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Recent Developments and Future Direction

A. Recent Major Developments

Recent major developments are considered those that occurred or have been announced in the Hong Kong market since the first publication of the Bond Market Guide in April 2012.

1. Shanghai–Hong Kong Stock Connect

Shanghai–Hong Kong Stock Connect, a pilot scheme enabling mutual stock market access between the Shanghai Stock Exchange and SEHK, was launched on 17 November 2014.

Under Shanghai–Hong Kong Stock Connect, SEHK and the Shanghai Stock Exchange have established mutual order-routing connectivity and related technical infrastructure to enable investors of their respective market to trade designated equity securities listed in the other's market. HKSCC and ChinaClear are responsible for clearing and settlement, and the provision of depository, nominee, and other related services of the trades executed by their respective market participants and/or investors.[90]

According to Charles Li, Chief Executive of HKEX, the greatest significance of Shanghai–Hong Kong Stock Connect is that it provides the PRC with an interim model for opening up before it is completely ready for the large-scale arrival of international investors and departure of Chinese domestic investors. The interim model works like a "mutual market" in which investors on each side of the boundary are able to trade products of the other market within their home time zone, relying on their home market infrastructures. With the joint oversight of the two regulators, capital flows from the PRC and international markets are able to congregate and interact with each other in this mutual market, facilitating the gradual convergence of the PRC with international markets.

This model has the potential to be extended to other products, including equity derivatives, commodities, fixed income, and currencies. Capital market products in the PRC that are of interest to international investors can be placed in this mutual market, while those international products that have demand among Chinese investors can be added, thereby enabling Chinese investors to diversify their investments and hedge against international price risks.[91]

Under its Strategic Plan, 2016–2018 (see also Section B), HKEX is looking at initiatives to extend and enhance mutual connectivity by first seeking to enhance the

[90] For further information, please see the Information Booklet and FAQ available from the HKEX website at http://www.hkex.com.hk/eng/market/sec_tradinfra/chinaconnect/Documents/EP_CP_Book_En.pdf
[91] For comments on this and other HKEX initiatives, please see the Charles Li Direct blog on the HKEX website at http://www.HKEX.com.hk/eng/newsconsul/blog/150120blog.htm

functionality of Shanghai–Hong Kong Stock Connect, launch Shenzhen–Hong Kong Stock Connect, and add exchange-traded funds, listed bonds, and convertible bonds to the two Stock Connect schemes. Second, HKEX will work with regulators in Hong Kong, China and the PRC to relax trading restrictions including quotas, eligible securities, eligible investors, holiday trading, and stock borrowing and lending.

For details on the envisaged enhanced connectivity for debt securities, please see item B.3.

The SFC has been in discussion with the China Securities Regulatory Commission, Shenzhen Stock Exchange, and HKEX on a proposed extension of the Stock Connect to the Shenzhen Stock Exchange.

B. Future Direction

A number of significant developments will come into effect beginning in the second half of 2015 and are expected to have a beneficial impact on the Hong Kong bond market and, possibly, the region's bond markets at large.

1. Enhancements to Post-Trade Processing in Asian Bond Markets

The HKMA will continue to collaborate with central banks and central securities depositories in the region to improve the post-trade environment in Asia, taking into account the specific needs for Asia in terms of cross-border access, stimulation in local issuance, automation of post-trade process, the possibility of cross-border collateralization, and reductions in post-trade costs.

2. Consultations on Changes to the Professional Investor Regime

In May 2013, the SFC issued a consultation paper to invite public comments on proposed amendments to the Professional Investor Regime that aimed to strengthen the manner in which market participants treat Professional Investors and Non-Professional Investors.

In September 2014, the SFC published the conclusions paper on the proposed amendments to the Professional Investor Regime. The proposals will not affect the definition of the professional investor under the SFO as mentioned in the General Definition section in Part N. The amendments only relate to regulatory exemptions that intermediaries can rely on when serving certain types of professional investors. Please refer to the Consultation Conclusions on the Proposed Amendments to the Professional Investor Regime and Further Consultation on the Client Agreement Requirements published on 25 September 2014 for details.

In summary, as set out in the Consultation Conclusions, the SFC decided to proceed with the proposal not to allow intermediaries, when serving Individual Professional Investors and certain Corporate Professional Investors,[92] to be exempt from (i) the suitability requirement,[93] (ii) the requirement to enter into a written client agreement and provide relevant risk disclosure statements,[94] and (iii) other fundamental requirements that have a significant bearing on investor protection under the General Code of Conduct. Except for the requirement to enter into a written client agreement and provide relevant disclosure statements, which will come into effect on 9 June 2017, all other amendments relating to the Professional Investor Regime became effective on 25 March 2016.

