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Accelerating Offshore RMB Market Development: Enriching Hong Kong's Offerings as an International Financial Centre

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Executive Summary

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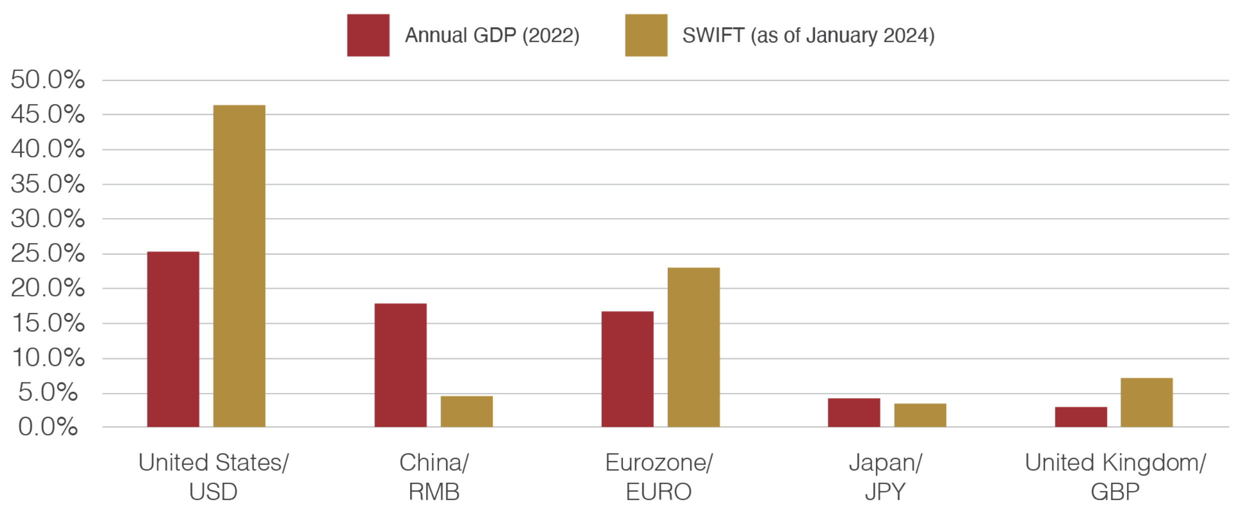
Hong Kong, a leading international financial centre (IFC), should continue to boost its competitiveness by capitalising on its strong connections with the Mainland and the global financial community. A particularly promising avenue that holds immense potential for this pursuit is the proactive enhancement of its offshore RMB business.

The internationalisation of the RMB, as reflected in the non-domestic market usage of the currency as well as the use of it in cross-border transactions, has gained traction since the 2000s, a period when China's economic growth was steaming ahead of global economic momentum. In this context, Hong Kong, as the most open territory in China and a crucial gateway between the country and the global community, serves as a conduit for the RMB's entry into wider circulation. The city's sophisticated financial infrastructure and its status as a global financial centre provide the requisite conditions for the RMB's offshore expansion. Instrumental to this process has been the establishment of a range of mutual market access schemes, which have facilitated seamless cross-boundary capital flows. As a result, Hong Kong has become a leading offshore RMB centre, boasting the largest RMB deposit pool among RMB offshore markets and a diverse portfolio of Mainland product offerings.

Looking ahead, RMB internationalisation shows room for improvement. A case in point is the stark contrast between the country's share of global GDP and its currency's share of cross-boundary payments, which stayed at 17.78% in 2022 and 4.51% (Figure 1) in January 2024, respectively. Noting the evolving global landscape and other domestic and external drivers, RMB internationalisation is poised to move forward on a global scale. Along the trend is an uptick in demand for the RMB as an international medium of exchange, a tool for financing, and as an investment currency. To capture these opportunities, support national development, and strengthen its status as an IFC, Hong Kong must proactively adapt and respond.

Figure 1. The global GDP share of top 5 economies and the global payment share of their currencies



Source: World Bank, SWIFT

The Financial Services Development Council (FSDC) has established a dedicated Working Group comprised of industry experts to steer the research process. Additionally, through private consultations with various industry associations, the FSDC has sought a broad representation of market insights. This collaborative effort has resulted in a set of recommendations presented in this report, aimed at supporting the internationalisation of the RMB, thus further strengthening Hong Kong's status as an IFC.

The recommendations in this report are structured around three major themes. The first theme focuses on enhancements building upon the existing mutual market access schemes. The second set of recommendations aims to expand the offshore RMB market's scope and influence. Lastly, the report outlines potential measures to expedite the development of the RMB ecosystem in Hong Kong. The recommendations include:

- ***Optimising mutual market access schemes and exploring new connectivity options***
    - Recommendation 1: Optimising current mutual market access schemes
    - Recommendation 2: Strengthening connectivity in emerging high-growth areas

- ***Enhancing the depth and breadth of the offshore RMB market***
    - Recommendation 3: Boosting liquidity for the offshore RMB market
    - Recommendation 4: Diversifying offshore RMB product offerings
    - Recommendation 5: Enriching RMB risk management tools

- ***Accelerating RMB ecosystem development***
    - Recommendation 6: Broadening talent connectivity
    - Recommendation 7: Enabling cross-boundary data flow
    - Recommendation 8: Leveraging infrastructure development, digital currency advancements, and innovation

These recommendations are structured around short-, medium-, and long-term priorities, considering practicality and feasibility while focusing on maximising mutual benefits for the markets of Mainland China and Hong Kong. The overarching objective is to promote the dual circulation of cross-boundary RMB, which is essential for the sustainable and long-term growth of Hong Kong's offshore RMB business and further cementing Hong Kong's status as a leading international financial centre.

Introduction

Introduction

The emergence of the RMB as a significant player in the global financial landscape underscores China's ascendance in the world economic structure. This transformative process, spanning across the last few decades, is marked by the internationalisation of the RMB and pivoted on the strategic role of Hong Kong.

Hong Kong, as the most open territory in China, serves as a unique gateway between the country and the global community, facilitating cross-boundary flows of people, goods, services, and capital. This pivotal role has solidified Hong Kong's position as an international financial centre, and the city has emerged as a leading offshore RMB centre, boasting the largest amount of RMB deposits among offshore markets – amounting to RMB 954.7 billion at the end of January 2024[1,2] – and a diverse portfolio of Mainland product offerings. This unique positioning amplifies its capacity to support China's ambition of propelling the RMB to global prominence.

In particular, the series of Connect schemes have been pivotal in this process. These schemes serve as essential channels, fostering cross-boundary investment flows and boosting the international use of the RMB. Notably, the average daily turnover (ADT) for Southbound and Northbound Stock Connect has seen remarkable growth, expanding from HKD 4.1 billion and RMB 4.7 billion in 2016 to HKD 28.9 billion and RMB 107.4 billion in December 2023, respectively.[3] Separately, investment products of Hong Kong and Macao held by Mainland investors under cross-boundary Wealth Management Connect (WMC) stood at around RMB 4.87 billion, with reverse holdings at RMB 230 million at the end of December 2023.[4]

Despite these impressive figures, the world of finance is ever-evolving, demanding constant vigilance and adaptability. To ensure that Hong Kong continues to lead the charge in RMB internationalisation as an offshore centre, it is crucial to regularly assess the existing ecosystem's effectiveness and identify areas for refinement. As an increasing number of jurisdictions seek to diversify their foreign reserve portfolios, with the RMB emerging as a favoured asset, Hong Kong should explore ways to promote the RMB for cross-boundary trade and increase its weight in international foreign currency reserves. As of 3Q 2023, the RMB's share of the world's foreign exchange reserves was 2.37%, up 1.30 percentage points compared to its first inclusion in the IMF's special drawing rights basket in 4Q 2016.[5] This trend is conducive to RMB internationalisation, further reinforcing Hong Kong's pivotal role.

In this context, this research report embarks on an exploration of potential areas for refinement and opportunities to leverage Hong Kong's seamless regional connectivity. An analysis of the city's mutual market access schemes forms the basis of this study, followed by a discussion of potential improvements to these schemes. Furthermore, other measures that can foster the growth of offshore RMB liquidity, RMB products, and risk management tools in Hong Kong are explored. These initiatives align with the objectives of the Government, as highlighted in the 2024-25 Budget Speech, to enhance various mutual market access schemes, capitalise on the increasing demand for RMB, and fully utilise Hong Kong's role as a functional platform for the Belt and Road Initiative.[6]

1 HKMA, (February 2024), *Monetary Statistics for January 2024*, https://www.hkma.gov.hk/eng/news-and-media/press-releases/2024/02/20240229-7/
2 In 2022, the RMB deposit balance in major offshore markets exceeded RMB 1.54 trillion, with Hong Kong accounting for 60% of the total. PBOC (October 2023), *2023 年人民幣國際化報告*, http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/5114765/2023102720175126516.pdf
3 HKEX (December 2023), *HKEX Monthly Market Highlights*. https://www.hkex.com.hk/Market-Data/Statistics/Consolidated-Reports/HKEX-Monthly-Market-Highlights?sc_lang=en
4 Guangdong Provincial Branch of PBOC (December 2023), *2023年12月跨境理財通業務情況通報*, http://guangzhou.pbc.gov.cn/guangzhou/129196/4332364/4332376/5211537/index.html
5 IMF, *Currency Composition of Official Foreign Exchange Reserves (COFER)*, https://data.imf.org/regular.aspx?key=41175 (accessed on 5 September 2023)
6 HKSAR Government (February 2024), *The 2024-2025 Budget*, https://www.budget.gov.hk/2024/eng/budget16.html

From domestic currency to global asset: the narrative of RMB internationalisation

The importance of currency internationalisation

The path towards currency internationalisation is multi-faceted, involving the expansion of its use and acceptance in global trade and investment, as well as its transcendence beyond domestic borders to gain worldwide recognition. This journey can be facilitated through various strategic measures, including further opening the domestic financial market to foreign investors, allowing free trade of the currency on international markets, and establishing bilateral exchange agreements with other countries.[7]

The internationalisation of a currency is not merely a strategic tool for national leverage, but also a mechanism that brings tangible benefits to various stakeholders, including businesses, investors, citizens, and the government.[8] For instance, it can significantly reduce transaction costs and mitigate currency exchange risks, thereby enhancing the efficiency of international trade and investment. This, in turn, supports economic growth and development.

In China, the internationalisation of the RMB is no mere policy footnote; instead, it is an integral cornerstone of the nation's long-term strategic vision.[9] By facilitating the RMB to become a global reserve currency, a trend of increasing alignment of its economic well-being and the usage of its currency internationally is presented.

At the same time, the internationalisation of a currency plays a crucial role in creating a stable monetary environment that supports sustainable economic development.[10] A stable monetary environment, in turn, fosters investor confidence, encourages domestic and foreign investment, and facilitates long-term strategic planning. By promoting the use of the RMB in international trade and investment, China may enjoy further stability of its monetary system, benefiting both domestic and international investors. It can also offer the global economy an additional major foreign currency, which will lessen transaction costs associated with international trade and investment activities, while diversifying any potential concentration risk of the international monetary system.

Several influential reserve currencies, including the US dollar, Euro, Chinese RMB, Japanese Yen, and Pound Sterling, shape the global financial landscape and will continue to take important positions.[11] Among which, the US dollar has been a dominant force in the global financial system for decades, taking around two-thirds of the world's foreign exchange reserves, despite a mild adjustment over the years due to the increasing use of other foreign currencies, such as the Euro, Japanese Yen, and the RMB (Figure 2).

7 Asian Development Bank Institute (May 2014), *The Benefits and Costs of Renminbi Internationalisation,* https://www.adb.org/sites/default/files/publication/156336/adbi-wp481.pdf

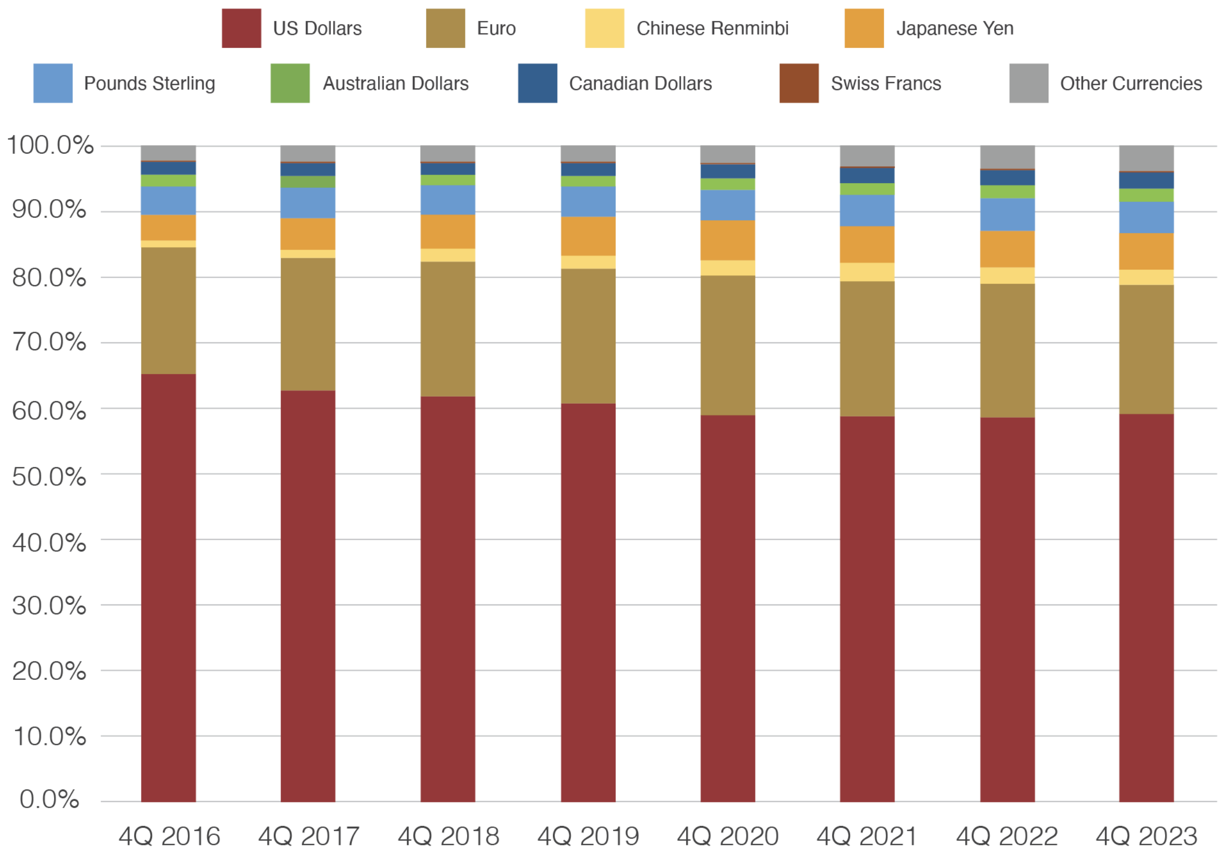
8 BIS (March 2009), *Currency internationalisation: an overview*, https://www.bis.org/repofficepubl/arpresearch200903.01.pdf

9 The State Council of the People's Republic of China (March 2016), *中華人民共和國國民經濟和社會發展第十三個五年規劃綱要*, https://www.gov.cn/xinwen/2016-03/17/content_5054992.htm; The State Council of the People's Republic of China (March 2021), *中華人民共和國國民經濟和社會發展第十四個五年規劃和2035年遠景目標綱要*, https://www.gov.cn/xinwen/2021-03/13/content_5592681.htm; The State Council of the People's Republic of China (October 2022), *習近平：高舉中國特色社會主義偉大旗幟 為全面建設社會主義現代化國家而團結奮鬥——在中國共產黨第二十次全國代表大會上的報告*, https://www.gov.cn/xinwen/2022-10/25/content_5721685.htm

10 The Hong Kong University of Science and Technology (June 2015), *Renminbi Internationalisation: The Prospects of China's Yuan as the Next Global Currency*, https://iems.ust.hk/publications/thought-leadership-briefs/renminbi-internationalisation-the-prospects-of-chinas-yuan-as-the-next-global-currency

11 IMF (March 2019), *The Future of China's Bond Market*, https://www.elibrary.imf.org/downloadpdf/book/9781484372142/ch001.xml

Figure 2. Share of the world's foreign exchange reserves



Source: IMF[12]

The broader international use of the RMB is part of the liberalisation process of China's financial sectors, which would improve efficiency of cross-boundary investment and trade activities. With these potential advantages in sight, the Chinese government has been actively facilitating the globalisation of the RMB since 2009. This strategy aligns with China's broader objectives of opening its financial market and integrating itself with the global economy in a gradual and prudent manner.[13] Measures adopted include easing restrictions on foreign investment, providing greater access to domestic bond and equity markets, and fostering a more open and transparent financial ecosystem.

Milestones and progress of RMB internationalisation policies

Cross-border usage of RMB took off around the 2009 global financial crisis, and it has since been one of the factors fortifying the country's economic and financial stability.[14] The inception of RMB internationalisation began with the launch of pilot programmes in 2009 and 2010, that aimed to permit and induce RMB settlement for cross-boundary trade and direct investment. These programmes were subsequently rolled out on a nationwide scale in 2011. Another significant milestone was reached in 2012 when the People's Bank of China began constructing the Cross-boundary Interbank Payment System (CIPS), which is an essential financial infrastructure for RMB cross-boundary transactions. This infrastructure is in line with international standards, providing fund clearing and settlement services to domestic and foreign participants engaged in cross-boundary RMB businesses, effectively serving as a "highway" for RMB internationalisation.[15]

At the end of 2014, the Central Economic Work Conference first proposed "steady progress in RMB internationalisation", replacing the previous expressions of "cross-boundary RMB pricing and settlement business" or "cross-boundary RMB circulation and usage". It was incorporated into the outline of the "Thirteenth Five-Year Plan" (2016–2020).[16] The plan outlined a systematic approach to achieving steady progress, encompassing initiatives such as RMB capital account convertibility, enhanced flexibility in RMB usage, and facilitating RMB capital going global.

12 IMF, *Currency Composition of Official Foreign Exchange Reserves (COFER)*, https://data.imf.org/regular.aspx?key=41175 (accessed on 5 September 2023)
13 The State Council of the People's Republic of China (March 2021), *中華人民共和國國民經濟社會發展第十四個五年計畫和2035年遠景目標綱要*, https://www.gov.cn/xinwen/2021-03/13/content_5592681.htm
14 香港人民幣國際化小組 (February 2023), *全面推動香港離岸人民幣中心建設，鞏固提升香港國際金融中心地位*
15 PBOC (May 2018), *Phase 2 of RMB Cross-border Interbank Payment System Fully Launched*, http://www.pbc.gov.cn/english/130721/3533376/index.html
16 The State Council of the People's Republic of China (March 2016), *中華人民共和國國民經濟和社會發展第十三個五年規劃綱要*, https://www.gov.cn/xinwen/2016-03/17/content_5054992.htm

The "Fourteenth Five-Year Plan" (2021–2025) reaffirms the steady and prudent progress in RMB internationalisation, adhering to market-driven principles and fostering corporate autonomy. It aims to create a new mutually beneficial cooperation relationship based on the unrestricted use of the RMB. Additionally, the plan highlights the importance of Hong Kong's role as an international financial centre and its evolving function as a global hub for offshore RMB business, international asset management, and risk management.[17]

The 20th National Congress Report of the Communist Party of China, held in October 2022, delineated the goal of orderly promoting RMB internationalisation.[18] The advancement of high-level opening-up has progressed from a phase of cautious progress to a stage of systematic development, where the focus has shifted from exploration and accumulating experience to designing institutional frameworks and coordinating actions. This indicates a more structured and strategic approach to RMB internationalisation.

Additionally, government departments are streamlining policies related to cross-boundary RMB transactions. For example, in 2021, various regulators of the Mainland jointly issued a notice in support of stable foreign trade and investment. In this notice, these regulators propose simplifying the cross-boundary RMB settlement process, optimising cross-boundary RMB investment and financing management, facilitating personal cross-boundary RMB payments, and easing overseas institutions' use of RMB settlement accounts.[19] These measures simplify procedures, enhance efficiency, and ensure the uninterrupted flow of cross-boundary RMB transactions for individuals and institutions, reinforcing China's commitment to RMB internationalisation.

The current state of RMB internationalisation

Despite China's position as the second-largest economy globally, accounting for 17.78% of the world's GDP as of 2022,[20] the RMB still has a relatively limited presence in global trade and the foreign exchange market. With a foreign exchange turnover and global payment share standing at only 3.51%[21] and 4.51% (Figure 3), respectively, the RMB's role on the international stage has hardly mirrored the country's economic representation. This disparity highlights a potential for the RMB to assume a more significant role in global financial affairs and presents a compelling case for continued efforts towards RMB internationalisation.

Figure 3. The global share of major international currencies and the key economic indicators of their issuing countries

	Annual GDP (2022)	Foreign Exchange Reserves (3Q 2023)	Global payments (January 2024)	Trade Finance (January 2024)
United States / USD	25.21%	59.17%	46.64%	82.84%
European Union / EURO	16.50%	19.58%	23.02%	5.41%
United Kingdom / GBP	3.04%	4.83%	7.10%	0.15%
Japan / JPY	4.19%	5.45%	3.56%	1.49%
China / RMB	17.78%	2.37%	4.51%	5.25%

Source: World Bank, IMF, SWIFT

Nevertheless, the RMB has been making waves in the global financial scene despite its current underrepresentation. As the Chinese economy continues to grow, recent data has recorded a notable upswing in the acceptance and usage of the RMB in various aspects of international finance. The RMB is gaining traction from global payments to foreign exchange transactions and international reserves to cross-boundary RMB settlements. The following is a closer look at the RMB's increasing prominence in some of these areas:

- **International reserves:** According to a report by the PBOC on the RMB, it has been observed that more than 80 foreign central banks or monetary authorities have included the RMB in their foreign exchange reserves.[22] Data from the Currency Composition of Official Foreign Exchange Reserves (COFER), released by the International Monetary Fund (IMF), indicates that the RMB's share was 2.37% in 3Q 2023, marking an increase of 1.29 percentage points (compared to a share of 1.08% in 4Q 2016) since its inclusion in the Special Drawing Right (SDR) currency basket in 2016.[23]

17 The State Council of the People's Republic of China (March 2021), *中華人民共和國國民經濟和社會發展第十四個五年規劃和2035年遠景目標綱要*, https://www.gov.cn/xinwen/2021-03/13/content_5592681.htm
18 The State Council of the People's Republic of China (October 2022), *習近平：高舉中國特色社會主義偉大旗幟 為全面建設社會主義現代化國家而團結奮鬥*, https://www.gov.cn/xinwen/2022-10/25/content_5721685.htm
19 National Development and Reform Commission (January 2021), *人民银行 发展改革委 商务部 国资委 银保监会 外汇局联合发布《关于进一步优化跨境人民币政策 支持稳外贸稳外资的通知》*, https://www.ndrc.gov.cn/fggz/lywzjw/wstz/202101/t20210128_1266105.html
20 World Bank (July 2023), Gross domestic product 2022, https://databankfiles.worldbank.org/public/ddpext_download/GDP.pdf
21 BIS (December 2022), *Triennial Central Bank Survey of foreign exchange and Over-the-counter (OTC) derivatives markets in 2022*, https://www.bis.org/statistics/rpfx22.htm
22 PBOC (October 2023), *2023 年人民幣國際化報告*, http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/5114765/2023102720175126516.pdf
23 IMF, *Currency Composition of Official Foreign Exchange Reserves (COFER)*, https://data.imf.org/regular.aspx?key=41175 (accessed on 5 September 2023)

The official inclusion of the RMB in the IMF's Special Drawing Rights (SDR) currency basket in 2016 was a significant milestone in the internationalisation of the RMB. In May 2022, the IMF further increased the weight of the RMB in the SDR basket from 10.92% to 12.28%,[24] demonstrating the continued progress in enhancing the RMB's status and its increased freedom of use.

- **Foreign exchange transactions:** As of April 2022, the RMB's share in foreign exchange transactions also saw a notable increase, reaching 7% and being ranked as the 5th most traded foreign exchange currency, according to a PBOC report, citing data from BIS.[25] This growth suggests a steady shift in forex market dynamics, with traders and investors becoming increasingly comfortable with including the RMB in their transactions.

- **International payments:** According to the Society for Worldwide Interbank Financial Telecommunications (SWIFT), the usage of the RMB in international payments experienced significant growth. In 2022, the total amount of cross-border payments in RMB reached RMB 42.1 trillion, representing a year-on-year growth of 15.1%.[26] For the first nine months of 2023, cross-border RMB payment was RMB 38.9 trillion.[27]

  In 2011, the RMB was merely the 17th global payment currency, taking 0.29% of the share in global payments. In December 2021, the percentage of RMB usage reached 2.7%, surpassing the Japanese Yen (JPY) and becoming the world's fourth most active payment currency.[28] The upward trend continued into January 2024, and the RMB's share in international payments reached a remarkable record of the second-highest level in history, standing at 4.51%.[29]

- **RMB financing**: In October 2023, the RMB's share as a global currency in the trade finance market secured a record-high share of 5.8%, surpassing the Euro to become the second most used currency in trade finance, trailing only behind the US dollar.[30] In January 2024, the RMB's share in the trade finance market had slightly decreased to 5.25%, still solidifying its position among the top three currencies used in international trade.[31]

- **Offshore RMB clearing**: In 2022, the volume of RMB clearing conducted by overseas clearing banks totalled RMB 504.3 trillion, a year-on-year increase of 7.7%.[32] These numbers indicate a growing reliance on the RMB for cross-boundary transactions.

- **Domestic RMB financial assets held by overseas entities**: As of December 2023, overseas entities had a total of RMB 9.4 trillion worth of domestic RMB financial assets, which include stocks, bonds, loans, deposits, and other forms.[33] This represents a significant increase from RMB 2.9 trillion at the end of 2013.[34] This trend reflects "skin in the game" of international stakeholders in China, a growing level of trust in Chinese financial markets, and an increasing openness of China's financial markets to foreign investment.

- **Trading volumes in offshore RMB markets**: The offshore RMB markets have experienced a notable surge in trading volumes. By the end of 2022, the RMB deposit balance in major offshore markets had reached approximately RMB 1.54 trillion, back to a historical high.[35] Initially, the RMB deposit balance in major offshore markets surpassed RMB 1.5 trillion in late 2015, but experienced a gradual decline until early 2017. From that point onwards, growth has been steady, coinciding with the implementation of the Thirteenth Five-Year Plan to enhance flexibility in RMB usage and to facilitate RMB capital going global. Additionally, it is believed that the introduction of the Bond Connect scheme has further contributed to these developments.[36]

24 IMF, (May 2022). *IMF Executive Board Concludes Quinquennial SDR Valuation Review.* https://www.imf.org/en/News/Articles/2022/05/14/pr22153-imf-board-concludes-sdr-valuation-review
25 PBOC (October 2023), *2023 年人民幣國際化報告*, http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/5114765/2023102720175126516.pdf
26 PBOC (October 2023), *2023 年人民幣國際化報告*, http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/5114765/2023102720175126516.pdf
27 The State Council of the People's Republic of China (October 2023), *China's cross-border RMB use up 24 pct in January-September*, https://english.www.gov.cn/archive/statistics/202310/30/content_WS653f1eecc6d0868f4e8e0c8f.html
28 Swift, *RMB Tracker*, https://www.swift.com/zh-hans/node/11096 (accessed on 28 February 2024)
29 Swift, *RMB Tracker*, https://www.swift.com/zh-hans/node/11096 (accessed on 11 November 2023)
30 Swift, *RMB Tracker*, https://www.swift.com/zh-hans/node/11096 (accessed on 11 November 2023)
31 Swift, *RMB Tracker*, https://www.swift.com/zh-hans/node/11096 (accessed on 28 February 2024)
32 PBOC (October 2023), *2023 年人民幣國際化報告*, http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/5114765/2023102720175126516.pdf
33 PBOC, *Money and Banking Statistics*, http://www.pbc.gov.cn/en/3688247/3688975/4787948/4788001/index.html (accessed on 30 January 2024)
34 PBOC (June 2015), *人民幣國際化報告*, http://www.pbc.gov.cn/eportal/fileDir/image_public/UserFiles/goutongjiaoliu/upload/File/%E4%BA%BA%E6%B0%91%E5%B8%81%E5%9B%BD%E9%99%85%E5%8C%96%E6%8A%A5%E5%91%8A%EF%BC%882015%E5%B9%B4%EF%BC%89.pdf
35 PBOC (October 2023), *2023年人民幣國際化報告*, http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/5114765/2023102720175126516.pdf
36 PBOC (November 2022), *2022 RMB Internationalisation Report*, http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/4666144/2022112809590450941.pdf

Key factors driving the success of RMB internationalisation

The internationalisation of the RMB is a result of China's improved financial market infrastructure. A myriad of factors has backed the rising acceptance and prominence of the RMB in worldwide trade and investment activities.

Strengthened economic ties – opportunities brought by the Belt and Road Initiative, Regional Comprehensive Economic Partnership, and others

A range of initiatives, such as the Belt and Road Initiative (BRI) and the Regional Comprehensive Economic Partnership (RCEP), have strengthened China's economic ties with its international counterparts, thereby bolstering the global profile of the RMB.

For instance, with its massive infrastructure projects in different countries, the BRI has driven the demand for RMB financing and settlement to facilitate trade and investment among participating countries. Evidence of this can be found in the growth of trade between China and other BRI participants, which rose from USD 1.04 trillion in 2013[37] to USD 2.71 trillion (RMB 19.41 trillion) in 2023.[38] China's non-financial direct investments[39] in BRI nations soared along the same period, too, and it rose to USD 31.8 billion in 2023, marking a 22.6% year-on-year increase;[40] such investments are mainly directed towards countries such as Singapore, Indonesia, Malaysia, Thailand, Vietnam, Pakistan, United Arab Emirates, Cambodia, Serbia, and Bangladesh.[41]

With the RMB being considered as the currency used for funding BRI-related projects, RMB usage has seen an uptick. In the first three quarters of 2023, the cross-boundary RMB receipts and payments between China and the Belt and Road partner countries amounted to RMB 6.5 trillion, accounting for 16.7% of the total cross-boundary RMB payments during the same period.[42]

Simultaneously, the RCEP, whose partners in total account for roughly 30% of the world's population and 30% of global GDP, has contributed significantly to this trend. Comprising 15 countries, including 10 ASEAN nations and five other important economies (Australia, China, Japan, New Zealand, and the Republic of Korea),[43] the RCEP strengthens economic integration among its members, fostering closer economic ties and encouraging the use of regional currencies, including the RMB, for settlement and investment purposes. In 2023, China's trade with the other 14 RCEP members reached RMB 12.6 trillion,[44] a slight decrease from 2022's RMB 12.95 trillion,[45] but still represented a 5.3% increase compared with that in 2021 before the agreement became effective.

