

**Letterhead of THE HONG KONG CAPITAL MARKETS ASSOCIATION**

**Presentation to Legislative Council Panel  
on Financial Affairs**

**“The Effects on HK\$ Debt Capital Markets of Recent HKMA  
Measures to Strengthen the Currency Board Arrangement”**

**Tom Y. Hsiao**

**Tokyo-Mitsubishi International (HK) Ltd.  
HKCMA Vice Chairman**

**November 7, 1998**

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### Summary

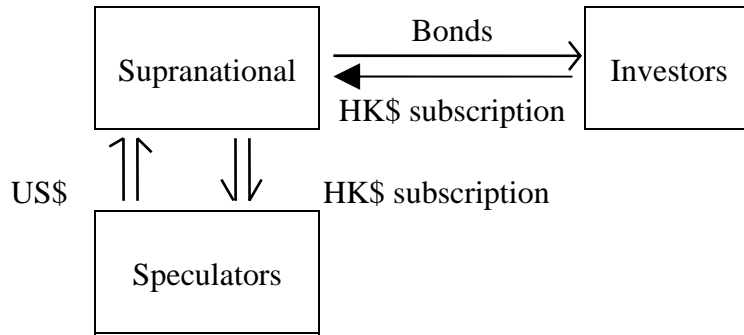
- The recent Asian financial turmoil highlights the importance of a deep, liquid and mature capital market. Depending mainly on the banking sector as a funding source has exacerbated the effect of the financial crisis for many economies.
- A stable currency and interest rate environment is important for the development of the capital market. In general, the Hong Kong Capital Market Association supports the recent measures announced by HKMA to strengthen the currency board arrangement.
- Two measures, however, affected the development of the capital market. Firstly, no private debt issues will be eligible for acceptance at the Discount Window in the future. This will affect local banks' effort to obtain medium term funding. Secondly, HKMA requested nine supranationals to refrain from issuing HK\$ bonds with maturities less than three years. This will affect market liquidity, the availability of cross currency swaps to local corporates and the supply of high quality shorter term securities for investors.

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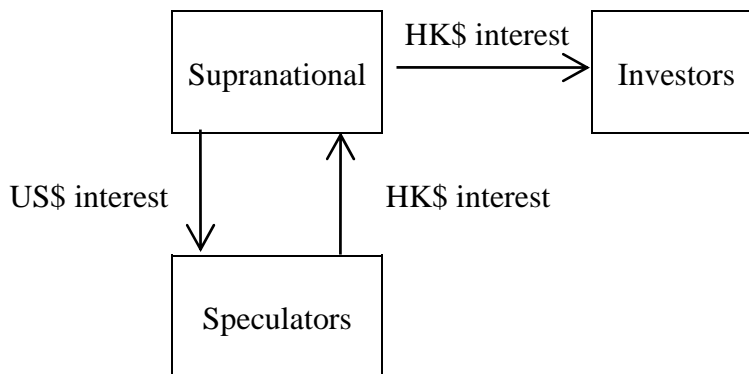
Appendix I

Cash flow diagram of a HK\$ bond issue by a supranational

I. Payment Date of HK\$ bond issue



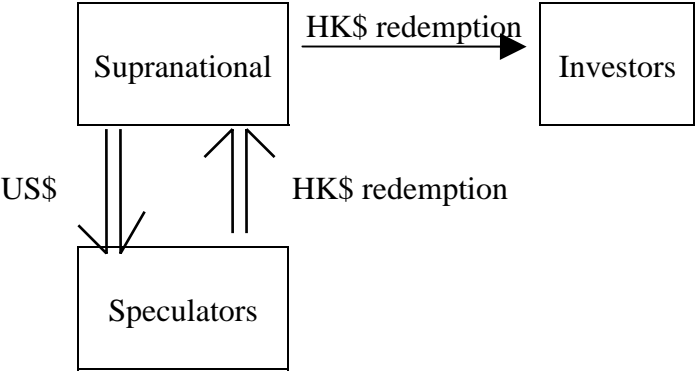
II. Interest Payment Date of HK\$ bond issue



Appendix II

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III. Redemption Date of HK\$ bond issue



## Appendix II

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29th September, 1998

Mr. Norman T L Chan  
Deputy Chief Executive  
Hong Kong Monetary Authority  
30<sup>th</sup> Floor, 3 Garden Road  
Hong Kong

Dear Norman,

Effects of Recent HKMA Measures on the Hong Kong Dollar Debt Capital Markets

We write to express our views on the recent measures of the Hong Kong Monetary Authority (“HKMA”) to strengthen the currency board arrangement and the HKMA’s letter requesting nine supranational institutions to issue Hong Kong Dollar bonds with maturities of at least 3 years.

We support the 7 measures announced by the HKMA on 5<sup>th</sup> September, 1998 as they act to enhance the stability of the currency peg and Hong Kong Dollar interest rates. A stable currency and interest rate environment is important for the development of the local debt capital markets, as volatility reduces investment confidence and appetite for debt capital market products.

The measures on the discontinuance of private sector LAF-eligible issues and short-term supranational issues do, however, have very negative implications for the future development of the local debt capital markets.

Private sector LAF-eligible issues and supranational issues with maturities less than three years together accounted for 51% and 47% of the total issuance volume of the Hong Kong Dollar capital markets in 1997 and the first nine months of 1998, respectively.

Local banks, which were the major beneficiaries of LAF-eligibility, will have difficulties in refinancing their maturing LAF-eligible issues in the coming few years. This will have a negative impact on the banks’ ability to lend and will further delay the recovery of the local economy.

There will be a lower issuance volume (which benefitted dramatically from LAF-eligibility in the past) and the general liquidity of the market will be dampened.

The HKMA's request for the Supranationals to confine their issuance of Hong Kong Dollar debt to maturities of at least 3 years will further reduce liquidity in the market. It will also reduce the supply of cross currency swaps to local corporates, which have a genuine need to hedge their U.S. Dollar liabilities. The HKMA's request is also affecting investors' demand for higher quality paper in shorter maturities.

The HKMA has been actively promoting the development of the domestic debt capital markets through the improvement of market infrastructure. The private sector has responded positively and has contributed in building the Hong Kong Dollar debt market to become perhaps the most effective and open example in Asia.

The Hong Kong Capital Markets Association maintains a close working relationship with the HKMA and cooperates closely with the HKMA to strengthen the financial markets in Hong Kong. This in turn benefits the future of the local debt capital markets. With recent measures hampering market development, we would propose that the HKMA consider the following positive measures:

1. To facilitate the granting of a profits tax exemption for all Hong Kong Dollar debt products in order to create a level playing field for all issuers. This will help to stimulate interest in local corporate and bank paper.
2. Given the pending implementation of the Mandatory Provident Fund Scheme, to support the education of the general public to diversify the risk of their investment portfolios across a spectrum of investment products.
3. To encourage government and semi-government bodies to invest in debt instruments issued by local corporates and banks. This will help local corporates to access the domestic debt markets and the local banks to refinance their maturing Hong Kong Dollar debt obligations.
4. To work with the Association to develop the retail market for debt capital market products.
5. To support the Association's continuous efforts in lobbying for a reduction in the minimum denomination of certificates of deposit which is currently set at HK\$500,000.

We assure you that the Association will maintain a close dialogue with the HKMA and work towards the betterment and development of the domestic debt capital markets.

Yours sincerely,

Helen Wong  
Chairperson