Hong Kong, China
Bond Market Guide

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Asian Development Bank (ADB) Team

List of Interviewees:

Hong Kong, 18 May 2011

- Hong Kong Monetary Authority (HKMA)
- Slaughter and May, Hong Kong
- HSBC, Hong Kong
- State Street Bank
- J.P. Morgan

I. Structure, Type, and Characteristics of the Market

A. Overview

The bond market in Hong Kong, China, has for some time been a significant market place for issuers and investors, in both domestic and foreign currencies. The range of product offerings, the open access for issuers and investors, both domestic and international, and the increasing significance of offshore RMB bond issuances make Hong Kong, China one of the most frequented international bond markets in Asia.

Public sector bonds come in the form of (a) government bonds; (b) Exchange Fund Bills and Notes (EFBNs) issued by the Hong Kong Monetary Authority (HKMA); (c) bonds issued by statutory bodies (e.g., Hong Kong Airport Authority and Hong Kong Housing Authority); and (d) bonds issued by government-related corporations (e.g., Bauhinia Mortgage-Backed Securities Limited, Hong Kong Mortgage Corporation, Hong Kong Link 2004 Limited, etc.).

The Central Moneymarkets Unit (CMU) was set up primarily to provide computerized clearing and settlement facilities for EFBNs, which provide benchmark yields that guide private debt pricing. In December 1993, the HKMA extended the service to other Hong Kong dollar debt securities. Beginning in December 1994, the CMU has been linked to international clearing systems such as Euroclear. This has helped promote Hong Kong dollar debt securities to overseas issuers and investors who can make use of these links to participate in the Hong Kong dollar debt market. In December 1996, an interface between the CMU and the real-time gross settlement (RTGS) interbank payment system was established. This enables the CMU system to provide its members with real-time and end-of-day delivery versus payment (DVP) services.

The CMU Service provides a central depository for CMU Instruments held within the CMU and an electronic book-entry system which eliminates the physical delivery of CMU Instruments. CMU Instruments lodged with the CMU Service are held with a sub-custodian appointed by the HKMA. Where instruments are lodged with the CMU Service by a CMU Member as the authorized agent of an issuer/acceptor, the lodging CMU Member must have obtained an appropriate authority from the issuer/acceptor authorizing the CMU Member to lodge on its behalf.

Bond trading takes place mostly through over-the-counter (OTC) markets. However, some bonds are traded on the securities market of the Hong Kong Stock Exchanges and Clearing (HKEx), which is the holding company that operates the stock exchange.

In addition, three-year Exchange Fund Note (EFN) futures are traded on the HKEx derivatives market.

Hong Kong, China is a preferred location in Asia for bond issues by foreign and domestic corporations—as well as supranational borrowers—because of the easy access to the market for investors and via international clearing systems.

A wide range of asset classes is available for securitization. The two main asset classes securitized are i) residential and commercial mortgages, and ii) HKMA claims on central governments and central banks. For instance, the Hong Kong Mortgage Corporation (HKMC), which was established by the HKMA, and Hong Kong Link 2004 Limited were set up to facilitate securitization of residential mortgages and toll facilities, respectively.

To promote the development of the local debt market, authorities introduced a number of new products, expanded and improved market infrastructure, and provided a tax and regulatory environment conducive to market development.

B. Types of Bonds

1. By Issuer Category

a. Public Entity Issuers

i. Hong Kong Government (for Government bonds)
ii. Hong Kong Monetary Authority
iii. Statutory Bodies[1]
iv. Government-Related Corporations[2]

b. Private Entity Issuers

i. Authorized Institutions[3]
ii. Local Corporates
iii. Multilateral Development Banks[4]
iv. Non-Multilateral Development Banks, Overseas Borrowers

1 Statutory bodies that issue bonds include the Hong Kong Airport Authority (HKAA), Hong Kong Housing Authority (HKHA), Kowloon-Canton Railway Corporation (KCRC), Mass Transit Railway Corporation (MTRC), and Hong Kong Mortgage Corporation (HKMC), among others.

2 Government-related corporations that issue bonds include Bauhinia Mortgage-Backed Securities Hong Kong Mortgage Corporation (HKMC), Hong Kong Link 2004, Kowloon-Canton Railway Corporation (KCRC), and the Mass Transit Railway Corporation (MTRC).

3 Authorized institution means a bank, a restricted-licence bank, or a deposit-taking company as defined in Section 2 of the *Banking Ordinance*.

4 Multilateral development banks (MDB) refer to the Asian Development Bank, the Council of Europe Social Development Fund, the European Company for the Financing of Railroad Rolling Stock, the European Investment Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, the International Bank for Reconstruction and Development, the International Finance Corporation, the African Development Bank, and the Nordic Investment Bank.

2. By Type of Bonds

a. Straight Bonds (Government Bonds and Corporate Bonds)
b. Floating Rate Notes
c. Corridor Notes
d. Index-Linked Bonds
e. Loan Stocks
f. Exchange Fund Notes (EFN)

The EFN Programme commenced in 1993. EFNs are Hong Kong dollar fixed-income debt securities issued by the government of Hong Kong, China under the Exchange Fund Ordinance (Chapter 66 of the Laws of Hong Kong) and for the account of the exchange fund.

Currently, EFNs of 2 years, 3 years, 5 years, 7 years, 10 years and 15 years are being issued at such times as the HKMA may determine. Notes of other maturities may be offered from time to time at the discretion of the Financial Secretary.

The EFNs are issued in multiples of HKD50,000 in computerized book-entry form only.

To enhance the liquidity of the secondary market of EFNs and facilitate access by retail investors to the EFN market, the HKMA has listed the EFNs on the Stock Exchange of Hong Kong.

EFBNs and government bonds are in scripless form, while other papers are either bearer or registered and held in physical form.

All government bonds and most corporate bonds are eligible for clearing at the CMU and maintained in book-entry form.

3. Money Markets Instruments

Some of the common money market instruments are listed below:

a. Certificate of Deposit
b. Commercial Paper
c. Exchange Fund Bills

The Exchange Fund Bills Programme was introduced in March 1990. Bills of 91 days (or 90 or 92 days, as the calendar may fall), 182 days, and 364 days are issued under this program.

4. By Listing Status

Between listed and unlisted bonds, unlisted bonds are typically retail bonds that are publicly available. When considering listing, a cost-benefit trade off (fees versus visibility) may exist for an issuer. Fund managers may appreciate access to official pricing but can also determine a realistic price through modelling.

a. Bonds Listed and Traded on the Hong Kong Stock Exchange

Exchange listing of some bonds may probably be due to separate requirements for mutual funds or unit trusts only to buy listed bonds.

b. Bonds (Tap Issue) and Listed Debt Issuance Programmes[5] that can be Traded Over the Counter

c. Selectively Marketed Securities Status Listing

Selectively marketed securities refer to debt securities marketed to or placed with any number of registered dealers or financial institutions who will either resell such securities as principals off-market or place such securities with a limited number of such investors, thus, "selective marketing" shall be construed accordingly. Nearly all of these securities, because of their nature, will normally be purchased and traded by a limited number of investors who are particularly knowledgeable in investment matters.

d. Non-Listed Bonds that can be Traded Over the Counter

An issuer may choose to issue listed bonds by filing a listing application with the Hong Kong Stock Exchange (HKSE) for the listing of and permission to deal in the bonds on the HKSE, and satisfy certain qualifications for listing as stated in Chapters 23 to 26 of the Listing Rules.

Issuers having debt securities listed or seeking to list debt securities on the HKSE must comply with the requirements set out in the Listing Rules as promulgated by the HKSE. For details, refer to Chapters 22-37 of the Listing Rules.[6] Chapter 37 of the Listing Rules sets out the requirements for the listing on the exchange of selectively marketed securities.

Most bonds in the Hong Kong domestic bond market are traded OTC. In most cases, the purposes of bonds listing or the Debt Issuance Programme listing on the HKSE are profiling, regulations, and price discovery.

HKEx listed bonds include EFN issues.

5. By Note Forms

(a) Bonds may either be in bearer or registered form, represented by definitive or global notes.

(b) The most common form of bonds is global notes which are deposited with the CMU Service in either bearer or registered form.

(c) There is a proposal for dematerialization by 2013, but this would require amendments to the *Companies Ordinance* (CO).

Bonds in Hong Kong, China may be held within the CMU Service operated by the Hong Kong Monetary Authority (HKMA) in either definitive or global-instrument form. The CMU Service provides a central depository service for CMU Instruments held within the CMU and an electronic book-entry system, which eliminates the physical delivery of CMU Instruments between CMU Members.

5 Issues of debt securities where only part of the maximum program's principal amount or aggregate number of securities under the issue is issued initially, and a further tranche (or tranches) may be issued subsequently.

6 Hong Kong Stock Exchanges and ≠Clearing (HKEx). "Chapter 29 (Debt Securities, Tap Issues, Debt Issuance Programmes and Asset-Backed Securities)," *Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong.* http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/vol1_4.htm.

The bond instruments must be lodged with a sub-custodian appointed by the HKMA. The bond issuer must either be a CMU Member or a CMU Member authorized as a Lodging Agent to use the depository services of the CMU Service.

While the bonds are represented by global notes, the CMU Lodging Agent holds the legal title of these bonds, which are then "immobilized" via the CMU accounts. The holders of the CMU accounts hold the bonds in the Main Account for their own benefit, and the bonds in the General/Specific Custody Accounts for and on behalf of their own customers. For bonds held in the General/Specific Custody Accounts, CMU Members have to refer to their own internal records to ascertain the beneficial ownership of the bonds held in such accounts. The Issuer and the Paying Agent directly make payments of principal, interest or any amounts to the persons for whose account interests in the global bond are credited (as set out in a CMU Instrument Position Report, or as notified to the CMU Lodging Agent by the CMU Service). The individual beneficial holders have to rely on the CMU Member or the CMU Lodging Agent for the delivery of payments and notices to them.

On certain bond issues, a temporary global note is produced where a 40-day lock-up period is required under United States (US) tax and securities laws (Regulation S of the *Securities Act 1933*), during which interest in the securities cannot be traded or paid. After the 40-day period, the temporary global note may be exchanged for a permanent global note (which may be conditional upon the CMU Service having received certification as to the non-US beneficial ownership of the CMU Instruments for compliance with Regulation S). The permanent global note may be exchanged into definitive notes in limited circumstances (e.g., closure of the clearing systems or events of default of the issuer or guarantor).

The CMU Service has linkages with other clearing systems. An investor holding an interest through an account with either Euroclear or Clearstream in any CMU Instruments held in the CMU Service will hold that interest through the respective accounts which Euroclear and Clearstream each have with the CMU Service.

6. By Structure of Bond Issue

There are generally two structures for bond issues—the fiscal agent structure and the trustee structure. The rights and obligations of bondholders and an issuer are different depending on the structure.

It is possible to appoint a trustee but this is not a legal requirement in the Hong Kong bond market under the professional nature of the investors in the Hong Kong market. Only about 10% of bond issues feature a trustee, and no recent such appointment has been observed. Between a trustee and a fiscal agent, the choice typically revolves around the question of cost and may be influenced by the limited number of trustees in the market. The issuer may, however, appreciate having a central party to handle matters.

Many issuers are using the fiscal agent system. However, a fiscal agent may not have fiduciary responsibilities as opposed to a trustee. From a foreign institutional investor's point of view, a trustee can be considered as safer compared with a fiscal agent.

No recent issues or programmes featured trustees. Trustee provisions under Hong Kong law are considered out-dated in comparison with the *English Trustee Act* (2000).

a. Fiscal Agent Structure

A fiscal agency agreement is executed between the issuer and the fiscal agent as the principal paying agent of the issuer. The issuer pays the interest or the principal to the fiscal agent and the fiscal agent instructs other paying agents to pay the amounts of interest or principal to the bondholders. The fiscal agent then reimburses the paying agents the amounts paid out.

The fiscal agent also has other functions, such as keeping records of payments on the bonds, calling and holding bondholders' meetings when necessary, sending notices to bondholders, and issuing replacements for lost or destroyed bonds.

As fiscal agents are the agents of the issuer, they do not represent the interests of the bondholders. The issuer would generally execute a deed of covenant,[7] under which bondholders are given direct rights of enforcement against the issuer for default in payment or delivery of definitive bonds.

An example of a fiscal agent structure is the Swire Pacific MTN Financing and Swire Properties Offshore Financing's USD3.5 billion medium-term note (MTN) program dated 18 October 2010.

b. Trustee Structure

Bonds may be constituted in a trust deed, under which the issuer covenants with the trustee to perform its duties under the terms and conditions of the bonds, including to pay any amount due under the bonds and to notify the trustee of any event of default.

The trustee is the representative of the bondholders and exercises the bondholders' rights on behalf of the bondholders and monitors the issuer's performance of its obligations under the bonds.

A paying agency agreement is executed between the issuer, the trustee and the paying agent, under which the paying agent (as agent for the issuer) receives payments due the bondholders from the issuer and pays the relevant interest or principal to the bondholders.

Although, in practice, payments to bondholders are effected through paying agents, the trust deed usually provides power to the trustee, if it declares that an event of default has occurred, to require the issuer to make payments directly to it rather than to the paying agent, or to require the paying agent to act as the trustee's agent, rather than the issuer's agent, when making payments. This protects the bondholders where the issuer is insolvent; the money held by the paying agent would belong to the trustee, rather than being vulnerable to claims by the issuer or the issuer's liquidators.

[7] A deed of covenant is an arrangement under which a party promises to pay a certain sum regularly to another party within a specified timeframe.

An example of a trustee structure is the MTR Corporation Limited USD3 billion debt issuance program dated 16 November 2010.

C. Methods of Issuing Bonds

1. Government Bonds

Government bonds are issued through competitive tender on a bid-price basis. Tenders must be submitted through recognized dealers, which are also appointed as primary dealers as announced by the government from time to time.

Underwriting arrangements are in place by which recognized dealers, which are also appointed as primary dealers, may be required to subscribe for bonds that have not otherwise been subscribed pursuant to valid tenders.

For details, refer to the Information Memorandum of the Government Bond Programme.[8]

2. Exchange Fund Bills and Notes issued by the Hong Kong Monetary Authority

Exchange Fund Bills are issued through competitive tender on a bid-yield basis, whereas EFNs are issued either through competitive tender on a bid-price basis or through non-competitive tender. The tender and underwriting arrangements are similar to those applicable to the Government Bond Programme.

For details, refer to the Information Memorandum of Exchange Fund Bills Programme and the Information Memorandum of Exchange Fund Notes Programme published in the HKMA website.[9]

3. Bonds Issued by Other Statutory Bodies and Government-Owned Corporations

Methods are similar to those of issuing corporate bonds stated below.

4. Methods of Issuing Corporate Bonds

Private entities generally adopt one of the following methods to issue corporate bonds:

(a) A public offer for bonds intended to be sold to the public; or

(b) A private placement for bonds intended to be sold to a small group of investors.

There are some differences in the requirements for the two methods. For instance, a more comprehensive and detailed prospectus is generally required for public offer whereas a relatively simple form of offer document or term sheet suffices for private placement.

For details, refer to Part 2 of the Companies Ordinance (CO). For public offers, specific

8 Government of Hong Kong Special Administrative Region. Hong Kong Monetary Authority. 2011. *Government Bond Programme: Institutional Bond Issuance Programme, Information Memorandum.* http://www.hkgb.gov.hk/en/others/documents/Information_Memorandum.pdf

9 Hong Kong Monetary Authority. http://www.hkma.gov.hk/eng/key-functions/international-financial-centre/debt-market-development/exchange-fund-bills-notes.shtml

reference is made to sections 38 to 41A, and the 17th Schedule of Part 2, in addition to the full prospectus.[10]

For bonds to be listed on the HKSE, issuers should also observe the requirements of the Listing Rules, as well as Parts II and XII of the CO including section 44B.[11]

D. Credit Rating Agencies and Credit Rating of Bonds

There are no credit rating agencies (CRAs) based exclusively in Hong Kong, China. However, the three largest CRAs have offices in this jurisdiction, alongside several smaller multinational CRAs.

In view of the revised Code of Conduct Fundamentals for Credit Rating Agencies issued by the International Organization of Securities Commissions (IOSCO) in May 2008 and the Declaration on Strengthening the Financial System made by the Group of Twenty on 2 April 2009, the Securities and Futures Commission (SFC) is proposing to introduce a regulatory framework to strengthen its oversight of CRAs.

Refer to the Consultation Paper and Consultation Conclusions Concerning the Regulatory Oversight of Credit Rating Agencies published in SFC's website for details.[12]

E. Bond-Related Systems for Investor Protection

Investor protection for investment into debt instruments traded or listed on the Stock Exchange of Hong Kong in the Hong Kong market is evident through, among other measures, the existence of a trustee system and the Investor Compensation Fund (ICF) introduced under the SFO.

While the use of a trustee is not mandatory, the ICF is very much an integral part of the market risk mitigation mechanism and is supported by the Investor Compensation Company Limited (ICC) for the administration of any claims received.

Please refer to details on both trustee regulations and the ICF in the further course of this document.

F. Governing Laws of Bond Issuance

Unless otherwise specified in the prospectus, offer document, or term sheet, the issuance of bonds in Hong Kong, China is governed by and construed in accordance with the laws of Hong Kong, China. Specific references to provisions in other jurisdictions and issue conditions for an offer cannot breach the laws of Hong Kong, China.

10 Hong Kong Legal Information Institute. http://www.hklii.org/eng/hk/legis/ord/32/s38.html
11 Footnote 11. http://www.hklii.org/eng/hk/legis/ord/32/s44B.html
12 Securities and Futures Commission. http://www.sfc.hk/sfc/html/EN/speeches/consult/consult.html

Specific laws governing different types of bonds are summarized as follows:

1. Government Bonds

The issuance of government bonds is governed by the *Loans Ordinance* (Chapter 61 of the Laws of Hong Kong). On 8 July 2009, the Legislative Council passed a resolution under section 3 of the *Loans Ordinance* authorizing the Government to borrow up to a maximum principal amount outstanding at any time of HKD100 billion or its equivalent under the Government Bond Programme. For details, refer to the resolution and the *Loans Ordinance* at the Hong Kong Government Bond Programme website.[13]

2. Exchange Fund Bills and Notes issued by the Hong Kong Monetary Authority

EFBNs are issued for the account of the Exchange Fund under the *Exchange Fund Ordinance* (Chapter 66 of the Laws of Hong Kong). For details, refer to the HKMA website.[14]

3. Bonds Issued by Other Statutory Bodies and Government-Related Corporations

Issuance of bonds is governed by the respective ordinances governing the statutory bodies and/or the CO where applicable. For instance, bonds issued by the Hong Kong Airport Authority, which is a statutory body established under the *Airport Authority Ordinance* (Chapter 483 of the Laws of Hong Kong), are governed by the same ordinance.

