HK FINANCIAL SERVICES DEVELOPMENT COUNCIL 香港金融發展局

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Enhancing Hong Kong's Status as Offshore RMB Business Hub through the Development of the RMB Asset Market

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Content

Executive Summary

Renminbi ("RMB") internationalisation has seen remarkable progress since its commencement in 2009. Global capital has shown a huge demand for RMB assets following the inclusion of the RMB in the Special Drawing Rights ("SDR") currency basket of the International Monetary Fund ("IMF") in 2016, the inclusion of A-shares in the MSCI Emerging Markets Index in 2018 and the inclusion of Chinese bonds in the Bloomberg Barclays Global Aggregate Index in 2019. It is clear that offshore investors are increasing their holdings: at present, more than 60 countries and regions have included RMB in their foreign exchange reserves, and more central banks have expressed their intention to invest in RMB assets.

Banks in Hong Kong began providing RMB services to individual customers in 2004. In 2009, the Pilot Scheme for Settlement of Cross-border Trade in Renminbi was launched, followed in subsequent years by other schemes including the Shanghai-Hong Kong Stock Connect, Shenzhen-Hong Kong Stock Connect and the Bond Connect. With the support of the Central Government, Hong Kong has gradually developed into the world's largest offshore RMB business hub, with over 70% of global offshore RMB payment transactions currently handled in Hong Kong[1]. At the same time, Hong Kong owns the deepest offshore RMB capital pool in the world and provides the broadest spectrum of offshore RMB investment products around the globe[2]. Thanks to the strengths of Hong Kong as an RMB hub, China Development Bank issued the first offshore RMB bonds in Hong Kong as early as in 2007, and the Ministry of Finance has also issued RMB bonds in Hong Kong for 11 consecutive years since 2009. These developments have strengthened the depth and breadth of the offshore RMB asset market in Hong Kong. They have also laid a solid foundation for RMB internationalisation and the two-way opening of the Mainland capital market, enhancing the interconnection of domestic and overseas financial markets.

China's financial markets are reforming and opening up to the world, creating significant development potential for the RMB asset market. Amidst such progresses, Hong Kong is well placed to capitalise on the potentials as the world's leading offshore RMB business hub. In the National 13th Five-Year Plan, the Central Government highlighted that Hong Kong's position as a global offshore RMB business hub should be strengthened. The Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area ("Outline Development Plan"), published in 2019, also proposed a gradual expansion of the scale and scope of the cross-boundary use of RMB in the Greater Bay Area ("GBA") and the continued development of the offshore RMB businesses in Hong Kong. The financial services industry in Hong Kong must prepare to embrace these unprecedented opportunities.

1 *SWIFT, "RMB Tracker March 2020", https://www.swift.com/file/67981/download?token=9jCDTPae*
2 *HKSAR, Greater Bay Area website, https://www.bayarea.gov.hk/tc/opportunities/finance.html*

Proposals

In view of this, the Financial Services Development Council (“FSDC”) set up a dedicated Working Group of industry experts with a view to further developing the RMB asset market. Based on the discussion of the Working Group and other market opinions, the FSDC proposes the following measures to promote the development of the offshore RMB asset market in Hong Kong:

- Develop Hong Kong into a safe and reliable cross-border and cross-system trading, clearing, settlement and custodian centre in the Asian time zone. At the same time, promote further extension and broadening of the risk-controllable channels of the Connect Schemes, such as allowing southbound trading of Bond Connect (“Southbound Bond Connect”). These measures will strengthen Hong Kong's position as the premier offshore RMB business hub and facilitate the Mainland in achieving full RMB capital account convertibility;

- Promote development of the offshore RMB bond market by nurturing a comprehensive spectrum of offshore RMB bond issuers and developing RMB bond index-linked products. Related RMB assets and services in areas of foreign exchange hedging, asset management, asset securitisation and risk management should also be further enriched for this purpose.

- Enhance financial innovations in cross-boundary investment and the free trade account system by leveraging Hong Kong’s role as a ‘super-connector’ and making the most of the institutional advantages arising from the Connect Schemes. Such innovations should be tailored for the offshore RMB products and services demands from corporates and financial institutions in the Free Trade Zones and the Greater Bay Area as semi-offshore market participants.

- Establish Hong Kong's local insurance-linked securities market and accelerate the creation of supporting regulations and preferential policies to further broaden the range of RMB offshore assets available in Hong Kong.

- Strengthen Hong Kong’s pivotal role in the Belt and Road Initiative by providing liquidity for RMB capital and asset transactions. Hong Kong should also leverage its internationalised professional and third-party accreditation services to promote itself as a hub for regional headquarters as it helps align Mainland China’s green RMB assets with international standards.

Preface

Since the RMB internationalisation process began in 2009, Hong Kong has been the largest offshore RMB business hub in the world. Over the last decade, despite the volatility of the offshore RMB market, Hong Kong's position has remained stable. One of the strategies clearly stated in the Outline Development Plan, published in February 2019 by the Central Government, was: *"to consolidate and enhance Hong Kong's status as international financial, transportation and trade centres as well as an international aviation hub, strengthen its status as a global offshore Renminbi (RMB) business hub and its role as an international asset and risk management centre, promote the development of high-end and high value-added financial, commercial and trading, logistics and professional services, etc."*[3] It is clear that the Central Government highly recognises the development of Hong Kong's offshore RMB market and has high expectations of it.

The internationalisation of RMB is closely associated with the reform and opening up of the financial markets in Mainland China. Due to its unique status as China's international financial centre together with advantageous institutional and international market connections, Hong Kong has been playing a pilot role in this opening-up process. By leading the way through measures such as the opening up of trade settlement and personal remittance, Shanghai-Hong Kong Stock Connect, Shenzhen-Hong Kong Stock Connect, the Bond Connect and others, Hong Kong has made significant contribution to RMB internationalisation – helping it become more accessible while mitigating risks.

[3] *"Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area", https://www.bayarea.gov.hk/filemanager/en/share/pdf/Outline_Development_Plan.pdf*

From the ‘trilogy’ of RMB internationalisation, RMB’s role as a ‘transaction currency’ has matured gradually with the implementation of policy initiatives. For instance, with the setup of the Free Trade Zones, the cross-border RMB-denominated current account item settlement has been growing steadily; the function of RMB as an ‘international reserve currency’ has increasingly gained recognition since the International Monetary Fund (“IMF”) included RMB in the Special Drawing Rights (“SDR”) basket in 2016. As of publication of this paper, more than 60 central banks or monetary authorities have incorporated RMB in their foreign exchange reserves, demonstrating remarkable progress. Looking ahead, it is expected that RMB internationalisation will focus more on its function as a ‘currency of financial investment’. Since the SDR-basket inclusion in 2016, the inclusion of A-shares in MSCI in 2018 and the inclusion of Chinese bonds in the Bloomberg Barclays Global Aggregate Index in 2019, a huge demand for RMB asset allocation has emerged globally, while Mainland China has also been increasing its efforts to reform and opening up its financial market. To cement its role as an agent in advancing all of this progress, Hong Kong should proactively further develop its offshore RMB businesses and capitalise on the opportunities from favourable policies. Hong Kong should also develop offshore RMB asset markets even more actively and seek further policy breakthroughs and supports; this would, in turn, reinforce and enhance its status as an offshore RMB business hub.

The Outline Development Plan also serves as a blueprint for RMB internationalisation for other cities. For instance, it supports Macao in *“developing a China-Lusophone countries platform for financial services”, and to “develop as an RMB clearing centre for Lusophone countries”*, as well as to “study the feasibility of establishing in Macao a securities market denominated and cleared in RMB”. Advancing the offshore RMB market in Hong Kong therefore not only entails developing itself as the pioneer within the region but also calls for closer cooperation with other cities to encourage integrated competitiveness, which will in turn reinforce Hong Kong’s advantage.

