6: More Users will Tap Hong Kong IFC's "Deepcraft"

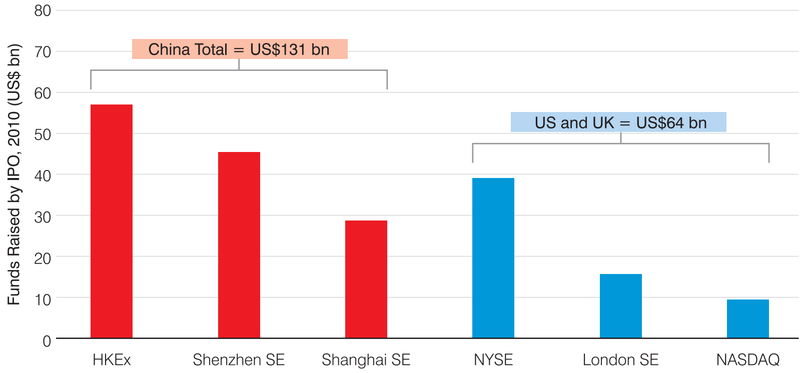
As we discussed in Section 2, a number of structural factors are leading to a trend of a growing stream of users tapping the Hong Kong finance industry platform. This trend will enhance Hong Kong IFC's capacity and capabilities in (1) Equities, (2) Fixed Income, (3) Rmb Products, (4) Private Banking, and (5) Asset Management. If there are any further adverse changes to regulatory or taxation in some western jurisdictions, there may be some diversion of flows from these markets to the Hong Kong platform.

(1) Equities

Hong Kong topped global IPO league tables 4 times in past 5 years

Hong Kong has become the undisputed King of IPOs in recent years. In the last five years, the amounts of capital raised in IPOs have topped global league tables four times, exceeding London every year except 2008. However, there is a unique advantage of the London Stock Exchange (LSE) that the HKSE has struggled for years to keep up with: the geographic diversity of the companies listed. For example, LSE currently has over 200 companies from Asia Pacific, 100 from the CIS region, 65 from India, 50 from Africa and 35 from the Middle East. A large portion of these are secondary listings.

Hong Kong is now the World's Premier Destination for IPOs

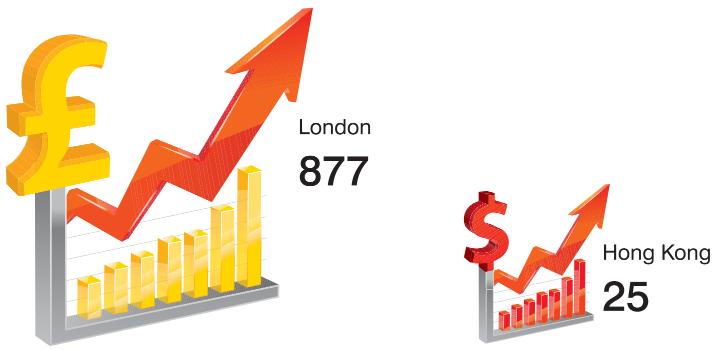


Source: Dealogic, Savills Research & Consultancy

On the other hand, HKSE only has 25 countries from overseas jurisdictions apart from China. This kind of diverse market catchment is a hallmark of an IFC where corporations from all over the world tap the exchange's wide investor base for the supply of capital.

London serves many more companies from overseas than Hong Kong

Number of Overseas Companies Listed



*As of Dec 2011

Source: HKEx, LSE

Hong Kong still has a long way to catch up in this aspect – but the process has started and gathering momentum

With the growing international recognition of Hong Kong's ability to raise sizeable sums of capital and solid reputation as a premier jurisdiction for listing, Hong Kong is rapidly gathering a string of large and famous corporation to do their primary listing, including RUSAL from Russia, Prada from Italy, L'Occitane from France and Samsonite from Belgium/US these 2 years. With global economic focus shifting eastward, more and more companies wanting to capture Asian growth potential will enter capital markets in Asia to increase exposure to the region. With Chinese markets still largely closed to foreigners and the Singaporean market still amounting to less than a quarter of the city's market capitalisation, Hong Kong is the natural destination for IPOs.