While the BRI and RCEP have distinct frameworks and objectives, they share a common goal of promoting international economic cooperation. Both initiatives seek to enhance connectivity, trade, and investment among participating countries, albeit through different means. The synergy between these two initiatives has, in one way or another, amplified the global stature of the RMB. This acceptance is further propelled by the escalating trade flows and business connectivity between China and its intra-Asia trading partners, especially ASEAN nations, the Middle East, and Latin America.

Bilateral currency swap agreements and RMB-clearing banks

Complementing these initiatives, bilateral currency swap agreements and RMB-clearing banks have been instrumental in advancing RMB internationalisation. Bilateral currency swap agreements enable direct exchange of currencies between nations to circumvent the need for a common reserve currency, such as the US dollar. As of September 2023, China had established swap agreements with 40 central banks or monetary authorities, 30 of which were along the BRI, with a total value exceeding 4 trillion RMB.[46] This strategic manoeuvre has significantly fostered the use of RMB in cross-boundary trade and investment.

37 National Development Reform Commission (March 2023), *商務部：2013年到2022年 我國與"一帶一路"沿線國家貨物貿易額年均增長8%*, https://www.ndrc.gov.cn/xwdt/ztzl/zgdmydylcntzhz/202303/t20230331_1352966.html

38 People's Republic of China (January 2023), *國務院新聞辦就2023年全年進出口情況舉行發佈會*, https://www.gov.cn/lianbo/fabu/202401/content_6925700.htm

39 Non-financial sector refers to domestic investors' outward FDI to overseas non-financial enterprises. Please refer to Ministry of Commerce of the People's Republic of China, National Bureau of Statistics, and State Administration of Foreign Exchange (September 2023), *2022 Statistical Bulletin of China's Outward Foreign Direct Investment*, http://images.mofcom.gov.cn/fec/202310/20231030091915777.pdf

40 Ministry of Commerce of the People's Republic of China (January 2024), *2023年我對"一帶一路"共建國家投資合作情況,* http://hzs.mofcom.gov.cn/article/date/202401/20240103469619.shtml

41 Ministry of Commerce of the People's Republic of China (February 2023), *2022年我對"一帶一路"沿線國家投資合作情況*, http://hzs.mofcom.gov.cn/article/date/202302/20230203384453.shtml

42 PBOC (October 2023), *2023 年人民幣國際化報告*, http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/5114765/2023102720175126516.pdf

43 Ministry of Commerce of the People's Republic of China (June 2023), *國際司負責人就《區域全面經濟夥伴關係協定》（RCEP）對所有簽署國全面生效答記者問*, http://fta.mofcom.gov.cn/article/rcep/rcepnews/202306/54024_1.html

44 Ministry of Commerce of People's Republic of China (January 2024), *海關總署：2023年我國對RCEP其他14個成員國合計進出口12.6萬億元*, http://fta.mofcom.gov.cn/article/rcep/rcepgfgd/202401/55040_1.html

45 Ministry of Commerce of the People's Republic of China (June 2023), *國際司負責人就《區域全面經濟夥伴關係協定》（RCEP）對所有簽署國全面生效答記者問*, http://fta.mofcom.gov.cn/article/rcep/rcepnews/202306/54024_1.html

46 PBOC (October 2023), *2023 年人民幣國際化報告*, http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/5114765/2023102720175126516.pdf

Alongside these agreements, the PBOC has judiciously designated RMB-clearing banks in critical international financial hubs. As of September 2023, 31 clearing banks were operational in 29 countries and regions, expediting RMB transactions.[47] These banks processed a sum of RMB 504.3 trillion, marking a 7.7% increase from the preceding year;[48] there is a presence of RMB-clearing banks in 17 countries along the BRI as of September 2023.[49] Further endorsing the rising international stature of the RMB, several countries, including Malaysia, Argentina, and Cambodia, have officially adopted it as a reserve currency.

Looking ahead, the development of financial technology and the exploration of Central Bank Digital Currencies (CBDCs) may catalyse for the progress of RMB internationalisation.[50]

The strategic role of offshore financial centres

The global prominence of the RMB is also attributed to Mainland China's unwavering commitment and determination to open up its capital market further. The country has utilised Hong Kong's unique position, not only as an international financial centre, but also as the leading offshore RMB centre to facilitate opening its market to international investors. Hong Kong and other offshore RMB centres, including London, provide platforms for offshore RMB transactions and serve as critical hubs for RMB liquidity, contributing to the RMB's overall growth and acceptance globally (more details in the following section).

The Ongoing Opening of Mainland China: A Key Driver for RMB Internationalisation

Mainland China is determined to continue opening up its capital markets.
Over the past five years, there have been several significant milestones that have contributed to this goal:

2018
China opening its onshore FX market to offshore corporates and investors (PBOC Rule 159)

2019/ 2020
A slew of relaxations led to the inclusion of Chinese stocks into both the GBI-EM Global Diversified Index and the MSCI Emerging Markets Index.

2021
Extending the Connect schemes to the wealth management space via WMC

2021-2023
New momentum on allowing Mainland FIs outbound investments via Southbound Bond and continuing to grant new quotas for Qualified Domestic Institutional Investors (QDII) and Qualified Domestic Investment Enterprise (QDIE)

Recent development have further supported RMB internationalisation:

2022
- Adding ETFs to Stock Connect
- Passing Futures and Derivatives Law to make China a clean-netting jurisdiction for derivative trading

2023
- Increasing derivatives access via Swap Connect
- Enriching HK's RMB product suite via dual counter stocks on HKEX

2024
Promoting the use of Mainland bonds as eligible collaterals; allowing foreign investors to participate in the Mainland bond repurchase business; enhancing the Wealth Management Connect Scheme; further expanding the cross-boundary e-CNY pilots

Offshore currency centres are a crucial partaker of the internationalisation process as they provide channels for currency outflows and inflows, thereby enhancing the circulation and convenience of the currency in the international market. This is due in part to the preference of non-resident entities, who tend to deposit their non-domestic currency assets in offshore markets, particularly in international financial centres with well-developed financial services.[51] For instance, with London being both a global financial centre and a hub for the European dollar market, it plays a crucial role in internationalising the US dollar.

According to a report from the BIS, the share of global RMB foreign exchange originating from Mainland China declined from 28.0% in April 2019 to 17.4% in April 2022 worldwide.[52] However, in offshore markets, the latest shares in Hong

47 PBOC (October 2023), *2023 年人民幣國際化報告*, http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/5114765/2023102720175126516.pdf
48 PBOC (October 2023), *2023 年人民幣國際化報告*, http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/5114765/2023102720175126516.pdf
49 PBOC (October 2023), *2023 年人民幣國際化報告*, http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/5114765/2023102720175126516.pdf
50 Such as the collaboration between the PBOC and institutions like the Hong Kong Monetary Authority, the Bank of Thailand, and the Central Bank of the United Arab Emirates on the Project m-Bridge.
51 BIS (September 2010), *Offshore markets for the domestic currency: monetary and financial stability issues*, https://www.bis.org/publ/work320.pdf
52 Caixin (December 2022), *離岸人民幣中心新動向*, https://weekly.caixin.com/2022-12-10/101976508.html?sourceEntityId=102064665

Kong, the UK, and Singapore are 28.2%, 21.9%, and 14.9%, respectively.[53] Considering this and the fact that it handles 70%–80% of global RMB payments, Hong Kong has long been and maintained the position as the leading offshore RMB centre.

Hong Kong has tapped into the wave of offshore RMB bonds (Dim Sum bonds) issuance, opening new opportunities for growth. In 2022, the issuance volume of Dim Sum bonds in Hong Kong reached RMB 330 billion, marking over 100% increase from the previous year.[54] This growth is not confined to traditional overseas issuers and financial institutions, with government entities also participating actively.[55] Offshore RMB bond issuance in Hong Kong amounted to RMB 545.1 billion in 2023, represents a 65% increase from the year before.[56] Despite the relatively slow development of RMB-related projects, London, the second-largest offshore RMB centre globally, continues to play a role in bridging the European and American markets and ensuring the round-the-clock operation of offshore RMB.[57]

Geopolitical factors have also led to the rise of **emerging RMB offshore markets**. For instance, Dr Liao Qun, Chief Economist at the Renmin University of China's Chongyang Institute for Financial Studies, highlighted the potential of Southeast Asia, given China's geographical proximity and strong economic ties with the region. The balanced trade between ASEAN and China, coupled with China's active participation in Southeast Asian infrastructure projects, has created an ideal structure for promoting RMB trade settlement and infrastructure investments.[58]

53 BIS (December 2022), *Triennial Central Bank Survey of foreign exchange and Over-the-counter (OTC) derivatives markets in 2022*, https://www.bis.org/statistics/rpfx22.htm

54 Securities and Futures Commission (SFC; August 2023), *Asset and Wealth Management Activities Survey 2022*, https://www.sfc.hk/-/media/EN/files/COM/Reports-and-surveys/AWMAS-2022_E.pdf?rev=3b6a43ac11404a2cacf7123c2f5c949e&hash=C33D88F5AAEAC176BC072AE9326091CC

55 HKMA (July 2023), *債券通周年論壇2023主旨演講*, https://www.hkma.gov.hk/gb_chi/news-and-media/speeches/2023/07/20230704-1/

56 HKMA (February 2024), *Briefing to the Legislative Council Panel on Financial Affairs,* https://www.hkma.gov.hk/media/eng/doc/about-the-hkma/legislative-council-issues/20240205e2.pdf

57 Caixin (December 2022), *離岸人民幣中心新動向*, https://weekly.caixin.com/2022-12-10/101976508.html?sourceEntityId=102064665

58 Caixin (December 2022), *離岸人民幣中心新動向*, https://weekly.caixin.com/2022-12-10/101976508.html?sourceEntityId=102064665

Hong Kong's role in the internationlisation of the RMB

Hong Kong as a leading offshore RMB centre and its accomplishments

As highlighted in the previous section, Hong Kong, the top offshore RMB centre, continues to play an important role in the RMB internationalisation journey.

The Central Government recognises the city's resilience as a financial hub and China's international financial centre, and it is actively supporting the growth of offshore RMB business in Hong Kong. As highlighted in the Fourteenth Five-Year Plan, it is acknowledged that Hong Kong plays significant functions and has a unique positioning in the country's overall development, which is an endorsement of its role as a global offshore RMB business hub.[59] In 2022, efforts were made to enhance the liquidity of RMB in Hong Kong when the PBOC and the Hong Kong Monetary Authority upgraded the currency swap agreement to a long-standing one; this action has increased the swap size from RMB 500 billion / HKD 590 billion to RMB 800 billion / HKD 940 billion, strengthening the city's position as an offshore RMB market.

Financial cooperation between the Mainland and Hong Kong has reached further milestones. In January 2024, the PBOC and HKMA announced six policy measures to deepen financial cooperation between Hong Kong and the Mainland. Among these measures, four are particularly conducive to advancing Hong Kong's offshore RMB business. These measures involve the inclusion of certain onshore RMB bonds as eligible collateral for the HKMA's RMB Liquidity Facility,[60] further opening up the onshore repurchase agreement (repo) market to all foreign institutional investors (including Bond Connect investors) that already have access to the China Interbank Bond Market, releasing the implementation arrangements for the enhancements to the Wealth Management Connect Scheme, and expanding the cross-boundary e-CNY pilots in Hong Kong.[61] These measures are expected to further open up the Mainland's financial market, strengthen Hong Kong's status as an international financial centre and offshore RMB business hub, and foster closer connections within the Greater Bay Area (GBA).

Over the past two decades, Hong Kong has proven to be instrumental in facilitating the opening of Mainland China's financial markets and advancing the global expansion of the RMB. The city's commitment to embracing the RMB and promoting its international adoption is demonstrated through numerous initiatives. Hong Kong reached a remarkable milestone in 2004 by introducing the RMB business, marking a critical development in the internationalisation process. In 2009, the city launched a **pilot scheme for cross-boundary trade settlement in RMB**.

Through consistent efforts, Hong Kong has constructed a **robust offshore RMB market infrastructure comprising comprehensive RMB clearing and international payment systems.** This framework has provided investors with accessible channels to participate in offshore RMB investment and transactions.[62]

For example, the city has facilitated the issuance of **offshore RMB bonds**, contributing to the liquidity and depth of the offshore RMB market.[63] Moreover, Hong Kong has rolled out measures such as tax exemptions to incentivise the issuance of RMB bonds. The city has also introduced **HKD-RMB Dual Counter Model**, **a series of Connect schemes, and the mBridge initiative.** These initiatives underscore Hong Kong's commitment to bolstering RMB internationalisation and its role as a forerunner in this global financial evolution.

Backed by the abovementioned initiatives, Hong Kong has successfully carved out its position as a leading offshore RMB centre. This success is built on a foundation of several key factors: the city's extensive RMB liquidity pool, its role as the world's foremost offshore RMB clearing centre, its prominence in both foreign currency and RMB currency trading, its status as a primary platform for offshore RMB financing, and its establishment as a significant platform for global RMB investments.

59 The State Council of the People's Republic of China (March 2021), *中華人民共和國國民經濟和社會發展第十四個五年規劃和2035年遠景目標綱要*, https://www.gov.cn/xinwen/2021-03/13/content_5592681.htm

60 HKMA (January 2024), *RMB Liquidity Facility and Primary Liquidity Providers*, https://www.hkma.gov.hk/eng/key-functions/money/liquidity-facility-framework/rmb-liquidity-facility-and-primary-liquidity-providers/

61 HKMA (January 2024), *The HKMA and the PBOC announce measures to deepen the financial cooperation between Hong Kong and the Mainland*, https://www.hkma.gov.hk/eng/news-and-media/press-releases/2024/01/20240124-3/

62 Takungpo (April 2023), *撥雲見日/建好離岸市場 助力人幣國際化*, http://www.takungpao.com/finance/236134/2023/0414/839498.html

63 HKSAR Government (November 2021), *Green bond issuance successful*, https://www.news.gov.hk/chi/2021/11/20211124/20211124_164215_119.html

Figure 4. Key success factors as a leading offshore RMB centre

- **A substantial offshore RMB liquidity pool**

  Hong Kong possesses a substantial offshore RMB liquidity pool outside Mainland China, reaching a scale close to RMB 945.7 billion at the end of January 2024.[64] It forms the backbone of the vibrant offshore RMB business in Hong Kong. This liquidity pool and its size directly impact a wide range of business activities, providing ample liquidity for transactions and contributing to the strength of the offshore RMB market.

- **Dominance as an offshore RMB clearing centre**

  Hong Kong has consistently maintained its position as the top-ranked offshore clearing centre globally for the past five years, reflecting its designated role in facilitating RMB clearing activities. According to SWIFT's statistical data, Hong Kong handles over 70%–80% of global offshore RMB payment settlements.[65] The total remittance of RMB for cross-boundary trade settlement amounted to RMB 1,400.9 billion in January 2024.[66] The daily transaction volume of RMB payments in Hong Kong has witnessed a substantial increase, reaching 2,064 billion for 2023.[67] This represents an increase of approximately 82% compared to 2019, indicating a strong upward trend in RMB transactions in Hong Kong.[68]

64 HKMA, (February 2024), *Monetary Statistics for January 2024*, https://www.hkma.gov.hk/eng/news-and-media/press-releases/2024/02/20240229-7/
65 Swift, *RMB Tracker*, https://www.swift.com/zh-hans/node/11096 (accessed on 30 January 2024)
66 HKMA, (February 2024), *Monetary Statistics for January 2024*, https://www.hkma.gov.hk/eng/news-and-media/press-releases/2024/02/20240229-7/
67 HKMA (February 2024), *Briefing to the Legislative Council Panel on Financial Affairs*, https://www.hkma.gov.hk/media/eng/doc/about-the-hkma/legislative-council-issues/20240205e1.pdf
68 HKMA (May 2019), *HKMA Annual Report 2019*, https://www.hkma.gov.hk/media/eng/publication-and-research/annual-report/2019/05_Highlights.pdf

- **Leading offshore RMB financing platform**

  Hong Kong's financial institutions and corporations are crucial in meeting investors' demand for offshore RMB assets by issuing offshore RMB bonds. This satisfies investor needs and creates additional financing opportunities for Mainland Chinese enterprises. The offshore RMB bond market in Hong Kong experienced a significant resurgence at the end of 2022. As mentioned earlier in the report, the issuance volume of these bonds soared to RMB 330 billion, reflecting a robust 100% increase from the previous year.[69] This momentum continued in 2023 with offshore RMB bond issuance amounted to RMB 545.1 billion.[70]

  Hong Kong's role extends beyond being a trusted platform for corporate bond issuance, as it is also a destination of choice for issuing offshore sovereign bonds and local government bonds. From their actions, it is clear that the PBOC and the Ministry of Finance have chosen Hong Kong as a go-to platform for issuing RMB central bank bills and bonds.[71] In October 2023, the Ministry of Finance issued a RMB 16 billion sovereign bond in Hong Kong, marking the 15th consecutive year of RMB sovereign bond issuance since the inaugural issuance in 2009.[72] The Shenzhen Municipal Government and the Hainan Provincial Government debuted their offshore RMB issuances in Hong Kong, each worths RMB 5 billion, in 2021 and 2022 respectively.[73,74] These issuances have strengthened the offshore secondary market for RMB bonds and opened up new investment avenues for foreign investors.

  Further reinforcing Hong Kong's standing as a leading offshore RMB hub was the Memorandum of Understanding (MOU) signed on 18 October 2023 between the National Development and Reform Commission of Mainland China and the Hong Kong Monetary Authority. The MOU focuses on supporting cross-boundary financing by Chinese enterprises and promoting the development of the Hong Kong bond market. The two authorities will collaboratively foster the development of Hong Kong's green and sustainable finance market and the Dim Sum bond market. They aim to encourage Chinese enterprises to undertake green and sustainable financing activities via Hong Kong's platform. Moreover, they intend to leverage Hong Kong's position as an offshore RMB business hub to increase the size and liquidity of the Dim Sum bond market and broaden the scope of RMB business.

- **Prominence in RMB currency and foreign currency trading**

  Hong Kong is prominent in the global offshore RMB foreign exchange and derivatives trading market. According to the BIS's triennial survey on foreign exchange and derivatives market turnover, the city has witnessed considerable growth in the average daily turnover of RMB foreign exchange transactions and over-the-counter (OTC) interest rate instruments.[75] According to the most recent data made available by BIS, the average daily amount of RMB foreign exchange transactions reached USD 107.6 billion in April 2019; as of April 2022, this metric had made a substantial leap of 77.7%, reaching USD 191.2 billion.[76] Moreover, the average daily amount of RMB OTC interest rate instruments, another critical market indicator, also experienced an increase as it climbed from USD 12.7 billion in April 2019 to USD 14.7 billion in April 2022, marking a significant growth of 15.5%.[77]

- **A fronting platform for global RMB investments**

  Hong Kong has been the main platform for global investment in RMB assets. Its rich array of RMB asset classes and the introduction of initiatives like Stock Connect, Bond Connect, and WMC[78] have transformed Hong Kong into an indispensable hub for global investments in RMB assets. The increasing volume of Northbound (Hong Kong and overseas investors investing in the Mainland) and Southbound (Mainland investors investing in Hong Kong) transactions, alongside the enhanced fluidity of capital flow between onshore (Mainland) and offshore (outside of Mainland, primarily Hong Kong) markets signifies a momentous shift in the openness of the RMB capital account.

69 SFC (August 2023), *Asset and Wealth Management Activities Survey 2022*, https://www.sfc.hk/-/media/EN/files/COM/Reports-and-surveys/AWMAS-2022_E.pdf?rev=3b6a43ac11404a2cacf7123c2f5c949e&hash=C33D88F5AAEAC176BC072AE9326091CC
70 HKMA (February 2024), *Briefing to the Legislative Council Panel on Financial Affairs,* https://www.hkma.gov.hk/media/eng/doc/about-the-hkma/legislative-council-issues/20240205e2.pdf
71 HKMA (October 2023), *Tender Notice*, https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2023/20231018e3a1.pdf
72 HKMA (October 2023), *Ministry of Finance issues Renminbi Sovereign Bonds through Central Moneymarkets Unit of Hong Kong Monetary Authority*, https://www.hkma.gov.hk/gb_chi/news-and-media/press-releases/2023/10/20231018-3/
73 HKSAR Government (October 2022), *HKSAR Government welcomes issuance of bonds in Hong Kong by Hainan Provincial Government and Shenzhen Municipal Government*, https://www.info.gov.hk/gia/general/202210/24/P2022102400499.htm
74 HKSAR Government (Sep 2021), *HKSAR Government welcomes issuance of bonds in Hong Kong by Shenzhen Municipal People's Government.* https://www.info.gov.hk/gia/general/202109/24/P2021092400201.htm
75 HKMA (October 2022), *Results of 2022 Bank for International Settlements Triennial Survey of Foreign Exchange and Derivatives Market Turnover*, https://www.hkma.gov.hk/eng/news-and-media/press-releases/2022/10/20221027-3/
76 BIS (April 2023), *Triennial Central Bank Survey OTC foreign exchange turnover in April 2022*, https://www.bis.org/statistics/rpfx22_fx_annex.pdf
77 BIS (April 2023), *Triennial Central Bank Survey OTC interest rate derivatives turnover in April 2022*, https://www.bis.org/statistics/rpfx22_ir_annex.pdf
78 At this stage, WMC is only accessible to GBA residents (i.e. residents in the nine Mainland cities in the GBA, HK and Macao).

Since its launch in 2014, the Stock Connect programme has seen a surge in average daily turnover, demonstrating the scheme's effectiveness in facilitating cross-boundary investments. Similarly, the Bond Connect programme that is in place since 2017 has allowed international investors unprecedented access to China's interbank bond market, one of the largest in the world.

Moreover, these developments have made fundraising and investment activities substantially easier, leading to an increasingly diverse international investor base. Adding to this allure is the availability of effective risk management options through Swap Connect, which bolsters investor confidence by offering robust hedging tools against potential financial risks. The following section will delve deeper into the series of Connect Schemes and their pivotal role in strengthening Hong Kong's position in global RMB investments.

The role of mutual market access schemes in bolstering RMB internationalisation: A comprehensive review

In a joint effort to advance the global adoption of the RMB, Hong Kong and Mainland China have launched a series of mutual market access schemes. These initiatives, which foster cross-boundary investment between the two financial markets, include the notably successful Stock Connect and Bond Connect. The recently introduced Northbound Trading of Swap Connect further amplifies risk hedging possibilities for overseas investors, fuelling the growth of the financial derivatives markets in Mainland China.

The consensus among market participants is that these Connect schemes, both current and future iterations, are critical in bolstering Hong Kong's strategic position. Despite Hong Kong's indisputable strengths, complacency is to be avoided. Thus, Hong Kong should persistently optimise Connect schemes operationally, with the aim of enabling foreign investors to tap into Mainland China's economic opportunities with less friction.

This section offers a summary of the following schemes: Stock Connect, ETF Connect, Bond Connect, Swap Connect, WMC, and Mutual Recognition of Funds. By evaluating and identifying potential enhancements to these mutual market access schemes, Hong Kong can ensure their effectiveness and maximise their advantages to investors.

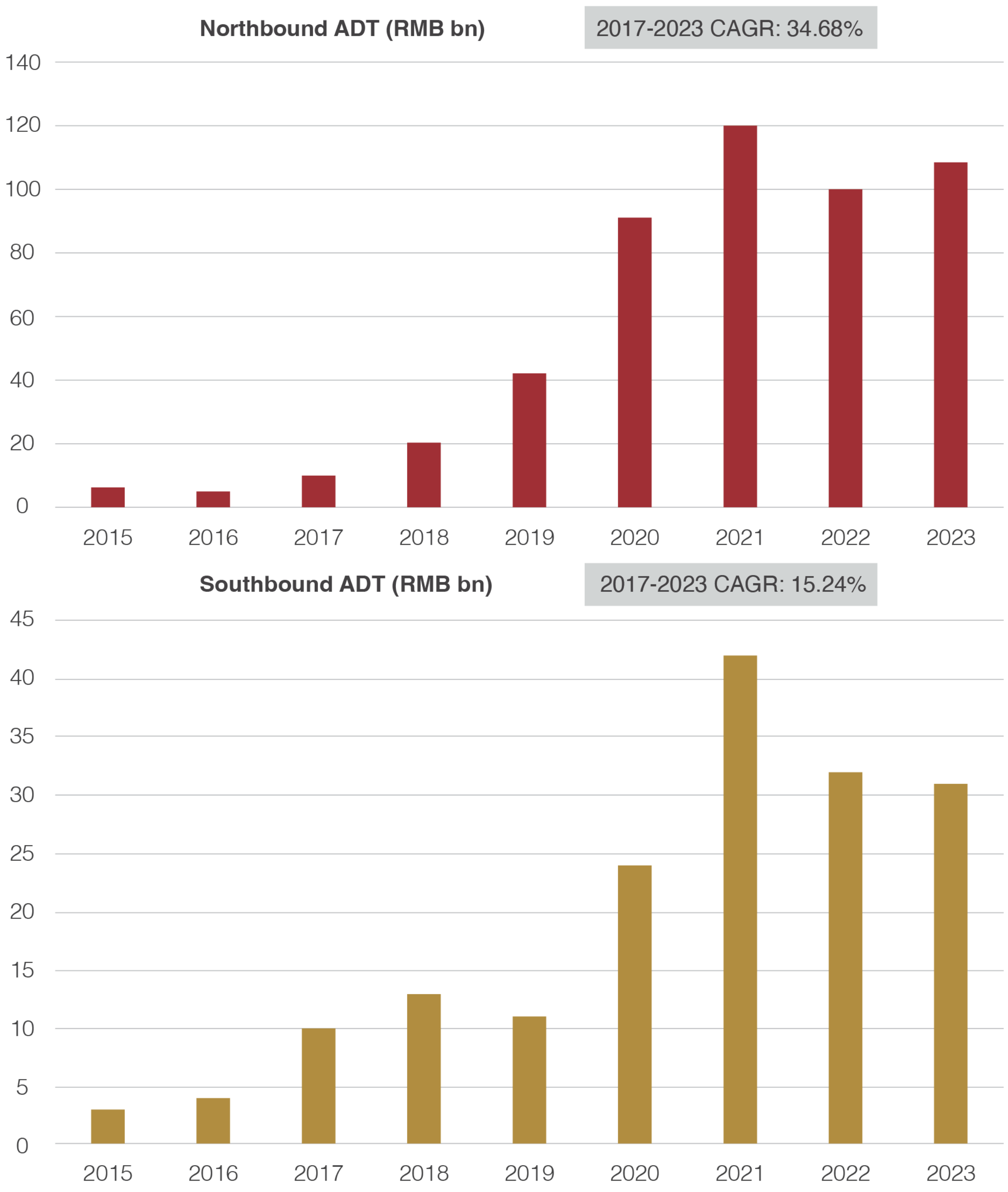
Stock Connect

Stock Connect is widely acknowledged as a practical initiative facilitating cross-boundary investment and trading opportunities. Market participants have emphasised that Stock Connect has solidified Hong Kong's position as the preferred venue for accessing Chinese stocks.

Continued enhancements over the years have contributed to its success. The average daily trading (ADT) value on the Northbound and Southbound channels of Stock Connect has seen impressive growth. Between 2017 and 2023, Northbound trading surged with a compound annual growth rate (CAGR) of 34.68%, while Southbound trading with a 15.24% CAGR.[79] As of 2023, the ADT was RMB 108 billion for Northbound and HKD 31 billion for Southbound trading (Figure 5).[80] Furthermore, the Connect Scheme, especially the Southbound trading channel, has positively contributed to the development of Hong Kong's stock market, with the percentage of Southbound ADT of the Hong Kong market in 2023 being over 14.8%.[81]

79 HKEX (January 2024), *Market Statistics 2023*, https://www.hkex.com.hk/-/media/HKEX-Market/Market-Data/Statistics/Consolidated-Reports/Annual-Market-Statistics/FY_2023-Annual-Market-Stat_Eng.pdf
80 HKEX (January 2024), *Market Statistics 2023*, https://www.hkex.com.hk/-/media/HKEX-Market/Market-Data/Statistics/Consolidated-Reports/Annual-Market-Statistics/FY_2023-Annual-Market-Stat_Eng.pdf
81 HKEX (March 2024), *2023 Annual Report*, https://www.hkexgroup.com/-/media/HKEX-Group-Site/ssd/Investor-Relations/Regulatory-Reports/documents/2024/240318ar_c.pdf

Figure 5. Average daily trading value on Stock Connect Northbound and Southbound



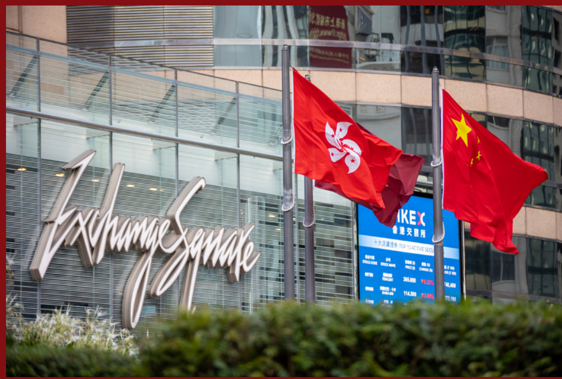
Source: HKEX

Challenges and limitations

Stock Connect is highly regarded as one of the most successful mutual market access schemes between Mainland China and Hong Kong throughout all discussions between the FSDC and industry practitioners. Market participants highly commend the scheme for its achievements. Strategies such as broadening the product scope and further enhancing infrastructure – like extending the HKD-RMB dual counter to the Southbound channel – are vital to maintaining its success.

