

Peter Pang: Asia Treasury Trailblazer Summit 2015

Speech by Mr Peter Pang, Deputy Chief Executive of the Hong Kong Monetary Authority, at the Asia Treasury Trailblazer Summit 2015, Hong Kong, 30 April 2015.

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Distinguished guests, ladies and gentlemen,

1. I am delighted to join you this morning to take part in The Asset's inaugural Asia Treasury Trailblazer Summit. I like the buzz word "Trailblazer" in the banner and the chosen theme of this event: "Taking Treasury to the Next Level".

2. "Trailblazer" quite rightly describes the role and requisite mentality of corporate treasurers now operating in Asia. The region is in uncharted waters awash with groundbreaking opportunities and, at the same time, unprecedented challenges. If we can rise up to the challenges and capitalise on the opportunities, multinational companies (MNCs), leveraging on strategic application of their treasury capabilities, can certainly raise their business to the next level.

3. Let's take a closer look at these opportunities and challenges and give some thoughts on how the public and private sectors can work together to engineer a win-win solution.

4. After three decades of high speed growth, propelled by China's rise to become the second largest economy and the largest trading nation, all global MNCs are expanding their presence in Asia, and the share of global revenues generated in Asia continue to rise at a staggering speed. According to the Asia Business Outlook Survey by the Economist, "In 2011, Western firms said that Asia contributed 19% of their global revenues. In 2012, that figure rose to 22%. By 2017, Western firms expect Asia to contribute 32%. However, this will still be below Asia's estimated 35% share of the global economy in 2017."

5. The use of RMB is now catching up with China's rising economic clout. Starting from scratch in 2009, the portion of China's trade settled in the RMB quickly surged to 20% in 2014, amounting to 6.6 trillion yuan, equivalent to more than US\$1 trillion. And, in the same year, over 30% and 16% of China's inward and outward direct investment respectively were denominated in the RMB. Increasingly, MNCs will find it advantageous and necessary to trade with their Asian counterparts, and to conduct the related financing, investment and hedging activities in the RMB.

6. In parallel, riding on her rapid economic growth in the past decades, Mainland China now has a growing cluster of home grown MNCs in a wide range of sectors. Chinese companies now account for 95 of the Fortune 500 companies. These MNCs are now flexing their muscles in the international arena, typically starting with trade and eventually venturing into mergers and acquisitions and global portfolio investment. We can safely assume that they will take even bolder steps with the supportive policies under the "One Belt, One Road" strategy, bringing new business and business partners for other global MNCs.

7. These favourable macro trends are indeed good news to the corporate treasurers. Yet, in shaping strategies to capture these opportunities, there is also a realization that the business environment has become significantly more challenging after the global financial crisis.

8. The quantitative easing by the G3 economies is causing wide swings in exchange rates, asset and commodity prices which have heightened the need for hedging and risk management. The ultra-low yields of their treasuries (for example, yields of government bonds of Germany and France of maturity less than 6 years and 4 years respectively are in the negative zone) in turn has made cash management and portfolio investment difficult. The

alternative of searching for yields in emerging markets has resulted in more risks to manage. The interbank market as a source of liquidity also can no longer be taken for granted.

9. Compounding the challenge of treasury management is the regulatory landscape after the global financial crisis. The capability of banks in providing funding and making market for hedging tools has become more constraint due to deleveraging and implementation of the global regulatory reform, in particular the Basle III requirements on capital and liquidity. The increased market volatility has also made the raising of funds in the capital markets more challenging.

10. To stay ahead of the game, corporate treasurers need to ensure that the treasury function can be transformed to better support international growth in order to capture the immense opportunities in Asia, and at the same time sharpen the management of capital, liquidity, funding and treasury related risks in order to navigate safely in the post crisis intricate market environment.

11. So, as the agenda of this Summit suggests, corporate treasury management can no longer afford to remain in a passive maintenance mode, but need to adopt a proactive and strategic mode. To use a soccer analogy, an effective corporate treasurer needs to be like a good mid-fielder who is able to make lethal passes to the strikers to score goals, and at the same time organise and support the defence to consolidate the victory for the team.

12. Like the mid-fielder in the soccer team, the corporate treasury function needs to be strategically located to support the front line business team in spots where they can strike business deals and where defence can be efficiently organise to handle the risks that may be encountered by the team. In the context of Asia, there is a compelling case for MNCs to set up corporate treasury centres in a financial centre where they can easily capture the China opportunities and where the key treasury functions can be organised efficiently.

13. This can be better achieved by the formation of a regional CTC to centralise the management of treasury activities which is essential for advancing operational efficiency, risk management and cost reduction. The business case is obvious and compelling. Regional cash pooling reduces idle cash and transaction costs by standardising payment systems and centralizing foreign exchange management. Cost of capital can be reduced by optimising external and internal funding. It can also optimize the corporate tax structure and compliance with international regulatory requirements to support global business expansion.

