

Hong Kong as a Global Financial Centre - Comparative Advantages, Challenges and Prospects

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Definition

At the most general level, a financial centre can be defined as a place in which there is a high concentration of banks and other financial institutions, and in which a comprehensive set of financial markets are allowed to exist and develop, so that financial activities and transactions can be effectuated more efficiently than at any other locality.

Criteria as an International Financial Centre

- Open economy and the free flow of international capital
- The availability of a free market (free flow of information)
- Free entry for foreign banks
- Strong and credible banks
- Stable exchange rate
- Well-educated and sophisticated bankers, bank regulators and supervisors
- Minimum non-prudential bank regulations

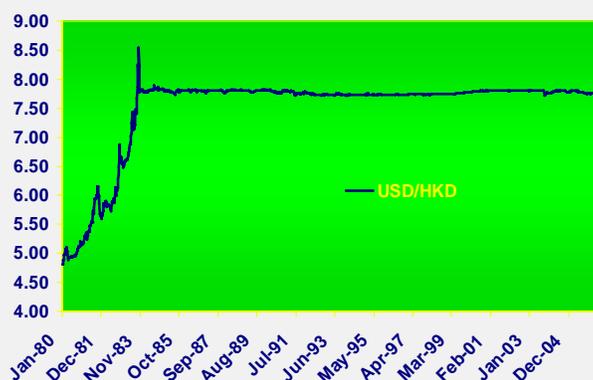
Criteria as an International Financial Centre

- A strong legal framework, including property rights, contract enforcement, a functioning court system and bankruptcy processes
- A critical mass of financial activity
- Good telecommunications network
- Politically independent government
- Peaceful environment

Strengths of Hong Kong as a Financial Centre

- In 2006, HK's total factor income inflow amounted to \$643.1 bn, representing 43.7% of the GDP (\$1,472.3 bn). On the other hand, total factor income outflow was some \$638 bn or 43.3% of the GDP.
- Hong Kong has one of the highest concentrations of banking institutions in the world. 69 of the largest 100 banks in the world have an operation in Hong Kong. At the end of December 2006, there were 138 licensed banks, 31 restricted licence banks and 33 deposit-taking companies in business. These 202 authorized institutions operate a comprehensive network of 1,313 local branches. Of these 202 authorized institutions, 181 are beneficially owned by interests from 30 countries.

Strengths of Hong Kong as a Financial Centre



Strengths of Hong Kong as a Financial Centre

- The Hong Kong Monetary Authority (HKMA) seeks to establish a regulatory framework which is fully in line with international standards, especially those recommended by the “Basle Committee” on Banking Supervision, for example, the capital adequacy framework, and Core Principles for effective banking supervision.
- Legal system: Common law based system, which is a unwritten law based on custom and precedent in contrast with the Continental Law System
- Regulatory balance: Well balance between the market development and investor protection

Strengths of Hong Kong as a Financial Centre

- Ease of doing business: Free corruption, strong expertise in professional services, developed infrastructures and business networks
- Financial market is now deep enough to meet large companies’ capital needs locally
- Strategic location allows provision of 24-hour international financial services alongside with New York and London within the Asian time zone.
- Attractiveness of skilled people: Job opportunity, lower personal tax, a vitality city
- Competitive Corporate Tax Rate (low and efficient tax system)
- Hong Kong Brand: Reliable, international practice

HKMA & Other Regulatory Authorities

- Insurance Authority (IA) - supervision of the insurance-related activities of authorized institutions
- Securities and Futures Commission (SFC) - regulation and supervision of registered institutions and their relevant staff
- China Banking Regulatory Commission (CBRC) - sharing of supervisory information and co-operation in the area of banking supervision
- Monetary Authority of Macau - co-ordination of supervision of the branches, rep. offices and subsidiaries of financial institutions from each other's territory

Development of Banking

- Two arms of HK’s financial centre: banking and portfolio.
- Hong Kong’s banking sector developed rapidly in the 1960s; consolidated after the crisis in 1965. Aid the development of other financial activities.
- Banking activities are more fundamental, facilitate a great number of investment & monetary transactions; has become a social good.
- Portfolio activities focus on the stock market and all other non-bank financial investment markets.

Banking Business

- Hong Kong banks are comprehensive.
- Money market is the major source of funding for the banking system.
- Business
 - asset transformers: deposit taking and extension of loans and advances
 - non-interest income from a wide array of businesses
- Lending dilemma after AFC. Lending to real estate more profitable than lending to SMEs. Real estate sector collapsed and fluctuated after AFC.
- Over concentration on lending to property – close to 60% of total loans reflected narrowness in HK investments. At the end of March 2005, mortgages accounted for about 32% of total loan use in Hong Kong.

