

Expansion of mainland-Hong Kong financial markets connectivity

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On 2 September 2022, at the Annual Forum of the China International Fair for Trade in Services, Dr. Fang Xinghai, Vice Chairman of the China Securities Regulatory Commission (CSRC), indicated that the CSRC will work with Hong Kong's relevant authorities to launch three new initiatives to expand the connectivity of the mainland and Hong Kong capital markets.¹

Expand eligible stocks for the Stock Connect

First, the CSRC will include more Hong Kong primary-listed foreign companies and more companies listed on the Shanghai and Shenzhen exchanges as eligible stocks for the Stock Connect program.

Mr. Paul Chan, the Financial Secretary of the Hong Kong government, welcomes this initiative.² Allowing mainland investors to invest in more Hong Kong listed stocks would help enhance the liquidity and valuation of those stocks and would attract quality enterprises to list in Hong Kong, thus

enhancing the competitiveness and uniqueness of Hong Kong as an international financial centre. It may also further open up the mainland financial market in a manner that manages exchange rate risks.

Renminbi stock trading counters in Hong Kong

Second, the CSRC and relevant authorities of Hong Kong will study the introduction of more Renminbi securities trading counters under the southbound trading of the Stock Connect. This initiative will increase the choice of Renminbi investment instruments in Hong Kong and reduce exchange risks and costs for mainland investors at the same time.

¹ https://english.www.gov.cn/statecouncil/ministries/202209/03/content_WS631299d0c6d0a757729df931.html

² <http://www.takungpao.com.hk/231106/2022/0905/761188.html>

To actualize a deeper implication of this proposal, Renminbi securities trading in Hong Kong is conducive to deepen the liquidity and depth of the offshore Renminbi market, thus speeding up the internationalization of Renminbi as a currency of making investments and accumulating wealth outside the mainland.

Mainland treasury bond futures in Hong Kong

Third, the CSRC will support the issuance of mainland government bond futures in Hong Kong and boost the two-way opening-up of the mainland treasury bond futures market. This initiative will introduce an effective risk management tool for investment in treasury bonds through channels such as the "Bond Connect". Together with the "Swap Connect" announced earlier, this will enable foreign investors to hedge against the risk of interest rate fluctuations on Renminbi assets.

In practice, the liquidity of the two government bond markets can be enhanced and the bid-ask spreads may be reduced. The increased international participation in the mainland treasury bonds will also accelerate the internationalization of Renminbi as well as the development of Hong Kong as an offshore Renminbi hub and a risk management centre.

Current financial market connectivity mechanisms

At present, the financial market connectivity mechanisms between the mainland and Hong Kong mainly comprise the "Stock Connect", the "Bond Connect", the "Cross-boundary

Wealth Management Connect" and the "Swap Connect".

Stock Connect: The Shanghai-Hong Kong Stock Connect was launched in November 2014, providing a two-way trading link between the Shanghai Stock Exchange and the Hong Kong Stock Exchange in respect of eligible stocks. Following the success of the Shanghai Connect, Shenzhen-Hong Kong Stock Connect was launched in December 2016 by and large applying similar principles and arrangements as in the Shanghai Connect. Stock Connect enables mainland and Hong Kong investors to trade stocks listed on the other exchange through local securities brokers within prescribed limits.

Bond Connect: The Bond Connect allows investors from the mainland and overseas to trade in each other's bond markets through a market infrastructure linkage in Hong Kong. Northbound trading commenced in July 2017, offering international investors the access to the China Interbank Bond Market. Southbound trading was launched in September 2021, providing an efficient channel for mainland institutional investors to invest in offshore bonds through the Hong Kong bond market.

Cross-boundary Wealth Management Connect: The scheme was launched in September 2021, allowing eligible mainland, Hong Kong and Macau residents in the Guangdong-Hong Kong-Macau Greater Bay Area to invest in wealth management products distributed by banks in each other's market through a closed-loop funds flow channel established between their respective banking systems. A major breakthrough achieved by this scheme is the flexibility provided to individual retail investors to open

and operate cross-boundary investment accounts directly, through a formal channel, and to choose their preferred products. Please refer to our earlier article for more details on Cross-boundary Wealth Management Connect.³

Swap Connect: The People's Bank of China, the Hong Kong Securities and Futures Commission and the Hong Kong Monetary Authority jointly announced in July 2022 the Swap Connect which is expected to be launched in early 2023. This arrangement will enable investors to participate in the interest rate swap markets in the mainland and Hong Kong through a connection in respect of trading, clearing, and settlement between Infrastructure Institutions in the two jurisdictions. At the initial stage, northbound trading will commence first, where investors from Hong Kong and other countries and

regions may trade interest rate swap products offered in the mainland. This will add to the depth and breadth of the opening-up of the mainland financial markets. Southbound trading, which gives mainland investors the access to trade Hong Kong financial derivatives, will be explored in due course.⁴

Key Takeaway

The existing mechanisms together with the three new initiatives will mark a new phase in the internationalization of Renminbi. The enhancing financial cooperation between the mainland and Hong Kong will further highlight Hong Kong as the most important offshore Renminbi products centre.

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³ https://www.eylaw.com.hk/en_hk/publications/our-latest-thinking/2021/sept/cross-boundary-wealth-management-connect

⁴ <https://www.sfc.hk/en/News-and-announcements/Policy-statements-and-announcements/Joint-Announcement-of-the-PBoC-the-SFC-and-the-HKMA>

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