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Paper for the House Committee

**Report of the Subcommittee on Two Proposed Resolutions
under Section 3(1) of the Loans Ordinance**

Purpose

This paper reports on the deliberations of the Subcommittee on Two Proposed Resolutions under Section 3(1) of the Loans Ordinance ("the Subcommittee").

Background

2. The Government Bond Programme ("GBP") was set up in 2009 with the policy objective of promoting the further and sustainable development of Hong Kong's bond market. On 8 July 2009, the Legislative Council ("LegCo") passed a resolution under section 29 of the Public Finance Ordinance (Cap. 2) authorizing the Government to set up a fund known as the Bond Fund ("BF") for managing the proceeds raised under GBP, and a separate resolution under section 3 of the Loans Ordinance (Cap. 61) ("LO") authorizing the Government to borrow up to a maximum principal amount outstanding at any time of HK\$100 billion or equivalent for the purposes of BF. The borrowing limit of BF was raised from HK\$100 billion to HK\$200 billion following the passage of a resolution under section 3 of LO by LegCo in May 2013.

3. The Government Green Bond Programme ("GGBP") was set up in 2018 with the policy objective of promoting the development of green finance in Hong Kong and signifying the Government's support for sustainable development and determination to combat climate change by financing projects with environmental benefits under the Public Works Programme. The sums borrowed under GGBP would be credited to the Capital Works Reserve Fund ("CWRP") to provide funding for green public works projects of the

Government. On 15 November 2018, LegCo passed a resolution under section 3(1) of LO authorizing the Government to borrow under GGBP, for the purposes of CWRP, sums not exceeding in total HK\$100 billion or equivalent, being the maximum amount of borrowings that may be outstanding by way of principal at any time. The proceeds raised under GGBP will be used exclusively to finance or refinance public works projects of the Government that fall under one or more of the eight eligible categories¹ set out in the Green Bond Framework.

4. The Financial Secretary ("FS") announced in the 2021-2022 Budget the Administration's plans to issue: (a) at least HK\$15 billion of iBond and HK\$24 billion of Silver Bond in the current financial year; and (b) green bonds regularly and expand the scale of GGBP to allow for further issuance of Government Green Bonds ("GGB") totaling HK\$175.5 billion within the next five years. According to the Administration, BF's position is projected to reach HK\$191.5 billion, near its borrowing limit by end-2022, and the total outstanding amount of GGB is projected to reach the current borrowing ceiling around 2023. The Administration therefore considers it necessary to raise the borrowing limits for GBP and GGBP to enable both programmes to operate in a sustainable manner to meet growing market demand, and promote the further development of Hong Kong's bond market.

The two Proposed Resolutions

The proposed resolution to raise the maximum amount of borrowings under the Government Bond Programme

5. The proposed resolution on GBP to be moved by the Secretary for Financial Services and the Treasury ("SFST") under section 3(1) of LO seeks LegCo's approval to authorize the Government to borrow for the purposes of BF sums not exceeding in total HK\$300 billion or equivalent, being the maximum amount of sums borrowed that may be outstanding by way of principal at any time under GBP. The proposed resolution requires that sums borrowed be credited to BF, and is to replace the previous resolution passed by LegCo on 22 May 2013 (Cap. 61E) prescribing the current borrowing limit of HK\$200 billion or equivalent.

¹ The eight eligible categories are renewable energy; energy efficiency and conservation; pollution prevention and control; waste management and resource recovery; water and wastewater management; nature conservation/biodiversity; clean transportation; and green buildings.

The proposed resolution to raise the maximum amount of borrowings under the Government Green Bond Programme

6. The proposed resolution on GGBP to be moved by SFST under section 3(1) of LO seeks LegCo's approval to authorize the Government to borrow for the purposes of CWRP sums not exceeding in total HK\$200 billion or equivalent, being the maximum amount of all sums borrowed that may be outstanding by way of principal at any time. The proposed resolution requires that the sums borrowed be credited to CWRP, and is to replace the resolution passed by LegCo under LO on 15 November 2018 (Cap. 61F) prescribing the current maximum amount of borrowings of HK\$100 billion or equivalent. Moreover, the Administration proposes to expand the scope of GGBP so that the proceeds can be used to fund a wider variety of green projects under CWRP.

The Subcommittee

7. At the House Committee meeting on 4 June 2021, Members agreed to form a subcommittee to study the two proposed resolutions under section 3(1) of LO. At the request of the House Committee, SFST has withdrawn the notice for moving the two motions mentioned in paragraphs 5 and 6 above in order to allow time for the Subcommittee to study the proposed resolutions.