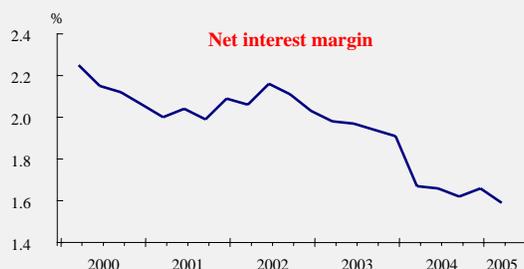
Banking Lending

	Total Bank Loans	Property-Related Loans	Non-Property Related Loans	% of Property-Related Loans to Total Loans
1990	690,228	255,464	434,764	37.0
1991	817,077	324,894	492,183	39.8
1992	909,912	368,791	541,121	40.5
1993	1,075,777	448,470	627,307	41.7
1994	1,258,589	547,608	710,981	43.5
1995	1,398,193	611,408	786,785	43.7
1996	1,637,191	754,922	882,269	46.1
1997	2,037,278	981,096	1,056,182	48.2
1998	1,960,371	1,005,884	954,487	51.3
1999	1,819,792	992,686	827,106	54.5
2000	1,861,465	1,024,650	836,815	55.0
2001	1,790,063	1,035,831	754,232	57.9
2002	1,742,869	1,020,590	722,279	58.6
2003	1,708,521	976,649	731,872	57.2

Note: Property-related loans include loans to three categories: flats under home ownership and private participation, other residential properties, and building, construction, property development and investment.

Source: CEIC Database, Hong Kong.

Profitability



Source: HKMA.

The Three-tier Banking System

- Three-tier banking system: licensed banks, restricted licensed banks, deposit-taking companies. Supervision up to international standard.
- An internationally recognised framework for assessing the Capital adequacy, Asset quality, Management, Earnings and Liquidity of banks. The primary purpose of CAMEL is to help identify institutions whose weaknesses require special supervisory attention.
- Reform concentrated on transparency and rule-based, for example, Basel II on capital requirements to strengthen HK's position.
- HKMA completed a review of the existing market entry criteria and the three-tier authorization system. Some of the market entry criteria was relaxed without compromising banking stability.

The Three-tier Banking System

- Balance sheet size criteria, which are currently HK\$3 billion for customer deposits and HK\$4 billion for total assets, applicable to both locally incorporated and overseas-incorporated bank applicants.
- The period of operation as a restricted licence bank (RLB) or deposit-taking company (DTC) reduced from ten to three years and dispensing with the "association with Hong Kong" requirement for locally incorporated RLBs and DTCs to upgrade to licensed bank status.
- Minimum capital requirement for locally incorporated bank applicants from HK\$150 million to HK\$300 million and extending this requirement to overseas-incorporated bank applicants to strike a balance between making it easier for institutions to enter the market as full licensed banks and avoiding a multiplicity of small banks.
- Allowing overseas incorporated banks to subsidiarise their Hong Kong operations provided that they have been authorized to conduct banking business in Hong Kong for not less than three years and the amounts of customer deposits and assets that will be transferred to the subsidiary seeking authorization are not less than HK\$3 billion and HK\$4 billion respectively.

Capitalisation

- Capital adequacy ratio (CAR)
 - The ratio of an authorized institution's (AI) capital base to its risk-weighted credit exposure.
 - International minimum: 8%.
 - HKMA may increase it to not more than 12% for licensed banks and not more than 16% for restricted licence banks.
 - Average consolidated CAR of locally-incorporated AIs was 15.4% as at end-March 2005, well above the international minimum.

Bank Loan Classifications

- Corporate failures would exert severe distress on the banking sector, especially when the corporate sector relies heavily on bank financing.
- Five loan categories: pass, special and classified (substandard, doubtful and loss).
- Data on overdue, rescheduled and non-performance loans.
- After AFC, loss loan and NPL increased, but declined after 2001. By March 2004, NPL is low at 3%. Low by world standard.

Reforms and Innovations

- Interest Rate Liberalization
 - A two-phased approach to deregulate the remaining Interest Rate Rules. The first phase took place on 3 July 2000 with the remaining regulated time deposits with a maturity of below seven days. The second phase took place in July 2001 with full deregulation of savings and current account deposits.
- Deposit Protection Scheme (DPS)
 - Design of differential premium system to minimise the potential moral hazard.
- Commercial credit reference agency (CCRA)
 - Credit information sharing among banks to improve credit quality.

