Peter Pang: Launch of the new cross-border collateral management service

Remarks by Mr Peter Pang, Deputy Chief Executive of the Hong Kong Monetary, at the cross-border collateral management service signing ceremony and press conference, Hong Kong, 20 June 2012.

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Mr. Grimonpont, Mr. Bhatia, ladies and gentlemen,

Good afternoon. It is my pleasure to welcome you to this signing ceremony. The bilateral agreements that I shall sign on behalf of the Hong Kong Monetary Authority with the Euroclear Bank and J.P.Morgan today will pave the way for the launch of the new cross-border collateral management service, a critical building block of the cross-border bond investment and settlement platform launched in March 2012.

The new service, which will commence on 25 June, will bring significant benefits to the contracting partners and the money market as a whole. For Hong Kong, it will advance the development of our repo market, enhance the stability of our financial system and strengthen further Hong Kong's role as the global hub for offshore renminbi business.

The repo market is a key component of major international financial centres. It serves as the link between the money and capital markets, and is vital to the well functioning of the financing channels. By providing credit enhancement through the use of securities as collateral, the repo market also serves as the lubricant that keeps the financial engine running particularly during times of risk aversion. The new collateral management service, with its cross-border, cross-system, cross-time zone and cross-currency capabilities, will provide an efficient repo infrastructure that will help develop the repo market in Hong Kong.

The importance of the repo market as a financing channel has assumed added prominence since the outbreak of the global financial crisis in 2008. Due to a combination of the large inflows of funds into Hong Kong in late 2008 and early 2009 and heightened risk aversion, the interbank money market has been less active in recent years and financial institutions have been more careful in lending funds to each other on an uncollateralized basis. The average daily turnover of the uncollateralized interbank market has dropped significantly, by 71% from HK$286 billion in November 2007 to HK$83 billion in March 2012. The higher frequency of flight to quality, and resultant tightness in the global supply of US dollar, has also affected turnover in the currency swap market. The average daily turnover of the Hong Kong dollar swap market also reduced notably by 32% from HK$263 billion to HK$179 billion in the same period. While the Hong Kong banking sector is now faced with ample liquidity, the situation will not be permanent and we will need to find new ways to facilitate efficient interbank borrowing. Development of the repo market will help to activate the money market by addressing the credit risk through the collateralized arrangement.

The cross-border funding issue is particularly important to Hong Kong given its role as an international banking centre. 139 of the 199 authorized institutions in Hong Kong are either branches or subsidiaries of banking groups incorporated outside of the territory. An important function of the new service is to enable financial institutions to make use of securities held in one of the partner systems as collateral to conduct secured borrowing in the Hong Kong dollar or renminbi in Hong Kong. As an example, a bank in Europe can make use of its securities held with Euroclear Bank or J.P. Morgan to borrow Hong Kong dollar to meet the liquidity needs of its Hong Kong subsidiary. The enhanced capability of authorized institutions to manage the liquidity needs in the local currency, no doubt, will help to maintain financial stability in Hong Kong.

The facility will also substantially strengthen Hong Kong's role as the global hub for offshore renminbi business. Being the first mover in developing offshore renminbi business, Hong Kong has the largest offshore renminbi liquidity pool, amounting to RMB 674 billion at the end of April 2012, and has developed a vibrant CNH market and the largest offshore RMB bond market. More foreign banks are either choosing to have a base in Hong Kong or are using RMB correspondent banking services provided by banks in Hong Kong. As at the end of May 2012, there were 196 banks participating in Hong Kong's renminbi clearing platform. Of these, 170 are foreign-owned or located overseas. At the same time, over 1,100 renminbi correspondent accounts were maintained by overseas banks with banks in Hong Kong. The amount due to and due from such overseas banks amounted to RMB 128 billion and RMB 146 billion respectively. This is a clear indication that banks from around the world are using Hong Kong's robust platform and large liquidity pool to offer renminbi services to their customers at home.

As more and more companies and financial institutions conduct business and transactions in the renminbi, we will see an increasing number of financial centres offering offshore renminbi business in different parts of the world. These centres can benefit significantly from having an access to the offshore renminbi platform and liquidity pool in Hong Kong. The HKMA is taking proactive steps to aid the private sector in this endeavour. The private sector led Hong Kong – London Forum is an excellent example of this effort. The Forum just held its first meeting in Hong Kong in May this year, and agreed on a number of joint actions in the areas of renminbi liquidity, payment and settlement arrangements and development of products and services, to bring mutual benefits to the growth of offshore renminbi business in Hong Kong and London. One of the key action points agreed at the Forum is to expand cross-market renminbi funding activities through the cross-border collateral management arrangement that will be launched jointly by the HKMA, Euroclear and J.P. Morgan on 25 June.

The HKMA is delighted to work with Euroclear Bank and J.P.Morgan, the two premier global tripartite repo system operators, to bring this concept to fruition. With security pools valued at EUR 10.8 trillion and US$ 17.9 trillion respectively, both institutions provide a huge reservoir and a highly sophisticated platform to support cross-border cross currency lending with ample choices of securities as collateral. Linked up by the HKMA's Central Moneymarkets Unit (CMU) as an agent, CMU members will be able to enjoy the collateral management service of the global repo operators which include functions like auto-selection and auto-substitution of collateral, collateral eligibility filters, daily mark-to-market and prudent haircut execution, all of which will help financial institutions in their collateral management processes.

As a further development, we are working with our two partners to expand the repo service to allow financial institutions in Hong Kong to use their securities kept with the CMU, Euroclear and J.P. Morgan as collateral to obtain foreign currency liquidity such as US dollars from the global broker dealers in the second half of 2012. This will help local companies and financial institutions to obtain foreign currency liquidity as they expand their business overseas.

Finally, the HKMA has a long term vision for repo financing to become a more important source of funding for companies and banks in Hong Kong. It is in Hong Kong's and Asia's long-term interest to promote further development of the repo market, underpinned by a closer integration with overseas markets to enable a wider variety of collateral to be mobilized across borders and currencies. In this regard, the HKMA will continue to work closely with the industry to advance the repo market with a dual aim to provide a safe and more resilient source of funding, as well as to foster financial stability of the region.

Thank you.