4. Bonds Issued by Private Entities

The issuance of bonds by private entities is governed by sections 41, 44A, 44B and 48A of the CO (Chapter 32 of the Laws of Hong Kong), in addition to the SFO. The terms and conditions of the offers are set out in the offer documents, such as the prospectus. In addition to these, an offer cannot be in breach of other Hong Kong law. For details, refer to the Hong Kong Legal Information Institute (HKLII) website.[15]

If the bonds are to be listed on the HKSE, in addition to the CO, issuers have to observe the Listing Rules as mentioned above and other relevant rules promulgated by the HKSE.

If participants use the clearing, settlement and custody services provided by the CMU, the debt securities settlement system operated by the HKMA, they should observe the relevant rules promulgated by the HKMA.

G. Transfer of Interests in Bonds

The transfer of title can be evidenced through registration.

13 Hong Kong Government Bond Programme. http://www.hkgb.gov.hk/en/overview/legal.html
14 Footnote 10.
15 Footnote 11. http://www.hklii.org/eng/hk/legis/ord/32/

1. Transfer of Entitlement and Ownership of Securities

Transferees and transferors should send transfer instructions to the CMU for matching and settlement. The transfer of ownership becomes effective upon matching a debit instruction with the corresponding credit instruction and registration in the book entries in the securities accounts of CMU Members within the CMU Service.

2. Entitlement Perfection against a Third Party (Finality of Transactions)

a. Real-time securities transfer transactions on the CMU Members' Terminal or SWIFT[16] are immediately completed upon successful debiting of funds from the buyer and debiting of securities from the seller, and are deemed final (not subject to waiting time).

b. End-of-day securities transfer transactions are balanced during the CMU end-of-day settlement processing.

c. Notwithstanding the mode or means of transfer, all local securities transfer instructions effected through the CMU Service shall be settled by the HKMA, debiting or crediting the relevant securities accounts of the CMU Members concerned; once debited or credited to such securities accounts, such securities transfer instructions shall be deemed made, completed, irrevocable and final.

d. The situation can be more complex where the securities transfer instructions are effected through linkages with other regional central securities depositories (CSDs) including the Korea Securities Depository, AustraClear, and China Central Depository and Clearing (CCDC), or with international CSDs (ICSDs), including Clearstream or Euroclear.

e. It is also worth noting that the finality of the transactions settled through the CMU system is protected from insolvency laws (including liquidators and receivers) under section 19 of the *Clearing and Settlement Systems Ordinance* (Cap 584). For example, securities transactions, once settled, may not be set aside on grounds of unfair preference.

3. Prohibited transfers

a. On-exchange naked short selling of listed securities is prohibited in Hong Kong, and all CMU Members must undertake not to incur a short position in any of the CMU Instruments. Securities may only be sold at or through a recognized stock market if the seller (as principal) or his principal (himself as agent) has, or has reasonable grounds for believing that he or the principal has, a presently exercisable and unconditional right to vest the securities in the purchaser (section 170 of the *Securities and Futures Ordinance* [SFO]).

b. The concept of "presently exercisable and unconditional right to vest the securities in the purchaser" is interpreted with some flexibility. For further illustration, see the SFC's Guidance on Short Selling Reporting and Stock Lending Record Keeping Requirements available at the SFC website.[17]

16 SWIFT stands for Society for Worldwide Interbank Financial Telecommunication.
17 Securities and Futures Commission. http://www.sfc.hk/sfcRegulatoryHandbook/EN/displayFileArchServlet?docno=H141

c. On-exchange covered short sales (i.e., short-selling orders) in "designated securities" (as designated by the HKSE pursuant to the *Short Selling Regulations* in the Eleventh Schedule to the Listing Rules) are permitted provided that

   (i) the seller (whether acting as principal or agent) must, at the time of placing a short-selling order, identify it as a short-selling order and provide documentary assurance that the sale is "covered" and
   (ii) An intermediary who receives a short-selling order must ensure that he has obtained a documentary assurance that the sale is "covered".

d. The maximum penalties for contravention of section 170 of the SFO are a fine of HKD100,000 and imprisonment for 2 years.

e. The Hong Kong Securities Clearing Company (HKSCC) charges a default fee of 0.50% of the market value of failed transactions.

H. Definition of Securities

As far as the legal definition of debt instruments is concerned, for bonds to be listed on the HKSE or cleared through the CMU, they must satisfy the criteria set out in, among others, the Listing Rules[18] and the CMU Service Reference Manual (which is accessible to CMU members only), respectively. A definition of securities is also laid down in the SFO.

1. Definition of "CMU Instruments" in the Central Moneymarkets Unit Service Reference Manual

CMU Instruments are money market and capital market instruments, which are specified in the CMU Service Reference Manual as capable of being held within the CMU Service. CMU Instruments include:

(i) Asset-backed securities,
(ii) Equity linked instruments,
(iii) Fixed-rate certificates of deposit,
(iv) Government bonds,
(v) Floating-rate certificates of deposit,
(vi) Bonds,
(vii) Fixed-rate notes,
(viii) Floating-rate notes,
(ix) Commercial papers,
(x) Mortgage-backed securities,
(xi) Fixed-rate linked securities,
(xii) Floating-rate linked securities,
(xiii) Zero coupon certificates of deposit,
(xiv) Zero coupon notes,
(xv) Bills of Exchange other than trade bills, and
(xvi) Any other Hong Kong dollar money market and capital market instruments as the HKMA may specify from time to time

[18] Footnote 3. http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/vol1_4.htm

2. Definition of "Securities" in the *Securities and Futures Ordinance* and the Listing Rules

a. Section 1 of Part 1 of Schedule 1 to the *Securities and Futures Ordinance*

"Securities" means

(i) shares, stocks, debentures, loan stocks, funds, bonds or notes of, or issued by, a body, whether incorporated or unincorporated, or a government or municipal government authority;

(ii) rights, options or interests (whether described as units or otherwise) in, or in respect of, such shares, stocks, debentures, loan stocks, funds, bonds or notes;

(iii) certificates of interest or participation in, temporary or interim certificates for, receipts for, or warrants to subscribe for or purchase, such shares, stocks, debentures, loan stocks, funds, bonds or notes;

(iv) interests in any collective investment scheme;

(v) interests, rights or property, whether in the form of an instrument or otherwise, commonly known as securities;

(vi) interests, rights or property which are interests, rights or property, or are of a class or description of interests, rights or property, prescribed by notice under section 392 of the SFO as being regarded as securities in accordance with the terms of the notice;

(vii) a structured product that does not come within any of paragraphs (i) to (vi), but in respect of which the issue of any advertisement, invitation or document that is or contains an invitation to the public to do any act referred to in section 103(1)(a) of the SFO is authorized or required to be authorized, under section 105(1) of the SFO,

but does not include–

(1) shares or debentures of a company that is a private company within the meaning of section 29 of the CO (Cap 32);

(2) any interest in any collective investment scheme that is -

(A) a registered scheme as defined in section 2(1) of the *Mandatory Provident Fund Schemes Ordinance* (Cap 485), or its constituent fund as defined in section 2 of the *Mandatory Provident Fund Schemes (General) Regulation* (Cap 485 sub. leg. A);

(B) an occupational retirement scheme as defined in section 2(1) of the *Occupational Retirement Schemes Ordinance* (Cap 426); or

(C) a contract of insurance in relation to any class of insurance business specified in the First Schedule to the *Insurance Companies Ordinance* (Cap 41);

(3) any interest arising under a general partnership agreement or proposed general partnership agreement unless the agreement or proposed agreement relates to an undertaking, scheme, enterprise or investment contract promoted by or on behalf of a person whose ordinary business is or includes the promotion of similar undertakings, schemes, enterprises or investment contracts (whether or not that person is, or is to become, a party to the agreement or proposed agreement);

(4) any negotiable receipt or other negotiable certificate or document evidencing the deposit of a sum of money, or any rights or interest arising under the receipt, certificate or document;

(5) any bill of exchange within the meaning of section 3 of the *Bills of Exchange Ordinance* (Cap 19) and any promissory note within the meaning of section 89 of that ordinance;

(6) any debenture that specifically provides that it is not negotiable or transferable (excluding a debenture that is a structured product in respect of which the issue of any advertisement, invitation or document that is or contains an invitation to the public to do any act referred to in section 103(1)(a) of the SFO is authorized, or required to be authorized, under section 105(1) of the SFO);

(7) interests, rights or property which are interests, rights or property, or are of a class or description of interests, rights or property, prescribed by notice under section 392 of the SFO as not being regarded as securities in accordance with the terms of the notice;

b. Section 7 of Part 1 of Schedule 1 to the *Securities and Futures Ordinance*

In the SFO, a reference to securities (however described) as those of a corporation shall, unless the context otherwise requires, be construed as a reference to securities (having the applicable meaning, whether under section 1 of Part 1 of Schedule 1 to the SFO or otherwise) which are –

(i) issued, made available or granted by the corporation;

(ii) proposed to be issued, made available or granted by the corporation; or

(iii) proposed to be issued, made available or granted by the corporation when it is incorporated.

c. Rule 1.01 of Chapter 1 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong

(i) "Debt securities" means debenture or loan stock, debentures, bonds, notes and other securities or instruments acknowledging, evidencing or creating indebtedness, whether secured or unsecured and options, warrants or similar rights to subscribe or purchase any of the foregoing and convertible debt securities.

(ii) “Equity securities” means shares (including preference shares and depositary receipts), convertible equity securities and options, warrants or similar rights to subscribe or purchase shares or convertible equity securities, but excluding interests in a collective investment scheme.

I. Self-Governing Rules behind the Market

Self-governing rules are not applicable in the Hong Kong context.

J. Bankruptcy Procedures

Any bond issuers declaring bankruptcy are subject to the relevant rules set out in the *Bankruptcy Ordinance* (Chapter 6 of the Laws of Hong Kong).

The ranking of a bond vis-à-vis other indebtedness of the bond issuer is determined taking into account the terms and conditions set out in the prospectus, offer documents, term sheets, or similar form of documents as well as section 38 (Priority of Debts) of the *Bankruptcy Ordinance*.

“The Asia-Pacific Restructuring and Insolvency Guide 2006” provides more information on the restructuring and insolvency frameworks of Asia-Pacific countries. The report on Hong Kong, China can be found in the Asian Development Bank (ADB) website.[19]

The insolvency law in Hong Kong, China is contained in the CO, the *Bankruptcy Ordinance* and the *Companies (Winding-up) Rules*. It is based on the law of the United Kingdom (UK), prior to the introduction of the Cork Report. Like the regimes in Australia and New Zealand—also UK law-based jurisdictions—it is generally creditor friendly.

Out-of-court restructuring, schemes of arrangement, compulsory liquidations, creditors’ voluntary liquidations, and receiverships are available under the insolvency law. No corporate rescue procedure is currently available.

K. Meetings of Bondholders

1. Resolution of a Meeting of Bondholders

The terms on the rights to convene meetings of bondholders and quorum requirements may be stated in the trust deed or the fiscal agency agreement, and depend on the agreement of the parties.

a. Fiscal Agent Structure

(i) The issuer or noteholders holding not less than 10% in nominal amount of the bonds for the time being outstanding may convene a meeting of noteholders.

[19] Asian Development Bank. 2006. *The Asia-Pacific Restructuring and Insolvency Guide 2006*. Malaysia: Shearn Delamore & Co. and PricewaterhouseCoopers.

(ii) The quorum is one or more persons holding or representing not less than 50% in nominal amount of the notes for the time being outstanding.

(iii) An example of a fiscal agent structure is Swire Pacific MTN Financing and Swire Properties Offshore Financing's USD3.5 billion MTN program dated 18 October 2010.

b. Trustee Structure

(i) Noteholders holding not less than 10% in principal amount of the notes for the time being outstanding may convene a meeting of noteholders.

(ii) The quorum is two or more persons holding a clear majority in principal amount of the notes for the time being outstanding (except where the business of the meeting covers certain "reserved matters", a higher threshold is required).

(iii) An example of a trustee structure is the Standard Chartered/Standard Chartered Bank/Standard Chartered Bank (Hong Kong) /Standard Chartered First Bank Korea USD35 billion debt issuance program dated 10 November 2010.

(iv) Resolutions passed in a meeting of bondholders, or simply written resolutions of holders holding a specified percent of aggregate principal amount of outstanding bonds, would be binding on all holders of the bonds.

(v) Usually any changes to the terms would have to be agreed to by the issuer. Bondholders' meetings are generally only convened by the issuer.

2. Appointment of a Trustee

There is no mandatory requirement for the appointment of a trustee to represent the interests of bondholders in Hong Kong. The most common structure for bond issues is the fiscal agent structure with the issuing-cost consideration for the issuers.

Protection of bondholders and representation of their interests are discussed above.

L. Event of Default

1. Terms of Events of Default

Events of default are a matter of negotiation but, generally, cover non-payment of principal or interest by the issuer; non-compliance with obligations under the bond instruments; non-payment of other indebtedness of the issuer or guarantor when due; and the occurrence of certain specified events, for example, change of control, commencement of proceedings against the issuer, passing of an effective resolution for the winding up, administration or dissolution of the issuer or guarantor.

Events of default are usually found in the trust deed, fiscal agency agreement, or deed of covenant (executed by the issuer and guarantor).

2. Declaration of Default

a. Fiscal Agent Structure

Noteholders may give written notice to the issuer to declare that the notes would become forthwith due and payable. This direct right is contained in a deed of covenant.[20]

b. Trustee Structure

The trustee may, at its discretion, give notice of default by:

(i) Declaring the notes immediately due and repayable (with a certified opinion that the event is materially prejudicial to the interests of the holders of the notes); or

(ii) If so directed in writing by the holders of at least 25% in principal amount of the notes, or by an extraordinary resolution of the holders of the notes, declaring all the notes immediately due and repayable.

The trustee may institute proceedings against the issuer to enforce repayment of the principal of the notes with accrued interest and to enforce the provisions of the trust deed. However, the noteholders are not entitled to proceed directly against the issuer unless the trustee fails to do so within a reasonable period and such failure is continuing. The noteholders' interests are represented by the trustee.[21]

c. Event of Default

The default may happen at any time during the day.

M. Options Available on the Bond Market

1. Currency

The most common currencies in which bonds are denominated are Hong Kong dollar, renminbi, US dollar, and euro. The CMU Service is linked to the Hong Kong dollar, US dollar, euro and renminbi RTGS settlement systems in Hong Kong to provide real-time DVP capability for settlement of debt securities denominated in these currencies.

2. Convertible Bonds

As far as convertible bonds are concerned, the issuer will engage a Conversion Agent, who is responsible for handling on behalf of the issuer the conversion notices sent by the bondholders, receiving payments from bondholders and the issuer in respect of the conversion, and cancelling the original bonds upon conversion.

The Conversion Agent will also be responsible for calculating the number and aggregate principal amount of new shares to which the bondholders exercising the conversion rights will be entitled.

The Conversion Agent is normally a bank.

[20] See Swire Pacific MTN Financing and Swire Properties Offshore Financing's USD3.5 billion MTN program dated 18 October 2010.

[21] See MTR Corporation's USD3 billion debt issuance program dated 16 November 2010.

3. Retail Bonds

Retail bonds are usually represented by a single global bond certificate issued in a principal amount equal to the total principal amount of the bond units issued. The placing banks will hold these bonds in their securities accounts with the CMU Service for and on behalf of individual investors.

CMU Account holders are treated as the bondholders. Interest and principal payments will be made to the CMU Account holders (i.e., the placing banks).

Individual investors hold their interests only indirectly in book-entry form through the securities accounts they hold with the placing banks. Individual investors have to rely on the placing banks to ensure that payments are credited to their securities or investment accounts with the placing banks. Individual investors also have to rely on CMU Participants to enforce any rights against the issuer on their behalf.

Where the bonds are listed, the bonds may be traded on the Exchange. Where the bonds are not listed, secondary markets may be established between the placing banks.

An issue of bonds to the public is required to comply with the prospectus requirements under the CO (Cap. 32), including the contents as specified in Third Schedule to the CO, and the offer of investments regime under the SFO (Cap. 571).

An example of such case is the Bank of China Limited retail 2.65% and 2.90% renminbi bonds due on 2012 or 2013 dated 7 September 2010, which adopted the fiscal agent structure.

N. Parties in a Bond Issue and Their Respective Roles

1. Issuer
2. Guarantor
3. The CMU and its appointed sub-custodian for safekeeping of physical global notes
4. Trustee, Paying Agent and/or Fiscal Agent
   a. The trustee, paying agent and/or fiscal agent are responsible for paying the interest and principal under, and sending notices pursuant to, the notice provisions of the CMU Instruments.

      (i) The Paying Agent receives an Issue Position Report from the CMU Service on the interest payment dates of the relevant CMU Instruments, the aggregate nominal value of the relevant CMU Instrument held by each CMU Member based on the Interest Payment Record Date, the maturity date of the relevant CMU Instruments, the aggregate nominal value of the relevant CMU Instrument held by each CMU Member based on the Maturity Record Date.

      (ii) The CMU Member is responsible for further distributing interest payments received from the paying agent to beneficial holders of the bonds.

b. They are also responsible for organizing and holding meetings of bondholders.

5. CMU Member and/or CMU Lodging Agent

The CMU Member or CMU Lodging Agent holds the legal title of the bonds held within the CMU Service.

With regard to payment of interest, if the CMU Member holds the CMU Instrument for and on behalf of its customers, it should arrange for the relevant amount of interest to be paid to the customers according to the standing arrangements between the CMU Member and the customers.

The CMU Member or CMU Lodging Agent receives the Account Position Report, confirming the balances in their securities accounts with the CMU Service.

CMU Membership is open to members of the Asia Capital Markets Association,[22] "authorised institutions" under the *Banking Ordinance* of Hong Kong, China and local and overseas financial entities at the discretion of the HKMA. All CMU Members are required to sign a CMU Membership Agreement with the CMU Service.

6. Arrangers
7. Dealers
8. Legal advisers
9. Auditors
10. CMU Service
11. Participating banks of the respective RTGS settlement systems

O. Major Participants in the Market

1. Issuers

The HKMA is the main issuer of Hong Kong-dollar debt instruments, followed by non-MDB overseas borrowers and authorized institutions.

In 2009, the amount of Exchange Fund Bills issued by the HKMA amounted to HKD1,048 billion, which accounted for 84% of the aggregate amount of Hong Kong-dollar debt instruments issued by any party. Such portion was exceptionally high in 2009 due to the reasons set out in part IX of this report on "History of Debt Market Development".

