

The Role of Financial Infrastructure in Regional Financial Interaction

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Financial Interaction in Asia

Asia is famous for its diversity – some say it is no more than a “geographical expression” or a “time zone”. However, Asian economies share more similarities than most people thought:

- Fast economic growth
- Rising income and high savings ratio
- Use of US dollar as the currency for most, if not all, cross border trade and financial transactions within the region for more than six decades – well before euro came into existence in Europe

Increasing intra-regional trade and funds flow \Rightarrow closer economic interaction

Financial Interaction in Asia

Closer financial interaction gives rise to increasing needs for:

- Safe and efficient intra-regional financial intermediation services
- Robust financial infrastructure platforms to channel savings to investment within the region

Hong Kong on the Regional Map

Strong underlying economic strength

(Per capita GDP in Hong Kong around US\$30,000)



Hong Kong is regarded as an important international financial centre

Well developed and fast growing financial sector



278 banks have branches / subsidiaries / offices in Hong Kong

68% of the World's top 100 banks have presence in Hong Kong

Demand for financial infrastructure service by the financial institutions

Financial Services – For Who’s Benefits?

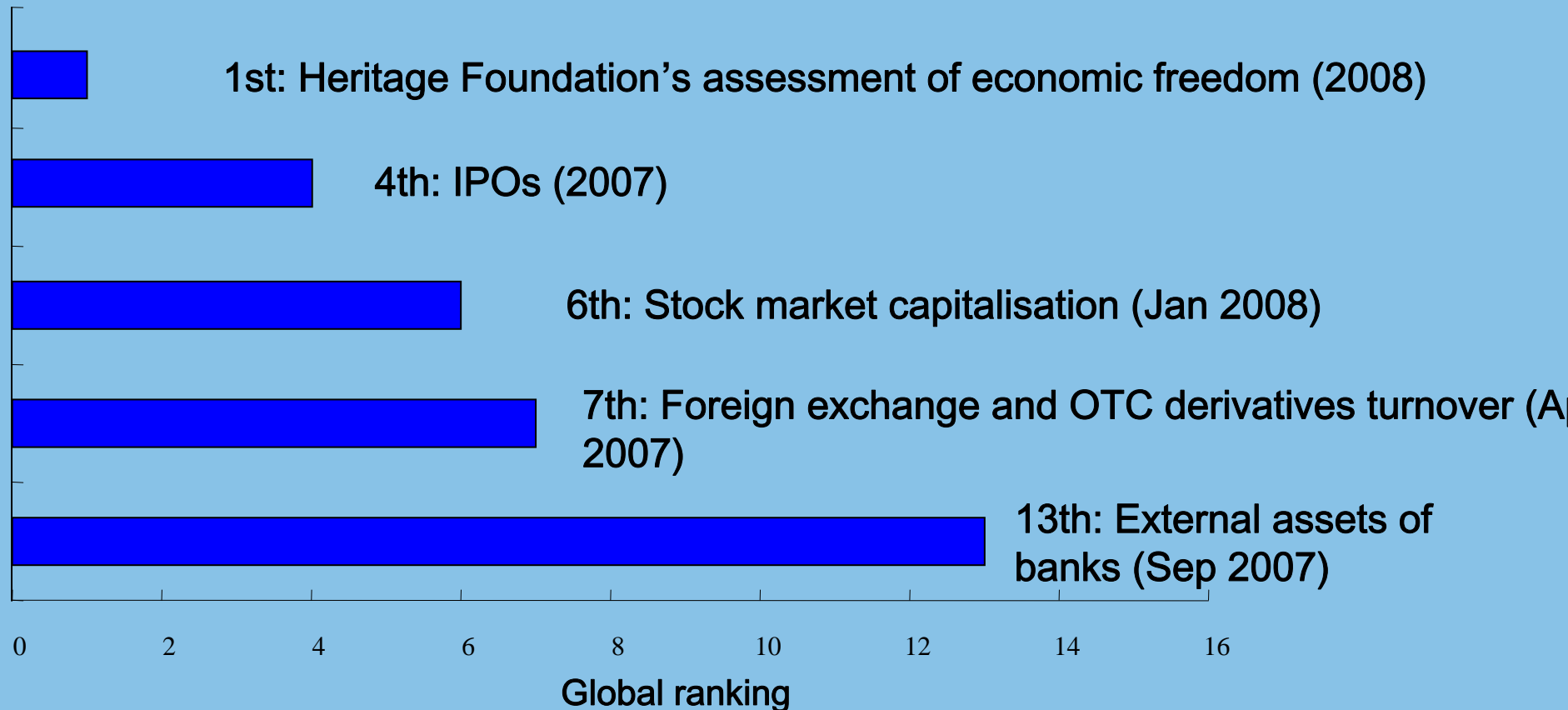
Financial services are for the benefits of the people in the region – both savers and investors

“A strong financial system is vitally important – not for Wall Street, not for bankers, but for working Americans.”