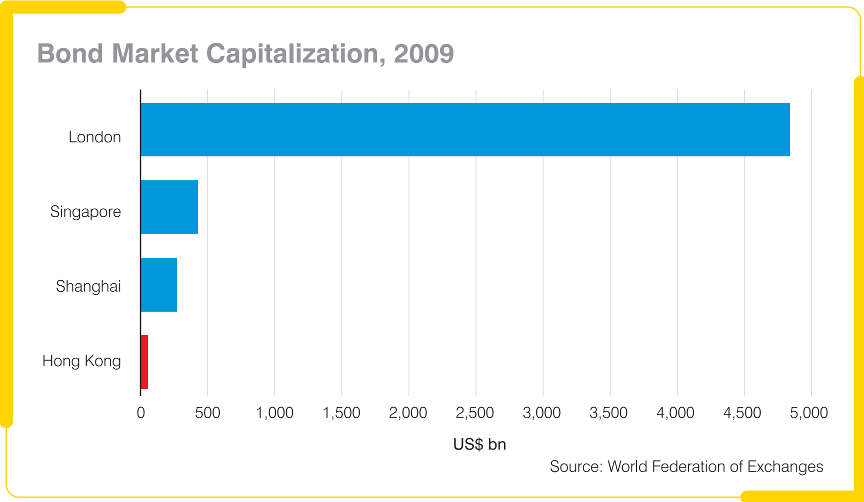
With Chinese markets still amounting to less than a quarter of Hong Kong's market capitalization, Hong Kong is the natural destination for IPOs

Despite the volatile capital market condition this year, there is still a healthy collection of famous foreign companies in the pipeline for IPO in Hong Kong, including Graff Diamonds of London, Rovio, the Finnish software developer, Baroque, the Japanese retailer and Bluestar Adisseo, the French-originated animal nutrition feed producer. This trend will continue to contribute to increasing internationalization and diversity of Hong Kong's capital markets.

(2) Fixed Income

The bond and commodity markets in Hong Kong are severely underdeveloped. Compared to London and other major Asian centres, Hong Kong's bond and commodities market capitalization is tiny – merely 1% of that of London's. Singapore, Shanghai and even Taiwan and Thailand have larger bond markets than Hong Kong.

Hong Kong's bond and commodities market is 1% that of London's



This shortcoming is partly because many Hong Kong corporations operate on a lower leverage than Western corporations and tend to sit on abundant cash, thus having little need to raise long term capital from debt issuance. For historical reasons, major/sizable commodities producers and consumers are located in the western world. The absence of large and liquid bond and commodities markets is limiting the variety of fixed income or commodities investment options that wealth management professionals can offer clients.

(3) Rmb Products

Fixed Income – Hong Kong's Missing Pillar Fixed by Rmb Bonds?

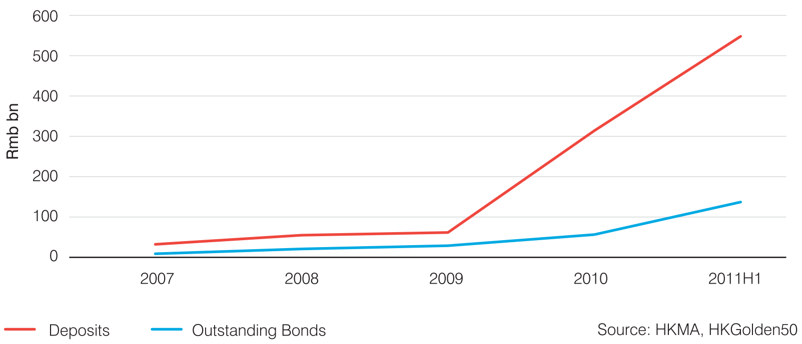
Fortunately, an influx of opportunities can make what Hong Kong cannot do on its own happen, i.e. developing an active bond market. Since 2007, mainland and foreign companies have started to issue offshore Rmb bonds nicknamed "dim sum bonds" in Hong Kong, and these issuances skyrocketed since 2010 as the People's Bank of China allow for more Rmb foreign direct investment. So far, MNCs such as McDonald's, Caterpillar, Yum!, Unilever; Chinese corporations such as SinoChem, COFCO, China Merchants Holding; and supranational institutions such as Asia Development Bank and International Finance Corporation of the World Bank Group have raised capital from the offshore Rmb (CNH) market.

