



Update on HKEx's Preparations for RMB Products

2 March 2011

The introduction of renminbi (RMB) products is a key aspect of the Strategic Plan 2010-2012 of Hong Kong Exchanges and Clearing Limited (HKEx). The following questions and answers provide an update on HKEx's efforts to develop sustainable markets for RMB products.

HKEx & Market Participant Readiness

Q: Are HKEx and market participants ready to support RMB securities trading?

A: HKEx is fully prepared and technically ready for the listing, trading and clearing of RMB products. Two RMB-denominated debt securities are already successfully listed and available for trading at HKEx.

HKEx will hold a RMB Readiness Test from 17 to 20 March to allow Exchange Participants (EPs), participating banks and others to verify their operational readiness for dealing in listed RMB-denominated securities. The end-to-end Test will include a payment run to ensure a smooth flow of CCASS (Central Clearing and Settlement System for securities) money settlement in RMB, as well as electronic IPO subscriptions, trading, clearing and settlement of listed RMB-denominated securities.

The March test is different from the testing last September, which only covered trading.

Following the March test, EPs will be required by the Securities and Futures Commission (SFC) to confirm their readiness for dealing in listed RMB-denominated securities to HKEx. A list of the EPs which have completed the March test and confirmed their readiness will be published on the HKEx website for the public's information.

The SFC has advised EPs via circular that EPs which fail to ensure their readiness to conduct listed RMB securities business should refrain from dealing in listed RMB securities or clearing transactions in such securities.

RMB Products

Q: What RMB products does HKEx plan to introduce besides bonds? Are there any plans for structured products, stocks, futures, other products?

A: HKEx's objective is to develop a comprehensive range of sustainable RMB-denominated products for its markets. The development of products for listing and trading on an exchange depends on many factors, including technical and operational readiness (which HKEx has achieved in its securities market and will achieve in its derivatives market by midyear, insofar as its systems and operations are concerned), market demand and in the case RMB-denominated products, RMB liquidity in Hong Kong.

RMB-denominated bonds are already listed at HKEx and HKEx looks forward to the listing of other RMB-denominated products such as structured products on its markets at an appropriate time. HKEx will continue to assess all the relevant factors and work closely with market participants on the introduction of different RMB-denominated products on its markets.

RMB IPOs

Q: There have been discussions in the market about using the Hong Kong dollar (HKD) to subscribe for RMB IPOs and then settling in RMB when the shares on offer are allotted. Is that feasible?

A: HKEx thinks it is a good idea to enable subscription by HKD for RMB IPO but settlement for allotment in RMB as a means to address possible RMB liquidity constraints arising from over-subscription. HKEx will work closely with all relevant parties, including regulators and market participants, to see what arrangements we need to put in practice to make it work in practice and whether there are regulatory issues that need to be addressed.

Q: What is HKEx view on the suggestion that there should be dual currency tranches in RMB IPOs and dual-currency trading counters for RMB-denominated shares?

A: HKEx is open-minded towards suggestions which will support the development of sustainable RMB-denominated shares for listing in Hong Kong, and it would be happy to explore ideas with market participants. As for dual-currency IPO tranches and dual-currency counters for trading are concerned, HKEx will look at how the two tranches would work in the RMB IPO process and how two trading counters for the same stock would interact in the secondary market, and their implications for liquidity, price formation and market efficiency.

Fees and Other Transaction Costs Associated with RMB IPOs and Trades

Q: What currency/currencies will investors/brokers use to pay for RMB IPOs and trades?

A: For RMB IPOs, investors and brokers will be able to pay the levies and other costs (such as commission) in RMB. For secondary market trading in RMB-denominated securities, brokers will have to pay the SFC levy as well as other exchange and clearing fees in HKD. For stamp duty, HKEx's understanding is that the current legislation requires the stamp duty for securities transactions, including transactions in RMB-denominated shares, to be paid in HKD. HKEx is currently exploring with the relevant government agency and brokers as to how it may facilitate stamp duty collection for trading of RMB-denominated shares in the secondary market and make it as efficient as possible.

RMB Equity Trading Support Facility^{Note} (TSF)

What is the TSF and how will it work?

The RMB Equity TSF, or Trading Support Facility, is aimed to serve as a back-up facility to enable investors to buy RMB-denominated shares in the secondary market with HKD if they have difficulty in obtaining RMB.

Key features of the TSF:

- It will be a back-up facility;
- RMB available through the TSF will be recyclable;
- It will be open and optional to all Stock Exchange Participants; and
- The TSF RMB will be a committed source of funding and priced at commercial rate.

The TSF will source RMB from one or more banks in Hong Kong and provide the RMB through its participating brokers to investors who wish to buy RMB-denominated shares in the secondary market. RMB from the TSF will be used to settle trades in RMB-denominated shares through HKEx's securities clearing house, the Hong Kong Securities Clearing Company (HKSCC) – the operator of CCASS. The forex rate used by the TSF will be set on a commercial basis by the TSF partner banks.

The users of the TSF will pay HKD for RMB. When they sell the RMB-denominated shares they bought with RMB from the TSF, they will have to return the RMB to the TSF for the equivalent amount of HKD. This so-called Hong Kong Dollar In, Hong Kong Dollar Out (or “HKD In, HKD Out”) mechanism, which will all take place inside CCASS, will ensure that the TSF is sustainable without access to an unlimited supply of RMB.