Recent Changes in Banking Environment

- From traditional lending bank to fee-based financial supermarket
- From financial intermediation to financial facilitation
- From branch banking to electronic banking and internet banking
- From “relatively labour” intensive operations to “more capital” intensive operations

Renminbi Offshore Centre

- China's WTO accession requires gradual banking liberalization. Foreign banks can open branches and conduct RMB business in China. But state banks face large NPLs and are inefficient. Pressure on RMB to revalue began in 2003.
- From 2004, four types of RMB financial services are allowed in HK: deposits, exchange, remittances & credit cards.

Debate on Advantages

- Two advantages: infrastructure established on cross-border RMB clearing; HK becomes the RMB offshore centre.
- Against: limited near-term banking opportunities; China's closed capital account limited circulation of RMB; lending in RMB excluded, interest spread earning is small; marginalised the HK\$.

World Concentration of Traditional Financial Activities

Financial activities concentration (average normalized score)	World share in individual markets (%)								
	Equity turnover	Fund raised thru IPO	Int'l Bond Market - amount outstanding	Domestic Bond Market - amount outstanding	Bank Foreign Assets	Bank Foreign Liabilities	FX turnover**	FX / Interest Rate Derivatives: Market turnover**	
1 US	100.0	49.0	16.3	23.3	44.6	8.9	11.7	18.2	18.4
2 UK	90.6	10.9	16.9	12.6	2.4	19.8	22.7	21.3	18.1
3 Japan	32.7	8.3	3.7	0.9	18.1	7.6	3.2	8.3	6.0
4 Germany	23.0	3.9	3.6	10.6	4.4	10.6	7.3	4.9	4.1
5 France	22.1	2.8	3.8	6.2	4.4	9.1	9.3	2.6	6.6
6 Hong Kong	18.2	1.2	11.9	0.3	0.1	2.3	3.4	4.2	2.7
7 Netherlands	10.9	1.3	3.7	7.1	1.5	3.8	3.7	2.0	2.0
8 Switzerland	9.9	2.0	0.8	0.1	0.5	4.6	4.4	3.3	2.4
9 Singapore	9.9	0.3	1.3	0.3	0.2	2.4	2.6	1.2	3.2
10 India	9.6	2.3	2.6	4.3	2.2	1.8	2.6	0.8	1.7
11 Australia	8.6	1.2	3.9	1.9	0.8	0.5	1.5	1.4	2.4
12 Spain	8.2	2.8	4.5	4.8	2.3	1.7	2.4	0.6	0.7
13 Canada	7.7	1.8	2.7	2.1	2.0	1.0	1.0	2.2	1.7
14 Belgium	5.4	0.2	0.1	0.8	0.9	3.3	3.0	0.8	1.5
15 Ireland	4.6	0.1	1.1	3.4	0.2	2.8	3.3	0.3	0.5
16 Austria	4.3	0.1	3.6	1.5	0.5	1.3	1.2	0.5	0.7
17 Luxembourg*	4.2	0.0	0.6	1.9	0.0	3.6	2.5	0.6	0.6
18 Sweden	4.1	1.1	0.3	0.9	0.7	1.0	1.4	1.3	1.0
19 Denmark	4.1	0.3	0.2	0.5	0.9	0.6	1.0	1.7	1.4
20 Korea	3.5	1.9	0.8	0.5	1.5	0.3	0.6	0.8	0.4
21 Norway	3.5	0.6	4.2	0.6	0.2	0.2	0.5	0.6	0.6
22 Shanghai*	3.3	1.1	3.6	0.1	2.2	0.0	0.0	0.0	0.0
23 Mexico	3.3	0.1	0.3	0.4	0.5	0.1	0.1	0.6	0.2
24 Portugal	1.1	0.1	0.4	0.4	0.3	0.4	0.7	0.1	0.1
25 Finland	1.0	0.5	0.3	0.6	0.3	0.3	0.4	0.1	0.0
26 Greece	1.0	0.2	0.0	0.8	0.5	0.2	0.3	0.2	0.1
27 Turkey	0.8	0.3	0.3	0.2	0.3	0.1	0.2	0.1	0.1
28 Poland	0.6	0.1	0.0	0.2	0.2	0.0	0.0	0.2	0.2
Total (%)	94.3	91.7	81.4	91.7	88.3	88.7	96.1	98.3	

*Data for 2005. **Data for 2004. Source: World Federation of Exchanges, International Exchanges, CIBC, BSI and AIF Publications.

