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Research Report

The Rising On-Exchange Bond Market in Mainland China and Hong Kong

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SUMMARY

The combined market size of exchange-traded bonds in Mainland China and Hong Kong has grown to a scale comparable to leading bond markets globally, in terms of number of bonds, bond issue amount and turnover value. Apart from the rising demand of financing for the real economy, key drivers for the growth include policy incentives and institutional enhancements in both the Hong Kong and Mainland bond markets.

In Hong Kong, the listed bond market is freely open to global issuers and investors, and allows the issuance and trading of bonds denominated in multiple currencies. Types of listed bond include plain vanilla bonds, convertible bonds and asset-backed securities; on-exchange bond repurchase instruments are currently not available. Types of issuer include states, state corporations, banks, private corporations and supranationals. Listed bonds can be issued through tendering or private placement to institutional investors or public offering to public investors. Professional investors have access to all listed bonds while public investors only have access to those listed bonds eligible for public offering. On-exchange bond trading is conducted on the electronic securities trading system of the Stock Exchange of Hong Kong (SEHK) and manual trades conducted off-exchange are reported to SEHK's system. Trades may be cleared and settled through the SEHK's securities clearing and settlement system — Central Clearing and Settlement System (CCASS) (for bonds admitted to CCASS), or through the Central Moneymarkets Unit (CMU) operated by the Hong Kong Monetary Authority (HKMA) (for bonds admitted to the CMU) which has linkages with international central securities depositories.

In the Mainland, access to the on-exchange bond market by foreign issuers and investors is limited. Apart from spot trading of government bonds, financial bonds, enterprise bonds, corporate bonds, convertible bonds, exchangeable bonds and asset-backed securities, bond repurchase instruments are available on the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE). Bonds issued in the Mainland are mainly denominated and traded in Renminbi (RMB). Bond issuance in the Mainland is governed by different regulators depending on the bond type. The on-exchange bond market has a more balanced mix of investors compared to the China Interbank Bond Market (CIBM). Qualified investors with a relatively large asset size and investment experience meeting given thresholds can have a broader access to the on-exchange bond market; other public investors can only invest in certain high-quality bonds. Apart from the auction trading system and block trading platform, the SSE provides a dedicated Fixed Income Platform for bond trading. Clearing and settlement is done through the China Securities Depository and Clearing Corporation Limited (CSDC).

Riding on the experience of Stock Connect and Northbound Bond Connect schemes, the mutual market access between the Hong Kong and Mainland on-exchange bond markets for both issuance and trading, if implemented[1], is expected to generate mutual benefits. This could attract a wider scope of investors and issuers to both markets, expand investment choices and achieve synergy in cross-border bond investment with the trading of risk management tools. Moreover, the comprehensive internationalisation of the Mainland bond market covering the on-exchange market could facilitate the process of RMB internationalisation, generating more development opportunities for both the Mainland and Hong Kong markets.

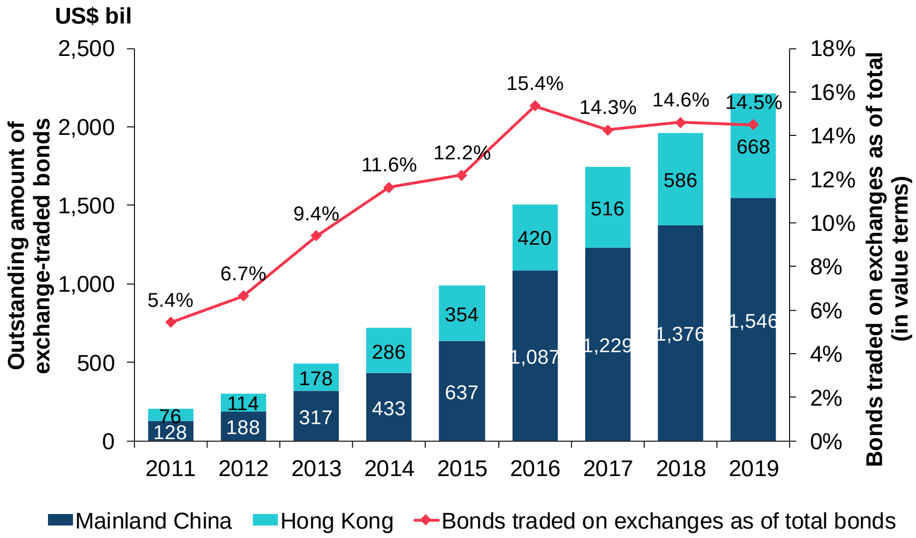
1 Subject to regulatory approval.

1. THE GROWTH OF THE ON-EXCHANGE BOND MARKET[2] IN MAINLAND CHINA AND HONG KONG

Mainland China now has the world's second largest bond market[3], comprising the China Interbank Bond market (CIBM) and the on-exchange bond market. China's government and corporate sectors are increasingly using bonds to raise funds, not only from the onshore market, but also from the offshore markets, particularly Hong Kong. In fact, Hong Kong is the largest offshore bond financing centre for Mainland companies[4].

The off-exchange bond market, i.e. the over-the-counter (OTC) market, has been the dominant bond market, vis-à-vis the on-exchange bond market, in the Mainland and Hong Kong. Nevertheless, the size of the on-exchange bond markets in the Mainland — on the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE), and in Hong Kong — on the securities market of Hong Kong Exchanges and Clearing Limited (HKEX), have grown rapidly in recent years (see Figure 1). The combined proportion of bonds in outstanding value terms that are traded on-exchange in the Mainland and in Hong Kong rose from 5.4% in 2011 to 14.5% in 2019.