HKD-RMB Dual Counter Model

In June 2023, HKEX introduced the HKD-RMB Dual Counter Model and Dual Counter Market Making Programme to the secondary market, enabling trading and settlement of securities from a single issuer in both HKD and RMB. The strategic move aims to enhance liquidity for dual counter securities and minimise price discrepancies between the two counters, further solidifying Hong Kong's position as the leading offshore RMB hub. The Hong Kong Government and relevant stakeholders are actively considering the benefits of the potential inclusion of the RMB dual counters under the Southbound Stock Connect, facilitating the trading of Hong Kong stocks in RMB.



Market participants have shared that although dual counter arrangements may not be highly appealing at the current stage, they are considered favourable and essential for the long-term prosperity of Hong Kong's capital market. However, they recognise that implementing such arrangements poses specific challenges, particularly around adapting trading mechanisms and systems for HKEX's counterparts in Mainland China.[82] For instance, a stock traded through Shenzhen-Hong Kong Stock Connect and Shanghai-Hong Kong Stock Connect involving two currencies, RMB and HKD, would require two distinct stock codes in each Stock Connect channel. This would require the development of more sophisticated trading mechanisms capable of managing equities with multiple stock codes. Despite these challenges, the industry anticipates a surge in applications for these schemes, reflecting a positive outlook for the financial integration between Hong Kong and Mainland China.

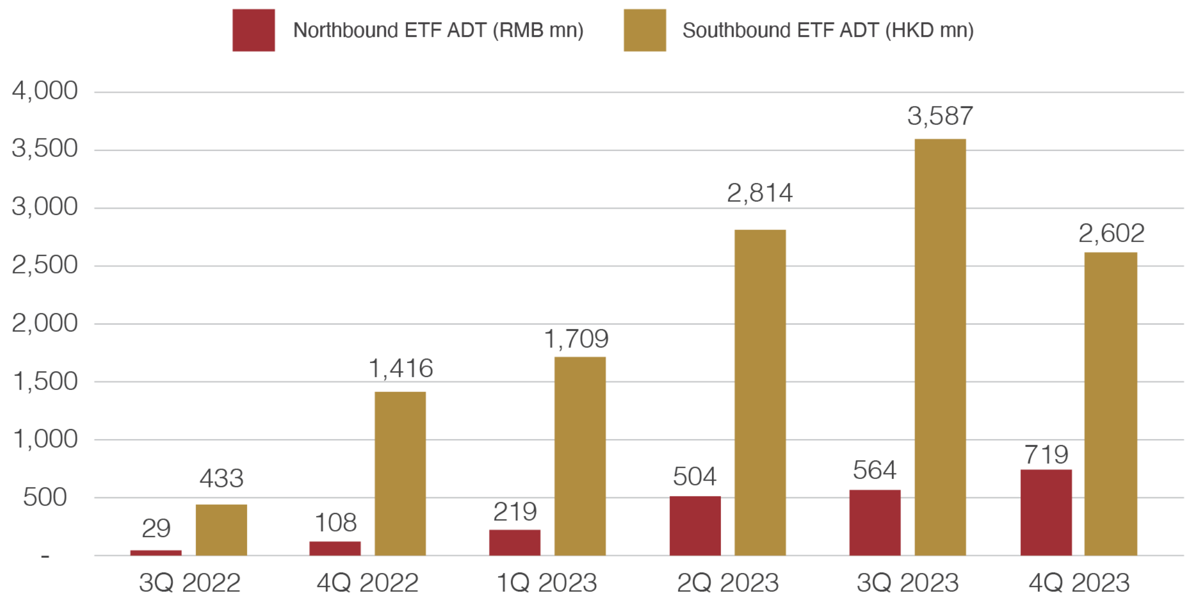
ETF Connect

In July 2022, Stock Connect expanded its scope to include eligible ETFs. This expansion serves as a tool for issuers to broaden their funding channels. ETF investors can explore new markets without the burden of stock selection, this mitigates the risk exposure to a single stock. They can benefit from a diversified portfolio across diverse industry segments. This expansion could potentially attract more investors to Hong Kong and Mainland markets.

The introduction of ETFs into Stock Connect has proven to be a valued advancement, stimulating trading activities in both directions. Since the inclusion of ETFs into Connect schemes in July 2022, a steady growth in the turnover of ETFs has been observed. The Northbound ADT escalated from RMB 29 million in 3Q 2022 to RMB 719 million by 4Q 2023.[83] Similarly, the Southbound turnover increased from HKD 433 million to HKD 2,602 million within the same period (Figure 6).[84] The remarkable growth trajectory reflects investors' interest and confidence in utilising ETFs through Stock Connect. As the investor base expands, asset managers may consider introducing more ETFs with distinct investment mandates in domestic Chinese and Hong Kong markets.

82 According to insights provided by the Working Group.
83 HKEX (February 2024), *HKEX Investor Presentation*, https://www.hkexgroup.com/-/media/HKEX-Group-Site/Ir/IR-Pack/202402_HKEX-IR-Pack_vFF.pdf
84 HKEX (February 2024), *HKEX Investor Presentation*, https://www.hkexgroup.com/-/media/HKEX-Group-Site/Ir/IR-Pack/202402_HKEX-IR-Pack_vFF.pdf

Figure 6. ADT value of ETFs in Northbound and Southbound trading under Stock Connect



Source: HKEX

Challenges and limitations

Despite the promising potential of ETF Connect, the stringent requirements and other restrictions imposed on ETF Connect hinder its expansion and possibility. Currently, the scheme has limited ETFs for Southbound trading, primarily due to strict admission criteria.[85]

The eligibility of ETFs is determined based on factors such as underlying asset class, fund size, turnover, and index tracking. Mainland ETFs must have an average daily fund size of over RMB 1.5 billion (USD 223 million) over the previous six months to be eligible; on a reciprocal basis, qualified Hong Kong ETFs require an average of HKD 1.7 billion (USD 217 million).[86] Noting the differences in the size of markets, as of January 2024, there were 151 ETFs listed on the HKEX, with only eight included in the Southbound leg of ETF Connect; on the other hand, from 899 ETFs listed on the Shenzhen and Shanghai stock exchanges, 141 ETFs are included in the Northbound ETF Connect.[87]

Despite ETF Connect's nascent stage of development, market participants have recognised its strong potential. This is evidenced by the substantial representation of included ETFs in the local market's average daily turnover. As of January 2024, these ETFs account for approximately 96% and 38% of the ADT in the Southbound and Northbound directions, respectively.[88]

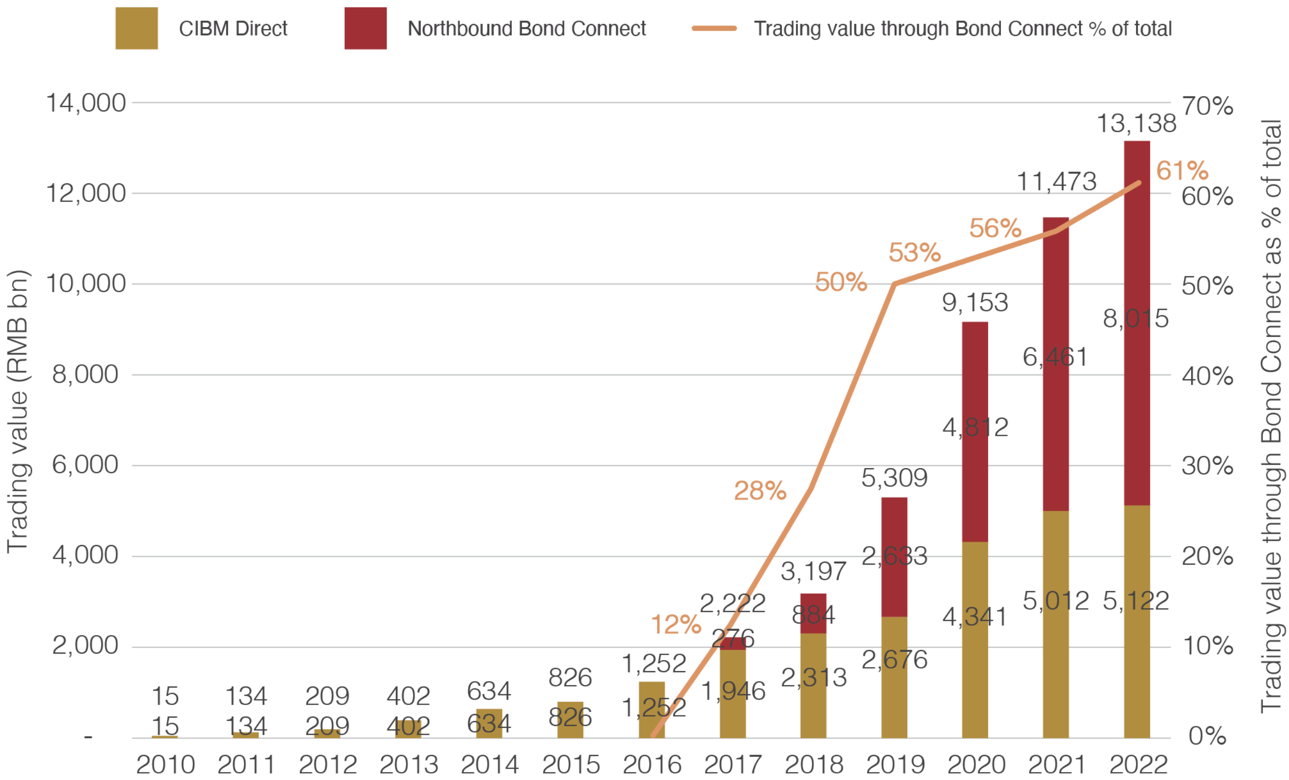
85 Hong Kong Institute of Certified Public Accountants (October 2022), *What are the opportunities and limitations of ETF Connect?* https://aplus.hkicpa.org.hk/second-opinions-30/
86 Dezan Shira & Associates (June 2022), *What Can the Newly Approved ETF Connect Between Mainland China and Hong Kong Bring to Foreign Investors?* https://www.China-briefing.com/news/what-can-the-newly-approved-etf-connect-between-Mainland-China-and-hong-kong-bring-to-foreign-investors/
87 HKEX (February 2024), *HKEX Investor Presentation*, https://www.hkexgroup.com/-/media/HKEX-Group-Site/Ir/IR-Pack/202402_HKEX-IR-Pack_vFF.pdf
88 HKEX (February 2024), *HKEX Investor Presentation*, https://www.hkexgroup.com/-/media/HKEX-Group-Site/Ir/IR-Pack/202402_HKEX-IR-Pack_vFF.pdf

Bond Connect

The bond market of Mainland China is the second largest in the world, with a total size of USD 21.3 trillion, surpassed only by the US market, which reached USD 53.57 trillion as of 2Q 2023.[89]

While the market is primarily driven by domestic investors, the Bond Connect is one of three avenues for foreign investors to access the Mainland's onshore bond market; the other two avenues are the Qualified Foreign Investor (QFI) scheme and the China Interbank Bond Market (CIBM) direct scheme. Since launching the Northbound Bond Connect in 2017, it has rapidly grown into the preferred route among others, accounting for 61% of the trading value of overseas investors in CIBM cash bonds in 2022 (Figure 7).[90]

Figure 7. Trading value of overseas investors in CIBM cash bonds through CIBM Direct and Bond Connect (2010 – 2022)



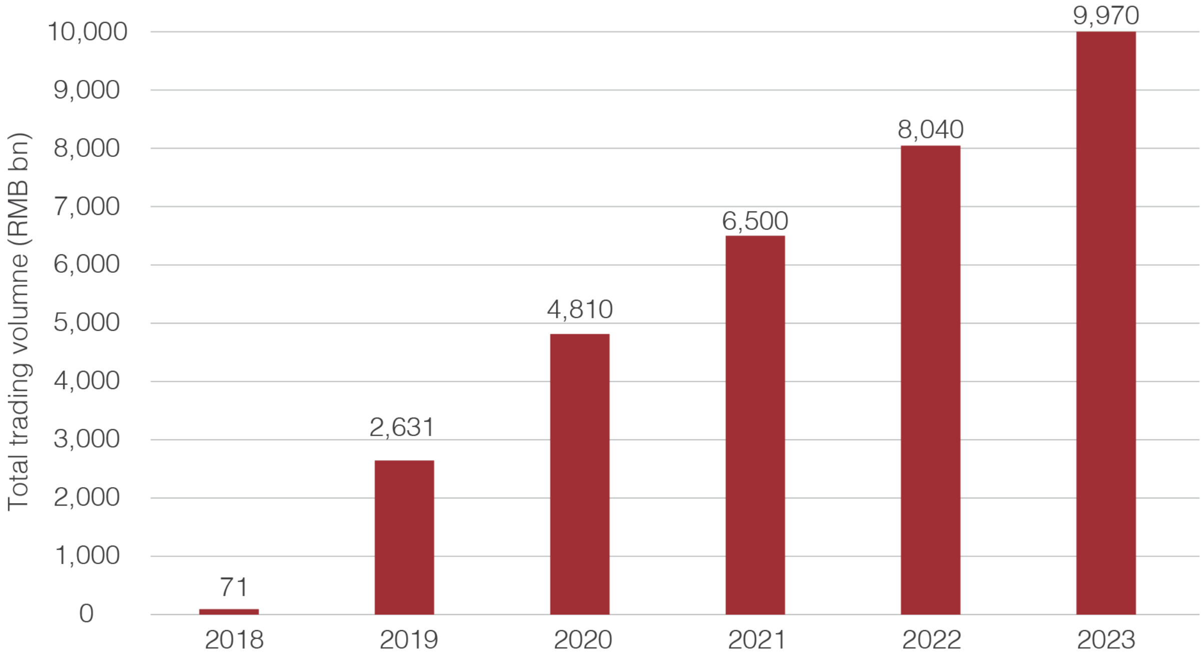
Source: CFETS, BCCL, HKEX

This success is primarily due to its unique features that streamline trading, settlement, and bond holding for both Mainland and international investors. It effectively links the financial infrastructure institutions of Mainland China and Hong Kong, allowing investors to maintain their standard trading practices while enjoying efficient access to both bond markets.[91]

89 *BIS: Debt Securities statistics*, https://data.bis.org/topics/DSS/tables-and-dashboards/BIS,SEC_C1,1.0?time_period=2023-Q2 (accessed on 11 November 2023)
90 HKEX (June 2023), *Swap Connect – A Convenient Access Channel to Mainland China's Derivatives Market for Onshore Bond Investment*, https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2023/CCEO_SwapConnect_202306_e.pdf
91 Finance 40 Forum (July 2017), *債券通中的金融制度創新*, http://www.cf40.com/news_detail/7607.html

Market participants have observed that, similar to the Stock Connect scheme, the Northbound component of Bond Connect has solidified Hong Kong's position as the preferred gateway to China's bond market. In 2023, yearly trading volume of Northbound Bond Connect increased 24% to RMB 9.97 trillion (Figure 8).[92]

Figure 8. Trading activities of Northbound Bond Connect



Source: Bond Connect Company

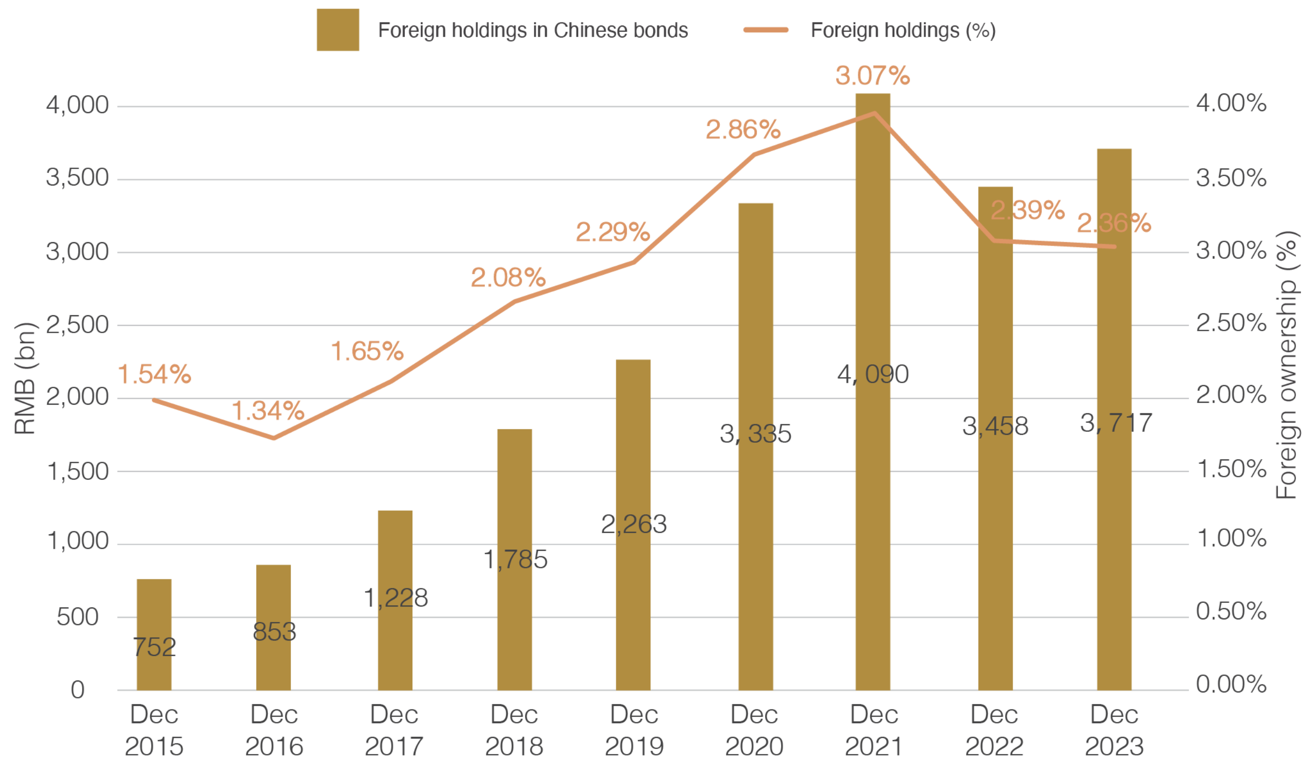
Foreign holdings in China's onshore market grow steadily

According to a study conducted by the Bank of China, Mainland China's bond market, although it is already the second-largest globally, lags behind in development and maturity compared to its well-established counterparts in Europe and the US.[93] The study highlights several areas where the market is not fully developed, including processes surrounding debt issuance, trading structure, and debt default mechanisms. Additionally, the bond credit rating system within Mainland China is still evolving, and there is a recognition that agent banks can further develop their expertise in servicing offshore investors. That said, the introduction of Bond Connect has established a competitive mechanism for cross-boundary bond investment and spurred reforms in Mainland China's bond market. Bond Connect enables RMB bonds to access major markets worldwide, promotes interconnectivity between global bond markets, and enhances the RMB's investment and reserve functions.

Six months after the launch of Bond Connect in Dec 2017, foreign institutions held RMB 1.22 trillion in bonds, accounting for only 1.65% of the total.[94] As of December 2023, the amount and proportion of foreign bond holdings in China's onshore bond market totalled RMB 3.172 trillion, roughly 2.36% of the total market (Figure 9).[95]

92 China Bond Connect (January 2024), *Bond Connect Flash Report - December 2023,* https://www.chinabondconnect.com/en/Resource/Flash-Report/Bond-Connect-Flash-Report---December-2023.html
93 BOC (July 2020), *"Bond Connect" lifts RMB internationalisation to a higher level*, https://www.bochk.com/dam/investment/bocecon/SY2020020(en).pdf
94 The People's Bank of China, *Statistics and Analysis Department,* http://www.pbc.gov.cn/diaochatongjisi/116219/116319/4780803/4780808/index.html (accessed on 7 March 2024)
95 The People's Bank of China, *Statistics and Analysis Department,* http://www.pbc.gov.cn/diaochatongjisi/116219/116319/4780803/4780808/index.html (accessed on 7 March 2024)

Figure 9. Foreign holdings in China's onshore bond market (2015 – 2023)



Source: PBOC

Several enhancements have been introduced over the years to bolster the utility and effectiveness of Bond Connect. These improvements range from tax-related measures to expanding trading platforms and reducing platform usage fees. Notably, implementing Delivery Versus Payment (DvP) settlement has increased settlement efficiency and lowered the associated risks.[96] An online allocation function was established to facilitate block trades, allowing investors to allocate transactions to multiple individual accounts before submitting orders. This function has significantly streamlined the trading process for investors.[97] In September 2023, the HKMA added nine financial institutions as market makers for Southbound trading under Bond Connect, which brings the total number of designated market makers from 13 to 22,[98] further enhancing liquidity for Southbound investors.

Challenges and limitations

Bond Connect has been in operation for six years, and with the collaborative efforts of public sector stakeholders, industry practitioners, and investors, the scheme has been functioning effectively. However, there remain areas for improvement to unlock its full potential.

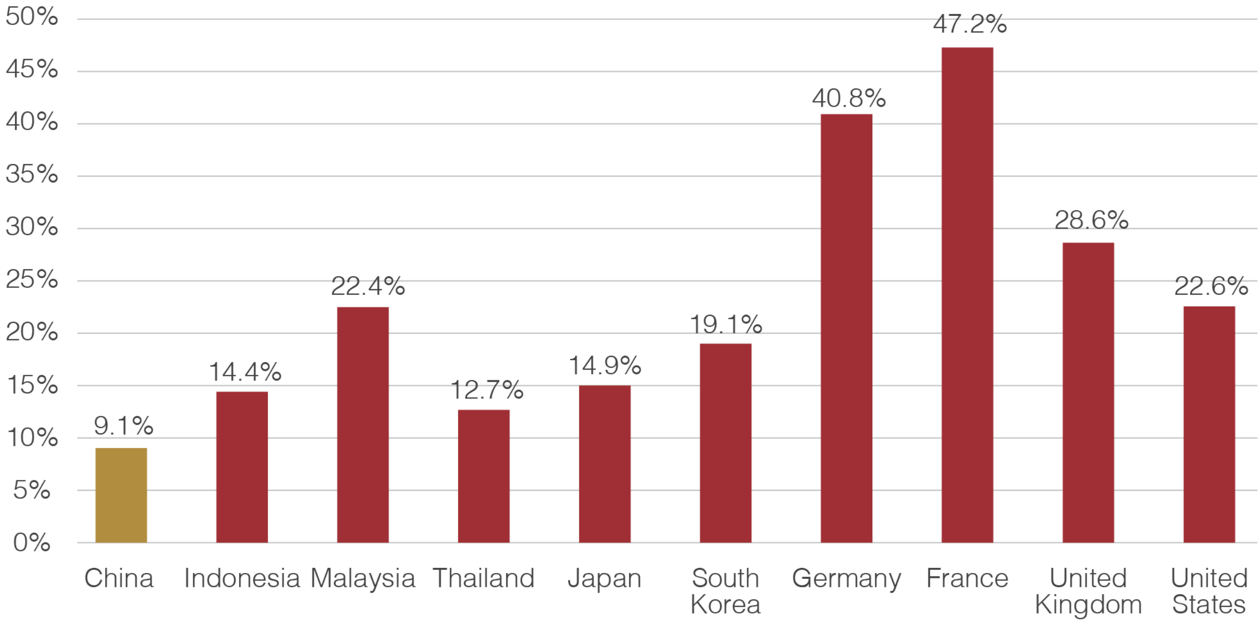
Market participants have emphasised the importance of streamlining the application process for Bond Connect and simplifying cross-boundary fund management of Southbound flows. Currently, quota mechanisms are implemented for Southbound flows to prevent excessive cross-boundary fund outflows, with a daily investment quota set at RMB 20 billion and an annual limit of RMB 500 billion.[99]

However, as interest in Bond Connect continues to rise, there may be a growing demand from investors to expand Southbound flows. Therefore, conducting regular reviews and assessments of these quotas would be beneficial to ensure they align with the evolving market dynamics.[100]

96 DVP is a settlement method that ensures that the transfer of securities occurs only after payment has been successfully completed.
97 BOC (July 2020), *"Bond Connect" lifts RMB internationalisation to a higher level*, https://www.bochk.com/dam/investment/bocecon/SY2020020(en).pdf
98 HKMA (September 2023), *HKMA Designates Market Makers for Southbound Trading under Bond Connect*, https://www.hkma.gov.hk/eng/news-and-media/press-releases/2023/09/20230922-3/
99 HKMA, *Southbound Bond Connect*, https://www.cmu.org.hk/en/bond-connect-southbound (accessed on 11 November 2023)
100 Securities Times (July 2023), *債券通"北向通"六周年：走過外資湧入期，機制仍有優化空間*, https://www.stcn.com/article/detail/909049.html

Foreign institutions currently hold roughly 2.36% of the total share of the domestic bond market (Figure 9). Several interviewed sources have pointed out that this figure is still comparatively low, suggesting significant potential for future expansion. When it comes to foreign investment in domestic bonds, there is a preference for government bonds, which are perceived to be more secure than corporate bonds. That said, despite this preference, foreign investment in Chinese government bonds is still low compared to government bond holdings in other markets. For illustration, while foreign ownership in government bonds stood at 9.1% for China as of 4Q 2022, such a percentage of other governments were higher; in the case of Japan and the US, these figures were 14.9% as of 4Q 2022 and 22.6% as of 4Q 2022, respectively.[101]

Figure 10. Share of foreign ownership in government bonds of selected markets in 4Q 2022



Source: Asian Development Bank, International Monetary Fund

One way to encourage further international holdings of domestic bonds in China is to further advance the transparency of the credit rating system. Market participants have called for improvements in such an area within Mainland China to facilitate the robust development of the Northbound flow within Bond Connect. With credit and fixed income investors looking for insights into firms' and the government's ability to repay debt, greater transparency would encourage international investors to tap into the Chinese bond market and foster growth in Bond Connect.[102]

International investors are also seeking additional risk management tools to facilitate their investment activities in the bond market. The introduction of Swap Connect represents a significant milestone in addressing this need. Swap Connect offers a platform for investors to engage in derivatives trading, enabling them to hedge risks effectively while participating in Mainland China's bond market. HKEX has already expressed its intention to provide further risk management tools for Northbound investors,[103] which will support Hong Kong's role as a risk management centre and cater to the requirements of investors seeking enhanced risk mitigation capabilities.

Swap Connect

Introduced in May 2023, Swap Connect is a market access agreement between Hong Kong and Mainland China's interbank interest rate swap markets. In its initial phase, Swap Connect focuses on establishing the Northbound connection. This connection will bridge Hong Kong and international investors with Mainland China's interbank interest rate swap market. With the continued opening of Mainland China's bond market to international investors, facilitated by initiatives like CIBM Direct and Bond Connect, there has been a notable increase in global capital inflows, mainly through Bond Connect. Consequently, a demand for risk management tools has emerged as international investors' exposure to Mainland China's onshore market expands.

101 Asian Development Bank, https://asianbondsonline.adb.org/data-portal/ (accessed on 1 December 2023)
International Monetary Fund, https://www.imf.org/-/media/Websites/IMF/imported-datasets/external/pubs/ft/wp/2012/Data/_wp12284.ashx (accessed on 1 December 2023)
102 Finet (July 2021), *摩通朱海斌: 改善債券通三大建議*, https://www.finet.hk/newscentre/print_content/60de9c3bbde0b3600d14a155
103 HKEX (March 2023), *Annual Report*, https://www1.hkexnews.hk/listedco/listconews/sehk/2023/0313/2023031300159.pdf

While international investors can access offshore interest rate swaps (IRS), Swap Connect allows them to access the onshore IRS market. According to the HKEX, onshore IRS could be more effective and cost-efficient for risk management tools than offshore IRS.[104] This claim is supported by closer correlations of onshore IRS products with crucial benchmarks in the onshore fixed-income market, lower volatility, and the notably tighter bid-ask spreads they feature.[105]

By providing access to the onshore RMB interest swap market, Swap Connect empowers international investors to manage RMB interest rate risks effectively. This, in turn, bolsters the attractiveness of onshore RMB bonds as a viable investment option.

Swap Connect's role goes beyond providing access to China's interbank interest rate swap markets – it is instrumental in supporting the broader internationalisation of the RMB. By facilitating international access to onshore financial instruments, Swap Connect contributes to the growing acceptance of the RMB as a global currency for trade settlement, cross-boundary investment, and national reserves. Swap Connect enriches the RMB ecosystem by offering a diverse range of RMB assets to international investors in Hong Kong, including Mainland stocks and debt securities available through Connect schemes. Consequently, Swap Connect strengthens the framework for offshore RMB investments and facilitates using offshore RMB to access and invest in the onshore interest rate swap market.

Challenges and limitations

Swap Connect is a valuable mechanism for hedging investments in CIBM bonds. However, the current restriction of using it solely as a hedging tool for CIBM bond-related risks may hinder the full potential of Swap Connect. To maximise the benefits of Swap Connect, it is worth considering the expansion of its applications to hedge against other risks. Additionally, although the initial underlying product in Swap Connect is an interest rate swap, with a view to enhancing its effectiveness, it is crucial to explore the inclusion of other products into the scheme. Moreover, considering an expansion into the Southbound channel could further broaden the reach and impact of Swap Connect, ensuring a more comprehensive solution for both domestic and international investors.