The offshore Rmb bond market is predicted to grow in a J-curve fashion during these Golden 5 Years, and if trends continue, total capitalization can rise to a level comparable to Singapore and Shanghai. The issuance of the Rmb20bn Chinese government treasury bond (China Development Bank) has further broadened the width of the market. Also, the new measures announced by Vice Premier Li Keqiang in August, establishing a formal procedure for offshore Rmb funds to be repatriated back to mainland China and allowing PRC companies to issue Rmb bonds in Hong Kong, help to establish an ecosystem for a virtuous cycle of currency circulation. While Hong Kong still may not stand out as an international fixed income centre in the near future, its unique status as the offshore Rmb bond hub offers international investors the main way to gain exposure to Chinese fixed income securities, ensuring Hong Kong's important role in the international bond scene.

Various industry experts have forecast the development of offshore Rmb products will create tens of thousands of jobs. To build on this trend, HKEx is advised to establish a public exchange platform for bonds, which enhances price discovery and transparency, as well as provide guaranteed trade settlement.

The range of offshore Rmb products will grow and grow and should create tens of thousands of new jobs for Hong Kong IFC. The city needs to step up its production of top grade offices in order to physically accommodate this new opportunity

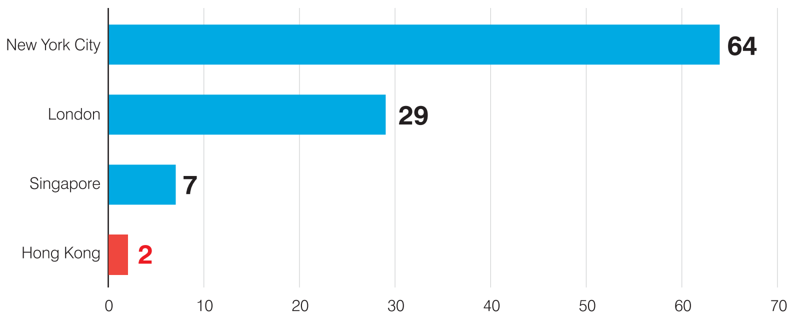
Offshore Rmb Deposits vs. Bonds in Hong Kong



Source: HKMA, HKGolden50

With the proximity to many Asian commodity production centers and major consumption markets, Hong Kong is taking the first steps towards creating a viable Asian price discovery and benchmarking system with the establishment of the Hong Kong Mercantile Exchange in May. HKMEx provides standardised, cleared, and exchange-traded products on a transparent pricing platform to the Asia Pacific time zone.

Number of Commodity Products Traded on Exchanges



Source: CME Group, IntercontinentalExchange, LME, SMX, HKMEx

The Exchange currently offers USD denominated gold and silver futures contracts and plans to launch yuan-priced gold and silver futures to capitalise on growing investor demand for China's strengthening currency, with further ambition for products in base metals, energy and agriculture. Compared to cash settlement precious metal contracts offered by Singapore, HKMEx's precious metal contracts are viewed as more advantageous given its physical settlement capabilities under the cooperation with Hong Kong International Airport's Precious Metals Depository as a licensed storage venue. Despite this, the plan to roll out USD denominated fuel oil contracts has been delayed due to complications related to physical delivery in China.

Compared to cash settlement precious metal contracts offered by Singapore, HKMEx's ones are more advantageous given its physical settlement capabilities under the cooperation with Hong Kong International Airport's Precious Metals Depository as a licensed storage venue

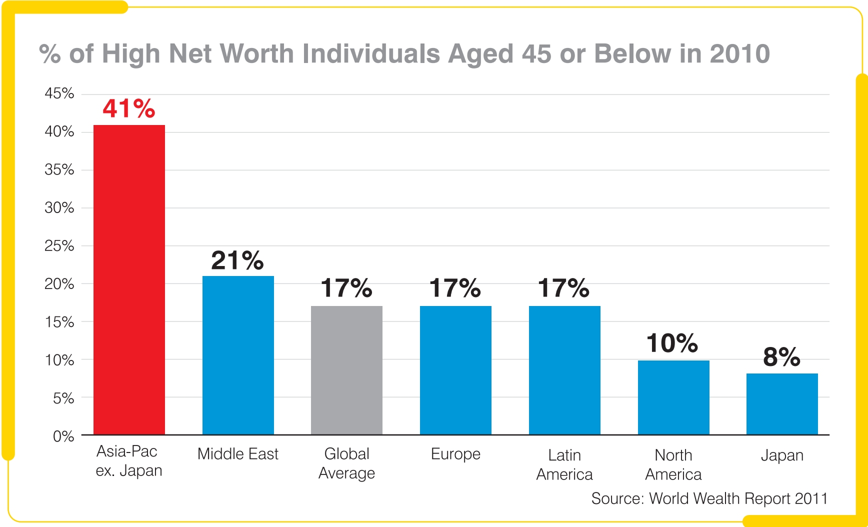
(4) Private Banking

Hong Kong needs to increase its capture of huge Private Banking and Asset Management Markets