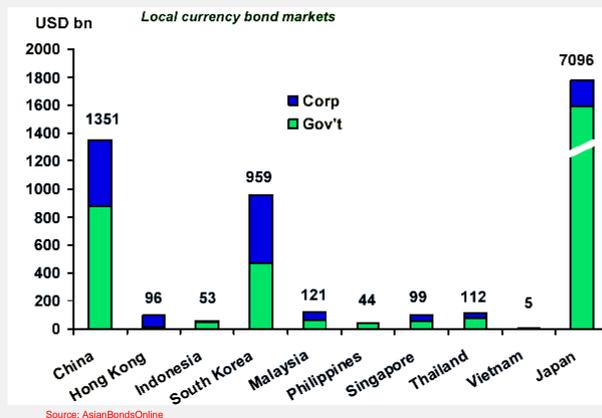
Debt Market

- Debt market is relatively small, compared to the banking and equity markets.
- However, the market has been experiencing rapid growth and the outstanding amount of debt securities has increased to 48% of GDP in 2005, compared with only 8% of GDP in 1994.

Outstanding Amount of Hong Kong Dollar Debt Instruments	Dec 2005	Sep 2006
Total (US\$ billion)	85	93
Exchange Fund Bills and Notes	16	17
Private sector debt instruments	69	76

Source: Hong Kong Monetary Authority

Bond Market Sizes



Source: AsianBondsOnline

Exchange Fund Notes (EFN)

- The EFN programme was launched in 1993.
- EFN are Hong Kong dollar fixed income bonds issued by the Hong Kong Monetary Authority (HKMA) on behalf of the HKSAR Government for the account of the Exchange Fund.
- The initial maturity of EFN varies from 2 to 10 years - providing the market with a benchmark yield curve running up to ten years.

HKMC Retail Bond Issuance Programme

- The HKMC was incorporated in March 1997 with a view to developing Hong Kong's secondary mortgage market.
- The HKMC established its HK\$20 Billion Retail Bond Issuance Programme in May 2004, following the successful application of the placing bank mechanism since 2001 under which retail bonds were distributed through designated placing banks.
- These placing banks also perform the role of market makers for the bonds, facilitating transactions in the secondary market.

Measures to Facilitate Market Development

- Exchange Fund Bills and Notes programme (EFBN)
 - benchmark yields to facilitate pricing
- An efficient clearing and settlement system - Central Moneymarkets Unit (CMU) established in 1990
- Mandatory Provident Fund Scheme since Dec 2000
- Streamline listing and offering documentation procedures
- Profits Tax Concession

Equity Market - History and Development

- 1881 – “The Association of Stockbrokers in Hong Kong
- 1891 – Hong Kong's first formal stock market established
- 1914 - Name changed to “The Hong Kong Stock Exchange”
- 1921 - The Hong Kong Stockbrokers Association established.
- 1947 – Merged into The Hong Kong Stock Exchange Ltd.
- 1969 – Far East Exchange Ltd.
- 1971 – Kam Ngan Stock Exchange Ltd.
- 1972 – Kowloon Stock Exchange Ltd.
- 1973 – The Stock Exchange Ordinance 1973
- 1976 – Futures Exchange established (named The Hong Kong Commodity Exchange Limited at the time)
- 1980 – The Stock Exchange of Hong Kong Ltd.
- 1986 – Trading commenced on the unified Stock Exchange

Hong Kong Stock Exchange

- 1989 – HKCC assumed the functions performed by the Futures Exchange's former guarantee corporation and clearing house.
- 1992 – CCASS introduced
- 1993 – First listing of H shares and Stock Exchange AMS introduced by the Stock Exchange
- 1995 – Stock Options market launched ATS introduced by the Futures Exchange
- 1996 – AMS/2 introduced by the Stock Exchange
- 1999 – GEM launched; ATS upgraded and renamed as HKATS
- 2000 – Completed the merger of Exchanges and Clearing Houses under HKEx on 6 March and listed its shares on 27 June
- 2002 – ELI Listed

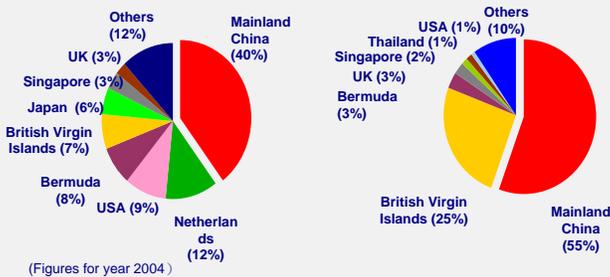
Market Capitalisation of the World's Top Stock Exchanges (As at end-June 2006)

	Worldwide Ranking	Ranking in Asia	Market Capitalisation (US\$ billion)
US (NYSE)	1		13,940
Japan (Tokyo)	2	1	4,523
US (Nasdaq)	3		3,541
UK (London)	4		3,347
Euronext	5		3,175
Canada (Toronto)	6		1,633
Germany (Deutsche Borse)	7		1,372
Hong Kong	8	2	1,262
Spain	9		1,111
Switzerland	10		1,042
Australia	11	3	897
Italy	12		897
N. Europe (OMX Exchanges)	13		878
Korea	14	4	732
South Africa	15		600

Financial links between Hong Kong & the Mainland

- Mainland is the largest source of direct investment into Hong Kong as well as the favoured destination of Hong Kong's outward direct investment.