Figure 1. Outstanding amount of exchange-traded bonds in the Mainland and Hong Kong (2011 – 2019)



Note: The outstanding amount of listed bonds in Hong Kong and the Mainland were converted into US dollars (USD) based on the exchange rates from Wind. "Total bonds" refer to all bonds traded on-exchange and off-exchange in Hong Kong and the Mainland combined.

Source: Bank for International Settlements (BIS) for total bond market size in Hong Kong and Mainland China respectively; HKEX, SSE and SZSE for outstanding amount of listed bonds.

Compared to the major on-exchange bond markets, both the Mainland and Hong Kong markets are in the developing stage, in terms of market size and trading volume. Nevertheless, the on-exchange bond market in China — SSE, SZSE and HKEX combined, is among the top ten in the world in terms of number of listed bonds, annual issue size and annual turnover value.

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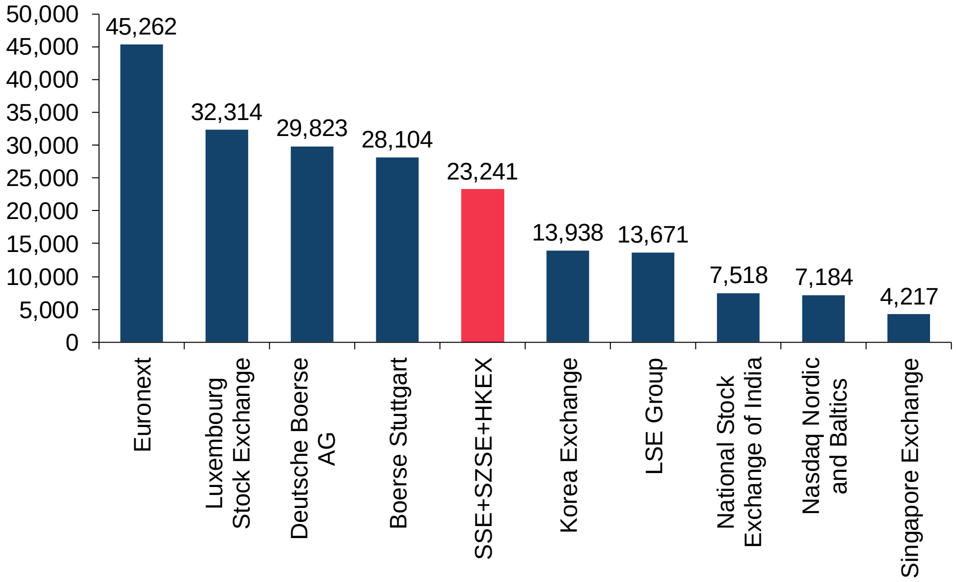
2 In this paper, the "on-exchange bond market" refers to the listed bond market and bond trading market on exchanges.

3 Data as of end-December 2019. Source: "Table C1 Summary of debt securities outstanding", debt securities statistics on the Bank for International Settlements (BIS)'s website, 3 June 2020.

4 See HKEX research report. "Hong Kong's role in supporting the fund-raising of Mainland private enterprises", published on HKEX's website, 13 June 2019.

In terms of number of bonds, the combined figure of SSE, SZSE and HKEX ranked 5th among global exchanges as of end-2019, following key exchanges in Europe (see Figure 2). Euronext[5] and Luxembourg Stock Exchange (LuxSE) ranked first and second in 2019. As a result of a favourable environment offered by the bond listing regimes, the two exchanges have attracted a wide range of issuers globally, with a variety of debt instruments targeting European investors. For Euronext, bond issuers benefit from the efficiency of the listing process that enables a bond to be listed in as short a time as one business day for existing issuers and seven business days for new issuers[6]. For LuxSE, the fast listing process of a bond involves the first prospectus review within three business days and subsequent reviews within two business days[7]. LuxSE's bond issuers benefit from the available choices of four types of listing (two with admission to trading facilities, one without admission to trading and one for information disclosure of green bonds)[8] and the strong potential demand for trading listed bonds by investment funds in Luxembourg as Luxembourg is the world's second largest investment fund centre after the US[9]. These funds may be attracted by the exemption of withholding tax, tax on income and capital gains, and wealth tax in Luxembourg[10].

Figure 2. Leading exchanges by number of listed bonds (end-2019)



Note: Official monthly statistics of SZSE were used (these not only include bonds, but also asset-backed securities).

Source: Statistics on the World Federation of Exchanges (WFE)'s website and monthly statistics of SZSE on its website.

The combined number of bonds listed in the Mainland and Hong Kong rose from 2,540 bonds as of end-2013 to 23,241 bonds as of end-2019 and the 6-year compound annual growth rate (CAGR) was 44.6% (44.5% for SSE, 55.9% for SZSE and 22.9% for HKEX) (see Figure 3).