– US Treasury Secretary Henry M. Paulson Jr.

Hong Kong's Competitiveness

Rankings in International League



Hong Kong's Benefits to Regional Financial Institutions

- Deep and liquid capital markets
- Gateway to 2.6 million High Net Worth Individuals (HNWIs with assets > US\$1mn) in Asia Pacific, with wealth totalling US\$8.4trillion (end-2006) *(Source: World Wealth Report 2007 by Merrill Lynch and Capgemini)*
- China factors:
 - High saving rates in China
 - First choice of investment destination for China's US\$1,500bn foreign reserve and social security fund
 - Mainland's QDII and QFII schemes
 - CEPA IV – qualified mainland fund management companies to be established in Hong Kong

Hong Kong's Benefits to Regional Financial Institutions *(cont'd)*

- Clean and efficient government
- Rule of law, sound legal system
- Robust banking industry
- Simple and low tax:
 - Abolition of estate duty
 - Corporate tax @ 16.5% - one of the lowest in Asia
 - Profit tax exemption for off-shore funds
- Free flow of capital and exchange rate stability
- Safe and efficient financial infrastructure
- Talented human resources

Hong Kong's Benefits to Regional Investors

- Easy to buy a wide variety of financial assets denominated in whatever currencies in Hong Kong
- Easy to arrange credit facilities denominated in whatever currencies in Hong Kong for credit worthy investors