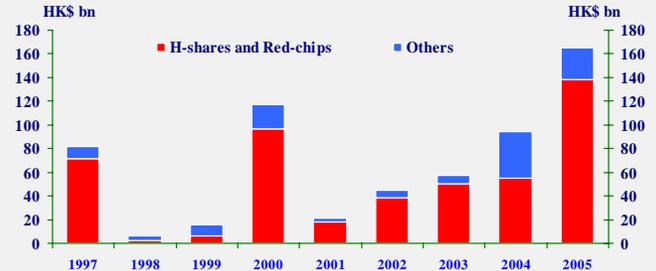
Sources of HK's Inward DI and Destination of HK's Outward DI (end-2003)



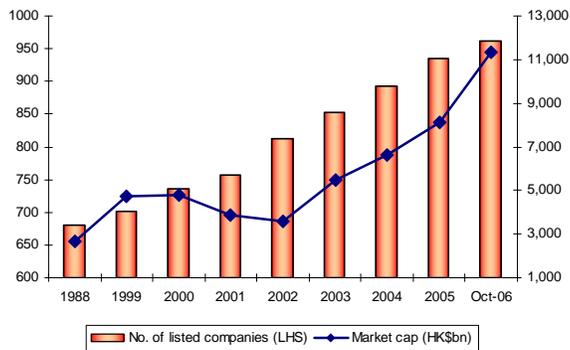
Financial links between Hong Kong & the Mainland

- In 2005, Mainland-related enterprises raised HK\$ 138.4 bn through IPOs on the Hong Kong stock market -- 84% of total funds raised through IPOs on the Hong Kong stock market.

Funds Raised by IPOs in HK Stock Markets

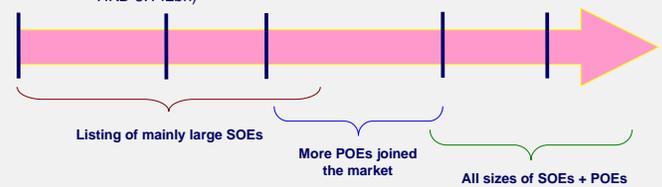


Listed Companies – Main Board



Increasing Influence of Listings

Year	Key Event
1980's	Listing of Red Chips
1993	The first H share listed in Jul-1993 (Total fund raised: HKD 8.142bn)
1994	15 H shares listed by end of 1994
2000	Mainland enterprises listed on GEM
April 30, 2006	344 Mainland enterprises Listed & over 250 MOEs



SOEs: State-owned Enterprises
POEs: Privately-owned Enterprises
MOEs: Mainland-operating Enterprises

Source: Hong Kong Exchanges and Clearing

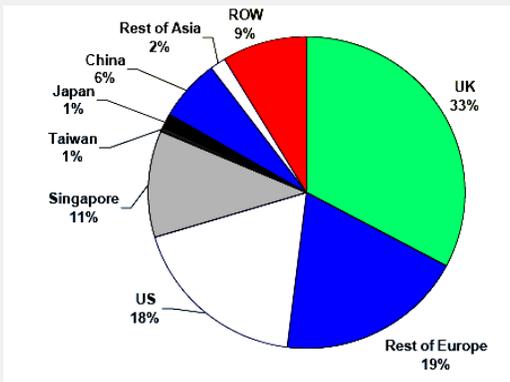
Global Trends & Challenges

- Globalisation and internationalization of the stock exchange industry
- Demutualisation of Stock Exchanges
- Merger, alliances and consolidation of Exchanges
- Growing reliance of Exchanges on technology-led initiatives (Internet trading and extension of trading hours)
- Greater focus on the need for better and sounder regulations
- Proliferation of new financial products

Hong Kong's Derivatives Market

- A fast growing market
- HK is the 7th in the world in 2004 (combined turnover of FX and OTC derivatives)
- Both exchange-traded and OTC-traded
- Market activity increased: hedging needs and yield enhancement
- Swaps, options and futures, forwards, credit derivatives, equity or currency-linked instruments