8. The membership list of the Subcommittee is in **Appendix I**. Under the chairmanship of Hon Holden CHOW Ho-ding, the Subcommittee has held one meeting with the Administration to examine the proposed resolutions and has invited written views from the public.²

Deliberations of the Subcommittee

9. Members of the Subcommittee generally support the proposed resolutions to raise the borrowing ceilings of GBP and GGBP so as to allow the Administration to increase the issuance of bonds. The major deliberations of the Subcommittee are set out in the ensuing paragraphs.

² The Subcommittee has received one written submission (LC Paper No. CB(1)1608/20-21(01) (Chinese version only).

Issuance sizes and interest rates of Government Bonds

10. Noting the strong market demand for Government Bonds ("GB") in recent years, some members considers that the borrowing ceiling of GBP can be raised further to over HK\$300 billion to enable the Administration to issue more GB. Moreover, in view of the current global low interest rate environment, some members opine that the Administration should explore the feasibility of raising funds for financing large infrastructure projects in Hong Kong through GB issuance.

11. The Administration has explained that the policy objective of GBP is to promote the sustainable development of the local bond market through the systematic issuance of GB. All proceeds raised under GBP will be credited to BF. Expenditure of BF includes interest payments and principal repayment for bonds issued under GBP as well as other relevant expenses (e.g. expenses for external services). BF does not form part of the fiscal reserves and is managed separately from other Government accounts. Furthermore, BF is placed with the Exchange Fund for investment and attracts investment income on the basis of the "fixed rate" sharing arrangement applicable to the fiscal reserves. Proceeds from issuances under GGBP, on the other hand, will be used for financing green projects including infrastructure projects under CWRP.

12. As regards the borrowing ceiling of GBP, the Administration has pointed out that the ceiling was HK\$100 billion when GBP was set up in 2009, and was raised to the current level of HK\$200 billion in 2013. The Administration considers that the proposed new ceiling of HK\$300 billion would enable GBP to operate in a sustainable manner to provide room for further bond issuances for the next few years, and would allow flexibility for adjusting the issuance size and tenor of individual tranches in response to the prevailing market conditions. The Administration would continue to monitor future development of GBP and examine the need for raising the borrowing ceiling further when necessary.

13. The Subcommittee notes that past tranches of iBond and Silver Bond were well received by the public with considerable over-subscription. Some members have invited the Administration to consider setting a proportion on the retail bonds to be issued under GBP so as to meet the strong demand of retail investors (including the general public and senior citizens) for stable investments of high quality bonds.

14. The Administration has advised that GBP comprises an institutional element and a retail element. Under the institutional part which is restricted to application by institutional investors, GB are issued with tenors ranging from three to 15 years through regular tendering to ensure a steady supply of public debt paper for satisfying the demand of institutional investors, such as pension

funds, banks and insurance companies. By issuing institutional bonds in a systematic and consistent manner, the Administration has established a representative benchmark yield curve to facilitate the market in determining the pricing of other types of bonds (such as corporate bonds). Under the retail part which is restricted to subscription by members of the public (i.e. retail investors), the Administration issues inflation-linked bonds (including iBond and Silver Bond) to meet the general public's demand for stable investments of a high quality and to promote public understanding of bond investment.

15. As regards the distribution of institutional bonds and retail bonds under GBP, the Administration has advised that all along no ratio has been set on the two elements. Since institutional bonds and retail bonds are different in terms of their distribution mechanisms, formats, channels and target investors, the Administration has been formulating the respective issuance sizes and terms of the institutional bonds and retail bonds separately in accordance with market conditions. The factors to be considered include the prevailing market environment, the supply and demand situations, interest rate and inflation, the potential impact on other issuers in Hong Kong, the sustainability of BF, etc. In the past five years, there has been stable market demand for institutional bonds, with the annual issuance size of institutional bonds under GBP hovering between HK\$16.6 billion and HK\$24.4 billion. On the other hand, as the public's interest in retail bond investment has increased, the annual issuance size of retail bonds under GBP also increased significantly from HK\$3 billion in 2016-2017 to HK\$30 billion in 2020-2021. FS has also announced the Administration's plan to issue at least HK\$15 billion of iBond and HK\$24 billion of Silver Bond in 2021-2022.

16. Upon request of the Subcommittee, the Administration has provided information on the retail bonds and institutional bonds issued under GBP as well as the interest rates of iBond and Silver Bond issued in recent years. The information is set out in **Appendix II**.