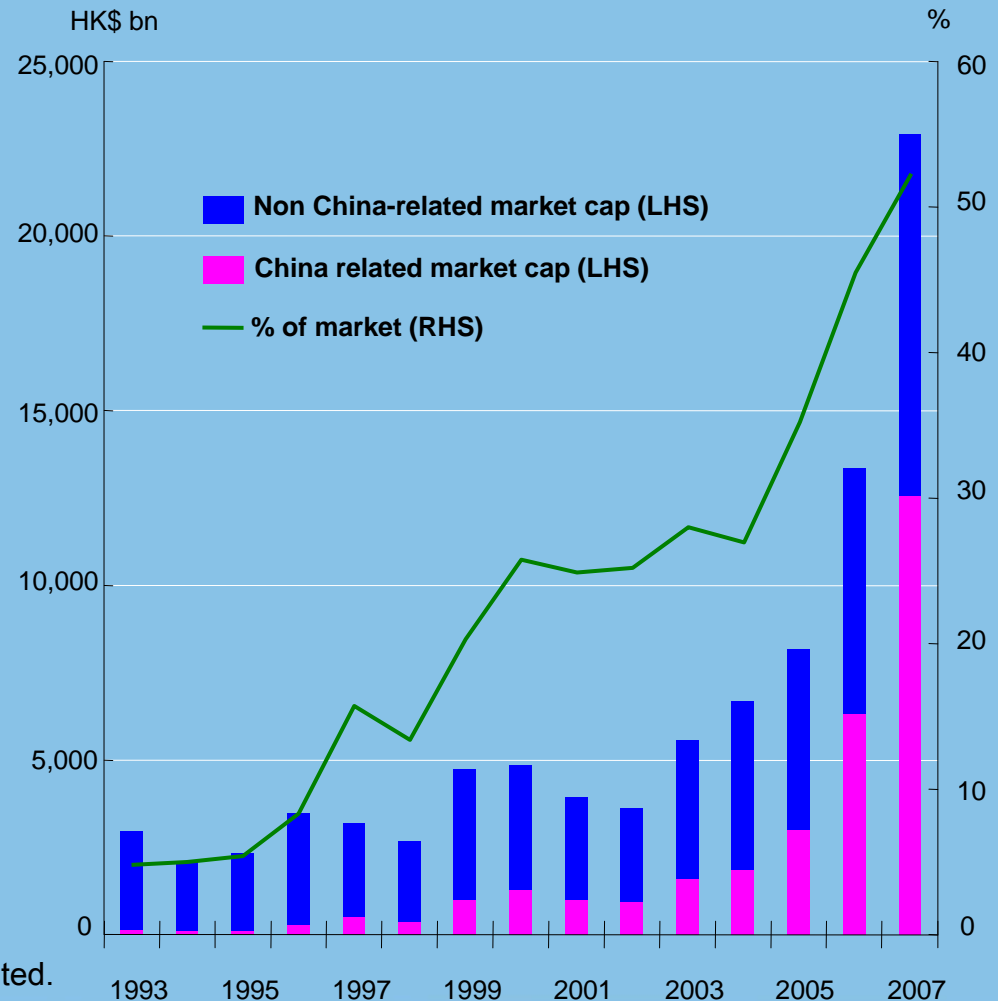
The Unique China Factor

Hong Kong is a convenient conduit/platform through which

- Savings in Mainland China can be channelled to overseas investment
- Savings overseas can be channelled to investments in Mainland China

Key Fund Raising Platform for China