In view of this, the FSDC has set up a dedicated Working Group, led by and comprising leading industry experts and academics, to formulate policy recommendations on further developing the offshore RMB asset market in Hong Kong. This paper begins by outlining the current situation of the offshore RMB asset market in Hong Kong, followed by an analysis on the challenges and difficulties identified for its further development. Relevant recommendations are presented towards the end of the paper.

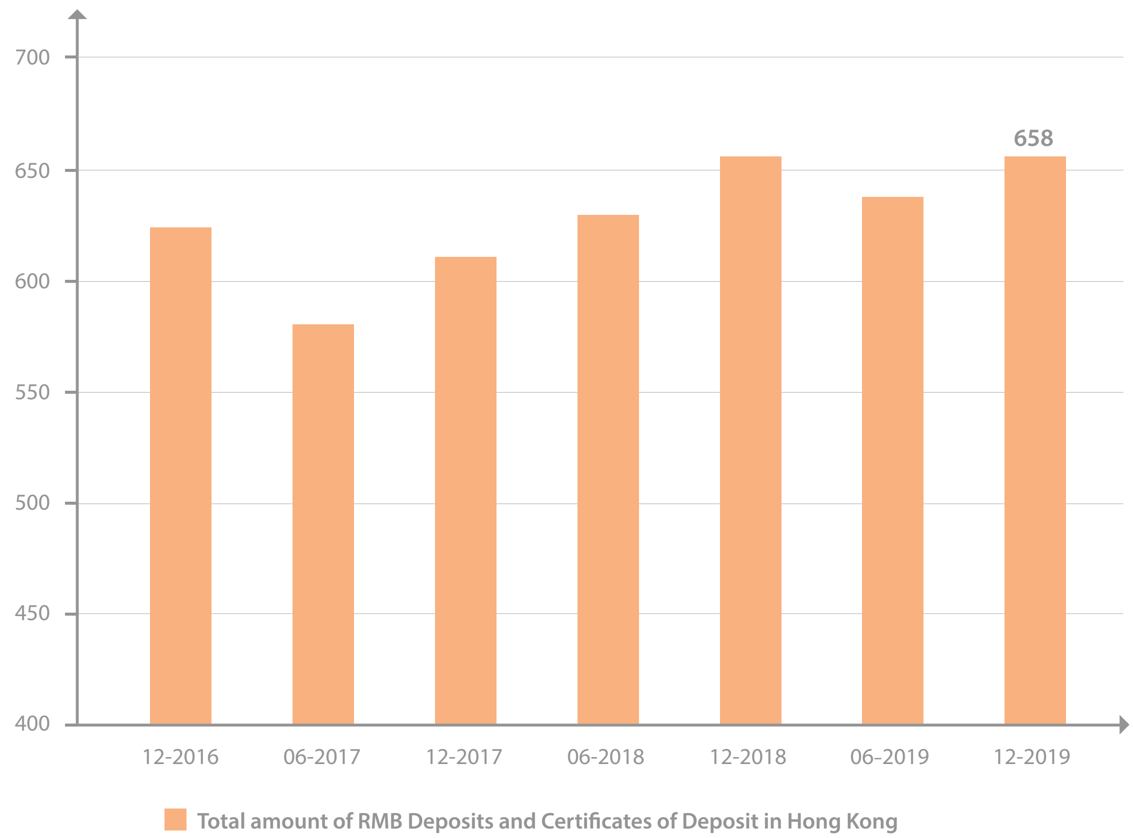
I. The Current Status of the Offshore RMB Asset Market in Hong Kong

As the world's largest offshore RMB business hub, Hong Kong has been actively developing the offshore RMB asset market for many years. As an overview of the current status of the offshore RMB asset market in Hong Kong, the paper discusses five key areas: (1) the scale of RMB capital pool; (2) the Stock Connect and the Bond Connect Schemes; (3) RMB transactions in the foreign exchange market; (4) RMB bond issuance; and (5) the offshore RMB derivatives market.

The RMB Capital Pool

As of the end of 2019, the size of Hong Kong's offshore RMB capital pool stood at RMB 658 billion, representing an increase of 0.1% from the end of 2018[4]. The size of Hong Kong's RMB capital pool has declined from its peak of RMB 1,158.3 billion at the end of 2014, bottomed out mid-2017 and maintained a generally stable upward trend since.

Figure 1 : Size of Hong Kong's Offshore RMB Capital Pool (RMB billion)



Source: Hong Kong Monetary Authority

[5] *People's Bank of China, "2019 RMB Internationalization Report", http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/3879422/2019082317152314540.pdf*

According to the "2019 RMB Internationalisation Report" published by the People's Bank of China ("PBOC"), Hong Kong is home to the world's largest offshore RMB capital pool.[5] As of the end of 2018, the balance of RMB deposits (excluding interbank deposits and certificates of deposit) in major offshore markets around the world exceeded RMB 1.2 trillion. Hong Kong ranked 1st in the world with a deposits balance of RMB 615 billion, while Taiwan came 2nd with deposits of nearly RMB 300 billion. RMB deposits in the United Kingdom and Singapore were approximately RMB 56.2 billion and RMB 50 billion, ranking them 3rd and 4th respectively.

The Stock Connect Schemes and the Bond Connect

Following the launches of the Shanghai-Hong Kong Stock Connect and the Shenzhen-Hong Kong Stock Connect in 2014 and 2016 respectively, investors can invest in RMB-denominated Mainland securities through Hong Kong, expanding the breadth of RMB-denominated asset market locally. These two Stock Connect Schemes are viewed favourably by the financial market. As at the 5th Anniversary of Shanghai-Hong Kong Stock Connect on 31 October 2019, the total cumulative Northbound trading turnover on Stock Connect was RMB17.41 trillion, bringing net capital inflows of RMB860 billion into the A-share market. Meanwhile, total cumulative Southbound trading turnover was HKD 8.75 trillion, bringing net capital inflows of HKD 987 billion into the Hong Kong market[6].

By the end of 2019, the Stock Connects had accumulated turnover of RMB 27 billion since their inception. According to HKEX's data, as at the end of 2019, offshore investors held RMB1,429 billion worth A-shares stocks, representing 3.0% of the eligible stocks' free float market capitalisation under Shanghai-Hong Kong Connect and 3.8% of that under Shenzhen-Hong Kong Connect. Likewise, Southbound shareholding grew to HKD1,138 billion, making up 3.7% of the market capitalisation of eligible stocks[7].

With the continuous policy enhancement and the inclusion of Chinese bonds in the Bloomberg Barclays Global Aggregate Index in 2019, international investors have been widely drawn to the Chinese bond market, while the amount of Chinese bonds held by international investors has reached a new high. Meanwhile, the number of participants and transaction volume of the Bond Connect have both risen significantly. As of the end of 2019, 1,601 institutions from 31 regions were registered as qualified investors for the Bond Connect, while the Bond Connect turnover reached RMB 2.6 trillion in 2019. Such trends show that the Bond Connect has become a major channel for international investors to access the Chinese bond market.