[22] Established in 1986, the Hong Kong Capital Markets Association (HKCMA) is an industry association founded by a group of financial institutions active in the Hong Kong market to help promote the development of the local and regional debt capital markets. Since its inception, the HKCMA has performed four main functions: i) Providing various professional recommendations and feedback to regulators with respect to developmental issues of the debt markets; ii) Providing a forum for market professionals to discuss and implement best practices guidelines; iii) Organizing regular functions for market participants to network; iv) Providing bond market education and training to the public. http://www.hkcma.org/

In other typical years, the HKMA was still the main issuer and accounted for around 50% of total Hong Kong-dollar debt instruments issued. As of the end of 2009, the outstanding amount of bonds issued by public entities including the Government, the HKMA, statutory bodies, and government-owned corporations accounted for 55%; private entities including authorized institutions, local corporates, MDBs, and non-MDB overseas borrowers accounted for the remaining 45%.

In terms of the domicile of issuers (excluding the HKMA), in 2009, 51% were from Hong Kong, followed by Australia (8%), France (7%), and the UK (4%). In terms of the industry of issuers (excluding the HKMA), financial institutions remained the major issuers in the private sector in 2009, and the utilities industry recorded the highest growth (1,514%) as the base was relatively small in 2008.

2. Investors

Pension funds including the Mandatory Provident Fund schemes, Hong Kong banking institutions, and government-related institutions are the major institutional investors of bonds issued in Hong Kong. However, the breakdown of their investment amounts is not available.

For details, refer to the feature article "Hong Kong-dollar debt-market development in 2009" of the *Quarterly Bulletin* March 2010 issue.[23]

[23] Government of Hong Kong SAR. 2010. "Hong Kong-dollar debt-market development in 2009," *Quarterly Bulletin*. March. http://www.info.gov.hk/hkma/eng/public/qb201003/qb_all_index_new.htm

II. Primary and Secondary Markets Regulatory Framework

A. Hong Kong Market Regulatory Structure

1. Market Entry Requirements

There are no market entry requirements or prior registration for foreign market participants to enable them to commence trading in the Hong Kong bond market.

2. Market Regulatory Bodies

a. Hong Kong Monetary Authority

The Hong Kong Monetary Authority (HKMA) is Hong Kong's de facto central bank. The HKMA was established on 1 April 1993 by merging the Office of the Exchange Fund with the Office of the Commissioner of Banking. Its main functions and responsibilities are governed by the *Exchange Fund Ordinance* and the *Banking Ordinance*, and it reports to the Financial Secretary.

The HKMA is the government authority in Hong Kong responsible for maintaining monetary and banking stability. Its main functions are:

(i) Maintaining currency stability within the framework of the Linked Exchange Rate System;

(ii) Promoting the stability and integrity of the financial system, including the banking system;

(iii) Helping maintain Hong Kong's status as an international financial center, including the maintenance and development of Hong Kong's financial infrastructure; and

(iv) Managing the Exchange Fund.

The HKMA solely operates the Central Moneymarkets Unit (CMU), which provides clearing, settlement and depository services for both HK dollar-denominated and international debt securities available for trading in the Hong Kong market.

The HKMA has developed external infrastructure linkages with other regional and international central securities depositories (ICSDs) to settle securities lodged with the CMU.

b. Securities and Futures Commission

The principal regulator of Hong Kong's securities and futures market is the Securities and Futures Commission (SFC), which is an independent statutory body established in 1989 by the *Securities and Futures Commission Ordinance* (SFCO). The SFCO and nine other securities and futures-related ordinances were consolidated into the *Securities and Futures Ordinance* (SFO), which came into effect on 1 April 2003.

The SFC is responsible for administering the laws governing the securities and futures market in Hong Kong. Its regulatory objectives as set out in the SFO are:

(i) to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;

(ii) to promote understanding of the public of the operation and functioning of the securities and futures industry;

(iii) to provide protection for members of the public investing in or holding financial products;

(iv) to minimize crime and misconduct in the securities and futures industry;

(v) to reduce systemic risks in the securities and futures industry; and

(vi) to assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

In addition to regulating the Hong Kong Stock Exchange (HKEx), listed companies and share registrars, the SFC oversees licensed corporations and individuals carrying out the regulated activites listed below[24], with a direct relevance for the bond market indicated by an asterisk:

(i) Dealing in securities*
(ii) Dealing in futures contracts
(iii) Leveraged foreign exchange trading
(iv) Advising on securities*
(v) Advising on futures contracts
(vi) Advising on corporate finance*
(vii) Providing automated trading services*
(viii) Securities margin financing*
(ix) Asset management*
(x) Providing credit rating services*

24 Securities and Futures Commission. http://www.sfc.hk/sfc/html/EN/aboutsfc/regulate/regulate.html.

c. Hong Kong Stock Exchanges and Clearing

The Hong Kong Stock Exchanges and Clearing Limited (HKEx) is a recognized exchange controller under the SFO. It owns and operates the only stock exchange and futures exchange in Hong Kong and their related clearing houses, namely Hong Kong Securities Clearing Company (HKSCC), HKFE Clearing Corporation (HKCC), and the SEHK Options Clearing House (SEOCH).

For securities identification, the National Numbering Agency (NNA) appointed the HKEx to assign and update the International Securities Identification Number (ISIN) codes for securities listed on the Stock Exchange of Hong Kong (SEHK) and registered in Hong Kong, China.

For other Hong Kong listed securities registered outside Hong Kong, the ISIN codes assigned and updated by the NNAs or their substitute agencies in the corresponding countries will be used. The ISIN codes are available for ordinary shares, debt securities, warrants and trusts.

SEHK also uses local five-digit codes to identify listed securities.

d. The Stock Exchange of Hong Kong

The Stock Exchange of Hong Kong (SEHK), a wholly-owned subsidiary of HKEx, is a recognized exchange company under the SFO. It operates and maintains a stock market in Hong Kong and is the frontline regulator of Stock Exchange Participants with respect to trading matters and of companies listed on the Main Board and Growth Enterprise Market of the Stock Exchange.

e. Hong Kong Futures Exchange

Hong Kong Futures Exchange (HKFE), a wholly-owned subsidiary of HKEx, is a recognized exchange company under the SFO. It operates and maintains a futures market in Hong Kong and is the frontline regulator of Futures Exchange Participants with respect to trading matters.

f. Clearing Houses

HKSCC, SEOCH and HKCC, wholly-owned subsidiaries of HKEx, are recognized clearing houses for the purposes of the SFO. HKSCC and SEOCH provide services for the clearing and settlement of securities and stock option transactions, respectively, including trades and transactions effected on, or subject to the rules of, the Stock Exchange. HKCC provides services for the clearing and settlement of transactions on the Futures Exchange.

B. Regulation of the Hong Kong Securities Markets

1. Legislative Framework

The key legislations governing the Hong Kong capital market are the SFO and the *Companies Ordinance* (CO). The SFO consolidates and modernizes 10 previous ordinances regulating the securities and futures market. The primary legislation and the subsidiary legislation came into effect on 1 April 2003.

The provisions of the SFO provide the SFC with the ability to, amongst others and so far as reasonably practicable, supervise, monitor and regulate the activities carried on by:

(a) persons carrying out activities regulated by the SFC under the SFO relating to:
   (i) dealing in securities and futures contracts;
   (ii) leveraged foreign exchange trading;
   (iii) advising on securities, futures contracts and corporate finance;
   (iv) providing automated trading services;
   (v) securities margin financing;
   (vi) asset management; or
   (vii) providing credit rating services.

(b) persons carrying out activities regulated by the SFC under certain parts of the CO relating to:
   (i) prospectuses;
   (ii) the purchase by a corporation of its own shares; and
   (iii) a corporation giving financial assistance for the acquisition of its own shares.

(c) recognized exchange companies (e.g., The Stock Exchange and Hong Kong Futures Exchange).

(d) recognized exchange controllers (e.g., HKEx).

(e) recognized clearing houses (e.g., HKSCC, HKCC and the SEOCH).

(f) recognized investor compensation companies (e.g., Investor Compensation Company).

(g) persons authorized by the SFC to provide automated trading services.

2. Trading Rights

By law, any person carrying on a business dealing in securities, or carrying on a business dealing in futures contracts in Hong Kong,China, has to be licensed by the SFC or fall within one of the licensing exemptions. In addition, the rules promulgated by the Stock Exchange and Futures Exchange require any person who wishes to trade on or through their respective facilities to hold a Trading Right. The Trading Right confers on its holder the eligibility to trade on or through the relevant exchange. However, holding a Trading Right does not, of itself, permit the holder to actually trade on or through the relevant exchange. To be able to actually trade on or through the relevant exchange, it is also necessary for the person to be registered as a participant of the relevant exchange in accordance with its rules, including those requiring compliance with all relevant legal and regulatory requirements. Stock Exchange Trading Rights and Futures Exchange Trading Rights are issued by the Stock Exchange and Futures Exchange at a fee and in accordance with the procedures set out in their respective rules.

C. Regulations and Rules Related to Issuing Debt Instruments

1. For bonds to be listed on the HKSE, bond issuers should observe, among others, the Listing Rules which set out the qualifications for listing, application procedures and requirements, and listing documents and arrangements. For details, refer to Chapters 22-37 of the Listing Rules.[25]

2. Issuers of bonds to be listed on the HKSE should also observe the Trading Rules promulgated by the HKEx.[26]

3. For bonds to be listed on the HKSE, issuers should also observe the requirements, of the Listing Rules, as well as Parts II and XII of the CO, including section 44B.[27]

4. Save for the above and the specific laws mentioned above on bonds issued by different types of entities, other regulations governing the issuance of listed or non-listed bonds in Hong Kong include the following.

   (a) Both domestic and foreign entities are eligible to issue debt instruments in Hong Kong.
   (b) Foreign entities interested in raising funds in Hong Kong should, however, ascertain whether it is permitted under the law of their jurisdictions.
   (c) If the debt instruments are to be listed on the HKSE, issuers have to comply with the requirements for reporting and disclosure of information as set out in the Listing Rules and other relevant documents of the HKSE.

D. Related Rules and Regulations on Investment in Debt Securities

Unless otherwise stated in the prospectus, offer document, term sheet or similar document, there is no restriction on the types of investors who are eligible for investing in particular debt instruments. Foreign investors, whether institutional or retail, should, however, ascertain whether it is permitted under the law of their jurisdictions.

From intermediaries' point of view, when selling unlisted securities to retail investors, they are required to observe, among others, the Code of Conduct for Persons Licensed by or Registered with the SFC; the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC; the Frequently Asked Questions on Suitability Obligations issued by the SFC; and, where applicable. Intermediaries which are registered institutions under the supervision of the HKMA are also required to observe the guidelines issued by the HKMA. For details, refer to the HKMA guidelines and the SFC Regulatory Handbook for the Code of Conduct for Persons Licensed by or Registered with the SFC.[28]

25 Footnote 3. http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/vol1_4.htm
26 Footnote 3. http://www.hkex.com.hk/eng/rulesreg/traderules/tradingrules.htm
27 Footnote 11. http://www.hklii.org/eng/hk/legis/ord/32/s44B.html
28 Footnote 10. http://www.info.gov.hk/hkma/eng/guide/circu_date/20100520e1.pdf; Footnote 18. http://www.sfc.hk/sfcRegulatoryHandbook/EN/displayFileServlet?docno=H652

E. Investor Protection

1. Existence of the Non-Mandatory Trustee System

Many issuers are choosing to appoint a fiscal agent. However, trustees have a fiduciary responsibility while a fiscal agent does not. From a foreign institutional investors' point of view, a trustee is a 'safer' option than a fiscal agent.

2. The Investor Compensation Fund

Prior to the enactment of the SFO, there were two separate investor compensation schemes called the Unified Exchange Compensation Fund (UECF) and the Commodity Exchange Compensation Fund (CECF) managed respectively by the SEHK and the Hong Kong Futures Exchange. The CECF wound up in May 2006 and the residual monies were transferred to the Investor Compensation Fund (ICF) subsequently. The UECF is applicable to the claims submitted before 1 April 2003 and no longer covers the claims submitted after that. The prevailing ICF was introduced on 1 April 2003 under the SFO.

The maximum compensation limit for each claimant was pegged at HKD150,000. The main aim of the ICF is to pay compensation to investors (any nationality) who suffer financial losses on account of a default on the part of a licensed intermediary or an authorized financial institution in relation to exchange-traded products in Hong Kong.

The Investor Compensation Company was established for the administration and determination of claims received against the ICF. The main source of income for the ICF is from the Investor Protection Levy imposed on each exchange-traded product transaction. The current levy is as follows:

Table 2.1 Current Levy on Exchange-Trade Product Transactions

Nature of Transaction	Amount Payable
Securities transactions	0.002% payable by both buyer and seller
Futures contract	HKD0.5 per side of a contract or HKD0.1 per side of a mini contract or stock futures contract

Source: Deutsche Bank AG Domestic Custody Services Market Guide Hong Kong, October 2009.

A levy trigger mechanism came into effect on 28 October 2005. As the net asset value of the compensation fund exceeded the limit of HKD1.4 billion in 2005, the payment of Investor Compensation Levy has been suspended by the SFC according to the levy trigger mechanism beginning on 19 December 2005. Other funding sources of ICF include investment income, bank interest earned on deposits maintained, and transfers from the UECF and CECF.

F. Taxation Framework and Tax Requirements

Residents and non-residents investing in the Hong Kong, China market are not charged with withholding tax on dividends and fixed income. Interest income derived from bond holding is not taxable for individuals. For corporations, interest on bonds issued by the government and government-related entities is not taxable. Other interest is taxable if it has a Hong Kong source. Thus, interest on a corporate bond listed on the HKSE is taxable.

Currently, full exemption from profits tax for interest income and trading profits in respect of certain debt instruments is granted under section 26A of the *Inland Revenue Ordinance*.[29] These debt instruments include, inter alia, long-term debt instruments with an original maturity of not less than 7 years.

In addition, pursuant to section 14A of the *Inland Revenue Ordinance* (IRO), a tax concession at 50% of the normal profits tax rate is applied to interest income and trading profits derived from a debt instrument which satisfies the relevant criteria including the following:

(i) it is lodged with and cleared by the CMU operated by the HKMA;
(ii) it has an original maturity of not less than 3 years but less than 7 years;
(iii) it has a minimum denomination of HKD50,000 or its equivalent in a foreign currency;
(iv) it is issued to the public in Hong Kong, China; and
(v) it is issued by a person and has, at all relevant times, a credit rating acceptable to the HKMA from a credit rating agency recognized by the HKMA.

Residents and non-residents investing in the Hong Kong market are charged no withholding tax on dividends and fixed income interest.

Table 2.2 Duties and Taxes in the Hong Kong Market

Duties and Tax	
Withholding Tax (WHT)	
WHT – Equities	NIL, except for withholding tax on US Securities traded under the NASDAQ Pilot Program.
WHT - Fixed Income	Nil.
Capital Gains	Nil
Stamp Duty	Stamp duty on Stock Exchange Transactions: 0.1% of the value of the transaction on both the buyer and the seller. Stamp duty on Contract Notes: HKD1 for every HKD1,000 and part thereof on the transaction value.
Other Taxes	Stamp duty on Stock Exchange Transactions: 0.1% of the value of the transaction on both the buyer and the seller. Stamp duty on Contract Notes: HKD1 for every HKD1,000 and part thereof on the transaction value.

Source: Deutsche Bank AG Domestic Custody Services Market Guide Hong Kong, October 2009.

1. Withholding Tax

There is no withholding tax on dividends and the interests in Hong Kong, China.

2. Tax Treaties (Double Taxation Avoidance)

Hong Kong, China has entered into a very limited number of Double Taxation Avoidance (DTA) treaties. However, since there is no withholding tax on bond interest

[29] Footnote 11. http://www.hklii.org/eng/hk/legis/ord/112/s26A.html

and dividends, DTAs may not be relevant in this content. Investors are, however, advised to check their tax position with a qualified tax advisor.

3. Stamp Duty

The following stamp duties are applicable on securities traded in Hong Kong, China.

(a) Stamp duties and transaction levies are payable on transactions by both buyer and seller. The stamp duty is charged at 0.1% of the consideration by the Inland Revenue Department of Hong Kong on both the buyer and the seller. Any fraction in ad valorem stamp duty will be rounded up to the nearest HKD1.

(b) A transfer stamp duty must be paid by the seller on transactions for securities which are physically settled and not cleared by the Central Clearing and Settlement System (CCASS). This transfer stamp duty is charged at the rate of HKD5 per Transfer Deed by the Inland Revenue Department of Hong Kong, China.

For trades executed on HKEx, the stamp duty is included in the contract note issued by the broker. The broker pays ad valorem stamp duty on behalf of their clients on T+2. It is the responsibility of the investor to ensure that stamp duty is paid at the correct rate; otherwise, severe penalties can be imposed for non-payment of stamp duty under the *Stamp Duty Ordinance*. As per the *Stamp Duty Ordinance*, on change in the beneficial ownership of shares, ad valorem stamp duty is payable:

(i) Within 2 days for trades (on exchange or off-market) executed in Hong Kong, China.
(ii) Within 30 days for off-market trades executed outside Hong Kong, China.

4. Capital Gains Tax

There is no capital gains tax in Hong Kong, China.

5. The Qualifying Debt Instrument Scheme

An active and diverse debt market is important to the further development of Hong Kong as an international financial center. The Qualifying Debt Instrument (QDI) scheme was formulated with the policy intention of developing and enhancing the competitiveness of the local debt market. For the QDI scheme to achieve its policy intention, enhancements need to be introduced from time to time in response to the changing market landscape and measures adopted by other financial centers in the region for developing their respective debt markets.

Interest income and trading profits of debt instruments issued and traded in Hong Kong are chargeable to profits tax under the IRO as stated above.

Currently, a 100% exemption from profits tax for interest income and trading profits arising from certain categories of debt instruments is granted pursuant to section 26A of IRO as stated above. These debt instruments include government bonds, Exchange Fund debt instruments, Hong Kong dollar-denominated multilateral agency debt instruments, and long-term debt instruments with an original maturity of 7 years or longer. In addition, under section 14A of IRO, a tax concession at 50% of the normal profits tax rate is applied to interest income and trading profits derived from a debt instrument that satisfies the relevant criteria stated in page 28.

Notwithstanding the refinements introduced to the QDI scheme in 1999 and 2003, respectively, the percentage of QDI issuance in Hong Kong's total debt issuance remained small. Only 4% of Hong Kong's total debt issuance has been subject to QDI issuance since the last refinement in 2003. There is still room for improving the scheme to enable it to better serve its policy objectives.