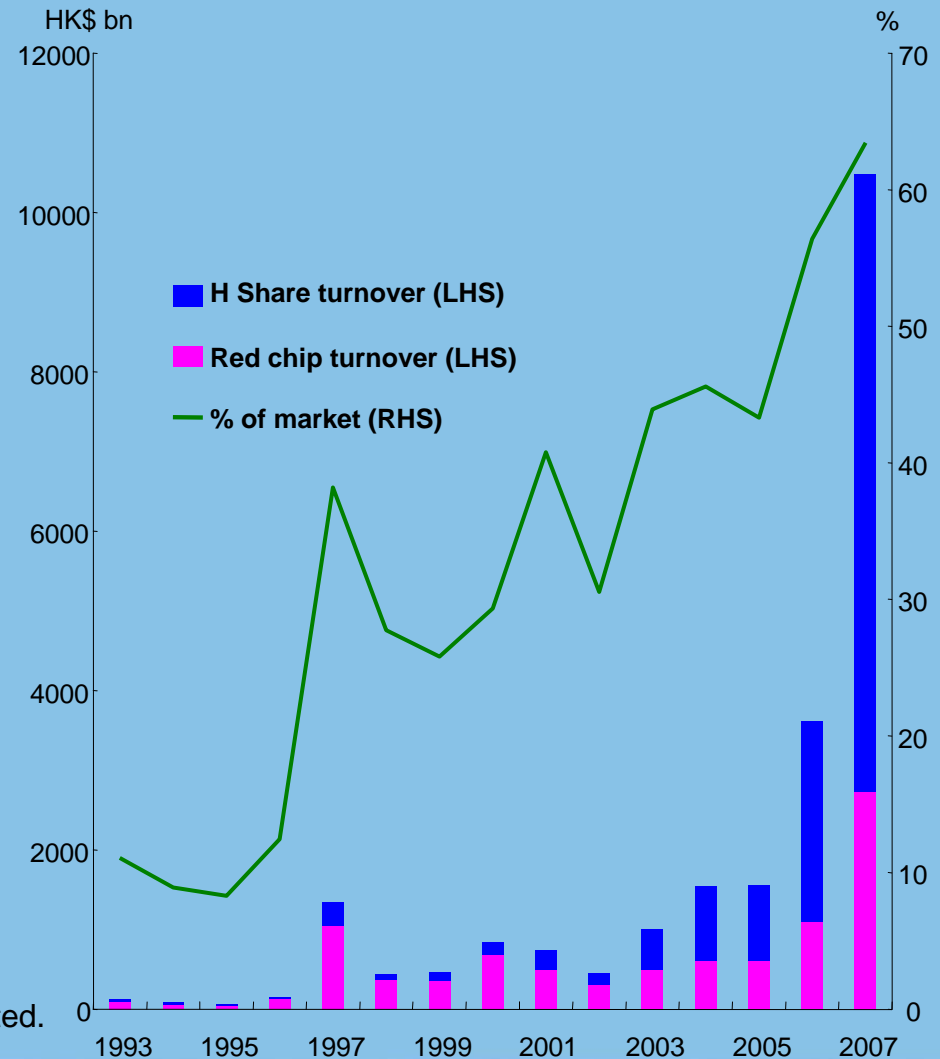
- Hong Kong serves as a platform for fund raising activities of Mainland companies
 - 53 Mainland stocks dual-listed in Hong Kong and Shanghai
 - Mainland-related companies account for 52% of Hong Kong's stock market capitalisation



Source: Hong Kong Exchanges and Clearing Limited.