[5] *People's Bank of China, "2019 RMB Internationalization Report", http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/3879422/2019082317152314540.pdf*
[6] *HKEX, 'Celebrating Five Years of Stock Connecty', https://www.hkex.com.hk/News/News-Release/2019/191115news?sc_lang=en*
[7] *HKEX figures*

RMB transactions in the Foreign Exchange Market

The transaction volume of RMB in Hong Kong's foreign exchange market has been growing rapidly. According to the 2019 Triennial Survey of Foreign Exchange and Derivatives Market Turnover published by the Bank of International Settlements ("BIS"), Hong Kong remains the largest offshore RMB foreign exchange and interest rate derivatives market in the world[8]. As of 2019, the average daily turnover of RMB foreign exchange and RMB OTC interest rate derivatives transactions in Hong Kong was USD 120 billion[9], 45% higher than three years ago and accounting for 42% of the total transactions in the world[10].[11]

The Singapore Exchange's ("SGX") USD/CNH Futures has been traded relatively actively in recent months. For 2019, the average daily volume of SGX USD/CNH Futures was USD 3.7 billion[12], higher than that of the HKEX's, which stood at USD 0.8 billion[13]. However, it should be noted that market participants in Hong Kong mainly use OTC products such as forwards and swaps for hedging, which are not accounted for in the figure above. As a point of reference, the average daily turnover of RMB foreign exchange in the OTC market reached USD 120 billion in 2019, much larger than the transactions recorded by the Exchange. In addition, according to the BIS, Hong Kong's share of RMB foreign exchange transactions (outside of the Mainland) in 2019 was 41%, notably higher than that of the second- and third-ranked London (22%) and Singapore (16%), respectively[14].

RMB Bond Issuance

As a leading international financial centre and the world's largest offshore RMB business hub, Hong Kong has been providing a significant share of offshore RMB financing to corporates and institutions worldwide; it has also become the preferred market for offshore RMB bond issuance. However, due in part to the increasing volatility of the RMB foreign exchange rate in recent years, the overall offshore RMB bond issuance has shown an unfavourable trend despite the fact that Mainland corporates have issued more offshore USD bonds in Hong Kong. According to HKMA's data, both the number and the value of offshore RMB bonds issued in Hong Kong have dropped significantly. While 149 Dim Sum Bonds amounting to RMB 196.8 billion in total were issued in 2014, only 75 Dim Sum Bonds worth RMB 41.9 billion were issued in 2018. In other words, the number of bonds issued fell by 50% while the value of the bonds issued decreased by 79% over the five-year period.[15]

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[8] Bank of International Settlements, "2019 Triennial Survey of Foreign Exchange and Derivatives Market Turnover", https://www.bis.org/statistics/rpfx19.htm

[9] Hong Kong Monetary Authority, "Results of 2019 Bank for International Settlements Triennial Survey of Foreign Exchange and Derivatives Market Turnover", https://www.hkma.gov.hk/eng/news-and-media/press-releases/2019/09/20190917-3/

[10] The total foreign exchange turnover of RMB (which was USD 284 billion) in the BIS 2019 report included both foreign exchange and OTC interest rate derivatives transactions. See footnote 7.

[11] Other institutions in the market also publish reports in relation to the size of global RMB foreign exchange transactions, including the Society for Worldwide Interbank Financial Telecommunication ("SWIFT"). Yet we observed that SWIFT's statistics only included offshore-to-offshore transactions where the origin of transactions are defined by the location of the sender and receiver or the SWIFT messages only. As such, we consider that the BIS report could better represent the full picture of the international RMB foreign exchange market. For the SWIFT methodology, please refer to the following report https://www.swift.com/file/64651/download?token=h9xZuKG4

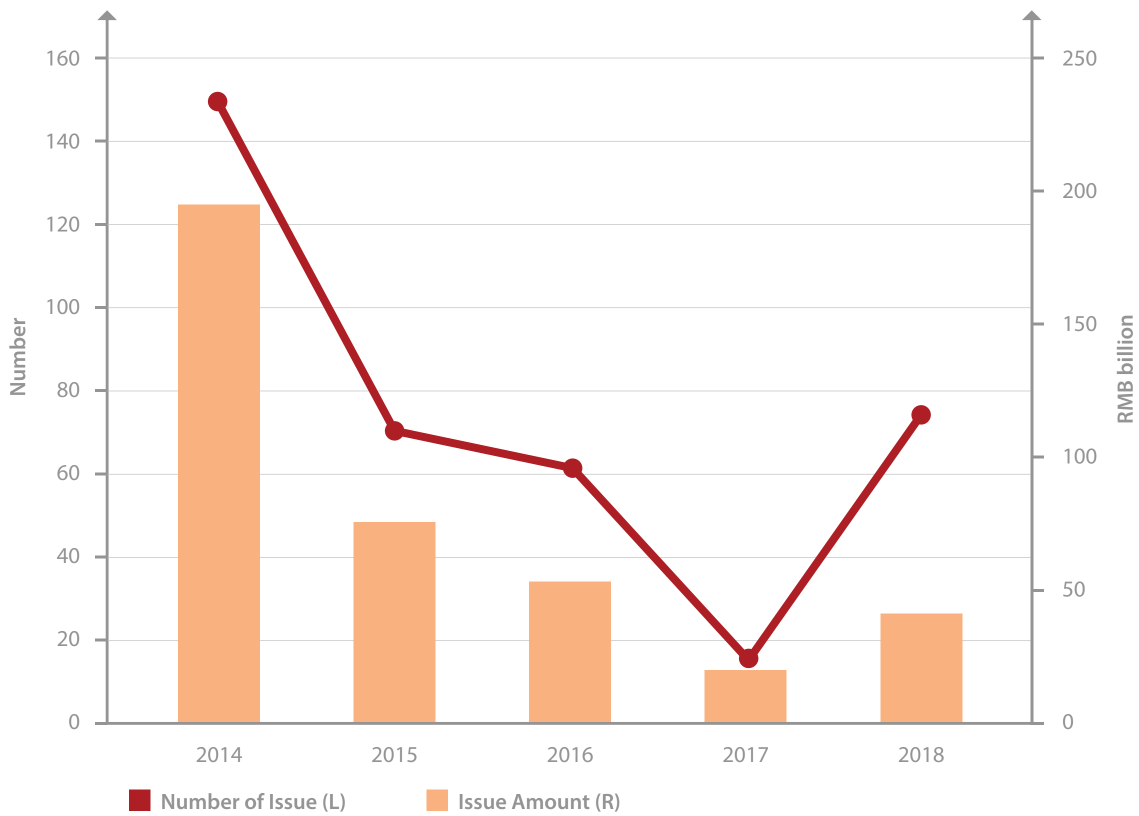
[12] Singapore Exchange, "SGX FX futures post record 2019 growth as geopolitical, economic uncertainties spur demand for risk management", https://www2.sgx.com/research-education/market-updates/20200114-sgx-fx-futures-post-record-2019-growth-geopolitical

[13] HKEX, "Market Statistics 2019", https://www.hkex.com.hk/-/media/HKEX-Market/Market-Data/Statistics/Consolidated-Reports/Annual-Market-Statistics/2019-Market-Statistics.pdf

[14] Bank of International Settlement, "BIS Quarterly Review December 2019", https://www.bis.org/publ/qtrpdf/r_qt1912f.pdf

[15] Hong Kong Legislative Council, "Replies to initial written questions raised by Finance Committee Members in examining the Estimates of Expenditure 2019-20", https://www.legco.gov.hk/yr18-19/english/fc/fc/w_q/fstb-tsy-e.pdf

Figure2 : Number and Amount of RMB Bonds Issued in Hong Kong



Source: HKMA, Bloomberg and market information

The Offshore RMB Derivatives Market

A number of RMB-denominated hedging tools have been introduced to the market since 2012, providing investors with a broad selection of products and risk management tools. RMB-denominated derivative transactions are active at present, and several RMB-denominated commodity futures contracts have also been rolled out (including the following six types: aluminium, copper, zinc, lead, nickel and tin). According to HKEX, the transaction volume of RMB currency products reached a new record high in 2018 with 1.81 million contracts, up 137% from 2017. The average daily trading volume of RMB currency futures in 2019 was 8,042 contracts, up 11% over the same period the previous year[16]. These provide good liquidity and market depth for investors.