[92] Paragraph 15.2 of the General Code of Conduct.
[93] Paragraph 5.2 of the General Code of Conduct.
[94] Paragraph 6.1 of the General Code of Conduct.

In this context, the SFC has started public consultations on the need to strengthen the manner in which market participants treat professional and nonprofessional investors. Changes to the present SFO provisions were expected to take effect by March 2016.

3. Potential Shanghai–Hong Kong Bond Connect

As mentioned under A.1, the connection between SEHK and the PRC's exchange-traded bond market is a potential next step in the fulfilment of a mutual market concept between the two jurisdictions.

In its Strategic Plan, 2016–2018, HKEX is exploring mutual market access with the PRC in the institutional cash bond market through a proposed Bond Connect scheme.[95] HKEX believes that stimulating cross-border capital flows in the underlying CNY bond market is an important prerequisite for the long-term success of fixed-income derivatives traded on HKFE. To facilitate these flows, HKEX will explore the creation of a Bond Connect scheme to provide cross-border cash bond trading and settlement connectivity with the PRC's major onshore bond market infrastructures, with a focus on the institutional bond market.

4. Upcoming Hong Kong Exchanges and Clearing Limited Initiatives

Also mentioned in the HKEX Strategic Plan, 2016–2018 are a number of initiatives aimed at building new capabilities in pre-trade risk management, stock borrowing, and lending (which includes fixed-income securities traded on SEHK and settled in CCASS), remote participant-ship, a new hedge exemption regime for derivatives position limits, and new after-hour and holiday trading arrangements.

In addition, HKEX plans to launch exchange-traded derivatives in Hong Kong, China based on renminbi and onshore interest rates on HKFE.

5. Association of Southeast Asian Nations Plus Three Multi-Currency Bond Issuance Framework

The introduction of AMBIF in regional markets over the course of 2015 signalled another opportunity for additional bond or note issuance activities in the Hong Kong bond market. Potential issuers have identified Hong Kong, China as one of the markets of particular interest, largely due to the presence of Institutional Investors and its role as a listing hub for CNY-denominated bonds and notes and an issuance hub for bonds and notes denominated in offshore Chinese renminbi.

Aimed particularly at the issuance of bond and note to Institutional Investors (professional investors), AMBIF encourages domestic and regional issuers to take advantage of streamlined issuance approval processes in Hong Kong, China and other regional markets. For additional information on AMBIF, kindly refer to Chapter IX.5.

The key advantage of AMBIF lies in the ability of regional issuers to tap multiple markets, including Hong Kong, China, by using the same or similar approval processes. This additional issuance avenue is seen as offering an alternative to other forms of funding for corporate issuers.

[95] Available for download from the HKEX website at
http://www.HKEX.com.hk/eng/exchange/corpinfo/mission/mission.htm

6. People's Republic of China–Hong Kong, China Mutual Recognition of Funds

On 18 December 2015, the SFC granted authorization for the first batch of four PRC-based funds under the PRC–Hong Kong, China Mutual Recognition of Funds (MRF) initiative for public offering in Hong Kong, China. The SFC also welcomed the approval by the China Securities Regulatory Commission of the first batch of three funds from Hong Kong, China for offering in the PRC market.

The MRF initiative is a major breakthrough in the opening up of the PRC's funds market to offshore funds. It will open up a new frontier for the PRC and Hong Kong, China's asset management industries and make available a wider selection of fund products to investors in both markets. The SFC and the China Securities Regulatory Commission have been accepting MRF applications since 1 July 2015. The approval of the first batch of funds under the MRF initiative is a milestone in the implementation of this important cross-border cooperation initiative.

The initiative, while aimed at funds, is also expected to draw fixed-income products, which in turn are expected to provide further stimulus for the Hong Kong bond market.

7. Enhancements to Post-Trade Processing in Asian Bond Markets

The HKMA will continue to collaborate with central banks and central securities depositories in the region to improve the post-trade environment in Asia, taking into account the specific needs of Asian investors in terms of cross-border access, stimulation of local issuance, automation of the post-trade process, the possibility of cross-border collateralization, and reductions in post-trade costs.