Hong Kong is well-poised to become the major private banking / wealth management centre for a booming new population of Asian millionaires. Wealth creation is increasingly focused in Asia Pacific, with the population of high net worth individuals with net assets > US$1m (HNWIs) in Asia Pacific overtaking that in Europe for the first time in 2010, and growing in a much quicker rate of 12.1% compared to the West (Europe's rate is 7.2% and North America 9.1%), according to Merrill Lynch Cap Gemini, the consultants. Asian HNWIs now amount to 3.3 m, 16% (535,000) of whom are from China, and is only second to North America which has 3.4 m HNWIs. With the Asian economy continuing to register strong growth and the West slowed by a string of fiscal and economic problems, we expect the Asia Pacific HNWI population to overtake that of North America within these two years and likely to extend its lead in the coming decade. Private bank Julius Baer forecasts the wealth of HNWIs in Asia to triple to almost $15.81 trillion by 2015.

Hong Kong wealth managers' tasks are more challenging than elsewhere in the world as their "young" clients do not just want to "preserve wealth" but to "create further wealth"

The young age of the average Asian HNWIs (41% of Asian HNWIs are below the age of 45, the highest portion worldwide) also guarantees long term demand of wealth management services. Furthermore, their youth allows for a higher risk, higher return range of products and advice. Hong Kong, situated in the high-growth part of Asia, and a sub-region full of entrepreneurs, should provide fertile "home ground" for the wealth managers, investment banks and corporate financiers to work with the same clients and providing a service mix (including custom-made structured products) that is not typical for most parts of the world and add to the "deepcraft" of the IFC.



On the other hand, increased regulatory pressures in Switzerland and London mean that more and more wealth managers and HNWIs from the West may consider relocating their wealth functions to Asian centres. Hong Kong and Singapore are expected to compete for this potential new source of business.

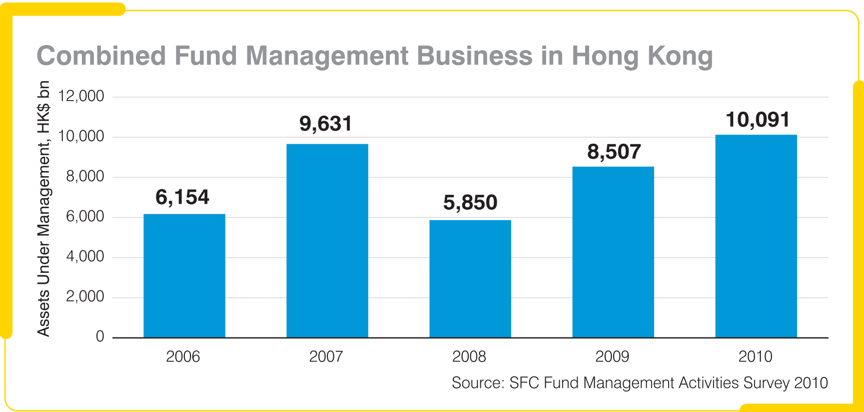
Hong Kong urgently needs a Code of Conduct for Private Bankers – this will assure potential clients of the service quality of the industry and the legal recourse

To reinforce Hong Kong's image as a world class IFC and to give HNWI the extra confidence that the professional service and legal protection accorded to them by Hong Kong private banking is at least as good and comprehensive as other jurisdictions', the city must make this point clear, if only as a marketing point. Singapore passed a 29-page Private Banking Code of Conduct in April 2011 (came into effect 1st September) which sets out the standards of behaviour required of practitioners and legal remedies for any breach of conduct. It is important that Hong Kong takes similar steps to codify best practice and set up an examination or similar means of ensuring quality of wealth advisers.