5 Euronext consists of Euronext Amsterdam, Euronext Brussels, Euronext Dublin, Euronext Lisbon and Euronext Paris.

6 Source: "Euronext Listing FAQ", published on Euronext's website, 13 September 2019.

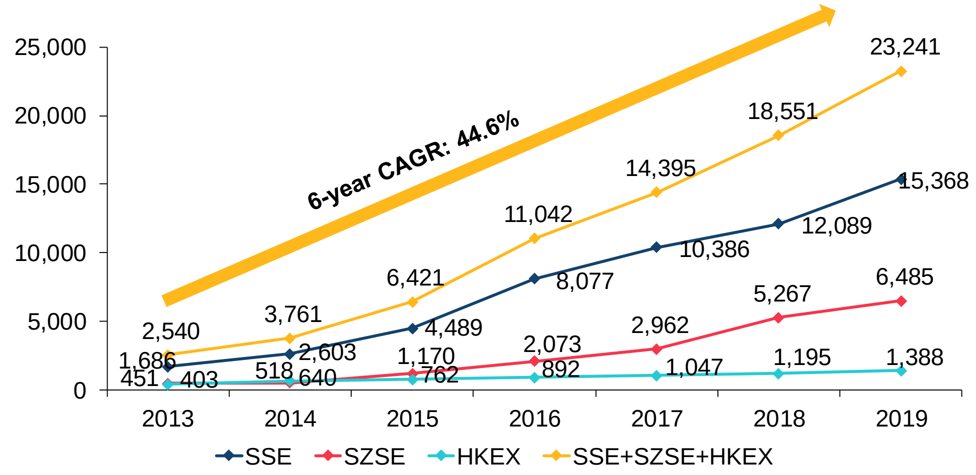
7 Source: "Listing", webpage on LuxSE's website, viewed on 23 June 2020.

8 The listing platforms include Bourse de Luxembourg Market for investors in the European Union, Exchange-regulated Euro MTF Market for local investors, LuxSE Securities Official List (SOL) and Luxembourg Green Exchange (LGX). Source: "Bond listing markets in Luxembourg", published on *creatrust.com*, 16 September 2019.

9 Source: "Luxembourg, the European Hub: Bridging gaps across Europe for China", published on Deloitte's website, 8 July 2019.

10 Source: "Taxation and investment in Luxembourg 2016", published on Deloitte's website, viewed on 23 June 2020.

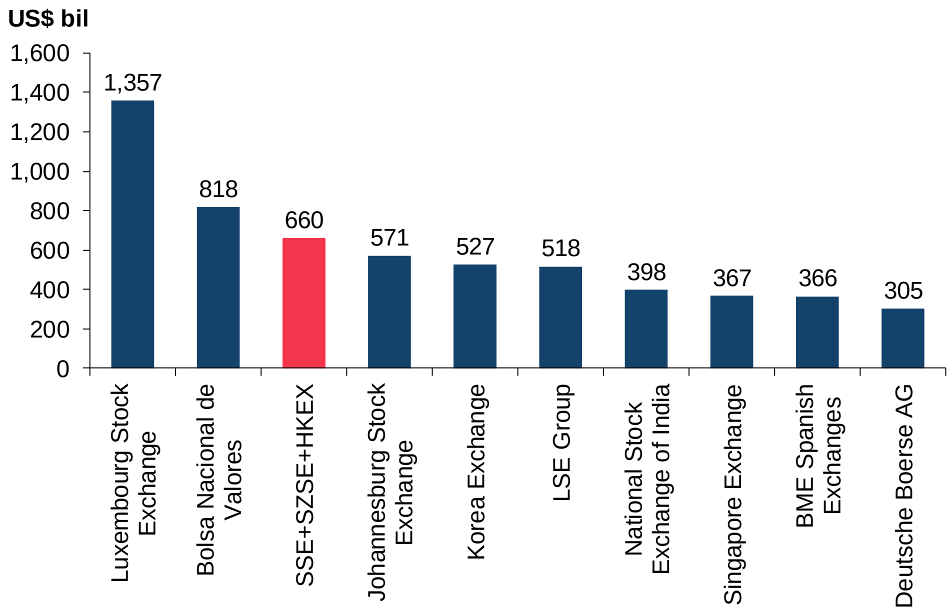
Figure 3. Number of bonds listed on SSE, SZSE and HKEX (2013 – 2019)



Source: Monthly statistics of SSE and SZSE on their websites and HKEX Fact Books.

In terms of bond issue amount, the combined figure of SSE, SZSE and HKEX ranked third largest among global exchanges in 2019 while LuxSE ranked the first (see Figure 4).

Figure 4. Leading exchanges by total issue amount of bonds (2019)

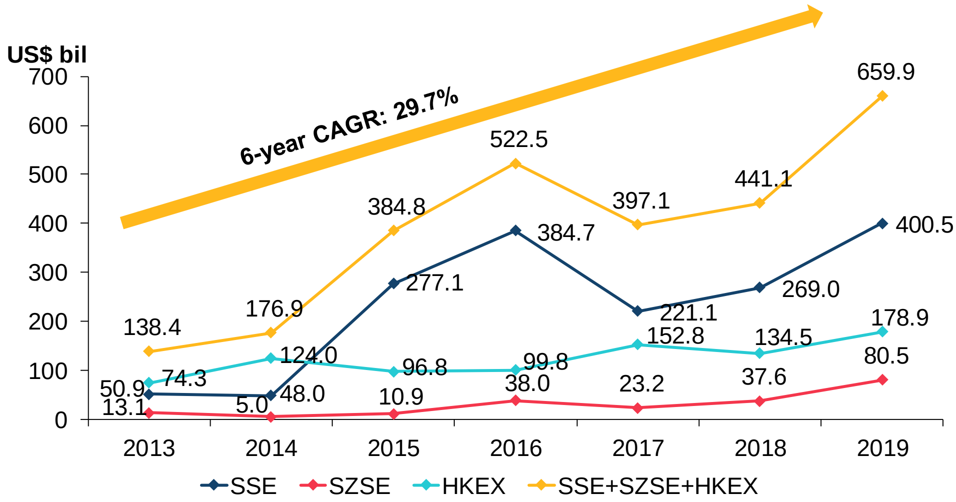


Note: The data of SSE and SZSE is obtained from the monthly statistics on their websites and converted into USD using the average daily spot exchange rate of USD to Renminbi (RMB) in 2019 from Wind.

