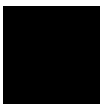




Economic reform and opening-up in 1978

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”.



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.

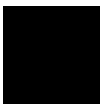
That said, our part in the RMB story began much earlier. Hong Kong and the Mainland began discussions as early as 2002 on developing RMB business in Hong Kong. In December 2003, the Hong Kong Monetary Authority announced that Bank of China (Hong Kong) Limited was appointed as the clearing bank for RMB 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 we go through this