

An offshore RMB market – The Hong Kong story Keynote speech 4th Offshore RMB Markets Conference

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Ladies and gentlemen

I would like to thank the organiser for inviting me here today. I am delighted to have the opportunity to speak about Hong Kong's role as an offshore renminbi (RMB) market in the process of RMB internationalisation.

As the world's pre-eminent offshore RMB centre, as well as the global hub for both RMB trade settlement and offshore RMB financing and RMB wealth management, Hong Kong continues to play an important role in facilitating the transformation of the RMB into an internationally accepted and widely used currency. As you know, RMB business is one of Hong Kong's strengths.

The prospect of the Mainland further opening its markets is an area that the world follows with intense interest; everyone is hoping to find out what will be next. Winston Churchill once said "the farther backward you can look, the farther forward you are likely to see." The same would hold true if you were to talk to the Chinese leaders you would be struck by their intense interest in history, because they all believe that in history they can draw the inspiration for the way forward.

With that in mind, I would like to share some thoughts on Hong Kong's unique relationship with the Mainland in the reform and opening up of her financial markets. I will then offer some ideas on the way forward on the development of offshore RMB markets and how the different offshore RMB centres can work together.

Hong Kong's role in the Mainland's reform and opening up process

Hong Kong enjoys a unique position of strength in developing its offshore RMB business, thanks to a number of key factors rooted close to home. Indeed, Hong Kong is both an international market and an offshore market of China, where the Chinese Central Government can experiment with policies and reform initiatives, with full confidence that those policies and reform initiatives will be tested with the utmost rigour, and be subject to intense external scrutiny.

Hong Kong is China's natural global financial centre for very good reasons - Hong Kong has been deeply involved in the Mainland's financial liberalisation since the late 1970's.



Economic reform and opening-up in 1978

Let me share with you the story of how the Hong Kong-Mainland partnership helped the Mainland implement financial market reform and open up its economy. This process broadly consists of two phases. The emphasis of the first phase of the journey was on “going in”.

Hong Kong’s close cooperation and partnership with the Mainland in developing various solutions for the reform and development of its financial markets date as far back as 1978 – the year when the Mainland began to implement its policy of “reform and opening-up”.

The Chinese government wanted to expand rural income and incentives, encourage experiments in enterprise autonomy, reduce central planning, and promote foreign direct investment (FDI) on the Mainland. In this context, Hong Kong was the first to reach out, to collaborate with and assist the Mainland.

Today, it should come as no surprise that Hong Kong is the number one contributor of FDI on the Mainland. Between January and December 2013, Hong Kong ranked first out of the top ten nations and regions, with investment in the Mainland at US\$78.3 billion¹.

Hong Kong as the premier fundraising centre for Mainland enterprises²

By the 1990s, Mainland China needed to attract international capital for modernisation and reform its state-owned enterprises. But how was the Mainland going to bridge the obvious credibility gap that existed at that time so that it could tap international capital? Who would be brave enough to take the first step to invest in companies listed on the two fledging stock exchanges in Shanghai and Shenzhen?

Well, Hong Kong was the first to seize the opportunity. We came up with a strategy to help Mainland state-owned enterprises access much needed capital. The strategy involved putting in place the necessary regulatory infrastructure for Chinese state-owned enterprises to list in Hong Kong.

In June 1993, the Stock Exchange of Hong Kong (SEHK) announced amendments to the Listing Rules to allow listing of state enterprises in Hong Kong followed by a Memorandum of Understanding (MoU) on regulatory cooperation signed between the Hong Kong regulators (Securities and Futures Commission (SFC) and SEHK) and the China Securities Regulatory Commission (CSRC), Shanghai Stock Exchange, and Shenzhen Stock Exchange. This formally opened the door for Mainland Chinese companies to list in Hong Kong.

In less than a month from the signing of the MoU, the shares of Tsingtao Brewery began trading, and the second batch of approvals for listing of H-shares in Hong Kong was announced in January 1994, consisting of 22 companies. Since the listing of the first

¹ From January to December this year, the top ten nations and regions with investment in the Mainland (as per the actual input of foreign capital) are as follows: Hong Kong (US\$78.302 billion), Singapore (US\$7.327 billion), Japan (US\$7.064 billion), Taiwan (US\$5.246 billion), USA (US\$3.353 billion), Republic of Korea (US\$3.059 billion), Germany (US\$2.095 billion), Holland (US\$1.281 billion), UK (US\$1.039 billion) and France (US\$762 million), total of which accounted for 93.15% of total actual use of foreign investment in the country (2012: US\$71.289 billion; 2011: US\$77.011 billion; 2010: US\$67.474 billion). Source: <http://english.mofcom.gov.cn/article/statistic/foreigninvestment/201402/20140200498911.shtml>

² http://www.hkex.com.hk/eng/newsconsul/hkexnews/2013/Documents/Fact%20Sheet_20th%20H%20shares.pdf



Mainland enterprises in Hong Kong in 1993, Mainland enterprises (H-shares and red chips) have raised a total of \$2.9 trillion from the Hong Kong stock market³.