Derivatives - Distribution of Overseas Investors

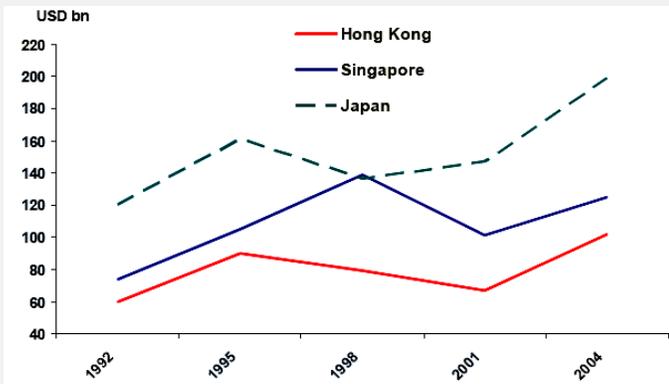


Source: HK Ex

Hong Kong's Foreign Exchange Market

- An OTC market
- Hong Kong was the world's 6th largest centre for foreign exchange trading, according to the 2004 triennial global survey conducted by the Bank for International Settlements.
 - Daily turnover: US\$100 bn, 6th in the world for 2004
- Shrinking market liquidity due to
 - reduced number of market players
 - reduced number of tradable currencies

Daily FX Market Turnover



Source: Bank for International Settlements

Top 10 Financial Centres Comparison



Source: The Global Financial Centres Index, The City of London Corporation

Recent Development of Hong Kong Financial Sector

- Driven by the strong growth of financial sector, Hong Kong has transformed itself into a metropolitan economy like New York and London.
- Hong Kong is now among one of the most developed International Financial Centres (IFCs) and International Centres of Commerce (ICCs) in the world.
- But measured by some key factors (such as financial service penetration, innovation), Hong Kong is still only a regional IFC rather than a Global IFC. Owing to small domestic economy, ranks lower than New York, London and Tokyo in terms of total bank assets, equity market capitalisation and bonds outstanding.

Types of Financial Centre

- By functional division:
 - Functional Centre (NY, London, HK)
 - Paper Centre [Cayman Islands, Hamilton (Bermuda)]
- By role division:
 - Global Financial Centre
 - Regional International Financial Centre
 - National Financial Centre
 - Regional Financial Centre
 - Niche Financial Centre

Features of different Financial Centres

- **Global Financial Centre:**
Service covers worldwide, big market volumes, a variety of financial products and talents, the center of financial innovation and product pricing, global financial services leadership. (London, New York)
- **Regional International Financial Centre:**
Activity involves at least two locations in different jurisdictions, significant international participations but modest market scale and variety, limited capability on financial innovation and product pricing (HK, Zurich, Sydney, Singapore)

Features of different Financial Centres

- **National Financial Centre:**
mainly services domestic economy, market volumes which link to the scale of domestic economy can be very big or very small, (Toronto, Shanghai, Seoul, Mumbai, Johannesburg, Dublin)
- **Regional Financial Centre:**
conducts most of its business within one region of one county (Shenzhen, Edinburg, Charlotte, Montreal)
- **Niche Financial Centre:**
Being strong in one particular niche of financial services (Zurich for private banking, Chicago for Futures and Options)

The Roles that Financial Centres are Playing

FC	Global	Regional	Niche	National	Regional
London	X	X	X	X	X
New York	X		X	X	X
Chicago		X	X	X	X
Tokyo		X		X	X
Zurich		X	X	X	
Hong Kong		X		X	
Singapore		X		X	
Shanghai				X	X

Hong Kong as a National Financial Centre

- Mainly as a platform for channelling foreign capital into Mainland, i.e. servicing Mainland's international financial intermediation
- Use of Hong Kong for Mainland's domestic financial intermediation limited due in part to capital controls
- Need to expand our financial intermediary role on the hinterland

Gap between Hong Kong and Global Financial Centres

- Service penetration
- Market scale and variety
- Ability of financial innovation

Service Penetration

- Inactive currency transaction (HK dollar's percentage shares of average daily turnover accounted for only 0.95 percent of the global foreign exchange market, compared with the 44.4 percent of US dollar, 8.5 percent of Pound Sterling, 10.2 percent of Japanese Yen and 3.1 percent of Swiss franc)
- Lack of leading financial business (Switzerland has worldwide influence in private banking and assets management)
- Less aggressive on exploring the external markets other than China

Market Scale and Variety

Constricted domestic market

The size of the financial industry's workforce

New York: 328,400 (2005)

London: 318,000 (2005)

Hong Kong: 167,712 (2006)

- Banking business (HK's total amount of banking loans and deposits is only 7 percent that of the U.S., 14 percent that of the U.K. although it is widely recognized as one of top three international banking centers measured by presence and intensity of global banking institutions)
- Bond market (the market share of bond issuances and outstanding value are less than 0.2 percent of global markets, compared with about 50 percent that of the US)
- Commodity market (HK is still absent)