Source: Statistics on WFE's website, monthly statistics of SSE and SZSE on their websites.

The combined annual issue amount of listed bonds on SSE, SZSE and HKEX rose from US$138.4 billion in 2013 to US$659.9 billion in 2019, with a 6-year CAGR of 29.7% (41.0% for SSE, 35.3% for SZSE and 15.8% for HKEX) (see Figure 5).

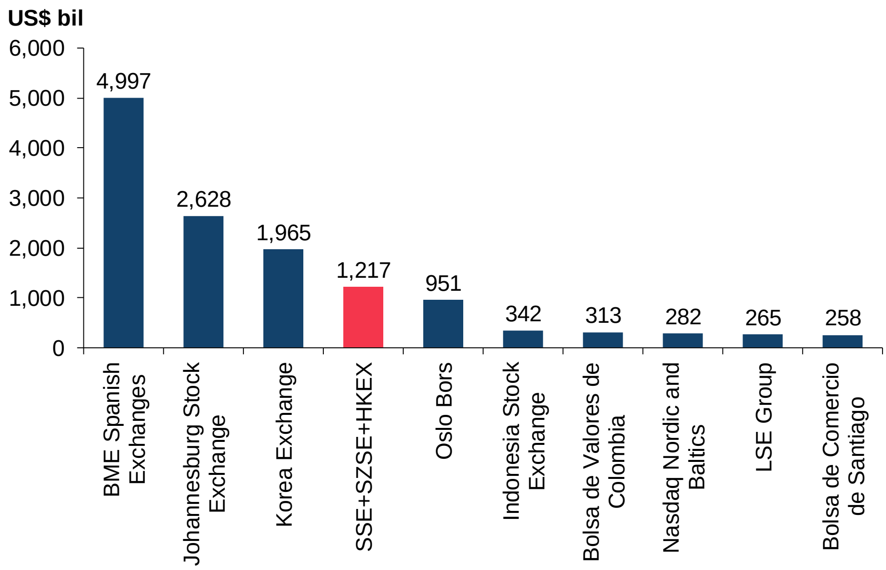
Figure 5. Annual issue amount of bonds on SSE, SZSE and HKEX (2013 – 2019)



Source: Monthly statistics of SSE and SZSE on their websites and HKEX Fact Books.

In terms of bond trading value, the combined figure of SSE, SZSE and HKEX ranked fourth among global exchanges in 2019. The BME Spanish Exchanges (BME) ranked first (see Figure 6), owing to the fact that its turnover includes bond trading on both the on-exchange market and the OTC market because all bond trades (including those on the OTC market) are mandated to be cleared through Iberclear (a BME-owned entity)[11]. The BME operates three key bond markets — the quote-driven main market (AIAF) for both domestic institutional and retail investors, the order-driven secondary public debt market (SENAF) and the market mainly for bonds issued by unlisted private companies (MARF) for institutional investors across Europe. Bond trading on the BME markets is mainly conducted through negotiated deals (78.4% of total trading value in 2019[12]). The liquidity is supported by the availability of risk management tools that include the 10-year government bond futures on MEFF (BME's derivatives exchange).

Figure 6. Leading exchanges by total turnover value of bonds (2019)



Note: The data of SSE and SZSE is obtained from the monthly statistics on their websites and converted into USD using the average daily spot exchange rate of USD to Renminbi (RMB) in 2019 from Wind.

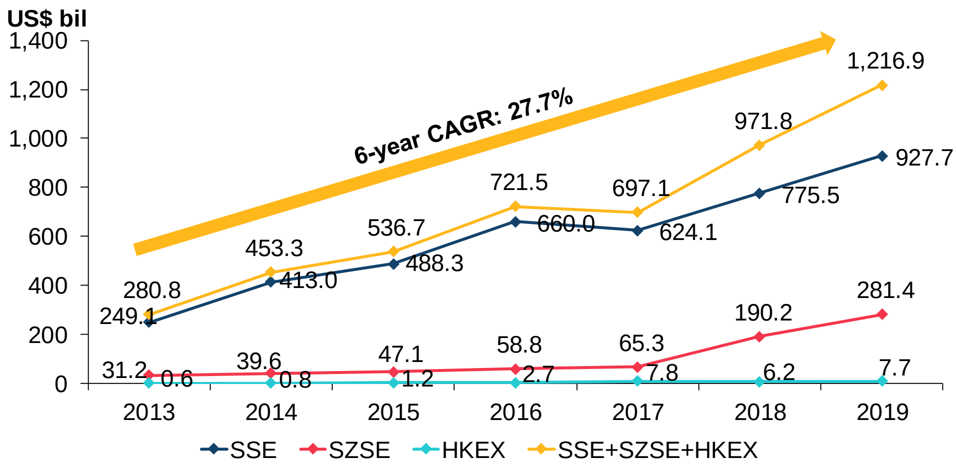
Source: Statistics on WFE's website, monthly statistics of SSE and SZSE on their websites.

11 See "Electronic trading platforms in government securities markets", published on the World Bank's website, November 2013.

