For information

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Legislative Council Panel on Financial Affairs

Measures of the Central Government to support the financial development in Hong Kong

PURPOSE

At the Forum on the 12th Five-Year Plan and Mainland-Hong Kong Economic, Trade and Financial Co-operation held on 17 August 2011, Mr Li Keqiang, Vice-Premier of the State Council, announced the Central Government's package of measures to support the financial development in Hong Kong. This paper sets out such measures and their effects, as well as the follow-up actions to be taken by the Special Administrative Region (SAR) Government.

BACKGROUND

2. Mr Li Keqiang, Vice-Premier of the State Council, announced the Central Government's package of measures to support the economic and social development in Hong Kong at the Forum on the National 12th Five-Year Plan and Mainland-Hong Kong Economic, Trade and Financial Co-operation held on 17 August 2011. Among the measures, 13 are related to financial development, demonstrating the support of the Central Government in strengthening Hong Kong's position as an international financial centre. Eight of the measures are beneficial to the development of offshore Renminbi (RMB) business, which provide a strong driving force for the development of an offshore RMB market. Overall, the measures will facilitate the overall development of the financial markets and institutions in Hong Kong and enhance the competitiveness of our financial markets. In the long run, the measures will not only expedite the economic restructuring of Hong Kong and create more job opportunities, but also help the nation build a multi-layer financial market in the 12th

Five-Year Plan period and fulfil its policy objective of expanding the cross-border use of RMB.

OFFSHORE RMB BUSINESS CENTRE

3. On the development of an offshore RMB business centre, the following measures will be implemented:

(a) Extension of the Pilot Scheme for Cross-border Trade Settlement in RMB to cover the whole country

- The People's Bank of China (PBoC) and relevant Mainland authorities introduced the Pilot Scheme for Cross-Border Trade Settlement (Scheme) in RMB in July 2009. Under the Scheme, trade between five Mainland cities (Shenzhen, Guangzhou, Zhuhai, Dongguan and Shanghai) and Hong Kong, Macau and ASEAN member countries could be settled in RMB. In June 2010, the Scheme was greatly extended to cover trading between 20 Mainland provinces/cities and the global community. In December 2010, the number of Mainland enterprises eligible for settling merchandise exports in RMB rose substantially from 365 to 67 359. On 24 August 2011, PBoC announced the extension of the Scheme to cover the whole country.

- This is an important step in speeding up the cross-border use of RMB. At present, the cross-border RMB trade settled through Hong Kong banks accounts for over 80% of the total foreign trade settled in RMB in the Mainland. Extension of the Scheme will further strengthen Hong Kong's status as an international RMB settlement centre.

(b) Launching of pilot projects for foreign-funded banks to replenish capital with RMB

- Under the existing arrangements, in injecting funds into their sub-branches in the Mainland, foreign-funded banks (including Hong Kong-funded banks) will have to obtain prior approval before remitting foreign currency into the Mainland and the funds so remitted can only be converted into RMB for use in the Mainland after further approval is obtained.

- The new measure allows Hong Kong banks to inject RMB into their sub-branches, thus minimizing the risk brought about by currency exchange. This is conducive to the enhancement of capital structure of such sub-branches in the Mainland. This will not only expand the channels for the use of RMB, but also significantly enhance the operational efficiency of the sub-branches of Hong Kong banks on the Mainland.

(c) Encouraging the use of RMB by Hong Kong enterprises in making direct investment in the Mainland, launching of Pilot Scheme of RMB Settlement for Foreign Direct Investment in phases and revising the "Measures for the Administration of Overseas Investment Projects" as soon as possible

- Hong Kong is the major source of foreign direct investment in the Mainland, accounting for about 50% of total foreign direct investment. At present, foreign direct investments in the Mainland are mainly settled in US dollars. Last year, the Mainland authorities allowed direct investments in RMB by certain foreign enterprises on a trial basis. To regularize the measures on foreign direct investment, the Mainland authorities need to revise or formulate the relevant administrative measures. On 22 August 2011, the Ministry of Commerce issued a consultation document on the related notice on cross-border RMB settlement for foreign direct investment. Relevant

Mainland authorities are expected to introduce respective administrative measures.

