

Proposal by TFEC Member Mr K C Leong
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An Uphill Battle

The global recession has exposed many weaknesses in the Hong Kong economy and society. The announcement by the Central Government to designate Shanghai as the international financial center of our country has dealt yet another blow, at least perception-wise, to our prosperity. Our long term position as a financial hub is at risk, and unless we can come together now and act quickly, we may lose out during the next five to ten years if even that. At this moment, the only factor working to Hong Kong's favor is the fact that the RMB is not freely convertible. We must take full advantage of this to strengthen our position.

Crucial to our survival is our ability to attract and retain highly qualified people of all walks of life to HK and our ability to maintain liquidity in our market and our economy. This will not be easy. One can reasonably anticipate that during the next few years, international institutions will gravitate to and want to expand more in Shanghai. Since the 80's, there existed the notion that Shanghai would become the international financial center of China, and now this idea seems to have become a reality.

We can expect accordingly then that even Hong Kong business enterprises will look to Shanghai. A flood of our blue chip companies will seek to list there. This should come as no surprise to us and should happen sooner rather than later.

In this context, we need to do whatever it takes to maintain the confidence of all our stakeholders in the Hong Kong market. We can do this. There is still time.

Towards that end, we might look to the Blueprint on The Development of The Pearl River Delta. The Blueprint is the sustaining legacy of this government and, I believe, the key to our future. If we can identify 5 to 8 economic areas and/or financial opportunities noted or implied in the blue print and exploit them, we can become the financial focal point of the development, and this can give the Hong Kong market great strategic

advantage into the future.

To do this, we will of course also need to rally and make a concerted effort to broadly promote the development of the Pearl River Delta over the next ten years, but this is eminently do-able. We can become the economic lynch pin of the Pearl River Delta's future, and this in turn, will be a testament to the world of our spirit and financial acumen.

I suggest we form focus groups to identify the 5 to 8 areas. The government can lead the studies, but I think, the involvement of the private sector in the process will make it easier to formulate common goals and facilitate a more efficient implementation of our plans.

Universities should set up research and study units for the development of the Pearl River Delta. They should be encouraged to get outside fellows involved. This should engage a broader spectrum of people in the project and cause better thinking of the critical issues. What is wanted is a sort of Harvard Kennedy School approach to provide an environment that would involve the participation of both the government and the private sector. We need to invite the input of the best and brightest to make this vision work.

Universities have also to play a role to educate the young to understand that the future of Hong Kong is vitally tied to our success in designing and implementing the development of the Pearl River Delta. We need to let them know that their future, indeed, the future of all in Hong Kong, is inextricably linked to the fate of the Pearl River Delta. We need everyone in Hong Kong to be vested in the project, and we must make every effort to sway public opinion in this direction.

As I have previously noted, critical to our future viability in the world financial market is our talent and liquidity. All the same, these factors are stillborn without vision. In this regard, we need a broader mind set. We must look at issues and problems not solely from a Hong Kong perspective but from a broader, Pearl River Delta perspective, and this may require some adaptation of our current financial policies.

For example, when we review our regulatory issues in the financial market, we may have to take an extra step. We may have to look at the issues with

the Mainland, or at least, the Pearl River Delta in mind. That is after all our integrated market, and a lot of liquidity and talent can be captured in casting this wider net.

When I look at the issues through this perspective, the following occurs to me.

When the RMB finally becomes convertible, Shanghai will definitely become an international financial center. In the long run, the scale of business and money there will draw to Shanghai a lot of talent and great liquidity.

Even so, Hong Kong must remain competitive; there are plenty of niches for us to develop to keep us in the game.

There is however another question that comes to mind when I entertain this prognosis: precisely what will a stock exchange look like in 10, 15 or 20 years? The financial market is changing rapidly, but many say that we are trending back to the basics. Is it still worthwhile to project a long term nature of an exchange under the circumstances? What are the basics?

In the past 15 years, so much has happened to the market that it feels like an entirely different sort of game than when I started out. In that respect, I doubt that “going back to the basics” means going back to old technology. New knowledge, concepts, and ideas have been imprinted on our minds. The market is going to remain sophisticated: less leverage, to be sure, but not less sophisticated.

Hong Kong must have the talents at every level, from policy makers, regulators and market practitioners to face this challenge of sophistication. Besides providing a platform for global participants, we must develop local talent who would care about Hong Kong, about the development of the Pearl River Delta, about China’s financial market. We need policy makers, regulators and market practitioners who understand where our future and interests are. It is all interconnected, and we can no longer afford to work and live only in a Hong Kong market. At the minimum, we have to think also about a Pearl River Delta market; then a China market, an Asian market, and in the end, a global market.