Strong China Presence in Hong Kong Stock Market

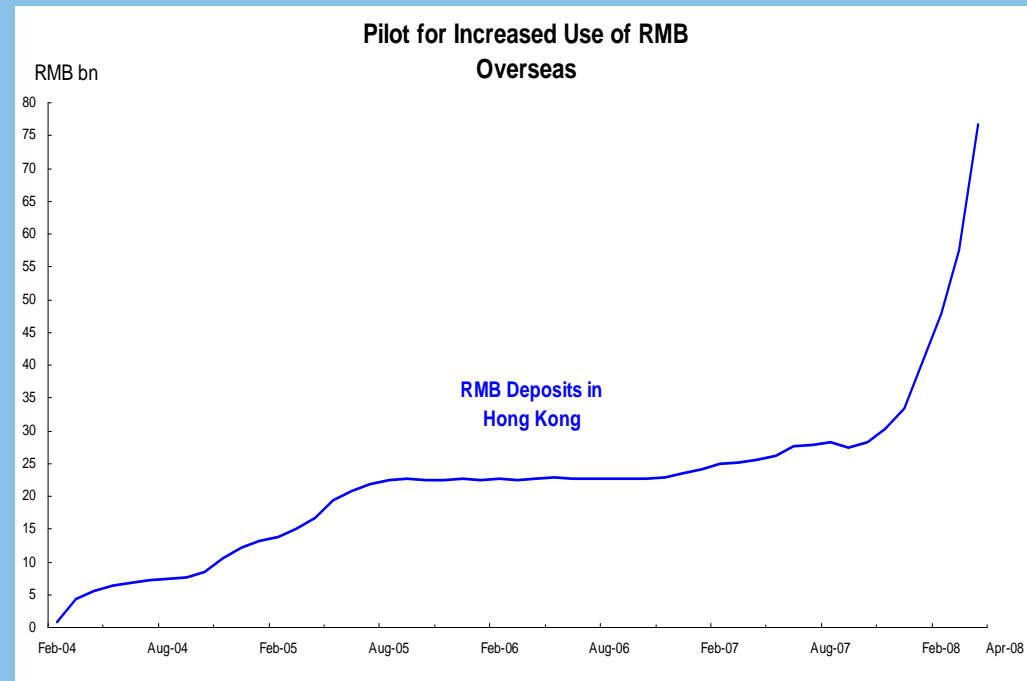
- Daily average trading volume of HK\$66 bn in 2007, 2.5 times more than that in 2006
- Turnover of red chips and H-shares accounts for 63% of total Hong Kong stock market turnover in 2007



Source: Hong Kong Exchanges and Clearing Limited.

Hong Kong as an International Financial Centre for Mainland China

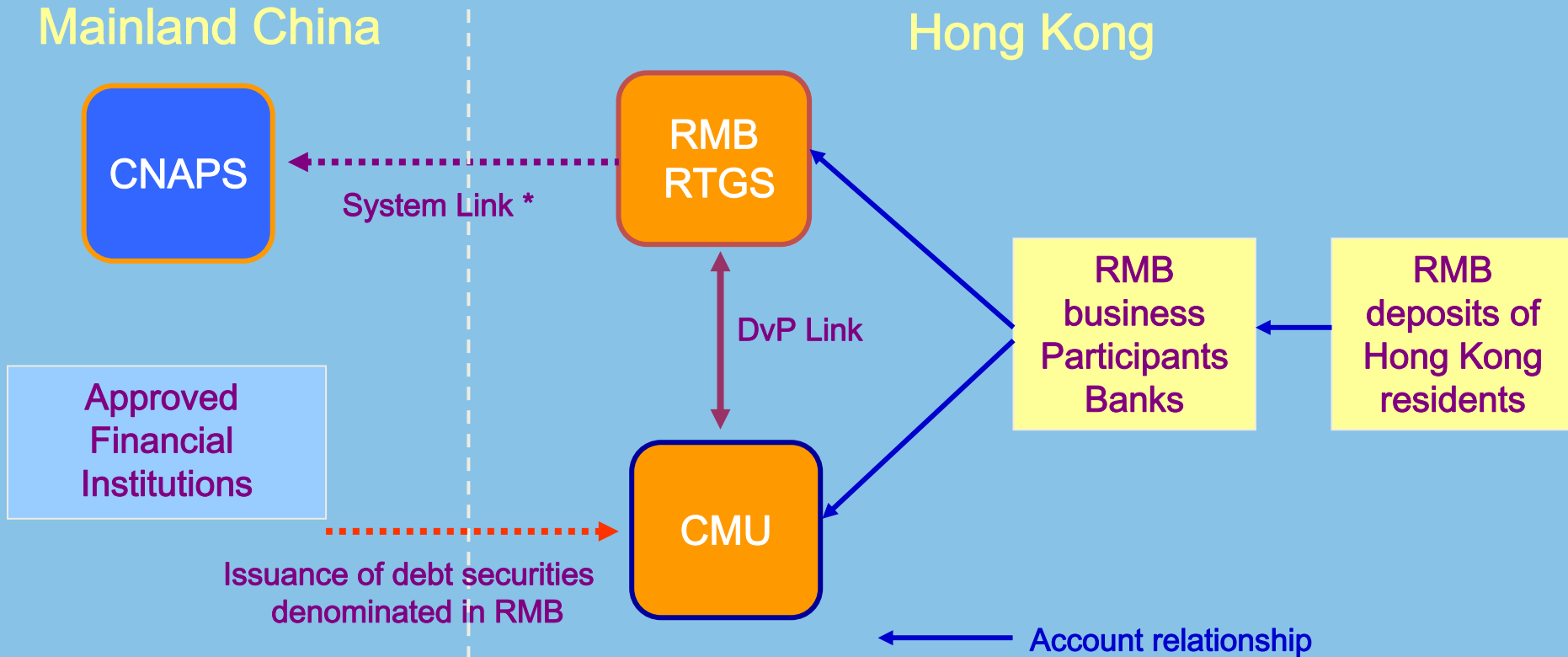
- QDII scheme will help Hong Kong as an IFC to service Mainland's capital outflows
- Solid growth in Renminbi (RMB) banking business (deposit-taking, currency exchange, remittances, credit cards, RMB bonds (RMB10 bn issued by financial institutions from Mainland China in Hong Kong))