12 Calculated from statistics for 2019 on WFE's website.

The annual turnover value of bonds listed on SSE, SZSE and HKEX rose from US$280.8 billion in 2013 to US$1,216.9 billion in 2019, with a 6-year CAGR of 27.7% (24.5% for SSE, 44.3% for SZSE and 54.3% for HKEX) (see Figure 7).

Figure 7. Annual turnover value of listed bonds on SSE, SZSE and HKEX (2012 – 2019)



Note: The turnover value did not include repo turnover.

Source: Monthly statistics of SSE and SZSE on their websites and HKEX Fact Books.

1.1 The growth in Hong Kong's on-exchange bond market[13] and its drivers

Certain issuers choose to list their bonds on exchanges to attract a broader investor base, given that mutual funds or unit trusts are mandated to buy listed products only[14]. Hong Kong's listed bond market welcomes global issuers. The listing of bonds is supported by an efficient listing process and government incentives. The listing regime of bonds issued to professional investors only was streamlined in 2011 to promote quicker turnaround time (see Section 2.3). To attract new bond issuers, the Hong Kong Government introduced the Pilot Bond Grant Scheme in May 2018 to subsidise part of the costs involved in the issuance for bond issuers who did not issue bonds since May 2013. In addition, the Green Bond Grant Scheme was introduced in June 2018 to subsidise the costs in obtaining the Hong Kong Quality Assurance Authority (HKQAA)'s green bond certification in order to attract green bond issuers[15].

The total outstanding amount of bonds listed in Hong Kong has grown significantly in the past decade from HK$392 billion in 2009 to HK$5,205 billion in 2019, achieving a 10-year CAGR of 29.5% (see Figure 8). This is partly attributable to the issuance of offshore RMB bonds (dim sum bonds) in Hong Kong by issuers in the Mainland, Hong Kong and overseas since 2010[16]. The increase in USD bond issuance, particularly from Mainland real estate companies, has also contributed to the growth[17]. The annual issue amount of all listed bonds rose from HK$47 billion in 2009 to HK$1,402 billion in 2019, with a 10-year CAGR of 40.4% (see Figure 9). More state and private corporations took advantage of the low interest rates for "pre-refinancing" since 2016[18], such that bonds issued by these corporations accounted for 90.4% of the total outstanding value as of end-2019 (see Figure 8).

13 In Hong Kong, listed bonds may be traded on the HKEX's securities market or off-exchange in the OTC market.

14 Source: *ASEAN+3 Bond Market Guide: Hong Kong, China*, published on the ADB's website, November 2016.

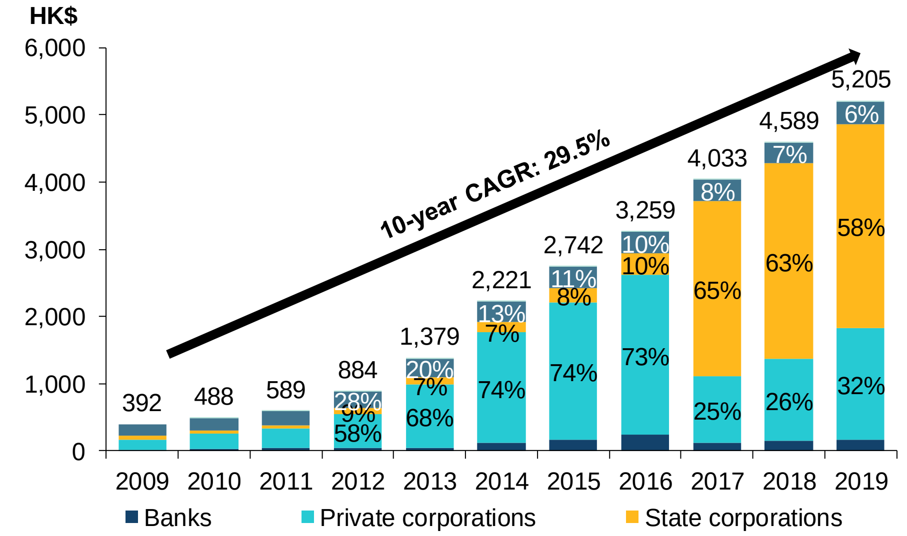
15 See HKEX research report, "The green bond trend: Global, Mainland China and Hong Kong", published on HKEX's website, 13 December 2018.

16 See "10 years and counting — a decade of offshore Renminbi business", Hong Kong Government's press release, 28 February 2014.

17 See "Real estate companies repay old debt with new finances: the issue amount reached US$1.85 billion in February" (〈地產「借新還舊」發債創紀錄：房企 2 月已發 18.5 億美元債〉), *21st Century Business Herald*, 13 February 2019.