The government conducted a review of the QDI scheme and identified several areas for improvement. First, the structure of the tax incentives in the scheme does not match the landscape of Hong Kong's corporate bond market. While Hong Kong's corporate bond market is dominated by privately-placed short-term debt instruments with an original maturity of less than 3 years (46% of total issuance), the scheme only offers tax incentives to debt instruments with an original maturity of 3 years or more and which are "issued to the public".

Second, since the "issued to the public" criterion is not clearly defined in the IRO, there were uncertainties in the market about how such criterion should be interpreted in practice. In addition, the eligibility criteria of the scheme appeared to be more stringent than those of similar schemes in other financial centers in the region.

To address these issues, the government proposed to make enhancements to the QDI scheme. These measures, which aim to strike a balance between meeting market development needs and minimizing the risk of tax avoidance, are expected to help further develop the local debt market and put Hong Kong, China on a more equal footing with other financial centers in the region in attracting debt market activities.

6. Extending Tax Concession to Short-Term Debt Instruments

With the passing of the Inland Revenue (Amendment) Ordinance No. 4 in March 2011, the government extended the 50% tax concession previously granted under section 14A of the IRO to interest income and trading profits derived from debt instruments with an original maturity of less than three years.

At the same time, the Amendment Ordinance clarified the "issued to the public" criteria as issuance to more than 10 persons, or that if issued to less than 10 persons, none of the investors can be a party related to the issuer.

The enhancements to the QDI scheme aim to strike a balance between meeting the market development needs and minimising the risk of tax avoidance, and to place short-term debt instruments on a level-playing field with longer-term debt instruments in respect of profits tax treatment. The changes are expected to help stimulate new demand for bond issues in Hong Kong, China.

G. Offers of Bonds to Professionals

Generally, an offer to sell bonds to professional investors (as defined below) is not required to comply with the prospectus requirements in the CO (Paragraph 1 of Schedule 17 to the CO). This is contrasted with a general offer of bonds to the public, which has to comply with a prospectus requirements in the CO.

A "professional investor" includes any authorized financial institution, any recognized exchange company, recognized clearing house, any authorized insurer, any investment services intermediary, collective investment scheme, any government institution that performs the functions of a central bank, and any person of a class which is prescribed by rules under section 397 of the SFO (section 1 of Part 1 of Schedule 1 to the SFO).

A "prospectus" means any prospectus, notice, circular, brochure, advertisement or other document offering any shares or debentures in a company to the public for subscription or purchase for cash or other consideration; or calculated to invite such offers, with certain exceptions, for example, prospectus that relates to an offer to sell bonds to professional investors (as discussed above).

For offers of bonds listed on the exchange markets, there are set of modified rules for listing application for issues of selectively marketed securities on the HKSE (chapter 37 of the Listing Rules). The requirements are relaxed compared to the rules for listing of debt securities in general in chapters 24-26 (e.g., shorter period of audited accounts and longer period between listing document and latest financial period in the latest audited accounts).

To qualify as "selectively marketed securities", the offer and sale of the bonds is restricted so that they are marketed to or placed with any number of registered dealers or financial institutions either with a view of reselling such securities as principals off-market—the bonds are of such a nature that nearly all of them will normally be purchased and traded by a limited number of investors who are particularly knowledgeable in investment matters—or placing such bonds with a limited number of such investors.

H. Definition of "Professional Investors" in the Hong Kong, China

1. Section 1 of Part 1 of Schedule 1 to the *Securities and Futures Ordinance*

"Professional investor" means -

(a) any recognized exchange company, recognized clearing house, recognized exchange controller or recognized investor compensation company, or any person authorized to provide automated trading services under section 95(2) of the SFO;

(b) any intermediary, or any other person carrying on the business of providing investment services and regulated under the law of any place outside Hong Kong, China;

(c) any authorized financial institution, or any bank which is not an authorized financial institution but is regulated under the law of any place outside Hong Kong; China;

(d) any insurer authorized under the *Insurance Companies Ordinance* (Cap 41), or any other person carrying on insurance business and regulated under the law of any place outside Hong Kong, China;

(e) any scheme which -

(i) is a collective investment scheme authorized under section 104 of the SFO; or

(ii) is similarly constituted under the law of any place outside Hong Kong, China and, if it is regulated under the law of such place, is permitted to be operated under the law of such place, or

(iii) any person by whom any such scheme is operated;

(f) any registered scheme as defined in section 2(1) of the *Mandatory Provident Fund Schemes Ordinance* (Cap 485), or its constituent fund as defined in section 2 of the *Mandatory Provident Fund Schemes (General) Regulation* (Cap 485 sub. leg. A), or any person who, in relation to any such registered scheme, is an approved trustee or service provider as defined in section 2(1) of that ordinance, or who is an investment manager of any such registered scheme or constituent fund;

(g) any scheme which -

(i) is a registered scheme as defined in section 2(1) of the *Occupational Retirement Schemes Ordinance* (Cap 426); or

(ii) is an offshore scheme as defined in section 2(1) of that Ordinance and, if it is regulated under the law of the place in which it is domiciled, is permitted to be operated under the law of such place, or

(iii) any person who, in relation to any such scheme, is an administrator as defined in section 2(1) of that Ordinance;

(h) any government (other than a municipal government authority), any institution which performs the functions of a central bank, or any multilateral agency;

(i) except for the purposes of Schedule 5 to the SFO, any corporation which is -

(i) a wholly-owned subsidiary of -

(A) an intermediary, or any other person carrying on the business of providing investment services and regulated under the law of any place outside Hong Kong, China; or

(B) an authorized financial institution, or any bank which is not an authorized financial institution but is regulated under the law of any place outside Hong Kong, China;

(ii) a holding company which holds all the issued share capital of -

(A) an intermediary, or any other person carrying on the business of the provision of investment services and regulated under the law of any place outside Hong Kong, China; or

(B) an authorized financial institution, or any bank which is not an authorized financial institution but is regulated under the law of any place outside Hong Kong, China; or

(iii) any other wholly owned subsidiary of a holding company referred to in subparagraph (ii); or

(j) any person of a class which is prescribed by rules made under section 397 of the SFO for the purposes of this paragraph as within the meaning of this definition for the purposes of the provisions of the SFO, or to the extent that it is prescribed by rules so made as within the meaning of this definition for the purposes of any provision of the SFO;

2. Section 3 of the Securities and Futures (Professional Investor) Rules (Cap 571D)

For the purposes of paragraph (j) of the definition of "professional investor" in section 1 of Part 1 of Schedule 1 to the SFO (see above), the following persons are prescribed as within the meaning of that definition for the purposes of any provision of the SFO other than Schedule 5 -

(a) any trust corporation having been entrusted under the trust or trusts of which it acts as a trustee with total assets of not less than USD40 million or its equivalent in any foreign currency -

(i) as stated in the most recent audited financial statement prepared -

(A) in respect of the trust corporation; and

(B) within 16 months before the relevant date;

(ii) as ascertained by referring to one or more audited financial statements, each being the most recent audited financial statement, prepared-

(A) in respect of the trust or any of the trusts; and

(B) within 16 months before the relevant date; or

(iii) as ascertained by referring to one or more custodian statements issued to the trust corporation -

(A) in respect of the trust or any of the trusts; and

(B) within 12 months before the relevant date;

(b) any individual, either alone or with any of his associates on a joint account, having a portfolio of not less than USD8 million or its equivalent in any foreign currency -

(i) as stated in a certificate issued by an auditor or a certified public accountant of the individual within 12 months before the relevant date; or

(ii) as ascertained by referring to one or more custodian statements issued to the individual (either alone or with the associate) within 12 months before the relevant date;

(c) any corporation or partnership having -

(i) a portfolio of not less than USD8 million or its equivalent in any foreign currency; or

(ii) total assets of not less than USD40 million or its equivalent in any foreign currency,

as ascertained by referring to -

(iii) the most recent audited financial statement prepared -

(A) in respect of the corporation or partnership (as the case may be); and

(B) within 16 months before the relevant date; or

(iv) one or more custodian statements issued to the corporation or partnership (as the case may be) within 12 months before the relevant date; and

(d) any corporation the sole business of which is to hold investments and which is wholly owned by an individual who, either alone or with any of his associates on a joint account, falls within the description in paragraph (b).

I. Challenges and Expected Changes

1. Consultation on Market only for Professional Investors

The HKEx is undergoing market consultation on some proposed changes to the requirements for the listing of debt issues to professional investors only. The proposed changes include, but are not limited to the following:

(a) to unify the definition of professional investors in the Listing Rules with the definition in the SFO stated above;

(b) to replace the current detailed disclosure requirements with an obligation to include information that is customary for offers of debt securities to professionals, as there is perception that listing in Hong Kong, China is more document intensive than other jurisdictions such as Singapore; and

(c) To streamline the application procedures.

For details, refer to the Consultation Paper on Proposed Changes to Requirements for the Listing of Debt Issues to Professional Investors Only published at the HKEx website.[30] For updates on market consultations, updated Responses to Consultation

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30 Footnote 3. http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2010122.pdf; http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2010122q.doc

and Consultation Conclusions Proposed Changes to Requirements for the Listing of Debt Issues to Professional Investors Only (October 2011), see the HKEx website as well.[31]

2. Enhancement Measures to the Qualifying Debt Instrument Scheme

Regarding the taxation regime, as announced in the Financial Secretary's Budget for 2010-2011, the government will introduce enhancement measures to the QDI scheme.

Specifically, the government will extend the 50% tax concession to interest income and trading profits derived from debt instruments with an original maturity of less than 3 years with a view to encourage a wider spectrum of participants and stimulate new demand for debt instrument issuance activity.

3. Clarification of the "Issued to the Public" Criterion

The government also clarified the "issued to the public" criterion in the IRO to better meet market requirements. The government prepared the legislative amendments and introduced the bill in the Legislative Council in the first quarter of 2011.[32]

To remove uncertainties concerning what constitutes "issued to the public" as stipulated in paragraph (e) of the definition of "debt instrument" in section 14A(4) of the IRO, the government proposed to replace the "issued to the public" criterion with a new requirement that, at issuance, the instrument is issued in Hong Kong, China to –

(a) ten or more persons; or

(b) If less than 10 persons, none of whom is an associate of the issuer of the instrument.

The "issued to the public" criterion was introduced to address potential tax avoidance through arranging as QDIs intra-group or inter-group debt issues that are otherwise not necessary to enjoy tax benefits. However, since the IRO does not specify what constitutes "issued to the public", the legal uncertainties involved have put many debt-market participants off using the QDI scheme.

The proposed amendment was formulated taking into account the landscape of Hong Kong's debt market and the criterion's original intent of preventing tax avoidance. In drawing up the proposal, the government made reference to similar schemes overseas which are considered successful in facilitating the development of the relevant local debt market. For instance, under Singapore's scheme, debt securities are deemed "issued to the public" if they are issued to four persons or more; or have less than 50% of the issue of debt securities being beneficially held or funded by related parties of the issuer of those debt securities at the time of primary launch. If, at any time during the life of an eligible debt issue, 50% or more of the issue is beneficially held or

31 Footnote 3. http://www.hkex.com.hk/eng/newsconsul/mktconsul/marketconsultation.htm; Responses to Consultation Paper Updated (21 October 2011), http://www.hkex.com.hk/eng/newsconsul/mktconsul/responses/cp2010122r.htm; Consultation Conclusions Proposed Changes to Requirements for the Listing of Debt Issues to Professional Investors Only (October 2011), http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2010122cc.pdf

32 Government of Hong Kong Special Administrative Region. Legislative Council. http://www.legco.gov.hk/yr10-11/english/bills/brief/b21_brf.pdf

funded, directly or indirectly, by a related party of the issuer, the portion of the issue held by related parties will not be eligible for tax concessions under the scheme. On the other hand, under Australia's scheme, issuers are only required to offer the issue to a specified minimum number of potential investors. No requirement is set on the number of investors to whom the debt securities are ultimately issued.

III. Trading of Bonds and Trading Market Infrastructure

Most bond trading is done via the over-the-counter (OTC) market. However, there are various types of debt securities listed on the Hong Kong Stock Exchange (HKEx). These include corporate bonds, convertible bonds, and Exchange Fund Notes. Securities (mainly shares) listed and traded on the HKEx are also in scripless form, and holders of Central Clearing and Settlement System (CCASS) accounts are credited or debited for securities purchased and sold respectively. Besides the above standard securities, Equity Linked Instruments and Exchange Traded Funds are also available for trading on the HKEx.

In December 1993, the Hong Kong Monetary Authority (HKMA) extended their settlement and clearing facilities to debt securities traded on the HKEx. But, as far as the debt securities is concerned, many listed bonds are not traded on the HKEx. Listed bonds are mainly traded in the OTC market and, in some cases, traded on the HKEx; unlisted bonds, on the other hand, are traded in the OTC market.

If bonds are listed and traded on the HKEx, the prevailing bid-and-ask prices, yield-to-maturity, and certain static information such as the bond's coupon rate and maturity date are usually disseminated by the HKEx through information vendors to the market.

Trading of listed debt securities is subject to Trading Rules of the HKEx.[33] For the trading activities of bonds listed on the HKEx, refer to the HKEx Factbook 2009, the Securities and Futures Commission (SFC) Joint Consultation Paper on a Proposed Operational Model for Implementing Scripless Securities Market in Hong Kong, and the SFC Joint Consultation Paper on a Proposed Operational Model for Implementing Scripless Securities Market in Hong Kong.[34]

33 Footnote 3. http://www.hkex.com.hk/eng/rulesreg/traderules/tradingrules.htm
34 Footnote 3. http://www.hkex.com.hk/eng/stat/statrpt/factbook/factbook2009/fb2009.htm; Securities and Futures Commission (SFC). 2010. Joint Consultation Paper on a Proposed Operational Model for Implementing Scripless Securities Market in Hong Kong. https://www.sfc.hk/sfcConsultation/EN/sfcConsultMainServlet?name=scripless; SFC. 2010. Joint Consultation Conclusions on a Proposed Operational Model for Implementing a Scripless Securities Market in Hong Kong. http://www.sfc.hk/sfc/doc/EN/speeches/consult/ConsultationConclusions_Paper_Final_Eng.pdf

A. Over-the-Counter Market Trading

If bonds are traded in the OTC market, any interested investors can obtain direct access to relevant information supplied by various financial information providers (e.g., Bloomberg and Reuters), or rely on intermediaries, such as, distributing banks to get such information.

In Hong Kong, China bonds may be held within the Central Moneymarkets Unit (CMU) Service operated by the HKMA in either definitive or global instrument form. The CMU Service provides a central depository service for CMU Instruments held within the CMU Service and an electronic book-entry system for electronic trading between CMU Members of CMU Instruments without physical delivery of CMU Instruments. The bond instruments must be lodged with a sub-custodian appointed by the HKMA. The bond issuer must either be a CMU Member or authorize a CMU Member as a Lodging Agent to use the depository services of the CMU Service.

While the bonds are represented by global notes, the CMU Lodging Agent holds the legal title of these bonds, which are then "immobilized" via the CMU accounts. Holders of CMU accounts hold the bonds in the "Main Account" for their own benefit, and the bonds in the General/Specific Custody Accounts for and on behalf of their own customers.

For bonds held in the General/Specific Custody Accounts, CMU Members would have to refer to their own internal records to ascertain the beneficial ownership of the bonds held in such accounts. The Issuer and the Paying Agent directly make payments of principal, interest or any amounts to the persons for whose accounts interests in the global bond are credited (as set out in a CMU Instrument Position Report, or as notified to the CMU Lodging Agent by the CMU Service). Individual beneficial holders will have to rely on the CMU Member or the CMU Lodging Agent for the delivery of payments and notices to them.

Clearing and settlement of debt securities lodged with the CMU is subject to the Exchange Fund Bills and Notes (EFBN) and CMU Service Reference Manuals (which are accessible by CMU members only) and other relevant documents. Furthermore, for trading activities of bonds lodged with the CMU, refer to the CMU Bond Price Bulletin website, scroll down to "CMU Bond Price Bulletin" section and click the hyperlink, which provides investors with convenient online access to indicative bond prices quoted by major banks and securities firms in Hong Kong, China.[35]

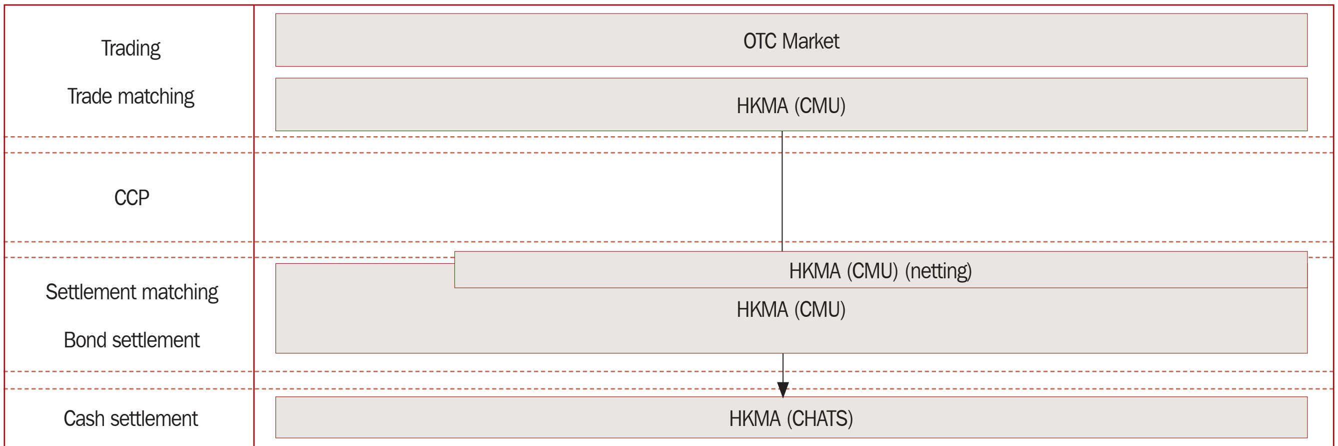
Some intermediaries with bond trading services will also post bond price information on their websites.