Funding for green projects under the Government Green Bond Programme

17. Some members have enquired about the mechanism for determining the funding for Government green projects using the proceeds raised under GGBP, and LegCo's role, if any, in the mechanism.

18. The Administration has advised that in line with international best practice, the Green Bond Framework has been drawn up which sets out how the Government intends to issue green bonds to fund projects that will improve the environment and facilitate the transition to a low carbon economy. The Steering Committee on GGBP, chaired by FS, has also been established to oversee and give strategic direction on the implementation and development of

GGBP. On the mechanism for determining the funding for green projects, the Administration has explained that, currently, all public works projects included under CWRP have already been approved by the Finance Committee of LegCo. If such approved projects fall under one or more of the eight eligible categories set out in the Green Bond Framework, they can be funded by the proceeds raised under GGBP following the review and approval by the Steering Committee on GGBP. The Administration will also expand the scope of GGBP so that other types of eligible green projects under CWRP, including minor works projects (e.g. energy saving, recycling and greening projects), major systems and equipment (e.g. pollution surveillance, climate observation and early warning projects), and capital subventions (e.g. hospitals, school and welfare premises projects implemented by non-government organizations) can be funded by the proceeds.

19. The Subcommittee has enquired about the reason(s) for not setting out the Administration's proposal of expanding the scope of GGBP in the proposed resolution on GGBP.

20. The Administration has explained that it is mentioned in the explanatory note of the proposed resolution that GGBP will provide funding for green projects funded by CWRP. The previous resolution under section 3(1) of LO passed by LegCo on 15 November 2018 (Cap. 61F) also adopted similar drafting and did not expressly provide for the scope of the projects or "green projects". The purpose is to provide flexibility in view of the fast evolving green bond market without a single set of universally-accepted green standards or guidelines at present. The Administration has added that the relevant LegCo Brief (File Ref: B&M/3/1/4C dated 26 May 2021) has elaborated on the proposed expansion of GGBP.

Environmental benefits of green projects funded under the Government Green Bond Programme

21. In order to enhance the public's understanding of the Government's efforts in promoting sustainable development and a green environment for Hong Kong, the Subcommittee suggests that the Administration should enhance publicity on the quantifiable positive environmental impacts of the green projects financed under GGBP.

22. The Administration has responded that the inaugural GGB of US\$1 billion issued in May 2019 had financed seven public works projects with significant environmental benefits, the details of which were set out in the Green Bond Report 2020 that is available online and distributed to global investors,

showcasing to the world the sustainable development of Hong Kong.³ Proceeds from the second and future GGB issuances will similarly be allocated to a variety of eligible green projects with the details set out in the Green Bond Report to be compiled every year. The current proposal to raise the borrowing limit and expand the scope of GGBP will provide more room for piloting the issuance of green bond that involves more types of currencies, project types, issuance format (including retail green bond) and channels, thereby further enriching the green and sustainable finance ecosystem in Hong Kong and enhancing the public's understanding of the green projects in Hong Kong.

Development of the Hong Kong bond market

23. Noting that continuous implementation of GBP and GGBP would help promote the development of Hong Kong's bond market, and in turn strengthen its status as an international financial centre and a green and sustainable finance hub in the region, some members have called on the Administration to implement other measures to promote the growth of Hong Kong's bond market, such as encouraging securitization of bonds, allowing more financial intermediaries (e.g. smaller brokerage firms) to participate in bond issuances, and expanding the investor base of bonds.

24. The Administration has stressed that it attaches great importance to promoting the development of Hong Kong's bond market. Currently, the Hong Kong Monetary Authority ("HKMA") assists in implementing GBP and GGBP, and investors can already approach securities brokers for subscription of retail bonds. The Administration further plans to issue retail green bonds and lower the eligible age for subscribing Silver Bond to 60 in 2021-2022. FS will also lead a steering group comprising members from the Financial Services and the Treasury Bureau, HKMA, the Securities and Futures Commission, the Insurance Authority and the Hong Kong Exchanges and Clearing Limited to formulate a roadmap for promoting the diversified development of Hong Kong's bond market and reinforcing its functions. The steering group will consider initiatives to support market development including enhancement of market infrastructure and means to promote securitization of bonds.

³ The seven public works projects are: Integrated Waste Management Facilities Phase 1, Organic Resources Recovery Centre 1 (commonly known as O.PARK 1), West Kowloon Government Offices, Inland Revenue Tower in the Kai Tak Development, Upgrading of San Wai Sewage Treatment Works - Phase 1, Additional Sewage Rising Main and Rehabilitation of the Existing Sewage Rising Main between Tung Chung and Siu Ho Wan, and District Cooling System at the Kai Tak Development.