Returning to the question of the nature of an exchange, I think we must think about the users of the exchange. There are global participants who, at the moment, are leading the global technology. There are local financial institutions and local retail market players. The Mainland, in terms of proportion and growth potential, is rich in investors. We must, therefore, review our exchange infrastructure in the light of these facts to meet the challenges of the next 15 years. Issues from product mix, to order types, to execution format, to clearing and settlement, to risk management, all must be reviewed. Are we ready to meet the challenge?

One thing for certain that we need to do immediately is to go scriptless in settlements. This will in the long run cut cost, and leave an audit trail. It is so much easier to work out the audit trail in a scriptless environment. For example, if the regulator currently wants to know the nature of short selling, he must deploy a lot of resources. A scriptless environment would put the audit trail at his finger tips, especially if the data is accompanied by a clear reporting requirement.

The future development of the exchange and the market is critically dependent upon the talent of those in I.T. It goes without saying that part of the financial turmoil we are currently experiencing is the result of developments in trading outpacing developments in risk management, i.e. the mid and back office. To solve this problem, I.T. is very important, but the cost to financial institutions is an issue. Perhaps the government should look at how it can help I.T. help financial institutions to develop better risk management engines.

Risk management, to be sure, is and will continue to be, an important issue in the development of the Pearl River Delta market. Different regulators, however, also have different philosophies in regards to risk management. Our experience and background has an important role to play in dealing with this matter. Hong Kong has a long market history and is a very sophisticated market place. Our experience should serve well in working with the Mainland regulators to iron out the issues involved in risk management. And with the global regulatory scene in apparent disarray, this is probably an opportune time for all of us to explore a broader Asian regulatory protocol. Hong Kong, in conjunction with the Mainland, can

take the lead here.

Consider too the issue of regulatory confidence in the risk management of commodities in futures trading. The Mainland would never have confidence in clearing outside of its border or beyond Hong Kong. Our clearing house has a great opportunity in this fact.

There are other niches we can develop as well. We can promote Mainland private enterprises to list in Hong Kong. Whether state owned enterprises would come to Hong Kong or not is dependent upon the policy makers in the Mainland. It is consequentially prudent to incentivize Mainland private enterprises to list with us. At the moment, private enterprises on the Mainland may not be very large, but in 5 or 10 years, many of them will probably grow to mega size. Just look at Nasdaq listings: some of the original companies were really very small at the onset. When they received the help of the market, however, they got huge. It takes some time to get a listing approval at the moment, but we might take the occasion of a Pearl River Delta cooperation to facilitate a speedier regulatory approval time.

In fact, we can use this as an opportunity to consolidate the relationship with the Shenzhen Stock Exchange. We can even explore the possibility of a joint venture with them. Perhaps this will enhance us to take a lead, as a testing ground, to launch new products and services in RMB. New product such as ETFs in RMB may then be possible.

We can also try to identify several crucial commodities in the Pearl River Delta and work to develop the market for them in cooperation with the authorities. We can create trading centers for these commodities. In time, this effort will evolve into forward markets and futures markets for the commodities.

Hong Kong has one of the best banking facilities in the world. By rights, we should naturally become the clearing center for many Mainland commodities, and if this would happen, we in turn cannot help but become a major financial center in the region. The point is that we aim to transform Hong Kong into the clearing and risk management center in this part of the world. Wherever clearing is done, in whatever currency, there is always

liquidity; wherever clearing is done, risk management is necessary and flourishes. Other banking services such as credit and financing will come with clearing and risk management. If we can quickly become a clearing and risk management powerhouse, we will become indispensable as a financial center for the indefinite future. This will be another entry point to add our breadth and depth in our market. Competitors will find it very difficult to overcome the pool of talent that we will attract and the knowledge gap that they will have to surmount to challenge us.

Lastly, I came across a Science and Technology Parks study the other day on “Capturing the Delta Opportunity,” prepared by Ventac Partners. It seems that there is a huge hidden potential in the biomedical business around here. Might it not be one of the 5 to 8 areas that we could focus on? It’s just a thought, and begs the question of other “hidden” business opportunities in the area.

The above is by no means exhaustive. I am sure there are a lot we can do. The message I bring is that we are fighting an uphill battle, but it is a battle that must be fought and not one that is lost from the start. If we focus and play our role in the Blueprint on the Development of the Pearl River Delta, there are many large and small financial and entrepreneurial niches that we can cultivate to maintain our sustainability and growth. Only, time is of the essence.