A New Frontier for RMB Investment Products and Asset Management Business

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Introduction

The RMB QFII touched on a large number of complex issues, including foreign access to the Mainland capital markets, cross-border RMB flow and the use of RMB outside the Mainland. It involved multiple Mainland authorities. It took the Mainland authorities a good year's time to settle the policy. Their final decision was to start the program on a small scale. Only Hong Kong licensed asset management subsidiaries of Mainland brokers and fund managers would be given a quota, initially.

In August 2011, during his visit to Hong Kong, Vice Premier Li Keqiang publicly announced his support of the RQFII scheme (giving official blessing and a formal name to our "Mini QFII"). Then finally, in mid December 2011, the three responsible Mainland authorities, the CSRC, PBoC and SAFE jointly released the RQFII rules.

By February 2012, we authorized a total of 19 unlisted RQFII public funds. You will recall that there were some queries in the market why it took us so little time to authorize 19 RQFII funds. As we had explained at the time, we had been vetting many of these applications for compliance with our requirements well before the final rules were published by the Mainland. But the point to make here is, not willing to waste a moment, the managers who qualified for the RQFII quota worked zealously to meet all our public fund requirements immediately after Vice Premier Li's visit. As Hong Kong continues to compete for RMB business, this is the attitude we must all adopt.

When the RQFII funds were first launched, there were some unfavourable comments – that these funds did not sell well, because they were all the same (they had to conform to rather structured investment and strategy restrictions), many of the managers were unknown to the Hong Kong market, and Hong Kong investors were not familiar with the Mainland interbank bond market (in which these funds invested). These comments might have been a little too harsh. On average, the funds were about 50% subscribed during initial launch. For a matured market like Hong Kong that offers a broad depth of products, this is not a bad result. In my mind these funds carried the very special mission of bringing about a new breakthrough for our RMB investment product market. For the first time in our history, SFC-authorized funds could invest directly in the Mainland equity and interbank bond market in RMB. In that, these funds were successful. They demonstrated to the Mainland that as an arrangement that links the offshore RMB market and the Mainland capital market using the Hong Kong asset management platform, the RQFII works.

Further opening of the RQFII quota came very quickly two months later, when Mainland authorities announced in April 2012 an expansion of the RQFII quota by RMB50 billion for A-share ETFs to be authorized by us and listed in Hong Kong. Four RQFII ETFs have since been launched. At the end of December, these ETFs were managing about RMB44 billion assets. In a short span of three months from launch, one of these ETFs became the second most actively traded ETF in Hong Kong.

In November 2012, the State Council approved an additional RMB200 billion RQFII investment quota. We are holding high-level discussion with various Mainland authorities on expanding the scope of eligible RQFII applicants and relaxing the RQFII investment restrictions.

The RQFII may be a watershed in the history of the development of many Mainland asset managers. Prior to the RQFII, these firms had little or no access to international liquidity, and

leverage their comparative advantage and tap international money interested in investing in China.

Second, Hong Kong will offer a platform for Mainland fund managers to compete against other international players, learn international standards and practices, understand the requirements and preferences of international investors and build international branding. In the asset management value chain, Hong Kong is particularly strong in client service and sales. Mainland fund managers could learn and bring new strengths back to their Mainland operations. This would raise their overall service quality and risk management, benefiting their customers in the Mainland.

Mainland investors would gain too. They would enjoy a broader range of investment choices. SFC-this money is now sitting in banks, and bank lending represents by far the biggest source of financing in the Mainland economy. But banks are not necessarily the most efficient apparatus for pricing capital and risks. This is the function of efficient capital markets.

Efficient capital markets require a healthy proportion of institutional investors. The Mainland stock markets are still heavily retail (80%). The percentage has been improving. The CSRC outside funds. Existing structures such as the QDII and QFII do not quite accommodate this new creature. As mutual recognition involves cross-border RMB flow between Hong Kong and the Mainland and fundamental questions on RMB capital account, the initiative will need detailed consideration by different Mainland authorities. This would take time. When exactly the initiative would be launched would also be influenced by the macroeconomic climate.

Conclusions and implications for market participants

I would urge that you start to consider the role you wish to play in this new initiative.

For those of you that are already operating in Hong Kong managing funds domiciled here and authorized by us, I encourage you to start thinking about which of your products would be suitable for the Mainland market, why they would be suitable, who your target investors would be, and how your products would help them.

Over the years, a number of you have complained that our market in Hong Kong is too small for you to enjoy economies of scale for building your fund domicile here. We are looking at what would be an appropriate regulatory framework for fund domicile. The Hong Kong-Mainland fund platform that we are building will likely be Asia's largest and deepest. I hope you will complain no more.

Some of you here today may be Mainland fund managers. The fact that you are here today means that your firm probably already has a presence in Hong Kong or is planning to expand into Hong Kong or other overseas markets.