

Speech by the Honourable Frederick Ma, JP
Secretary for Financial Services and the Treasury
at the Hong Kong Capital Markets Association Forum 2005
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Hong Kong as an International Debt Financing Centre

Good afternoon, ladies and gentlemen,

I am most delighted to be here today at the opening of the Hong Kong Capital Markets Association Forum 2005 and be given the opportunity to share my thoughts with you on developing Hong Kong as an international debt financing centre. I would like to speak specifically on bond market development, which I understand has been the focus of the Association for many years and also the main theme for today's discussions.

About two weeks ago I was invited to speak at a conference on the challenges of globalisation. In this increasingly globalised and integrated financial world, borrowers and lenders now have access to international markets for fund-raising or investment activities. The liberalisation and development of capital markets have opened the way for firms, particularly those multinationals, to source capital from international financial markets through debt or equity financing, where they may enjoy lower cost of capital, more abundant liquidity and diversification of risks. As such, there is competition between foreign and domestic financing, and also in the choice of overseas capital markets. In making international financing decisions, corporations would all want to choose financial markets which are liberalised and well-developed with low international risks, having abundant supply of professional financial intermediaries, essential market infrastructure and strong investor base with no entry restriction to foreign investors. All these could point to greater availability of funds at lower cost.

Bond market in Hong Kong

Like many Asian economies, bank lending and equity financing in Hong Kong have traditionally dominated corporate financing. According to a study conducted by the Bank for International Settlements, by the end of 2003, the share of the bond market as a percentage of total financing in Hong Kong was about 7%, up from 4.8% in 1995, which was far below the 23% from bank financing and 70% from

the stock market. Although Hong Kong's success as an international financial centre is unquestionable and our financial system has proved to be highly stable, I see the need to improve the functioning of the financial sector by developing the bond market from the perspective of macroeconomic stability and microeconomic efficiency. I also take the view that the heavy reliance on bank and equity financing in Hong Kong is a result of historical reasons, and not because Hong Kong lacks the competitive advantages for developing the bond market. Against this background, I have been strongly advocating the development of a deep and liquid bond market in Hong Kong.

With the active cooperation between the Government, the financial regulators, public corporations and the private sector, we have made some very significant progress in developing our bond market in the last few years, and our advantages for international debt financing have become more prominent as we continue to review and benchmark our domestic financial system against best international standards and practices.

Such progress is shown by the growth of the bond market. For the past 10 years, the combined total outstanding amount of both Hong Kong dollar-denominated and foreign currency-denominated bonds has tripled, while the Hong Kong dollar debt market has increased by four times during the period. The size of the bond market as a percentage of GDP has also doubled from 1995 to 2003. I am pleased to note that some listed companies in Hong Kong have made use of our bond market for raising funds in recent months.

Meanwhile, we also see a remarkable increase in foreign participation in the bond market in Hong Kong. From 1997 to end September 2004, the outstanding Hong Kong dollar-denominated debt securities issued by overseas borrowers have increased by 20 times. And as of mid-2004, over half of the total outstanding debt securities issued in Hong Kong involved international debt securities. The statistics give us a good indication that the bond market in Hong Kong is growing and is becoming more globalised.

The issuance of high quality and innovative debt securities is another indication of a quality market. In May 2004, the Government successfully launched a HK\$6 billion toll road securitised bond which was the largest securitisation issuance in Hong Kong, and also the first securitisation in Asia publicly offered to retail investors as well as the largest cash securitisation in Asia. The programme received a total of eight financial awards for excellence for being the best domestic and Asian securitisation project. The HK\$20 billion Global Bond Offering launched by the

Government in July 2004, which was the largest-ever dual-currency and multi-tranche offering from the region available to both institutional and retail investors, also won a financial award as the best sovereign bond. The successful launch of these two bond issues and the overwhelming response from both retail and institutional investors have proved that Hong Kong possesses the expertise and infrastructure for large-scale issuance of debt instruments. Separately, I note that the Hong Kong Mortgage Corporation launched a number of retail and institutional bond issues in 2004, including a HK\$20 billion Retail Bond Issuance Programme, and a HK\$2 billion Mortgage-backed Securities (MBS) programme which was the first-ever retail MBS in the whole of Asia. Also, I realize that many structured debt products have been launched in Hong Kong in recent years, some of which have already been introduced to retail investors. The increase in debt issuance activities by the public and private sectors, particularly those with longer maturity periods and at the retail level, has helped set the benchmark yield curves for pricing of portfolios, settlement of derivative transactions and structuring of new issue financing.