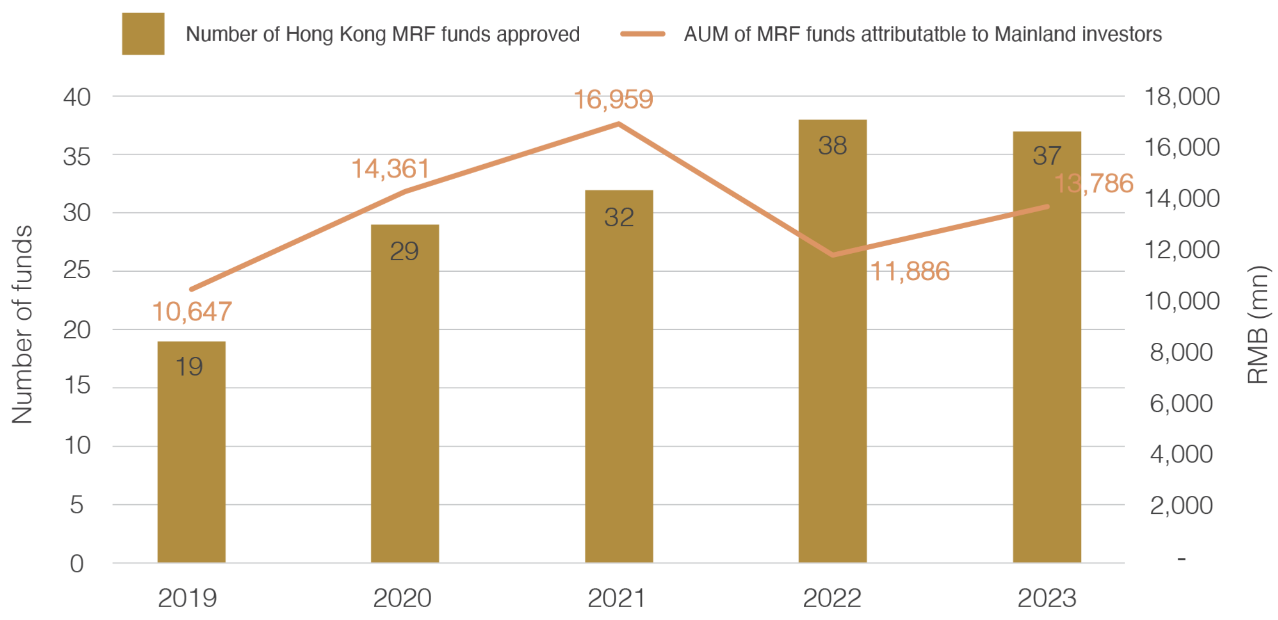
Mutual Recognition of Funds (MRF)

Introduced in July 2015, the Mutual Recognition of Funds (MRF) arrangement was a groundbreaking initiative by Mainland China that allows the distribution of foreign retail funds within its domestic market and the sale of domestic retail funds outside of Mainland China. This arrangement not only creates new avenues for development in both Mainland and Hong Kong fund markets, but also provides investors on both sides with a broader range of fund products and promotes greater diversification in investment opportunities. The MRF scheme covers general equity, balanced, bond, and index funds.

As of March 2023, 47 Mainland MRF funds have been authorised by the Securities and Futures Commission (SFC), while the China Securities Regulatory Commission (CSRC) has approved 37 under the MRF. Despite fluctuations, MRF funds' assets under management (AUM), attributable to the counterpart market, showed overall growth between 2019 and 2023. Specifically, the AUM of Hong Kong MRF funds, attributable to Mainland investors, has experienced a notable increase of 16%, reaching RMB 13,786 million (Figure 11).[106] In contrast, the AUM of Mainland MRF funds, attributable to Hong Kong investors, has declined by 9% to RMB 1,130 million (Figure 12).[107]

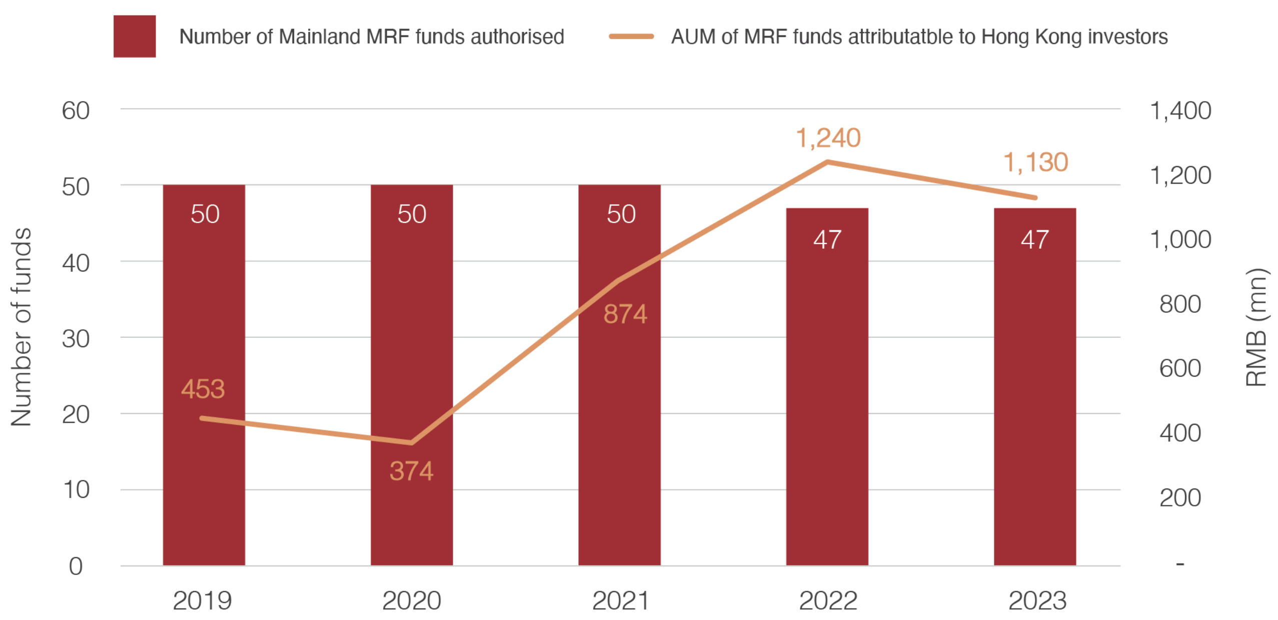
104 HKEX (October 2022), *Swap Connect: a new channel, a new chapter*, https://www.hkexgroup.com/media-centre/insight/insight/2022/hkex/swap-connect-a-new-channel-a-new-chapter?sc_lang=en
105 HKEX (October 2022), *Swap Connect: a new channel, a new chapter*, https://www.hkexgroup.com/media-centre/insight/insight/2022/hkex/swap-connect-a-new-channel-a-new-chapter?sc_lang=en
106 SFC (August 2023), *Asset and Wealth Management Activities Survey 2022*, https://www.sfc.hk/-/media/EN/files/COM/Reports-and-surveys/AWMAS-2022_E.pdf?rev=3b6a43ac11404a2cacf7123c2f5c949e&hash=C33D88F5AAEAC176BC072AE9326091CC
107 SFC (August 2023), *Asset and Wealth Management Activities Survey 2022*, https://www.sfc.hk/-/media/EN/files/COM/Reports-and-surveys/AWMAS-2022_E.pdf?rev=3b6a43ac11404a2cacf7123c2f5c949e&hash=C33D88F5AAEAC176BC072AE9326091CC

Figure 11. Hong Kong MRF Funds



Source: SFC

Figure 12. Mainland MRF Funds



Source: SFC

Challenges and limitations

Since its inception, the MRF scheme has been a significant step towards market integration between Hong Kong and Mainland China. However, specific challenges and limitations have hindered it from reaching its full potential.

Publicly offered funds domiciled in the home jurisdiction: One of the critical challenges is the geographical restriction on fund managers. Under the current arrangement,[108] fund managers must be based in Hong Kong, and the appointment of non-Hong Kong-based fund managers for investments in European and US markets is prohibited. This policy is not in-line with global industry practices, where fund managers often delegate portfolio management to specialised managers based in the invested markets. This restriction has, directly or indirectly, led to a limited product scope under the MRF scheme, primarily favouring the Asian market and resulting in an underrepresentation of global or European and American asset allocations, thereby reducing the available choices for investors.[109]

50/50 value of sales requirement: This rule mandates that a fund sold on the Mainland must have balanced interest in terms of raised capital on the Mainland and Hong Kong. For instance, if a fund raises HKD 10 million in Hong Kong, it can only raise a maximum of HKD 10 million in Mainland China.

This requirement presents considerable limitations due to the significant disparity in market sizes between Hong Kong and Mainland China, noting that the Mainland market is substantially larger and theoretically could present further opportunities to domestic investors for asset diversification. However, the 50/50 rule effectively caps a fund's potential by tying its sales in Mainland China to its sales in the smaller Hong Kong market.

This has led to suggestions to revisit the 50/50 value of sales requirement. By allowing asset managers to raise capital more flexibly according to market potential and investor demand in each region, the MRF scheme could tap into its full potential, thus benefiting fund managers and investors alike.[110]

Approval process: Under the Mutual Recognition of Funds regime, after securing approval from the SFC, Hong Kong originated products must go through an additional approval process with Mainland China's regulatory authorities. This layered approval process adds complexity and considerable uncertainty to the product launch timeline.[111] According to a Hong Kong Investment Funds Association study, the approval process can take approximately eight to nine months, sometimes even longer. This lengthy approval timeline can significantly deter fund managers from considering the MRF scheme, as it impacts their strategic planning and market entry timing.[112]

Wealth Management Connect

Introduced in 2021, Wealth Management Connect (WMC) represents the inaugural mutual market access programme designed specifically for individual investors in the GBA. This scheme offers a range of low-to-medium-high risk and non-complex wealth management products.[113] Its primary objective is to cater to the evolving investment requirements of individuals as the accumulated wealth within the GBA continues to expand.

Cross-boundary remittance under the WMC programme is conducted in RMB, and currency conversion is performed in offshore markets. Residents of Mainland GBA cities can directly use RMB to invest in eligible products offered by banks or securities firms in Hong Kong and Macao. Likewise, Hong Kong and Macao residents can use offshore RMB to invest in qualified RMB-denominated assets distributed by Mainland Chinese banks or securities firms in the GBA. These developments can accelerate RMB internationalisation and strengthen Hong Kong's global offshore RMB hub position.[114]

As of December 2023, the WMC programme had attracted 69,200 individual investors, with 45,400 from Hong Kong and Macao and 23,800 from Mainland China.[115] These investors conducted 43,300 cross-boundary transfers of related funds, which amounted to RMB 12.81 billion.[116] However, a substantial portion of the quota remains unused.[117]

108 SFC (May 2015), *Circular on Mutual Recognition of Funds (MRF) between the Mainland and Hong Kong*, https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=15EC29
109 Ta Kung Wen Wei (May 2022), *發展建議/優化基金互認 公會倡三項改革*, https://epaper.tkww.hk/a/202205/18/AP62840e25e4b0a4690265f7ab.html
110 Caijing (October 2021), *跨境理财通首批产品即将上架 粤港两地公募、银行积极布局*, https://m.caijing.com.cn/api/show?contentid=4806691
111 Caijing (October 2021), *跨境理财通首批产品即将上架 粤港两地公募、银行积极布局*, https://m.caijing.com.cn/api/show?contentid=4806691
112 Ta Kung Wen Wei (May 2022), *發展建議/優化基金互認 公會倡三項改革*, https://epaper.tkww.hk/a/202205/18/AP62840e25e4b0a4690265f7ab.html
113 SFC-authorised tokenised products are assessed as "low" risk to "medium-high" risk and "non-complex" are also eligible products under the WMC.
114 KPMG (July 2020), *Launch of the Cross-boundary Wealth Management Connect Scheme in the Greater Bay Area*, https://assets.kpmg.com/content/dam/kpmg/cn/pdf/en/2020/07/cross-boundary-wealth-management-connect-scheme.pdf
115 Guangdong Provincial Branch of PBOC (January 2024), *2023年12月跨境理財通業務情況通報*, http://guangzhou.pbc.gov.cn/guangzhou/129196/4332364/4332376/5211537/index.html
116 Guangdong Provincial Branch of PBOC (January 2024), *2023年12月跨境理財通業務情況通報*, http://guangzhou.pbc.gov.cn/guangzhou/129196/4332364/4332376/5211537/index.html
117 Guangdong Provincial Branch of PBOC (January 2024), *跨境理财通额度使用情况(截至2024年1月31日24时)*, http://guangzhou.pbc.gov.cn/guangzhou/129196/4332364/4332372/4332394/4363171/index.html

Challenges and limitations

In response, in January 2024, Mainland and Hong Kong regulators introduced five enhancements to further strengthen the WMC.[118] These enhancements include refining the eligibility criteria for investors to allow more residents from the GBA to participate in the WMC, expanding the scope of participating institutions to include securities firms, increasing the range of eligible products for both Southbound and Northbound flows, increasing individual investor quotas, and enhancing promotion and sales arrangements. The FSDC welcomes the introduction of enhancements to the schemes, and the market would widely embrace the inclusion of more diversified financial products.

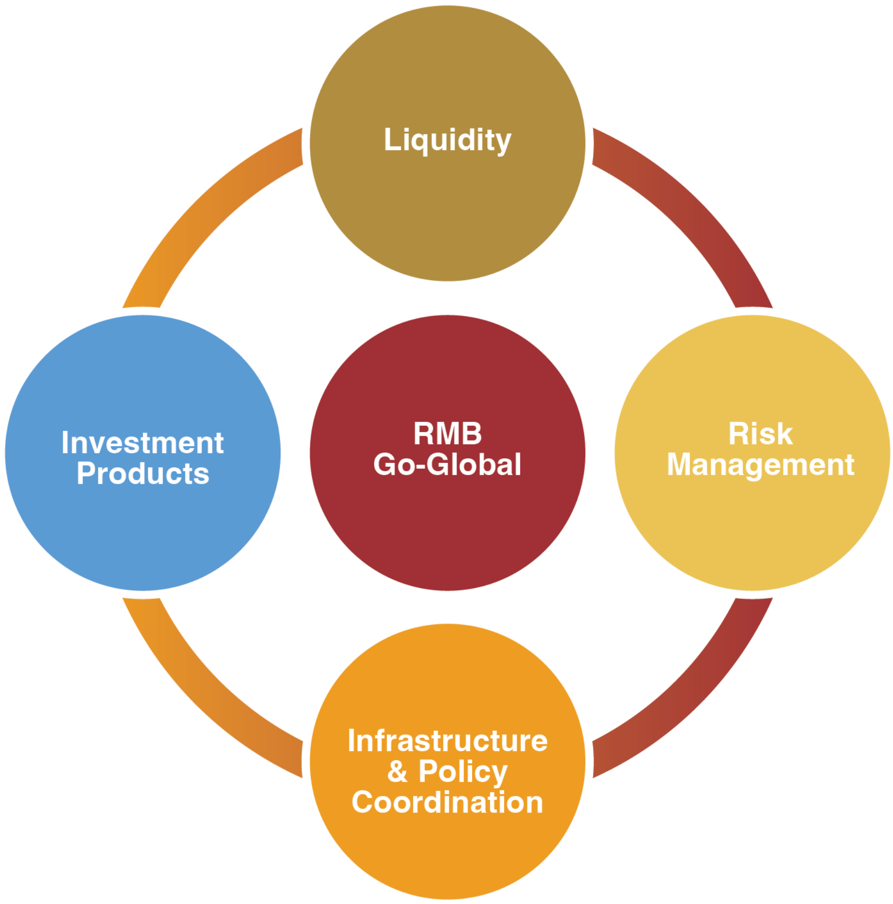
Another enhancement the market would like to see is a more streamlined sales process. Related to the setup of the WMC, cross-boundary data connectivity is considered a determining factor. Under the remit of such Connect Schemes, the sharing of personal data of customers, with their consent, between Hong Kong and Mainland China is essential. It is therefore essential for non-local organisations, including Hong Kong participating banks, that handle the personal information of Mainland individuals within the scope of the WMC to be subject to rigorous data regulations. These regulations govern the processing of personal data to provide services and products to Mainland customers under the WMC. Banks operating within the WMC scheme have strict data protection obligations, including obtaining customers' consent and conducting security assessments before cross-boundary data transfer activities. In 2022, the FSDC published a research paper indicating this challenge's recognition, proposing various recommendations to enhance data connectivity with the GBA.[119]

118 *《粤港澳大湾区"跨境理财通"业务试点实施细则》 修订并发布* (January 2024), https://www.cbirc.gov.cn/branch/shenzhen/view/pages/common/ItemDetail.html?docId=1149287&itemId=1038
119 FSDC (December 2022), *Connecting Data: Establishing Hong Kong as a Cross-Boundary Financial Data Hub*, https://www.fsdc.org.hk/media/rbjle0yr/20221209-datahub-report-final-en.pdf

Common challenges/ gaps in driving forward Hong Kong's agenda as the global offshore RMB business centre

The internationalisation of the RMB, fuelled by collective efforts, has achieved remarkable results. However, Hong Kong, as a leading offshore RMB business centre, has the potential to contribute more significantly to this process. Sound infrastructure and policy coordination are crucial for solidifying Hong Kong's position as a leading hub for RMB-related activities. A review of various literature, such as op-eds and research reports, coupled with insightful dialogues with industry practitioners, revealed a consensus on the further opportunities associated with the challenges of RMB internationalisation. These opportunities, which manifest as areas for enhancement include **broadening liquidity, expanding product offerings, and fortifying risk management tools,** which are intricately linked to and pave the way for progress.

Figure 13. Success factors for RMB internationalisation



Liquidity Needs

Overseas investors are steadily diversifying their RMB asset allocation to manage portfolio risk. Despite the interest, they encounter various challenges in expanding their investments in RMB assets, which include stringent access requirements to Mainland China's market for foreign investors, as well as a limited scale and market depth of offshore RMB assets. Market participants have highlighted the insufficient investment channels and scarcity of RMB products and services for investors, especially those holding RMB overseas, resulting in liquidity challenges.

Furthermore, market participants have indicated that while their clients have a positive sentiment towards the RMB as a settlement currency, its practical application in trade settlement is impeded by a limited fund pool and modest trading volumes in offshore RMB-denominated assets. For instance, the tendency to retain bonds until maturity instead of actively trading them is a common practice that limits market liquidity.

Investment Product Needs

Despite Hong Kong's status as a prominent RMB offshore centre, its spectrum of RMB product offering can be further expanded, primarily focusing on investment options. To satisfy investor appetite, Hong Kong must broaden its product suite to include a broader range of hedging tools.

Banking representatives have noted that key factors that investors consider include the variety of options available, and their associated risk, returns, and liquidity. However, most investors have expressed limited appealing investment opportunities in the offshore RMB market.

From the issuer's perspective, taking bonds as an example, there are hurdles in issuing RMB-denominated bonds for substantial amounts with maturities exceeding two years. These challenges are primarily due to the limited RMB reserves in Hong Kong, which restricts the capacity for such issuances.

Risk Management Needs

According to market participants, one notable obstacle for overseas investors looking to increase their allocation to China bonds is the yield differentials between the RMB and other currencies, which sometimes could make RMB bonds less appealing. This challenge could be partially addressed by improving the availability of risk management products. By providing a broader range of hedging tools and strategies, investors would have more options to manage these risks and potentially improve their returns.

Another deterrent for investors considering RMB-denominated assets is the volatility of exchange rates, and having more hedging tools specifically designed to mitigate exchange rate risk is crucial to address this concern.

Furthermore, the default of onshore debt by Chinese companies and insufficient effective risk mitigation measures have made many overseas investors cautious about investing in Mainland China through Hong Kong. Enhancing risk management practices and establishing effective risk mitigation measures are essential to improve investor confidence. Such measures might include greater company financial transparency, improved credit rating systems, and stronger regulatory oversight.

Figure 14. Case study from the banking sector

Regional perspectives on RMB

Perceptions and priorities regarding using the RMB as a settlement currency or investment asset can vary among clients based on their specific circumstances and geographical locations. In the banking sector, clients utilising the RMB as an investment asset often face challenges related to RMB convertibility, liquidity, evolving regulatory environments, and risk management associated with currency fluctuations.

Different regional players have demonstrated various patterns and preferences. For instance, clients in the ASEAN region tend to prioritise RMB settlement to enhance their payment processes, aiming for efficiency and convenience in cross-boundary transactions. On the other hand, clients in the Middle East often focus on investment diversification and participation in initiatives such as the BRI. They seek to leverage the potential benefits of the RMB in expanding their investment portfolios. European clients actively seek RMB investment opportunities, yet they place a substantial emphasis on adhering to regulatory standards and managing risks effectively, given their extensive engagement with the global financial markets.

Notably, each region has unique requirements and priorities that shape their perceptions and approach to utilising RMB as a settlement currency or investment asset.

RMB adoption dynamics in the Middle East

The Middle East has exhibited a growing interest in the RMB as a potential currency for trade settlement and investment. However, this interest comes with obstacles tied to the prevalence of USD-pegged currencies in the region. Transitioning to the RMB might entail giving up the benefits associated with the USD ecosystem. Some of the concerns raised by clients include:

Additional FX risk: Utilising currencies other than the USD or USD-pegged local currencies introduces additional foreign exchange risks. Many economies in the region, such as Saudi Arabia and the United Arab Emirates, have their currencies pegged to the USD. This peg provides predictability and stability that is highly valued by businesses and investors. Introducing the RMB into their operations exposes companies to potential volatility and uncertainty in currency exchange rates. This may impact the overall stability of investments and raise additional costs associated with hedging these risks.

Deployment limitations: The lack of investment options for surplus RMB funds inhibits the desire to maintain large RMB balances. Clients may face challenges in effectively allocating their RMB funds and optimising their returns without a wide range of investment opportunities. For instance, while China's bond market has grown significantly, access for foreign investors is still relatively limited compared to more open economies. This constraint could discourage Middle Eastern investors from holding surplus RMB funds.

Limited settlement experience: Concerns arise regarding potential disruptions along the settlement process, further amplified by anecdotal evidence. For instance, some banks within the Gulf Cooperation Council (GCC) have opened nostro accounts[120] with Chinese banks, where the clearing occurs in Mainland China. This setup is perceived as less efficient compared to conducting settlements through Hong Kong nostro accounts, which have a more established infrastructure and experience in RMB transactions.

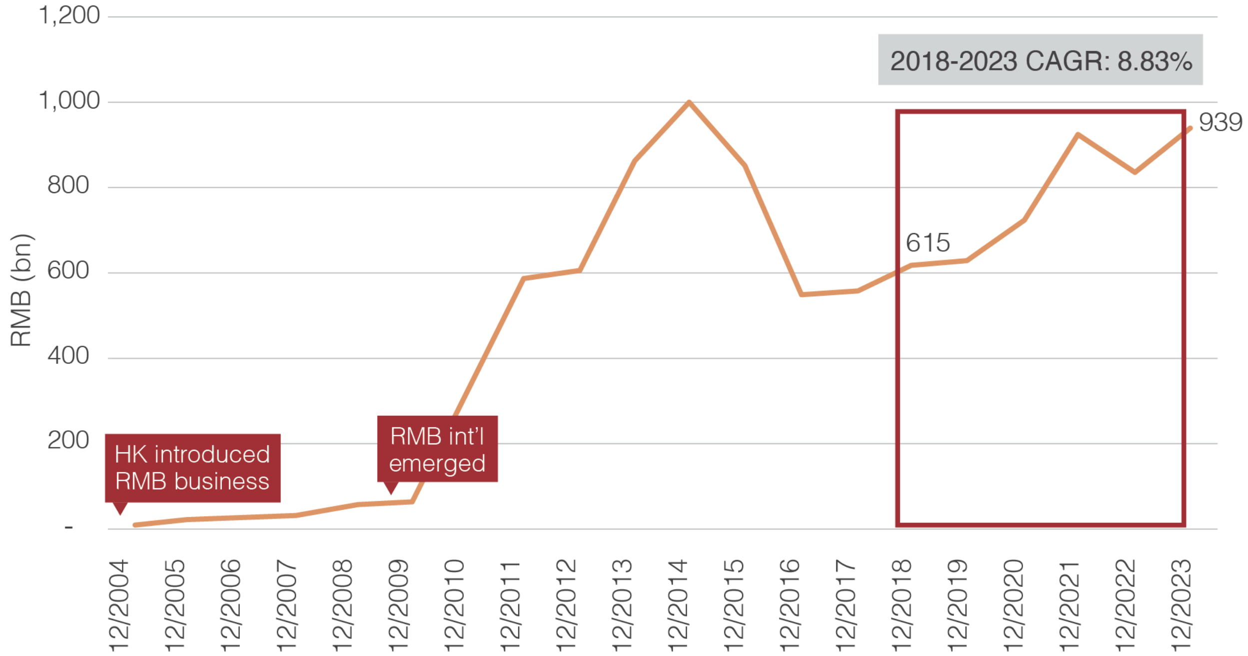
120 A nostro account refers to a bank account held by a domestic bank in another country, denominated in the currency of that particular overseas country.

Policy Recommendations

The internationalisation of the RMB is a strategic focus for Mainland China. As a prominent offshore RMB centre, Hong Kong plays a critical role in this endeavour. By actively participating in and driving the RMB internationalisation process, Hong Kong will see additional opportunities that will further its status as an IFC in return.

The size of RMB deposits in Hong Kong, while significant, should not be seen as the sole indicator of RMB internationalisation. A comprehensive assessment of the RMB's global integration should also consider other indicators, such as those related to the RMB's share in foreign exchange reserves, foreign exchange transactions, international payments, and trade finance. Together, these indicators provide a more comprehensive perspective on the acceptance and usage of the RMB in global markets.

Figure 15: RMB deposits in Hong Kong



Source: HKMA

Notwithstanding the above, industry leaders advocate for ambitious milestones to boost this process, with a particular focus on expanding Hong Kong's RMB deposit pool, crucial for the fluid trading of RMB-denominated assets. Currently, deposits are nearing the RMB 1 trillion mark, and there is a collective push to target a 50% increase within the next five years, potentially reaching RMB 1.5 trillion,[121] supported by historical growth trends of 8.83% CAGR from December 2018 to December 2023 (Figure 15).

Supporting this upward thrust, it is imperative for Hong Kong to refine its financial connectivity with the Mainland market. It is suggested that the Government can consider a twofold approach: initially, the focus to be set on enhancing the efficacy of existing Connect schemes to realise their full potential; these schemes are vital for the seamless flow of capital and must be optimised to reflect the dynamic needs of the market in the short to medium term. Concurrently, there should be a forward-looking vision that seeks to identify and cultivate new areas of high growth potential, strategically positioning Hong Kong to expand its financial services in alignment with future market demands.

The medium-term key performance indicator or target should be set on surpassing the RMB 2 trillion deposit milestone. This target can be achieved by targeting enhancements in critical aspects that contribute to the overall RMB market ecosystem, including liquidity, product offerings, and risk management capability (Figure 16). The ultimate objective of this internationalisation effort is to achieve continuous and seamless circulation of cross-boundary RMB between the Mainland and Hong Kong markets, making RMB-denominated assets more accessible and attractive to investors on both sides of the financial markets, which will contribute to allowing the RMB to play a more important role in the global investment arena.

121 HKMA (November 2023), *Monetary Statistics for October 2023*, https://www.hkma.gov.hk/eng/news-and-media/press-releases/2023/11/20231130-6/

Figure 16: Key milestones in enhancing Hong Kong's offshore RMB business

Timeline	Milestone
Short-term	To increase RMB deposits to RMB 1.5 trillion, surpassing the current level of just under RMB 1 trillion.
Medium-term	To increase RMB deposits to surpass RMB 2 trillion.
Long-term	To achieve continuous and seamless circulation of cross-boundary RMB between Mainland China and Hong Kong.

More specifically, the FSDC considers the following set of recommendations with short-, medium-, and long-term priorities optimal at least on the macro level. We believe these recommendations should be further studied by relevant departments and regulators, for they can build towards a common goal of maximising mutual benefits for the markets of Mainland China and Hong Kong.

- **Optimising mutual market access schemes and exploring new connectivity options**
  - *Recommendation 1: Optimising current mutual market access schemes*
  - *Recommendation 2: Strengthening connectivity in emerging high-growth areas*

- **Enhancing the depth and breadth of the offshore RMB market**
  - *Recommendation 3: Boosting liquidity for the offshore RMB market*
  - *Recommendation 4: Diversifying offshore RMB product offerings*
  - *Recommendation 5: Enriching RMB risk management tools*

- **Accelerating RMB ecosystem development**
  - *Recommendation 6: Broadening talent connectivity*
  - *Recommendation 7:* Enabling cross-boundary data flow
  - *Recommendation 8:* Leveraging infrastructure development, digital currency advancements, and innovation

These recommendations are designed to fulfil the long-term objective of achieving dual circulation of cross-boundary RMB between Mainland China and Hong Kong, which is crucial to the sustained growth and development of the city's offshore RMB businesses. By implementing these recommendations, Hong Kong can solidify its position as a preeminent offshore RMB hub, and play an instrumental role in the broader narrative of RMB internationalisation.

Optimising mutual market access schemes and exploring new connectivity options

Since the launch of Stock Connect in 2014, various Connect schemes have been introduced, marking wide-ranging efforts in joint market access between Hong Kong and Mainland China. These schemes have undeniably brought merits, from increased liquidity to diversified investment opportunities. However, upon reflecting on the journey thus far, there is room for further enhancement and optimisation, as well as untapped potential in new sectors.

Recommendation 1: Optimising current mutual market access schemes

To further optimise the existing mutual market access schemes and promote greater access for foreign companies to Mainland Chinese investments, several key actions can be taken to enhance the efficiency and attractiveness of these schemes.

Enhancements for Swap Connect

Two-way flow: The introduction of Northbound trading through Swap Connect has opened doors for investors in Hong Kong and beyond to access the Mainland's interbank financial derivatives market. Following this development, regulators from both regions are actively exploring the feasibility of Southbound trading to complement the Northbound initiative.[122] Over the near-term, it is important for Hong Kong to collaborate with relevant Mainland counterparts to facilitate the timely introduction of Southbound trading, ensuring a more symmetrical Swap Connect framework. We are aware that the Government and relevant regulators are engaged in dialogues with Mainland authorities in pursuit of this objective with the market eagerly anticipating the realisation of this initiative.[123]

122 HKMA (July 2022), *Joint Announcement of the People's Bank of China, the Hong Kong Securities and Futures Commission and the Hong Kong Monetary Authority*, https://www.hkma.gov.hk/eng/news-and-media/press-releases/2022/07/20220704-3/
123 HKSAR Government (February 2024), *The 2024-2025 Budget*, https://www.budget.gov.hk/2024/eng/budget16.html

Asset types: While the Swap Connect is helpful as a hedging strategy for CIBM bond investments, its exclusive focus on mitigating CIBM bond-related risks may limit its full potential as a comprehensive risk management instrument. In the medium term, it would be beneficial to consider expanding its scope into other areas, such as equity swaps, cross-currency swaps, and potentially even commodity swaps as the operation matures. By offering a more comprehensive range of risk management solutions that extend beyond the scope of CIBM bond investments, Swap Connect would become even more appealing and beneficial to investors. We are aware that the Government and relevant regulators are engaged in active dialogue with Mainland authorities in pursuit of this objective with the market eagerly anticipating the realisation of this initiative.

