Norman T L Chan: Hong Kong as a private banking hub – a regulator's vision

Speech by Mr Norman T L Chan, Chief Executive of the Hong Kong Monetary Authority, at the HKAB – HKIB Distinguished Speaker Series and HKIB Fellowship Conferment Ceremony, Hong Kong, 12 June 2012.

*   *   *

Peter (Wong), Anita (Fung), Patrick (Fung), Julia (Leung), Ashley (Alder), distinguished guests, ladies and gentlemen,

Good afternoon. I am most honoured to be conferred a Fellowship by the Hong Kong Institute of Bankers (HKIB) and would like to thank HKIB for recognising my contributions, which are in effect contributions of the HKMA, to the banking sector.

The achievements of Hong Kong's banking industry are attributable to the efforts of many stakeholders. Among them is HKIB, which has been providing quality education and training to the banking industry for decades. Many industry practitioners, and the banking industry as a whole, have benefited from the good work of HKIB.

On this special occasion, I am also honoured to be invited to speak in HKAB-HKIB Distinguished Speaker Series. I will be speaking on "Hong Kong as a private banking hub – A regulator's vision". I have chosen this topic because over the past few months, the Hong Kong Monetary Authority (HKMA), together with the Securities and Futures Commission (SFC) and the Financial Services and the Treasury Bureau, has been working very closely with the Hong Kong Association of Banks (HKAB) on what Hong Kong should do to take the private banking industry to the next higher platform. I would like to take this opportunity to share with you my views on the steps Hong Kong needs to take to develop as the premier private banking hub in Asia. To start with, I want to talk about some facts relevant to Hong Kong's realisation of this aspiration.

Hong Kong's strengths to be a leading private banking centre

Wealth in Asia-Pacific is growing exponentially. According to industry research, the region accounted for half of the growth in global wealth from 2010 onwards. In particular, China was the second top contributor to the growth in global wealth after the US.[1] In 2011, there were about 30 million millionaires worldwide. Among these, about 20% were from Asia-Pacific.[1] This trend is likely to continue. It is estimated that global wealth will rise 50% further by 2016.[1] This is hardly surprising in that the International Monetary Fund forecasts that, emerging Asia, led by China, will contribute almost 60% of the world's GDP growth by 2016. By 2020, the estimated number of millionaires in Mainland China and Hong Kong together will be 3.7 million, with an accumulated wealth of US$14 trillion.[2]

So it is beyond doubt that the expanding affluent population in China and the rest of Asia will generate ever increasing demand for private banking services for high-net-worth individuals. While it is clear that there will be increasing number of wealthy people in Asia looking for private banking services, the question we need to ask is: "Will they choose Hong Kong?". This begs the question on what Hong Kong can offer over and above the other centres that are equally keen to gain market share as a private banking hub. In this regard, there are

---

1 Global Wealth report 2011, Credit Suisse Research Institute

2 Deloitte and Oxford Economics

several fundamental attributes that make Hong Kong exceptionally well placed to become the leading private banking hub in Asia:

- Hong Kong has a robust legal framework with an independent judiciary that safeguards property rights. We have a simple, low and predictable tax system. Only profits and income derived in Hong Kong are subject to Hong Kong tax. There are no withholding tax, estate duty, and tax on capital gains, dividends, interests and so on. We have well established laws to protect the confidentiality of customer information. These advantages not only facilitate the creation and accumulation of wealth in Hong Kong but also make Hong Kong a very attractive place for people outside of Hong Kong to park and manage their wealth in Hong Kong.
- Hong Kong is also a leading IPO centre, ranked Number One globally for the third consecutive year. In 2011, there were more than 100 newly listed companies in Hong Kong, which together raised a total of US$36 billion equity funds. IPO activities help the private banking industry to flourish in at least two ways. Apart from providing opportunities for private banking clients to invest in promising businesses, IPO activities also create wealth for entrepreneurs who will then become important clients of the industry.
- What is more, Hong Kong benefits from being the most important gateway for capital flows into and out of China. Hong Kong has always been the largest source of Foreign Direct Investments (FDIs) into China since the beginning of the Reform and Opening Programme in 1979. And in the last few years, Mainland investors have been using Hong Kong as their main platform for Overseas Direct Investments (ODIs) to reach out to the world. This clearly demonstrates that Hong Kong, under the “One Country, Two Systems” framework, is serving the needs of Mainland customers for offshore financial services.

It is therefore natural to see the rapid growth of Hong Kong’s private banking business in recent years. From mid-2010, 7 new private banks have been set up in Hong Kong, taking the total number of private banks to 39. Further, the HKMA is seeking to modify the licensing requirements for banks so as to facilitate a broader range of financial institutions, including those specialised in private banking, to establish an operation in Hong Kong.