14. Hong Kong is keen to be considered by MNCs as a location for setting up CTCs as we see huge benefits in becoming a CTC hub in the region. The cash pooling function of CTCs will enlarge Hong Kong's liquidity pool and strengthen Hong Kong's role as an international financial centre as CTCs are major users of financial services, capital markets and professional services. It is our goal to capture in particular the high value-added segments of the CTC value chain, including cash and liquidity management, corporate finance activities and financial risk management. By attracting more CTCs and corporate activities here, we will not only bolster our financial sector but also advance the development of headquarters economy in Hong Kong.

15. So the interests of MNCs and Hong Kong are very much aligned. That said, we are fully aware that the competition to become the Asian CTC hub is very keen within the region. There is a need to understand our competitive position, amplify our strengths and double our efforts in areas that we need to catch up.

16. For this purpose, the Financial Secretary tasked the HKMA in 2014, with the assistance of consultants, to conduct a reality check on Hong Kong's competitiveness vis-a-vis our competitors and to devise a strategy to promote Hong Kong as the CTC hub in the region.

17. The reality check shows Hong Kong excels in many of the key factors that determine the competitiveness of CTCs. In terms of strengths as a business location, Hong Kong ranks third in the World Bank's "Ease of Doing Business" ranking and third in the

Global Financial Centres Index after only London and New York. We are also a leader in terms of access to capital markets. Hong Kong is a major international banking centre, with the presence of over 70 of the world's top 100 banks. Our equity market is one of the most active in initial public offers. Benefited from the recent launch of the Shanghai-Hong Kong Stock Connect, the market capitalization of the Hong Kong Exchange has reached almost US\$4 trillion as of two days ago. As of March 2015, it was the third largest exchange in Asia and the sixth largest in the world. In terms of foreign exchange market efficiency, Hong Kong is the fifth FX activity centre supported by a unique network of real time gross settlement systems in USD, Euro, RMB and the HKD. Hong Kong has a high standard of market transparency, disclosure, prudent supervision and without exchange controls which is crucial for centralized treasury functions.

18. A unique advantage of Hong Kong, which is difficult for other centres to match, is its proximity to Mainland China and status as the premier offshore RMB centre. For managing treasury activities denominated in the RMB, we have the largest offshore RMB liquidity pool exceeding RMB 1.1 trillion, a vibrant CNH market with daily settlement exceeding RMB 800 billion, the deepest offshore RMB (or Dim Sum) bond market, the unique access to the A share market through the Shanghai Hong Kong Stock Connect (which will soon be extended to include the Shenzhen Stock Exchange), and critical market infrastructure such as the CNH HIBOR fixing benchmark for pricing RMB financial products and the development of related risk hedging instruments.

19. We, of course, cannot afford to be complacent. Our study has also identified room for improvement in particular in the tax regime for corporate treasury activities. Hong Kong's tax system has many strengths: tax rates are low and the tax regime is simple with no tax imposed on dividends and capital gain. Hong Kong is also probably the only major jurisdiction in Asia without an interest withholding tax. That said, unlike some other financial centres, the tax regime has yet to make provisions that are customized for CTC activities.

20. Underscoring the Government's determination to promote Hong Kong as a CTC hub, and having considered the study's recommendations, the Financial Secretary in his latest budget speech announced two tax measures that will make Hong Kong's tax regime even more attractive for MNCs to set up CTCs in Hong Kong.

21. First, the interest deduction rules under the Inland Revenue Ordinance will be amended such that interest expense arising from genuine inter-company borrowing and lending will be deductible. This will resolve the "tax asymmetry" issue currently perceived by some MNCs as an impediment to their establishing or expanding CTC operations in Hong Kong.

22. Second, profits derived from qualifying activities of eligible CTCs will benefit from a half-rate concession. In other words, the applicable tax rate will be reduced from the current 16.5% to 8.25%. We will define the scope of qualifying activities in consultation with the industry later this year. But broadly speaking, the scope will encompass corporate finance, liquidity management and risk management activities typically conducted by CTCs for their overseas associated companies.

23. The HKMA is working closely with the Government to take forward the legislative work with a view to introducing the relevant bill to the Legislative Council in the 2015-16 legislative session.

24. I believe, and certainly hope that, with these latest refinements of the tax regime for CTC activities, we should be able to remove any remaining reservations that your firm may have in considering setting up CTCs in Hong Kong.

25. Coming back to my soccer analogy, setting up a CTC in Hong Kong will offer MNCs a home game advantage. For Mainland corporations, Hong Kong offers unmatched home turf advantage under the "one country, two systems" framework. They are familiar and comfortable with using Hong Kong's financial platform to advance their global business

objectives. For the other global MNCs, Hong Kong is the ideal place for centralizing their treasury operations in Asia, in particular those that are tied to the rising use of the RMB. We are right at the door step of China, the perfect spot for the CTC, the mid-fielder, to support their front line teams to strike deals and score business goals with their Chinese counterparts.

26. Looking at the very comprehensive agenda today, I am sure you will have very fruitful discussion on how to ride on the different industry trends and create cutting-edge, innovative treasury solutions. May I wish this Summit a great success.

27. Thank you.