B. Over-the-Counter Market Business Process

The following diagram shows the key infrastructure components as evident in the Hong Kong OTC bond market:

35 Footnote 10. http://www.info.gov.hk/hkma/eng/infra/index.htm

Figure 3.1 Bond Settlement Infrastructure in Hong Kong, China

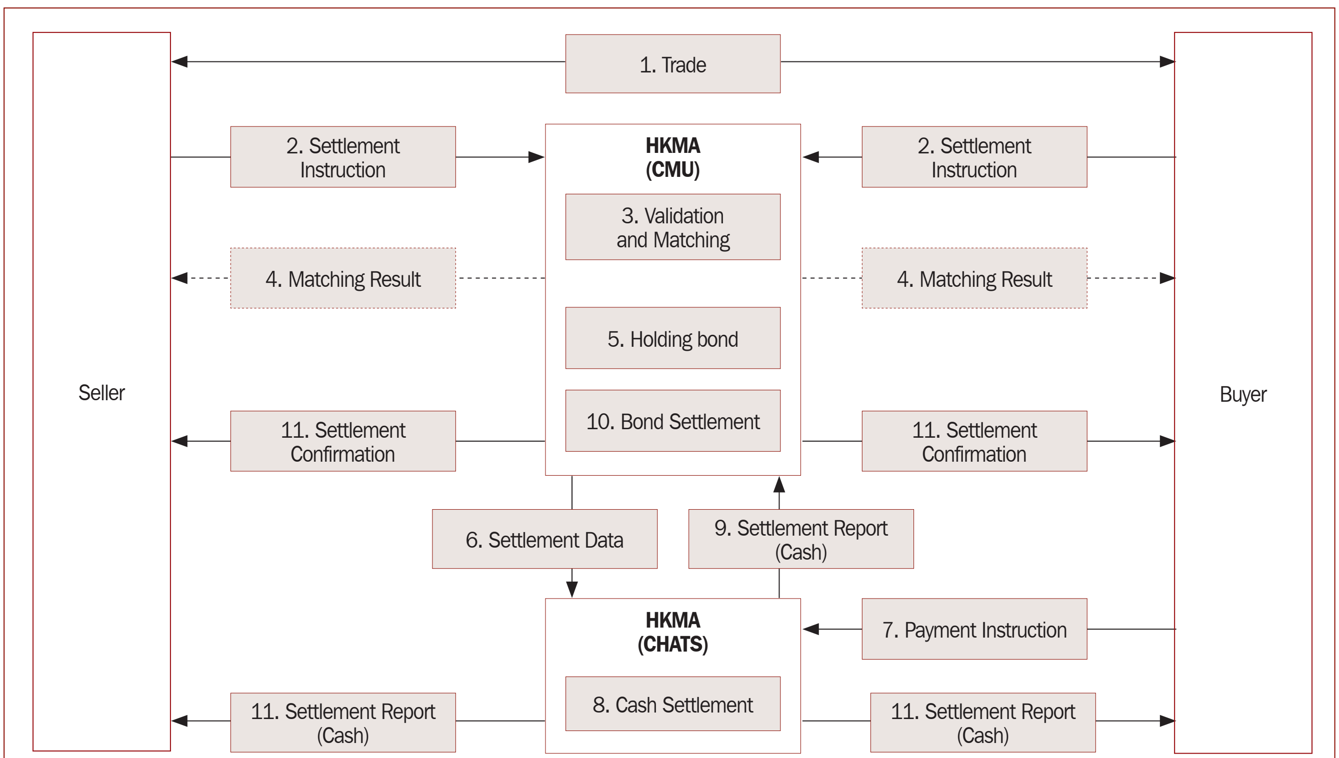


Note: There is no CCP for bonds in Hong Kong, China.
CHATS = Clearing House Automated Transfer System; CMU = Central Moneymarkets Unit; HKMA = Hong Kong Monetary Authority
Source: ABMF SF2.

Business Process Flowchart of the Hong Kong Bond Market

The following diagram shows the flow of a typical OTC bond transaction, settled on a delivery-versus-payment (DVP) basis, in the Hong Kong market. The individual steps of the process are explained in detail thereafter.

Figure 3.2 Business Process Flowchart Hong Kong Bond Market (Over-the-Counter Market/Delivery versus Payment)



CHATS = Clearing House Automated Transfer System; CMU = Central Moneymarkets Unit; HKMA = Hong Kong Monetary Authority
Source: ABMF SF2.

1. Seller and buyer trade over the counter.
2. The seller and buyer send instructions to Central MoneymarketsUnit(CMU) via CMT, SWIFT, Fax, AFT or by hand. When they use system, either seller or buyer enters trade data to be forwarded to the counterpart (buyer or seller). The counterpart can utilize the trade information as a message instruction to be sent to the CMU. Participants need to send the message instructions before the cutoff time (4:00 p.m.) on settlement day.
3. CMU performs validation and matching.
4. CMU sends matching result to the seller and buyer.
5. CMU holds the debt securities.
6. CMU sends settlement data to CHATS.
7. For real time DVP settlement involving non-bank debt securities buyer, the buyer instructs its bank to pay by sending payment instruction to CHATS.
8. CHATSexecutes cash settlement.
9. CHATS sends cash settlement report to CMU.
10. CMU executes debt securities settlement.
11. CHATS sends cash settlement report to the buyer and seller respectively, while CMU sends securities settlement confirmation to the seller and buyer.

At present, there is no central counterparty (CCP) for the OTC bond market. In this context, clearing effectively refers to a netting service for participants, i.e. in the form of the EOD settlement mode provided by CMU. In effect, 99% of trades are settled in the EOD settlement run.

Matching in the above business process is limited to settlement matching (since trading is not facilitated in CMU itself). Trade matching continues to be conducted between trading counterparties on a purely bilateral basis.

For settlement matching, central matching is supported, by way of two-sided input or the input and affirmation of an alleged trade; this allows trading platforms, such as Bloomberg to send trade details directly into CMU. However, instructions already matched in CMU can still be cancelled between counterparties before settlement.

One noteworthy feature in the CMU system is that blocking of securities positions will only take effect on Settlement Date. This allows settlement instructions with future settlement dates to be captured for up to 30 days prior to settlement date.

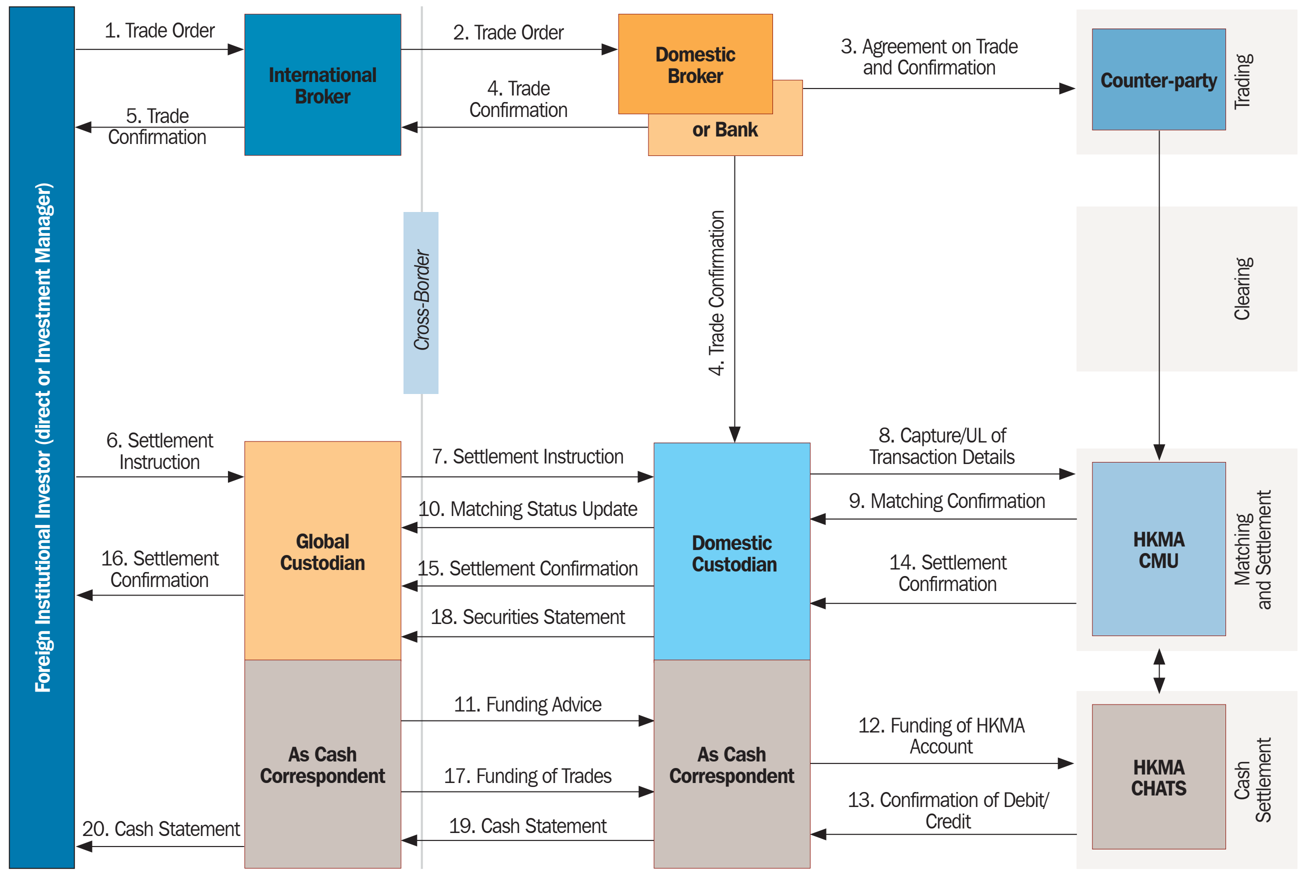
In general, the settlement cycle for Exchange Fund papers traded before 11 a.m. Hong Kong time is T+0 (same day settlement), and T+1 for Exchange Fund papers traded after 11 a.m. Hong Kong time.The settlement cycle for other Hong Kong government bonds is usually T+1 or T+2, while for corporate bonds and RMB bonds typically on T+2, in line with the equities market.

CMU supports multiple securities identifiers, including ISIN, CMU Instruments Number, and Common Code. CMU uses MT54x messaging.

C. Hong Kong Bond Transaction Flow (For Foreign Investors)

The following diagram shows the flow of a typical bond transaction in the Hong Kong OTC market from a foreign investor perspective, and settled on a delivery-versus-payment (DVP) basis. The individual steps of the process flow are explained in detail thereafter.

Figure 3.3 Hong Kong Bond Transaction Flow for Foreign Investors



Source: ABMF SF2.

T = Trade Date

T+2 = Settlement Date

Note: Below is the description of the OTC bond transaction flow for foreign investors in Hong Kong, China.

1. Foreign Institutional Investor places order with International Broker.
2. International Broker places order with Domestic Broker/Bank.
3. Domestic Broker/Bank trades over the counter with Counterparty (via phone or, e.g., Bloomberg).
4. Domestic Broker/Bank sends trade confirmation to International Broker.

5. Foreign Institutional Investor receives trade confirmation.
6. Foreign Institutional Investor instructs Global Custodian on securities settlement and cash funding details.
7. Global Custodian instructs Domestic Custodian on securities settlement.
8. Domestic Custodian captures (e-CMU Member Terminal or upload) settlement instructions into Central Moneymarkets Unit (CMU).
9. Domestic Custodian receives transaction matching confirmation from CMU or status updates.
10. Domestic Custodian sends matching status update to Global Custodian, either as a report or, typically, per individual transaction.
11. Global Custodian advises funding details to Domestic Custodian.
12. Domestic Custodian effects funding of Hong Kong Monetary Authority (HKMA) account via the Clearing House Automated Transfer System (CHATS).
13. Upon transfer of cash, HKMA sends cash settlement confirmation to Domestic Custodian.
14. Upon transfer of bonds, CMU sends bond settlement confirmation to Domestic Custodian.
15. Domestic Custodian sends settlement confirmation to Global Custodian.
16. Foreign Institutional Investor receives settlement confirmation from Global Custodian
17. Global Custodian funds trades into Domestic Custodian Hong Kong dollar account, or into foreign currency nostro.
18. Domestic Custodian sends securities statement to Global Custodian.
19. Domestic Custodian sends debit/credit confirmation as cash statement to Global Custodian.
20. Global Custodian sends debit/credit confirmation in cash statement to Foreign Institutional Investor.

IV. Future Developments

This section explores some of the typical areas of improvements for bond markets in ASEAN+3 and reviews the applicability of such potential to the Hong Kong bond market.

A. Repo Market

Banks holding Exchange Fund Bills and Notes (EFBNs) can obtain financing from the Hong Kong Monetary Authority (HKMA) through intraday repo or a discount window. Bank repo with types of eligible debt securities bilaterally agreed by both parties is also supported but the market remains insignificant.

The Central Moneymarkets Unit (CMU) launched enhancements to its bank repo service in November 2011 to support collateral management services. These include daily mark-to-market of collateral values, top-up and return of collateral and collateral substitution.

B. Liquidity in the Secondary Market

In 2009, the CMU processed a daily average value of HKD172 billion (242 transactions) in secondary market transactions. Debt securities traded in the secondary market were dominated by EFBNs, with only a tiny portion of private debt issues being traded. On the other hand, the secondary market of bonds listed on the Hong Kong Stock Exchange (HKSE) was comparatively inactive. In the same year, the aggregate turnover of debt securities traded on the HKSE amounted to HKD3.97 million only.

C. Renminbi-Denominated Bond Market

Bonds issued in Hong Kong, China were mainly denominated in Hong Kong dollars or US dollars before 2007. Since the first renminbi-denominated bonds issued by the China Development Bank in July 2007, the market has seen an increasing number and value of bonds issued in renminbi.

As of the end of October 2011, the total outstanding renminbi bonds lodged with the CMU amounted to RMB196 billion. The aggregate value of renminbi bonds issued in Hong Kong amounted to RMB233 billion.

In addition to financial institutions and the Mainland Government, some multinational corporations such as McDonald's and Caterpillar have also tapped the renminbi bond market in Hong Kong, China. Funds raised by bond issuers can be remitted back to the Mainland in the form of a shareholders' loan or equity capital injection subject to approval of the relevant Mainland authorities. They can also be used for any other purposes outside the Mainland as there is no restriction on the usage of renminbi in the offshore market.

D. Conclusion

Overall, there are no significant impediments that hinder the development and growth of the bond market in Hong Kong, China. Nonetheless, the Government and HKEx have identified some areas for improvement and are undergoing various procedures to put the enhancements in place as soon as practicable.

V. Description of the Securities Settlement System

A. Securities Settlement Infrastructure

1. Central Moneymarkets Unit

The Central Moneymarkets Unit (CMU) is the debt securities clearing and settlement system in Hong Kong, China operated by the Hong Kong Monetary Authority (HKMA). Established in 1990, the CMU provides an efficient clearing, settlement and custodian service for debt securities denominated in Hong Kong dollars and other major currencies. It also provides an electronic book-entry system which eliminates the physical delivery of debt securities between CMU Members. These debt securities include Exchange Fund Bills and Notes (EFBNs), government bonds, and debt securities issued by both public and private sector entities.

In December 1996, a seamless interface between the CMU and Hong Kong dollar real-time gross settlement (RTGS) system was established. Such linkage provides real-time and end-of-day delivery-versus-payment (DVP) services to CMU Members. The CMU was further linked to the RTGS systems of the US dollar in December 2000, the euro in April 2003, and the renminbi in March 2006 to provide real-time DVP capability for debt securities denominated in these currencies, as well as intraday and overnight repo facilities for the respective payment systems in Hong Kong, China.

The CMU has also developed external links with regional central securities depositories and international central securities depositories such as Euroclear and Clearstream. The linkages enable international investors to hold and settle CMU securities through these international networks, and enable investors in Hong Kong, China and other parts of Asia to hold and settle Euroclear and Clearstream debt securities directly in a secure DVP environment via their CMU Members.

In terms of settlement arrangements, if the debt securities are settled using real-time DVP mode, both cash and securities legs are settled on a gross basis. If the debt securities are settled using end-of-day (EOD) DVP mode, both cash and securities are settled on a net basis. Nevertheless, transactions settled at EOD are still completed on a deal-by-deal basis in legal terms. If securities are settled using free–of-payment (FOP) mode, settlement will be done on a gross basis for real-time FOP or net basis for end-of-day FOP.

Besides provision of clearing, settlement and custody services, the CMU also provides a tendering platform to facilitate price discovery and enhance price transparency. In November 2010, the Mainland's Ministry of Finance (CMoF) used the CMU Bid Service for the first time for tendering renminbi sovereign bonds among institutional investors. The tendering attracted a huge number of applications with highly competitive pricing, with the coupon rate of 3-year, 5-year and 10-year issues fixing at 1%, 1.8% and 2.48%, respectively. In August 2011, CMoF made use of the CMU Bid service for the second time to tender renminbi bonds in Hong Kong with coupon rates of 3-year, 5-year, 7-year, and 10-year fixing at 0.6%, 1.4%, 1.94%, and 2.36%, respectively.

The HKMA and the CMU encourage the use of RTGS but can also settle net at EOD. This is available for trades that have passed cut-off time(s). Presently, 90% of trades settle in the EOD mode because counterparties are covering short positions throughout the trading day.

2. Central Clearing and Settlement System

Linkages have also been established between the Central Clearing and Settlement System (CCASS) operated by the HKSE and Hong Kong dollar, US dollar and renminbi RTGS systems. Similar to the settlement arrangements for debt securities lodged with the CMU, settlement of listed debt securities can be done in real-time or end-of-day, DVP or FOP. It should, however, be noted that not all bonds traded on the HKSE are cleared and settled through the CCASS. Some of the listed debt securities are cleared and settled through the CMU. Examples of which include EFBNs issued by the HKMA.

B. Definition of Clearing and Settlement

1. Clearing

Clearing operates after trading and before delivery (or settlement). It involves techniques designed to address the risk of counterparty default after trading and before settlement, primarily through the netting of mutual post-trade obligations of market participants and the use of a well-capitalized intermediary (known as the clearing house). The clearing house assumes the contractual obligations of each party to settle the trade. Even if one party defaults post-trade and pre-settlement, settlement will still go ahead.

Instructions to transfer CMU instruments must be sent to the CMU by the CMU Member Terminals (CMT), SWIFT, by hand, by post, by fax, or by telex. There is no standard clearing services in the capacity of a central counterparty. The transfers are directly made between CMU Members themselves. For that reason, all DVP transactions under the CMU are subject to the credit risk of the settlement banks.

The CMU Service has linkages with Euroclear and Clearstream to enable investors in Hong Kong and overseas to hold and settle Euroclear and Clearstream debt securities directly in a secure DVP environment via their CMU Members.

For listed bonds, the Hong Kong Securities Clearing Company (HKSCC) does not provide any physical depository services in respect of CMU Instruments. However, as a result of clearing and settlement of transactions in CMU Instruments effected on the HKSE, allocation following an application for CMU Instruments made through the CCASS, or the provision of other CCASS services to CCASS Participants, CMU Instruments may be credited to and debited from CCASS Participants' stock accounts.

CCASS is a clearing system for the HKSE. It operates a continuous netting system for netting of holdings of interests in the CCASS securities accounts. As the HKSCC, which is the operator of CCASS, is the central counterparty with which market participants deal directly, they only bear the credit risk of HKSCC, not of the other market participant.