18 See "The Hong Kong debt market in 2016", *HKMA Quarterly Bulletin*, March 2017.

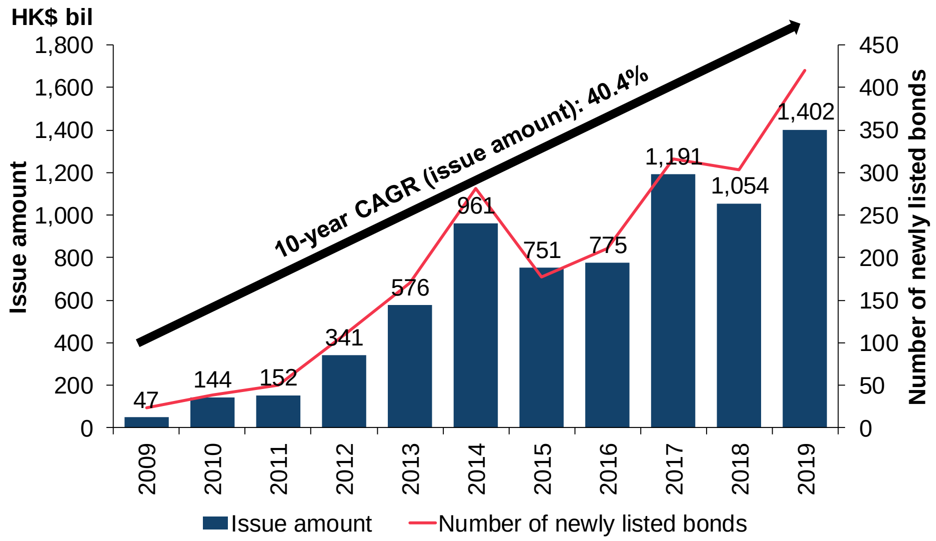
Figure 8. Total outstanding amount of bonds listed in Hong Kong by issuer type (2009 – 2019)



Note: Percentage shares of bonds issued by banks and supranationals are small and their respective data labels are not shown in the figure.

Source: HKEX Fact Books.

Figure 9. Total issue amount and number of newly listed bonds in Hong Kong (2009 – 2019)

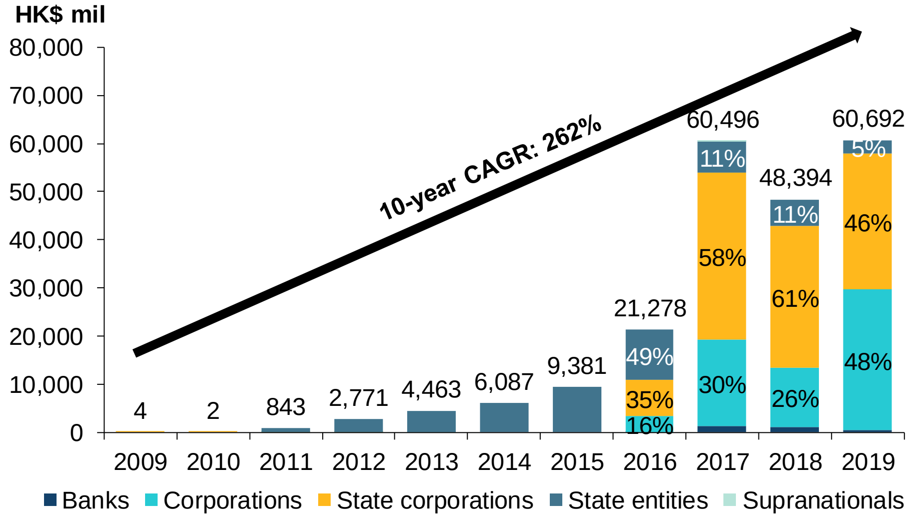


Source: HKEX Fact Books.

In respect of bond trading, the Hong Kong market is freely open to global investors. Investors enjoy a tax-friendly environment similar to that in Luxembourg — there is tax exemption on interest and profits from bonds listed in Hong Kong (issued on or after 1 April 2018) under the "Qualifying Debt Instruments" (QDI) scheme. The wide range of currency risk management tools in Hong Kong, including deliverable USD against offshore Renminbi (USD/CNH) futures and options, facilitate the risk management of bond investments.

The total turnover value of listed bonds in Hong Kong rose significantly from HK$4 million in 2009 to a record high of HK$60,692 million in 2019, with a 10-year CAGR of 262% (see Figure 10). This is partly attributable to the turnover of the inflation-linked 3-year iBonds, which were issued by the Hong Kong Government (classified as a state issuer) during 2011 to 2016. Similar to the case in terms of outstanding amount, private and state corporations accounted for a large share at 94.6% of turnover value in 2019. As most of these bonds are not publicly offered to public investors, these bonds are mainly traded among institutional investors (see Section 2.2).

Figure 10. Total turnover value of bonds listed in Hong Kong by issuer type (2009 – 2019)



Source: HKEX Fact Books.