The benefits were hardly one way. Mainland companies have contributed hugely to the Hong Kong securities market. As of end Jan 2014, the total market capitalisation of Mainland enterprises accounted for 56.6% of the total Hong Kong market and contributed to 69.8% of equity turnover⁴.

As a result, Hong Kong's market has grown in terms of its sphere of influence and attractiveness; we have been able to attract and keep international institutions, talent and capital flowing into Hong Kong. Hong Kong has also become a main source of advanced technology and modern management, and a provider of rigorous market discipline for Mainland enterprises.

Hong Kong's commitment to an open market and fair competition, our strong regulatory institutions that uphold the rule of law, and an open economy with free capital and information flows provides certainty, stability and a level playing field, all of which form the foundations of our success as an international financial centre. Today, Hong Kong is the undisputed premier destination for Mainland enterprises seeking to build international recognition and a solid first step onto the global stage.

More heavy-weight Mainland financial intermediaries coming to establish business in Hong Kong

In the last 10 years, the emphasis has shifted to the second phase, which can be described simply as "going out". After China joined the World Trade Organization in 2003, Mainland financial institutions had to face direct competition from international financial firms. I recall Mainland authorities asked us for individual responses on the best way it could prepare for this. In response, I shared my view that these Mainland securities firms and fund managers needed an open and international environment to develop their expertise. I believed that if the Mainland wanted its financial intermediaries to mature, it must allow them to learn from an open market where they would be subject to the rigour and discipline of international standards and regulations. Since the Mainland Chinese capital market is yet to be fully opened, they should come to Hong Kong to compete with the best and the brightest. This was what we had in mind when we designed the different initiatives under the Mainland and Hong Kong Closer Economic Partnership Arrangement umbrella.

As China takes its place as one the world's largest economies, every financial market in the world is competing for the attention and business of Mainland financial intermediaries. We are very fortunate that because of the strategic value we offer and the unique relationship that we enjoy with the Mainland, these Mainland intermediaries have chosen to use Hong Kong as their springboard to the world. From the Hong Kong perspective, given that China was destined to be a global player, and if Hong Kong wanted to maintain its standing as a global financial centre, it makes perfect sense that we would need to have major players from all over the world, including Mainland financial institutions.

Mainland financial institutions have since become an integral part of the Hong Kong market. The numbers speak for themselves.

³ http://www.hkex.com.hk/eng/newsconsul/hkexnews/2013/Documents/Fact%20Sheet_20th%20H%20shares.pdf

⁴ <http://www.hkex.com.hk/eng/stat/statrpt/mkthl/mkthl201401.htm>



- By the end of October 2013, a total of 78 companies with a Mainland background have set up 207 SFC-licensed corporations in Hong Kong. In Hong Kong, about 62% of the new licences granted by the SFC in 2013 are asset management licences. About 13% of these are granted to Mainland background asset management firms.
- During 2013, the market share of PRC-related SEHK participants (parent companies of which are under supervision of the CSRC or other PRC regulators) was around 11% of the total turnover.
- Out of 27 mega initial public offering transactions (ie, where market capitalisation was in excess of \$10 billion) in the past 24 months (up to 28 February 2014), Mainland sponsors were involved in 14 of them (51.9%).

Hong Kong as an international wealth management centre and the development of RMB business in Hong Kong

Around 2009, the Mainland Central Government began actively promoting the international use of its currency outside its borders. Hong Kong was the logical choice as a testing ground for reforms and measures to open up avenues for trading and investment in RMB. The National 12th Five-year Plan (2011-2015) clearly stated the intention was for Hong Kong to develop into an offshore RMB centre and an international asset management centre.

That said, our part in the RMB story began much earlier. Hong Kong and the Mainland began discussions as early as 2002 on developing RMB business in Hong Kong. In December 2003, the Hong Kong Monetary Authority announced that Bank of China (Hong Kong) Limited was appointed as the clearing bank for RMB business in Hong Kong. Following approval from the State Council, the People's Bank of China (PBoC) in November agreed to provide clearing arrangements for personal RMB business in Hong Kong. This included deposit-taking, exchange, and remittances⁵.

RMB deposit growth in Hong Kong remained slow until 2009, when direct settlement of RMB transactions for cross-border trade began in Hong Kong. We received a further boost in 2010, when the PBoC allowed companies in Hong Kong to open and use RMB accounts for any purpose, and not just for trade settlement. We have not looked back since. At the end of last year, RMB deposits and outstanding RMB certificates of deposits totaled more than RMB1 trillion, accounting for 70% of the offshore pool of RMB liquidity.

