

File Reference: G6/123/5C

LEGISLATIVE COUNCIL BRIEF
GOVERNMENT BOND PROGRAMME

INTRODUCTION

At the meeting of the Executive Council on 28 April 2009, the Council ADVISED and the Chief Executive ORDERED that –

- (a) the proposed Government Bond Programme (“the Programme”) be implemented; and
- (b) the Resolutions at Annexes A and B, which seek to authorize the Government to borrow and to set up a fund for the purpose of managing sums raised under the Programme respectively, should be introduced into the Legislative Council (“LegCo”).

BACKGROUND

2. In his 2009-10 Budget Speech, the Financial Secretary announced that to promote the further and sustainable development of our bond market, the Government intends to implement a programme to issue government bonds. The sums raised will be credited to a fund to be established under the Public Finance Ordinance. The fund will not be treated as part of the fiscal reserves and will be managed separately. Market views on the details of the bond programme will be sought and necessary adjustments will be made at the implementation stage having regard to market needs.

FRAMEWORK OF THE PROGRAMME

3. As stated in the Budget, the Programme’s primary objective is to promote the further and sustainable development of the local bond market. The Programme will also help promote financial stability by developing an alternative channel for financial intermediation. For the Programme to achieve these objectives, the overall issuance size should take account of the long-term nature of the Programme and provide enough room for the public debt market to grow into a critical mass, such that it can better attract investors and help

promote market development.

4. We propose that the borrowing ceiling, which refers to the maximum amount of outstanding principal (i.e. principal amount of bonds issued minus that of bonds redeemed) at any time under the Programme, be set at HK\$100 billion. The proposed ceiling represents a long-term target over a period of five to ten years. Given the on-going nature of the Programme, the proposed ceiling should give the Government the flexibility required for making necessary adjustments to the issuance size and tenor of individual tranches in response to prevailing market conditions. In this connection, we will seek LegCo's approval for a resolution under section 3 of the Loans Ordinance to authorize the Government to borrow up to the proposed limit of HK\$100 billion (see paragraph 14 below).

5. Given the primary objective of the Programme to promote the development of the local bond market, it is proposed that bonds to be issued under the Programme will mainly be denominated in Hong Kong Dollar. The Programme will comprise bond issues for institutional and retail investors respectively. For a diversified tenor mix and to meet market demand, bonds of tenors within the range of two to ten years will likely be issued at the initial stage of the Programme. Over the long term, consideration will be given to issuing bonds with longer tenors (say, 15 years or longer) so as to enable the Programme to develop a more complete yield curve. In addition, arrangements will be made to seek listing status for the bonds to be issued under the Programme.

6. Views from major market participants indicate that the market may be able to digest government bonds of HK\$10-20 billion over the course of a year. We will solicit further market views and conduct a more detailed assessment with a view to determining the appropriate issuance size for the first year of Programme implementation. In the process, due consideration will be given to the prevailing market conditions and impacts on other issuers in the market.

7. Sums raised under the Programme (less for example expenses deducted at source) will be credited to a fund ("Bond Fund") to be established under the Public Finance Ordinance. The Bond Fund will not be treated as part of the fiscal reserves and will be managed separately from the general revenue. It will be used to repay principal, meet the financial obligations and liabilities associated with the Programme and make investments. If there is a positive balance in the Bond Fund after all financial obligations and liabilities are met in relation to the Programme, the surplus funds may be transferred to the general revenue. Any shortfall of funds for fulfilling the financial obligations and liabilities in respect of the Programme may be financed from the

general revenue in accordance with the Loans Ordinance. We will seek LegCo's approval for a resolution under section 29 of the Public Finance Ordinance for the establishment of the Bond Fund (see paragraph 13 below).

8. A long-term and conservative investment strategy will be adopted for the Bond Fund with the objectives of preserving capital and generating reasonable investment returns for covering the financial obligations and liabilities under the Programme. The Hong Kong Monetary Authority ("HKMA") will be tasked to manage the Bond Fund, and the same "fixed rate" sharing arrangement for investment income applicable to the fiscal reserves will apply to the Bond Fund. In other words, the investment income to be paid by the HKMA on the Bond Fund for a year will be calculated on the basis of the average rate of return of the Exchange Fund's investment portfolio over the past six years or the average annual yield of three-year Exchange Fund Notes for the previous year, whichever is the higher. The rate for 2009 is 6.8%.