Functions: To further address the needs of investors, incorporating key features in swap trading, such as "unwind",[124] "forward-start",[125], "stub period"[126], "trade compression"[127], and "non-cash collateral" are essential. Developing a strategic roadmap for integrating these features will greatly promote the scheme's adoption and effectiveness, thereby increasing the utilisation rate among market participants.

Enhancements for ETF Connect

It is necessary to consider relaxations and expansions in eligibility criteria to enhance its potential and overcome current limitations. The limited number of ETFs available for Southbound trading, combined with strict admission criteria, poses a challenge to the growth of the ETF Connect scheme. To address this, it is recommended to expand the scope of ETF Connect by lowering the threshold for existing requirements and including new underlying asset classes, such as ETFs with international underlying securities and fixed income ETFs. This adjustment would increase the variety of ETFs eligible for trading, fostering growth and enhancing the attractiveness of the ETF Connect scheme.[128]

Introducing more distinctive ETFs into the mutual market access is considered an effective means to boost investor participation. Specifically, the inclusion of Hong Kong ETFs that provide exposure to specific overseas and multiple markets is particularly important for Mainland investors, as investment products that offer global asset allocation opportunities are relatively scarce on the Mainland. A comparative glance reveals a stark contrast in market offerings: Mainland ETFs have little, if any, exposure to certain foreign markets, such as Vietnam, a space where Hong Kong has already taken the lead with targeted ETFs. Additionally, while Mainland China's ETFs are largely confined to thematic products within the internet industry, they may not be representative of the global market. Hong Kong's ETFs boast a more diverse investment portfolio with stakes in numerous countries and across a broad spectrum of sectors. The potential synergy highlights the benefits of integrating a more comprehensive selection of Hong Kong ETFs into the Mainland market.[129] In addition, introducing new underlying asset classes would offer a new channel for international investors to invest in Mainland ETFs and further develop the internationalisation of the RMB.

The potential inclusion of non-equity ETFs, such as bond and commodities ETFs, could offer investors additional exposure to different asset classes. Furthermore, the inclusion of non-Hong Kong ETFs, particularly those investing in regions with strategic significance, stands to offer considerable advantages. Introducing ETFs from the Middle East and ASEAN markets, for instance, would not only diversify the investment options available to Mainland investors, but also align with the country's broader economic interests and diplomatic ties in the region.

Enhancements for Bond Connect

Asset securitisation products have become popular instruments for global investors to diversify their risks, given their asset-backed nature, relatively high yields, and historically low default rates.[130] According to an international credit rating company, China has emerged as the second-largest structured finance market globally, following the United States.[131] As of December 2023, the total issuance of the Mainland securitisation market was approximately RMB 17.67 trillion.[132]

124 Unwind refers to closing out a trading position.
125 Forward start refers to an agreement that starts at a specified future date with an expiration date set further in the future.
126 Stub period refers a short or partial period in a swap or loan, or coupons on a bond.
127 Trade compression is a way to reduce the number of outstanding contracts but keep the same economic exposure.
128 China Fund (January 2023), *ETF通開閘半年成績可圈可點未來多維度提升深度和廣度*, https://app-web.chnfund.com/fund/202301/t20230109_4139720.html
129 China Fund (January 2023), *ETF通開閘半年成績可圈可點未來多維度提升深度和廣度*, https://app-web.chnfund.com/fund/202301/t20230109_4139720.html
130 Regulation Asia (November 2021) *China ABS Market: A Magnet for Global Investors*, https://www.regulationasia.com/China-abs-market-a-magnet-for-global-investors/
131 Fitch Ratings (April 2023), *China Securitisation Market Overview*, https://www.fitchratings.com/research/structured-finance/china-securitisation-market-overview-17-04-2023
132 China Securitization Analytics (CN-ABS), https://www.cn-abs.com/#/home (accessed on 29 January 2023)

According to the Climate Bond Initiative, green asset-backed securities (ABS) are an important growth driver for the securitisation market.[133] Facilitating international access to green ABS on the Mainland would be particularly advantageous for asset owners, investors, bankers, as well as other financial and professional sector participants. This move would further enhance its status as a regional green finance hub and align with global environmental initiatives.

Bond Connect serves as an essential link connecting international investors with Mainland China's securitisation products, particularly those within the CIBM. However, given the expansive scale of the Mainland's securitisation market – the second largest globally – one could argue that the full potential of Bond Connect has yet to be fully realised, as securitisation products on the CIBM only account for about half of the Mainland's securitisation market.

Mainland China's securitisation market comprises two components – the CIBM (which also includes the Asset Back Note (ABN) market) and the China Stock Exchange Market (Exchange Market) (Figure 17).[134] The Exchange Market constitutes 57.5% of the Mainland's asset securitisation market as of December 2023 by market value.[135] The securitised products offered by the Exchange Market consist of offerings from companies operating in various new high-growth sectors, such as electronic vehicles and new energy. These sectors' rapid growth and potential make the products on the Exchange Market attractive to investors. However, under the current set up of Bond Connect, only Mainland securitisation products offered in the CIBM are included in Bond Connect, whereas products on the Exchange Market are not accessible to investors from Hong Kong and overseas.

Figure 17. Overview of Mainland China's securitisation market

Mainland China's securitisation market	Share of the total securitisation market in 2023	Accessible via Bond Connect
CIBM (Includes ABN market)	RMB 1.63 trillion (42.31%)	Yes
China Stock Exchange Market (Exchange Market)	RMB 2.22 trillion (57.7%)	No

The considerable market share of the Exchange Market and the growing interests of foreign investors in Mainland's asset securitisation offerings call for action. Hong Kong should act soon to explore foreign investor participation in Exchange Market securitisation transactions by expanding the scope of Bond Connect or through other mechanisms. Such an inclusion would provide foreign investors with a broader range of investment options, enabling optimal diversification. At the same time, it would offer domestic issuers in the Exchange Market access to an alternative investor base, thereby further deepening the offshore RMB bond market.

As a tool to enable more active participation of international investors in the RMB securitisation market, relevant parties could consider introducing a regime for securitisation special purpose vehicles (SPVs) incorporated in Hong Kong to be automatically qualified as investors in Bond Connect, QFII, or other access schemes. Such a mechanism could act as a bridge between foreign investors and the domestic Mainland securitisation regimes. It would essentially drive Hong Kong to develop itself into a location where domestic issuers can orchestrate their transactions, and foreign investors can invest in RMB products with structural features similar to typical international securitisation transactions. However, achieving this would require Hong Kong to review and potentially revise certain regulations. Some of the areas are highlighted below:

133 Climate Bond Initiative (September 2021), *China Green Securitisation Report State of the Market 2020*, https://www.climatebonds.net/files/reports/cbi_cn_2020_sotm_04h_1.pdf
134 Fitch Ratings (April 2023), *China's Securitisation Market Growing Rapidly, But Segmented*, https://www.fitchratings.com/research/structured-finance/china-securitisation-market-growing-rapidly-but-segmented-17-04-2023
135 China Securitization Analytics (CN-ABS), https://www.cn-abs.com/#/home (accessed on 29 January 2023)

Potential Regulatory Enhancements to Support the Development of the Hong Kong Securitisation Market[136]

The industry highlighted amendments that could be potentially made to the Money Lenders Ordinance, Inland Revenue Ordinance, and anti-Money Laundering and Counter-Terrorist Financing Ordinance.

- According to the Money Lenders Ordinance (MLO), an SPV is unable to obtain a Money Lenders License due to its limited function. However, certain SPVs, particularly those in Hong Kong, may still meet the definition of a "money lender" under the MLO, especially if they are involved in funding the origination of new loans and/or enforcing loans.[137] Engaging in money lending without a license is a criminal offense under the MLO unless an exemption applies. However, none of the exemptions listed in the MLO specifically intend to exempt SPVs. To resolve this issue, it is recommended that the Companies Registry can consider publishing a notice in the Gazette exempting securitisation SPVs from the requirements of the MLO.

- With regard to the Inland Revenue Ordinance (IRO) in Hong Kong, a securitisation SPV is subject to profits tax on its profits earned during a specific accounting period.[138] However, the definitions of "profits" in the IRO for a securitisation SPV may include the full amount of interest (yield) received on the underlying assets. Since securitisation SPVs are structured as pass-through entities, the majority of the cash flow, except for a small retained profit, is disbursed by the SPV to cover expenses, costs, and interest payments to investors. Unfortunately, not all of these disbursements are explicitly deductible under the IRO's definition, which means that a securitisation SPV in Hong Kong could potentially be liable to pay tax on an amount that exceeds its small retained profit. To address this issue, it is important to establish a clear and precise definition of "profits" for securitisation SPVs. This definition should reflect the amount that the SPV actually retains as profit after disbursing funds.

- Express trusts are commonly used in securitisation transactions in jurisdictions like the UK and Australia. An express trust is established when a settlor (the person creating the trust) provides explicit instructions on how their property should be held. Trusts are versatile tools that can assist in achieving the objectives of the parties involved in a transaction. Under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO), any individual who acts as a trustee of an express trust as part of their business activities must hold a trust or company service license issued by the Companies Registry.[139] Consequently, an originator who grants a trust over their assets or a securitisation SPV that establishes a trust for the assets it has acquired may fall within this definition and require a license. However, obtaining such a license may be challenging for securitisation SPVs due to their limited function or the absence of any financial services compliance function within a standard operating company. To address this issue, it is recommended that through regulations, exempt trusts from the trust licensing requirement under the AMLO if trusts are created for the purpose of enabling or facilitating genuine commercial transactions or protecting and enforcing rights relating to such transactions, where the use of the trust is incidental to the principal purpose of the transaction.

136 Based on meetings with a structured finance industry association.
137 Hong Kong e-Legislation, *Cap. 163 Money Lenders Ordinance*, https://www.elegislation.gov.hk/hk/cap163 (accessed on 8 January 2024)
138 Hong Kong e-Legislation, *Cap. 112 Inland Revenue Ordinance*, https://www.elegislation.gov.hk/hk/cap112 (accessed on 8 January 2024)
139 Hong Kong e-Legislation, *Cap. 615 Anti-Money Laundering and Counter-Terrorist Financing Ordinance*, https://www.elegislation.gov.hk/hk/cap615 (accessed on 8 January 2024)

Enhancements for Mutual Recognition of Funds (MRF)

The MRF initiative is a cornerstone in the financial symbiosis between Mainland China and Hong Kong, and further refinement will allow it to better serve investor interests and align it with global best practices. Engagements with industry stakeholders have illuminated areas that are ripe for improvement within the MRF framework.

Based on engagements with market participants, some requirements require prompt attention. One key area of consideration is the current requirement that mandates fund managers to be based in Hong Kong and prohibits the appointment of non-Hong Kong-based fund managers to handle investments in European and US markets. This constraint not only curtails the scheme's ability to tap into global market acumen, but also restricts the diversity of managerial perspectives that could enhance fund performance. Embracing a model akin to international standards, which permit fund managers to operate cross-border, could infuse the MRF with a wider spectrum of global insights and practices.[140]

Additionally, the current 50/50 value of sales requirement within the MRF framework mandate that the value of shares sold to investors in Hong Kong should not exceed 50% of the fund's total asset value, and the same applies reciprocally for Mainland China. Such an approach may not be congruent with the significant disparity in market scale of the two markets. A reassessment of this policy, guided by market indicators and a comparative analysis of fund market sizes, to relax the 50/50 sales limit would be beneficial for the development of the MRF. Such assessment could yield a more pragmatic and proportionate asset allocation framework.

Moreover, the protracted approval timeline by the Mainland side for mutual fund recognition, often spanning eight to nine months, impede the scheme's agility and its ability to adapt to the dynamic investment landscape. Instituting a more expedited and streamlined approval process would markedly enhance operational efficiency and better satisfy market demand. Mainland regulators should work towards timely and consistent information sharing and enhancing transparency throughout the approval processes.

Enhancements for Wealth Management Connect (WMC)

Since its proposal, the WMC scheme has been highly anticipated as a tool to materialise the promises of the development of the GBA. With its launch in 2021, relevant parties have been evaluating its efficiency and effectiveness, while the Government has promised to make necessary adjustments to ensure its operations are optimised and its adoption among investors is widespread. Industry experts have identified several areas for potential enhancement, such as streamlining cross-boundary account opening processes, increasing investment quotas, and expanding the range of available nvestment products.

As mentioned previously in this report, regulators from Mainland China and Hong Kong introduced five key enhancements in January 2024, which address some of these areas of concern. The most notable of these enhancements is the increase in investment quotas, a crucial adjustment that serves to alleviate a major constraint.

The inclusion of insurance products

Beyond the announced enhancements, the industry is of the view that the inclusion of insurance products would be sensible and conducive to market development. Insurance serves not only as a vital risk management tool, crucial for diversifying investment portfolios, but also plays a pivotal role in the grander vision of RMB internationalisation. RMB-denominated insurance products were introduced to the market in 2009, driven by the increasing demand for investment opportunities in RMB products at that time.[141] Currently, approximately half of the active life insurers in Hong Kong offer RMB-denominated products. This highlights Hong Kong's unique position as a provider of a wide range of insurance products that effectively meet the needs of a diverse customer base, including Mainland citizens.

Enhancing the integration of the insurance sector between Mainland China and Hong Kong is vital, especially because people traffic – from cross-boundary travel to Hong Kong residents calling other GBA cities home – is significant. Integrating RMB insurance products into the WMC scheme would offer investors a more comprehensive selection of financial instruments, along with the inherent stability and risk management benefits of insurance. This integration aligns with the needs of Mainland residents who are actively seeking diversified investment avenues, complementing the Chinese government's strategy to foster investment diversification.

140 Ta Kung Wen Wei (May 2022), *發展建議/優化基金互認 公會倡三項改革*, https://epaper.tkww.hk/a/202205/18/AP62840e25e4b0a4690265f7ab.html
141 S&P Global (November 2016), *Chinese currency depreciation hits yuan insurance market in Hong Kong*, https://www.spglobal.com/marketintelligence/en/news-insights/trending/hjtyvxqxohetpyl1g8hhwg2

Furthermore, the growing ageing population in Mainland China necessitates addressing their specific needs in terms of risk management. Relying solely on mandatory insurance would not be sufficient to meet the requirements of individuals in this demographic. This situation presents a significant opportunity to introduce annuity products that can offer a steady income stream for retirees, effectively addressing a critical need. Moreover, the RMB-denominated annuity policies issued by Hong Kong insurers can facilitate Hong Kong residents who plan to retire on the Mainland, particularly within the GBA. In this regard, RMB-denominated annuity products have the potential to enhance connectivity and further facilitate two-way people flow.

The inclusion of RMB insurance products in the WMC can be initiated with more straightforward and easily understandable products. With time, as familiarity and confidence in the market increase, more complex insurance products can then be introduced to cater to different risk profiles and investment preferences. For instance, alongside RMB-denominated products, the introduction of multi-currency convertible products can be considered. These products offer a currency exchange option that provides policyholders the flexibility to change the policy currency during the policy year. To start, an option for RMB versus USD can be implemented, providing investors with additional currency diversification opportunities.

The plan to establish after-sales service centres in key locations such as Nansha and Qianhai, along with the inclusion of insurance products within the WMC, sets the stage for developing an Insurance Connect scheme. Such a scheme would involve navigating the complex regulatory landscape in both Mainland China and Hong Kong. A prudent approach might involve establishing an offshore limit or a pilot scheme to begin with, providing a controlled environment to test, refine, and ultimately perfect the Insurance Connect framework. Such pilots can initially focus on less complex products, for instance, non-life insurance products. Additionally, closed-loop mechanisms can be explored. This can capitalise on the current arrangements for the WMC, including the use of designated accounts. However, a comprehensive assessment is necessary to evaluate the feasibility and viability of such measures.

Other potential enhancements

In parallel, the optimisation of the transboundary data exchange between Mainland China and Hong Kong is critical. This enhancement, along with the development of complementary infrastructures, signifies an opportunity to refine the cross-boundary account opening process. Simplifying the account opening process within the same banking group, for example, through the utilisation of digital certification and implementing a personal information collection statement that covers both Mainland China and Hong Kong, would further streamline the process, thereby facilitating a more seamless entry for Hong Kong investors into the Northbound trading of the WMC.

Recommendation 2: Strengthening connectivity in emerging high-growth areas

REIT Connect

Based on our engagement with market participants, there is rising interest in REITs due to their potential to offer the benefits of risk diversification to traditional asset classes. With the growth of the REIT market in Mainland China and the global popularity of REITs, it is crucial for Hong Kong to tap into this opportunity. The city should attract more REITs to be listed in Hong Kong and facilitate investor participation in onshore Mainland REITs (C-REITs) and Hong Kong REITs (H-REITs), establishing itself as a regional hub for REIT investment.[142]

The Mainland's REIT market has seen a rapid increase in the number of C-REITs across a broader range of asset classes since the first nine public infrastructure C-REITs were listed under the pilot scheme in June 2021.[143, 144] As of 2022, the C-REIT market was ranked as the fourth largest REIT market in Asia.[145] The rapid growth of the REIT market in Mainland China strengthens the case for including REITs in Stock Connect or establishing a new initiative such as REIT Connect. Recognising the potential for increased foreign participation, CSRC is exploring the potential inclusion of C-REITs in cross-border investment mechanisms.[146] We are pleased to learn that the Government is currently engaged in discussions with Mainland authorities to expand the mutual market access scheme and include REITs.[147]

As early as 2021, the FSDC had proposed to include REITs in the Stock Connect programme, enabling two-way REIT investment between Mainland and international markets.[148] Enhanced connectivity would provide investors with additional

142 HKEX (October 2023), *Development Potential of Offshore Mainland China REITs in Hong Kong*, https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2023/CCEO_ML_REIT_202310_e.pdf
143 Deloitte (July 2023), *中國REITs發展報告*, https://www2.deloitte.com/content/dam/Deloitte/cn/Documents/real-estate/deloitte-cn-re-china-REITs-development-report-zh-230714.pdf
144 Please refer to Annex 1 of this report for further details.
145 Cushman & Wakefield (2023), *Asia REIT Market Insights 2023*, https://cushwake.cld.bz/asia-REIT-market-insight-2023/4-5/
146 Shanghai Securities Journal (July 2023), *证监会：抓紧完善REITs信息披露体系 研究推动将REITs纳入互联互通机制*, https://news.cnstock.com/news,yw-202307-5087235.htm;
147 HKSAR Government (February 2024), *The 2024-2025 Budget*, https://www.budget.gov.hk/2024/eng/budget16.html
148 FSDC (May 2021) *Revitalisation of Hong Kong's Real Estate Investment Trusts Market - Promoting Liquidity*, https://www.fsdc.org.hk/en/insights/revitalisation-of-hong-kong-s-real-estate-investment-trusts-market-promoting-liquidity

opportunities to invest in the C-REITs and H-REITs, which could also benefit existing and potential issuers of these REITs (including state-owned enterprises, corporations and private equity firms) by providing additional liquidity. This, in turn, would amplify the global competitiveness of C-REITs and H-REITs, potentially drawing in additional sponsors not only from Hong Kong and Mainland China, but also from across the globe. An attractive opportunity arises from targeting issuers based in countries along the BRI. These markets are known for their extensive infrastructure projects, presenting potential investment prospects. According to a study from the World Economic Forum, in the first half of 2023, more than 100 agreements related to the BRI were signed, amounting to a total value of USD 43 billion in value. This figure represents a 20% uptick compared to the first half of 2022.[149]

Furthermore, PE fund managers have shown considerable interest in packaging their investments in the form of REITs. However, regulatory constraints in Mainland China have diminished the attractiveness of C-REITs as a viable exit strategy for PE investments, attributed to the requirement that 90% of IPO proceeds must be reinvested into new and existing projects typically within the same asset class. Further, certain asset classes in line with the country's national development plan are prioritised by Mainland regulators with C-REIT listings choreographed accordingly. Consequently, PE fund managers seeking an exit strategy and/or managing assets in non-prioritised sectors may view H-REITs as an alternative, though the current pricing disparity with Mainland Chinese REITs acts as a deterrent. The implementation of REIT Connect, coupled with improved liquidity, could position Hong Kong as an optimal platform for PE exits via REIT IPOs.

When formulating the eligibility criteria for REITs to be included in the Stock Connect / REIT Connect, adopting an inclusive approach would be more beneficial. The requirements should be as practical and comprehensive as possible, accommodating the diverse nature of the REIT market and recognising that the market capitalisation of REITs (particularly C-REITs) is typically lower than listed companies. In concert with these initiatives, encouraging more sponsors to list their portfolios via H-REITs aligns with the goals of RMB internationalisation, particularly if new and existing H-REITs are incentivised to adopt a dual-currency model.

PE Connect

The private equity (PE) sectors of Mainland China and Hong Kong are the top two markets in Asia, and both markets stand to benefit from strengthened connectivity. In fact, in recent years, we have witnessed the mutual intention of both sides to enhance connectivity in this sector.

- In February 2022, the Qianhai Authority and the FSTB jointly promulgated the '18 Measures to Support the Joint Development of Shenzhen and Hong Kong Venture Capital Investments in Qianhai' (18 Measures), which aims to promote the joint development of venture capital investments in Shenzhen and Hong Kong to meet the growing demand for private investment capital by start-ups in the innovation and technology sector. The 18 Measures support eligible Hong Kong LPFs to set up qualified investment entity in Qianhai, encourage Qianhai QDIE fund managers to invest in Hong Kong I&T, and propose making use of a cross-boundary supervisory "sandbox" mechanism for financial innovation to promote the linked development of Shenzhen and Hong Kong PE markets.[150]

- In February 2023, the Mainland promulgated the Opinion on Providing Financial Support for the "Comprehensive Deepening Reform and Opening Up of the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone" or known as 30 Measures, including measures to further support Hong Kong PE funds' development in Qianhai and to orderly explore connectivity mechanisms for Shenzhen and Hong Kong PE markets. The initiative streamlines processes, expands investment scopes, and lowers investor barriers, with preference for Hong Kong-registered PE funds to gain QFLP status and engage in Mainland investments, also clarifying tax positions.[151]

- In the Chief Executive's 2023 Policy Address, it was noted that the Government plans to take advantage of the financial reform and innovation measures in the Qianhai Co-operation Zone to expand the businesses of Hong Kong's financial institutions in Qianhai. Relevant measures include facilitating Hong Kong's limited partnership funds to be qualified under the Qianhai QFLP to participate in private equity investment in the Mainland.[152]

149 World Economic Forum (November 2023), *China's Belt and Road Initiative turns 10. Here's what to know,* https://www.cfr.org/backgrounder/chinas-massive-belt-and-road-initiative

150 Financial Services and the Treasury Bureau (February 2022), *18 Measures for Supporting the Linked Development of Shenzhen and Hong Kong Venture Capital Investments in Qianhai by the Authority of Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone of Shenzhen Municipality and the Financial Services and the Treasury Bureau of the Government of the Hong Kong Special Administrative Region,* https://www.fstb.gov.hk/en/financial_ser/financial-co-operation-with-the-mainland_Full-document.html

151 The State Council of the People's Republic of China (February 2023), *中國人民銀行 銀保監會 證監會 外匯局 廣東省人民政府對金融支持前海深港現代服務業合作區全面深化改革開放的意見*, https://www.gov.cn/zhengce/zhengceku/2023-02/23/content_5743026.htm

152 HKSAR Government (October 2023), *The Chief Executive's 2023 Policy Address*, https://www.policyaddress.gov.hk/2023/public/pdf/policy/policy-full_en.pdf

Enhancing cross-boundary PE connectivity is pivotal for economic growth, primarily facilitated through the QFLP and QDIE frameworks. These instruments are crucial for channelling offshore funds into Mainland China and directing onshore funds to Hong Kong. Therefore, a key strategic initiative is the refinement of the Qianhai model, which involves the implementation of more investor-friendly QFLP and QDLP policies to simplify and encourage cross-boundary investments between Qianhai and Hong Kong for fund managers and PE investors.

The existing 18 measures and 30 measures have established a foundation for such an arrangement. Building on this, the Government can consider a phased extension of these measures to other financial hubs, such as Shanghai and Hainan, to unlock additional opportunities. The adoption of such policies in these regions can potentially enhance the fluidity and breadth of cross-boundary capital transactions, solidifying the significance of PE investments within the wider economic framework. Concurrently, the existence nature of foreign exchange controls has a role to play in the success of such cross-boundary investments. If Hong Kong can initiate a pilot programme starting with Qianhai – a feasible move under the encouragement of the 30 measures advocating for experimental reforms in cross-boundary finance and foreign exchange management – this would facilitate a more efficient flow of funds for PE investments.

An additional approach to strengthening connectivity in this field is to facilitate the establishment of RMB-denominated PE funds in Hong Kong while enabling the withdrawal of RMB in Mainland China. By facilitating the flow of RMB from Mainland China to Hong Kong and back – perhaps in a closed-loop environment – the circulation of RMB outside Mainland China can be enhanced. This strategy will require collaboration between the Hong Kong and Mainland governments to formulate enabling policies.

In essence, these strategic initiatives aim to create a more integrated and dynamic PE landscape, fortifying the role of Hong Kong as a pivotal nexus for a diversified range of financial activities.

Commodity Connect

Commodities are integral in the internationalisation of the RMB, and Hong Kong has the potential to develop into a prominent commodity trading hub. To strive towards this, Hong Kong has already established a firm foundation with HKEX's acquisition of the LME, the world's largest non-precious metals exchange. According to a Reuters report in January 2024, the London Metal Exchange (LME) was reportedly studying Hong Kong as a potential location to expand its global metal warehouse network. The LME was hopeful that success in Hong Kong could potentially pave the way for further expansion into Mainland China.[153]

Throughout history, commodities trading hubs have emerged near the movement of physical commodities and well-developed transportation infrastructures. Several notable examples of established commodities trading hubs across the globe include Chicago, Houston, London, and Singapore. Given its position as an economic gateway to Mainland China, Hong Kong is in an advantageous position to serve as a hub that facilitates commodities trading in both Northbound and Southbound directions, connecting China with the global market.

Although Hong Kong has not traditionally been recognised for its strength in the trading of all commodities, it is a major hub for physical gold transportation into China from Europe and other regions. This has led to the development of a thriving gold trading market, positioning Hong Kong with the potential to become the primary price setter for gold in Asia. Currently, the Hong Kong Futures Exchange (HKFE) offers Gold and Silver futures. To fully realise Hong Kong's potential as a gold trading hub, HKFE could explore further collaboration with the Chinese Gold and Silver Exchange.

In terms of product offerings, with its robust financial trading infrastructure and history, Hong Kong can enhance them by granting Chinese investors access to commodities products traded on the LME. This could be accomplished by developing a Commodities Connect, echoing the structure of existing Connect schemes. This move would tap into China's vast investor base, fostering greater participation in international commodity markets. Additionally, HKEX could attract international investors by facilitating access to commodities traded on onshore exchanges such as the Qianhai Mercantile Exchange Co., Ltd. or the Shanghai Futures Exchange (SHFE).

Building on the momentum of the increasing usage of RMB for oil trade settlements in the Middle East,[154] Hong Kong and Mainland China should also focus on attracting more commodities consumed by the Mainland. This strategic move would enhance the RMB's role as a global currency and further strengthen the commodity trading ecosystem. For instance, commodities like Nickel from Indonesia, which are vital for the electric vehicle supply chain, should be targeted for RMB-denominated trading.

153 Reuters (January 2024), *Exclusive: LME targets Hong Kong as option for warehouse expansion*, https://www.reuters.com/markets/commodities/lme-targets-hong-kong-option-warehouse-expansion-2024-01-30/
154 Shanghai Petroleum and Natural Gas Exchange (SHPGX) (April 2024), *中国石油达成我国与海合会国家首单LNG跨境人民币结算交易*, https://www.shpgx.com/html/zxdt/20230424/5362.html

Indeed, some efforts have been seen in relevant areas. One of the key efforts in this regard is the internationalisation of its commodity products. Mainland China has internationalised 23 commodity products, providing direct investment opportunities for international investors.[155,156] However, a significant portion of Mainland commodity markets have remained accessible only through the QFII programme, creating inconvenience for international investors.

Given Hong Kong's strategic position as the gateway between Mainland China and the West, it is worth considering how it may take the lead in this initiative by strengthening connectivity between the two markets. By proactively positioning itself as a key centre for RMB-denominated commodity pricing within the Asian time zone, Hong Kong could shape the dynamics of the commodity market.[157] This endeavour would reinforce Hong Kong's status as the largest offshore RMB centre. Given the high potential for development in the commodity trading market, this warrants comprehensive exploration in a separate study, and the FSDC will look into relevant matters.

Enhancing the depth and breadth of the offshore RMB market

Strengthening financial connectivity between Mainland China and Hong Kong is indeed crucial to support RMB internationalisation. However, this strategy must be part of a broader, multifaceted approach. Successful RMB internationalisation hinges on several key factors: bolstering RMB liquidity, broadening the spectrum of available RMB-denominated products, fortifying risk management frameworks for RMB assets, and upgrading the transactional infrastructure for RMB dealings. Implementing these measures can enable Hong Kong to build a comprehensive RMB ecosystem, promoting the global adoption of RMB.

Remmendation 3: Boosting liquidity for the offshore RMB market

Liquidity is a crucial factor in the internationalisation of a currency. Hong Kong boasts the most extensive RMB deposit pool among offshore markets and maintains an active RMB foreign exchange market. In July 2022, the Currency Swap Agreement between the PBOC and the HKMA was expanded significantly, from RMB 500 billion / HKD 590 billion to RMB 800 billion / HKD 940 billion. Furthermore, this agreement transitioned into a long-standing arrangement, eliminating the need for periodic renewal. These enhancements aimed to increase RMB liquidity in Hong Kong as an offshore RMB market.[158] Furthermore, it is worth noting that the swap line established with the PBOC is the largest globally, serving as an adequate backstop liquidity facility to support the offshore RMB market development of the city.

