Eddie Yue: Hong Kong Monetary Authority's work on market development

Keynote address by Mr Eddie Yue, Deputy Chief Executive of the Hong Kong Monetary Authority, at the 2nd Asia Treasury and Trade Summit 2016 "Treasury Re-imagined", organized by The Asset, Hong Kong, 11 May 2016.

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Daniel (Yu), distinguished guests, ladies and gentlemen:

1. Good morning. I would like to thank The Asset for hosting its Asia Treasury and Trade Summit in Hong Kong again. And, it is my great pleasure to welcome all of you to this event, in particular those who have travelled from overseas. As CFOs and treasurers, you are important users of Hong Kong's financial services. Over the years, we have listened to and worked with many of you, not just to better serve your business needs, but also as partners to help develop Hong Kong as an international financial centre. Let me therefore start this morning by sharing with you a few examples of the HKMA's work on market development. Some of you here today may have heard these facts before, so apologies for that, but we like to repeat the good news whenever we can!

Development of Hong Kong as IFC

2. ***First, the promotion of renminbi business.*** And, I'm delighted to see that discussion of the renminbi "as a treasury currency" is high on your Summit agenda today! Indeed, Hong Kong is the largest global offshore renminbi business hub, with a liquidity pool of close to RMB900 billion, the largest outside Mainland China. Hong Kong also boasts a vibrant offshore renminbi bond market, again, the largest outside Mainland China, with some RMB340 billion bonds outstanding. More than 200 banks from all over the world are using our renminbi clearing platform to conduct a wide range of business activities. The goal of the HKMA, among other things, is to promote offshore renminbi business development through securing the necessary policy headroom, facilitating liquidity management and building a robust infrastructure for conducting the business.
3. To make this possible, we have put in place a RMB400 billion currency swap agreement with the People's Bank of China, which can be activated when market conditions warrant. We have also made available renminbi liquidity facilities to banks in Hong Kong, in the form of an intraday repo facility of RMB10 billion, and a bilateral repo line of RMB2 billion with each of the seven Primary Liquidity Providers. In terms of our renminbi real time gross settlement system, currently around RMB800 billion worth of transactions go through the system every day. So, you can see clearly why we have sought to further develop renminbi business.
4. ***Secondly, the promotion of asset management***. We want to attract Mainland and overseas asset managers to Hong Kong. We have made numerous trips to the Mainland and overseas to meet with asset managers, often on a one-on-one basis, to explain to them the benefits of establishing in Hong Kong. And, our work is paying off. By the end of 2014, the combined fund management business here reached a record high of US$2.3 trillion, an increase of more than 10% over 2013. Today, there are more than 1,150 licensed asset management companies operating in Hong Kong; and, more than 60 out of the top 100 global money managers have operations here. I think these are quite impressive statistics and reflect well on our status as an international financial centre.

5. ***Thirdly, the promotion of private equity funds.*** The HKMA proposed, and then worked with the Government, to extend the exemption on profits tax to offshore private equity funds. The legislation, which was passed last year, enables the operating structure of private equity funds to be streamlined, and also broadens private equity managers' ability to conduct asset management activities in Hong Kong. This is attracting more private equity firms to set up or expand their business here.

6. ***Fourthly, the promotion of Islamic finance***. Legislation was enacted in 2013 to provide a level playing field in terms of tax for sukuk vis-à-vis conventional bonds. Two sukuk were successfully launched by the Government in 2014 and 2015 using two different structures of ijarah and wakalah. We hope their success will have the effect of attracting more entities to issue sukuk in Hong Kong. Up till now, 10 global sukuk (including the two government ones I mentioned) have been listed on the Hong Kong Stock Exchange.

