Transcript of Interview with Antony Leung

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Interviewed by
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June 18, 2014

Note: This is a verbatim transcript but with minor editing for clarification.
Garten: Antony, thank you very much for having this discussion with me. I would like to start by asking you about greater China. Let’s start with a background question, which is this: when business leaders and statesmen think about greater China today, what should they be aware of in terms of some of the big trends that you see and that you experience -- trends that are going to influence both the arena and the world over the next decade. What's actually happening? Just two or three major trends.

Leung: Sure. Well, first of all, thank you for including me in this very meaningful study.

Garten: Thank you.

Leung: You ask a very important question because when we talk about changes, we have to look at the macro environment. I would say for greater China -- and obviously that applies very much to the mainland of China because that is such a large economy and such a large population -- I would say three things that are worth keeping in mind. The first thing is that China's growth -- People’s Republic of China -- the economic growth is going to continue, and alongside the economic growth will be reforms, structural reforms, particularly in the economy. That is important, particularly, as you know, regionally, there are a lot of bearish talks about the economy of China.

They talk about shadow banking, talk about the real estate bubble and talk about the excess capacity in many industries and that kind of thing. But I think if you set it against a five-to ten-year timeframe, I'm actually very confident that the Chinese economic growth will be maintained on a fairly decent rate of growth. But
the growth will have to be accompanied by structural reforms, which in a way, it's a good thing about the Chinese kind of policy watching is you don't really have to guess much. You can read it from their kind of government reports. So that I would say would be kind of the overriding background.

If you take a very different outlook of the longer term Chinese economic growth, then you'll reach a very different conclusion. If the China growth can continue, then greater China itself will do well because both the Taiwanese and the Hong Kong economies are so much dependent on the mainland of China's economy. So that is the first one.

The second one is that because of these continued growth, obviously with ups and downs, it is not going to be a straight line. And the growth also has happened in the last three decades, and you know full well that China came from basically, in the mid-'70s, I would say a bankrupt country to now the second largest economy in the world.

With that rise in the Chinese economy, the confidence of the Chinese, including the Chinese government, has also been increasing. So a lot of policies that they have adopted, including foreign policy, that they may have been maintaining in the last decades will change a bit, particularly right now with a number of the border conflicts. In the past they may have taken a more reconciliatory or even stepping back-type of stance. Now with the rise in confidence, they may be taking a firmer action to defend their territorial integrity.

That, I think, is something that we have to bear in mind -- meaning
that we can assume that China will repeat what they have done in the '70s or even '80s and assume that they would give way. So the rise in Chinese confidence, I think, will affect a number of these policies, not just in the area of defense, but also in the area of somehow protecting the Chinese interests in the global environment.

The third trend relates to the currency and also the Chinese economy. The first one I'll talk about is the continued growth, but on the other hand as China continues to grow, they have to ensure that a number of the other things would match right now their economic position. Renminbi (RMB) - I don’t know when it will be so-called fully convertible. A lot of people talk about that. I have my view. But even without fully convertible, the continued trend for so-called internationalization will just move forward because as the Chinese trade increases, and the Chinese investment increases, it is just natural that they would encourage the use of their own currency, rather than on other people's currency to do the trade settlement, to do the investment settlement. So that, I think, would be something that would be worth watching.

Simultaneously, besides the increase in trading, increased volume, we should also expect that there'll be more Chinese-owned bank investments. In the '70s and the '80s when they first opened up, they had no capital. So they were encouraging a lot of foreign investment into China, and they're still encouraging foreigners to invest into China.

But I think it'll be just fair to expect now that China is the second largest economy in the world, that the Chinese investment would also be going out so that the Chinese economy as a whole, through
all this extensive trading and the cross-investment – foreigners coming into China and Chinese investment going out – then China would be fully participating in a world economy and become one of a more regular global player. There are three trends I think would be worth remembering.

_Garten:_ Let me ask you a question about the second trend because that is getting a lot of attention, and I'm going to maybe just expand it a little bit and talk about China in Asia. To what degree do you think the confidence of the Chinese and the assertion of national interests will translate into geopolitical tensions that would have an impact on economic relations?

_Leung:_ Well, politics and economics are, of course, intertwined. We can't separate one from the two. Just like the Americans have global economic interests and America has been dominating the world, China would not like to be seen as submitting to the other countries. I don't think that the Americans would like to be seen as submitting to any other country in the world.

China, historically, has not shown itself to be a so-called kind of imperialist, at least not in the last several hundred years. But on the other hand, China – Chinese people, it's not just the government, has always had the view that we have to defend our own country. If we look at the so-called current disputes over the Diaoyu Island, the dispute with Japan over the island in the South China Sea, obviously other countries may have different claims. But if you look at the Chinese history and the Chinese documents, it is abundantly clear that these islands have always been part of China.
So right now Japan and other countries are also laying claims on them, and I believe in the past the Chinese government has had a proposal to these countries for co-development, but these countries are basically ignoring it. If you look at Japan, they even ignore the history. They refuse to admit history. They refuse to admit that they had massacred people in Nanjing. They refuse to admit that there were the existence of comfort women. They claim that all these were volunteers.