- For foreign enterprises, including Hong Kong enterprises, making direct investment in the Mainland in RMB will not only lower the cost and risk of currency exchange, but also promote the growth of the real economy in the Mainland. The revised "Measures for the Administration of Overseas Investment Projects" are expected to enhance the transparency and specificity of the approval criteria and process. This will greatly facilitate direct investment on the Mainland by Hong Kong and overseas enterprises through capital formation on the RMB fund raising platforms in Hong Kong. These measures provide more business opportunities for a growing pool of RMB funds in Hong Kong, further boost the development of Hong Kong's RMB bond and equity markets, and create employment.

(d) <u>Allowing Investments in the Mainland equity market by means of the RMB Qualified Foreign Institutional Investor (RQFII) scheme with an initial size of RMB20 billion</u>

- Currently, investments by qualified foreign institutional investors (QFII) in the Mainland equity market must be made through the US dollar-denominated quota approved by Mainland regulators. The RQFII is modelled on the existing QFII scheme, by making possible investment in the Mainland equity market through a preset RMB-denominated quota.

- This measure enhances the circulation of onshore and offshore RMB funds, and facilitates the launch of more innovative RMB-denominated products, benefiting investors, financial institutions and the financial markets as a whole.

(e) More umbrella Mainland financial institutions will be allowed to issue RMB-denominated bonds in Hong Kong/Mainland enterprises will be allowed to issue RMB-denominated bonds in Hong Kong/The scale of the issuance of RMB-denominated bonds in Hong Kong by Mainland institutions will be gradually expanded

- In the first seven months of 2011, RMB 49.6 billion worth of bonds had been issued by more than 40 institutions in Hong Kong. Counting the RMB 20 billion of sovereign bonds issued lately, the total issuance reached RMB 70 billion. Except for sovereign bonds, the issuers range from local and multi-national corporations to international financial institutions. Under the new measures, the size of RMB-denominated bonds to be issued by Mainland's institutions in Hong Kong will be raised to RMB 50 billion this year, with roughly half of them from financial institutions and the other half from non-financial enterprises.

- By allowing non-financial Mainland enterprises to issue RMB-denominated bonds in Hong Kong, the range of issuers from the Mainland will be enlarged. Investors will be provided with more diversified choices, and the breadth of the RMB bond market in Hong Kong will be further extended. Gradually expanding the scale of issuance will increase the supply of offshore RMB bonds. This will be a huge boost to the development of the offshore RMB capital market, thus further increasing the depth of the RMB bond market in Hong Kong.

(f) Making the issuance of RMB sovereign bonds in Hong Kong a long-term and institutional arrangement and gradually expanding the scale of issuance

- There have been three issuances of RMB sovereign bonds in Hong Kong by the Ministry of Finance. Bonds totaling RMB 6 billion were first issued in 2009, followed by RMB 8 billion in 2010 and RMB 20 billion in 2011.

- Issuing sovereign bonds with different maturities gives a yield curve for offshore RMB bonds, which can serve as a benchmark for pricing other RMB corporate bonds, thus reinforcing the development of the RMB capital market.

(g) Carrying on the Pilot Scheme for Eligible Institutions (including non-Mainland central banks, RMB clearing banks in Hong Kong and Macau, and non-Mainland participating banks) to invest in Mainland's interbank bond market

- In August 2010, the PBoC issued a Notice on Pilot Scheme for RMB Investment in the Interbank Bond Market by Three Types of Institutions Including Offshore RMB Clearing Banks. Under the Scheme, three types of institutions, namely non-Mainland central banks or monetary authorities, RMB clearing banks in Hong Kong and Macau, and non-Mainland participating banks for RMB settlement of cross-border trade, are allowed to apply for investing in the interbank bond market in the Mainland. To date, more than 20 Hong Kong banks have been permitted to invest in the interbank bond market on the Mainland.

- Carrying on this measure will facilitate the use and circulation of RMB funds in Hong Kong as well as the launch of more RMB-denominated products, benefiting investors, financial institutions and the financial markets as a whole.