[16] *HKEX, "Monthly Market Highlights December 2019", https://www.hkex.com.hk/Market-Data/Statistics/Consolidated-Reports/HKEX-Monthly-Market-Highlights?sc_lang=en&select={5B984B00-9551-4A5B-B3A4-4AFD16B70E88}*

II. Challenges and Opportunities for Further Development of the Offshore RMB Asset Market in Hong Kong

Compared with other International Central Securities Depositories ("ICSDs"), the Clearing and Custodian Functions of Debt Securities in Hong Kong may be Insufficient

Collateral Management

In addition to their function as an investment, debt securities also provide liquidity for investors, allowing holders to use them as collateral to acquire liquidity in the market. In this respect, the relevant collateral management functions and repurchase mechanism can help increase the liquidity of financial markets, reduce the credit risk of counterparties and strengthen the stability of the financial system. At present, the majority of Hong Kong's bond market settlements are through the Central Moneymarkets Unit ("CMU"), which primarily focuses on providing trade settlement and custodian services for bonds. As for the repurchasing financing ("repo") function, only CMU members which are banks are eligible to use Exchange Fund Bills and Notes or certain designated bonds as collateral for intra-day or overnight repo; non-bank CMU members, on the other hand, are not able to do so. In contrast, most of the major ICSDs allow repo financing to be carried out efficiently. In this context, market participants tend to agree that there is room for improvement in this area and believe that, by enhancing CMU's service capabilities, it would help capture more opportunities arising from the development of the offshore RMB bond market.

Corporate Actions (including Voting, Interest Payment, Redemption and Tax Arrangement)

The CMU has seen promising improvements in respect of corporate actions in recent years, with its level of automation being enhanced while containing its operational risk. However, the CMU still relies on manual operation in part of the operation when carrying out functions such as interest payment, principal redemption, announcement of corporate actions and execution of custodial instructions. It is also noted that there are limited – if any – standardised programmes to handle such matters. Hence, according to market participants, there is still room for improvement in terms of CMU's efficiency. In particular, CMU's capability to handle tax-related operations is considered noteworthy. This is, in part, because of the differences in tax regimes between Hong Kong and other jurisdictions. In general, interest income in Hong Kong is tax-free and there is also no capital gains tax; however, if overseas-issued bonds are to be processed by the CMU in the future, the tax regime in the issuing market will become applicable. In anticipation of such developments, the CMU will need to refine its functions and develop corresponding capabilities – in practice, this means allowing some level of automated processing.

Common Depository

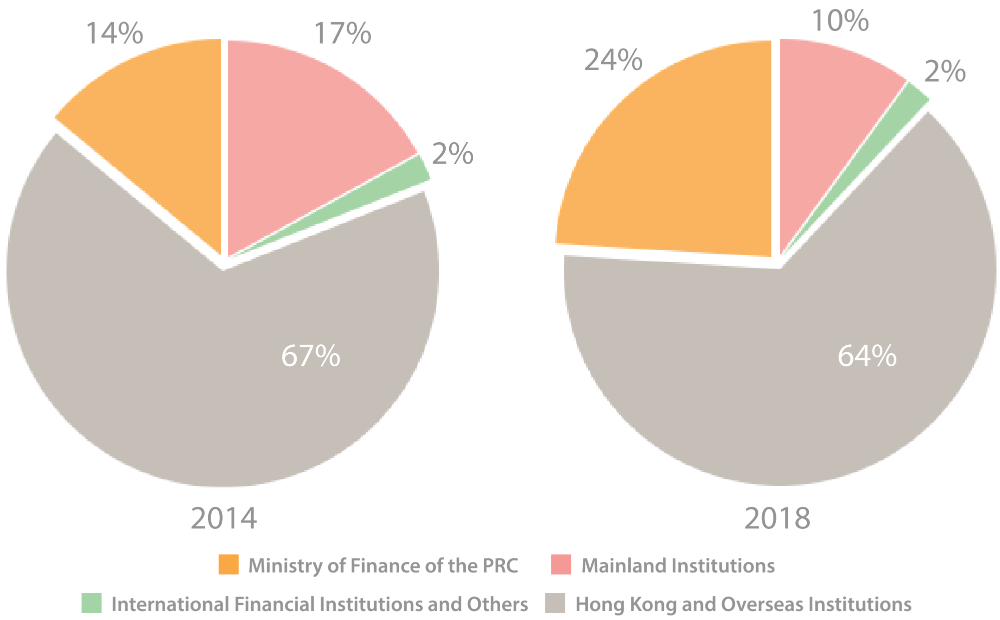
When bonds are issued globally, their global depositary receipts are usually handled in one of the common depositories. Both major ICSDs, Euroclear and Clearstream, have opened accounts with common depositories for information sharing. As per current practice, if both sides of the bond transaction (i.e. buyer and seller) are members of the same ICSD, there is no need for the parties to adjust the ICSD account in the common depository for such transactions; where the buyer and seller are using different ICSDs, the accounts of both ICSDs will also adjust positions in their common depositories accordingly. If, alongside developments in the RMB market, the CMU intends to become an ICSD, it will need to open accounts with common depositories just like the other ICSDs. By doing so, future bond issuances can be completed both in the CMU and the other two ICSDs, while information can be shared.

Room for Improvement in the Variety of Issuers of Offshore RMB Bonds in Hong Kong

Policies in relation to cross-boundary usage of RMB have been relaxed in recent years, building the platform for RMB to act as the currency for settling capital account-related transactions. Although certain control over Mainland enterprises' foreign liabilities remains, incurring RMB-denominated foreign liabilities has been allowed. For example, during the peak period of 2015/16, Hong Kong's offshore RMB loan balance once exceeded RMB 200 billion, most of which was used for cross-boundary financing for Mainland enterprises, indicating Mainland enterprises' interest in obtaining RMB financing through Hong Kong.

According to HKMA's data[17], while the proportion of Dim Sum Bonds issued by the Ministry of Finance in Hong Kong rose from 14.2% in 2014 to 23.9% in 2018, issuance by Mainland corporates and institutions dropped from 17% to 10%. It is noted that the decline in Dim Sum Bond issuance has been, to a certain extent, related to macro and market factors, such as the two-way fluctuations of the RMB exchange rate and global interest rates. At the same time, Mainland corporates and institutions are subject to certain approval and regulatory requirements when they issue offshore RMB bonds. As these approval processes and the compliance with regulatory requirements take time, issuers may find it more difficult to time the market (i.e. when to issue such bonds) effectively, leading to weaker interest in issuing offshore RMB bonds in Hong Kong. In this regard, if Hong Kong can better attract different bond issuers to carry out financing activities in Hong Kong, the size of offshore RMB bond issues could see huge room for improvement.

Figure 3 : Composition of RMB Bond Issuers in Hong Kong in 2014 and 2018 (By Issue)



Source: Bloomberg and market information

[17] *See footnote 14*

Room for Further Enrichment of Offshore RMB Products

While Hong Kong is already the leading offshore market with the most RMB products in the world, market participants believe there is still room for further enrichment to meet market demand and for advancement of the offshore RMB market.

Firstly, for products in the fixed income market, relevant financial institutions and the HKEX may build on the differences between the exchange's bond market and the Interbank Bond Market in the Mainland to advance the development of the bond market by adding innovative elements to relevant products. This can be achieved through using foreign capital in the offshore RMB bond market and introducing new bond types, hedging tools, and other derivatives. In addition, in terms of services provided, market participants see room for improvement in the offshore RMB bond market, including bond repurchase, interest rate risk hedging, exchange rate risk hedging, credit rating and the initial subscription of bonds. These innovative elements will encourage international institutions to participate in the offshore RMB bond in Hong Kong; this will attract both long-term international capital as well as capital focusing on short-term trading, thereby reinforcing liquidity of the offshore RMB asset market.

Secondly, the RMB bond index fund in Hong Kong still has room to grow. Compared with directly investing in offshore RMB bonds, RMB bond index funds can provide investors with exposure to a basket of different types of bond products. This not only meets foreign investors' demand for asset allocation to RMB bonds but also reduces tracking errors in bond indices and is complementary to specific bond investments. There are currently 18 SFC-authorised funds which mainly invest in the offshore RMB bond market and a few offshore RMB bond index ETFs. However, as the offshore RMB bond market has become less active in recent years, these funds have been facing a smaller selection of investments. As such, it is believed that more support would assist the development of these products.