Settlement happens 2 trading days after the date of the transaction on the HKSE.

2. Settlement

Settlement means delivery, usually against payment. Once a trade has taken place, the buyer is contractually bound to deliver the securities to the seller, and the seller is contractually bound to pay the purchase price to the seller. Settlement of securities through electronic systems usually takes the form of synchronized payment and delivery sides of each transaction.

The CMU Service provides the following settlement facilities:

(i) The CMU Service provides a real-time and end-of-day DVP facility for transactions denominated in Hong Kong dollar, renminbi, euro and US dollar through the RTGS systems. The HKMA, as operator of the CMU Service, matches the debit instruction with the corresponding credit instruction, including information on the settlement date, buyer and seller accounts, issue number, nominal currency and amount, settlement mode, currency and amount. Real-time settlement of the transaction happens immediately once both the payment funds are available from the settlement bank and the seller's securities account holds sufficient securities. It also offers the FOP facility as an alternative.

    DVP means delivery of securities simultaneously upon transfer of the funds for payment on a trade-by-trade basis, whereas FOP means delivery of securities with no corresponding payment of funds.

(ii) Cross-border DVP settlement is effected via regional central securities depositories (CSDs) and international central securities depositories (ICSDs).

C. Challenges/ Expected Changes

The CMU has been functioning smoothly and efficiently, and there are no planned material changes to be applied to the CMU as far as the settlement arrangement is concerned.

VI. Cost and Charging Methods

A. Initial Fees

Refer to Appendix 1 for the CMU tariffs and Appendix 2 for the fee schedule for debt securities listed on the Stock Exchange of Hong Kong (SEHK).

B. Maintenance (Ongoing) Costs

Refer to Appendix 1 for the CMU tariffs and Appendix 2 for the fee schedule for debt securities listed on the HKSE.

The following market charges exist in the Hong Kong, China market.

Table 6.1 Market Charges in the Hong Kong, China Market

Market Charge	Details
Trading Fees	0.005% per side payable by both buyer and seller
Brokerage Fees	Brokerage Commission on SEHK trades is freely negotiable.
Registration Fees	Registration fee of HKD2.50 per certificate is charged by the registrar.
Stock Settlement Fees	Stock settlement fee of 0.002% will be charged on gross settlement amount, subject to a minimum fee of HKD2 and a maximum fee of HKD100 per trade.

Source: Deutsche Bank AG Domestic Custody Services Market Guide Hong Kong, October 2009.

VII. Market Size and Statistics

A. Market Size

While the issuance of Hong Kong-dollar debt instruments remained relatively stable at around HKD400 billion annually between 1998 and 2008, the outstanding amount steadily increased from HKD393 billion to HKD717 billion over the same period. In 2009, due to the massive capital inflows and an increasing market demand for Exchange Fund Bills issued by the Hong Kong Monetary Authority (HKMA), HKD1,048 billion worth of exchange fund bills were issued, resulting in a substantial increase in the issuance of Hong Kong-dollar debt instruments from HKD424 billion in 2008 to HKD1,242 billion in 2009.

B. The Renminbi Bond Market

On the other hand, the renminbi bond market has recorded a rapid growth since the issuance of the first renminbi-denominated bonds in Hong Kong, China in July 2007. As of October 2011, the aggregate value of renminbi-denominated bonds lodged with the CMU amounted to RMB196 billion. Bond issuers comprised the Mainland Government, financial institutions, and multinational corporations.

C. Debt Issuance and Syndicated Loans vs. Equity Market

Among the different means of fund-raising activities in Hong Kong, China (excluding the issuance of Exchange Fund Bills), the equity market was the most favourite among fund raisers, amounted to HKD427 billion in 2008, accounting for 59% of the aggregate amount of funds raised. On the other hand, the size of Hong Kong-dollar debt issuance was comparable with that of the syndicated loan, with the Hong Kong-dollar debt issuance raising HKD138 billion and syndicated loan raising HKD154 billion in 2008.

For details, refer to the feature article "Hong Kong-dollar debt-market development in 2009" of the March 2010 *Quarterly Bulletin*.[36]

D. Market Data from *AsianBondsOnline.com*

1. Size of Local Currency Bond Market in Percentage of Gross Domestic Product (Local Sources)

Table 7.1 Size of Local Currency Bond Market in Percentage of Gross Domestic Product (Local Sources)

Date	Govt (in % GDP)	Corp (in % GDP)	Total (in % GDP)	Govt (in USD billions)	Corp (in USD billions)	Total (in USD billions)
Mar-95	5.1	0	5.1	7.05	-	7.05
Jun-95	5.1	0	5.1	7.20	-	7.20
Sep-95	5.2	12.3	17.5	7.36	17.47	24.84
Dec-95	5.3	12.6	17.9	7.60	18.21	25.81
Mar-96	5.3	13.5	18.8	7.83	19.81	27.63
Jun-96	5.4	14.4	19.8	8.05	21.61	29.66
Sep-96	5.4	14.7	20.1	8.29	22.60	30.89
Dec-96	7.5	15.4	22.9	11.88	24.53	36.40
Mar-97	7.5	15.4	23.0	12.29	25.16	37.45
Jun-97	7.5	16.5	24.0	12.66	27.86	40.51
Sep-97	7.4	17.3	24.7	12.90	30.03	42.94
Dec-97	7.4	18.0	25.5	13.12	31.75	44.87
Mar-98	7.6	19.1	26.7	13.35	33.68	47.03
Jun-98	7.8	20.5	28.3	13.58	35.72	49.30
Sep-98	7.4	22.3	29.6	12.58	38.00	50.58
Dec-98	7.5	22.9	30.4	12.58	38.17	50.75
Mar-99	7.6	24.4	32.1	12.57	40.21	52.79
Jun-99	7.8	25.3	33.1	12.74	41.14	53.88
Sep-99	8.0	26.4	34.3	12.92	42.72	55.64
Dec-99	8.0	26.6	34.7	13.11	43.39	56.50
Mar-00	8.0	28.0	36.1	13.29	46.29	59.58
Jun-00	8.1	27.8	35.9	13.49	46.21	59.70
Sep-00	8.2	27.6	35.7	13.70	46.31	60.01
Dec-00	8.2	27.6	35.8	13.92	46.58	60.51
Mar-01	8.4	27.5	35.9	14.12	46.41	60.53
Jun-01	8.5	28.6	37.1	14.3	48.21	62.51
Sep-01	8.6	29.0	37.7	14.45	48.69	63.14
Dec-01	8.8	29.2	38.0	14.59	48.71	63.29
Mar-02	8.9	30.4	39.3	14.7	50.22	64.93
Jun-02	9.0	32.6	41.6	14.84	53.52	68.35
Sep-02	9.1	31.8	40.9	14.94	52.12	67.06
Dec-02	9.2	32.4	41.6	15.06	53.02	68.09
Mar-03	9.3	33.4	42.7	15.16	54.54	69.70

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36 Hong Kong Monetary Authority. http://www.hkma.gov.hk/media/eng/publication-and-research/quarterly-bulletin/qb201003/fa1_print.pdf

Table 7.1 continuation

Date	Govt (in % GDP)	Corp (in % GDP)	Total (in % GDP)	Govt (in USD billions)	Corp (in USD billions)	Total (in USD billions)
Jun-03	9.5	34.6	44.2	15.26	55.55	70.81
Sep-03	9.7	35.2	44.8	15.46	56.30	71.76
Dec-03	9.7	35.4	45.1	15.48	56.32	71.80
Mar-04	9.7	36.1	45.8	15.47	57.54	73.01
Jun-04	9.6	36.4	46.0	15.54	59.07	74.62
Sep-04	9.5	37.1	46.7	15.63	60.76	76.40
Dec-04	9.5	37.6	47.1	15.77	62.44	78.21
Mar-05	9.4	38.1	47.6	15.80	63.81	79.61
Jun-05	9.4	39.2	48.6	16.00	66.88	82.88
Sep-05	9.3	39.8	49.0	16.16	69.49	85.66
Dec-05	9.2	38.8	48.0	16.34	69.25	85.59
Mar-06	9.1	39.4	48.5	16.48	71.67	88.14
Jun-06	9.0	40.1	49.1	16.64	73.77	90.42
Sep-06	9.0	40.9	49.9	16.74	76.04	92.78
Dec-06	8.9	41.8	50.7	16.94	79.24	96.19
Mar-07	8.9	41.1	49.9	17.02	78.85	95.87
Jun-07	8.8	42.0	50.8	17.20	82.00	99.20
Sep-07	8.6	39.6	48.2	17.44	79.84	97.27
Dec-07	8.5	38.8	47.3	17.52	80.46	97.98
Mar-08	8.7	35.3	44.0	18.41	74.96	93.37
Jun-08	8.6	34.5	43.1	18.51	74.15	92.66
Sep-08	8.6	33.8	42.4	18.67	73.61	92.28
Dec-08	9.4	33.3	42.7	20.34	72.12	92.46
Mar-09	13.3	34.4	47.7	28.24	73.15	101.39
Jun-09	17.7	35.2	52.9	37.22	74.12	111.34
Sep-09	25.8	35.9	61.7	53.75	74.79	128.54
Dec-09	33.3	35.6	68.8	69.58	74.44	144.03
Mar-10	37.7	35.0	72.7	80.37	74.73	155.11
Jun-10	39.9	34.0	73.9	85.69	73.10	158.79
Sep-10	39.3	34.0	73.2	86.55	74.92	161.47
Dec-10	38.8	34.2	73.0	87.11	76.63	163.75
Mar-11	38.3	34.4	72.7	87.58	78.71	166.29
Jun-11	37.6	33.8	71.4	87.95	79.07	167.02

Source: AsianBondsOnline. http://asianbondsonline.adb.org/hongkong/data/bondmarket.php?code=LCY_in_GDP_Local

2. Size of Foreign Currency Bond Market in Percentage of Gross Domestic Product (Bank for International Settlements)

Table 7.2 Foreign Currency Bonds to Gross Domestic Product Ratio

Date	as % of GDP	FCY Denominated Bonds (in USD billions)	GDP (in USD billions)
Dec-95	11.8	17.1	144.3
Dec-96	11.3	18.0	159.0
Dec-97	12.8	22.6	176.2
Dec-98	13.8	23.0	166.9
Dec-99	17.6	28.7	162.9
Dec-00	16.8	28.5	168.9
Dec-01	18.3	30.4	166.6
Dec-02	23.9	39.1	163.8
Dec-03	27.0	42.9	159.0
Mar-04	27.5	43.8	159.6
Jun-04	27.3	44.4	162.4
Sep-04	28.5	46.7	163.7
Dec-04	28.6	47.5	166.2
Mar-05	29.0	48.6	167.3
Jun-05	28.5	48.6	170.6
Sep-05	30.2	52.8	174.6
Dec-05	27.6	49.2	178.3
Mar-06	27.1	49.3	181.7
Jun-06	26.9	49.5	184.1
Sep-06	26.3	48.8	185.9
Dec-06	25.8	48.9	189.7
Mar-07	25.1	48.2	192.0
Jun-07	25.7	50.2	195.4
Sep-07	24.8	50.0	201.6
Dec-07	23.9	49.6	207.1
Mar-08	23.5	49.9	212.4
Jun-08	23.0	49.5	215.1
Sep-08	22.0	47.9	217.8
Dec-08	22.4	48.6	216.4
Mar-09	21.2	45.1	212.5
Jun-09	22.0	46.4	210.5
Sep-09	22.3	46.4	208.3
Dec-09	22.1	46.3	209.2
Mar-10	23.0	49.0	213.3
Jun-10	23.4	50.3	215.0
Sep-10	25.5	56.2	220.4
Dec-10	28.3	63.4	224.3
Mar-11	28.2	64.6	228.9

Source: AsianBondsOnline. http://asianbondsonline.adb.org/hongkong/data/bondmarket.php?code=FCY_in_GDP

3. Size of Foreign Currency Bond Market (Local Sources)

Table 7.3 Foreign Currency Bonds Outstanding (Local Sources) (USD billion)

Date	Government (in USD Billions)	Banks and Financial Institutions (in USD Billions)	Other Corporates (in USD Billions)	Total FCY (in USD Billions)
Mar-05	1.25	15.88	22.16	39.28
Jun-05	1.25	15.92	22.53	39.7
Sep-05	1.25	16.91	22.46	40.62
Dec-05	1.25	18.35	21.07	40.68
Mar-06	1.25	18.55	21.17	40.98
Jun-06	1.25	17.41	20.94	39.60
Sep-06	1.25	18.15	21.71	41.10
Dec-06	1.25	18.15	22.48	41.88
Mar-07	1.60	19.46	21.04	42.11
Jun-07	1.25	21.49	22.27	45.01
Sep-07	1.60	21.68	20.82	44.09
Dec-07	1.60	21.53	21.42	44.55
Mar-08	1.60	21.98	21.69	45.27
Jun-08	1.60	22.01	22.80	46.41
Sep-08	1.60	22.32	23.75	47.66
Dec-08	1.60	20.86	22.75	45.21
Mar-09	1.60	20.53	21.95	44.08
Jun-09	1.60	20.36	24.69	46.66
Sep-09	1.60	21.86	27.91	51.37
Dec-09	1.60	21.61	32.17	55.38
Mar-10	1.60	24.38	31.07	57.05
Jun-10	1.60	24.33	31.85	57.79
Sep-10	1.60	27.65	34.26	63.51
Dec-10	1.60	30.62	36.40	68.62
Mar-11	1.60	33.88	36.95	72.43
Jun-11	1.60	38.78	41.95	82.33

Source: AsianBondsOnline. http://asianbondsonline.adb.org/hongkong/data/bondmarket.php?code=FCY_Bonds_Outstanding

4. Issuance Volume of Local Currency Bond Market

Table 7.4 Issuance Volume of Local Currency Bond Market (USD billion)

Date	Govt (in USD bilions)	Corp (in USD billions)	Total (in USD billions)
Mar-95	12.6703	0	12.6703
Jun-95	14.4325	0	14.4325
Sep-95	15.8629	0	15.8629
Dec-95	15.5009	1.5124	17.0839
Mar-96	18.3050	1.9465	20.2515
Jun-96	15.2637	2.3913	17.7248
Sep-96	16.2871	1.7654	18.0524

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Table 7.4 continuation

Date	Govt (in USD bilions)	Corp (in USD billions)	Total (in USD billions)
Dec-96	27.7821	3.1144	30.8965
Mar-97	32.9876	1.6560	34.6436
Jun-97	27.5924	3.9699	31.6346
Sep-97	36.2697	3.9738	40.3232
Dec-97	38.1639	3.2726	41.4365
Mar-98	38.0537	2.9023	40.9560
Jun-98	29.1980	4.0261	33.2241
Sep-98	24.6422	3.9653	28.6076
Dec-98	20.8653	2.1267	22.9921
Mar-99	25.6497	4.6189	30.2685
Jun-99	28.1057	3.9664	32.0722
Sep-99	27.4251	6.6683	34.0934
Dec-99	28.4744	4.5266	33.2010
Mar-00	30.3044	7.7536	38.0580
Jun-00	29.0035	5.8991	34.8891
Sep-00	41.4970	6.3053	47.7792
Dec-00	41.0236	3.2554	44.2790
Mar-01	34.3370	4.0535	38.3906
Jun-01	37.1006	6.0602	43.1634
Sep-01	44.1604	5.1172	49.3085
Dec-01	38.5435	4.2307	42.7742
Mar-02	32.6278	6.7201	39.4911
Jun-02	38.6394	7.4807	45.7948
Sep-02	41.1734	4.8840	46.2087
Dec-02	40.5910	4.0351	44.6261
Mar-03	49.3757	5.3874	54.7631
Jun-03	48.1942	6.2419	54.4454
Sep-03	45.5170	4.8994	50.4204
Dec-03	42.0624	5.3501	47.4390
Mar-04	50.3782	5.4807	55.8590
Jun-04	41.2156	5.5493	46.7649
Sep-04	32.3957	5.2526	37.6483
Dec-04	36.6770	5.6479	42.3249
Mar-05	28.8067	6.6220	35.4288
Jun-05	31.7160	7.9984	39.7144
Sep-05	29.5160	5.5990	35.1149
Dec-05	26.9318	3.9976	30.9294
Mar-06	31.5263	8.2323	39.7586
Jun-06	33.8047	7.5592	41.3639
Sep-06	31.1612	7.3003	38.4615
Dec-06	27.7795	6.9697	34.7492
Mar-07	29.7346	7.9372	37.6718
Jun-07	30.1378	9.5277	39.6654
Sep-07	23.6669	4.1971	27.8640

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Table 7.4 continuation

Date	Govt (in USD bilions)	Corp (in USD billions)	Total (in USD billions)
Dec-07	35.4474	6.6836	42.1310
Mar-08	41.3260	2.7419	44.0678
Jun-08	40.7425	7.0390	47.7815
Sep-08	20.4425	4.8980	25.3404
Dec-08	45.8886	3.1263	49.0150
Mar-09	78.6807	6.7589	85.4396
Jun-09	148.278	7.4591	155.7371
Sep-09	162.7954	6.1607	168.956
Dec-09	217.7029	4.6951	222.3980
Mar-10	340.7332	6.1066	346.8398
Jun-10	168.8285	4.8981	173.7266
Sep-10	237.6786	5.7404	243.4190
Dec-10	163.690	6.3186	170.0086
Mar-11	336.7342	6.7028	343.4370
Jun-11	78.2567	7.8744	86.1311

Source: AsianBondsOnline. http://asianbondsonline.adb.org/hongkong/data/bondmarket.php?code=Issuance_Volume_LCY