(5) Asset Management

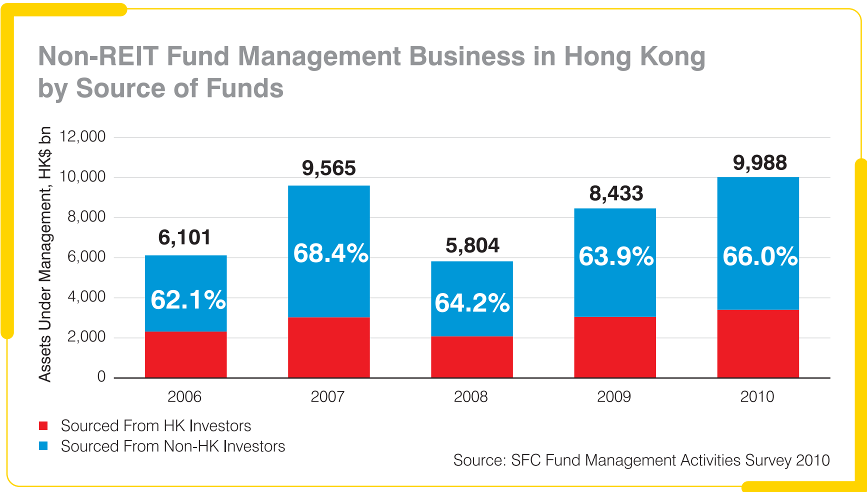
According to the 2010 Market Highlights issued by the World Federation of Exchanges (WFE): The total investment flows (comprising capital raised for IPOs and secondary equity issuance) around the world have shown an overall growth of 11.2% to US$1,012bn. According to the statistics, the investment flows into Asia Pacific grew by 21.3% year-on-year in 2010 to US$436bn. This compares with a 17% increase in investment flows into the Americas and a 9.5% decline in investment flows into the Europe-Africa-Middle East areas.

With respect to Rmb products, Hong Kong achieved a new milestone with the IPO and listing of the world's first Rmb-denominated REIT in Asia 2011. The REIT is the first Rmb-denominated equity product listed and traded outside the mainland and the distributions will also be declared and paid in Rmb.



The combined fund management business of Hong Kong sustained its growth in 2010, with a year-on-year increase of 18.6% to HK$10,091bn as at the end of the year

By types of business activity: Asset management business recorded a year-on-year 17.5% increase in total assets under management to HK$6,841bn in 2010. Other private banking business grew 32.1% to HK$2,230bn. Fund advisory business rose 0.4% to HK$917bn.

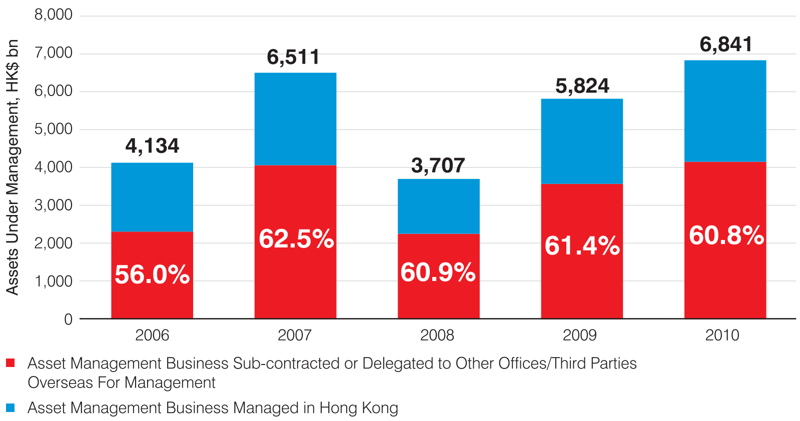


Hong Kong continued to be a preferred location for international investments. Of the total HK$9,988bn in non-REIT fund management business, 66% was sourced from non-Hong Kong investors

Hong Kong continued to maintain its position as an international asset management centre attracting international investors to select Hong Kong as an investment platform. This is attributable to Hong Kong's transparent regulatory regime, which strikes a balance between investor protection and market innovation, underpinned by a robust market infrastructure and a highly efficient financial market.

In 2010, the asset management business in Hong Kong continued to experience growth. Hong Kong's free economy, robust regulatory framework, local expertise, proximity to the mainland and the presence of a diverse population of asset management expertise together contributed to the sustainable appeal of Hong Kong as a leading asset management centre in Asia.