9. The HKMA will be tasked to assist the Government in coordinating the offering of the bonds under the Programme. In so doing, it will engage banks and/or financial institutions as primary dealers for offering bonds for institutional investors, co-arrangers for managing and offering of retail bonds, and placing institutions for distributing bonds to retail investors, etc., to provide the necessary assistance in implementing the Programme. Expenses arising from the procurement of the relevant services by the HKMA will be met by the Bond Fund.

THE RESOLUTIONS

10. Section 3(1) of the Loans Ordinance stipulates that the Government may, in such manner and on such terms and subject to such conditions as may be agreed between the Government and any person, borrow from such person such sum or sums and for such purposes as may be approved by resolution of the LegCo.

11. Section 29(1) of the Public Finance Ordinance provides that the LegCo may by resolution provide for the establishment of funds to which moneys appropriated for the purpose, and such other moneys received for the purposes of the Government as may be specified in the resolution, may be credited and from which moneys may, under the authority of a funds warrant issued by the Financial Secretary, be expended for the purposes for which the funds were established subject to such conditions, exceptions and limitations as may be specified in the resolution.

12. We will seek LegCo's approval for a Resolution each under section 29 of the Public Finance Ordinance and section 3 of the Loans Ordinance respectively for implementation of the Programme. The Department of Justice has advised that the Resolution under section 29 of the Public Finance Ordinance should be passed by LegCo before the latter's approval is sought for the Resolution under section 3 of the Loans Ordinance.

13. The purpose of the Resolution under section 29 of the Public Finance Ordinance is to establish the Bond Fund for the management of the sums raised under the Programme (see paragraphs 7-8 above).

14. The purpose of the Resolution under section 3 of the Loans Ordinance is to authorize the Government to borrow for the purposes of the Bond Fund such sums not exceeding in total HK\$100 billion or equivalent, being the maximum amount of all borrowings under the authorization that may be outstanding by way of principal at any time. The Resolution requires that sums borrowed (less for example expenses deducted at source) be credited to the Bond Fund (see paragraph 4 above).

LEGISLATIVE TIMETABLE

15. The tentative legislative timetable is as follows -

Moving the resolutions in LegCo	20 May 2009
Publication in the Gazette and commencement	29 May 2009

IMPLICATIONS OF THE PROPOSAL

16. The proposal has economic, financial, and sustainability implications as set out in Annex C. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. The resolutions at Annexes A and B will not affect the current binding effect of the Loans Ordinance and Public Finance Ordinance. The proposal has no civil service, productivity or environmental implications.

PUBLIC CONSULTATION

17. We have solicited the views of major market practitioners on the relevant details of the Programme, including the size of the programme and individual issues, tenor, denomination, frequency of issue, target clientele, etc. We will take into account their views in hammering out the relevant details.

18. We plan to consult the Panel on Financial Affairs at its meeting on 4 May 2009 before moving the two Resolutions in LegCo.

PUBLICITY

19. A press release will be issued. Also, a spokesman will be available to handle media enquiries.

ENQUIRIES

20. Enquiries on this brief may be directed to Miss Natalie Li, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) at 2529 0121, and Miss Ann Chan, Principal Assistant Secretary for Financial Services and the Treasury (Treasury) at 2810 3743.

Financial Services and the Treasury Bureau
28 April 2009

LOANS ORDINANCE

RESOLUTION OF THE LEGISLATIVE COUNCIL

Resolution made and passed by the Legislative Council under section 3 of the Loans Ordinance (Cap. 61) on 2009.

RESOLVED that –

- (a) the Government be authorized to borrow from any person from time to time for the purposes of the Bond Fund established by a resolution made and passed under section 29 of the Public Finance Ordinance (Cap. 2) such sums not exceeding in total \$100 billion or equivalent, being the maximum amount of all borrowings made under this paragraph that may be outstanding by way of principal at any time; and
- (b) sums borrowed under paragraph (a) are to be credited to the Bond Fund.