One cannot underestimate the nationalism, the rise in nationalism in China. So if the Chinese government is being seen as weak towards these countries that are somehow trying to take away our territory, the Chinese people will actually rebel. So that is, I think, one factor that outsiders should not ignore. Now, obviously, all this tension may and possibly will affect the economic tides, whether it is in trading or investment.

Unfortunately, there is a widely held belief in China, not just in the government, but among the population, that all these disputes were, in a way, supported, orchestrated, or at least condoned by the United States government. So I think you ask a very good question. How would this affect Chinese economic interests and also their participation in the world? It will affect, but on the other hand, as I said, the rising nationalism in China, the popular feeling should not be ignored. And the Chinese government has shown repeatedly in the past that they would not sell their national interests in face of just kind of trade or investment threats.

Garten: Okay. Let's make an assumption that these tensions will be handled through diplomacy and that they won't rise to the level where China's global economic integration will really be affected.
Let's just assume there'll be some ups and downs in the politics, but basically the inexorable momentum of China will continue. I'd like to talk a little bit about the meaning of Chinese global integration when it comes to finance. In the trade area, I believe that has already happened, but when it comes to finance, as you were saying, there is huge scope for more investment both ways.

There is huge scope for more use of the Chinese currency, and my guess is there will also be much more of a Chinese voice in the IMF and international forums. So my question is how does this change China? How does an increasingly integrated financial system, a Chinese financial system integrated into the global financial system, what is the impact on China of this kind of involvement? I realize we're speculating a little bit, but just from your standpoint, what kind of changes might one look for within China as a result of this kind of integration?

Leung: Well, I think we look back at what has happened because history is a good predictor of what may happen in the future. We have seen the Chinese currency now more so-called internationalized. So we have seen a lot of the practices in a way more aligned with the international standards. Take for example the change in the banking system in China. By and large, the banks are now following international standards like the capital adequacy requirements, like many of the governance practices, and that kind of thing.

And so we look back. That has been going on for the last kind of 20 plus years, with many of the largest banks in the China all listed and listed, also, in Hong Kong, which you will agree that it is an international market following international standards. I served on
the board of ICBC (Industrial and Commercial Bank of China) for six years, and so I have seen some of the changes. Because of the willingness of the Chinese institutions to adopt a lot of these international standards, ICBC is now run very much like a Western bank. Now, obviously, there are significant differences. So much so that they are now less susceptible to just direct government policies.

Now, ultimately if the government decides on something, since they are still jointly controlled by the government, they would do it. But it would be a much more well thought out decision, meaning before the Chinese government ordered the banks to do something, they'll think about whether it really is good for the banks and also good for China as a whole. Junior officials just cannot – unlike in the past – they cannot just order the banks to release a loan to their relatives. They have the think about how do you manage the risk of the bank rather just being the [inaudible] of the government.

When I was at ICBC, I was the chairman of risk management in the chief role there six plus years. For about three years I was there, I was the chairman of the audit committee. And we introduced a lot of the practices that international banks would use. We introduced reports that were much more quantitative with data much more accurately collected. We introduced sensitivity analysis. We introduced stress testing to somehow strengthen the risk management of the bank.

We increased the provision ratios, which initially we had discussions or arguments at the board level whether we should actually increase the provision level to 100 percent of the MPL.
When I first joined the board, it was less than 50 percent. I thought that we should be at least 100 percent, and now, as you know, it's over 200 percent. So using that as an example, following a lot of these international standards actually has strengthened the ICBC and that happened to all the banks. I think PBOC (People’s Bank of China) has also introduced a lot of very sensible and very good rules and standards.

So as a result of being part of the international economy, following or copying some of the best practices, it has strengthened the Chinese institutions and, therefore, the Chinese economy. The same thing with the stock market. Obviously from time to time, because of policy reasons, they may not be as international as one would like, but [inaudible]. And they allow also talking about how do you regulate and manage shadow banking. Now, obviously shadow banking in the West has also caused all kinds of problems, all kinds of products under different names.

So I think overall the benefits have been very good, but on the other hand, I will also argue that China should not just copy 100 percent of what has happened in the West because the economic environment is very different. China should not open up its market 100 percent to the world because I don't think 100 percent open is good to China because many of the practices, not just in financial regulation, but in a macroeconomic policy, have to be considered. China's stage of economic development is different. The readiness of the Chinese economy to take on some of the new products is also different.