1.2 The growth in the Mainland's on-exchange bond market and its drivers

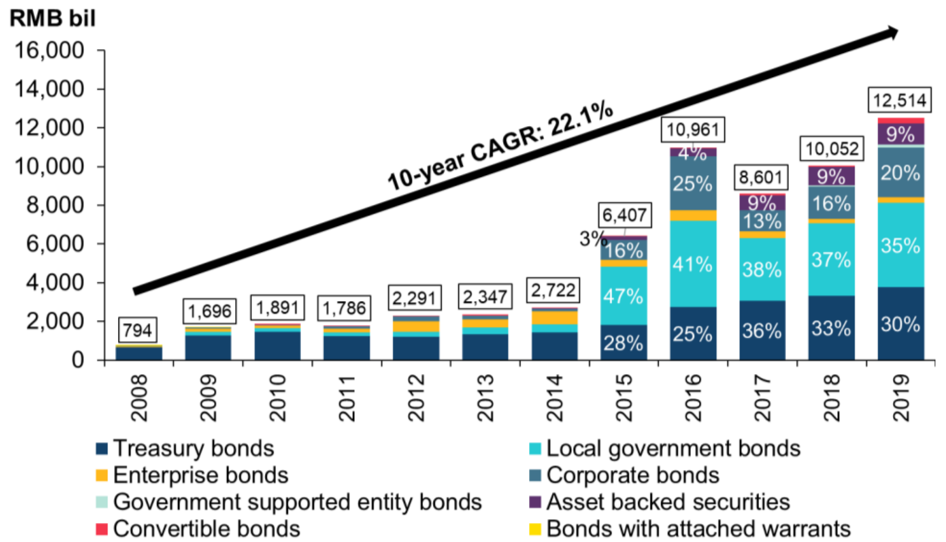
The issue amount of on-exchange bonds in the Mainland has increased significantly since 2014. In the past decade, the annual issue amount rose from RMB 1.7 trillion in 2009 to RMB 12.5 trillion in 2019, achieving a CAGR of 22.1% (see Figure 11). This is attributable mainly to the growth in the issuance of local government bonds and corporate bonds under the backdrop of the new budget law enacted in 2014[19] and the revisions of the rules and legislation governing corporate bond issuance[20]. The new budget law aims at resolving local governments' financing problems through local government debt swaps. Through a debt swap, the debts of local government financing vehicles (LGFVs) with high interest rates are replaced by local government bonds with lower interest rates and longer tenors. Furthermore, requirements for the approval of bonds issued by LGFVs have reportedly become less stringent — the cap of 50% on the share of the local government as a source of cash flows was removed, keeping only the cap of 50% on the share of the local government as a source of revenue[21]. Under the revised rules and legislation, the scope of corporate bond issuers has been expanded from only listed companies to include also unlisted companies, thereby covering a lot of real estate companies and LGFVs; and the public offering process has been streamlined (see Section 3.3 on the bond issuance and listing process).

19 *Budget Law of the People's Republic of China (2014 Amendment)* (《中華人民共和國預算法(2014 修正)》), issued by the Standing Committee of the National People's Congress, 31 August 2014; the Law was further revised on 29 December 2018.

20 The revised *Administrative Measures for the Issue and Trading of Corporate Bonds* (《公司債券發行與交易管理辦法》), issued by the CSRC, 15 January 2015; the revised *People's Republic of China's Securities Law (Effective from 1 March 2020)* (〈中華人民共和國證券法（自 2020 年 3 月 1 日起施行〉), 28 December 2019.

21 See "Market participants revealed: Local government financing vehicle repay old debt with new finances on relaxation of bond issuance requirement"(〈市場人士透露：地方融資平台借新還舊 發債條件放鬆〉), *China Securities Journal* (《中國證券報》), 14 March 2019.

Figure 11. Total issue amount of on-exchange bonds in the Mainland market by bond type (2009 – 2019)



Note: The Mainland on-exchange bond market comprise SSE and SZSE.

Source: Wind.

The spot trading of on-exchange bonds in the Mainland has been on the uptrend. The growth in turnover value has been slightly lower than that in issue amount (see Figures 5 and 7). To enhance investor protection, higher eligibility requirements on retail investors in bonds were introduced in 2017[22]; these include raising the net assets requirement from RMB 3 million to RMB 5 million and imposing certain investment restrictions in respect of the types of bond (see Section 3.2). Nevertheless, the spot trading of on-exchange bonds is supported by the availability of various investment and risk management tools on the Mainland exchanges, including bond repurchases (repos) on SSE and SZSE as well as government bond futures on the China Financial Futures Exchange (CFFEX).

Along with spot trading of bonds, bond repo trading is available on the Mainland exchanges as a means of short-term financing. In a typical bond repo transaction, an investor sells a bond to another party at one price and commits to repurchase from the buyer at a higher price at maturity. It is a repo to the seller (borrower) and a reverse repo to the buyer (lender). If the seller defaults, the buyer can sell the asset to a third party to offset his loss. The bond therefore acts as collateral and mitigates the seller's credit risk that the buyer has taken on[23]. This facilitates short-term borrowing to bondholders and provides principal protection (with bond as collateral) and returns (usually leveraged) to investors. Clearing banks and custodial agents are crucial in the intermediation of repo transactions[24].

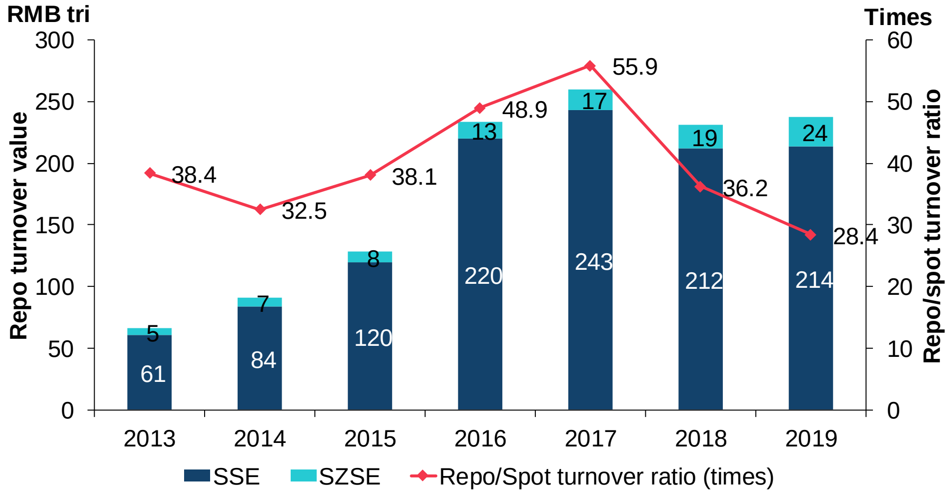
On-exchange trading of repos, including reverse repos, has been active on the Mainland exchanges but it is not currently available in the Hong Kong market. In the Mainland, the repo turnover of bonds on SSE and SZSE grew rapidly and the repo turnover (RMB 237.4 trillion) was about 28.4 times of the spot turnover (RMB 8.4 trillion) in 2019 (see Figure 12).