Thirdly, RMB's exchange rate has seen higher two-way volatility, both in terms of frequency and magnitude, in recent years. It is therefore necessary to enhance exchange rate hedging tools to help further development of the offshore RMB bond market. As exchange rate fluctuations would affect investors' interest in offshore RMB assets, these enhancements will facilitate the advancement of the offshore RMB market. This is because these tools can be used to reduce the volatility of offshore RMB asset prices, smoothen investors' return and attract those institutional investors with relatively low tolerance of volatility, such as foreign pension funds, sovereign funds, and others. Furthermore, as a testing ground and a segregated market, Hong Kong can provide a pioneering experience of such products for the Mainland market, which will help further liberalisation of the derivative market without affecting the Mainland market.

Convertibility of the Mainland's Capital Account and its Impact on the Offshore RMB Market

The Mainland has achieved current account convertibility since 1996. As for its capital account, out of the 40 different types of transaction in seven major categories, 37 are fully, basically or partially convertible, with only three types remaining non-convertible. These non-convertible transactions mainly concentrate on the primary domestic capital market, such as non-resident domestic issuance of stocks, money market instruments and derivatives business.[18] Nevertheless, these restrictions on the capital account will, to a certain extent, affect further development of Hong Kong's offshore RMB asset market.

First and foremost, capital account transactions in the secondary market of stocks and bonds have been broadly liberalised through the Qualified Foreign Institutional Investors ("QFIIs") and the RMB Qualified Foreign Institutional Investors ("RQFIIs") schemes, as well as the liberalisation policies such as the Connect Schemes. Nevertheless, foreign enterprises are not yet allowed to participate in the onshore IPO market, hindering the development of a more diversified spectrum of financing channels for enterprises and the real economy.

Secondly, in terms of money market instruments and derivatives business, as more international investors participate in the onshore market, they will need corresponding derivatives to hedge the risks involved. However, the cross-boundary flow of foreign capital relating to futures trading currently falls under certain regulations. Also, the development of onshore foreign exchange futures markets, which is complementary to the commodity futures market, remains lacklustre. As such, it is considered necessary for the derivatives market to be further liberalised so as to accelerate its internationalisation progress. Relatedly, if the Hong Kong market can provide risk management products that are related to the onshore capital market, such as bond or equity linked derivatives, it would facilitate international investors' risk management and thus encourage further investment; at the same time, this will contribute to consolidating and uplifting Hong Kong's role as offshore RMB business centre.

Thirdly, in the practical application of capital account management, private enterprises are subject to approval processes involving different departments and bureaux for matters related to their foreign liabilities. These processes affect the efficiency and model of foreign asset allocation by Chinese enterprises. In addition, the Mainland's current foreign investment is mainly carried out through Qualified Domestic Institutional Investors ("QDIIs"), and is subject to a certain quota. Both the channel and the scale of QDIIs are relatively limited and may not be able to fully meet the needs for foreign investment by the Mainland's capital. As China's international financial centre, Hong Kong has an established history of successfully implementing pilot policies. The city can be the appropriate venue for further liberalisation of the Mainland's capital account convertibility, such as through ETF Connect and southbound trading of the Bond Connect, when the optimal time arrives.

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[18] *China Forex 2016 Double Issue 3-4, "Exclusive Interview with GUO Song, Director of the Capital Project Management Department of State Administration of Foreign Exchange".*

Hong Kong’s Insurance-linked Securities Market is yet to be Built

With low correlation with the economic cycle, insurance-linked securities are attractive alternative investment options. However, as insurance-linked securities currently issued in the global market are mainly denominated in USD and EUR, offshore RMB capital cannot participate in such products directly. Hong Kong is at the centre of the Asia-Pacific market, close to Mainland China, Japan, South Korea and Southeast Asian countries; the insurance businesses in these regions are characterised by a large premium base or stable high growth momentum, and are key areas of development for international reinsurance companies. With these in mind, the investment and financing capacity of Hong Kong as an international reinsurance centre can be enhanced by raising funds through issuing insurance-linked securities in Hong Kong. This will also provide additional asset allocation and participation opportunities for offshore RMB capital and, at the same time, enhance Hong Kong's position as an offshore RMB centre and an international reinsurance centre. However, the insurance-linked securities market has yet been built in Hong Kong.

Recently, the Government has introduced the Insurance (Amendment) Bill 2020 into the Legislative Council; the Bill includes registration and regulatory requirements for special purpose insurers (“SPIs”) and provides for a new regulatory regime for the issuance of insurance-linked securities (“ILS”)[19]. Relatedly, one of the 16 measures announced in November 2019 for supporting the development of the GBA is to *“support Mainland insurers to issue catastrophe bonds in Hong Kong and Macao by relaxing the requirements for establishing special purpose insurers.”* [20] Against this backdrop, if the relevant law and regulations can be launched soon, it would provide a more suitable legal environment in Hong Kong to support the operations of special purpose vehicles (“SPVs”) specifically for issuance of insurance-linked securities.

In addition to setting out the legal framework, the Government may also consider referring to the experience of other overseas markets in launching preferential policies to help promote the insurance-linked securities market, such as providing subsidy for issuance fees. For instance, the Singapore government has launched a cost subsidy scheme for eligible insurance-linked bonds issued in Singapore. The Scheme provides a 100% subsidy to issuance-related expenses, with a ceiling of S$2 million (approximately HK$ 11.4 million). A related tax relief plan was also extended, whereby income generated from the trading of a special purpose vehicle established for the issuance of insurance-linked securities would be tax-exempted until 2023. These preferential policies have supported the development of insurance-linked securities in Singapore. For instance, a number of international insurance companies have issued catastrophe bonds, a type of insurance-linked security, in Singapore since 2019. Among them, Insurance Australia Group issued the first catastrophe bond denominated in Australian Dollars in the global market against catastrophic risks in Australia, with a principal of A$75 million.

[19] HKSAR Government, “Insurance (Amendment) Bill 2020 Gazetted”，https://www.info.gov.hk/gia/general/202003/20/P2020 031900598.htm?fontSize=1
[20] HKSAR Government, “CE attends meeting of Leading Group for Development of Guangdong-Hong Kong-Macao Greater Bay Area”, https://www.info.gov-.hk/gia/general/201911/06/P2019110600764.htm?fontSize=1

Hong Kong's Role in the "Belt and Road" can be Further Strengthened

By virtue of its open market environment, rule of law, sound regulatory system in line with international standards and a large pool of financial professionals, Hong Kong has become a financial amplifier in the promotion of the Belt and Road Initiative. In addition to providing funding to the Initiative through different types of funds, such as bonds and equities, Hong Kong may extend its role in the Belt and Road Initiative into other areas.

Firstly, bond issuance is required for project finance under the Belt and Road Initiative. As the world's largest offshore RMB business hub, Hong Kong's Dim Sum Bond market is well developed with sizeable scale, which should be attractive to Belt and Road countries and regions where their domestic bond markets are relatively less developed and incur higher financing costs. Some Belt and Road countries including the UAE, Qatar and Malaysia have issued Dim Sum Bonds before, but the scale and continuity were relatively limited. In this regard, Hong Kong may play a stronger facilitating role in the Belt and Road bond market.

Secondly, listing demands may arise for Belt and Road projects during the construction phase or after completion. As a global leader, Hong Kong's stock market is mature in every aspect and has connection with the Mainland markets and investors through channels such as the two Stock Connect Schemes; these attributes make Hong Kong the ideal place for listing companies with Belt and Road projects. Nevertheless, the relevant asset segment remains immature and offers room for improvement.