5. Domestic Financing Profile

Table 7.5 Domestic Financing Profile

Date	Domestic Credit (% of Total)	Bonds (% of Total)	Equity (% of Total)	Domestic Credit (in USD billions)	Bonds (in USD billions)	Equity (in USD billions)	Total (in USD billions)
Dec-00	25.15	6.62	68.23	229.76	60.50	623.40	913.66
Dec-01	28.83	7.91	63.25	230.69	63.30	506.07	800.06
Dec-02	30.53	8.90	60.57	233.41	68.08	463.05	764.54
Dec-03	22.80	7.05	70.15	232.32	71.80	714.60	1018.71
Dec-04	20.6	6.61	72.79	243.77	78.21	861.46	1183.44
Dec-05	18.24	6.14	75.62	254.52	85.59	1055	1395.11
Dec-06	12.35	4.65	83.00	255.13	96.18	1714.95	2066.27
Mar-07	12.84	4.57	82.60	269.49	95.87	1734.12	2099.48
Jun-07	11.59	4.12	84.29	278.73	99.20	2028	2405.93
Sep-07	9.44	3.29	87.27	279.36	97.28	2581.50	2958.14
Dec-07	8.62	3.25	88.13	259.68	97.98	2654.42	3012.07
Mar-08	10.70	3.67	85.63	272.06	93.37	2176.89	2542.32
Jun-08	12.06	3.72	84.22	300.19	92.66	2096.44	2489.30
Sep-08	14.96	4.60	80.45	300.16	92.28	1614.59	2007.03
Dec-08	15.94	5.47	78.59	269.54	92.46	1328.77	1690.77
Mar-09	15.60	6.08	78.33	260.22	101.39	1306.75	1668.36
Jun-09	13.47	4.97	81.56	301.39	111.34	1825.47	2238.20
Sep-09	12.88	5.12	82.00	323.44	128.54	2059.30	2511.27
Dec-09	12.54	5.14	82.32	351.05	144.02	2305.14	2800.21
Mar-10	13.17	5.43	81.40	376.18	155.10	2325.35	2856.63
Jun-10	15.02	5.72	79.26	416.78	158.79	2199.90	2775.47

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Table 7.5 continuation

Date	Domestic Credit (% of Total)	Bonds (% of Total)	Equity (% of Total)	Domestic Credit (in USD billions)	Bonds (in USD billions)	Equity (in USD billions)	Total (in USD billions)
Sep-10	14.23	5.13	80.64	447.54	161.47	2535.96	3144.97
Dec-10	13.43	4.93	81.64	445.94	163.74	2711.32	3320.99
Mar-11	13.95	4.91	81.15	472.82	166.29	2750.88	3389.99

Source: AsianBondsOnline. http://asianbondsonline.adb.org/hongkong/data/bondmarket.php?code=Domestic_Financing_profile

6. Trading Volume

Table 7.6 Trading Volume ($ billion)

Year	Govt Bonds (in USD billions)	Corp Bonds (in USD billions)	Total (in USD billions)
Sep-95	109.45	-	-
Dec-95	120.48	-	-
Mar-96	167.86	-	-
Jun-96	145.88	-	-
Sep-96	96.41	-	-
Dec-96	121.47	-	-
Mar-97	196.87	-	-
Jun-97	179.02	-	-
Sep-97	93.57	-	-
Dec-97	67.51	-	-
Mar-98	74.36	-	-
Jun-98	87.91	-	-
Sep-98	66.96	-	-
Dec-98	65.94	-	-
Mar-99	93.05	-	-
Jun-99	105.35	-	-
Sep-99	130.71	-	-
Dec-99	194.15	-	-
Mar-00	189.44	-	-
Jun-00	192.72	-	-
Sep-00	193.82	-	-
Dec-00	192.86	-	-
Mar-01	173.56	-	-
Jun-01	167.59	-	-
Sep-01	159.15	-	-
Dec-01	184.89	-	-
Mar-02	179.89	-	-
Jun-02	183.14	-	-
Sep-02	188.88	-	-
Dec-02	169.96	2.88	172.84
Mar-03	224.62	2.66	227.28
Jun-03	192.16	3.26	195.42
Sep-03	136.21	2.39	138.6
Dec-03	120.30	3.22	123.52

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Table 7.6 continuation

Year	Govt Bonds (in USD billions)	Corp Bonds (in USD billions)	Total (in USD billions)
Mar-04	116.14	2.59	118.73
Jun-04	141.41	3.79	145.2
Sep-04	147.68	3.24	150.92
Dec-04	135.77	3.47	139.24
Mar-05	200.19	3.53	203.72
Jun-05	195.94	2.97	198.91
Sep-05	209.09	4.08	213.17
Dec-05	250.71	2.29	253.00
Mar-06	262.08	3.26	265.34
Jun-06	321.65	2.76	324.41
Sep-06	298.60	3.51	302.11
Dec-06	271.27	2.69	273.96
Mar-07	282.51	2.88	285.39
Jun-07	398.32	5.27	403.59
Sep-07	491.19	2.31	493.5
Dec-07	386.38	3.47	389.85
Mar-08	416.28	2.85	419.13
Jun-08	405.37	3.61	408.98
Sep-08	366.69	3.03	369.72
Dec-08	425.66	1.82	427.48
Mar-09	691.93	2.05	693.98
Jun-09	1026.60	3.86	1030.46
Sep-09	1438.50	4.15	1442.65
Dec-09	2368.91	2.51	2371.42
Mar-10	2411.42	3.64	2415.06
Jun-10	2329.05	3.80	2332.85
Sep-10	2994.86	3.80	2998.66
Dec-10	4304.30	4.44	4308.74
Mar-11	6351.33	4.01	6355.34

Source: AsianBondsOnline. http://asianbondsonline.adb.org/hongkong/data/bondmarket.php?code=Trading_Volume

VIII. Presence of an Islamic Finance (Islamic bond [*Sukuk*]) Market

A. Regulatory Framework for Islamic Finance

In reference to the relevant laws relating to tax issues as stated in VIII.D, the regulatory and legal framework for Islamic finance largely follows those applicable to conventional debt instruments.

B. Types of Available Instruments, Segments, and Tenure

Though the market infrastructure, regulatory and legal framework are in place, the market remains inactive for the time being, probably due to the tax issues stated in VIII.D.

C. Basic Market Infrastructure for Islamic Finance

Enhancements have been made to the US dollar and euro real-time gross settlement systems, as well as the CMU in Hong Kong, China to facilitate the process for participating members to identify transactions related to Islamic finance and to segregate Islamic-related funds from others.

D. Tax-Related Issues

The key tax issue relating to Islamic bond is that the arrangement operates in the form of equity finance but is in substance similar to debt finance. In Hong Kong, tax law treats debt and equity differently. For instance, interest income and interest expenses arising from a debt finance arrangement may be taxable and deductible subject to certain conditions. In contrast, dividend income and distribution arising from an equity finance arrangement are generally not taxable or deductible.

As a result of a heavier tax burden, issuing and/or investing in Islamic bonds may be less favorable than issuing and/or investing in conventional debt instruments.

The Government is studying how to take forward amendments to the relevant laws to facilitate development of a local Islamic bond market, by levelling the playing field for Islamic bonds vis-à-vis their conventional counterparts as far as tax arrangements are concerned.

IX. History of Debt Market Development

A. Overview

The debt market in Hong Kong, China began in the late 1970s with the first debt instrument issued by a private entity. There was virtually no debt issued by the Government or related bodies during this period due to a cumulative fiscal surplus. The activities of the debt market thus remained limited.

With a view to facilitate the development of the local debt market, the Hong Kong Monetary Authority (HKMA) rolled out the Exchange Fund Bills and Notes Programme in 1990. The amounts of issuance and outstanding debt instruments have shown rapid growth since then.

B. The Development of Hong Kong Debt Markets[37]

Over the past 10 years, the Hong Kong, China government has contributed significantly to the growth of capital markets by introducing a number of measures designed to further develop an efficient infrastructure for the Hong Kong dollar bond market. These measures include the establishment in 1990 of the Central Moneymarkets Unit (CMU), which provides an efficient settlement, central clearing and custodian system for Hong Kong-dollar debt securities, and the introduction of the Exchange Fund Bills and Notes Programme to create a benchmark yield curve extending to 10 years.

1. Central Moneymarkets Unit

The CMU was set up primarily to provide computerized clearing and settlement facilities for Exchange Fund Bills and Notes. In December 1993, the HKMA extended the service to other Hong Kong-dollar debt securities. Since December 1994, the CMU has been linked to international clearing systems such as Euroclear and Clearstream. This has helped to promote Hong Kong-dollar debt securities to overseas issuers and investors who can make use of these links to participate in the Hong Kong-dollar debt market. In December 1996, an interface between the CMU and the real-time

[37] Li, Tony. n.d. *Market Overview: Hong Kong Capital Markets Association*. http://www.hkcma.org/about_us/market_overview.html

gross settlement (RTGS) interbank payment system was established. This enables the CMU system to provide its members with real-time and end-of-day delivery-versus-payment (DVP) services. Other market infrastructure enhancements by the CMU include launching a Securities Lending Programme for private sector securities in December 1997. The aim of this program was to enhance the liquidity of private-sector debt securities by providing a mechanism to make securities held by long-term investors available for short-term use by more active market participants.

The HKMA launched the Exchange Fund Bills Programme in March 1990. Exchange Fund Bills and Notes are Hong Kong-dollar debt securities issued by the HKMA. The Exchange Fund Bills and Notes constitute direct, unsecured, unconditional and general obligations of the government of Hong Kong, China for the account of the Exchange Fund.

The Exchange Fund Bills and Notes Programme ensures the supply of high quality Hong Kong-dollar debt paper that can be employed as trading, investment and hedging instruments. Banks that maintain Hong Kong-dollar clearing accounts with the HKMA can use their holdings of Exchange Fund paper to borrow Hong Kong dollars overnight from the discount window. Under the program, bills that have tenors of less than 1 year are regularly auctioned by way of public tender. To facilitate the management of liquidity by banks participating in the RTGS, three tap issues of 28-day Exchange Fund Bills have been issued since November 1996. As banks in Hong Kong have become more proficient in managing their intraday liquidity, demand for tap issues has fallen. Consequently, the HKMA has gradually reduced the size of each of the tap issues of 28-day Exchange Fund Bills and replaced them with a range of longer term Exchange Fund Notes.

Two-year and 3-year Exchange Fund Notes were introduced in May 1993 and October 1993, respectively. This was followed by the inaugural issue of 5-year Exchange Fund Notes in September 1994, 7-year Exchange Fund Notes in November 1995, and 10-year Exchange Fund Notes in October 1996.

As of the end of 2010, the value of outstanding Exchange Fund Bills and Notes totalled HKD653 billion.

2. Corporate Bond Market

The private sector bond market is currently just over twice the size of the Exchange Fund Bills and Notes market. As of 30 September 2002, the total value of outstanding private sector bonds was HKD408 billion. The largest issuer category was local banks and corporations, followed by international banks and then supranational bodies.

3. Market History

According to available records, the first debt market issue in Hong Kong, China was a certificate of deposit issue launched in September 1977 by Chase Manhattan Bank. The issue size was HKD100 million—a large issue at the time. It was a 5-year issue with a coupon rate of prime but subject to an interest rate floor of 5.25%.

The first fixed-rate issue was launched in July 1980. It was an 18-month issue and carried a coupon of 10%. The issuer was Banque Paribas and issue size was HKD70 million. The interbank money market was still rather undeveloped at that time and certificate of deposit issuance was the only way for international banks to raise Hong Kong-dollar funds.

The first swap-driven issue occurred in 1984 when interest-rate swaps were introduced into the Hong Kong-dollar market. The coupon of the issue was 11.625% and the swap counterparty was a major property company in Hong Kong.

Supranational issuers have also played an important role in the development of the Hong Kong-dollar bond market. The first supranational issue was launched in 1989 by the World Bank, which was the first supranational issuer to tap the Hong Kong-dollar market after the Hong Kong government granted tax exemption on interest and capital gains on holding supranational paper. The availability of this type of high-quality paper helped attract investor attention and enlarge the investor base for Hong Kong-dollar bonds.

The Hong Kong dollar bond market has developed rapidly in the last several years. New issue volume was below HKD100 billion in 1997 but has grown to a level of between HKD150 billion and HKD180 billion per year in the last 2 years. While the floating-rate market has remained fairly stable, there has been substantial growth in the fixed-rate market. This was the result of a more conservative investment attitude after the Asian financial crisis and a deflationary environment that gave Hong Kong-dollar bond investors an attractive real rate of return.

Excluding the yen bond market, the Hong Kong-dollar market is the second largest Asian currency bond market, ranking just after the Korean won market. It is the most open market among the Asian currency bond markets although in terms of diversity of issuers, the Korean won and the Singapore dollar markets seem to show a greater range.

At a global level, the Hong Kong dollar is an important medium-term note (MTN) issuance currency. In 2001, the volume of MTNs denominated in Hong Kong dollars ranked just after the US dollar, euro, yen and British pound as the fifth most popular issuance currency. However, the average size of Hong Kong dollar issues is small relative to these other four currencies.

In terms of issuer type, international banks have replaced supranational entities as the most active issuers. Supranational issuers normally have more aggressive issuing targets than international banks. With investor interest increasingly concentrated in the short end of the credit curve, issuance by international banks has more than doubled in the last 2 years.

The Hong Kong-dollar market is primarily a private placement market. Issue size typically is around HKD100 million to HKD200 million. Usually, there is only one arranger taking down the issue from an issuance program and selling the paper to a small number of investors. The private placement nature of the market means the secondary market has not been very active because:

(i) a small issue size means there are a small number of investors involved which generally leads to lower liquidity; and
(ii) in a private placement, banks other than the lead managers will not feel obligated to make a market in an issue in which they have no involvement.

In terms of tenor, the market is dominated by three- to five-year issues, which represent about 65% of total issuance. Tenor longer than 7 years only represents 3% of the market. This explains why many Hong Kong issuers have to issue in the US dollar market if they want to obtain long tenor, although almost all of them will enter into a Hong Kong Interbank Offered Rate/London Interbank Offered Rate (HIBOR/LIBOR) basis swap to hedge US-dollar proceeds back to Hong Kong dollars.

Although many investors are prepared to go down the credit curve, the Hong Kong-dollar market is still a high investment-grade market with single A or better rated issues accounting for 80% of total issuance. It is expected that the Hong Kong-dollar market will remain a high-grade market for the foreseeable future.

4. Institutional Investors

Investors in Hong Kong, China can broadly be divided into three major categories: the retirement funds, which are commonly referred to in Hong Kong, China as Mandatory Provident Fund (MPF); the Hong Kong banking institutions; and Hong Kong government-related institutions.

The MPF scheme was introduced in December 2000 and covers over 90% of the Hong Kong work force. Under the MPF scheme, both employer and employee are obligated to contribute amounts equivalent to 5% of the employee's monthly income (mandatory payments are only due on the first HKD20,000 of monthly salaries, i.e., the maximum mandatory payment for employer and employee is HKD1,000 each per month) to the MPF. The size of the retirement fund market in Hong Kong, China in mid-2002 was more than HKD200 billion. It is expected that when the scheme is fully mature, the total size of this market will grow by HKD36 billion per year.

Banking institutions are the largest investor category in Hong Kong, China. The total amount of Hong Kong dollar deposits in the banking system is currently about HKD1.8 trillion. As of October 2001, banking institutions in Hong Kong were holding Hong Kong dollar non-government bonds worth about HKD230 billion in their portfolios. Under the banking regulations in Hong Kong, banks have to keep 25% of the deposits they accept in liquid assets. Among other things, debt securities are regarded as liquid assets.

Government-related institutional investors include the Housing Authority, the School Fund, and the Hospital Authority. Although not strictly a government-related institution, the Hong Kong Jockey Club is also an important Hong Kong dollar investor. The investment subsidiaries of a number of central banks in the region are also significant buyers of high-grade Hong Kong dollar bonds.

5. Retail Investors

Unlike the case in other markets, there is currently no overlap between the institutional and the retail markets in Hong Kong, China. Institutional investors do not participate in the retail market due to its tight pricing. Retail investors cannot buy institution-targeted issues due to the large denomination. This contrasts with other public markets where both institutional and retail investors get the same price. In the equity initial public offering (IPO) market in Hong Kong, China retail investors usually get a better deal than institutional buyers.

The Hong Kong Mortgage Corporation continues to be a pioneer in the development of the retail bond market. The corporation has tried a variety of ways to access the retail market, some of which have been more successful than others. One of the first strategies was to use stockbrokers to distribute using the equity IPO mechanism. However, this proved to be a costly and ineffective distribution channel. A small group of banks with retail branch networks were then signed up to distribute bonds over the counter. This method proved to be more effective as bonds are good substitutes for bank deposits. The number of banks involved in recent retail targeted issues has expanded to more than 10 and the number of branches involved increased to nearly 500. The introduction of underwriting banks has helped issuers shift a significant amount of market risk to the underwriters.

There are a number of factors contributing to the quick development of the retail market. The current low interest rate environment and a conservative investment attitude are two key influences. Public awareness and educational campaigns undertaken by the Hong Kong Capital Markets Association is another key element. The increasing awareness of wealth management by banks and their customers and the introduction of investment accounts are helping to make bond purchases over the counter as convenient as buying stocks through brokers. With the removal of the interest rate cartel, banks must now increasingly compete more on non-deposit products and are therefore more eager to help selling bonds. In the past, banks were reluctant to sell bonds as they were regarded as directly competing with deposits.

The Securities and Futures Commission has recently adopted a more "issuer friendly" attitude towards new bond issues. This has made the issuing process smoother and issuers are now less exposed to market risks. Under the leadership of the Financial Service Bureau, outdated laws governing the issuance of bonds as established in the *Companies Ordinance* and the *Protection of Investors Ordinance* are being reviewed.

Industry professionals have welcomed these changes and hope to see additional steps taken by regulatory authorities to further improve the environment for new bond issues. In particular, industry participants look forward to seeing the prospectus requirements for bond issuance to be made less onerous than those for equity requirements as these two instruments entail very different risks.

X. Next Step ⇨ Future Direction

A. Offshore Renminbi Bond Market (Dim-Sum Bond)

Chinese offshore renminbi (RMB) denominated debt securities, commonly known as *Dim-Sum Bonds*, represent an opportunity to invest in Chinese debt securities for those investors who may not qualify for, or may choose not to avail themselves of, the Qualified Foreign Institutional Investor (QFII) scheme or similar investment avenues into China.

Due to Hong Kong's position as an official RMB offshore center, the Hong Kong market features:

(i) An abundant supply of RMB liquidity in the offshore market;

(ii) No restrictions on the usage of RMB in the offshore market; and

(iii) A well-developed RMB-related financial infrastructure in Hong Kong, China.

Leveraging these competitive advantages, the HKMA will continue its efforts to promote and develop the RMB bond market in Hong Kong, China.

(iv) Sales of *Dim-Sum Bonds* increased to RMB144.1 billion in 2011, four times the RMB 35.7 billion of issuance for all of 2010, according to data compiled by Bloomberg.[38] One of the most significant recent *Dim-Sum Bonds* placements was the Baosteel Group November-2011 issue of RMB3.6 billion, across two-, three- and five-year tenures.

B. Enhancements to Post-Trade Processing in Asian Bond Markets

The HKMA will continue to collaborate with central banks and central securities depositories in the region to improve the post-trade environment in Asia, taking into account the specific needs for Asia in terms of cross-border access, stimulation of

[38] Bloomberg News, Nov 28, 2011

local issuance, automation of the post-trade process, the possibility of cross-border collateralization, and the reduction in post-trade costs.