Recommendation

25. The Subcommittee notes that SFST will give fresh notice for moving the motions to seek LegCo's approval of the two proposed resolutions at the Council meeting of 21 July 2021. The Subcommittee will not propose amendments to the two proposed resolutions.

Advice sought

26. The Subcommittee Chairman gave a verbal report on the deliberations of the Subcommittee at the House Committee meeting on 2 July 2021. Members are invited to note this written report.

Council Business Division 1
Legislative Council Secretariat
14 July 2021

**Subcommittee on Two Proposed Resolutions under
Section 3(1) of the Loans Ordinance**

Membership list

Chairman Hon Holden CHOW Ho-ding

Members Hon Starry LEE Wai-king, SBS, JP
Hon CHAN Hak-kan, BBS, JP
Dr Hon Priscilla LEUNG Mei-fun, SBS, JP
Hon Christopher CHEUNG Wah-fung, SBS, JP

(Total : 5 members)

Clerk Ms Connie SZETO

Legal Adviser Ms Clara WONG

Retail Bonds Issued under the GBP

Financial Year	Bond Issue	Issuance Size (HK\$ billion)	Annual Issuance Size (HK\$ billion)	Fixed Rate (i.e. minimum guaranteed per annum interest rate)	Actual Average Per Annum Interest Rate
2016 – 2017	Silver Bond 1	3	3	2.00%	2.26%
2017 – 2018	Silver Bond 2	3	3	2.00%	2.41%
2018 – 2019	Silver Bond 3	3	3	3.00%	3.04%*
2019 – 2020	Silver Bond 4	3	3	3.00%	3.08%*
2020 – 2021	iBond 7	15	30	2.00%	2.00%*
	Silver Bond 5	15		3.50%	3.50%*
2021 – 2022	iBond 8	20		2.00%	First interest payment not yet due

* Calculated based on the interest payments that have been paid on or before 30 June 2021.

Institutional Bonds Issued under the GBP

Financial Year	Bond Issue	Issuance Size (HK\$ billion)	Annual Issuance Size (HK\$ billion)	Annualised Yield#
2016 – 2017	3-year(05GB1902)	4	24.4	0.860%
	3-year(05GB2002)	4		0.634%
	5-year(05GB2011)	2.5		1.066%
	5-year(10GB2108)	2.5		0.858%
	10-year(10GB2601)	1.2		1.008%
	10-year(10GB2601)	1.2		1.773%
	15-year(15GB3007)	0.6		0.974%
	15-year(15GB3203)	0.6		2.029%
	10-year Islamic Bond (USD denominated)	About 7.8		3.132%
2017 – 2018	3-year(05GB2002)	4	16.6	1.084%
	3-year(05GB2011)	4		1.262%

	5-year(05GB2205)	2.5		1.197%
	5-year(05GB2205)	2.5		1.505%
	10-year(10GB2706)	1.2		1.386%
	10-year(10GB2706)	1.2		1.992%
	15-year(15GB3203)	0.6		1.561%
	15-year(15GB3203)	0.6		2.209%
2018 – 2019	3-year(10GB2108)	4	16.9	2.108%
	3-year(10GB2108)	4		2.592%
	5-year(10GB2301)	2.5		2.507%
	5-year(10GB2301)	2.5		2.472%
	10-year(10GB2706)	1.2		2.391%
	10-year(10GB2901)	1.5		2.141%
	15-year(15GB3203)	0.6		2.709%
	15-year(15GB3403)	0.6		2.118%
2019 – 2020	3-year(05GB2205)	4	17.8	1.822%
	3-year(10GB2301)	4		1.599%
	5-year(10GB2408)	2.5		1.835%
	5-year(10GB2408)	2.5		1.693%
	10-year(10GB2901)	1.5		1.682%
	10-year(10GB2901)	1.7		1.478%
	15-year(15GB3403)	0.8		1.539%
	15-year(15GB3403)	0.8		0.965%
2020 – 2021	3-year(10GB2301)	4	18.4	0.547%
	3-year(03GB2310)	4		0.267%
	5-year(10GB2601)	2.5		0.482%
	5-year(10GB2601)	2.5		0.406%
	10-year(15GB3007)	1.7		0.790%
	10-year(15GB3007)	1.7		1.012%
	15-year(15GB3403)	1		0.812%
	15-year(15GB3603)	1		1.787%
2021 – 2022	3-year(03GB2404)	4		0.382%
	5-year(10GB2601)	2.5		0.674%
	10-year(15GB3203)	1.7		1.505%

Based on the average accepted tender yield.