Sources: CEIC; HKMA.

Infrastructure Support for RMB Bonds Issued in Hong Kong

Cross Border Cross Currency DvP Model



* The System Link between CNAPS in Mainland and RMB RTGS in Hong Kong is established through the Clearing Bank, Bank of China, Hong Kong (BoC, HK).

Hong Kong's Financial Infrastructure — Serving the Regional Financial Sector

- Development of multi-currency payment systems and securities settlement system to serve the financial institutions in Hong Kong as well as those in the Mainland and overseas

Financial Infrastructure Capabilities in Hong Kong

Payment systems

- Three major currencies in the 21st Century : USD, EUR, RMB (Hong Kong has developed RTGS payment systems for all three major currencies, as well as another one for HKD)

Securities settlement systems

- Major objective is to facilitate cross border transactions – as cost effective and efficient as domestic transactions

Harmonising and Modernising Payment and Settlement Systems

- Increase efficiency
 - settlement efficiency
 - liquidity efficiency
- Reduce cost
- Create business opportunities

⇒ upward, pro-market and business oriented

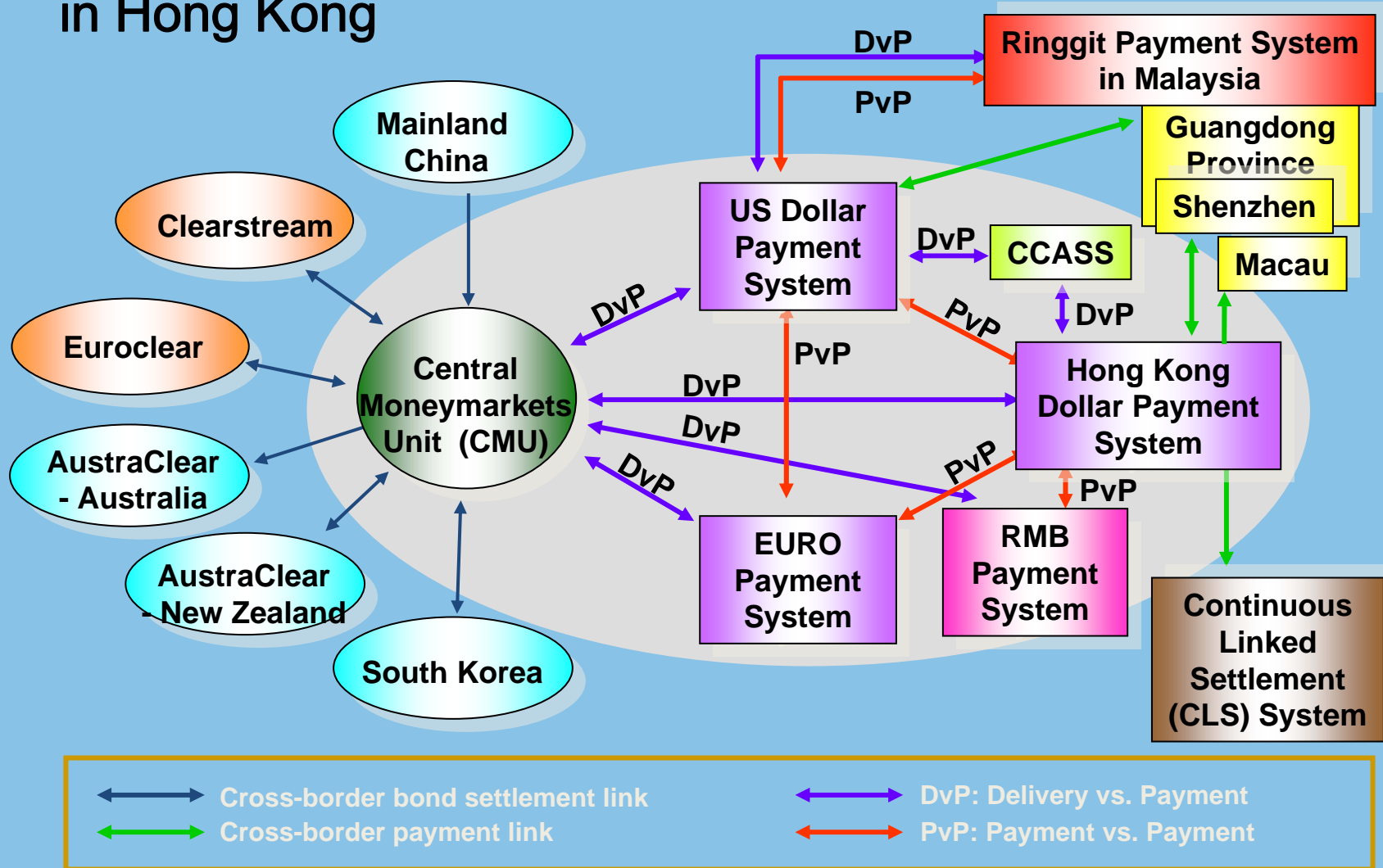
Recent Financial Infrastructure Initiatives in Hong Kong

	Increase Efficiency	Reduce Cost	Business Creation
Foreign currency RTGS systems (USD/EUR/RMB)	✓	✓	✓
Cross border bond settlement system linkage	✓	✓	✓
Regional cross border payment systems (for commercial payments)	✓		✓
PvP with Malaysia (USD/Ringgit PvP)	✓	✓	
Electronic trading platform for bonds and other OTC products	✓		
Migration to SWIFTNet	✓	✓	✓

Migration to the SWIFTNet Platform

- Localise the international payment messages from overseas
- Internationalise the local payments within Hong Kong
 - One system for both local and international payments and securities transfers

Overview of Payment and Settlement Infrastructure in Hong Kong



CMU – Settlement system for bonds

CCASS – Settlement system for shares

Hong Kong's Regional CHATS Payment Service

- **CHATS** – name of the RTGS systems in Hong Kong
- **Regional CHATS** – a network for multi-currency cross border payments