However, ongoing efforts and measures are required to ensure the continuous growth and stability of liquidity, which, in turn, will support the further development of Hong Kong's offshore RMB market.

Attract further RMB flows from other markets to stimulate demand for investment tools and products denominated in RMB

The campaign for global RMB adoption requires a more targeted marketing effort to spread its awareness beyond Hong Kong and Mainland China, encouraging businesses and individuals worldwide, particularly in countries across Southeast Asia and the Middle East, to endorse RMB as a preferred currency for settlement in cross-border investments and trade. A particularly strategic sector for this promotion is the oil industry. The introduction and advocacy of RMB-denominated oil contracts could serve as an influential tool, especially with nations already maintaining strong ties with China. This move is expected to generate new arbitrage opportunities and contribute to increased market liquidity.

The expansion of RMB settlement has a twofold effect: it increases the number of individuals and institutions holding RMB and stimulates demand for investment tools and products denominated in RMB. The Middle East, in particular, is a good partner who may drive further usage of RMB. With the RMB already in use for oil payments,[159] this region presents a prime opportunity for Hong Kong to capitalise on and promote the use of the RMB in transactions beyond the trading of goods. By fostering an environment conducive to the utilisation of the RMB in third-party transactions, Hong Kong can facilitate a broader embrace of the currency.

155 CSRC (January 2023), *證監會確定菜籽油、菜籽粕、花生期貨和選擇權為境內特定品種*, http://www.csrc.gov.cn/shanghai/c105566/c6974400/content.shtml
156 China Futures Association (January 2023), *完善行業自律規則體系 促進期市健康平穩發展*, https://www.cfachina.org/aboutassociation/associationannouncement/202301/t20230116_35150.html
157 The People's Government of Shenzhen (July 2023), *前海聯合交易中心：助力提升大宗商品人民幣定價能力*, http://www.sz.gov.cn/cn/xxgk/zfxxgj/zwdt/content/post_10692731.html
158 HKMA (July 2022), *Enhanced Currency Swap Agreement between People's Bank of China and Hong Kong Monetary Authority*. https://www.hkma.gov.hk/eng/news-and-media/press-releases/2022/07/20220704-5/
159 Shanghai Petroleum and Natural Gas Exchange (SHPGX) (April 2024), *中国石油达成我国与海合会国家首单LNG跨境人民币结算交易*, https://www.shpgx.com/html/zxdt/20230424/5362.html

China's Growing Ties with the Middle East

China's economic diplomacy and strategic investments in the Middle East signal a deliberate effort to cement the role of the RMB in the region's financial architecture. In 2022, China demonstrated its commitment to fostering strategic partnerships and promoting economic development in the Middle East by hosting the first China-Arab States Summit and China-GCC Summit.[160] Moreover, a free trade agreement (FTA) with GCC members has remained prominent on China's diplomatic agenda.[161]

Furthermore, China has emerged as the leading non-oil trading partner for Saudi Arabia[162] and the United Arab Emirates (UAE) globally, with the UAE maintaining its position as China's second-largest trading partner.[163]

The BRI has been China's signature foreign policy and economic strategy to foster connectivity and cooperation across various regions. According to the China BRI Investment Report, the Middle East and North Africa (MENA) region attracted considerable attention from Chinese investors in 2021, with a notable surge in BRI engagement in 2022, which accounted for approximately 23% of total engagement, up from 16.5% the previous year.[164]

To capitalise on the growing economic synergy between Mainland China and the Middle East, there is a strategic opportunity for Mainland China and Hong Kong to tailor RMB investment products that cater to Shariah-compliant funds. These funds adhere to Islamic finance principles, necessitating stringent adherence to ethical investment guidelines, which preclude revenue from sectors like alcohol, pork, armaments, etc. According to sharing from market participants, foreign investors, especially those from the Middle East, their interest is driven by sectors such as oil and banking, which are deemed compatible with Shariah principles.[165] Hong Kong possesses advantageous platforms such as Stock Connect and dual currency counters, making it well-positioned to effectively bridge Middle Eastern capital with Chinese equities.

Recommendation 4: Diversifying offshore RMB product offerings

Market participants have indicated that the availability and spectrum of RMB products in Hong Kong are limited, which in turn restricts the utility of available liquidity. Although the ongoing development of the Connect schemes has led to diversity, there is a need for additional variety in RMB products to meet the evolving demands of investors.

Further develop the offshore RMB debt market

Despite already being a leading offshore RMB bond market, Hong Kong should seek further improvements in depth and breadth. In 2022, the issuance of offshore RMB bonds, including Certificates of Deposit, in Hong Kong reached RMB 330 billion.[166] In 2023, RMB 545.1 billion was issued[167] which included RMB 15 billion green bonds issued by the Government.[168] These developments have played a crucial role in extending the offshore RMB yield curve and enhancing the range of offshore RMB product offerings in the market.

While these efforts have been positive, further development is necessary to attract a broader spectrum of issuers. It is particularly important to consider the needs of investors from emerging markets, such as the Belt and Road, ASEAN, the Middle East, and Latin America, who often face higher funding costs than those in developed markets. Consequently, these investors are usually drawn to investment opportunities that offer higher alpha. As such, the market must present investment products that desirably balance risk and return characteristics to entice these investors towards the RMB as

160 Ministry of Foreign Affairs of the People's Republic of China (December 2022), *President Xi Jinping Attends the First China-Arab States Summit and Delivers a Keynote Speech, Underscoring the Importance of Carrying Forward the Spirit of China-Arab Friendship Featuring Solidarity and Mutual Assistance, Equality and Mutual Benefit, and Inclusiveness and Mutual Learning and Jointly Building a China-Arab Community with a Shared Future in the New Era,* https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/202212/t20221211_10988748.html
161 China Daily (February 2023), *China-Gulf states free trade pact high on agenda*, https://www.chinadaily.com.cn/a/202302/01/WS63d9a031a31057c47ebac2b7.html
162 Arab News (December 2022), *How China became Saudi Arabia's top trading partner, revived ancient Silk Road* https://www.arabnews.com/node/2213231/business-economy
163 Embassy of the People's Republic of China in United Arab Emirates (September 2022), *A Speech by H.E. Zhang Yiming Chinese Ambassador to the UAE at the Reception Celebrating the 73rd Anniversary of the Founding of the People's Republic of China*, http://ae.china-embassy.gov.cn/eng/dshd/202209/t20220929_10773756.htm
164 Green Finance & Development Center (February 2023), *China Belt and Road Initiative (BRI) Investment Report 2022*, https://greenfdc.org/china-belt-and-road-initiative-bri-investment-report-2022/
165 Sina (September 2023), *中東土豪上半年爆買A股，多國主權財富基金同步中國佈局，現身89家上市公司前十大流通股東*, https://finance.sina.cn/stock/ggyj/2023-09-07/detail-imzkvxmk8315705.d.html?vt=4&cid=76524&node_id=76524
166 SFC (August 2023), *Asset and Wealth Management Activities Survey 2022*, https://www.sfc.hk/-/media/EN/files/COM/Reports-and-surveys/AWMAS-2022_E.pdf?rev=3b6a43ac11404a2cacf7123c2f5c949e&hash=C33D88F5AAEAC176BC072AE9326091CC
167 HKMA (February 2024), *Briefing to the Legislative Council Panel on Financial Affairs,* https://www.hkma.gov.hk/media/eng/doc/about-the-hkma/legislative-council-issues/20240205e2.pdf
168 HKSAR Government (June 2023), *HKSAR Government's Institutional Green Bonds Offering,* https://www.hkma.gov.hk/eng/news-and-media/press-releases/2023/06/20230601-5/

an investment currency. These efforts align with the Government's objective to leverage Hong Kong's role as a functional platform for the BRI and to expand into new markets with the ASEAN and the Middle East.[169] In this regard, several initiatives can be considered:

Offshore RMB bond issuances with non-domestic market exposure: Expanding the range of offshore RMB products to include non-domestic market exposure is worth exploring. This approach offers foreign investors the opportunity to diversify their RMB investments by investing in RMB products that are less correlated with the Chinese market and economy. It also motivates non-Chinese companies, including those from the Middle East and ASEAN countries who have already established strong trade and investment ties with China, to issue RMB bonds in Hong Kong. To facilitate this, it is essential to establish a benchmark yield curve for such RMB bond issuance, which provides a reference point for pricing and valuation. At the same time, it is crucial to attract non-Chinese issuers, to list and issue RMB-denominated bonds and certificates of deposit in the Hong Kong Central Moneymarket Unit (CMU). Leveraging platforms like the Dim Sum bond market and Southbound Bond Connect is therefore essential. Streamlining and expanding Southbound Bond Connect by allowing larger trading quotas and increasing investor participation would facilitate the entry of non-Chinese issuers into the RMB bond market.

Tokenised bonds: On 16 February 2023, the Government introduced a groundbreaking initiative by issuing a one-year HKD 800 million tokenised green bond.[170] This issuance holds significance as it represents the first tokenised bond governed by Hong Kong law, showcasing the city's adaptable and supportive legal and regulatory environment for innovative bond issuances. On 6 February 2024, the Government took a step further to issue the first multi-currency digital green bond offering in the world, denominated in HKD, RMB, USD, and Euro.[171] By leveraging the successful experience gained from the tokenised green bond issuance, Hong Kong can explore possibilities to incorporate innovative technologies and financial tools into the RMB bond market, which not only enhances efficiency, improves transparency, and broadens accessibility, but also contributes to the market's evolution and its attractiveness to investors.

Brady bonds: Brady bonds were issued in exchange for commercial bank loans at risk of default. These bonds are often secured by zero-coupon bonds, which are purchased at a discount and whose value at maturity would be sufficient to repay the principle of the Brady bonds, thereby in theory reducing credit risk for the bondholders. Issuing a Brady bond to support RMB internationalisation could be a strategic move to attract a broader base of investors and enhance the appeal of RMB-denominated investments.[172] Researchers from the PBOC have proposed using Brady-like bonds denominated in RMB as a potential solution for restructuring distressed debts owed by highly indebted countries to Chinese financial institutions. According to Zhou Chengjun, Director of the Financial Research Institute of the People's Bank of China, alongside debt sustainability assessments are essential policy reforms to restore economic stability and growth in debtor nations. Introducing these RMB-denominated Brady-like bonds can not only address debt restructuring challenges, but also contribute to the expansion and development of the global RMB bond market.[173]

Overall, it is crucial to ensure that the cost of financing for issuers in Hong Kong is as attractive as the cost of financing in Mainland China.

Diversify and expand RMB-denominated stocks

To capitalise on the opportunities within the Mainland China and Hong Kong stock markets, a multi-pronged strategy to expand the range of RMB-denominated stocks could be considered.

Encouraging Mainland China-listed technology firms to issue Hong Kong depositary receipts (HDRs): By facilitating Mainland China-listed technology firms to issue HDRs in Hong Kong, investors gain exposure to the performance of this dynamic sector while benefiting from the liquidity and transparency of the Hong Kong stock market. HDRs provide a convenient and accessible means for international investors to participate in the growth potential of Mainland China's technology sector, especially for those firms that are not under Stock Connect schemes.

Expanding the HKD-RMB Dual Counter: The HKD-RMB Dual Counter Model, introduced in June 2023, holds potential in fostering a more robust RMB product ecosystem. Nevertheless, this model has yet to reach its full potential.

169 HKSAR Government (February 2024), *The 2024-2025 Budget*, https://www.budget.gov.hk/2024/eng/budget16.html
170 HKMA (February 2023), *HKSAR Government's Inaugural Tokenised Green Bond Offering*, https://www.hkma.gov.hk/eng/news-and-media/press-releases/2023/02/20230216-3/
171 HKMA (February 2024), *HKSAR Government's Digital Green Bonds Offering,* https://www.hkma.gov.hk/eng/news-and-media/press-releases/2024/02/20240207-6/
172 Brady bonds, named after former U.S. Treasury Secretary Nicholas Brady, are sovereign debt instruments issued by emerging market countries to restructure their external debt. These bonds are typically issued in a foreign currency, such as U.S. dollars, and offer various features, that make them attractive to investors. Callable bonds or step-up coupons are among the most common features. Some common features include callable bonds or step-up coupons, which provide flexibility and potentially higher returns. Additionally, certain bonds may offer additional sources of income tied to economic factors or the price of oil, further enhancing their appeal to investors.
173 Global Development Policy Center of the Boston University (January 2022), *Reflections on Sovereign Debt Restructuring in Low-Income Countries and the 'Shanghai Model'*, https://www.bu.edu/gdp/2022/01/30/reflections-on-sovereign-debt-restructuring-in-low-income-countries-and-the-shanghai-model/

Currently, only 24 Hong Kong-listed companies are included in the dual counter trading scheme.[174] HKEX should explore ways to encourage a broader spectrum of securities to join this scheme to attract a wider investor base and create a more dynamic market. Looking ahead, considerations might also be given to extending the option of dual currencies to other financial instruments, such as derivatives and other financing initiatives.

A limitation of the current scheme is its inaccessibility to Mainland investors via Stock Connect. Rectifying this by fully integrating the dual counter mechanism into the Stock Connect scheme would be a critical step towards fostering deeper market integration and enabling Mainland investors to engage with Hong Kong's RMB-denominated stocks.

Enriching RMB-denominated products with Hong Kong-listed overseas stocks: Enrich the underlying assets of RMB-denominated products by incorporating Hong Kong-listed overseas stocks that have ties with other markets, such as Japan and the Middle East. Currently, the RMB product portfolio in Hong Kong is predominantly composed of A-shares and Chinese bonds. The proposed expansion would enable investors to access more diversified RMB-denominated products, potentially reducing the concentration risk associated with Mainland China's market. Such a broadened asset base could boost investor interest and encourage a more sustained engagement with RMB-denominated products across various investment cycles.

Promoting RMB for pricing, trading, and financing of Hong Kong stocks: To further deepen the utilisation of RMB in the city's equity market, a collaborative approach is beneficial. Engaging with key financial institutions, such as banks, brokerages, and financial service providers could facilitate creating tailored RMB products and services that align with investor preferences. Additionally, introducing incentives can drive greater adoption among market participants. Furthermore, continuous investment in upgrading market infrastructure, including trading systems, clearing and settlement mechanisms, and payment systems, will ensure the efficient and smooth execution of RMB transactions in the Hong Kong stock market.

Explore further innovative RMB products

The asset tokenisation industry has gained mainstream recognition as corporations recognise the growing market potential and demand. In 2023, the global tokenisation market reached USD 2.87 billion and is projected to reach USD 6.89 billion by 2027. Leading countries such as the US, Germany, and Switzerland have taken the lead in terms of launching security token offerings (STOs) and are capitalising on this fundraising market.[175]

As previously mentioned, the Government's two issuances of tokenised green bonds in HKD, RMB, USD, and Euro stands as a testament to Hong Kong's flexible and supportive legal and regulatory framework for tokenised product issuance. This positive approach can be extended to other RMB products, as evidenced by the issuance of two SFC circulars specifically addressing tokenised securities-related activities and authorised investment products in November 2023.[176]

As Hong Kong continues its efforts to foster a sustainable fintech ecosystem, it could attract Mainland China corporations or product issuers to explore STOs or other tokenised assets denominated in RMB, thereby providing an additional fundraising channel for them.

Recommendation 5: Enriching RMB risk management tools

As observed by market participants, while Hong Kong's RMB offshore centre is well-regarded for its investment products, a consensus is emerging about the benefits of incorporating a more comprehensive range of hedging products into the city's RMB ecosystem. Such an expansion can mitigate the risks of holding RMB and reinforce Hong Kong's position as a regional risk management centre. As mentioned earlier, the growing trend of settling payments for oil in RMB,[177] along with Mainland China's strengthening relationships with countries involved in the Belt and Road Initiative and its participation in the Regional Comprehensive Economic Partnership (RCEP), has resulted in an increased usage of RMB.[178] Consequently, there is a rising demand for financial products denominated in RMB to effectively manage risk.

174 HKEX (June 2023), *HKEX Launches HKD-RMB Dual Counter Model and Dual Counter Market Making Programme*, https://www.hkex.com.hk/News/News-Release/2023/230619news?sc_lang=en
175 IFLR (September 2023), *Security token offerings in Hong Kong: raising capital in the Web3 era,* https://www.iflr.com/article/2c5buqbppkg8jsuallse8/features/security-token-offerings-in-hong-kong-raising-capital-in-the-web3-era
176 SFC (November 2023), SFC's Circular on intermediaries engaging in tokenised securities-related activities, https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=23EC52; and SFC (November 2023), SFC's Circular on tokenisation of SFC-authorised investment products, https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=23EC53
Gibson, Dunn & Crutcher (November 2023), *Hong Kong's SFC Updates Guidance on Tokenised Securities-Related Activities*, https://www.gibsondunn.com/hong-kong-sfc-updates-guidance-on-tokenised-securities-related-activities/
177 Shanghai Petroleum and Natural Gas Exchange (SHPGX) (April 2024), 中国石油达成我国与海合会国家首单LNG跨境人民币结算交易, https://www.shpgx.com/html/zxdt/20230424/5362.html
178 PBOC (October 2023), *2023 年人民幣國際化報告*, http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/5114765/2023102720175126516.pdf

One option is the introduction of the **RMB bond futures market**. Bond futures are recognised for their efficiency and flexibility as a hedging mechanism, enabling investors to manage risks associated with Chinese bond portfolios effectively. In November 2023, HKEX announced its plans to launch China Treasury Bond Futures in Hong Kong, expanding its suite of China-related risk management tools.[179] The SFC is working closely with HKEX on the launch. This product comes at a timely moment and can assist international investors in hedging their exposure to Mainland assets. Market participants are eager to see the actual implementation of this plan. Furthermore, as the market develops and conditions permit, it would be beneficial to expand the offering to cover other RMB-denominated bonds.

Alongside expanding hedging products, establishing **a robust and flexible regulatory framework** for accessing onshore RMB foreign exchange is crucial. Such a framework would facilitate corporate clients' hedging needs and support the RMB ecosystem's growth in Hong Kong. Failing to do so could potentially lead to the outflow of RMB business to other offshore RMB centres. Therefore, creating an enabling environment that meets the hedging requirements of corporate clients is imperative to ensure Hong Kong remains a competitive hub for RMB-related activities.

For Hong Kong to elevate its status as a major RMB trading centre, the Government should foster an environment that supports a **high degree of market-driven activities** while implementing appropriate safeguards.

Accelerating RMB ecosystem development

Recommendation 6: Broadening talent connectivity

The cross-boundary mobility of professionals in the financial services industry is critical for the sector's growth. While the connectivity of financial products between Mainland China and Hong Kong has been robust, there are more stringent restrictions when it comes to specific cross-boundary business activities. This disparity creates a bottleneck, particularly when it comes to initiatives like the WMC, where the effective promotion and sale of products depend on the movement of talent.

One potential approach to this challenge is easing examination requirements and /or providing incentives for professionals with overseas qualifications to encourage their participation in the Mainland market. Such an approach recognises the value of foreign expertise and encourages the integration of international perspectives and skills to enrich the Chinese financial landscape.

It is acknowledged that under the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA), the Mainland has simplified the procedures for securities practising registrations, futures or fund qualification applications for Hong Kong professionals since 2004. Professionals holding relevant licenses issued by the SFC in Hong Kong are only required to pass examinations on Mainland laws and regulations, and are exempted from professional knowledge examinations. Hong Kong professionals will need to be employed by a Mainland securities, futures or asset management firm to be registered or licensed in the Mainland. The SFC has offered reciprocal arrangements to the Mainland professionals.

Despite these arrangements, the number of professionals taking these exams remains relatively low, according to insights shared by a Mainland industry association. This suggests that further efforts are needed to encourage more foreign professionals to practice in Mainland China.

The scarcity of qualified talent also poses challenges for cross-boundary sales of financial products, particularly ETFs. Professionals without Mainland Chinese licenses face limitations in selling such products. One possible solution is to establish affiliations with banking associations for registration purposes. These affiliations could provide a pathway for professionals to obtain the necessary licenses and expand their capacity to sell financial products across jurisdictions.

Another potential solution is to establish an arrangement that allows certain financial professionals to engage in ad hoc cross-boundary financial activities of a less risky and complex nature, without the need for additional exams or meeting local employment requirements. As early as 2021, the Shenzhen Government has implemented an innovative approach in various sectors, including taxation, architecture, urban planning, medical care, maritime affairs, and tourism. The Shenzhen Government has exempted professionals from Hong Kong in these fields from taking additional exams to practice in the Qianhai district of Shenzhen or the entire city. Instead, these professionals are required only to complete a registration process with the local authorities.[180] This development opens the door for the financial services industry to consider a parallel pilot scheme, with the GBA as a potential starting point.

179 HKEX (November 2023), *HKEX to launch China Treasury bond futures*, https://www.hkex.com.hk/News/News-Release/2023/2311242news?sc_lang=en
180 General Office of Shenzhen Municipal People's Government (March 2022), *我市推进境外专业人才执业便利化* https://www.sz.gov.cn/cn/ydmh/zwdt/content/post_9609523.html

The implications of such enhancements in professional mobility are profound. Not only would they expand the talent pool accessible to financial institutions in both regions, but they would also fortify the interconnectivity of financial products and services, fostering a more integrated and robust financial ecosystem.

Recommendation 7: Enabling cross-boundary data flow

Efficient data flow within the GBA and beyond is critical for regional integration and economic development. The market has highlighted challenges concerning the transfer of Mainland data and the management of cross-boundary data flow. Variations in the legal and regulatory frameworks between Mainland China and Hong Kong have led to a diverse range of service provisions, which in turn have introduced additional considerations for operational processes. Furthermore, regulations concerning data exports affect the sharing of information within financial groups, influencing customer service and financial operations.

In 2022, the FSDC published a research paper, "Connecting Data: Establishing Hong Kong as a Cross-Boundary Financial Data Hub," proposing measures to enhance data connectivity between Hong Kong and Mainland China. These recommendations include clarifying regulations governing cross-boundary data flow, strengthening data governance and policy coordination within the GBA, formulating standard contractual clauses for cross-boundary data transfers, establishing a third-party certification agency for impartial conformity assessments, exploring the use of new technologies for data transfers, and attracting and nurturing talent with technological and digital-related skillsets.[181] Additionally, a pilot scheme to enable cross-boundary data flow through various Connect Schemes is also worth considering.

FSDC is pleased to see that the Innovation, Technology and Industry Bureau (ITIB) and the Cyberspace Administration of China (CAC), the major regulator of data governance in Mainland China, are working closely in pushing cross-boundary data flow from Mainland China to Hong Kong, especially within the GBA. In June 2023, ITIB and the CAC signed a "Memorandum of Understanding on Facilitating Cross-boundary Data Flow Within the Guangdong-Hong Kong-Macao Greater Bay Area", demonstrating their commitment to this initiative.[182] Building on this, in December 2023, both regulators announced the facilitation measure known as "Standard Contract for the Cross-boundary Flow of Personal Information Within the Guangdong-Hong Kong-Macao Greater Bay Area" (the GBA Standard Contract) and its early and pilot implementation.[183] The banking, credit referencing, and healthcare sectors, which display a strong demand for cross-boundary services, were invited to participate in the first phase. Looking ahead, it is recommended expanding the scope to involve more financial institutions in participation. Furthermore, should the contract prove effective within the GBA, extending its application beyond the GBA to encompass more Mainland cities would be a logical progression.

It is noteworthy that as part of the six policy measures announced by the HKMA and PBOC in January 2024, regulators from both sides have agreed to promote collaboration on cross-boundary credit referencing to facilitate cross-boundary financing activities for corporations. This initiative will enable banks in Hong Kong and Mainland China to share credit information of companies, thereby providing Hong Kong companies with more access to affordable funding. The HKMA has stated its commitment to commence pilot testing in the coming months, with the Shenzhen-Hong Kong corridor identified as the initial focus area. FSDC welcomes this new development and looks forward to the introduction of more facilitative measures to support cross-boundary data usage.

Recommendation 8: Leveraging infrastructure development, digital currency advancements, and innovation

Several strategic initiatives could be taken to create a more comprehensive ecosystem for RMB utilisation in Hong Kong. These initiatives centre on enhancing efficiency, resiliency, and the overall robustness of the RMB ecosystem.

A crucial step is the continual modernisation and upgrade of Hong Kong's **cross-boundary infrastructure linkages to enhance efficiency and robustness**. A notable example of this is the multi-year enhancement programme initiated by the HKMA, aimed at modernising the system to enable its Central Money Markets Unit to perform all necessary functions.

Equally important is the role financial institutions plays in nurturing a more efficient RMB ecosystem. They should enhance their infrastructure to encourage broader RMB usage. Strategies can include expanding the network of RMB clearing banks, which would, in turn, increase access to RMB services and enhance market liquidity. Moreover, improving cross-boundary payment systems is vital for smooth and efficient RMB transactions between the Mainland and Hong Kong.

181 FSDC (December 2023), *Connecting Data: Establishing Hong Kong as a Cross-Boundary Financial Data Hub*, https://www.fsdc.org.hk/media/rbjle0yr/20221209-datahub-report-final-en.pdf

182 HKSAR Government (June 2023), *ITIB and CAC signed Memorandum of Understanding*, https://www.info.gov.hk/gia/general/202306/30/P2023063000219.htm

183 HKSAR Government (June 2023), *ITIB and CAC signed Memorandum of Understanding (December 2023), Facilitation measure on "Standard Contract for Cross-boundary Flow of Personal Information Within the Guangdong-Hong Kong-Macao Greater Bay Area (Mainland, Hong Kong)" and its early and pilot implementation arrangements*, https://www.info.gov.hk/gia/general/202312/13/P2023121300134.htm

Additionally, developing a diverse range of financial instruments denominated in RMB will provide investors with more investment options, contributing to the growth of the RMB market in Hong Kong.

In parallel, Hong Kong can **leverage the development of digital currency to support the international expansion of the RMB**. By positioning itself as an essential node in the global cross-boundary payment network for digital RMB, Hong Kong can tap into the growing popularity of digital currencies and enhance its competitiveness as a global financial hub.[184]

For Hong Kong to continue to flourish as a global financial hub, industry leaders have emphasised the importance of continuing to foster an environment conducive to innovation, recognising that setbacks are a natural part of progress. This approach would allow companies to take calculated risks and learn from missteps, promoting growth within a framework that protects investors. It is important for Hong Kong to calibrate its regulatory thresholds appropriately, ensuring they are attainable and fair. Setting them too stringently can entrench established entities and stifle smaller, yet potent innovators.

Hong Kong was commended for its responsiveness to investor needs historically, as demonstrated by the pioneering introduction of H shares, the introduction of a new listing regime for specialist technology companies, and the issuance of guidance on tokenisation. These are clear indicators of the Government's commitment to fostering new growth in the financial markets through embracing innovation. Hong Kong must continue to bridge the innovation gap to align with evolving investor preferences.

The current shift in market trends, especially towards digital assets and tokenised securities, signals a shift in investor preferences and the financial industry's trajectory. While traditional markets for bonds and equities in Hong Kong remain strong, there is a clear demand for innovation in product development to align with these evolving trends.

To bridge this innovation gap and capitalise on emerging opportunities, Hong Kong must cultivate a long-term vision that wholeheartedly supports pioneering initiatives. This entails adapting regulatory standards to be more conducive to competition and entry of new market participants. Reframing regulatory conditions thoughtfully will not diminish the quality or integrity of the financial markets, and instead provide a fertile ground for new entrants to contribute to the diversification and dynamism of Hong Kong's financial services industry. Such strategic adjustments are essential to foster an ecosystem that is both resilient and adaptive to the demands of a rapidly evolving global financial landscape.

184 Peking University HSBC Business School (May 2023), *張明：數字貨幣如何助推人民幣國際化？*https://mp.weixin.qq.com/s/Z2dj4j_GS6Pey5cI1qTMFQ

Figure 18. Summary of recommendations

Optimising mutual market access schemes and exploring new connectivity options

	Remenndation 1: Optimising current mutual market access schemes	***Recommendation 2: Strengthening connectivity in emerging high-growth areas***
Short term	• Swap Connect: Launch the Southbound trading • ETF Connect: Add distinctive and non-equity ETFs • Bond Connect: Add (green) ABS from the Exchange Market • MRF: Allow overseas fund managers to manage abroad investments; Adjust the 50/50 value of sales requirements • WMC: Add insurance products	• PE: Establish green channels for cross-boundary private equity trading • REITs: Add REITs to Stock Connect or set up REIT Connect
Medium term	• Swap Connect: Broaden the scope and features • MRF: Relax 50/50 sales limit	• Commodity: Introduce Commodity Connect

Enhancing the depth and breadth of the offshore RMB market

	***Remenndation 3:* Boosting liquidity for the offshore RMB market**	***Remenndation 4:* Diversifying offshore RMB product offerings**	***Remenndation 5:* Enriching RMB risk management tools**
Short term	• Attract further RMB investment from other markets, such as the Middle East and Southeast Asia	• Expand the HKD-RMD Dual Counter model	• Swiftly launch RMB Treasury Bond Futures
Medium term		• Encourage offshore RMB bond issuances with non-domestic market exposure • Promote RMB for pricing, trading, and financing of HK stocks	• Establish a robust and flexible regulatory framework that governs access to onshore RMB FX • Enhance Swap Connect

Accelerating RMB ecosystem development

	Recommendation 6: Broadening talent connectivity	***Remenndation 7: Enhancing cross-boundary data flow***	***Recommendation 8: Leveraging infrastructure development, digital currency advancements, and innovation***
Short term	• Allow more entities to participate in the GBA Standard Contract initiative • Set up pilot schemes to enable the cross-boundary flow of data across various Connect Schemes	• Ease examination requirements or provide incentives to encourage financial professionals from both regions to actively participate in each other's respective markets	
Medium to long term	• Clarify regulations governing cross-boundary data flow, strengthening data governance and policy coordination within the GBA • Establish a third-party certification agency for impartial conformity assessments • Explore the use of new technologies for data transfers • Attract and nurture talent with technological and digital-related skillsets	• Permit financial professionals to engage in ad-hoc cross-border financial activities that are of a less risky and complex nature	• Update its cross-boundary infrastructure linkages to enhance efficiency and robustness • Leverage the development of digital currency to support the international expansion of the RMB • Foster an environment that encourages innovation and embraces failure to allow companies to take hold of steps to develop innovative products

Conclusion

Conclusion

In a rapidly evolving global financial landscape, Hong Kong's competitiveness depends on its ability to adapt, innovate, and stay ahead of emerging trends. A key strategy to achieve this is to strengthen its offshore RMB business. The internationalisation of the RMB is a strategic priority for China, and Hong Kong has emerged as a key player in this transformative journey, facilitating dual circulation of cross-boundary RMB. The city's role as the gateway to Mainland China's capital market has positioned it as a driving force behind the adoption of the RMB for international trade, financing, and investment.

