Norman T L Chan: Building "Hong Kong" as a brand for financial services - beyond marketing

Welcoming remarks by Mr Norman T L Chan, Chief Executive of the Hong Kong Monetary Authority, at the Treasury Markets Summit 2017, Hong Kong, 18 September 2017.

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Ladies and gentlemen,

1. A few months ago when my staff asked me what I would wish to talk about at today's Summit, my immediate response was "culture". In a rather polite manner, my staff told me that I had spoken on this subject many times before and it would help the TMA sell the tables if I could talk about something else. I didn't commit myself one way or the other and so I hope it won't disappoint you too much if I am going to talk about culture and ethics again this morning.

2. That said, I am not totally insensitive to the audience's desire to hear something different from me, so I am going to start with a true and, I hope, interesting story on what marketing can and cannot do. We all know and appreciate the importance of good marketing in the commercial world. Rule number one in marketing: No matter how good your product is, you need to undertake an effective campaign to reach out to your target customers to make them aware of the product and convince them that they should be interested in it. Recognising the potency of marketing, I set up in 2010 within the HKMA a new team dedicated to reaching out to promote Hong Kong as the premier international financial centre (IFC) in Asia. One of the priority areas that our team has sought to promote, which is highly relevant to our treasury practitioners, is clearly the use of Hong Kong as the corporate treasury management hub for multinational companies as well as Mainland corporates with increasingly larger business footprint offshore. Our team has in the past year alone reached out to nearly 300 companies.

3. Many corporates that we have approached recognise the attractiveness of Hong Kong as an IFC. Hong Kong is a major banking centre with mature and sophisticated capital markets. Our financial system is resilient and is underpinned by a robust regulatory regime. We have first class transport and communications infrastructure. There is a large cluster of finance and legal professionals and talents etc. Yes, we do have a long list of advantages that we can deploy to lobby corporates to come to Hong Kong to set up corporate treasury centres (CTCs) to manage their cash, FX, credit, hedging, interest rates transactions. However, the HKMA outreaching team soon realised that they had run into a major problem. The problem had to do with the tax asymmetry that treated CTCs' overseas interest expenses and income differently. Simply put, a CTC could not claim tax deduction for interest paid to fund providers within the group as expenses, but all its interest income was subject to profits tax. This tax asymmetry greatly diminished the attractiveness of Hong Kong as a CTC hub, especially as our main competitors in the region and elsewhere do not seem to have this problem.

4. When faced with this possible deal breaker in our effort to promote Hong Kong as the CTC hub, what did we do? Rule number two in marketing: you cannot do good marketing if the product is not a good one. You can only fool some people some of the time but not for long. So one has to make good a product if it is found defective or inferior. Thanks to the help from the TMA, we formed a working group to study the problem and make recommendations to remove the obstacles undermining Hong Kong's development as a CTC hub. We made a report to the Financial Secretary and obtained his support to change this tax anomaly. With the support of the Financial Services and the Treasury Bureau (FSTB) and the Inland Revenue Department (IRD), and in consultation with the industry, we managed to pass the legislative amendments to remove the tax asymmetry in May 2016. In addition, the Government has gone one step further by providing additional tax incentive by halving the profits tax rate payable on specified CTC activities in Hong Kong from 16.5% to 8.25%. Ladies and gentlemen, as an illustration of the keen

competition between financial centres in the region, two months before our tax proposals were approved by the Legislative Council in Hong Kong, Singapore, you know what, announced the lowering of its concessionary tax rate for eligible treasury activities from 10% to 8%.

5. Our story did not end there. As a member of the OECD's Inclusive Framework on Base Erosion and Profit Shifting, commonly known as BEPS, Hong Kong is committed to implementing the BEPS standards. The relevant OECD Forum on tax practices has recently studied over 100 tax regimes worldwide and taken a view that our newly enacted CTC tax regime has a ring-fencing feature in that only corporate treasury activities relating to non-Hong Kong associated corporations are entitled to the concessionary profit tax rate of 8.25%. This ring-fencing feature is of concern to the OECD. In view of this, Hong Kong has been in close dialogue with the OECD Forum and has come up with a solution to address OECD's concern. So we are planning to extend the concessionary profits tax rate for specified CTC activities to onshore entities subject to some appropriate anti-abuse safeguards. The HKMA is now working with the IRD and FSTB, in consultation with the stakeholders, to work out the details for implementing this solution.