What kind of regulatory framework Hong Kong needs to support the sustainable development of private banking?

While Hong Kong is fortunate enough to be endowed with many underlying competitive advantages, these advantages are not enough, in my view, to sustain the healthy development of our private banking industry in the long run. Hong Kong also needs a regulatory framework that is user friendly to private banking clients and yet sufficiently robust to provide appropriate investor protection.

The regulatory framework in Hong Kong is basically a disclosure-based regime, supported by suitability assessment by intermediaries at the point of sale. In a nutshell, product issuers have to make adequate disclosure in product documents about the features and risks of investment products. Intermediaries, when making a recommendation or solicitation in respect of an investment product, must assess the product suitability for individual clients, and clearly explain to clients the key product features and risks.

A proper suitability assessment starts with a robust Know-Your-Client (KYC) process and client risk profiling. These processes not only help to fight money laundering and the financing of terrorism, but also enable private banks to obtain relevant information to better understand their clients, including their background and, most importantly, their risk appetite and investment needs. By doing so, private banks can agree on an investment strategy with clients and provide suitable products and services that fit their needs.

As we all know, private banking clients cover a wide spectrum of individuals. At one end of the spectrum there are clients who are highly seasoned investors, at the other end there may be unsophisticated clients with only very basic investment knowledge, notwithstanding that they have substantial wealth. While our regulatory framework is aimed at providing appropriate investor protection to all clients, regardless of the size of their wealth, it does not mean all investors have to be treated in exactly the same way in the process of making investments. In other words, the HKMA agrees that private banking and retail banking clients can and should be treated differently in the investment process.

This being the case, we need to have a clear and practical definition of "Private Banking Customer". After consulting the industry and the SFC, the HKMA is minded to agree that a "Private Banking Customer" can be defined as a customer with either (a) at least US$1 million of assets under the management (AUM) with the bank concerned or (b) total investable assets of at least US$3 million. This is an expanded definition to cater for the operational needs of private banks. Once we have defined who qualifies as a "Private Banking Customer", the next step is to consider specific measures that would help make private banking more "user friendly" without compromising the need to accord appropriate protection to private banking customers.

First of all, let's talk about suitability assessment. The HKMA agrees that private banks need not mechanically match their client's overall risk tolerance level to product risk level. This is because in private banking, customers often look to their private bankers for investment advice on a continuous basis having regard to the customers' entire portfolios or balance sheets. This is quite different from the retail end of the market in which one-off sales transactions are common. We therefore consider that suitability assessment for private banking customers can be conducted on a holistic or portfolio basis, taking into account all the relevant circumstances of the customers. For example, as long as the portfolio allocation and the overall risk level agreed with the client is adhered to, a low or medium risk tolerance client buying high risk products that only constitute a minor proportion of his portfolio is not necessarily a "mismatch". The same principle applies to some other aspects like investment tenor and concentration risk of AUM with any individual private bank because the entire portfolio of the customer will be taken into account. Also, we agree that the documentation of rationale for recommendations need not be on a per transaction basis. It can be done on a portfolio level at the outset, subject to some conditions being met. These conditions include the preparation of an Investment Mandate stipulating the types, risks and allocation of investments after taking into account all relevant circumstances of the client. The Investment Mandate should be explained to and agreed by the client, and a copy of the Mandate should be provided to and acknowledged by the client. The Investment Mandate should of course be reviewed and, if necessary, modified whenever there are material changes to the relevant circumstances of the private banking customer.

Usually the review of client risk profile is expected to be conducted at least once every two years. However, we appreciate that private banks need to minimise demand on the time of customers and have regard to the fact that private banking services are normally conducted on a continuous basis. As a result, the HKMA agrees that private banking clients need not go through the biennial reviews if they can confirm that there is no material change in their circumstances that warrants updating or modification of the Investment Mandate. Moreover, private banks may choose to document the rationale for recommendations in writing instead of audio-recording a face-to-face interview with the clients.

I am pleased to say that the above-mentioned measures, which are aimed at making private banking more user friendly, will be promulgated in an HKMA Circular to be issued later today. While I believe these measures would be welcomed by the private banks and their clients as they offer greater convenience and flexibility, I must remind everybody that the core objective of our regulatory framework continues to be investor protection. So private banks must ensure that they have in place the necessary systems and internal controls to implement the portfolio based approach and other related measures to facilitate the investment process.