Meanwhile, Hong Kong has also joined forces with other Asian economies to support a number of initiatives launched by EMEAP, APEC and ASEAN+3 (Note) to help channel the resources held by Asian economies back to the region, and promote the development of local and regional bond markets.

Hong Kong as an international debt financing centre

Intense competition exists between many economies which aspire to transform their domestic bond markets into regional or international bond markets. I am confident to say that Hong Kong is very well-positioned to survive the competition and emerge as the regional and international financing and trading centre for debt securities. Hong Kong's free and open financial markets with free flow of capital gives us the natural advantage in attracting active participation of foreign borrowers and creating a large international investor base. In addition, our sound legal system provides essential support to debt financing activities, including support for securitisation schemes which are gaining popularity in Hong Kong and also the whole region. While Hong Kong's fundamental strengths as an IFC may be well known to you and many overseas investors, I think it would be useful to put our competitive advantages in perspective of our strong potential to become an international debt financing centre, particularly in the light of more recent developments.

First of all, Hong Kong has extensively developed our payment and settlement systems to enable cross-border multi-currency transactions to be conducted

and settled in real time and without settlement risk. For debt settlement, bilateral linkages have been established between the Central Moneymarkets Unit (CMU) and debt depositories in other jurisdictions. A direct link with the Government Securities Book-Entry System in the Mainland was also set up in April 2004 to enable Mainland investors to access debt securities issued and traded outside the Mainland in a safe and cost-effective manner.

Second, good corporate governance and high standards of accounting and auditing are important elements of the market infrastructure that underpins investor confidence and successful bond markets. In Hong Kong, accounting, auditing, disclosure and governance standards are high by international standards, and have constantly been improved to match international best practices. The recent assessment made by the IMF Article IV Consultation Mission in November 2004 also recognised that Hong Kong had achieved substantial progress in further enhancing the corporate governance regime over the past year.

Third, Hong Kong has a rich pool of international financial professionals and intermediaries. Over 40% of those licensed intermediaries which may provide advice on bond issuance is run by foreign shareholders. The active participation of international investment banks, brokers and dealers in providing professional underwriting and financing plan advice in the bond market plays an important role in international debt financing in Hong Kong, in particular in bringing in overseas issuers and investors, and importing the most advanced product knowledge and expertise.

To meet the needs of advanced financial markets, the Government recognises the importance of constantly strengthening our pool of human resources in terms of both quality and quantity. In recent years, we have focused our efforts in expanding our pool of talent through both strengthening local education and training and attraction of talent from outside. In addition to increasing investment on education to upgrade the quality of our manpower, which takes up about one-quarter of the Government's operating expenditure, we are also working, as the CE mentioned in his Policy Address, on a strategy to attract talented people from the Mainland and overseas to develop their careers in Hong Kong.

Fourth, the Government has spearheaded reforms in recent years to simplify the issuance process and offer tax incentives.

In order to provide the most efficient, competitive and fair environment for issuers and investors, the Securities and Futures Commission (SFC) is conducting

a comprehensive review of the public offering regime with reference to regulatory reforms introduced in other leading international financial centres. I understand that the SFC will soon put forward proposals of possible reforms for public consultation. Separately, the Mandatory Provident Fund Authority has also been reviewing its investment guidelines to facilitate investment in bonds by MPF funds. We will continue to improve our financial regulatory system in line with international practices and standards, with a view to ensuring prudential market supervision without compromising the needs for market development.