Non-REIT Fund Management Business in Hong Kong by Source of Funds



Source: SFC Fund Management Activities Survey 2010

Of the total non-REIT assets under management (AUM) of HK$6,841bn, 60.8% or HK$4,161bn was managed in Hong Kong

Hong Kong's pre-eminent position as an international financial centre gained clear policy support from the mainland. For the first time, explicit support for the development of Hong Kong into an offshore Rmb centre and an international asset management centre was clearly set out in the mainland's 12th Five-year Plan.

The amount of mainland assets managed in Hong Kong registered a year-on-year increase of 2.6% to about HK$77bn in 2010. More than 50% of these mainland assets were invested in Hong Kong, around 25% were invested in the Asia-Pacific region, and the remaining portion was invested in North America, Europe and other regions.

The inflow of mainland asset managers have only just started and should increase in both numbers and assets-under-management soon

Not only is Hong Kong recognised as the testing ground to promote globalisation of renminbi, it is also a gateway and a bridge connecting the mainland economy to the world's financial markets. The number of mainland-related financial institutions establishing operations in Hong Kong is increasing. As at the end of April 2011, around 51 mainland-related groups established a total of 152 licensed corporations or registered institutions in Hong Kong, broken down as follows:

- 14 mainland securities companies have established 56 licensed corporations.
- 6 mainland futures companies have established six licensed corporations.
- 9 mainland fund management companies have established nine licensed corporations.
- 6 mainland insurance companies have established seven licensed corporations.
- Other types of mainland companies, totalling 16, have established 60 licensed corporations and 14 registered institutions.

Top 8 Chinese Fund Management Companies and their Arrival Date in Hong Kong

Company Name	Total AUM (Rmb bn)*	Arrival Date in Hong Kong
China Asset Management	222	Dec 2008
E Fund Management	153	Jan 2009
Harvest Fund Management	144	Feb 2009
China Southern Fund Management	122	Sept 2008
Bosera Asset Management	111	Nov 2010
GF Fund Management	102	Sept 2011
Dacheng Fund Management	89	Oct 2009
HuaAn Fund Management	76	Dec 2010

*As in 2011 1st Half
Source: HKSFC, Chinafund.cn

All of the 8 largest Chinese fund management firms have already set up operations in Hong Kong, following keenly by smailer firms

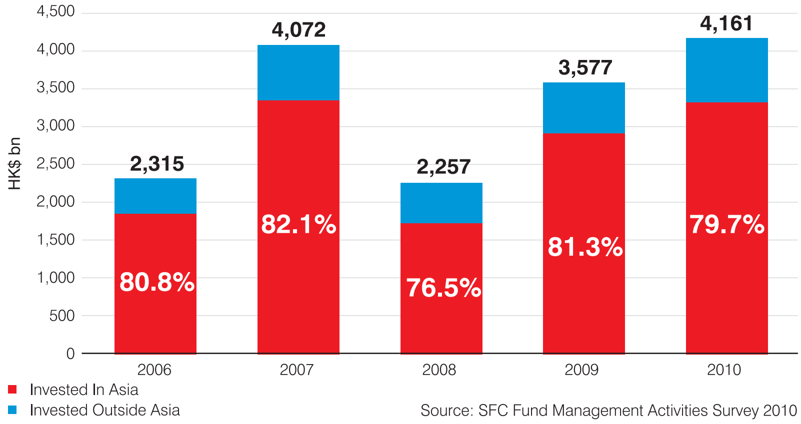
Other Chinese Fund Management Firms Setting Up in HK or Having Plans to Do So

Company Name	Ranking of Scale in China	Arrival Date in Hong Kong
Yinhua Fund Managment	9th	Pending
ICBC Credit Suisse Asset Management	11th	Pending
China Universal Asset Management	12th	Feb 2010
China International Fund Management	13th	Jul 2011
Lion Fund Management	14th	Pending
Guotai Junan Securities	20th	May 2008
HFT Investment Management	23rd	Oct 2010
UBS SDIC Fund Management	25th	Oct 2011

