

## Mr Yam looks at the benefits a US dollar clearing system will bring to Hong Kong

Speech by Mr Joseph Yam, Chief Executive, Hong Kong Monetary Authority, at the Signing Ceremony for the US Dollar Clearing System, Hong Kong, on 9 March 2000.

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It is a pleasure to welcome you all to this afternoon's signing ceremony. The purpose of the ceremony is for the HKMA formally to appoint HSBC as the Settlement Institution for the new US dollar clearing system that will be developed in Hong Kong over the coming months. When it is fully running - prospectively by the end of the year - this system will enable a wide range of financial transactions in US dollars to be settled here in Hong Kong, many of them on a real time basis. The project marks an important milestone in the development of Hong Kong's financial infrastructure and it should help to consolidate Hong Kong's position as an international financial centre.

Developing Hong Kong's financial infrastructure is, along with maintaining currency and banking stability, one of the three main policy objectives of the HKMA. Financial infrastructure, when it works efficiently, is something that is so much taken for granted that it is barely noticed. It is a far less prominent public issue than currency or banking stability. Yet, without a properly working financial infrastructure, there is little chance of currency and banking stability. Effective financial infrastructure is as important to Hong Kong as is the extensive and far more visible physical infrastructure that we see around us. And Hong Kong is fortunate to be equipped with a financial infrastructure that is as advanced, reliable and efficient as the road, rail and airport facilities that keep our city moving.

Since 1994 the HKMA has implemented a number of major reforms to Hong Kong's payment and settlement systems. The largest of these reforms was the launch, in December 1996, of Hong Kong's Real Time Gross Settlement (RTGS) system for interbank payments in Hong Kong dollars. This state-of-the-art system is widely acknowledged to be one of the most advanced and robust of its kind. It has served Hong Kong remarkably well, and made an important contribution to maintaining financial stability during the Asian financial crisis, which erupted not long after its introduction. Our experience with the RTGS system, and in particular the technology produced for it, plays an essential role in the development of the next great milestone, the US dollar clearing system.

The US dollar is the currency in which most world trade in merchandise and financial products is denominated. Because of Hong Kong's role as an international financial centre, and the fact that our own currency is linked to the US dollar, there is extensive holding of US dollars and a considerable trade in US dollar-denominated assets. The *existing* market demand within Hong Kong for a US dollar clearing system is a persuasive enough argument for its introduction: the *potential* demand for such a system, and the strategic impetus that it would give to our development as a leading financial centre, is considerable. In the near term, Hong Kong's US Dollar Clearing System will provide the necessary infrastructure to support the Stock Exchange's launch of the Growth Enterprise Market (GEM), which will allow listed shares to be denominated and settled in US dollars. In the longer term, the system will provide a range of opportunities for further developing our stock and debt markets into major world markets.

A local US dollar clearing system will bring with it the advantages of speed, convenience and efficiency: it will, for example, allow US dollar cheques to be settled within two days, instead of the current two weeks. In addition to these obvious advantages, it will also carry the benefit of safety, in the form of reduced settlement risk. By enabling, within Hong Kong, delivery versus payment (DvP) for US dollar-denominated securities, and payment versus payment (PvP) for foreign exchange

transactions between US dollars and Hong Kong dollars, the system will eliminate the settlement risk that arises when a transaction is spread across different time zones.

Greater safety at the level of individual transactions will be complemented by the contribution the system will make to monetary stability. By reducing the need for using the Hong Kong dollar as a vehicle currency for conducting non-domestic financial business, the US Dollar Clearing System will reduce the impact on local monetary conditions of movements in portfolio capital unrelated to economic developments intrinsic to Hong Kong. This is an excellent illustration of how a piece of robust and efficient financial infrastructure can be conducive to other important policy objectives, in this case monetary stability.

Let me turn now to the mechanics of the system. The arrangement adopted here is a private sector solution, in which the Settlement Institution is a commercial bank. This is not only consistent with the tradition in Hong Kong, but is also in line with international practice and with the recommendations of the Bank for International Settlements. At the end of a rigorous selection process, a Selection Panel made up of disinterested members of the Exchange Fund Advisory Committee (EFAC) and senior executives from the HKMA recommended to EFAC that HSBC be appointed the Settlement Institution for a franchise period of five years. Under the arrangements agreed between the HKMA and HSBC, the Settlement Institution will in turn appoint Hong Kong Interbank Clearing Ltd, the current operator of the Hong Kong dollar payment system, to develop and operate the US dollar clearing system. The role of the HKMA will be to oversee the design and implementation of the system and to ensure that it meets the highest international standards.

The conceptual design of the system is firmly in place. The intention is that it should encompass not only the best, internationally agreed, principles of payment system design but also state-of-the-art technology. Leveraging on the technology used for the existing Hong Kong dollar RTGS system, this US Dollar Clearing System will offer a range of advanced and sophisticated clearing functions. These will include linkage with the Hong Kong dollar payment system to provide real time PvP settlement for US dollar-Hong Kong dollar transactions, as well as linkages with the stock and debt securities clearing houses to provide DvP settlement. For the general public, the System will enable banks to offer US dollar cheque deposit accounts, which means that US dollar payments can be discharged through the writing of a cheque in US dollars drawn upon a bank in Hong Kong. The various features of the system will be introduced in phases. All being well, we hope to see real-time interbank payments and PvP for US dollar-Hong Kong dollar foreign exchange transactions introduced by the third quarter of this year and US dollar paper cheque clearing and a linkage with the HKMA's Central Moneymarkets Unit completed by the end of the year.

People have asked whether we propose to introduce clearing in other foreign currencies once the US dollar system is established. In principle this would be possible. In practice there needs to be a business case. The HKMA is certainly ready to respond if there appears to be market demand for similar clearing systems for other major currencies.

Hong Kong will shortly have a state-of-the-art facility for conducting US dollar transactions in Asian time. The benefits of this for both local business and international customers, in both trade and finance, should be considerable. I take this opportunity to thank and congratulate those who have worked hard to bring the project to its present advanced stage in so short a time, and I wish every success to all who will be involved in translating the design into reality.