Looking ahead, Hong Kong holds the potential to propel the RMB to new heights on the world stage. The actionable recommendations outlined in this report, crafted through close collaboration with industry experts and underpinned by comprehensive market insights, chart a clear path forward for policymakers and regulatory bodies to accelerate RMB internationalisation.

By enhancing the synergies between Mainland China and Hong Kong and fortifying the offshore RMB marketplace, Hong Kong is well-positioned to enhance its stature as a global financial hub. This strategic thrust will not merely expedite the RMB's global journey, but also attract international investors to Mainland China's dynamic markets.

Annex

Annex 1: Accelerate and to go beyond – opportunities ahead

Hong Kong has much untapped potential to cement its role as a central hub for offshore RMB business. Recent reforms and enhancements in the local and Mainland stock markets contribute to this journey.

Concurrently, the increasing demand for RMB-denominated bonds signals a flourishing market that Hong Kong is well-placed to cater to. Adding to the dynamism, the development of the Mainland's REITs and commodity markets introduces new opportunities for RMB transactions. The city is also primed to embrace the emerging digital currency movement, potentially setting the pace for RMB digitalisation in the offshore market.

Collectively, these developments offer clear paths for growth and a compelling impetus for Hong Kong to solidify its stature as a leading offshore RMB business centre. This section will delve into each potential market, assess its current landscape and highlight the opportunities.

Stock Market

Mainland China

In September 2023, the market capitalisation of Mainland China's stock market reached USD 10,889 billion, maintaining its position as the second-largest capital market globally.[185]

Mainland China is home to the two largest stock exchanges in the world in terms of Initial Public Offering (IPO) proceeds (Figure 19).[186] In 2023, the A-share IPO market experienced a slowdown, mirroring the global trend in IPO activities.[187] However, both the Shanghai Stock Exchange and the Shenzhen Stock Exchange maintained their positions as the top two listing venues globally in terms of funds raised.

Figure 19. Top IPO markets in 2023

Rank	*Stock Exchange*	*IPO Proceeds (USD billion)*
1	Shanghai (Main Board and STAR market)	31.3
2	Shenzhen (Main Board and ChiNext)	22.0
3	US (NASDAQ)	12.5
4	US (NYSE)	9.8
5	India National and Bombay	6.9

Source: KPMG

Recognising the need to foster a more sustainable capital market, the Ministry of Finance and the CSRC have put forward measures to boost the capital market and bolster investor confidence by creating a conducive listing environment conducive.

In February 2023, the CSRC issued regulations for fully implementing the registration-based IPO regime.[188] The shift from the previous approval-based system is seen as a step forward in facilitating greater diversification and inclusivity in the issuance criteria for mainboards.[189] The reform is also anticipated to improve China's multilevel capital market system, whereby each exchange caters to a specific set of companies at different stages of growth and across various sectors. The role of each exchange is summarised below.[190]

185 CEIC, https://www.ceicdata.com/en/indicator/china/market-capitalization (accessed on 9 November 2023)
186 KPMG (January 2024), *Chinese Mainland and Hong Kong IPO markets*, https://assets.kpmg.com/content/dam/kpmg/cn/pdf/en/2024/01/china-hk-ipo-markets-2023-review-and-2024-outlook.pdf
187 KPMG (January 2024), *Chinese Mainland and Hong Kong IPO markets*, https://assets.kpmg.com/content/dam/kpmg/cn/pdf/en/2024/01/china-hk-ipo-markets-2023-review-and-2024-outlook.pdf
188 The State Council Information Office of the People's (February 2023), *China rolls out registration-based IPO system across the board in milestone reform*, http://english.scio.gov.cn/pressroom/2023-02/18/content_85113621.htm
189 Deloitte (June 2023), *Mainland and Hong Kong IPO markets to become more robust in 2H 2023*, https://www2.deloitte.com/cn/en/pages/audit/articles/pr-mainland-and-hk-ipo-markets-in-1h-2023.html
190 Deloitte (June 2023), *Mainland and Hong Kong IPO markets to become more robust in 2H 2023*, https://www2.deloitte.com/cn/en/pages/audit/articles/pr-mainland-and-hk-ipo-markets-in-1h-2023.html

Figure 20. Capital market system in Mainland China

	Main Board of Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE) Prioritise "large-cap blue chip stocks", primarily catering to established companies that meet specific criteria.
	SSE STAR Market Focus on "hard-tech" companies. This market segment aims to include more companies in the field of advanced technology and scientific innovations.
	ChiNext Focus on innovative growth companies and start-ups. It allows the listing of pre-revenue companies, providing a platform for emerging companies with significant growth potential.
	Beijing Stock Exchange (BSE) and National Equities Exchange and Quotations (NEEQ) Explore the development of rules tailored for innovative small-to-medium-sized companies. This initiative aims to provide more targeted services and support to these companies in their listing and growth processes.

Source: Deloitte

Hong Kong

As of December 2023, the market capitalisation of Hong Kong stood at HKD 31 trillion.[191] The city has traditionally been recognised as one of the premier IPO destinations globally. Despite a slight decline to sixth place among global stock exchanges due to fewer deals in 2023 compared to the same period in 2022,[192] the pipeline of over 100 active IPO applicants (as of September 2023) suggests a sustained interest in Hong Kong's market as a capital raising platform.[193]

HKEX and the Government have been actively introducing measures to strengthen the stock market. Several recent developments that aim to enhance the stock market offerings are outlined below:

Chapter 18C: The new Chapter 18C launched in March 2023, is specifically designed to support companies specialising in advanced technologies such as artificial intelligence, robotics, automation, and semiconductors.[194]

Inclusion of international companies in Stock Connect: Starting from March 2023, shares of multinational companies with primary listings in Hong Kong are now included in the Southbound trading of Stock Connect.[195] This development boosts Hong Kong's attractiveness as a listing destination. International issuers can gain access to an expanded investor base.

HKD-RMB Dual Counter Model and Dual Counter Market Making Programme: The HKD-RMB Dual Counter Model allows investors to trade securities issued by the same issuer in both HKD and RMB. The Dual Counter Market Making Programme helps enhance the liquidity of dual counter securities and reduces price discrepancies between the two counters, providing investors with more flexibility in their trading activities.

Inclusion of ETFs under Stock Connect: This inclusion of ETFs in the Stock Connect scheme presents long-term diversification and investment prospects for international and Mainland investors. This eases global investors' access to Mainland and RMB assets while enabling Mainland investors to broaden their investment portfolios, in turn promoting cross-boundary investment.

191 HKEX (December 2023), *HKEX Monthly Market Highlights*,
https://www.hkex.com.hk/Market-Data/Statistics/Consolidated-Reports/HKEX-Monthly-Market-Highlights?sc_lang=en
192 KPMG (January 2024), *Chinese Mainland and Hong Kong IPO markets*,
https://assets.kpmg.com/content/dam/kpmg/cn/pdf/en/2024/01/china-hk-ipo-markets-2023-review-and-2024-outlook.pdf
193 HKEX (October 2023), *2023 Q3 Results Analyst Presentation*,
https://www.hkexgroup.com/-/media/HKEX-Group-Site/Ir/Analyst-Presentation/2023-Q3-Results-Presentation-(16x9)_vF.pdf
194 HKEX, *Listing of Specialist Technology Companies*,
https://www.hkex.com.hk/Listing/Rules-and-Guidance/Listing-of-Specialist-Technology-Companies?sc_lang=en (accessed on 9 November 2023)
195 HKEX (March 2023), *Expansion of Stock Connect Eligible Stocks to Take Effect 13 March*,
https://www.hkex.com.hk/News/News-Release/2023/230303news?sc_lang=en

Task Force on Enhancing Stock Market Liquidity: The establishment of this task force highlights the Government's commitment to improving the liquidity and efficiency of the stock market.[196] Notably, the 2023 Policy Address incorporated the Task Force's recommendations, which affirm the Government's proactive stance on this. These endorsed proposals encompass a range of measures, such as reducing the stamp duty on stock transfers, reviewing stock trading spreads, lowering market data fees, reforming the Growth Enterprise Market (GEM), and promoting stock market development via diverse strategies.

Reform GEM: In September 2023, the Hong Kong Exchanges and Clearing Limited (HKEX) initiated a public consultation on reforming the GEM.[197] Notably, in 2022 and 2023, there were no new listings on GEM in Hong Kong. To encourage the listing of small and medium-sized enterprises in Hong Kong, HKEX has proposed reforms to the GEM Listing Rules. These reforms include streamlining the transfer mechanism to the Main Board and introducing a new listing route specifically tailored for R&D-focused companies, among other proposals. Following the consideration of public feedback, HKEX implemented the revised Listing Rules in January 2024.[198]

Stamp duty reduction: Effective in November 2023, the Hong Kong Government reduced the stamp duty on stock transfers from 0.13% to 0.1% of the consideration or value of each transaction payable by buyers and sellers, respectively.[199] This move is expected to lower transaction costs and encourage participation in Hong Kong's capital markets to drive liquidity.

With its strategic position as a unique gateway between Mainland China and international investors, Hong Kong offers prominent access to the Mainland's capital market. The ongoing enhancements to the listing regime could attract more Chinese firms to list in the city, presenting additional opportunities for international investors to tap into the growth of the Mainland Chinese economy.

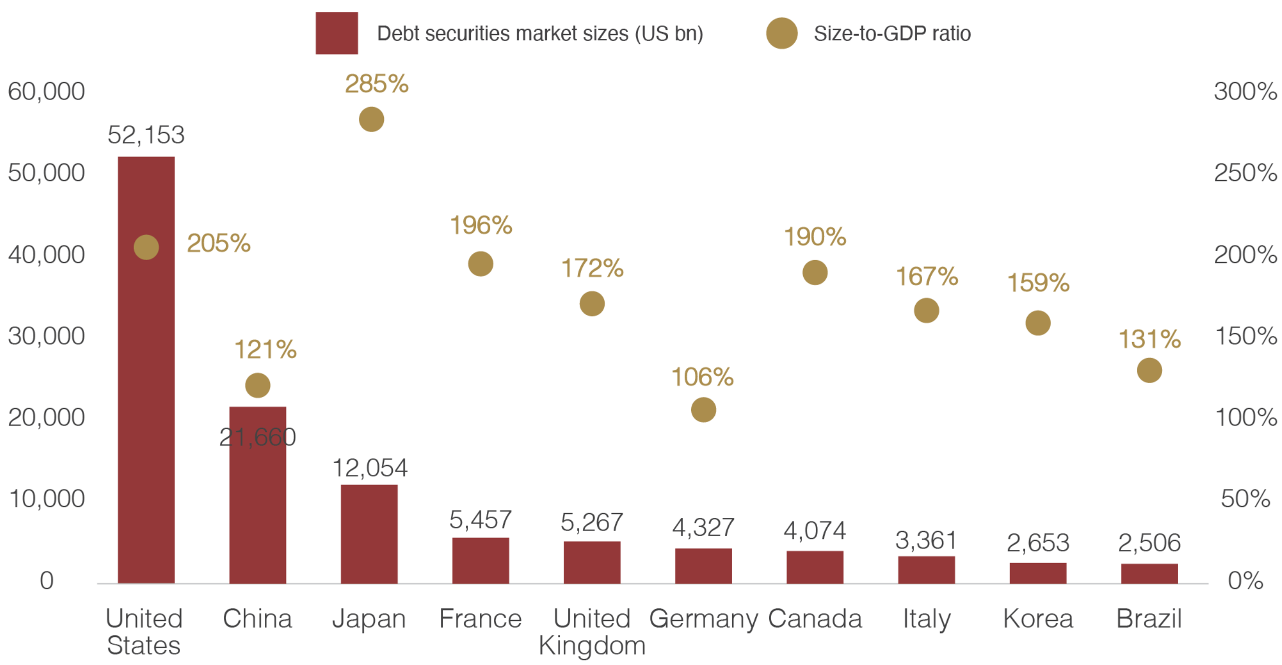
196 Financial Secretary of the Government of the HKSAR (September 2023), *Enhancing Stock Market Liquidity and Showcasing Hong Kong's New Advantages*, https://www.fso.gov.hk/eng/blog/blog20230903.htm
197 HKEX (September 2023), *Exchange publishes consultation paper on GEM listing reforms*, https://www.hkex.com.hk/News/Regulatory-Announcements/2023/230926news?sc_lang=en
198 HKEX (December 2023), *Exchange Publishes Consultation Conclusions On Gem Listing Reforms*, https://www.hkex.com.hk/News/Regulatory-Announcements/2023/2312152news?sc_lang=en
199 HKSAR Government (October 2023), *Policy Address*, https://www.policyaddress.gov.hk/2023/en/p70.html

Bond Market

Onshore bond market

The onshore bond market in China, currently ranked as the world's second largest, holds considerable growth potential. Compared to other mature markets, the Chinese bond market remains relatively small compared to the country's substantial gross domestic product (GDP) (Figure 21). Moreover, the rising demand for and utilisation of RMB-denominated assets on a global scale further contributes to the growth prospects of China's onshore bond market.

Figure 21: Debt securities and the size-to-GDP ratio of the top 10 largest bond markets in the world (2022)



Source: BIS and World Bank[200]

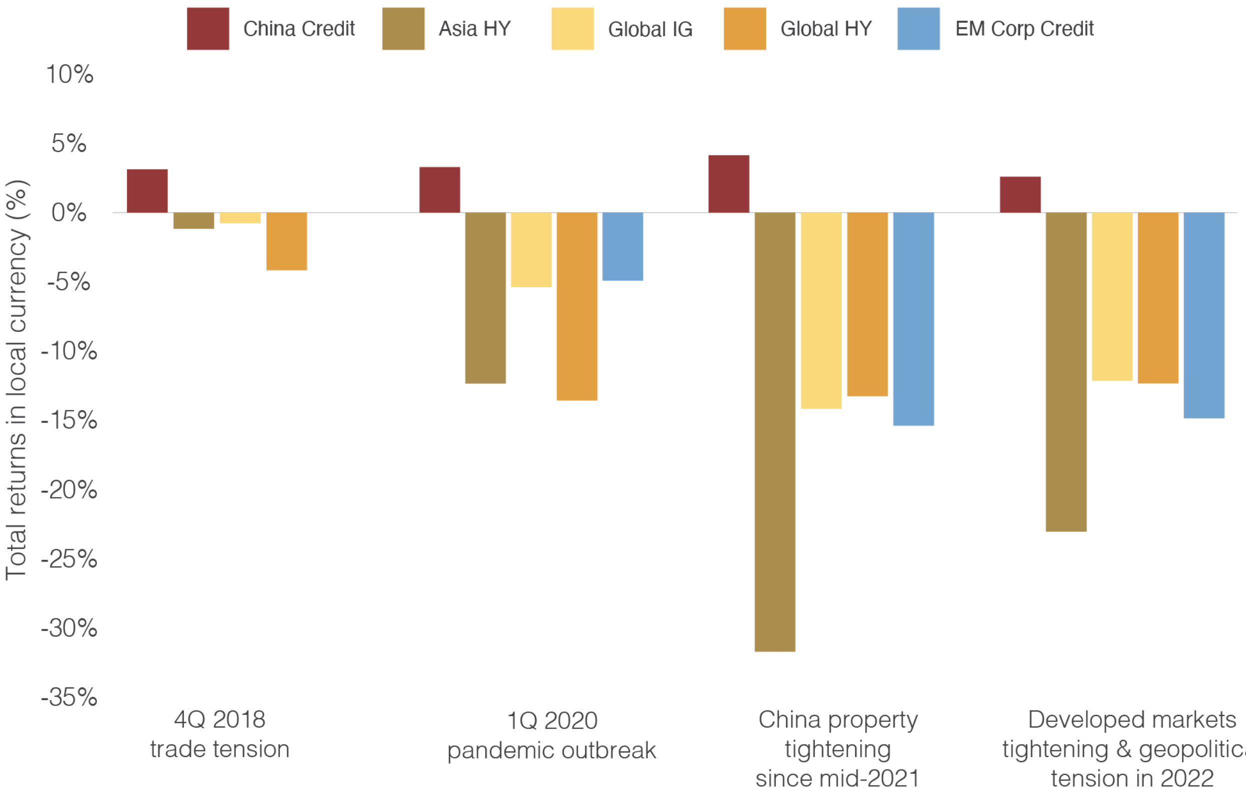
Increased demand for RMB bonds

Over the years, there has been a gradual increase in the holdings of RMB bonds by foreign institutional investors. By the end of 2023, the total value of foreign holdings in onshore bonds reached RMB 3.7 trillion, representing a growth in value of 203% since the launch of Bond Connect in June 2017.[201] However, this only accounts for 2.4% of the total Chinese onshore bond market.[202] The proportion of foreign holdings in the Chinese bond market is considerably lower than other international markets and does not reflect China's weight in the global economy. Compared to smaller markets, although China surpasses them in absolute terms, its size-to-GDP ratio (121%) falls short of several smaller bond markets, except for Germany (Figure 21).

A study by the HKMA also noted that Mainland onshore bonds tend to correlate less with traditional asset classes, such as government bonds in developed markets and global equities.[203] International asset managers are increasingly considering investing in Mainland onshore bonds for asset diversification.[204] Particularly during periods of weak global economic growth and heightened market volatility, such as the periods affected by the pandemic in recent years, Chinese bonds performed relatively stable compared to other bonds (Figure 22).

200 *BIS: Debt Securities statistics*, https://data.bis.org/topics/TDDS/tables-and-dashboards/BIS,SEC_C1,1.0?time_period=2022-Q4 (accessed on 11 November 2023); World Bank, *Gender Data Portal, GDP (current USD)*, https://genderdata.worldbank.org/indicators/ny-gdp-mktp-cd/ (accessed on 9 November 2023)
201 The People's Bank of China, *Statistics and Analysis Department*, http://www.pbc.gov.cn/diaochatongjisi/116219/116319/4780803/4780808/index.html (accessed on 7 March 2024)
202 China Central Depository & Clearing, https://www.chinabond.com.cn/zzsj/zzsj_tjsj/tjsj_tjyb/### (accessed on 31 January 2024)
203 HKMA (September 2021), *A Closer Look at Bond Connect and the Journey Ahead*, https://www.hkma.gov.hk/media/eng/publication-and-research/quarterly-bulletin/qb202109/fa1.pdf
204 Goldman Sachs (July 2021), *Four Reasons to Consider Increasing China Bond Exposure*, https://www.gsam.com/content/gsam/us/en/institutions/market-insights/gsam-connect/2021/China-Bond-Exposure.html

Figure 22: The return of different bonds in local currency between 2018 and 2022



Source: Bloomberg[205]

From the issuers' perspective, representatives from the banking sector observed a growing interest in RMB-denominated borrowing, including bond issuance and loans.[206] This trend is largely influenced by the interest rate differentials between the USD and RMB, alongside the recent depreciation of the RMB. Furthermore, onshore investors have been capitalising on the rate differential between the lower onshore rates and higher offshore rates by purchasing RMB assets through the Southbound Bond Connect.[207] Market participants also noted that clients with predominant assets in Mainland China had been actively seeking to refinance their USD/HKD loans with RMB loans. This strategic shift allows them to access loans at lower interest rates and provides a natural currency hedge.

205 China Credit refers to Bloomberg China Aggregate Total Return Index; Asia HY refers to Bloomberg Asia High Yield Total Return Index; Global IG refers to Bloomberg Global Aggregate Corporate Total Return Index; Global HY refers to Bloomberg Global High Yield Corporate Total Return Index, and EM Corp Credit refers to Bloomberg Emerging Markets Investment Grade Total Return Index.
206 According to insights provided by market participants from the banking sector.
207 According to insights provided by market participants from the banking sector.

The Convergence of RMB Reinsurance and Onshore Bond Market Opportunities

The rise of China has sparked a growing market demand for conducting transactions using RMB, creating opportunities for RMB reinsurance. The strengthened economic ties with countries participating in initiatives like the BRI and the RCEP have further promoted this trend. Consequently, banks, acting as intermediaries, are handling a growing volume of business in RMB.[208] These banks will require RMB reinsurance to manage some of the risks involved. Additionally, Chinese banks play a crucial role in providing the majority of financing for Belt and Road projects, with loans typically denominated in RMB.[209] Given the inherent risks and uncertainties associated with infrastructure projects in Belt and Road regions, it is common for banks lending to project developers to seek to transfer risk to reinsurers. This presents opportunities for the RMB reinsurance sector.

Hong Kong, as a prominent financial and insurance centre, has the potential to establish itself as the premier hub for RMB reinsurance. It boasts the highest insurance density in Asia and ranks second in insurance penetration in the region. Additionally, seven of the world's top 10 insurers are authorised to operate in Hong Kong.[210] In 2014, the FSDC released a paper titled "Developing Hong Kong as an Offshore RMB-denominated Reinsurance Centre", proposing several measures to establish Hong Kong as China's leading offshore RMB reinsurance centre.[211] Given recent developments and favourable market conditions, there is a growing consensus that Hong Kong should intensify its efforts to develop its RMB reinsurance centre.

The market suggests attracting insurance and reinsurance companies to establish their operations in Hong Kong by forming locally registered companies. Offering incentives such as easier access to China's asset market would be an effective approach to entice these companies. By earning premiums denominated in RMB, these companies would naturally seek investment opportunities in RMB-denominated assets. China's onshore RMB-denominated bond market is particularly appealing to foreign investors. Currently, accessing this market through the RMB Qualified Foreign Institutional Investors (RQFII) programme can be cumbersome. To streamline investment, Hong Kong and the Mainland could consider allowing exclusive quota-free access to the Chinese onshore bond markets for locally registered reinsurance companies.

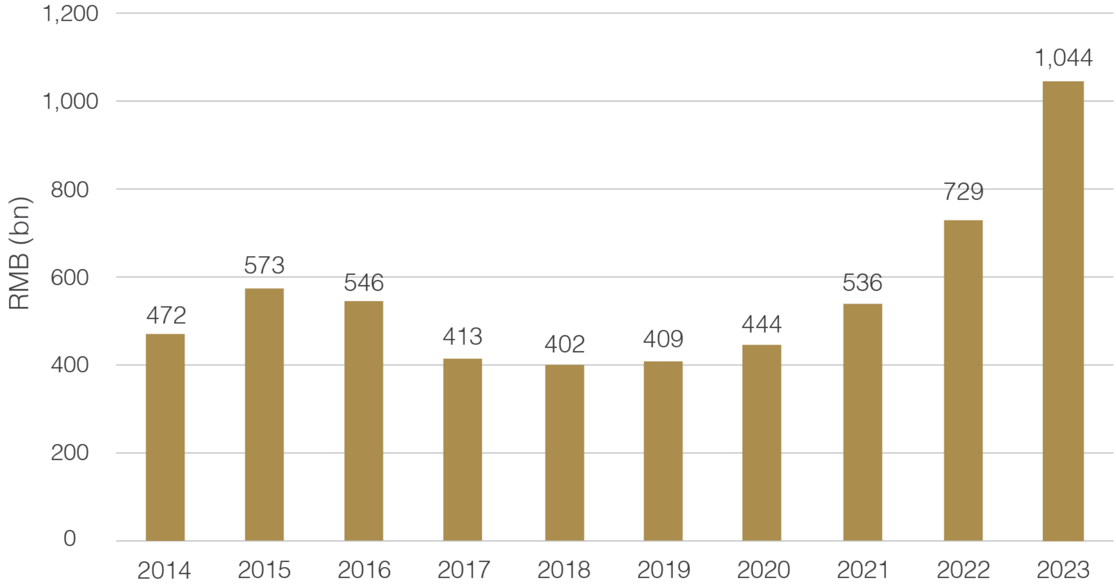
Offshore bond market

Hong Kong has established itself as the preeminent centre for offshore RMB activities. It boasts a significant offshore RMB fund pool, the largest offshore RMB FX trading centre, and a bustling offshore RMB bond market. Since Mainland China continues its efforts toward more open capital accounts and the advancement of RMB internationalisation; the city's offshore RMB bond market has also shown considerable growth in recent years.

The offshore RMB bond market, which had a modest start in 2007, has gradually evolved into a critical platform for offshore RMB financing. Between 2014 and 2020, the growth in size was moderate, with the value of total outstanding bonds staying within the RMB 400–500 billion range (Figure 23), but a surge of issuance prompted the market size by over 20% in 2021, with a further rise of over 35% in 2022 and 43% in 2023. The momentum continued in 2023, with the issuance reaching RMB 545.1 billion.[212]

208 PBOC (October 2023), *2023 年人民幣國際化報告*, http://www.pbc.gov.cn/huobizhengceersi/214481/3871621/5114765/2023102720175126516.pdf
209 China Daily (October 2023), *Bank of China boosts development of Belt and Road,* https://regional.chinadaily.com.cn/en/2023-10/18/c_931497.htm
210 Insurance Authority (2024 February), *Annual Report 2022 – 23*, https://www.ia.org.hk/en/infocenter/files/Insurance_Authority-AR23_eng.pdf
211 FSDC (December 2014), *Developing Hong Kong as an Offshore RMB-denominated Reinsurance Centre*, https://www.fsdc.org.hk/media/d4odpfe4/fsdc-paper-no-11-rmb-re-insurance-final-16-12-2014.pdf
212 HKMA (February 2024), *Briefing to the Legislative Council Panel on Financial Affairs,* https://www.hkma.gov.hk/media/eng/doc/about-the-hkma/legislative-council-issues/20240205e2.pdf

Figure 23: Dim Sum Bond Market Size



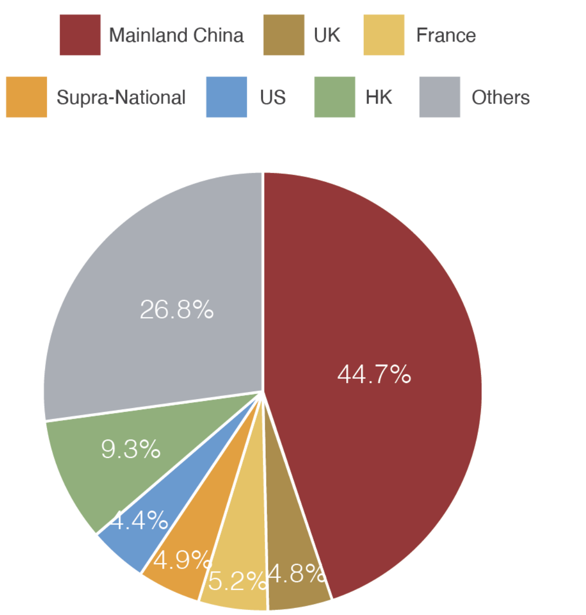
Source: Haitong International

Issuers' profile

As an essential channel for offshore RMB funding, Chinese issuers primarily fuel the Dim Sum bond market, accounting for 44.7% of the outstanding bonds issued (Figure 24). Issuers from other locations, including Hong Kong and the US, also participate, representing 9.3% and 4.4% of the market issuances, respectively.

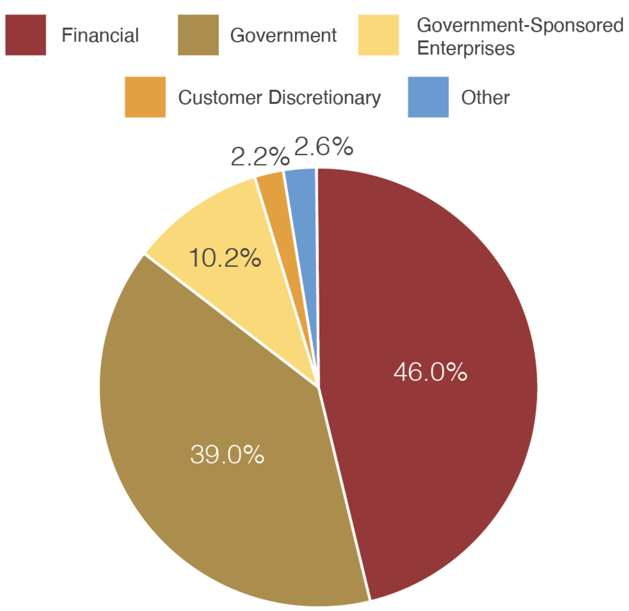
The market is concentrated across several sectors. The financial sector and the government sector accounted for more than half of the market, totalling 46% and 39%, respectively (Figure 25). Bonds issued by the Chinese Local Government Financing Vehicles (LGFVs), also known as Government-Sponsored Enterprises (GSEs), are a distant third in market share (10.2%), followed by the consumer discretionary sector (2.2%). The relatively small representation of other sectors highlights a limited diversity in the industry profile of issuers.[213]

Figure 24: Outstanding bonds by country



Source: Bloomberg, Haitong International (As of 07 March 2024)

Figure 25: Outstanding bonds by industry



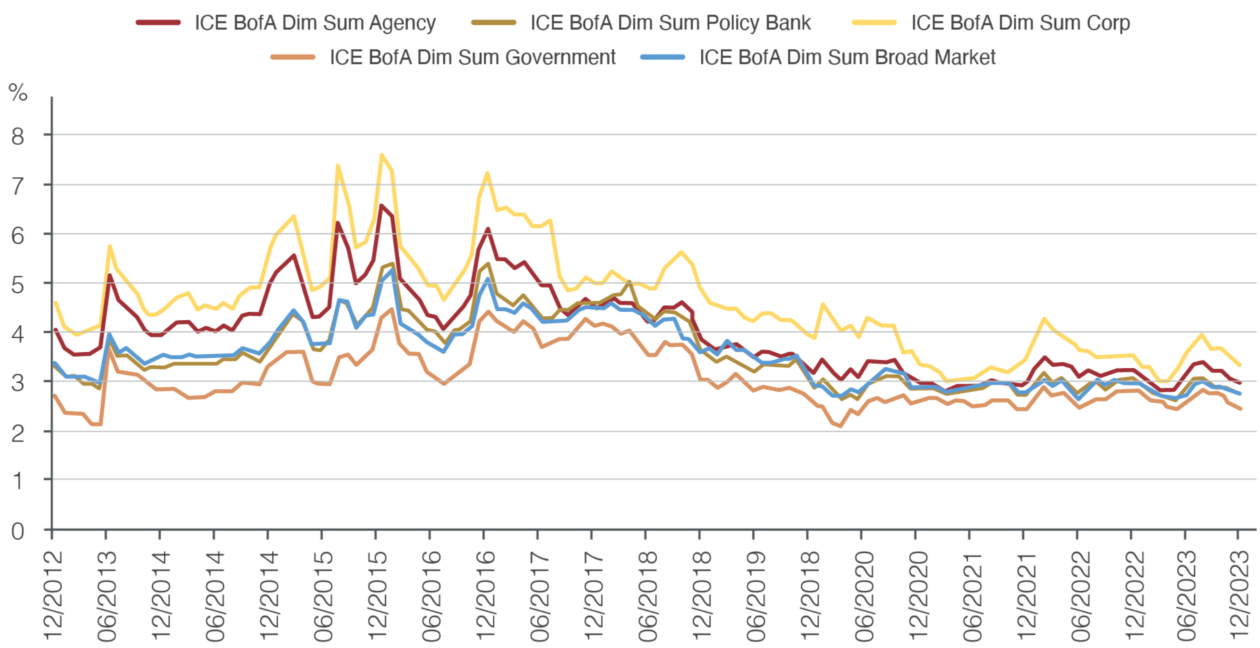
Source: Bloomberg, Haitong International (As of 07 March 2024)

213 Bloomberg and Haitong International

Maturity profile

Effective yields for Dim Sum bonds peaked in 2016 before declining to hit record lows in 2021. In 2023, the yields of government-issued bonds ranged between 2.45% and 2.84% (Figure 26), whereas corporate-issued Dim Sum bond yields were trading between 3% and 3.95%, reflecting a spread of 39 - 95 basis points (bp), down from 186 - 375bp in 2015. Such narrowing indicates enhanced market perception of the credit quality for corporate issuers.