7. These are just some of the examples of our work on market development. Although there is one other important initiative I would like to mention here – our recent work to establish IFFO, or to give its title in full, the Infrastructure Financing Facilitation Office. As you are no doubt aware, the need for infrastructure financing is huge. The Asian Development Bank puts the overall infrastructure investment needs of Asia at US$8 trillion over the 2010–2020 period. And, with the Mainland authorities implementing the "Belt and Road" strategy to enhance connectivity within the region through increased infrastructure investments, there is likely to be an even greater financing requirement. As such, Hong Kong is well positioned to develop into a major financing hub for investments in this field.

8. Indeed, the establishment of IFFO has three main objectives:

- building a cluster of key stakeholders in infrastructure financing, including equity and debt investors, project sponsors and developers, professional advisors, and relevant agencies from the "Belt and Road" countries;
- providing a platform for information exchange, experience sharing and capacity building on infrastructure financing among the cluster members; and
- promoting Hong Kong as a major platform for Belt and Road infrastructure project sourcing, financing and fund management, leveraging on our role as an international financial centre.

9. The HKMA is now in the process of setting up IFFO and the response, to date, has been most encouraging. In-principle support has been received from the Asian Infrastructure Investment Bank, the Asian Development Bank, and the International Finance Corporation under the World Bank Group. And others have also indicated an interest. IFFO will be launched in July and we look forward to sharing with you more information about its work.

Corporate Treasury Management

10. I would now like to turn to issues of more immediate concern to you in your treasury management roles, and to share a few factors which I believe are shaping your business:

11. ***First, the continuing liberalisation of the Mainland's capital account.*** As I mentioned earlier, the Mainland authorities have continued to implement measures to liberalise cross-border fund flows. I am sure many of you are familiar with the progress, but let me just quickly name a few key measures introduced in recent years:

- The Shanghai-Hong Kong Stock Connect has been in place and operating smoothly since November 2014, allowing international investors access to the A-shares listed in Shanghai through the stock exchange in Hong Kong, and vice versa.
- The Mainland-Hong Kong Mutual Recognition of Funds scheme was implemented in July 2015, allowing Mainland and Hong Kong funds to be distributed in each other's markets through a streamlined approval process.
- The QFII arrangement was refined in February this year by relaxing individual quotas and shortening the investment lock-up period, among other improvements.
- The People's Bank of China announced in February a widening of the access to the China Interbank Bond Market to a broad range of foreign financial institutions without any quota restrictions.
- And, earlier this month, the Bank announced that it would extend nationwide the pilot measure for cross-border financing by Mainland corporates and financial institutions, with the result that case-by-case pre-approval is no longer required.

12. These initiatives demonstrate the central government's commitment to liberalising the Mainland's capital accounts. They also present CFOs and treasurers with new opportunities to meet their business and investment needs. And, there will be more to come. Premier Li Keqiang has said the Shenzhen-Hong Kong Stock Connect will be launched later this year.

13. ***Secondly, the "China connection" is growing rapidly.*** Let me briefly explain what I mean by this: in 2014, China's ODI amounted to US$123 billion, 10 times the amount in 2005. This number will be even bigger in the years to come as Chinese corporates go global, and as the implementation of the "Belt and Road" strategy helps more Chinese corporates to invest in these countries. At the same time, multinational corporates are paying more and more business attention to China. In 2015, FDI into China reached US$126 billion, compared to US$72 billion in 2005. The point here is that with more business opportunities, either because Chinese corporates are "going out" or multinational corporates are expanding into China, comes the need for more sophisticated treasury management.

14. ***Thirdly, while corporates find more business opportunities, they also face even more challenges*** which you, as corporate treasurers, are probably well familiar with. For example, increasing market risks, where corporates operating in multiple countries are faced with growing exposures to different currencies and rates. In fact, divergent monetary policies among key advanced economies have led to greater volatility in the global foreign exchange market. And, with the international use of the renminbi on the rise, the reform of the yuan's exchange rate since August 2015 has also resulted in more two-way movements of the exchange rate against other currencies. These recent developments have created more market risks.