Major Financial Centres

(Billion of US dollars)

	Stock Market capitalisation	Foreign Exchange Market turnover	Derivatives turnover in foreign exchange and interest rate	Banking deposits	Banking loans
HK	2028	102	82	648	339
New York/US	16604	461	599	6365	8561
London/The UK	4037	753	1176	3056	3843
Tokyo/Japan	4681	199	185	68510	4331
Switzerland	1290	79	74	290	131
Singapore	506	125	100	196	138
Global	57361	2406	30890	-	-

- Stock market: 6th place measured by market cap.
- Foreign Exchange: 6th place measured by turnover
- Derivatives in interest rate and foreign exchange: 7th place measured by the daily transaction.

Ability of Financial Innovation

- The major areas of global financial innovation:
 - derivatives (foreign exchange, interest rate, futures and options)
 - debt securitization: (CDO, MBS, ABS)
- Currently, London, New York are global centers for financial product innovation, HK acts their product distributor in the Asia and Pacific Region.
- HK's bottleneck of doing financial innovation:
 - insufficient domestic investors,
 - the lagged bond markets,
 - limited number of large international banks taking root in HK

Currency Board System vs. Central Bank

- Currency Board System is a monetary system that complies with the Monetary Rule requiring that any change in the Monetary Base should be matched by a corresponding change in Foreign Reserves in a specified foreign currency at a fixed exchange rate. In operational terms, the Rule often takes the form of an undertaking by the Currency Board to convert Domestic Currency into Foreign Reserves at the fixed exchange rate.
- Monetary base under currency board is based on sell/buy of foreign currency, central bank cannot change the monetary base. Reserve currency regarded as assets in currency board. Cash in banks regarded as liability side in central bank system.

Monetary Policy

- Conventional: fiscal & monetary policies are two arms of policy control.
- Fiscal policy directs on aggregate demand.
- Monetary arm is indirect through money supply (open market operation), interest rate (banks), exchange rate (export/import).
- Bond issue: future debt, must spend on enlarging future economic capacity.
- Linked Exchange Rate under Currency Board System limits the freedom of monetary policy.

Advantages

- Assured convertibility based on 100% reserve cover
- Discipline over fiscal policy
- Certainty in balance of payment adjustment
- Public confidence.
- Results: convertibility removes foreign exchange risk; cannot be used to finance fiscal deficit; has a built-in payment adjustment mechanism; rule-based and free from intervention.

Disadvantages

- Disabled monetary policy: cannot use interest rate policy to achieve price stability.
- Cannot act as the lender of last resort: central bank cannot issue domestic currency in exchange for foreign currency.
- Sudden shocks may require structural adjustment, may prolong adjustment.

Liberalisation in China

- World Trade Organisation (WTO)
 - more business opportunities to HK's financial service industry
- Qualified Foreign Institutional Investors (QFII) Scheme
 - qualified overseas institution investors are permitted to invest in Mainland shares and bonds
- Qualified Domestic Institutional Investors (QDII) Scheme
 - allow investors in the Mainland to invest in HK stocks
 - widely discussed though not yet implemented

Breakthrough in Hong Kong Banking Development

- RMB banking services introduced in Feb-2004
- Some banks in Hong Kong are providing personal account services in RMB. These consumer banking services cover deposits, money exchange, remittance and credit cards.
- However, RMB business in HK operates within a very narrow scope, and is basically limited to deposit services for individual HK residents only. Bank's RMB funds cannot be used in providing liquidity and financing.
- Limited deposit services for retail businesses

Qualified Domestic Institutional Investor (QDII)

- In People's Republic of China, QDII allows investors to invest in foreign securities markets via certain fund management institutions, insurance companies, securities companies and other assets management institutions which have been approved by China Securities Regulatory Commission (CSRC).
- On 13 April 2006, the Chinese government announced the QDII scheme, allowing Chinese institutions and residents to entrust Chinese commercial banks to invest in financial products overseas. But the investment was limited to fixed-income and money market products.
- After granting 15 banks and funds a total quota of US\$14.2 billion to invest overseas, the Chinese government announced on 11 May 2007 to widen the scope of the QDII investment. With certain restriction, banks can now offer stocks related products. The net value of an QDII product investing in stocks must not exceed 50%, with the net value represented by a single stock capped at 5%. The minimum commitment by each client is 300,000 yuan.