Thirdly, Mainland corporates that are interested in investing along the Belt and Road routes will need to conduct a series of cross-border financial activities, including capital transfers, asset transactions, cross-border liquidity management, cross-border holding structure, among others. They may also need to adapt to various types of international standards and require third-party assessment. Hong Kong, as China's international financial centre, can further step up and play an indispensable role in providing cross-border financial and relevant supporting services.

III. Policy Recommendations

We believe that the offshore RMB asset market continues to present significant potentials for further development, which will in turn cement Hong Kong's position as the offshore RMB business hub. Based on expert opinions, suggestions and ongoing initiatives, the FSDC has prepared the following key pragmatic recommendations for relevant stakeholders' consideration. The FSDC suggests that Hong Kong focus on the development in three areas, namely 1) promoting the development of the offshore RMB bond market, 2) enriching offshore RMB investment products, and 3) strengthening RMB corporate financial services.

Promoting the Development of the Offshore RMB Bond Market

Recommendation 1: Develop Hong Kong into a safe and reliable cross-border and cross-system trading, clearing, settlement and custodian centre in the Asian time zone. At the same time, promote further extension and broadening of the risk-controllable channels of the Connect Schemes, and develop Southbound Bond Connect with the CIBM. These measures will strengthen Hong Kong's position as the premier offshore RMB business hub and facilitate the Mainland in achieving full RMB capital account convertibility.

- **To strengthen the collateral management capability of debt securities settlement firms in Hong Kong, which will allow the clearing and settlement of bonds in different currencies including USD, RMB, EUR and others**

  Both major ICSDs, Euroclear and Clearstream, are special purpose bank licensees. As with the current operation of collateral management, these ICSDs can use bonds deposited in their systems by members as collateral to enable bond settlement through the provision of short-term liquidity. Members can settle their bonds in the ICSD via delivery versus payment ("DvP") through a bond account and a multi-currency account. As both of these ICSDs are based in the Eurozone, they can easily provide liquidity in EUR to banks within the region; if necessary, these two ICSDs can also facilitate clients to borrow EUR from local central banks (National Bank of Belgium and Deutsche Bundesbank). As far as USD is concerned, the two ICSDs rely on commercial banks to provide liquidity.

  To provide more efficient collateral management services, multi-currency repo should be provided; this will allow bonds to become more commonly used as collaterals, and thereby providing liquidity more efficiently. The CMU can take reference from the operating model of the two major ICSDs and explore if it should apply for a restricted bank licence from HKMA, and – together with the HKMA – limit and clarify the functions of such a restricted licence, i.e. to only provide bond clearing and settlement services and related businesses. Under such arrangement, the CMU will be able to provide members with a bond account and a multi-currency account at the same time; like other ICSDs, it will be able to provide liquidity by using the bonds deposited by members in the system as collateral to enable the clearing and settlement of bonds by way of DvP.

With regards to operation, the CMU's USD and EUR liquidity can be supported by commercial banks; HKD liquidity can be settled through DvP using central bank money by maintaining an HKD clearing account with the HKMA; the CMU can rely on the Hong Kong offshore RMB market in terms of RMB liquidity.

By turning the CMU into an ICSD in the Asian time zone, it will uplift Hong Kong's financial infrastructure and facilitate development of its bond market. The Government and relevant stakeholders can also consider initiating a feasibility study, exploring the necessity of allowing the CMU to operate as an independent, commercial entity; or encouraging financial institutions to participate and cooperate, with the aim of developing a bond settlement platform that meets the demands of an ICSD in the Asian time zone.

- **To address the southbound investment needs of Bond Connect investors through developing RMB financial infrastructure that is in line with international standards**

When future conditions permit, the Southbound Bond Connect will eventually be launched and become another convenient channel for RMB capital to go global. At the early stage of the Southbound Bond Connect, Mainland investors can trade and hold bonds available in Hong Kong, including (1) bonds that are deposited, cleared and settled in the CMU under the HKMA, and (2) bonds that are listed on the HKEX. In addition, since the CMU already has accounts connected to the two major ICSDs, Mainland investors will be able to trade and hold international bonds outside Hong Kong. Through this arrangement, Mainland residents can allocate assets globally, while the regulatory requirements for attaining transparency and safety can also be met.

Additionally, with the support of post-trade financial infrastructure, operations of the Southbound Bond Connect, including the clearing and settlement processes, may be conducted in a closed-loop manner. In other words, the proceeds of bond investments in the Southbound Bond Connect system can only be used to buy and sell bonds under certain conditions (i.e. bonds cleared and settled in the CMU, or bonds listed on the HKEX). Funds derived from the sale of bonds would need to return to the investor along the original route through the local settlement system. This would ensure that funds involved would not remain in the counterpart's market and thus prevent any capital outflow. All cross-boundary capital flows should be in RMB, while the two-way foreign exchange transactions involving RMB will be completed in the offshore market to minimise the impact on the onshore RMB market and exchange rate. Once the bonds in the closed-loop system originally used as collateral are sold outright, the funds will need to return to the Mainland unless they are used to purchase other eligible bonds; at the same time, the use of the proceeds obtained from such collateral management may also be restricted. In addition, the collateral management in the Southbound Bond Connect can follow the practice in the Mainland (i.e. lien) in order to be more in line with domestic practices in specific functional operations.

In the long term, if the transformation towards full convertibility of RMB capital account requires greater flexibility than the current closed-loop design can offer, it may be worth stakeholders looking at how the application of FinTech (e.g. Blockchain) can facilitate in tracing capital flow and usage; this would likely enhance the distinctive advantages of Hong Kong as a pivotal RMB centre.

Recommendation 2: Promote development of the offshore RMB bond market by nurturing a comprehensive spectrum of offshore RMB bond issuers and developing RMB bond index-linked products. Related RMB assets and services in such areas as foreign exchange hedging, asset management, asset securitisation and risk management should also be further enriched for this purpose.

- **To systematically uplift the breadth and depth of RMB Bond issuers**

  The healthy growth of the offshore RMB bond market in Hong Kong requires balanced development of both investment grade bonds and high yield bonds. It is therefore suggested that the industry and related institutions in Hong Kong should continue to encourage the PBOC, the Ministry of Finance ("MOF") and other high-grade issuers to issue offshore RMB bonds and list them on the HKEX. This is attractive from the perspective of investors who are interested in Mainland Chinese assets, as this arrangement will broaden the product spectrum of RMB-denominated investment products.

  In addition, the Hong Kong SAR Government, regulators and the industry may consider stepping up promotional efforts to encourage top-tier onshore financial institutions and enterprises in industries familiar to international investors to issue RMB-denominated bonds in Hong Kong. Through the trading of their bonds in the inter-bank market, these financial institutions and enterprises will become better known to international investors. At a later stage, the promotion can be extended to offshore RMB-denominated municipal bonds in regions with more advanced economic development. Promotional efforts for the issuance of corporate debentures, as well as bonds backed by "Public Private Partnership" projects, can follow at a later stage. Separately, the Government may encourage quasi-sovereign institutions in Hong Kong, such as the Hong Kong Mortgage Corporation Limited ("HKMC"), to issue more dim sum bonds. The Government may also continue to encourage closer communication between market participants and regulatory authorities to seamlessly push forward the development of the offshore RMB bond market.

  In terms of policy, it is suggested that the Government may consider to continue liaise with the National Development and Reform Commission to establish more flexible application policies for Mainland public and private institutions to issue RMB bonds in Hong Kong. Potential policy considerations could include adopting an aggregate quota, setting up a fast-track approval channel or implementing a post-filing system.

