securities and Futures Commission – the SFC, the Standing Committee on Company Law Reform and the HKSAR Government.

The Exchange amended its Listing Rules in 2004 to reinforce corporate governance standards. One amendment raised the minimum number of independent non-executive directors, or INEDs, from two to three. Furthermore, as of December 31 this year, all listed companies will be required to have at least one-third of their board comprised of INEDs. We're pleased to say that 81 per cent of our listed issuers were already in compliance as of March this year. In 2005, the Exchange introduced its

much-expanded Code on Corporate Governance Practices. Like the UK Combined Code, the Hong Kong code is principles-based and adopts the 'comply or explain' approach. We also worked with the Hong Kong Institute of Certified Public Accountants ("HKICPA") to issue the Internal Control and Risk Management Guide in June 2005.

Meanwhile, the Standing Committee on Company Law Reform pressed ahead with a corporate governance review focusing on detailed proposals to enhance the statutory corporate governance regime as it relates to directorship, shareholders' rights, and corporate reporting.

In July 2007, the Financial Reporting Council ("FRC") commenced operations. The FRC is jointly funded by the Exchange, the SFC, the HKICPA and the Companies Registry Trading Fund. Its role is to conduct investigations into possible auditing and reporting irregularities in listed companies.

Good corporate governance does not happen overnight. As you can see from our experience, it takes years of promotional efforts, improvements to Listing Rules and compliance, and communication with listed companies to continually boost the expectation of good corporate governance.

We are still on this journey today. In December 2010, HKEx issued a consultation paper on a Review on the Code of Corporate Governance Practices and Listing Rules, which contained proposals to amend the Corporate Governance Code and the Rules pertaining to corporate governance, as well as some plainer language amendments to improve the clarity, certainty and efficacy of the Listing Rules. We published the consultation conclusion in November last year, which showed general support for our proposals to strengthen corporate governance standards in Hong Kong.

Furthermore, we organised 5 seminars and 10 workshops on Environmental, Social and Governance (ESG) reporting for issuers with a view to raising ESG awareness and encouraging issuers to start ESG reporting. Over 800 participants from 498 issuers attended the seminars and over 500 participants from 348 issuers attended the workshops. Participants told us they were very happy about the workshops and found them useful.

Good corporate governance does not just benefit shareholders or investors, it plays a key role in Hong Kong's reputation as a developed and well-respected international financial centre. Quality markets also attract quality companies.

Hong Kong is very active in global organizations which aim to improve corporate governance and accounting standards. Hong Kong was selected by the International Organization of Securities Commissions, or IOSCO, to take part in a high-level sub-committee to examine regulatory issues which arose after Enron and other high-profile companies collapsed at the turn of the millennium.

The Hong Kong Monetary Authority is an active member of the Financial Stability Board, which helps to coordinate at the international level the work of national financial authorities and international standard setting bodies. It also aims to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies.

Furthermore, Hong Kong has been a member jurisdiction of the Financial Action Task Force since 1991. The Task Force aims to develop and promote policies, both at national and international levels, to combat money laundering and terrorist financing. In 2008, the FATF issued a report on Hong Kong, which noted that Hong Kong has a good legal structure to combat money laundering and terrorist financing. It said money laundering is well prosecuted with a satisfactory conviction rate.

HKEx is also one of the 50 plus global exchanges which belong to the World Federation of Exchanges of which I have the honour to be Chairman. Shanghai and Shenzhen Stock Exchanges are also WFE members. As chairman of the WFE, we have made promoting good corporate governance a priority.

In fact, in 2008, the WFE endorsed a motion by the Organization for Economic Cooperation and Development, or OECD, to strengthen corporate governance. The WFE is a staunch supporter and promoter of corporate governance. One example is when it endorsed the OECD Principles of Corporate Governance, which is one of the 12 key standards for international financial stability of the Financial Stability Board. The WFE believes through participation in developing national codes of corporate governance, by setting listing and maintenance requirements consistent with high standards of governance and through monitoring and disclosure of listed companies' corporate governance arrangements, exchanges have been at the forefront of a process of raising standards. HKEx, and Hong Kong as a whole, are important members and participants in these organizations to improve corporate governance standards.

I am also a Trustee of the London-based International Financial Reporting Standards Foundation which oversees due process of the International Accounting Standards Board. It is the IASB that sets global accounting standards for listed companies.

Hong Kong is also always looking to improve. In June this year, the Financial Dispute Resolution Centre was launched to provide one-stop mediation and arbitration services to the financial sector and the community. The goal is to provide more protection to investors by assisting them to resolve their money dispute in a speedy and cost effective way.

As a stakeholder in the stability of the global financial markets, we strive to work together with international organizations to promote good corporate governance and benefit shareholders, investors, issuers and the markets.

### The RMB and Qianhai

Before I wrap up, I do want to give you a quick update on RMB issuances in Hong Kong.

RMB deposits in Hong Kong stood at about RMB560 billion at the end of June this year, which creates enormous opportunities for companies wishing to issue shares or other products denominated in the Chinese currency.

We have introduced at HKEx measures that allow us to handle the listing, trading and clearing of pure RMB products. Therefore, companies can launch IPOs or follow-on offerings in RMB in Hong Kong or issue shares in both Hong Kong dollars and RMB under our Dual Tranche Dual Counter model. A strong offshore RMB market also requires sufficient RMB liquidity.

While RMB deposits have grown in Hong Kong, we set up our RMB Equity Trading Support Facility to enable investors to purchase shares in RMB even if they don't have RMB on hand.

Indeed, a number of RMB-denominated debt securities, one RMB-denominated REIT, Hui Xian, and an RMB-denominated gold ETF are already listed and traded on our Stock Exchange. We've also announced that we will introduce RMB currency futures in September.

We're also keenly watching the development of the Qianhai Industrial Zone in Shenzhen. The State Council has approved the area as a key economic zone in Shenzhen, and the plans for Qianhai are ambitious. The goal is to turn the area into a financial services hub with close links to Hong Kong.

The preliminary plan calls for a 15% profit tax and no income taxes on financial professionals, lawyers, accountants, and other professionals. It will be easier for Hong Kong banks to set-up their businesses in Qianhai, and much easier for RMB to flow across the border between Qianhai and Hong Kong. And I believe one of the priorities of Qianhai will be to establish a legal and regulatory framework which can support its development into a financial services hub linking to Hong Kong.

Qianhai provides an excellent opportunity for the Mainland and Hong Kong to continue cooperating, and allows the Mainland to build stronger links to Hong Kong and internationally to the benefit of people on both sides of the boundary.

### Conclusion

In sum, we are living in a time of great change. The Mainland is changing, as I see every time I come up here. But Hong Kong is also changing. In fact, we are at the dawn of a new era. Despite the challenge we face in the global economy today, particularly in the West there is no doubt that the centre of gravity of economic activities is gradually shifting from the west to the east. We should seize the opportunities that are before us.

I look forward to working with many of you in the years to come.

Thank you.