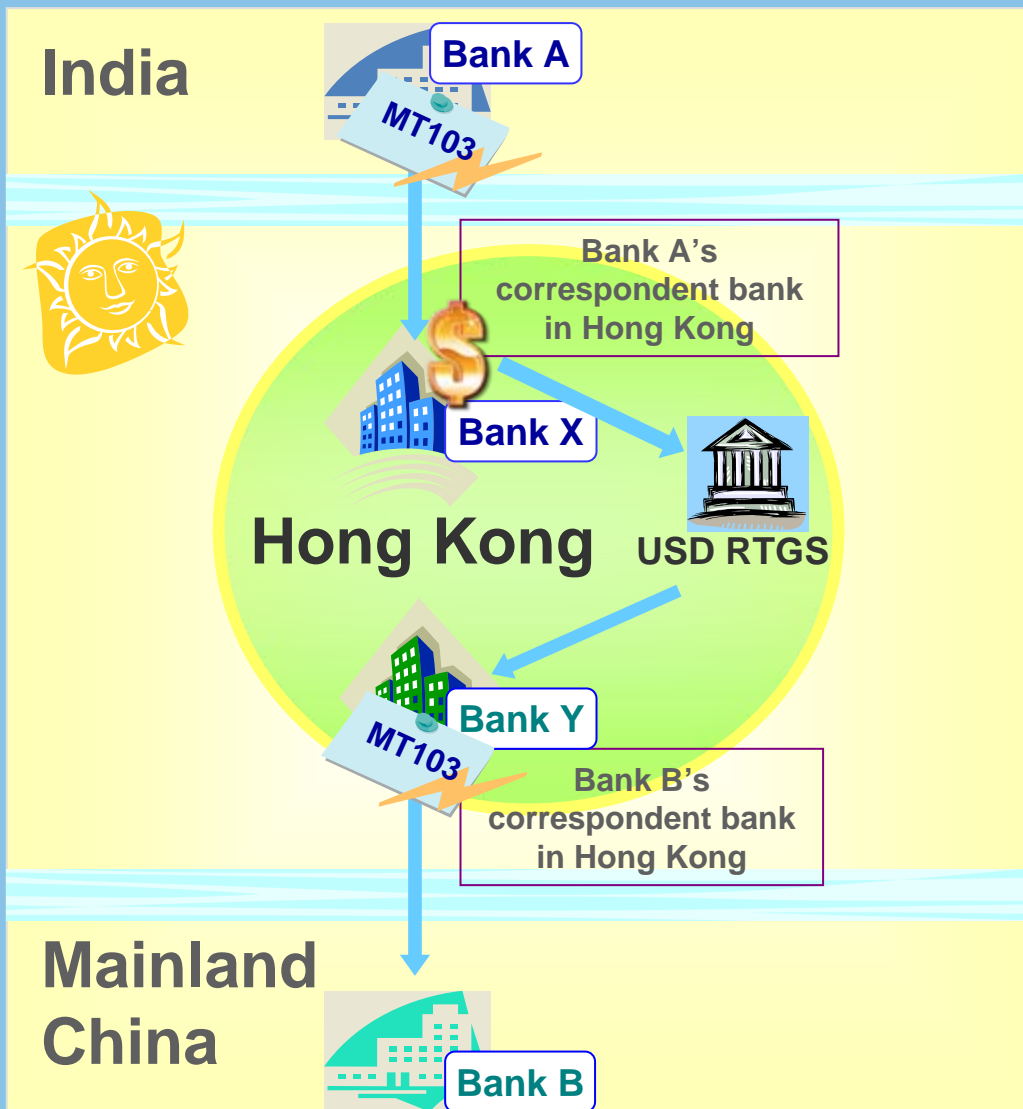
Enhancing
the existing
RTGS
functions

Correspondent banking payments
across banks in the Asian region

Multi-currency – USD, EUR, HKD

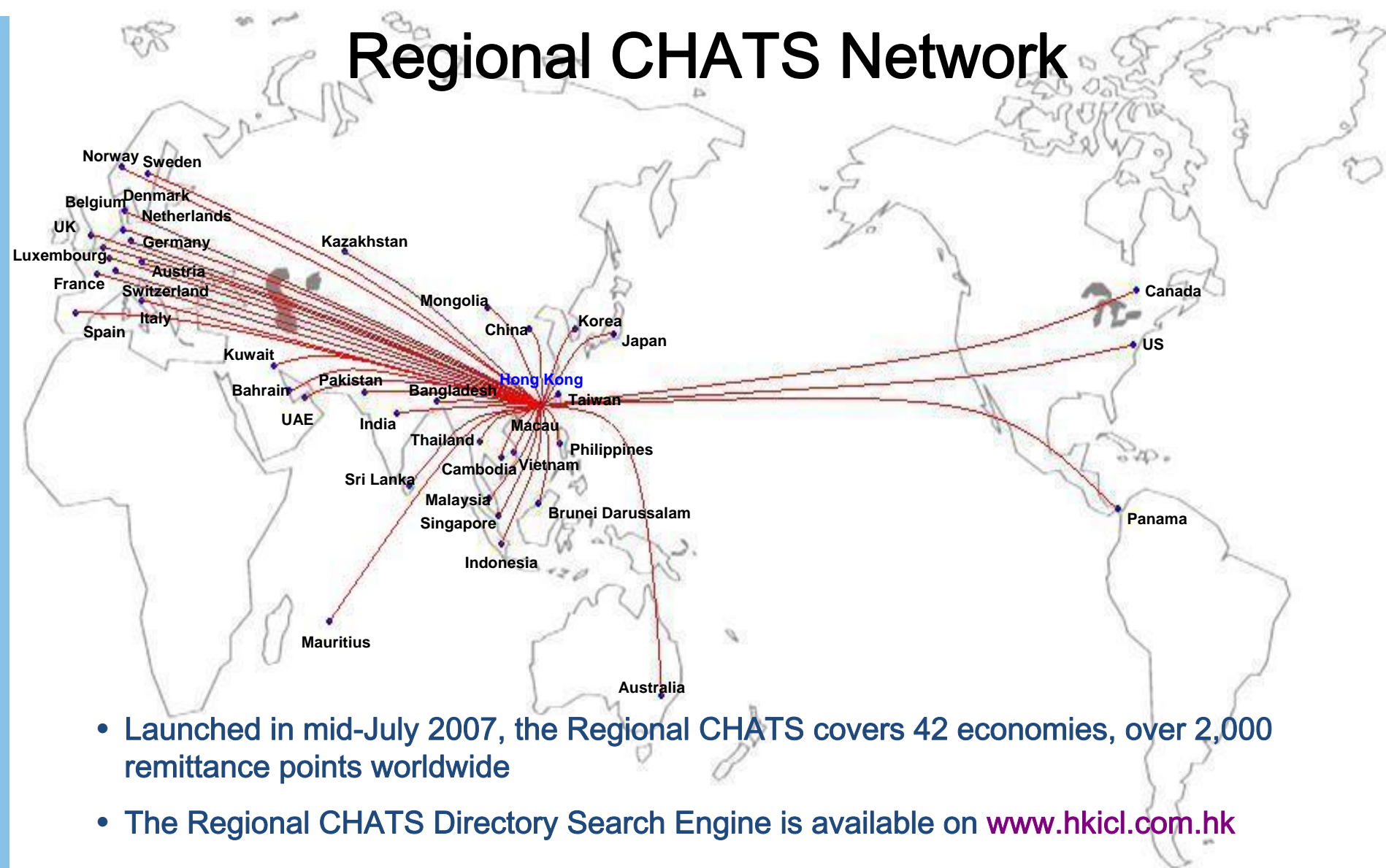
Real time same day

Regional CHATS: Efficient Regional Cross Border Payments



- With the USD, EUR and HKD RTGS in Hong Kong, USD, EUR and HKD payments across the region can be conducted efficiently in Asian time

Regional CHATS Network



- Launched in mid-July 2007, the Regional CHATS covers 42 economies, over 2,000 remittance points worldwide
- The Regional CHATS Directory Search Engine is available on www.hkicl.com.hk

Changes Brought by the Regional CHATS to Cross Border Correspondent Banking Business

- Open and transparent – the correspondent banking network can be searched over a website directory developed by the HKMA
- From bilateral to multi-lateral – the USD Clearing House Rules serve as the regulatory framework for such payments