Like say for example, I would not advocate that China would free up the development of new products, especially in area of
derivatives. We have seen what the subprime products have done to the United States. I'm not saying that derivatives is not a good thing, but derivatives, one issue is that clients have a certain sophistication. It can actually create unpredictable results.

I would not advocate an early total free up of the Chinese currency because I don't think a total free trade currency is a good thing for China because the amount of hot money that is available going in and out of any country is actually a very, very bad thing. The United States is fortunate because people use your currency mostly, so the amount of money that is being printed – sorry to use that term – by the Federal Reserve, the ECB, and the Bank of Japan has created so much investment dollars, well beyond the size of the real economy, has caused volatility. I don't think China is ready for its currency to be speculated freely, especially without all these high-tech and derivative products. I think, also, China should learn from the good lessons and bad lessons of the West, but I don't think China should just copy.

_Garten:_ When it comes to all the things you're saying, tell me if I have it right because I take several points, but here are two of them. One is that China is moving in a direction of continued liberalization. In other words, the direction is pretty clear. But the second point is it's going to move at a very measured pace. Keeping in mind, first of all, things that simply didn't work outside of China or that caused major problems, and secondly, being very aware of its stage of development.

That is, not to move in a direction which – or at a magnitude which basically misreads all the other things that have to happen in the economy to give it the flexibility and the cushion. How do you
think about these trends when it comes to the rest of Asia? Let's assume that what you say about growth happens, strong growth well into the future. Let's assume progress on structural reforms, and let's assume gradual integration into the global financial system.

People used to write about a China-centric Asia several years ago, but I haven't heard that term much anymore. So what I'm wondering is from your standpoint, you have this very powerfully emerging economy. It's very big, as you say. Second biggest, maybe first biggest. It doesn't matter. How should we think about the rest of Asia? I don't just mean greater China, but Southeast Asia, Japan, Korea. What's the impact of a China that we're talking about? I'll stipulate political tensions that are very containable. How do we think about this?

**Leung:** Well, I hope that with all these positive factors, the intra-Asia trade and intra-Asia investments will continue to grow and grow fast. So at the end of, say, 10 or 20 years, we'll see trade flows within Asia in a way being the largest flow when compared with Asia trading with places outside of Asia. We will see that countries within Asia will be investing in to each other. Now, with China being such a large player, necessarily a lot of the trading will be with China, a lot of investments will be Asian investments investing in to China, and vice versa, Chinese investments going in to various places. Going to Taiwan, going in to, obviously, Hong Kong, these two being parts of China.

Going in to all the ASEAN countries. Going in to hopefully India, which obviously would be probably a bit more difficult because the Indians are so afraid of the Chinese. Going in to, I hope, in to
Japan and going, clearly, in to Korea. So very much an intertwined web of trading and investment. And all these will promote, actually, friendship, understanding, and trust among its people.

It doesn't mean that Asia will be a closed Asia, but Asia itself would be trading with the rest of the world as well, including, obviously, America. I still believe that America will for a very long time be the largest economy in the world because America has a lot of strengths that China still doesn't have, including its appeal to the global challenge, its ability to innovate. So I still believe that the higher technology mostly would come from America. But I do not see as many enemies in the past.

If you take a look in the last five years or so, I have not really been hearing as much. But I remember in the '80s and even in the '90s, some predicted that, "Well, maybe there'll be an Asian currency," just pretty much like the euro. But now with a rising China having a number of territorial conflicts and the euro isn't really considered a convincing success, people are not talking about common currency anymore. But there are clearly a lot more talks about the renminbi rising as one of trading currencies and may possibly be a reserve currency. But the second point, I feel, needs more discussion. So I think it'll be just a more intertwined, fast-growing Asia with China adopting a certain significance, and a very open Asia. That would be the ideal case, but when that will happen or if it will happen quickly is something that we need to think about.

Garten: And finally, let's talk about Hong Kong. When people think about global finance, Hong Kong for so many years has really been considered as one of the most dynamic financial centers, and yet I
know from lots of discussions that people have very different views as to how Hong Kong will operate if we took a timeframe of a decade, let's say. So I'm wondering, from your standpoint, what are some of the alternative scenarios here for the role of Hong Kong, again, in this context of a rising China?

Leung: Well, very good question. Within Hong Kong there are discussions about the role of Hong Kong as well, not just in a financial sector, but in other sectors. Here I have a few beliefs or observations.

My first belief is that Peking (Beijing), meaning the Chinese government, really wants the one country/two systems to do well. They are not doing this just to appease the Hong Kong people.

Right now they have so much confidence, so what is 7 million people to a country or one country with 1.3 billion. But the leaders in China are very pragmatic, and actually, could be more pragmatic. Now, obviously, from time to time there may be policies that are difficult to understand, but on the other hand overall in the total scheme of things, they are very pragmatic.