*As in 2011 1st Half

Source: HKSFC, Chinafund.cn, Various Hong Kong and Chinese News Sources

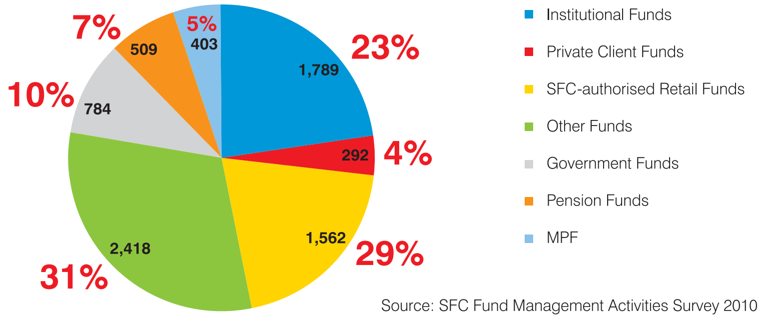
Assets Managed in Hong Kong By Geographical Distribution of Investments



Source: SFC Fund Management Activities Survey 2010

Majority of the assets managed in Hong Kong was invested in Asia, accounting for 79.7% in 2010

Asset Management & Fund Advisory Business of Licensed Corporations, Registered Institutions & Insurance Companies in 2010 (HK$ bn)



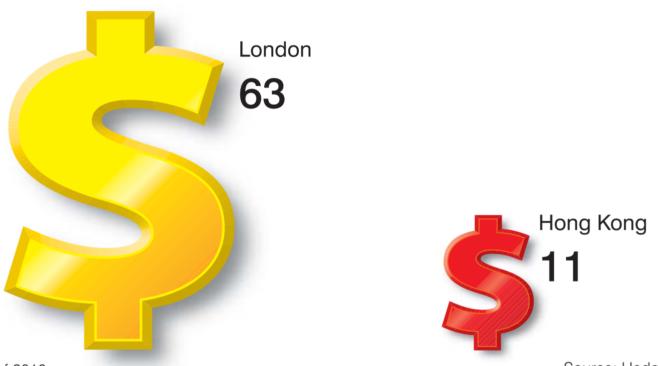
Source: SFC Fund Management Activities Survey 2010

Asset Management and Fund Advisory Business of Licensed Corporations, Registered Institutions and Insurance Companies (HK$7,758bn)

However, Hong Kong needs to quickly capitalize on these strengths in order to fight against regional competition, particularly from Singapore, which is already way ahead and is keen to reinforce its position as 'Switzerland of Asia'. Singapore has long branded itself as the 'safe haven' for money' with its independent political status, and has even successfully attracted a number of leading private banks to set up regional bases there. The city-state is also investing heavily in grooming private banks such as funding the Singapore Management University, Master of Science course in Private Banking and setting up the Singapore Wealth Management Institute, which partners with major banks and asset managers. Hong Kong should also provide private banking education training in post-secondary institutions.