- **To develop RMB bond investment and derivative products**

  When the offshore RMB bond market reaches a certain scale, liquidity and depth, and has formed a relatively stable pricing system, the industry and market organisations (such as index companies) may consider advancing with RMB bond index funds; this will proliferate RMB-denominated bond products and meet investor demand. Furthermore, innovations in derivatives can also make it easier for foreign investors to participate in the Chinese bond market. In this regard, for instance, hedging instruments and derivatives – such as negotiable certificates of deposit, asset-backed securities, repo, bond lending, bond forwards and interest rate swaps contracts – can be considered.

At the same time, in order to attract foreign capital, relevant institutions can encourage international credit rating agencies to play a larger role in the rating and pricing of RMB assets. Along with the national strategy of consumption and industry upgrading, this process can start with securitising higher quality credit assets, such as those with lower default risk, in Hong Kong. The scope of securitisation can be expanded to higher risk assets, such as credit assets of private companies with lower credit ratings[21], under appropriate market conditions.

- **To enrich foreign exchange hedging tools to assist bond investors' risk management**

At present, foreign exchange products offered in the market include forwards, USD / CNH futures and options, RXY RMB currency index, and others. It is suggested that the industry may consider launching a series of futures, options and ETFs by using the HKEX's RXY index as a point of reference. The design of such products may refer to that of the DXY futures, options and ETF products of the Intercontinental Exchange ("ICE") Futures US. The industry can also consider designing bond repo products with terms targeted for hedging RMB exchange rate fluctuations; this arrangement will limit RMB exchange rate risks during the repurchase period.

Enriching Offshore RMB Investment Products

Recommendation 3: Enhance financial innovations in cross-boundary investment and the free trade account system by making use of Hong Kong's role as a 'super-connector' and making the most of the institutional advantages arising from the Connect Schemes. Such innovation should be tailored for the offshore RMB products and services demands from semi-offshore market participants, such as corporates and financial institutions in the Free Trade Zones and the Greater Bay Area.

- **To expand the Connect Schemes to cover more asset classes**

It is suggested that the scope of the Connect Schemes may be further expanded in two directions. Firstly, extension of the Connect Schemes to the primary market may be considered, as it will allow foreign enterprises to issue stocks in the onshore markets under a controllable manner. In reality, the current scope of the Bond Connect has already covered both the primary and secondary markets. Under a similar mechanism, cross-boundary transactions can also be permitted in the primary stock market through the risk controllable channel of Connect Schemes, enabling foreign investors to directly invest in high-quality companies through the IPO processes in the Mainland. Mainland investors can also benefit from the proliferation of higher quality investment choices.

[21] The direct effects of asset securitisation of onshore assets in Hong Kong include: 1) directly expanding the scope of Chinese assets that foreign investors may invest in; 2) helping to vitalise onshore assets, benefiting the financing of the domestic real economy and the consumption upgrading; 3) providing reference for onshore asset securitisation; 4) further attracting onshore capital to participate in Hong Kong's financial market.

Secondly, the product scope of the Connect Schemes may be further expanded to cover other asset classes, including a wide range of international assets that can be invested through the potential ETF Connect and Southbound Bond Connect, providing more options for capital in the Mainland. These products need not be limited to tracking Hong Kong listed securities but also other international assets, especially those in the Asia-Pacific region. Through this mechanism under the broader Connect Schemes, Mainland investors can purchase international products with unique local features that meet their needs (such as global energy and emerging markets) while balancing their risk exposure. At the same time, overseas investors will also be able to invest in different high-quality assets in the Mainland by using Hong Kong as the platform, which will further consolidate Hong Kong's status as an international financial centre.

Thirdly, supporting measures of the Bond Connect may be further optimised and expanded, such as further opening up onshore bond transaction and repo, introducing offshore market makers for the Bond Connect and providing convenient foreign exchange services. These measures would be beneficial to the enhancement of market liquidity.

- **To optimise the free trade account management system of Free Trade Zones to facilitate cross-boundary capital flow**

To establish the dual main account model in the two-way capital pool, it is suggested that banks set up or registered in Free Trade Zones (“FTZs”) should establish a Hong Kong branch or be listed in Hong Kong. The connectivity of the cross-boundary liquidity pool can be strengthened through collaboration in RMB loans under the free trade accounts and streamlining procedures for RMB settlement between the free trade account and its Hong Kong branch. This will enhance the efficiency and facilitate fund transfers between the accounts set up in the FTZ and that in the Hong Kong branch belonging to the same customer.

In addition, it is suggested to further encourage urban commercial banks located in FTZs to set up representative offices in Hong Kong or even apply to operate as a restricted licence bank, thereby strengthening collaboration between Hong Kong and onshore institutions. Through arrangements such as these, financial institutions in Hong Kong can have more partners with close ties for the provision of financial services to enterprises in these FTZs, as well as the rest of the Mainland. Banks in Hong Kong may also be encouraged to actively begin derivatives transactions with banks in the FTZs to fully maximise Hong Kong’s strengths in offshore risk management practices; with Hong Kong’s advantages in terms of categories and pricing of derivatives, the collaboration makes an effective complement to the Non-Resident Account (NRA) in the Mainland.

- **To promote investment in RMB-denominated non-publicly traded assets**

  The Government, together with relevant Mainland authorities, can further explore the feasibility of allowing cross-boundary transaction of non-publicly traded assets among corporates in Hong Kong and Qianhai FTZ and to provide further clarification on relating regulations. Measures such as streamlining the approval and operational procedures of those transactions can be considered. Through such development, the industry can offer more diversified RMB assets, such as RMB-denominated alternative investments, and senior tranches of private equity funds with alternative assets as underlying assets. As the Qianhai Financial Asset Exchange has already been providing certain innovative financial services, Hong Kong may increase cooperation with the Qianhai FTZ to provide a cross-boundary trading platform and services for these assets. Market participants believe cross-boundary transactions of non-publicly traded assets offer significant business potentials for Hong Kong and overseas financial institutions. These transactions can also expand the range of Hong Kong's RMB businesses and diversify source of income. This recommendation will also encourage more Hong Kong asset management companies to launch private equity funds linked to cross-boundary transactions of non-publicly traded assets. As a result, capital with greater risk appetite will be attracted to Hong Kong.

- **To establish an RMB Mega Fund**

  On the other hand, internationally renowned bond index companies and investment banks have gradually recognised the importance of the Chinese bond market. With the inclusion of RMB into the SDR basket of the IMF, the demand for RMB-denominated assets by overseas investors, including central banks, will continue to rise. Hong Kong can utilise this trend and refer to the successful experience of the Tracker Fund of Hong Kong to establish an RMB Mega Fund. As it is noted that more mature mega funds in the market (such as the Asian Bond Fund[22]) are set up or funded by governments or central banks, it is recommended that the Government or other public institutions, in collaboration with relevant financial firms, conduct a feasibility study on establishing an RMB-denominated Mega Fund in Hong Kong. This should cover aspects including but not limited to investment tools, strategies and management matters. If practical, the participating financial institutions could make funding contributions by setting aside a certain portion of their existing investment portfolios as seed money to set up the world's first RMB Mega Fund. At the same time, the fund can seek policy support from the Mainland regulatory authorities on investment quotas or investment channels. The Mega Fund can potentially provide a highly liquid, convenient and safe RMB asset allocation option for idle global RMB capital. This can help attract global offshore RMB funds to Hong Kong, further enhancing Hong Kong's offshore RMB business hub status. The success of the fund may rely on relevant policy and market developments (e.g. bringing more RMB-denominated products). Additionally, it is expected that the establishment of the Mega Fund will vitalise the investment options of the offshore RMB liquidity pool and help promote RMB internationalisation. The Mega Fund is expected to mainly invest in the onshore bond market through the Bond Connect, which will in turn become more active. The HKMC can also consider issuing RMB-denominated annuity in a similar manner to that of HKD-denominated annuity. While the demand for such annuity product remains unclear, the FSDC believes that a pilot scheme would allow the Government and the industry to gauge the feasibility of broadening the usage of offshore RMB through such schemes.