Clerk to the Legislative Council

2009

Explanatory Note

This Resolution relates to the proposal in the 2009-2010 Budget to promote the further development of the bond market in Hong Kong.

2. This Resolution authorizes the Government to borrow for the purposes of the Bond Fund such sums not exceeding in total \$100 billion or equivalent, being the maximum amount of all borrowings under the authorization that may be outstanding by way of principal at any time, and requires that the sums be credited to the Bond Fund.

PUBLIC FINANCE ORDINANCE

RESOLUTION OF THE LEGISLATIVE COUNCIL

Resolution made and passed by the Legislative Council under section 29 of the Public Finance Ordinance (Cap. 2) on 2009.

RESOLVED that –

- (a) there is established a fund to be known as the "Bond Fund" in English and "債券基金" in Chinese;
- (b) the Fund is to be administered by the Financial Secretary, who may direct or authorize other public officers to administer the Fund and delegate the power of administration to other public officers;
- (c) the following are to be credited to the Fund –
 - (i) sums borrowed under section 3 of the Loans Ordinance (Cap. 61) that are required to be credited to the Fund by any resolution of the Legislative Council approving the borrowing;
 - (ii) sums received by way of interest, dividends or investment income earned in respect of the sums held in the Fund;
 - (iii) any appropriations from the general revenue that may be approved by the Legislative Council;
 - (iv) any other sums that may be received for the purposes of

the Fund;

- (d) earnings from interest or dividends on investments of the Fund are to be retained for the purposes of the Fund;
- (e) the Financial Secretary may expend money from the Fund for the purposes of –
 - (i) repaying or, if appropriate, paying the principal of, interest on, and expenses incurred in relation to, any sums that have been borrowed under section 3 of the Loans Ordinance (Cap. 61) for the purposes of the Fund; and
 - (ii) investing in the manner the Financial Secretary may determine, and paying the expenses incurred in relation to the investments;
- (f) the Director of Accounting Services, under the authority of a funds warrant issued by the Financial Secretary, is to pay from the Fund any sums that may be required to meet expenditures from the Fund; and
- (g) the Financial Secretary may transfer from the Fund to the general revenue the balance held in the Fund, if so approved by the Legislative Council, when all financial obligations and liabilities are met in relation to any sums that have been borrowed under section 3 of the Loans Ordinance (Cap. 61) for the purposes of the Fund.

2009

Explanatory Note

This Resolution relates to the proposal in the 2009-2010 Budget to promote the further development of the bond market in Hong Kong.

2. This Resolution establishes a fund known as the Bond Fund ("the Fund"). The Fund will be administered by the Financial Secretary or public officers under the Financial Secretary's authority. The Fund will have sums borrowed under section 3 of the Loans Ordinance (Cap. 61) ("the loans"), sums received by the Fund by way of interest, dividends or investment income, appropriations from the general revenue, and any other sums received for the purposes of the Fund. Earnings from interest or dividends on investments of the Fund will be retained in the Fund. The Fund will be used to repay the loans, meet related financial obligations and liabilities, and make investments. If the Fund has a positive balance after all financial obligations and liabilities are met in relation to the loans, the surplus funds may be transferred to the general revenue.

Economic implications

The Programme will promote the further and sustainable development of the local bond market. The development of bond market could supplement the other two channels of financial intermediation – equity and banking – to facilitate more efficient allocation of capital and flow of funds, thereby promoting economic growth and financial stability. It will also enhance Hong Kong's development as an international financial centre.

Financial implications

2. Given that the Bond Fund will be managed separately from the government accounts, the financial implications to be brought about by the implementation of the Programme should be minimal. Costs incidental to the issuance of bonds, annual payment of interest and repayment of principal will be met by the sums raised and investment income generated under the Bond Fund. If there is a positive balance in the Bond Fund after all financial obligations and liabilities are met in relation to the Programme, the surplus funds may be transferred to the general revenue. Any shortfall of funds for fulfilling the financial obligations and liabilities in respect of the Programme may be financed from the general revenue.

Sustainability implications

3. The Programme does not have significant sustainability implications. It is nevertheless conducive to the long-term development of the local bond market and the promotion of financial stability and economic growth.