The development of Hong Kong's Dim Sum bond market is also closely linked to the overall liberalisation of the RMB. In July 2007, China Development Bank issued the first CNY-denominated bond with an amount of RMB5 billion and a tenor of two years. Soon, other Chinese banks, state-owned enterprises, Hong Kong banks and corporations, and foreign corporations began to follow suit.

Another significant milestone was the issuance of the first RMB sovereign bond by the Ministry of Finance in Hong Kong in September 2009 (and again in June 2012). Since 2009, the Ministry of Finance has continued to issue sovereign bonds in Hong Kong every year, amounting to RMB80 billion. Last year, they issued sovereign bonds in Hong Kong twice, totaling RMB23 billion, and offered for the first time sovereign bonds of 30-year tenor. This demonstrates the Mainland Central Government's regularisation of the issuance of RMB sovereign bonds in Hong Kong.

⁵ <http://www.hkma.gov.hk/eng/key-information/press-releases/2003/20031224-3.shtml>



Development of the RQFII scheme

The success story of the Hong Kong-Mainland partnership would not be complete without understanding the inception and development of the Renminbi Qualified Foreign Institutional Investor (RQFII) scheme, which was launched in December 2011. There is a lot of excitement surrounding the RQFII. It has given some RQFII managers almost instant fame. Originally devised and proposed by Hong Kong, this rather simple concept has further evolved to a well recognised scheme with a broad range of RMB products, giving Hong Kong a wider lead as an offshore RMB centre.

So much magic appears to rest on the brand. Yet, as a concept, it is actually very simple. It is, simply, a Qualified Foreign Institutional Investor (QFII). China has been giving QFII quotas to different types of institutions like banks and institutional investors around the world since 2003.

What sets the RQFII apart from the regular QFII is that we saw that the QFII could be used to help RMB internationalise, so we asked for a QFII in RMB, to be given to Hong Kong-based asset managers so that they could use the Hong Kong asset management platform to create RMB investment products for investors worldwide. It has always been clear to us that for the RMB to become truly international, it must be widely used outside the Mainland for payment, for investment, and ultimately, as a vehicle for holding value. The RQFII could significantly help to drive the international use of RMB for investments.

In mid-2010, the SFC began discussions with Mainland authorities on how to structure the RMB QFII. This ambitious year-long project involved multiple Mainland authorities, and touched on a large number of complex issues, including foreign access to the Mainland capital markets, cross-border RMB flow and the use of RMB outside the Mainland. In the end, the final decision was to pilot the RQFII scheme on a small scale, ie, it would only be opened to Hong Kong licensed asset management subsidiaries of Mainland fund houses and securities companies. A modest initial quota of RMB20 billion was granted. Today, the total quota has increased to RMB270 billion.

All in all, the RQFII has been a success story and has grown from strength to strength. Our thesis has been vindicated by the success of the RQFII. Today, every aspiring offshore RMB centre wants a piece of the RQFII quota.

Summing up / Looking ahead

We have grown together with the Mainland, and continue to do so under the “one country, two systems” framework. The foundations of this historic and strategic relationship are firmly rooted in the mutual trust and confidence we share, and the result of years of bold experimentations and meticulous risk management to achieve the level of integration between the Hong Kong and Mainland markets that we now enjoy.

Although the liberalisation of the Mainland China economy, in particular, the internationalisation of the RMB through relaxing exchange and capital controls, has generated numerous growth opportunities for Hong Kong, it has also created challenges and uncertainties. With improved market infrastructure and governance in the Mainland market, the gap between Hong Kong and Mainland financial centres is narrowing. In particular, Shanghai has been earmarked to become an international financial centre by 2020 and the recently established Free Trade Zone indicates that some of the market liberalisation measures may first be tested there.



Many of you will no doubt have noticed that China has begun exporting RMB business to other financial centres, all with aspirations to have a bigger role in the unfolding of the global RMB story. We welcome the emergence of this trend.

We do not consider that Hong Kong has the sole, imperative right to develop offshore RMB business. The RMB story is not just a Hong Kong story. In fact, it is not even just a China story. It is a global story. Competition has always been the key driver for innovation and growth. It is during times of intense competition where Hong Kong shines brightest. I believe that firms and market participants will continue to turn to the expertise and experience in Hong Kong. What we need to do is to ensure that Hong Kong's platform continues to be robust and effective, and I am confident we have and will continue to develop sufficient expertise in Hong Kong for us to capture new opportunities as they emerge.

The offshore RMB business is not a zero sum game. With an increasing percentage of trade settled in RMB, the global pool of offshore RMB will continue to grow and generate businesses for financial centres around the world. Different financial centres can contribute to the growth of this pie, from which everyone can benefit.

In fact, I believe that there can and should be increased interaction amongst different financial centres - to identify strategic areas for collaboration and to explore, together, ways to support the overall growth and development of the wider offshore RMB market.

Thank you and I wish you all a successful conference.

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