The last, but probably the most important consideration by both issuers and investors, is the long-term growth potential of a bond market. The overwhelming response from retail and institutional investors to the two Government bond programmes last year has indicated enormous potential demand in Hong Kong for high quality bonds.

The size of Hong Kong dollar time deposits in the banking system, which could give some indication of the amount the public is prepared to put into assets that produce a stable return, was about HK\$710 billion as at September 2004, which is 1.5 times more than the outstanding HKD denominated fixed rate bonds. A transfer of even a small proportion of the time deposits to the bond market would significantly increase its size. Another source of funds for bond investment is the growing pension funds in Hong Kong. The total asset size of the MPF funds have reached HK\$118 billion as at end 2004, and are growing steadily by approximately HK\$24 billion per year.

The great availability of capital from outside Hong Kong for investment or management here provides a good foundation for a large base of international investors. According to a survey conducted by the SFC, the total assets in the fund management business in Hong Kong in 2003 amounted to HK\$2,947 billion, of which 63% came from overseas investors.

Our capital markets would also benefit from the gradual liberalization of capital account process in the Mainland. The approval given by Mainland authorities last year allowing the investment of a portion of the foreign currency funds of Mainland insurance companies and also the National Social Security Fund in overseas markets are significant developments. Given our close and long-standing economic relationship with the Mainland, I believe we will be the premier choice of investment platform for these funds seeking better investment opportunities outside the Mainland, as echoed by the Chairman of the National Council for Social Security Fund Mr

Xiang Huaicheng during his visit to Hong Kong last week. In particular, our bond market would likely benefit as the majority of these Mainland funds will be pursuing stable returns.

To take advantage of these developments, we have been in touch with the various Mainland authorities to explain to them the strengths of our markets. In November last year, I led a delegation of over 120 fund managers and other industry practitioners to attend a Forum on Management of Insurance Funds that we organized in Beijing to enhance the Mainland insurance practitioners' understanding of the financial markets and the investment opportunities in Hong Kong. The Forum proved to be a great success in fostering closer understanding and cooperation. In fact, Brian represented the Association at the Forum, and on that occasion his putonghua talent was vividly displayed.

Closing Remarks

Ladies and gentlemen, I firmly believe that Hong Kong is well positioned to be an international debt financing centre. We possess all the competitive advantages that attract fund raisers, including stable and liberalised capital markets, world-class markets and legal infrastructure with strong support from professional financial intermediaries, high governance and accounting standards, and a strong investor base with abundant liquidity of local and foreign origins.

Year 2004 was a significant and eventful year for our bond market. For 2005, I would like to share with you my three wishes for the bond market in Hong Kong:

- (a) My first wish is that more retail and institutional investors, as well as fund raisers from Hong Kong, the Mainland and overseas, would take advantage of the excellent debt financing environment in Hong Kong and participate in the market. I have a strong belief that the market should always be the driving force of the economy and financial sector developments, while the Government's role should be confined to setting the right policies and putting in place the essential market infrastructure. Our aspiration to become a debt financing centre would only materialize with the market's active participation.
- (b) My second wish is making Hong Kong the preferred platform for issuing bonds in various currencies, including renminbi. Ever since the successful launch of personal renminbi business by banks in Hong Kong

in early 2004, the total outstanding balance of renminbi deposits in Hong Kong has exceeded RMB10 billion, and I believe the amount will continue to go up. The strong interest in holding RMB assets indicates that there should be good demand for renminbi bonds as well. Issuing renminbi bonds in Hong Kong would facilitate the channelling of renminbi back to the Mainland and further the development of Hong Kong as the major fund raising centre for Mainland enterprises.

- (c) My third wish is that the local bond market would attract more public attention. I believe that by now the message that investing in bonds as a viable investment for the medium and long term has been put across to many in our community, but more would need to be done. I am looking forward to continuing the cooperation with the industry and the media to further enhance public understanding of the market and their interest in this instrument.

I wish this forum every success and hope all of you have a fruitful, healthy and prosperous year in 2005. Thank you very much.