Hong Kong should provide private banking training in post-secondary institutions

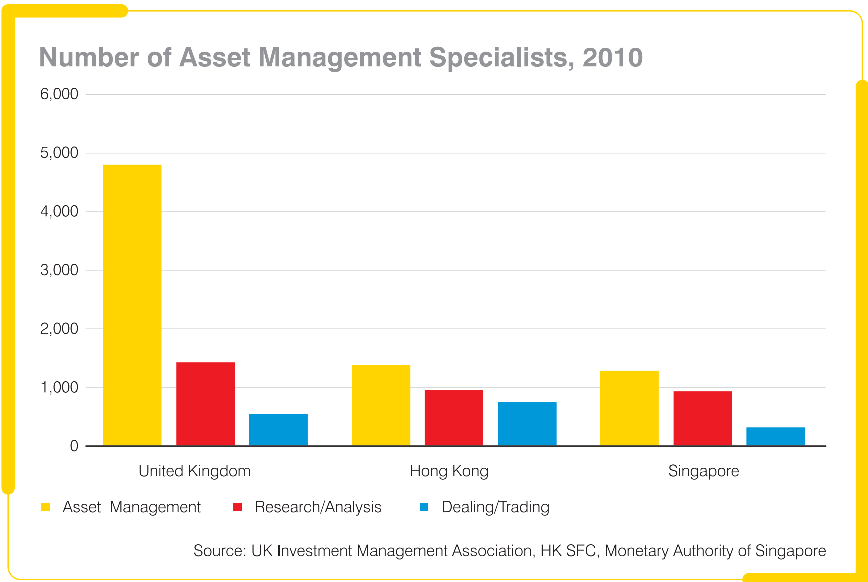
Number of Billion US$ Hedge Funds



*As of end of 2010

Source: Hedgeweek

Hong Kong's asset management industry is currently still dwarfed in scale and scope by that of London. Assets under management (AUM) of the fund management industry of Hong Kong is just a little more than one fifth of London's and Hong Kong has less than half as many asset management professionals as London. The sheer difference in scale of the industry in the two cities can be illustrated by the gap in the number of hedge funds with AUM over US$1bn at 63 vs 11. Hong Kong needs to take advantage of the rapidly growing market to catch up and fend off challenges from Singapore, whose government is actively encouraging the development of the wealth management industry.



London's Financial Sector under Pressure

Although these comparisons reveal that Hong Kong's financial markets still has a long way to catch up with London's in terms of depth and breadth, a series of recent developments underscore our optimism that Hong Kong is adding momentum as an IFC.

We will not go into the details on the problems that befall financial institutions in London but will set out key features below:

(1) Increasingly difficult tax and regulatory environment

High personal tax

London has never been a low-tax destination; the top-band income tax in London has always been 50% for those earning more than 150,000 pounds annually (which is not-at-all uncommon for many investment bankers), which is steep high compared to the 15% maximum standard tax rate in Hong Kong.

London's top-band income tax: 50%

Potential financial transaction tax

In late September 2011, the European Commission proposed to levy a 0.1% tax on all equity and bond trade, and 0.01% on all derivative trades, starting from January 2014. Sensitivity studies by the European Commission shows that the tax can potentially result in a 1.76% drop in GDP in those countries that adopt the levy, but expect the impact to be cushioned as the expected annual revenue of 57bn euros will be divided among EU member states' to fund their budget deficits.

Sensitivity studies by the European Commission shows that a 0.1% tax on all equity and bond trade and 0.01% on derivative trades can potentially result in a 1.76% drop in GDP

Although the EU hopes that the tax will be eventually applied to all global trades, Canada, US, Australia and China have already indicated their opposition as the tax would put more pressure on banks. The City of London, which handles up to 80% of all financial transactions in the E.U., of course follows suit in objecting the tax but it is unclear at this point whether the UK will veto this law.

The chief executive of HSBC, when asked about the impact of the Vickers reforms on the banks, said plans to force lenders to hold more capital could trigger a net cost of up to US$2.1bn (£1.3bn) a year for HSBC, which obtains most of its revenue overseas. "That is a very explicit cost of being headquartered in the UK," he said.

(2) Increasing concentration of leading corporations in the "East"

It might have been true that London was the "natural place to go" for leading financial corporations ten years ago but this is starting to change with corporations' increasing focus on Asia's fast-growing markets.

London is no longer the "natural place to go" with corporations' increasing focus on Asia's fast-growing markets

For instance, ten years ago, none of the top ten financial institutions on the Financial Times Global 500 list were located outside of the US or Europe. However, as of 2010, four of the world's top ten financial institutions by market capitalization were in Asia.

Top 10 Financial Firms in FT Global 500
(Chinese Firms Highlighted in Red)

Ranking	2001	2011
1st	Citigroup	**Industrial & Commercial Bank of China**
2nd	AIG	Berkshire Hathaway
3rd	HSBC	**China Construction Bank**
4th	Berkshire Hathaway	HSBC
5th	JPMorgan Chase	Wells Fargo
6th	Morgan Stanley Dean Witter	**Agricultural Bank of China**
7th	Wells Fargo	JPMorgan Chase
8th	Allianz	**Bank of China**
9th	Bank of America	Citigroup
10th	Fannie Mae	Banco Santander

Source: Financial Times

Many leading financial institutions with an increasing revenue pool from Asia have chosen to base the bulk of their functions in Asia or list their shares in Asia. For example, HSBC's chief executive office was relocated to Hong Kong in 2009, while Standard Chartered already has most of its operations based in Singapore. The insurance giant, AIA was successfully spun off from AIG group in 2010 and is listed and headquartered in Hong Kong. Prudential Insurance is now dual-listed in London and Hong Kong and BNP Paribas is rumoured to be seeking a listing in Hong Kong soon.

Many leading financial institutions have chosen to base the bulk of their functions in Asia