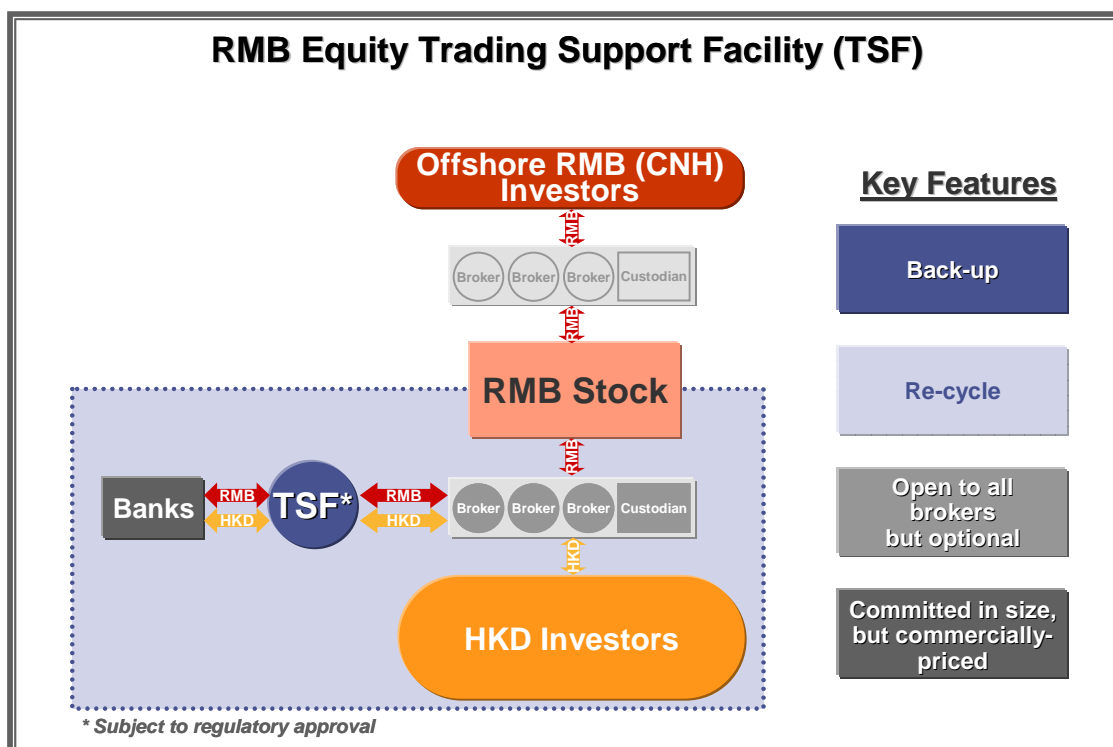
The design of the TSF will ensure the price discovery process for RMB-denominated shares in the secondary market and their liquidity will not be constrained by the prevailing level of RMB in the market at any given time. It also does not require any modification to the current trade settlement process in CCASS.

The TSF will be optional for investors as well as brokers. Investors' interest in using the TSF is likely to depend on his/her access to other sources of RMB. Brokers' interest is likely to depend on how they operate their business and their customers' needs.

Why is the TSF needed?

RMB-denominated shares are important to the further development of the offshore RMB market in Hong Kong, but the long-term growth and stability of the RMB stock market is subject to the challenge of whether there is sufficient and reliable RMB liquidity in Hong Kong. The TSF is designed to help overcome this possible hindrance and allow RMB-denominated shares to develop without constraints arising from limited RMB availability at any given time. The TSF will also help support the normal trading of RMB-denominated shares in exceptional situations if RMB supply becomes constrained.

Illustration of the TSF



TSF Details

Q: When will the TSF be rolled out?

A: HKEx is still working on the details of the funding and operational model of the TSF. The current plan is to roll out the TSF in the second half of 2011. HKEx will inform the market of the timetable as soon as it is ready.

Q: What will be the size of the TSF?

A: The TSF will be based on the amount of RMB available in Hong Kong (ie CNH) and therefore will be maintained at a size which is healthy and appropriate with respect to the total RMB deposit base in Hong Kong. HKEx expects the initial size of the TSF will be modest and correlated with the size of the RMB offerings that the TSF will support. Over time it may grow in tandem with RMB equity market demand and the overall RMB deposit base in Hong Kong. The TSF will be there to help support and ensure the sustainable development of the RMB equity market in Hong Kong, and it will be there as long as it is needed.

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Q: Will the TSF create additional risks for HKEx?

A: The major risk of the TSF is at its RMB fund flow. Since the TSF will manage the RMB/HKD fund flow on a back-to-back basis between its partner banks and the brokers, the risk would be manageable. HKEx will make sure that adequate risk management measures are established to mitigate the risks associated with and arising from the TSF operation.

Q: Will the TSF be competing with the banks and brokers in the RMB forex business?

A: No. The TSF will source RMB from the banks and therefore will not be competing with them. The TSF is meant to be complementary to the services of the brokers to help them better serve their customers interested in RMB share trading in the secondary market.

Q: Will the TSF be mandatory for Exchange Participants (EPs)?

A: No. It will be optional for EPs, and EPs and other market intermediaries will be free to offer other RMB-related services to their customers within the regulatory framework of the securities and money markets.

Q: Will the TSF be a heavy burden on EPs' operations and systems?

A: EPs wishing to use the TSF will probably have to modify their operations and possibly their systems, particularly their back-office systems. The efforts required will depend on the current operations and system set-ups of individual EPs.

Q: What would happen if no EPs were willing to work with the TSF?

A: HKEx believes the TSF presents interesting new business opportunities and there will be sufficient EP interest.

Note: Certain features of the TSF described above are subject to change as HKEx finalises the detailed funding and operational model and receives more market feedback. The introduction of the TSF and some of its features are subject to the required approvals from the relevant regulatory agencies.