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[22] *The Asian Bond Fund was launched in 2003 by the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP, a co-operative organisation comprising central banks and monetary authorities of 11 economies: Australia, Mainland China, Hong Kong SAR, Indonesia, Japan, South Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand), with an initial size of about US$ 1 billion. The mandate of the Asian Bond Fund was to further development in the regional bond market, through investing in a basket of USD-denominated bonds issued by major Asian economies. "HKMA welcomes the launch of the Asian Bond Fund", https://www.hkma.gov.hk/eng/news-and-media/press-releases/2003/06/20030602-3/*

Recommendation 4: Establish Hong Kong's local insurance-linked securities market, and accelerate the creation of supporting regulations and preferential policies, which will broaden the range of RMB offshore assets available in Hong Kong.

It is suggested that the Government may lead the industry by establishing a local insurance-linked securities market in Hong Kong. Such a market will not only be able to attract relevant entities to issue RMB-denominated products in Hong Kong but also to enrich the types of offshore RMB assets traded in Hong Kong and expand the trading scale. In addition, it will provide more asset allocation options for offshore RMB funds and enhance Hong Kong's position as an offshore RMB centre and an international reinsurance centre.

Drawing references from international experience, the Government may consider introducing preferential policies to encourage Hong Kong to develop insurance-linked securities, such as a cost subsidy programme and a tax relief plan. In principle, any SPI established for the purpose of issuing insurance-linked securities is to be exempt from profit tax on the income generated in its course of operation. Anti-tax avoidance clauses should be included in the plan for the healthy development of the market. The Government can also formulate operational guidelines for insurance-linked securities to improve the regulatory mechanism and clarify operational processes; these guidelines can help regulate organisation structure, entry qualifications, risk portfolios, sources of income and methods of distribution. In the meantime, the Government can also consider accelerating the legal amendment process for SPIs and introducing related pieces of ordinance related to insurance-linked securities; this should speed up the introduction of insurance-linked securities in Hong Kong. In view of enhancing Hong Kong's status as an offshore RMB business hub, the provision of additional preferential treatments for RMB-denominated insurance-linked securities is recommended.

Strengthening RMB Corporate Financial Services

Recommendation 5: Strengthen Hong Kong’s pivotal role in the Belt and Road Initiative by providing liquidity for RMB capital and asset transactions. Hong Kong should also leverage its internationalised professional and third-party accreditation services to promote itself as a hub for regional headquarters while aligning Mainland China’s green RMB assets with international standards.

- **To provide various types of RMB liquidity for Belt and Road Initiatives**

  The countries and regions along the Belt and Road, such as Malaysia and the UAE, have close business relations with the Mainland. In addition, as Belt and Road projects involve the participation of many Chinese enterprises, the Belt and Road Initiative as a whole creates significant demand for RMB and relevant financing needs. As a leading international financial centre and the largest offshore RMB business hub in the world, Hong Kong is connected to the global capital market and investors in various fields; at the same time, the cost of capital is relatively low. Against this background, it is recommended that the Government and relevant bodies may encourage the industry to increase promotion of Hong Kong’s value proposition as an ideal market for dim sum bond issuance in Belt and Road countries. Attention should be given to those markets that have demand for RMB capital and where the local financing cost is higher than that of Hong Kong. At the same time, the industry may make the most of Hong Kong's role along the Belt and Road by providing different types of RMB financial services such as bond issuance, equity financing and asset securitisation, among others. Risk management tools which could ensure the efficiency of the transaction, transfer and price setting of Belt and Road projects; would be essential to the promotion of the use of RMB in Belt and Road projects.

- **To make the most of Hong Kong's international professional services and third-party evaluation functions and promote the development of regional headquarters and green finance**

  Hong Kong has developed a rich financial ecosystem around the international investment and financing business, and it is poised to provide international professional services – such as mergers and acquisitions, reorganisation, international holding, equity allocation – for Belt and Road projects. Hong Kong can attract more of these enterprises to set up international operation centres and regional headquarters for the Belt and Road operations in Hong Kong by strengthening existing tax incentives.

  At the same time, Hong Kong should leverage its strengths in third-party assessment, by providing certification services that are in line with international standards for green financing projects in the Mainland and along the Belt and Road regions. This can improve information disclosure of green projects throughout Mainland China and the Belt and Road countries, which will help align standards of green RMB assets. Hong Kong can also help promote green projects with Chinese features to international organisations and provide support for cross-boundary financing, transaction and custody of green RMB assets.

- **To develop RMB liquidity management products fitting the needs of corporate treasury centres ("CTCs") and cross-border capital pools**

  To enable Hong Kong to develop into a treasury and settlement centre, it is recommended that financial institutions in Hong Kong could develop RMB liquidity management tools and products that fit the needs of CTCs and cross-border capital pools. Allowing onshore and offshore capital within the close-loop system of the cross-border two-way capital pools to purchase liquidity management products developed by Hong Kong's financial institutions can also be considered. Such a policy can support the development and enhancement of the overall RMB asset management market in Hong Kong.

  This recommendation may appear to compete with the free trade account of the Shanghai FTZ, as otherwise the capital will be pooled in the onshore free trade account in Shanghai. However, considering the convenience and taxation in practice, Hong Kong's advantages as a corporate treasury centre for Chinese enterprises remain intact. Therefore, combining the advantages of Hong Kong and Shanghai effectively and exploring the management model of dual main accounts can lead to a win-win solution. Meanwhile, with a higher RMB settlement volume and concentration of RMB CTCs, financial institutions in Hong Kong should invest more resources in the development of RMB-denominated asset management products. Liquidity management products can be used as a starting point; the next step would be to further enhance the supply of RMB asset management products through the Bond Connect and other tools.

  The Government and the HKMA may continue to promote the development of CTCs, in particular by focusing on cooperation with Mainland Chinese banks. Their promotions may target enterprises that have already set up RMB two-way cross-border capital pools in various FTZs. Through setting up CTCs in Hong Kong and factoring or leasing companies in various FTZs, the CTCs can be used as a capital hub for enterprises to cover and support business development in the Greater China region. The HKEX should work hand in hand with asset management firms to promote the development of RMB-denominated ETF money market products. The HKEX should also work with the HKMA and the SFC to create an ecosystem for the asset management industry that supports CTC development.

Conclusion

As the world's leading offshore RMB business hub, Hong Kong plays an important role in the further reform and opening up of the Chinese financial markets. In the process of RMB internationalisation, the offshore RMB asset market has great potential for future development. The financial services industry in Hong Kong can actively make the most of these opportunities to grow their own business as well as consolidate Hong Kong's leadership in the offshore RMB market.

After years of development, the offshore RMB market in Hong Kong has reached a new stage of development, with some low-hanging fruits having already been seized. If it is to develop further, Hong Kong will need to better tackle existing challenges and make the most of existing opportunities, and strategically enhance the offshore RMB market.

Based on expert opinions and ongoing initiatives, the FSDC proposes policy recommendations with a focus on three development areas, namely 1) promoting the development of the offshore RMB bond market, 2) enriching offshore RMB investment products, and 3) strengthening RMB corporate financial services. Through driving these strategic focuses, the Hong Kong offshore RMB asset market can be elevated to the next level.

About the Financial Services Development Council

The Hong Kong SAR Government announced in January 2013 the establishment of the Financial Services Development Council (FSDC) as a high-level and cross-sector platform to engage the industry and formulate proposals to promote the further development of Hong Kong's financial services industry and map out the strategic direction for development. The FSDC advises the Government on areas related to diversifying the financial services industry, enhancing Hong Kong's position and functions as an international financial centre of our country and in the region, and further consolidating our competitiveness through leveraging the Mainland to become more global.

Contact us

Email: enquiry@fsdc.org.hk
Tel: (852) 2493 1313
Website: www.fsdc.org.hk