C. Group of Thirty Compliance

The so-called G-30 Recommendations were originally conceived as the Group of Thirty's Standards on Securities Settlement Systems in 1989, detailing in a first-of-its-kind report nine recommendations for efficient and effective securities markets and covering legal, structural and settlement process areas. The recommendations were subsequently reviewed and updated in 2001, under leadership of the Bank for International Settlements (BIS), and through the efforts of a Joint Task Force of the Committee On Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organisation of Securities Commissions (IOSCO). Compliance with the G30 Recommendations in individual markets is often an integral part in securities industry participants' and intermediaries' due diligence process.

Table 10.1 Group of Thirty Compliance Recommendations

Recommendation		Implemented
1	Eliminate paper and automate communication, data capture, and enrichment.	No (Paper securities certificates still exist while most of the shares and bonds are safekept in central depositary and can be transfer via book keeping records)
2	Harmonize messaging standards and communication protocols.	Yes
3	Develop and implement reference data standards.	Yes (Common data standard such as ISIN and SWIFT BICs are used in local markets)
4	Synchronize timing between different clearing and settlement systems and associated payment and foreign exchange systems.	No (Real Time Gross Settlement Mode is optional and good payment for normal securities settlement will only be confirmed at next day morning)
5	Automate and standardize institutional trade matching.	Yes
6	Expand the use of central counterparties.	Yes (only for settlement for on exchange trades)
7	Permit securities lending and borrowing to expedite settlement.	Yes
8	Automate and standardize asset servicing processes, including corporate actions, tax relief arrangements, and restrictions on foreign ownership.	Corporate actions: No Taxation: Not applicable in Hong Kong. Foreign ownership restrictions: Yes.
9	Ensure the financial integrity of providers of clearing and settlement services.	Yes
10	Reinforce the risk management practices of users of clearing and settlement service providers.	Yes
11	Ensure final, simultaneous transfer and availability of assets.	Yes
12	Ensure effective business continuity and disaster recovery planning.	Yes
13	Address the possibility of failure of a systematically important institution.	Yes
14	Strengthen assessment of the enforceability of contracts.	Yes
15	Advance legal certainty over rights to securities, cash, or collateral.	Yes
16	Recognize and support improved valuation methodologies and closeout netting arrangements.	Yes
17	Ensure appointment of appropriately experienced and senior board members (of the boards of securities clearing and settlement infrastructure providers).	Yes
18	Promote fair access to securities clearing and settlement networks.	Yes
19	Ensure equitable and effective attention to stakeholder interests.	Yes

continued on next page

Table 10.1 continuation

Recommendation		Implemented
20	Encourage consistent regulation and oversight of securities clearing and settlement service providers.	Yes
Source:	Group of 30 (G30). 2003. Global Clearing and Settlement–A Plan of Action. http://www.partad.ru/wrld/word/g30app1.pdf	

D. Group of Experts Barrier Report Market Assessment - Hong Kong (April/2010)

The GoE Report refers to the published results in 2010 of the Group of Experts (GoE) formed under Task Force 4 of the Asian Bond Market Initiative (ABMI). In the report, published under the leadership of the Asian Development Bank (ADB), a group of securities market experts from the private and public sector in ASEAN+3, as well as International Experts, assessed the ASEAN+3 securities markets on potential market barriers, the costs for cross-border bond transactions, and the feasibility for the establishment of a Regional Settlement Intermediary (RSI). The findings in the GoE Report lead to the creation of ABMF.

Table 10.2 Group of Experts Barrier Report Market Assessment on Hong Kong, China

Potential barrier area	Current situation	Market Assessment Questionnaire scores	Overall barrier assessment
Quotas	There are no quotas on foreign involvement in the local market.	OK	OK
Investor registration	There are no foreign investor registration requirements.	OK	OK
FX controls - conversion	There are no exchange control restrictions on residents or non-residents. HKD is freely convertible.	OK	OK
FX controls - repatriation of funds	There is no restriction on the repatriation of funds.	OK	OK
Cash controls - credit balances	Non-residents may open accounts in HKD or in foreign currency. Credit balances are allowed.	OK	OK
Cash controls - overdrafts	Overdrafts are allowed.	OK	OK
Taxes	There is no withholding tax on any financial instrument. There is no capital gains tax in Hong Kong.	OK	OK
Omnibus accounts	Omnibus accounts are allowed.	OK	OK
Settlement cycle	The settlement cycle is T+2 for listed debt securities.	OK	OK
Message formats	CMU uses SWIFT for settlement messages, and plans to introduce SWIFT for corporate events messages from November 2009. Most local market participants use SWIFT format.	OK	OK
Securities numbering	ISIN are available for most local bond issues. ISIN are allocated at the time of issue or auction. CMU and local market participants use ISIN, but the local numbering (CMU Issue Number) is also commonly used.	OK	OK
Matching	There is no trade matching system for the local bond market. CMU pre-matches forward dated settlement instructions.	LOW	LOW
Dematerialisation	All fixed income instruments are either dematerialised or immobilised at the CSD.	LOW	LOW
Regulatory framework	The regulatory regime is regarded as stable and consistent and no adverse comments were received in this area.	-	OK

Source: Asian Development Bank. 2010. *Asian Bond Markets Initiative Group of Experts Final Report: Barriers to Cross-Border Investment and Settlement in the ASEAN+3 Bond Markets.* https://wpqr1.adb.org/LotusQuickr/asean3goe/Main.nsf/h_58E34A1388F9070B48257729000C0A4E/90F408746

Appendixes

Appendix 1.

Central Moneymarkets Unit Tariff (CMU Instruments)
Effective Date: 12 July 2010

Table A1.1 Central Moneymarkets Unit Tariff (CMU Instruments)

Membership Fee	Fee Amount	
Custodian Fee (Borne by holders)*	Sliding scale: (HKD millions) Rate (b.p.) <15,000 15,000-20,000 >20,000	 0.32 0.30 0.25
Fees relating to New Issues (to be borne by issuer/lodging agent) Administration Fee CMU BID – Tender for CMU Instrument		 $1,500 $1,500
Transaction Fee DvP or FoP (by SWIFT/CMT) DvP or FoP (by fax) In house transfer (by SWIFT/CMT) In house transfer (by fax)		 $20 $150 $10 $150
Income Distribution Service (to be borne by the paying agent)		$1,000 (per income event per issue)
HKD Repo Transaction Fee Intraday Repo Discount Window Repo Bank Repo (by CMT) Bank Repo (by fax)		 No Charge No Charge $20 $150

continued on next page

Table A1.1 continuation

Membership Fee	Fee Amount	
Foreign Currency Repo Transaction Fee		
Automatic Intraday Repo (USD, EUR) Automatic Overnight Repo (USD, EUR) Intraday/Overnight Repo (by fax)		$15 $15 $150
Bank Repo (CNY) by CMT Bank Repo (CNY) by fax		$20 $150
Securities Lending Program	Lender Borrower	1.00% 1.20%
Reporting Fee (SWIFT/CMT)		$0.5 per kilobyte
Enquiry Fee (SWIFT/CMT)		$0.5 per screen page

All fees are in Hong Kong dollar
* Remark: Custodian fees will be waived if CMU member certify that the beneficial owners are individuals.
Source: Hong Kong Monetary Authority.

Supplementary Notes

1. The fee schedule may be modified by CMU from time to time, however, CMU undertakes to advise our members in advance of such changes.

2. Custodian fee on account holders will be waived if CMU members can certify that the beneficial owners are individuals. Please refer to Appendix A.12a of the Central Moneymarkets Unit Service Reference Manual - "Guideline for Exemption of Custodian Fee for Retail Investors" for details of the exemption.

3. Custodian fee on account holders will only apply for those CMU Instruments lodged with CMU after 1 January 2005. Those lodged before 1 January 2005 have already been paid by lodging agent and will not be subject to any additional custodian fee.

4. CMU Tariff, as effective from 1 January 2005, will also apply to transactions and holdings relating to CMU's linkages with Austraclear in Australia and in New Zealand, and Korean Securities Depository in Korea.

5. Calculation of custodian fee

   a) Custodian fees are calculated based on monthly average nominal value of securities held in the CMU account. These average amounts are converted into Hong Kong dollar at the exchange rate prevailing at the end of the month and aggregated to obtain the monthly average value.
   b) The custodian fee will be invoiced in Hong Kong dollar.
   c) Custodian fees are calculated on an actual/365 day basis and expressed in basis points per annum. (1bp=0.01%)
   d) An example of custodian fees calculation of a member with an average monthly holding of CMU Instruments of HKD23,000 mn is shown below.

Holdings (HKD millions)	Fee Rate (b.p.)	Holdings by Member (HKD millions)	Custodian Fee for the Month (HKD)
<15,000	0.32	The first 15,000	40,767.12
15,000–20,000	0.30	The next 5,000	12,739.72
>20,000	0.25	The next 3,000	6,369.86
	Total	**23,000**	**59,876.70**

6. All fees are invoiced in Hong Kong dollar and billed monthly to CMU members. The total amount of fees payable will be advised to the members on the 20th day of the following month or the next business day if the 20th is not a business day. The total fees will be automatically debited from the members' clearing account with the HKMA (for direct clearing members) or the clearing account of their correspondent banks (for non-direct clearing members) on the 25th or the following business day if 25th is not a business day.

7. Report fees are charged based on usage by the participant irrespective of the types of securities involved and channels (FTS, CMT or SWIFT) received, i.e., a report involving Exchange Fund Paper, Government Bonds and CMU Instruments will be subject to the same report tariff rate. The report fee is applicable even if the report contains no item, but only the header and footer information.

8. Enquiry fees are charged based on the number of screen pages returned to the participant for an enquiry initiated at CMT irrespective of the types of securities involved, i.e., an enquiry involving Exchange Fund Paper, Government Bonds and CMU Instruments will be subject to the same enquiry tariff rate. The number of retrieved and displayed items per screen page returned is set by the participant.

Appendix 2.

Listing Fees for Debt Securities

In a new release on 8 March 2002, Hong Kong Exchanges and Clearing Limited ("HKEx") proposed to reduce the fees and charges of its wholly owned subsidiaries, The Stock Exchange of Hong Kong Limited ("SEHK") and Hong Kong Futures Exchange Limited ("HKFE"), in respect of certain securities, derivative products and the provision of market data with the view to enhance its competitiveness and to increase the attractiveness of Hong Kong to both local and international issuers and investors.

The current listing fees for debt securities are contained in Appendix 8 to the HKEx rules and regulations, Section 1A and have been provided below for easy reference:

Box A2.1. Appendix 8 Listing Fees, Transaction Levies and Trading Fees on New Issues and Brokerage

Appendix 8
Listing Fees, Transaction Levies and Trading Fees on New Issues and Brokerage

1. Initial Listing Fee

(1) In the case of an issue of equity securities by a new applicant, other than units in a unit trust, redeemable shares in a mutual fund, or an issue of securities by an openended investment company or other collective investment scheme, an initial listing fee shall be payable on the application for listing as follows:—

	Monetary value of the equity securities to be listed HK$M	Initial listing fee HK$
Not exceeding	100	150,000
	200	175,000
	300	200,000
	400	225,000
	500	250,000
	750	300,000
	1,000	350,000
	1,500	400,00
	2,000	450,000
	2,500	500,000
	3,000	550,000
	4,000	600,000
	5,000	600,000
Over	5,000	650,000

Note: An "open-ended investment company" is an investment company which is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting or trading in securities or collective investment schemes and which is offering for sale or has outstanding any redeemable shares or their functional equivalent of which it is the issuer.

(2) A new applicant shall pay the initial listing fee, in advance, at the same time as it submits its listing application form, in accordance with rules 9.03 and 20.08, as appropriate.

(3) In a transfer of listing from GEM to the Main Board, the new applicant shall pay the initial listing fee at 50% discount to the scaled fees set out in 1(1), in accordance with the provisions of Chapter 9A.

1A. Debt Securities and Structured Products

continued on next page

Box A.2.1 continuation

(1) In the case of a new listing of debt securities on or after 1st July, 2002 whether by a new applicant or otherwise, where the term of such debt securities until maturity is:—

(a) less than 2 years the listing fee payable in one lump sum upon the application of the listing of such debt securities shall be:
(1) HK$10,000 for up to HK$100 million of debt securities issued;
(2) HK$12,500 for more than HK$100 million but equal to or less than HK$500 million of debt securities issued;
(3) HK$24,000 for more than HK$500 million of debt securities issued;

(b) more than or equal to 2 years but less than or equal to 5 years, the listing fee payable in one single lump sum upon the application of the listing of such debt securities shall be:
(1) HK$20,000 for up to HK$100 million of debt securities issued;
(2) HK$25,000 for more than HK$100 million but equal to or less than HK$500 million of debt securities issued;
(3) HK$39,000 for more than HK$500 million of debt securities issued;

(c) more than 5 years but equal to or less than 10 years, the listing fee payable in one single lump sum upon the application of the listing of such debt securities shall be:
(1) HK$25,000 for up to HK$100 million of debt securities issued;
(2) HK$30,000 for more than HK$100 million but equal to or less than HK$500 million of debt securities issued;
(3) HK$55,000 for more than HK$500 million of debt securities issued;

(d) more than 10 years, the listing fee payable in one single lump sum upon the application of the listing of such securities shall be:
(1) HK$25,000 plus an additional HK$5,000 per each year or part year that the term of the debt securities exceeds ten years for up to HK$100 million of debt securities issued, provided that the listing fee shall not exceed HK$60,000;
(2) HK$30,000 plus an additional HK$5,000 per each year or part year that the term of the debt securities exceeds ten years for more than HK$100 million but equal to or less than HK$500 million of debt securities issued, provided that the listing fee shall not exceed HK$70,000;
(3) HK$55,000 plus an additional HK$5,000 per each year or part year that the term of the debt securities exceeds ten years for more than HK$500 million of debt securities issued, provided that the listing fee shall not exceed HK$90,000;

Provided that for securities listed before 1st July,2002 which had a term to maturity at the time of listing of more than ten years, a listing fee of HK$6,000 shall be payable annually from the expiry of the first ten years of the listing.

(2) (a) In the case of an application in respect of a new listing, a continuance or an increase in size of a debt issuance programme, the listing fee payable upon the application of such listing, continuance or increase in size of such debt issuance programme shall be HK$15,000.

(b) In the case of a listing of new issue of debt securities to be issued under a debt issuance programme pursuant to 1A(2)(a) above, the listing fees payable in one single lump sum upon the application of the listing of such debt securities (issued under a debt issuance programme) shall be 70% of the listing fees payable under 1A(1)(a), 1A(1)(b),1A(1)(c), or 1A(1)(d) as the case may be, rounded upwards to the nearest HK$1,000.

(3) In the case of all those debt securities which were listed before 1st January 1997, whether by a new applicant or otherwise, the annual listing fees payable for the same shall continue to be payable in accordance with 2(1)(b) and/or 2(1)(e) (as the case may be).

(4) (a) The listing fee for an issue of structured products is normally payable in one single lump sum upon the application of the listing of such structured product. The Exchange and/or HKEC may operate discount or rebate schemes for fees in respect of structured products or types of structured product. In such cases the Exchange may permit the fee to be paid net of such discounts or rebate.

(b) In the case of an issue of structured products, except equity linked instruments and callable bull/bear contracts, the listing fees payable in one single lump sum upon the application of the listing of such structured product shall be HK$60,000 (the "Basic Fee") for the first issue launched in any calendar year by an issuer over a particular security, index, currency or other asset and HK$40,000 (the "Reduced Fee") for any subsequent issues launched in that same calendar year by that issuer over the same underlying security, index, currency or other asset. The fee for baskets shall be HK$60,000 for each issue and each subsequent issue.

(c) In the case of an issue of equity linked instruments the listing fee, payable in one lump sum upon the application of the listing of such equity linked instrument, shall be:
(i) HK$5,000 if the market capitalisation is equal to HK$10 million;
(ii) HK$10,000 if the market capitalisation is greater than HK$10 million and up to or equal to HK$50 million; and
(iii) HK$15,000 if the market capitalisation is greater than HK$50 million for the first issue launched in any calendar year by an issuer over a particular security, index, currency or other asset. For any subsequent issues launched in that same calendar year by that issuer over the

continued on next page

Box A.2.1 continuation

same underlying security, index, currency or other asset, the listing fee, payable in one lump sum upon the application of the of the listing of such equity linked instrument, shall be:

(1) HK$3,000 if the market capitalisation is equal to HK$10 million;
(2) HK$6,000 if the market capitalisation is greater than HK$10 million and up to or equal to HK$50 million; and
(3) HK$9,000 if the market capitalisation is greater than HK$50 million.

The fee for basket equity linked instruments, payable in one lump sum upon the application of the listing of such equity linked instrument, shall be:

(I) HK$5,000 if the market capitalisation is equal to HK$10 million;
(II) HK$10,000 if the market capitalisation is greater than HK$10 million and up to or equal to HK$50 million; and
(III) HK$15,000 if the market capitalisation is greater than HK$50 million.

(d) In the case of an issue of callable bull/bear contracts the listing fees payable in one single lump sum upon the application of the listing of such structured product shall be 30% of the Basic Fee above for the first issue launched in any calendar year by an issuer over a particular security, index, currency or other asset and 30% of the Reduced Fee above for any subsequent issues launched in that same calendar year by that issuer over the same underlying security, index, currency or other asset. The fee for baskets shall be 30% of the Basic Fee above for each issue and each subsequent issue. In all cases the listing fee shall be rounded upwards to the nearest HK$100.

Hong Kong Exchanges and Clearing Limited. http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/appendix_8.pdf

Table A1.2 General Debt Securities

General Debt Securities				
Issue Size: above HKD100 million to HKD1,500 million				
Fee (HKD)	Term to Maturity			
	1 Year	5 Years	10 Years	15 Years
Current fee	25,000 – 30,000	50,000 – 60,000	60,000 – 80,000	90,000 – 110,000
Proposed fee	22,000 – 26,000	34,000 – 44,000	54,000 – 74,000	74,000 – 94,000

Table A1.3 Debt Issuance Programme Securities

Debt Issuance Programme Securities				
Issue Size: above HKD100 million to HKD1,500 million				
Fee (HKD)	Term to Maturity			
	1 Year	5 Years	10 Years	15 Years
Current fee	65,000 – 72,000	65,000 – 72,000	72,000 – 86,000	93,000 – 107,000
Proposed fee	31,000 – 34,000	39,000 – 46,000	53,000 – 67,000	67,000 – 81,000

Source: Hong Kong Exchanges and Clearing. http://www.hkex.com.hk/eng/newsconsul/hkexnews/2002/020308news.htm

The above proposed revised fee structure for listing of debt securities and debt issuance programmes in Hong Kong is competitive with a major debt listing exchange in Europe.

References

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