Figure 26: Effective Yields of Dim Sum Bond



Source: Bloomberg, Haitong International (As of 07 March 2024)

As the Central Government reaffirmed its commitment to internationalise the RMB and strengthen its global influence in the "14th Five-Year Plan", we continue to see favourable initiatives being introduced to support the broader use of the RMB. In October 2023, the National Development and Reform Commission of Mainland China and the HKMA signed an MOU to support cross-boundary financing of Chinese enterprises and promote the development of the Hong Kong bond market.[214] This MOU aims to expand the size and enhance the liquidity of the Dim Sum bond market, taking advantage of Hong Kong's position as an offshore RMB business hub.

Additionally, the ongoing development of central bank digital currency in Mainland China and Hong Kong (through the Project mBridge), together with the new financial infrastructure, could also help facilitate the tokenised issuance and trading of bonds for a broader range of issuers and investors, thus further boosting the volume and depth of the Dim Sum bond market.

214 HKMA (October 2023), *Memorandum of Understanding to support cross-border financing by Chinese enterprises and promoting the development of the Hong Kong bond market between the NDRC and the HKMA*, https://www.hkma.gov.hk/eng/news-and-media/press-releases/2023/10/20231019-3/

REIT market

A Real Estate Investment Trust (REIT) is a collective investment scheme constituted as a trust that invests primarily (75% and 80% for H-REITs and C-REITs, respectively) in real estate to provide returns to investors derived from the recurrent rental income of the real estate (e.g., shopping malls, offices, hotels, etc.).[215]

According to a study published by a global real estate services firm, Japan, Singapore, and Hong Kong collectively held over 80% of the Asia REIT market share (Figure 27) as of December 2022. Notably, the Mainland China REIT market has experienced significant growth and stood as the fourth largest REIT market in Asia as of 2022.

Figure 27. Total market value of active REITs on major Asian exchanges in 2022

	Quantity	Market value (USD billion)	% of major Asian exchanges
Japan	61	120.9	45.8%
Singapore	40	73.1	27.7%
Hong Kong	11	24.2	9.2%
Mainland China	23	12.4	4.7%
India	3	7.41	2.8%
Thailand	29	6.7	2.6%
Malaysia	18	6.1	2.3%
South Korea	21	5.5	2.1%
Philippines	7	4.1	1.6%
Others	7	3.3	1.3%
Total	220	263.8	100.0%

Source: Cushman & Wakefield

Mainland REITs (C-REITs)

Despite entering the scene late, Mainland China has witnessed remarkable growth in its REIT market. The onshore Mainland REIT market, also known as C-REITs, has seen a rapid increase in the number of REITs across a broader range of asset classes since the first nine public infrastructure REITs were listed under the pilot scheme in June 2021.[216]

Up until July 2023, a total of 33 products obtained approval for their initial public offerings and subsequent fundraising. These products raised nearly RMB 100 billion in funds, further spurring investments of over RMB 560 billion in new projects.[217] The asset portfolio encompasses various sectors, including industrial parks, highways, warehousing and logistics, wastewater treatment, clean energy, affordable rental housing, and new energy sources.

The role of REITs in Mainland China extends beyond serving as financial instruments; they also function as social policy tools, channelling capital to government-preferred sectors as 90% of IPO proceeds should be redeployed by sponsors towards existing and new developments typically within the same asset class (unlike H-REIT IPOs).[218] Among others, affordable rental housing, clean energy, and commercial infrastructure (e.g., shopping malls) are prioritised.[219] These preferences may shift over time in keeping with the country's national development plan, with C-REIT listings being orchestrated to reflect these changes. On 20 October 2023, the rules governing C-REITs were revised to include commercial infrastructure,[220] with the acceptance of the first four commercial infrastructure C-REIT applications on 26 October 2023,[221] and three were approved in November 2023.[222]

215 Investor and Financial Education Council, *Real Estate Investment Trust*, https://www.ifec.org.hk/web/en/investment/investment-products/REIT/REIT.page (accessed on 9 November 2023)
216 Deloitte (July 2023), *中國REITs發展報告*, https://www2.deloitte.com/content/dam/Deloitte/cn/Documents/real-estate/deloitte-cn-re-china-REITs-development-report-zh-230714.pdf
217 Shanghai Securities Journal (July 2023), *证监会：抓紧完善REITs信息披露体系 研究推动将REITs纳入互联互通机制*, https://news.cnstock.com/news,yw-202307-5087235.htm
218 National Development and Reform Commission (March 2023), *国家发展改革委关于规范高效做好基础设施领域不动产投资信托基金 (REITs) - 项目申报推荐工作的通知*, https://www.ndrc.gov.cn/xxgk/zcfb/tz/202303/t20230324_1351765.html
219 Cushman & Wakefield (2023), *Asia REIT Market Insights 2023*, https://cushwake.cld.bz/asia-REIT-market-insight-2023/4-5/
220 Xinhua Finance (October 2023), *消費基礎設施納入資產範圍 中國公募REITs市場揭開新篇章*, https://www.cnfin.com/yw-lb/detail/20231020/3952196_1.html
221 Xinhua Net (October 2023), *首批四單消費基礎設施REITs項目開啟受理*, http://www.news.cn/fortune/2023-10/27/c_1129942049.htm
222 Xinhua Net (November 2023), *首批3单消费基础设施REITs项目获批*, http://www.news.cn/2023-11/28/c_1129996398.htm

REITs allow China's local governments or private corporations to recycle their capital into new projects. Multinationals are showing interest in establishing C-REITs for their projects in Mainland China (for example, ESR, an Asia-focused real estate services and investment company, filed its logistics C-REIT for listing in December 2023, aiming to have its shares publicly traded by February 2024).[223] C-REIT market's growth and diversification underline its potential as a significant player in the global REIT landscape.

Policy support from various regulatory bodies has been instrumental in developing the C-REIT market. Zhou Xiaozhou, Director of the Bond Department at the CSRC, stated that the CSRC is promoting the regular issuance of REITs in the market and improving the foundational systems while strengthening market supervision.[224] Progress has been made in areas such as encouraging public mutual fund-of-fund (FOF) products to invest in REITs and enhancing the evaluation and incentives for market makers. In December 2023, the Ministry of Finance of the People's Republic of China released new measures signifying policy support for the country's national pension fund, the National Security Fund, and investing in C-REITs. The support has been broad and coordinated across several regulatory authorities.[225]

The CSRC is set to enhance the information disclosure system for REITs, reinforce temporary disclosure requirements, increase the frequency and timeliness of disclosures, and accurately reflect the underlying asset operations. Additionally, efforts will be made to encourage long-term institutional investors, such as social security funds, pension funds (as mentioned above), and corporate pensions, to participate in REIT investments and to actively cultivate a professional investor base for REITs. During a work meeting of the Asset Management Association of China (AMAC) in October 2023, which was attended by the CSRC and other regulators, a suggestion was made to accelerate the establishment of a multi-level REIT market, and explore coordinated development among public REITs, private REITs and pre-REITs.[226]

Hong Kong REITs (H-REITs)

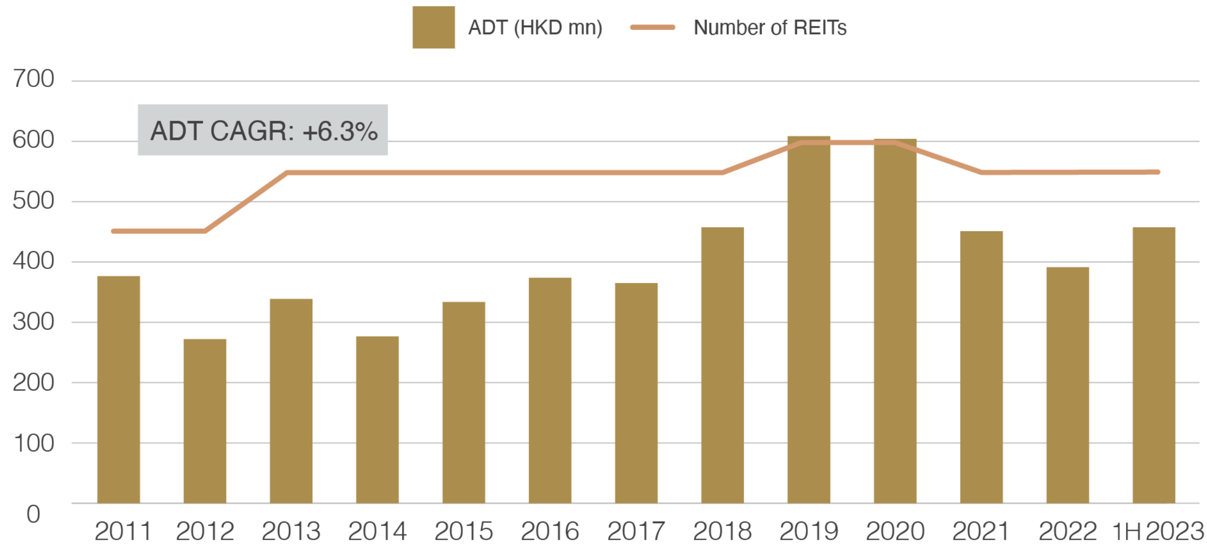
Hong Kong REITs allocate investments to properties spanning Hong Kong, Mainland China, Europe, and Australia. These properties encompass offices, shopping malls, hotels, mixed-use and industrial buildings, car parks, and logistics properties.[227]

There are 11 REITs listed in Hong Kong, with a market value of USD 26 billion as of 1Q 2023.[228] In terms of market size, Hong Kong's REIT market ranked as the third largest in Asia, representing approximately 9.2% of the overall Asian market in 2022 (Figure 27). However, it trailed behind the top two markets, Japan and Singapore, which hold market shares of 45.8% and 27.7%, respectively (Figure 27).[229]

Regarding trading activities, H-REITs' turnover has displayed a general upward trend, reflecting a growing level of investor interest. According to an HKEX study, from 2011 to the first half of 2023, the ADT of H-REITs achieved a compounded annual growth rate (CAGR) of approximately 6.3% (Figure 28).[230]

223 Mingtiandi (December 2023), *ESR China REIT Secures First Cornerstone Investor, Targets February Listing*, https://www.mingtiandi.com/real-estate/finance/esr-china-reit-secures-first-cornerstone-investor-targets-february-listing/
224 Shanghai Securities Journal (July 2023), *證監會：抓緊完善REITs資訊披露體系 研究推動將REITs納入互聯互通機制*, https://news.cnstock.com/news,yw-202307-5087235.htm; HKEX (October 2023), *Development Potential of Offshore Mainland China REITs in Hong Kong*, https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2023/CCEO_ML_REIT_202310_e.pdf
225 Ministry of Finance of the People's Republic of China (December 2023), *财政部拟出台管理办法进一步规范社保基金境内投资运营*, https://www.mof.gov.cn/zhengwuxinxi/caijingshidian/xinhuanet/202312/t20231207_3920283.htm
226 China Securities Journal (October 2023), *中基协资产证券化业务委员会2023年第二次工作会议在上海召开*, https://www.cs.com.cn/tzjj/jjdt/202310/t20231027_6373078.html
227 SFC (May 2023), *Fostering Growth of REITs in Hong Kong Luncheon remarks at Hong Kong REITS Association*, https://www.sfc.hk/-/media/EN/files/COM/Speech/20230516_CEO-speech-at-HKREITA-luncheon.pdf?rev=48bc48a7bccb4adcbb0d6f76c9f36dab&hash=3D6B01D8736F1FCEFA614E7A83F1930C
228 HKEX (October 2023), *Development Potential of Offshore Mainland China REITs in Hong Kong*, https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2023/CCEO_ML_REIT_202310_e.pdf
229 Cushman & Wakefield (2023), *Asia REIT Market Insights 2023*, https://cushwake.cld.bz/asia-REIT-market-insight-2023/4-5/
230 HKEX (October 2023), *Development Potential of Offshore Mainland China REITs in Hong Kong*, https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2023/CCEO_ML_REIT_202310_e.pdf

Figure 28: Number and ADT of H-REITs (2011-1H 2023)



Source: HKEX

Offshore Mainland REITs are primarily issued and listed in Hong Kong and Singapore, with the first such REIT debuting in Hong Kong in 2005. In terms of market share, these REITs have secured a more substantial foothold in Hong Kong than neighbouring regions. Specifically, they accounted for 13.2% of the total market value of Hong Kong REITs (H-REITs) and held a 3.3% share of Singapore REITs (S-REITs), as of June 2023.[231]

Hong Kong provides a conducive platform for listing and trading offshore Mainland REITs, thanks to the supportive policy measures and its strategic position as a nexus for international investors and Mainland China's economic activities. One notable development happened in December 2020 when the SFC implemented revisions to the REITs issuance regulatory regime to provide greater flexibility. These revisions included the relaxation of the limit on investments in property development projects, allowing REITs to allocate up to 25% of their total gross asset value to such projects,[232] thus providing greater flexibility to the REIT market.

Commodities market

Mainland China

In 2022, despite a slowdown mirroring the broader global trend, Mainland China's commodities market maintained its status as one of the world's largest, with the volume of domestic commodity futures and options reaching 6.616 billion lots (Figure 29). This represented a substantial 72.3% of the global total volume of commodity futures and options, which amounted to 9.153 billion lots.[233] This marked an increase of 2.5% compared to 2021.[234] In the first six months of 2023, domestic commodity futures and options accounted for 70.9% of the global total volume, representing a year-on-year increase of 1.84 percentage points.[235]

231 HKEX (October 2023), *Development Potential of Offshore Mainland China REITs in Hong Kong,* https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2023/CCEO_ML_REIT_202310_e.pdf
232 HKEX (October 2023), *Development Potential of Offshore Mainland China REITs in Hong Kong,* https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2023/CCEO_ML_REIT_202310_e.pdf
233 China Futures Association (February 2023), *2022年度期貨市場發展概論*, https://www.cfachina.org/aboutassociation/associationannouncement/202302/t20230221_36601.html
234 China Futures Association (February 2023), *2022年度期貨市場發展概論*, https://www.cfachina.org/aboutassociation/associationannouncement/202302/t20230221_36601.html
235 China Futures Association (August 2023), *2023上半年期貨市場發展概述*, https://www.cfachina.org/index/zygx/202308/P020230822331108151915.pdf

Figure 29. Top 10 commodity exchanges by the trading volume of exchange-traded commodity derivatives in 2022

Ranking	Exchange	2022 Volumne (billion lots)
1	Zhengzhou Commodity Exchange (ZCE)	2.398
2	Dalian Commodity Exchange (DCE)	2.275
3	Shanghai Futures Exchange (SHFE)[236]	1.943
4	Chicago Mercantile Exchange Group (CME Group)	0.965
5	Intercontinental Exchange (ICE)	0.839
6	Multi Commodity Exchange of India (MCX)	0.218
7	Moscow Exchange (MOEX)	0.161
8	Hong Kong Stock Exchange (HKEX)	0.135
9	Borsa Istanbul (BIST)	0.070
10	Singapore Exchange (SGX)	0.036

Source: China Futures Association, FIA

The Mainland's commodity market is experiencing growth and attracting interest from foreign investors to participate in Mainland China's commodity market. Factors such as increased travel and economic activities, infrastructure projects and economic growth in the APAC region, along with the opportunity to bridge the gap caused by EU sanctions on Russian products, are expected to support the growth of the commodities market in China and the broader Asia region as the effects of the COVID-19 pandemic subside.

The commodity market is recognised as a driver for RMB internationalisation.[237] In the ASEAN region, the increased usage of RMB for commodities and the higher level of trade flows with Mainland China contribute to a greater acceptance of the RMB.[238] A similar trend has been observed in the Middle East, where countries within the region have increasingly used RMB for oil payments.[239]

Hong Kong

Through HKEX and its subsidiaries, Hong Kong has been engaging in the commodities trading market. The HKEX operates an exchange and a clearing house in the UK, the London Metal Exchange (LME) and LME Clear, facilitating trading and clearing of base and ferrous metals futures and options contracts. Additionally, they have established a commodity trading platform within Mainland China, the Qianhai Mercantile Exchange (QME).

While Hong Kong may not naturally possess the traditional characteristics of a commodity-rich region, it compensates by capitalising on its strategic position as the economic gateway to Mainland China, establishing itself as an intermediary hub for commodity trading, connecting Mainland China with international markets. Hong Kong's Northbound and Southbound connections ensure a fluid flow of commodity trading between China and the rest of the world.

By actively participating in the commodities market, Hong Kong can enhance its position as a global financial centre and contribute to the broader goals of RMB internationalisation.[240]

236 SHFE includes the Shanghai International Energy Exchange (INE)
237 Shanghai Securities Journal (June 2023), *上證研究 | 全方位多舉措推進人民幣國際化*, https://news.cnstock.com/news,yw-202306-5078869.htm
238 China Forex (October 2023), *人民币东盟国家使用进展、趋势及建议*, http://www.chinaforex.com.cn/index.php/cms/item-view-id-52652.shtml
239 Shanghai Petroleum and Natural Gas Exchange (SHPGX) (April 2024), *中国石油达成我国与海合会国家首单LNG跨境人民币结算交易*, https://www.shpgx.com/html/zxdt/20230424/5362.html
240 HKEX (March 2020), *Research Report: The Hong Kong Commodities Market*, https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research%20Papers/2020/CMD_HK_CommMkt_e_202003.pdf

Private Equity

Mainland China

Mainland China is the largest private equity (PE) market in Asia and the second largest in the world, with an AUM of USD 1,501.2 billion as of 2022.[241] To draw more foreign investment, relevant Mainland stakeholders encourage PE fund managers to capitalise on programmes like QFII and Qualified Foreign Limited Partnership (QFLP).[242]

According to a study conducted by a global investment banking advisor, investors in the PE sector in Mainland China, also known as financial sponsors, have shown a preference for investing in policy-favoured/ driven sectors such as energy, industrial technology, and healthcare.[243] Many technology-driven companies in sectors such as the internet, biomedicine, and renewable energy have benefited from the involvement of PE and venture capital investment funds.

To further drive growth in the PE sector and the broader private market, Mainland China has implemented new regulations for private funds to uphold industry standards. The Regulations on the Oversight and Management of Privately-Offered Investment Funds came into effect on 1 September, 2023.[244] These rules establish clearer administrative measures that discourage misconduct among private fund managers, enhancing investor protection and promoting industry standards.

In recent years, competition among Mainland Chinese cities to attract fund managers to establish QFLP and Qualified Domestic Limited Partner (QDLP) programmes has intensified, with cities offering more favourable conditions. This includes further relaxation of eligibility criteria, filing requirements, and expanded investment scope.

Notably, several regions, including Beijing, Shenzhen, Hainan, Guangzhou, Nansha New Area, Ningbo, and Qingdao Free Trade Zone, have either eliminated or removed special requirements on the registered capital of QFLP fund managers.[245] Moreover, Shenzhen and Hainan have gone a step further by exempting fund managers from registering with the Asset Management Association of China (AMAC) for funds raised exclusively from overseas, reducing compliance costs.[246] Beijing has progressively expanded its investment scope from investing in non-publicly traded company equity to include sectors like bulk equity transactions, mezzanine investments, private debt, distressed assets, and other specialised investment areas that were once restricted.[247] These relaxations have created more opportunities for offshore fund managers to explore and identify the most regulation-friendly locations to establish QFLPs and QDLPs. This, to some extent, facilitates capital mobility within the PE sector.

Hong Kong

Hong Kong is a key centre for PE. As of the end of 2022, the amount of PE capital under management in Hong Kong reached USD 212 billion,[248] marking an almost 50% increase compared to the market size in 2017 (USD 141 billion).[249] The city remains the second-largest PE hub in Asia, with Mainland China being the largest. The sector has been further bolstered by recent legal and tax reforms that create a conducive environment for market development.[250,251,252]

The PE industry in Hong Kong benefits from its diversity and status as a preferred destination for global and regional investment fund managers. Home to approximately 650 PE/VC firms,[253] Hong Kong is a critical jurisdiction for top-tier pension funds, insurance companies, sovereign wealth funds, family offices, and other investors. The private market landscape in Hong Kong continues to evolve. As of December 2022, the PE market in Hong Kong accounted for approximately 4.0% of the market capitalisation of the public equity market.[254]

241 FSDC (August 2023), *Boosting Market Liquidity and Diversity: Enhancing Hong Kong's Competitiveness as an International Capital Formation Centre*, https://www.fsdc.org.hk/media/qd0agfzt/en-boosting-market-liquidity-and-diversity-enhancing-hong-kong-s-competitiveness-as-an-international-capital-formation-centre-_-final.pdf
242 Insights gained from FSDC's interaction with mainland stakeholders.
243 BDA Partners (February 2023), *China Private Equity Report 2023*, https://www.bdapartners.com/wp-content/uploads/2023/02/BDA-China-Private-Equity-Report-2023.pdf.pdf
244 The State Council of the People's Republic of China (July 2023), *私募投資基金監督管理條例*, https://www.gov.cn/zhengce/content/202307/content_6890738.htm
245 Zhong Lun Law Firm (May 2022), *QFLP政策的發展變化及實務*, https://www.zhonglun.com/Content/2023/05-22/1255345441.html
246 Zhong Lun Law Firm (May 2022), *QFLP政策的發展變化及實務*, https://www.zhonglun.com/Content/2023/05-22/1255345441.html
247 The People's Government of Beijing Municipality (May 2021), *北京市地方金融管理局, 北京市市場監督管理局關於印發《關於本市開展合格境外有限合夥人試點的暫行辦法》的通知*, https://www.beijing.gov.cn/zhengce/zhengcefagui/202105/t20210506_2382005.html
248 SFC (August 2023), *Asset and Wealth Management Activities Survey 2022*, https://www.sfc.hk/-/media/EN/files/COM/Reports-and-surveys/AWMAS-2022_E.pdf?rev=3b6a43ac11404a2cacf7123c2f5c949e&hash=C33D88F5AAEAC176BC072AE9326091CC
249 SFC (July 2018), *Asset and Wealth Management Activities Survey 2017*, https://www.sfc.hk/-/media/EN/files/ER/PDF/2017-Asset-and-WealthManagement-Activties-Survey_eng.pdf?rev=a6a391d3c1054145b1a63985c5d2878e&hash=A1727A12ABFFB88253A3F218D1121ED5
250 Law Business Research (March 2023), *The Private Equity Review*, https://www.shearman.com/-/media/files/perspectives/2023/04/hong-kong-fundraising.pdf
251 HKSAR Government (February 2023), *Attracting private equity funds to be domiciled and to operate in Hong Kong*, https://www.info.gov.hk/gia/general/202302/22/P2023022100422.htm
252 Private Wealth Management Association (March 2023), *Hong Kong 2035: A Global Wealth Management Centre*, https://www.pwma.org.hk/wp-content/uploads/2023/03/Hong-Kong-2035-A-Global-Wealth-Management-Centre-rv1.pdf
253 HKMA (November 2023), *Opening Address at the 36th Annual AVCJ Private Equity & Venture Forum*, https://www.hkma.gov.hk/eng/news-and-media/speeches/2023/11/20231114-1/
254 FSDC (August 2023), *Boosting Market Liquidity and Diversity: Enhancing Hong Kong's Competitiveness as an International Capital Formation Centre*, https://www.fsdc.org.hk/media/qd0agfzt/en-boosting-market-liquidity-and-diversity-enhancing-hong-kong-s-competitiveness-as-an-international-capital-formation-centre-_-final.pdf

Digitalisation of the RMB

The last few years have seen a marked trend among central banks worldwide to develop their own digital currencies, creating new channels for cross-border currency circulation. Data as of June 2023 indicates that over 20 countries or regions have embarked on piloting Central Bank Digital Currencies (CBDCs).[255] Among these, Mainland China has emerged as one of the front-runners in terms of the amount of currency in circulation – RMB 13.61 billion – and the number of users – 260 million wallets.[256]

One of the challenges in the internationalising RMB is establishing an independent cross-border settlement system. Digital technologies present a potential solution, laying the groundwork for a CBDC-based cross-border payment and settlement system.[257]

CBDCs are anticipated to have a transformative impact on the global payment system. Their adoption could catalyse national economic growth, creating a landscape that is in harmony with international standards and fosters rule-based international cooperation. By leveraging CBDCs, countries like China can increase their currency's role in the global payment system, facilitating a more diversified and balanced approach to cross-border investments, settlements, and trades.[258]

The development of the e-CNY in Hong Kong

The development of the e-CNY in Hong Kong has progressed steadily. The PBOC and the HKMA initiated cross-boundary cooperation for e-CNY payments at the end of 2020. The first technical testing phase was completed in December 2020, followed by the second phase, which commenced in July 2022. The second phase involved the participation of more Hong Kong banks and enabled the value-added feature for e-CNY wallets through the Faster Payment System (FPS).

In particular, the Bank of China (Hong Kong) (BOCHK) obtained approval from the HKMA at the end of 2022 to launch an e-CNY sandbox trial. Collaborating with its parent bank, Bank of China, they conducted two phases of priority trials for the usage of e-CNY in the Mainland and Hong Kong, with 2,100 trial quotas granted to Hong Kong retail customers to experience.[259] In December 2023, BOCHK completed the inaugural e-CNY cross-boundary transaction involving a bulk commodity valued at RMB 24 million.[260] This landmark transaction not only accentuates the practical viability of the e-CNY in commercial trade but also signals the potential for broader adoption of digital currencies in cross-border transactions.

As mentioned earlier in this report, in January 2024, the PBOC and the HKMA announced the expansion of the cross-boundary e-CNY pilots in Hong Kong. This expansion will enable more Hong Kong residents to use e-CNY wallets and make payments in RMB while also allowing Mainland residents to spend e-CNY in Hong Kong.[261]

With an increasing number of countries exploring CBDCs and alternative payment systems, Hong Kong is well-positioned to support the development of the e-CNY and further contribute to the internationalisation of the RMB.

255 Atlantic Council, *Central Bank Digital Currency*, https://www.atlanticcouncil.org/cbdctracker/ (accessed on 9 November 2023)
256 Atlantic Council (April 2023), *Central Practice makes perfect: What China wants from its digital currency in 2023*, https://www.atlanticcouncil.org/blogs/econographics/practice-makes-perfect-what-china-wants-from-its-digital-currency-in-2023/
257 Peking University HSBC Business School (May 2023), *張明：數位貨幣如何助推人民幣國際化？* https://mp.weixin.qq.com/s/Z2dj4j_GS6Pey5cI1qTMFQ
258 Peking University HSBC Business School (May 2023), *張明：數位貨幣如何助推人民幣國際化？* https://mp.weixin.qq.com/s/Z2dj4j_GS6Pey5cI1qTMFQ
259 BOCHK (February 2023), *BOCHK launches second phase of e-CNY Exclusive Experience by offering a further 1,600 trial quotas*, https://www.bochk.com/dam/bochk/desktop/top/aboutus/pressrelease2/2023/20230201_02_Press_Release_EN.pdf
260 BOCHK (February 2023), *BOCHK launches the "corporate e-CNY cross-boundary transaction pilot*, https://www.bochk.com/dam/bochk/desktop/top/aboutus/pressrelease2/2023/231213092_Press_Release_EN.pdf
261 HKMA (January 2024), *金管局总裁就国新办发布会回应记者*, https://www.hkma.gov.hk/gb_chi/news-and-media/speeches/2024/01/20240124-1/

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Financial Services Development Council

About the FSDC

The FSDC was established in 2013 by the Hong Kong Special Administrative Region Government as a high-level, cross-sectoral advisory body to engage the industry in formulating proposals to promote the further development of the financial services industry of Hong Kong and to map out the strategic direction for the development.

The FSDC has been incorporated as a company limited by guarantee with effect from September 2018 to allow it to better discharge its functions through research, market promotion and human capital development with more flexibility.

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