(h) Promoting innovation in the diversification of offshore RMB financial products in Hong Kong

- This measure promotes innovation in RMB financial products, giving enormous impetus to the development of the offshore RMB market.

OTHER FINANCE-RELATED MEASURES

4. As for the banking sector, the following measures will be implemented:

(i) <u>Allowing Hong Kong-funded corporate banks in the Mainland to engage in mutual fund business</u>

- In accordance with the Regulation of the People's Republic of China on the Administration of Foreign-funded Banks promulgated in 2006, the scope of business of Mainland-incorporated banks established by foreign-funded banks (including banks from Hong Kong) is basically the same as that of Mainland banks. However, foreign-funded banks are not allowed to operate business in some specific areas (e.g. intermediary business such as sales of funds).

- This measure will allow Hong Kong-funded banks to operate business within a wider scope in the Mainland. It will not only expedite the business development of local banks on the Mainland, but also help enhance the service quality of the Mainland's banking industry as a whole.

(j) <u>Supporting Hong Kong-funded banks in speeding up the opening of cross-location sub-branches in Guangdong with a view to establishing a planned and balanced presence</u>

- The branches established by Hong Kong banks or their Mainland subsidiaries in Guangdong Province may apply for setting up cross-location sub-branches in other cities in the province. This measure enables Hong Kong banks to expand their branch networks in the Mainland at a lower cost, thus facilitating the business development of Hong Kong banks in the Mainland. As at end-June 2011, four Hong Kong banks have set up a total of 12 cross-location sub-branches in cities like Foshan, Zhongshan and Huizhou.

- This measure will facilitate the opening of more business premises in Guangdong Province more cost-effectively by Hong Kong banks. For Mainland, the speeding up of business development of Hong Kong banks by opening more cross-location sub-branches will help enhance the service quality of the Mainland's banking industry as a whole, and better satisfy the needs of Mainland enterprises (including those funded by Hong Kong capital) for banking services.

5. As for the securities sector, the following measures will be implemented:

(k) <u>Launching of exchange-traded fund constituted by Hong Kong listed stocks on the Mainland</u>

- Exchange-traded fund constituted by Hong Kong listed stocks refers to funds that track Hong Kong stock market indices and can be traded at a stock exchange.

- This measure will not only attract Mainland investors to indirectly participate in the Hong Kong stock market, but also strengthen the tie between stock exchanges on both sides. Through the trading of such products in Mainland's securities markets like the Shanghai Stock Exchange and Shenzhen Stock Exchange, Mainland investors can indirectly invest in the Hong Kong stock market.

(l) Providing continuous support to encourage the listing of Mainland enterprises in Hong Kong

- With a highly efficient multi-currency capital formation platform, Hong Kong has developed into the premier international fund raising centre for the Mainland. As at July 2011, there were a total of 164 H-share companies and 103 red-chip companies listed in Hong Kong, representing 23.5% and 20.8% of market capitalization respectively. These two categories of Mainland enterprises account for 44.3% of the total market capitalization.

- This measure not only recognizes the status of Hong Kong stock market as a major capital formation platform for Mainland enterprises, but also reinforces Hong Kong's position as a global initial public offering centre.

6. As for the insurance sector, the following measures will be implemented:

(m) Encouraging Hong Kong's insurance companies to access Mainland's insurance market by setting up office or taking up stakes, and enhancing Mainland-Hong Kong cooperation in the development of insurance products, business operation and management

- This measure will bring immense opportunities to Hong Kong's insurance companies. It will also facilitate innovation in Mainland's insurance market, enabling Mainland's insurance industry to better play its social functions in risk management and the provision of protection. With their wealth of experience, Hong Kong's insurance companies can contribute to the further improvement of insurance service of both places through professional and technical exchanges with their Mainland counterparts.

FOLLOW-UP ACTIONS

7. The SAR Government, in collaboration with various regulators (including the Hong Kong Monetary Authority, the Securities and Futures Commission, and the Office of the Commissioner of Insurance), will follow up with the relevant authorities of the Mainland to bring the supportive measures into effect as early as possible.

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