6. Our efforts and dedication have yielded good results lately. The responses from the corporates have been very encouraging. More than 30 Mainland and multinational conglomerates have told us that they are actively considering establishing or expanding their CTC operations in Hong Kong. These include many household names in energy, electricity generation and power grids, infrastructure operators, consumer goods and financiers. This is exciting news for Hong Kong's treasury sector and its practitioners. We should expect increased treasury activities taking place here, bigger demand for a wide array of financial products, and importantly more promising career prospects for the treasury practitioners including our younger, aspiring professionals. If we succeed in attracting big corporates to use Hong Kong for their CTC functions, which I am confident that they will, it should also make it easier to convince them to locate their regional headquarters' management activities in Hong Kong too.

7. Ladies and gentlemen, IFC is a brutally competitive business because moneys are highly mobile, and asset owners and managers will only congregate in places which provide the best services. For Hong Kong to maintain its competitive edge, we must take a two pronged approach. On the one hand, we must continue to strive to improve and excel in the underlying product, i.e. to be able to deliver the safest and most efficient services in banking and finance. On the other hand, we must continue to promote and market Hong Kong as the most sought after brand in financial services. In this context, in addition to the intensive work on the CTC project that I have just described, the HKMA is also busily working on a number of other market development initiatives. One of such initiatives that I wish to highlight today is our effort seeking to modernise the legal framework and tax treatment to make it attractive for private equity funds to domicile in Hong Kong. The objective of this project is simple: to strengthen Hong Kong's leading position as a private equity fund hub in Asia.

8. Market development is a never ending race. It is not enough for us to be making good progress and improvements every now and then. We must be able to improve and move faster than our peers if we wish to stay ahead of the game.

9. Now that I am talking about 'brand', it should be no surprise to you if I now return to the theme of my first choice, "culture and ethics". Just like any luxury goods, a brand in the context of IFC entails quality and credibility. Quality requires technical competence in a wide range of financial services, such as FX, interest rate, credit, hedging, derivatives, ECM, DCM, asset management, private equity, etc. I think Hong Kong is in a good position in all these markets. We have done rather well in all these markets and should be able to further deepen and broaden them given the exceptional opportunities emerging from the internationalisation of RMB and the latest Belt and Road Initiative. However, I am less sanguine when it comes to the credibility component, which boils down to trust. Trust has to be earned over a long period of time, and can be lost overnight.

For Hong Kong to excel, it is not enough for our financial institutions and practitioners to be technically competent only. They must also uphold high ethical standards in order to gain the trust and respect of customers.

10. In the past few years, a number of misdeeds by some financial institutions and practitioners have come to light. For example, the rigging of LIBOR had led to international reform of interest rate benchmarks, a process which is still ongoing. There were also cases of front running and other irregularities in FX and gold trading that had led to investigation into some banks and senior bankers. All these point to the weakness of the tradition of "self-discipline" amongst financial practitioners. It is now considered that more comprehensive and possibly more prescriptive guidelines on ethical standards and conduct are needed to strengthen the system. The latest FX Global Code is the outcome of one of such reforms. The Code was developed over the past two years by 16 central banks, including the HKMA, together with private-sector institutions from both the buy and sell sides. It is a comprehensive set of global principles on good practice in the FX market, and it is intended to promote a robust, fair, liquid, open, and transparent market. The TMA has already incorporated the Code into its own code of conduct. So I would urge all treasury market practitioners to study the Code carefully and ensure that they and their firms fully comply with its provisions.