The reason why I believe that the Chinese government wants Hong Kong to do well under the one country/two systems is that a successful Hong Kong under the one country/two systems is useful to the Chinese government and to the nation as a whole.

Under the one country/two systems, Hong Kong will continue to use English laws. Hong Kong will have kind of the degrees of freedom that, even as China liberates, China will not have for some time, including the freedom of information. Hong Kong will have
a tax system that hopefully will continue to be very simple, very low rates that for a long time China cannot just copy. So all of these things would allow China to do experiments that they would not like to do in China in one go.

Meaning the Chinese way of reform, because China – as you know well and you are an expert on China – is such a large country, both territorial as well as in population that if you just want to change something, you don't want to change throughout China because the different parts of China have very different characteristics even though it is one country. So sometimes instead of doing something in China and, therefore, causing all kinds of pressure to spread it over China – and if you make a mistake, then you really make a mistake. Doing it in Hong Kong, because under the one country/two systems, they can actually test it without getting those pressures.

Just like in talking about the compensation of banking professionals. If ICBC wants to recruit people with international experience to populate certain departments, if you do it within China, you can only pay so much because Jiang Jianqing, the chairman, is getting not more than $300,00.00 US a year. For that salary, you can't even get an associate in a top investment bank or private equity firm, so how can you expect the best talent? Hong Kong would provide such an environment. So that is just one example of having a Hong Kong that is operating fully in the international environment and yet is part of China.

So I continue to believe that for a long while Hong Kong's usefulness will continue, but it's under one assumption: that Beijing is comfortable that Hong Kong is not being used by other
countries as a base to subvert the People's Republic of China. That is very important. Unfortunately, right now tensions in Hong Kong – we see strikes, demonstrations, protests almost every week, if not every day. And there are kind of accusations that some of these protestors were backed up by foreign forces, and as a result, there are actually suggestions by somebody in Hong Kong asking the Beijing government to be a lot firmer on Hong Kong. Such accusations and suspicions are not conducive to having Hong Kong playing a very constructive role under the one country/two systems to the benefit of China.

_Garten:_ You're talking about sort of Beijing's view of Hong Kong. What about the views of global investigators towards dealing with Hong Kong as opposed to Shanghai or Beijing if the politics works out? That is, if Hong Kong does not appear to be subversive. Under those circumstances, and given Beijing’s support – the kind that you talked about – do you feel that the global investment community, the global financial community would want to continue to accord Hong Kong the importance that they have in the past?

_Leung:_ I think so because even as China continues to follow international practices and adopt rules that are closer to international practices, it still does not have adequate experience, and also, the set of laws would still be different from that of Hong Kong. Because, as I said, Hong Kong still uses common law, basically, English laws. I believe international investors are much more still comfortable with English laws and common laws. Hong Kong’s regulators are very light handed.

Again, we use international standards, so international investors
are probably a lot more comfortable operating in Hong Kong. We do not have a very heavy-handed approval system as far as, say, listing is concerned. We leave it to the SFC (Securities and Futures Commission) and the stock exchange. Whereas in China, as we have seen in the past, IPOs are sometimes blocked, sometimes allowed, by the regulators. Not on a specific stock basis, but just say that the market position is no good, so no IPO for, say, two and half years.

The consistency in regulation, the consistency in government policy, is here in Hong Kong. But you can't say the same for China I think, for a long time. Because, again, Hong Kong is such an open economy, and we're used to it. And the Chinese government is comfortable that Hong Kong can manage our own business. We have the experience. So I think for a long time this will continue to be welcome by international investors. And, again, I stressed the point that I believe this is actually supported by the Chinese government.

**Garten:** I would just like to conclude with a hypothesis and tell me if I'm right. Basically, you've very optimistic about the trajectory of China in the broader picture. You recognize that there are some tender aspects, they fall in the political arena, and you acknowledge that you ultimately can't separate economics and politics. But the underlying momentum that you're talking about combined with the competence and the confidence of the Chinese leadership would lead you to say this region for a long time is a very good bet. Am I reading in between the lines the right way?

**Leung:** Well, in the long term, you're absolutely right. You have summarized it well. But I would also add the word of caution that
in the near term, there's a lot of headwind both economically and also in the [Break in Audio]. But I believe that the Chinese government has enough wisdom and, also, the government has good enough resources to deal with them without seeing the country going into bankruptcy or having a disaster. The territorial disputes, we'll have to handle very wisely. Nobody wants a war, least of all China itself. So there will be still a lot of headwind. There will be a lot of pessimism around in the near term, but I think in the medium to long term, I'm an optimist.

Garten: Thank you very much. That was very interesting. I really appreciate it.

Leung: Thank you, Jeff. I'm glad to have helped you and talked to you.

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