15. ***Lastly, global regulatory reforms have also had an impact on corporate treasury management.*** These reforms, particularly the higher capital and liquidity requirements under Basel III, have led to more constraints on global banks in providing funding and making a market for hedging tools for corporates. As such, there is an undesirable impact on corporate treasurers in terms of financing cost and asset and liability management.

Benefits of CTCs

16. Corporates need smarter solutions to address these opportunities and challenges. There has been a greater call for corporates to set up more structured regional corporate treasury centres, CTCs in short. Many market participants have considered CTCs useful for a number of reasons:

- one, through centralising treasury activities, CTCs help effectively translate management's vision into firm-wide policies, such as preferences on operating currencies, hedging and day-to-day transactions;
- two, CTCs help lower funding costs through the optimal use of intra-group funding and netting, as well as external financing; make more co-ordinated use of corporate balance sheets, and; enable corporates to more effectively tap capital markets for longer term funding;
- three, they help optimise working capital positions and facilitate daily sales through customised transactional arrangements. And by concentrating excess liquidity in CTCs, senior management can achieve better visibility and control over their cash and reduce frauds; and
- four, they act as corporate centres to consolidate various foreign exchange and interest rate exposures and allow centralised hedging on net positions. Therefore, corporates can eliminate redundant procedures to reduce associated costs and enhance efficiencies.

17. In addition, more and more corporates are adopting technologies, such as the "Enterprise Resource Planning" System and the "Treasury Management System", which enable them to improve control over local subsidiaries' activities and standardise treasury operations. All in all, CTCs can play the critical role of an in-house bank within a multinational corporation and a function that multinationals should develop in tandem with their global expansion plans.

Hong Kong as a preferred CTC location

18. At the HKMA, we have set a goal to promote the growth of CTCs in Hong Kong because their activities, such as foreign exchange and rate hedging, financing, and cash management, will help deepen our capital markets and create additional users of our financial and professional services industries. As you know, in many cases multinational corporates will co-locate their CTCs with their regional headquarters. By attracting more CTCs to Hong Kong, we hope this will hasten the process and further consolidate our status as an international financial centre.

19. Ladies and gentlemen, Hong Kong already provides a conducive environment in which CTCs can operate, but we are doing more, particularly on the all-important tax front. Through the work done by the Inland Revenue Department, Hong Kong's Comprehensive Double Tax Agreements network has expanded from just five in 2009 to currently 35 agreements. These DTAs are important to multinational corporates as they help reduce the withholding tax rate on interests of cross-border loans. The Government has also announced major changes to the tax regime that will make Hong Kong an even more attractive destination for setting up CTCs.

20. With the changes, the interest deduction rules under the Inland Revenue Ordinance will be amended so that interest expenses arising from genuine cross-border intra-group financing activities, under specified conditions, will be deductible. This will lower the overall tax cost and resolve the "tax asymmetry" issue currently perceived by some MNCs as an impediment to their establishing or expanding CTC operations in Hong Kong. Corporates which used to solely rely on external financing can now explore the additional option of internal funding through their CTC setup in Hong Kong.

21. And, the qualifying profits derived from corporate treasury activities and transactions conducted by qualifying CTCs will benefit from a half-rate concession. In other words, the applicable tax rate will be cut from the current 16.5% to 8.25%. Broadly speaking, the scope of this concession encompasses corporate finance, liquidity

management and risk management activities typically conducted by CTCs for their non-Hong Kong associated corporations. The concessionary tax rate at 8.25% will be among the most competitive in the region and can be obtained through simple election as part of a corporation's tax filing process. In other words, no separate, complicated approval process will be involved.

22. And, I'm delighted to say the relevant bill to give effect to these changes is now with the Legislative Council and the Government hopes to have the bill passed by the middle of the year.

Closing

23. Ladies and gentlemen, looking at today's programme, I note that many of the themes I have mentioned will be addressed by treasury professionals in greater depth. I hope the upcoming sessions will inspire new ideas for treasury management, and I wish you all a very successful conference. Thank you.