Playing a pivotal role

INTERVIEW WITH THE HON PROFESSOR K C CHAN, GBS, JP
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received his bachelor's degree in economics from Wesleyan University and his MBA and PhD in finance from the University of Chicago. Professor Chan has held a number of public service positions including Chairman of the Consumer Council and Director of the Hong Kong Futures Exchange. He is a former President of the Asian Finance Association and President of Association of Asia Pacific Business Schools. Professor Chan was Dean of Business and Management at HKUST before he was appointed Secretary for Financial Services and the Treasury in July 2007.

Arguably the biggest financial story in Hong Kong at the moment is the launch of Shanghai-Hong Kong Stock Connect. How significant a development is this for Hong Kong, and what possibilities does it open up for further linkages with other exchanges on the Mainland?

It's extremely significant because it's one of the most important openings of the Chinese stock market to the world – a historic moment for the Chinese capital market. And as at other key points in the opening up of China's economy, Hong Kong is always playing a pivotal role.

The Shanghai-Hong Kong Stock Connect is more significant even than previous schemes such as the QFII (Qualified Foreign Institutional Investor) programme, under which fund managers in the US or Europe are given quotas to invest offshore Renminbi (RMB) in the Chinese stock market, because for the first time, individual investors and fund managers will have a dedicated channel through which they can trade stocks in Shanghai directly.

To link up the two markets, it involves a lot of infrastructure – computer programs, trading rule changes, regulatory cooperation and so on – and that's only possible because of our close working relationship with the Mainland authorities. This clearly illustrates Hong Kong's unique position and how easy it is to work with the Hong Kong Exchange. If it works out, the next Connect would be with the Shenzhen Stock Exchange, and through that we would be able to link up to the entire China market.

How concerned are you about potential competition from the Shanghai Free Trade Zone (FTZ)? Will RMB convertibility in the FTZ cause problems for Hong Kong?

There might be some competition between Hong Kong and the Shanghai FTZ in terms of the offshore business provided by the banks there, but I think this will be easily outweighed by the potential for us to expand the scope of our own businesses. If the Shanghai FTZ succeeds in generating and capturing a large amount of offshore RMB liquidity, I can see a lot of potential for the Hong Kong market to play a role of providing services and products to that liquidity. So, I think at the end of the day there's going to be more room for mutual benefit. And of course, the Shanghai FTZ is really not contemplating setting up an offshore capital market for the time being, so Hong Kong will continue to have a unique advantage.

What is your strategy for maintaining Hong Kong's status as the largest offshore RMB centre?

We will continue to work on lowering the barriers to access for offshore RMB, both flowing into the China market and outwards, through Hong Kong. We believe that as China's capital account opens up further it will benefit Hong Kong. Hong Kong is already one of the largest Chinese capital markets, with the largest banks carrying on all kinds of businesses. Hong Kong's unique position means that we are already one of the largest providers of every kind of financial services for Chinese companies, so we're going to capture whatever RMB flow that comes out of China. Rather than working on specific initiatives to promote Hong Kong, our overall policy is geared towards assisting the opening-up of China's capital account.

To what extent do the Central Authorities and the PBOC (People's Bank of China, China's Central Bank) take advice from Hong Kong, which is obviously far advanced in terms of its financial infrastructure?

The Chinese regulators have a clear vision of where they want their RMB internationalisation policy to be. They understand Hong Kong's capabilities very well, and in the last 10 to 20 years we have worked together with them very closely. If you look at the major milestones in the development of Hong Kong's financial market that either involve a Chinese listing or Chinese investment schemes, they are always a product of collaboration between the Hong Kong and Chinese regulators. So, we have a long history of understanding each other's needs and policy direction.

Some people argue that if Hong Kong is to be this offshore RMB centre, shouldn't RMB just go to Hong Kong alone? But from the outset we have said that this is the wrong approach. It is not right that Hong Kong should have a monopoly on RMB business because it is not our currency to be had. We want to see RMB developing in different parts of the world – whether it be London, Singapore or New York – because that is the right way forward for the internationalisation of the RMB, as well as for the development of Hong Kong.

What opportunities do you see for greater cooperation with the likes of London and Singapore in order to facilitate this process?

The rise of the London RMB market will be driven largely by the government-to-government relationship between the UK authorities, their Chinese counterparts and the PBOC. But on the operational level, our banks and the Hong Kong Monetary Authority (HKMA) are also involved in helping banks in Hong Kong and London to tap into each other's RMB. We have actually extended our RMB clearing hours in Hong Kong in order to make this service available to European banks, so we are already cooperating with them and assisting them in their endeavours.

How serious a blow was Alibaba's decision to list in New York rather than Hong Kong?

Of course it was a loss for Hong Kong. We would definitely have liked to see the company list in Hong Kong. But Alibaba was a special case in that it wanted to have a very different kind of corporate governance structure to that permitted under our regulatory regime. To list Alibaba would have required a big change to our listing rules, and our regulators did not feel that they could contemplate such a huge change for one company.

But a lot of tech companies nowadays have these types of dual share structures. Is Hong Kong discounting these types of companies altogether, or can some kind of accommodation be reached – for example, creating a separate market for them?

Many markets would have difficulties accommodating that kind of dual share structure. It's actually a very difficult question for all markets outside the United States, because there is always an aversion to differential voting rights.

I think the issue is really that we have a stricter corporate governance structure. Should we contemplate some changes to the rules? I'm open-minded about that. In fact, our market has produced a concept paper on this question and is in the process of assessing the market's reaction. All the world's markets have different rules.

The question is how to accommodate the needs of the market, and that requires a lot of discussion.

Is there an appetite to create a deep and broad bond market in Hong Kong?

Yes. The difference between Hong Kong and other markets is that, historically, we did not issue government bonds, and our economy was small to begin with. Also, our corporations here have very good access to financing, through the banks. As a result, there has always been a lack of a demand for bonds in Hong Kong.

One potential way for us to develop a deep bond market would be by assisting Chinese companies to issue bonds. Chinese companies have been issuing 'dim sum' bonds in Hong Kong for some time, and we see this as an opportunity to develop the bond market for Chinese companies. At the same time we are looking at other ways to drum up interest in the bond market, which is why we have started a government bond programme, even though we don't need to borrow to cover fiscal expenditure. We recently issued our first sukuk, or Islamic bond, as part of this process.

How concerned are you about the level of exposure of Hong Kong's banking system to Mainland borrowers, particularly given the recently announced downgrade of forecasts for China's GDP growth?

Well, obviously, Hong Kong's banking system is very closely connected to the Chinese economy, so it's only natural to have exposure to it, and that has been growing because of the funding needs of Chinese corporations.

The HKMA has been reminding banks about the guidelines and risk management practices, and they conduct a lot of thematic on-site inspections of the banks' lending books to see how exposed they are to concentrated risk – whether it be from China, the real estate market or whatever.

Are you worried about the possible long-term damage to Hong Kong's brand and reputation arising from the on-going street protests and their effect on economic activity?

This is attracting the international media's attention at the moment, but it is part of Hong Kong's culture for people to express their views. People feel very strongly about the issue of electoral change, and that's something we should note.

In terms of the proposition of Hong Kong's financial markets, the fundamentals remain the same. We continue to have robust regulation, an independent judiciary, very strong capital markets and a very deep banking market. F

The opening of Shanghai–Hong Kong Stock Connect is a historic moment for the Chinese capital market and once again, Hong Kong is at the heart of it