

Letterhead of Hong Kong Investment Funds Association

Submission to the Legco Panel on Financial Affairs

Brief introduction of the Association

The Hong Kong Investment Funds Association (“HKIFA”) is the professional body that represents the investment management industry in Hong Kong.

It has two briefs, namely:

- consultation with the appropriate authorities on all regulatory issues that have an impact on the investment management industry in Hong Kong; and
- promotion of Hong Kong managed investment products.

Membership/Where we are coming from

The HKIFA has 50 fund company members. As at the end of 1997, they managed total assets (including unit trusts, mutual funds, pensions and other institutional assets) of US\$80 billion in Hong Kong. In addition, the HKIFA has 43 associates, including lawyers, accountants, trustees, custodians and other professionals involving in the administration and establishment of funds.

Investment focus of our members: Our fund company members are primarily traditional fund managers, who are targetted at pensions and other long-term investors; and focus on economic fundamentals (such as earnings, interest rates, yields, etc.) in their investment management process.

As the briefs of most of our members are to manage the long-term savings of investors, they have vested interest in the long-term stability and the smooth functioning of Hong Kong’s financial markets. It is against this background that we would comment on the recent developments in the local securities and futures markets.

Views on the recent market developments

If one examines the fundamentals of the local economy, one would note that the corrections in the markets in the last 12 months were a natural corollary of over-valuation in the markets.

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The over-valuation, to a certain extent, reflected weaknesses in the economy which had arguably been a cause for the speculative attacks. However, the attacks, if unthwarted, could in the worst scenario, pose real risks to the stability of the system as they could have aggravated the pace of corrections, resulting in severe pressure on the peg or in a situation which had more catastrophic effects on the local economy. In this context, we believe there might have been some grounds to justify Government's intervention in the equity market. However, as we do not have full information on what happened at that time, we are not in a position to comment on the overall appropriateness of the moves.

Regarding the subsequent measures adopted by the Government, we believe that in general the seven measures would help in strengthening and increasing the transparency of the currency board arrangements. We also believe that the thirty-point package can ensure more rigorous compliance with the rules and regulations on the stock and futures markets, in particular on settlement, short-selling, stock lending, and disclosure.

So far, the seven measures and the thirty-point package have achieved some results as it appears that speculative activities in the local markets have subsided. However, it must be noted that the latter is also attributed to the fact that some hedged funds have suffered major losses in Russia and other overseas markets, and that there is a tightening of liquidity.

In general, we believe that the approach to enforce compliance with the rules on trading and settlement as well as on disclosure is in order. However, a balance should be struck to avoid overshooting because a number of the activities serve specific market functions and are perfectly legitimate. For instance, stock lending is generally allowed in most well-developed jurisdictions, as long as the quality and value of collaterals for stock lending are ensured, and the activities are disclosed in the constitutive documents of the funds. Also, the use of futures to hedge against the risk of unfavorable market movements; and for efficient portfolio management are also perfectly legitimate as long as there are proper restrictions and sufficient disclosure.

What we would like to stress is that we are not advocating or condemning stock lending, short-selling or the use of futures. What we would like to point out is that with proper regulation, many of these activities, which are stigmatised as "speculative", are perfectly legitimate.

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Finally, we have concerns that the recently announced client identity rules may impose unnecessary burdens on both brokers and fund managers. We suggest that the government should be pursuing cooperative arrangements with other governments, other than imposing new, unusual requirements in the Hong Kong markets.

With the increasing sophistication of the financial markets, there are bound to be more instruments and financial engineering techniques being employed. To maintain its competitiveness as a major financial centre, Hong Kong should, instead of adopting a more restrictive approach, continue to increase the depth and liquidity of the markets as well as their efficiency and transparency.

From investment managers' perspective, an environment that is conducive to the investment management function should have the following attributes:

- well-established rule of law
- free flow of capital
- no minimum or maximum imposed on the type of instruments or markets one can invest in
- stability and predictability in the financial system
- pragmatic regulatory regime
- well-developed infrastructure

All along, Hong Kong has possessed these attributes, and the financial crisis and the recent developments have not resulted in any major changes to these attributes.

As to what the Government should do with its investments in the stock market, we believe it is most important to ensure sufficient transparency in the operation of the Exchange Fund Investment Company Ltd. ("EFI") We welcome EFI's move to disclose its holdings, and to reiterate its commitment to adopt a long-term approach to its holdings. We think it would be very useful if EFI can clearly specify its investment objectives, as well as measures adopted to ensure compliance with the relevant rules.

(November 7, 1998)