In this regard, it is hard to overstate the importance for private banks to have proper documentation. Proper documentation helps bank management monitor staff's sales practices and detect deficiencies. Proper documentation also provides audit trail and evidence on the sales process. A bank with proper documentation will be in a much better position to demonstrate that it has properly discharged its duties to its clients in the event of a dispute or complaint.

Enhancing competency of industry practitioners

Let me move to another pillar that is necessary to support the continued success of Hong Kong's private banking industry: namely the availability of professional talents. Institutions can only be as strong as the people that make them up. How the world perceives the standard of our financial services depends crucially on the quality of the people delivering such services. Private banking clients now demand quality and efficient services that are tailored to their specific investment needs. Meanwhile, the financial markets have become more complex and volatile. To create value for their clients in this challenging business environment, private banks need strong teams of professional staff, from the front end to the back office.

Both technical competency and ethical standard form the basic components of the professionalism of our industry practitioners. The HKMA encourages the industry to promote a competency framework for new entrants and on-going professional training. The financial market is very dynamic and rapidly changing. The industry therefore should ensure that staff are well-equipped with the necessary technical and market knowledge and skills in performing their jobs. It is also fundamental for private banks to act in the best interests of clients at all times. The HKMA therefore encourages the industry to promulgate a set of professional and ethical standards that are designed specifically for the private banking practitioners.

I know that the industry is moving towards this direction. HKIB has been providing professional qualifications like Certified Financial Management Planner. In 2011, the Hong Kong Securities Institute (HKSI) also introduced the Certified International Wealth Manager programme. These are well-organised programmes that help enhance the technical competency of industry practitioners. On a separate front, we very much welcome the industry's proposal to set up a new industry body called "Private Wealth Management Association". I also support the initiative to further upgrade the professional standards of industry practitioners by developing a new competency framework for wealth management. I envisage that, under this framework, industry practitioners can take different courses provided by professional bodies such as HKIB, HKSI, Treasury Markets Association and other tertiary institutions, and ultimately acquire a professional qualification that is widely recognised and accredited in Hong Kong and beyond. We in the HKMA will be pleased to work with the private banking industry and other stakeholders to ensure that Hong Kong has a large pool of talents with world class technical competence and professionalism.

Conclusion

Ladies and gentlemen, I would like to conclude my remarks today by posing the following three questions. First, what are the prospects for Hong Kong to develop into the premier private banking hub in Asia? The answer is clear. As Hong Kong possesses key and unique competitive advantages in serving rapidly increasing number of wealthy population in China and the rest of Asia, there will be exceptionally huge business opportunities and potential for our private banking industry.

Second, does Hong Kong presently have an appropriate regulatory framework that can help sustain a healthy development of the private banking industry in the long run? The answer is "yes", but I need to qualify the answer because I am acutely aware that no regulatory framework is perfect and can afford to remain static, bearing in mind the ever changing market conditions and evolving expectations of the society on investor protection. Having said that, you may rest assured that the HKMA is committed to continue its collaboration with the SFC and the industry to make sure that our regulatory framework and rules remain friendly to users without compromising investor protection as we go forward in the months and years ahead.

The third and final question is: are private banks fully equipped and ready to capture the rapidly growing business opportunities? The answer to this, I would say, is again "yes" followed by a "but". This is because much more needs to be done by the industry if it wishes to realise Hong Kong's full potential in the medium and long term. As I said earlier, the adoption of a portfolio approach in private banking would be a move welcomed by private banks and their customers, but private banks must ensure they have the proper systems and controls in place. A portfolio based approach cannot be taken as an excuse to compromise investor protection. For instance, when more Mainland clients open private banking accounts in Hong Kong, our banks must have in place sufficient number of account managers who are professionally competent and linguistically proficient. It is hard to imagine that quality service can be provided to a Mainland customer who does not speak English or Cantonese if the account manager cannot communicate in Putonghua. Moreover, it would also be helpful if important contracts or documents are written in bilingual forms so that Mainland customers find it easier to understand what they have signed or bought. Lastly, private bankers must also bear in mind that there is a very wide range of sophistication and investment experience among private banking clients from Mainland China. So private banks must ensure that their account managers take extra care in offering investment advice and marketing investment products to the less sophisticated clients.

Ladies and gentlemen, private banking is just a special type of banking: it is all about trust and service. It takes a private bank many, many decades to build up trust, but such trust can be destroyed overnight. My vision, which I am sure is shared by many of you, is that Hong Kong will become the most competitive and dynamic private banking hub in the region in the years to come. This is a highly achievable aspiration if both the industry and the regulators work closely together to develop, nurture and protect the reputation of the private banking industry as well as the professionalism and ethical standards of its practitioners.

Thank you very much.