- Lengthening of the operating hours of the RTGS systems in Hong Kong – the RTGS cut-off time will be extended from 5:30 p.m. to 6:30 p.m. starting from 3 November 2008

HK-Malaysia Cross-Border Linkages

Malaysia



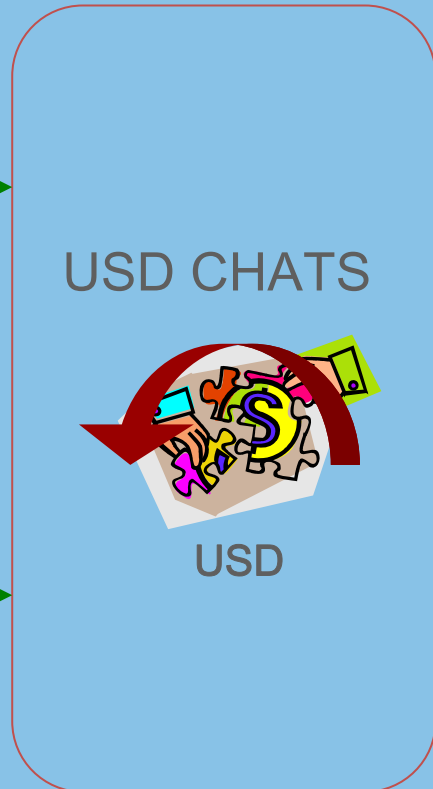
Real-time PvP Link

(FX transactions)

Real-time DvP Link

(bond transactions)

Hong Kong



Objectives of Hong Kong-Malaysia Linkages

- To achieve payment-versus-payment (PvP) settlement of USD/Ringgit foreign exchange transactions in the Asian time zone
- To achieve delivery-versus-payment (DvP) settlement of USD-denominated securities in Malaysia in the Asian time zone
 - Eliminate settlement risk for foreign exchange and securities transactions in Malaysia

Concluding Remarks

A robust, safe and efficient financial infrastructure serving the Asian region plays a critical role in:

- facilitating cross-border investments
- channelling savings among Asian markets
- enhancing market liquidity in Asian markets
- fostering interaction of financial markets
- enhancing regional financial stability

Thank you

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