Closer Economic Partnership Arrangement (CEPA) V

- As at end-February 2007, eight Hong Kong banking and financial services providers (excluding insurance and securities) had obtained certificates of Hong Kong Service Supplier. Hong Kong banks can open branches in different provinces of the mainland. Mainland financial institutions are also encouraged to take active participation in Hong Kong to acquire international best practices.
- Under CEPA V, mainland fund management companies approved by the China Securities Regulatory Commission (CSRC) will be allowed to establish subsidiaries in Hong Kong to operate relevant business.
- In July 2007, China Development Bank (CDB) became the first mainland financial institution to issue RMB bonds in Hong Kong.
- In line with its WTO commitment, foreign-funded banks established on the mainland, subject to the provisions, are allowed to engage in foreign exchange and RMB businesses.

National Finance Working Meeting

- Premier Wen Jiabao on 19 January this year at the National Finance Working Meeting held in Beijing concerns the promotion of financial openness. There he laid down clearly the need:
 - To continue to advance financial co-operation between the Mainland and Hong Kong.
 - To further develop a mutual-assisting, complementary and inter-active relationship between the two financial systems of the Mainland and Hong Kong.
 - To strengthen and promote the status and utility of Hong Kong as an international financial centre.

“Through-Train” Scheme and Impacts

- Pilot Scheme for Mainland Individuals to Invest Directly in Hong Kong Securities
- Implementation of “H.K. Stocks Through-Train” by helps promote the orderly outflow of funds from the Mainland.
- A further liberalisation of the capital account of the Mainland.
- Co-ordination process among the regulatory authorities on the Mainland.
- Understanding of Uncertainty
- Risk recognition

Key Challenges of Hong Kong

- Competition from other regional financial centres
- proximity to market
- tax incentives
- costs of doing business
- market infrastructure

Regional Competition

- Reduced use of Hong Kong possible when companies can raise funds more effectively from Mainland capital markets
- Direct participation of offshore investors in Mainland financial markets feasible when renminbi is convertible for capital account items
- Migration of activities to the larger and more liquid Mainland financial markets when liberalised.

Competition from Shanghai

- Hong Kong shares the same market hinterland with Shanghai, the key pressure from this city is the competition in fundraising.
- In the near and medium term, Hong Kong’s capacity in China will be still limited in offshore businesses, more fundraising activities are likely to move from Hong Kong to Shanghai, the evidence this year confirms that this shift is already under way
- It is expected that the competition between two cities will be intense further in the future, as a domestic national financial centre, Shanghai seems has more business resources to expand its markets size than Hong Kong.

Competition from Singapore

- Hong Kong shares the international financial value chain with Singapore and bears a heavy competition from this city - state in building up the function of financial innovation
- Singapore’s Jurisdiction perceived to be superior to Hong Kong on the measure of independence, now the international financial institutions prefer Singapore to be their key operating base for private banking and assets management while Hong Kong’s role is mainly in marketing. Such model is a division of labour. It is good for Singapore to develop its capability of financial product innovation.
- The innovation function and product pricing is a commanding point of financial centre, Hong Kong is now not that financial city closest to this point in Asia.

Opportunities of Hong Kong

- In terms of time zone and economic power, Asia is able to develop a global financial centre together with London and New York, which is not exist right now. Hong Kong is now well ahead of the major financial cities including Tokyo, Shanghai, and Sydney by the degree of internationalization.
- Financial sector will always benefits from sustainable growth of China economy, thus, is possible to achieve a leapfrog expansion. In facts Hong Kong’s stock market is growing much faster than it is in other major financial centres, even though the volatility increases. (IPO, QDII, individual investment in Hong Kong shares, a gateway of foreign companies to invest China)

Opportunities of Hong Kong

- In Strengthening the role in financial intermediation between Mainland and the rest of the world, by serving also outflows from the Mainland
- Participating in domestic financial intermediation activities on the Mainland.
- Providing a testing ground for renminbi internationalisation.
- New York's frustrations (fundraising, sub-prime mortgage).

Strategies

- HK retains financial centre status.
- Rule-based currency board is suitable.
- Need to diversify bank lending away from property. Lend more to real economic activities.
- Hong Kong financial institutions go into the Mainland to provide services.
- Hong Kong serves as a gateway for Mainland funds to come out
- Financial instruments issued in Hong Kong, particularly those issued by Mainland enterprises, would be made available on the Mainland.
- To enhance the capability of Hong Kong's financial system to handle renminbi-denominated transactions, such as establishing bond trading centre and RMB offshore centre is good for HK.
- To strengthen financial-infrastructure linkages between Hong Kong and the Mainland.

Conclusion

- Backdrop is changing for Hong Kong's role as a platform for Mainland to raise foreign capital from international markets.
- Hong Kong's role as an international financial centre has to move with the times

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