11. As I have said many times before, no external policing or enforcement is a substitute for good corporate culture that supports high ethical standards and values. If one asks any of the financial firms, they will without hesitation say that their corporate culture is to place customers' interest before their own. However, when you probe further, you will find out that not all of the financial firms have promulgated an explicit corporate culture statement. For those that have such statements, not many of them have a systematic way of ensuring that the values and ethics stipulated therein can filter down different levels of the firms and be understood by the staff and their supervisors. For those that have made some efforts to promote good corporate culture, many have not done enough to ensure that their incentive system, such as pay, bonuses, promotion etc, is aligned with the values that the firms seek to promote.

12. We have seen far too many examples that during the Global Financial Crisis (GFC) how some financial firms and their employees breached the trust of their customers by selling toxic products to them due to misaligned incentive system. In these horrific examples, we often witnessed that greed or short term profits were the main factor causing the management of the financial firms to lose their perspective and common sense. However, in the case of Wells Fargo, which survived unscathed amongst the US banks during the GFC, it revealed another shocking fact. Even though there could not have been any meaningful financial gains by the firm, the incentive system of the bank (i.e. by paying a cash reward for every new account opened) had prompted some of its employees to commit misdeeds that breached the trust of the customers and seriously harmed the reputation of the bank. The case is a powerful testimony that corporate culture, however good, must be aligned and reinforced by the appropriate incentive system across the entire firm at all levels. This is why the HKMA issued a circular earlier this year requiring the boards of locally incorporated banks to form a board level committee focusing on corporate culture as well as the compensation system. Many banks have told us that they have already started reviewing and enhancing their governance arrangements and policies and procedures in relation to corporate culture to drive the desired behavioural changes on the ground. I truly believe that only when good corporate culture and the incentive system aligns with each other will there be sustainable impact that helps reduce misconduct risks, a crucial element in gaining the trust of customers in the long run.

13. I should also mention that Hong Kong is not alone in this culture campaign. In October last year, I was invited by President Bill Dudley of the New York Federal Reserve Bank to join him in a panel to discuss corporate culture. This was in fact the third annual conference on culture organised by the New York Fed. The key takeaway from the New York conference was that there is a growing momentum amongst key supervisors as well as large international financial

firms to encourage and nurture good corporate culture and ethical values in the industry. I should also add that, since my appointment to chair the Standing Committee on Supervisory and Regulatory Cooperation of the Financial Stability Board in April this year, I have been pushing for closer international collaboration in promoting good corporate culture. The priority of this Committee in the next year or two is to place greater emphasis on three aspects of governance, namely, (i) addressing information gaps and due diligence in employment of individuals with a history of misconduct, or the so called "rolling bad apples" problem, (ii) responsibility mapping for senior managers of financial firms, and (iii) the use of governance framework and appropriate compensation system to address culture risk factors that drive misconduct. These priorities, when implemented, will go a long way in promoting the right kind of culture in the financial industry and in helping restore public confidence and trust in the financial firms. By this time next year, I should be able to report progress made in Hong Kong as well as in the international arena.

14. Let me conclude my speech with the big picture: Hong Kong, as the premier IFC in Asia, is uniquely well positioned under the One Country, Two Systems arrangements to benefit from the internationalisation of RMB and the Belt and Road Initiative. Whatever you have seen or witnessed in the past few years is merely the very beginning of a multi-decade long process. China has been on average contributing more than one third of global growth in the past 10 years and is clearly the most powerful engine for growth in the years to come. China has reached a stage that it has the necessary technology and surplus capital for its corporates to "go out". Hong Kong, which has been the major hub and springboard for foreign corporates to "go into" China since the beginning of China's reform and opening programme, has now taken up the extremely crucial role of serving as the hub and springboard for China's new "going out" era.

15. Ladies and gentlemen, it's a great pleasure to be able to talk to you today. As a treasury market practitioner, you are in the right place at the right time. Hong Kong is a place that will offer enormous headroom for growth. However, the headroom is only relevant if all of us – the financial firms, practitioners, regulators – work together to build the "Hong Kong Brand", a brand that is widely preferred and cherished by customers looking for the best and most reliable financial services. We in the HKMA are fully committed and ready to build the "Hong Kong Brand". I trust you all share the same commitment and readiness. Thank you very much!