22 See *Measures of SSE Bond Market Investors Suitability Management (2017 Revised)* (《上海證券交易所債券市場投資者適當性管理辦法（2017 年修訂）》), issued by the SSE, 28 June 2017; *Measures of SZSE Bond Market Investors Suitability Management* (《深圳證券交易所債券市場投資者適當性管理辦法》), issued by the SZSE, 28 June 2017.

23 See "1. What is a repo?", International Capital Market Association (ICMA)'s website, viewed on 27 August 2020. See Section 3.1 on the types of bond repo transaction in the Mainland market.

24 See Adrian, T., B. Begalle, A. Copeland and A. Martin (2013) "Repo and securities lending", *New York Fed Staff Reports,* No. 529.

Figure 12. Repo turnover value of bonds on SSE and SZSE (2013 – 2019)



Source: Monthly statistics of SZSE on its website for SZSE data; monthly statistics of SSE on its website for SSE data up to June 2019; Wind for SSE data since July 2019.

2. CHARACTERISTICS OF THE HONG KONG ON-EXCHANGE BOND MARKET

Hong Kong's listed bond market — the bond market operated by the Stock Exchange of Hong Kong (SEHK), a wholly-owned subsidiary of HKEX — is an open market with a diverse base of global issuers and investors and a wide range of currency exposure. As most of the listed bonds are issued to professional investors only, which are mainly institutional investors, the bond market has been dominated by institutional investors.

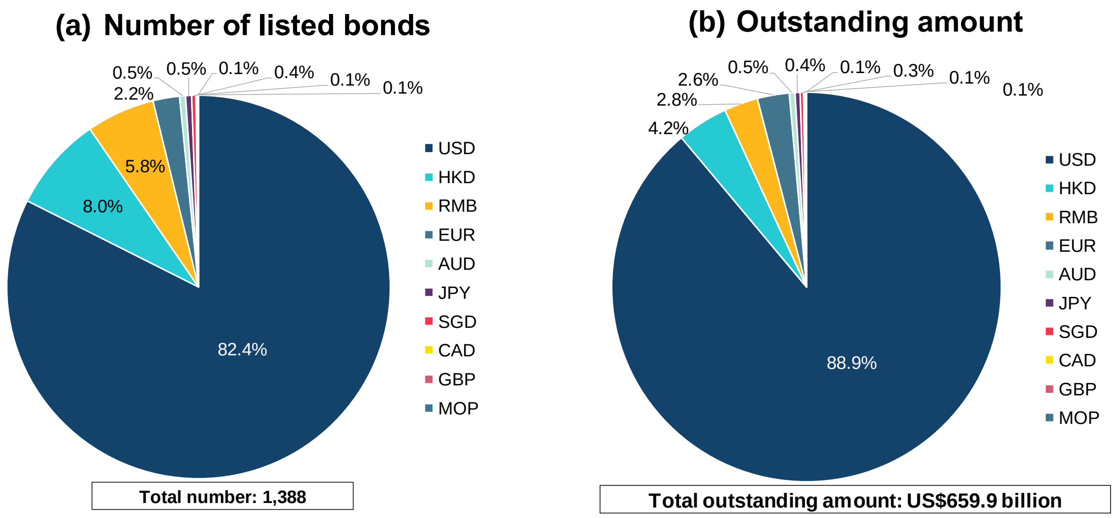
2.1 Types of bond

The issuers of listed bonds in Hong Kong comprise a wide range of global and Mainland entities of different natures, including corporate, state[25] and supranational. Bonds can be issued in multiple currencies. As of end-2019, there were ten denomination currencies of listed bonds in Hong Kong — US dollar (USD), Hong Kong dollar (HKD), Renminbi (RMB), Euro (EUR), Australian dollar (AUD), Japanese yen (JPY), Singaporean dollar (SGD), Canadian dollar (CAD), British pound (GBP) and Macau Pataca (MOP). About 96% of the listed bonds are denominated in USD, HKD or RMB — 82%, 8% and 6% respectively by number; 89%, 4% and 3% respectively by outstanding amount (see Figure 13). Listed bonds in Hong Kong are mostly debt securities issued to professional investors only — as of end-2019, this kind of debt securities numbered to 1,319 (95% of total), with an outstanding amount of US$646.2 billion (98% of total)[26].

[25] "State" entities cover states, regional authorities or local authorities. See Chapter 1 of the Main Board Listing Rules of the SEHK for its definition.

[26] Calculated from the list of debt securities on HKEX's website — 1,388 debt securities listed on HKEX as of end-2019, with the nominal value (outstanding amount) of each in its currency of denomination. The nominal values in currencies other than USD were converted into USD based on the exchange rates as of 31 December 2019 (source: Wind).

Figure 13. Number and outstanding amount of listed bonds in Hong Kong by currency denomination (as of end-2019)



Note: The outstanding amount of listed bonds denominated in different currencies were converted into USD amount based on the exchange rates as of 31 December 2019 in Wind. Percentages may not add up to 100% due to rounding.

Source: List of debt securities on HKEX's website, as of 31 December 2019.

The types of listed bond in Hong Kong classified by issuer type include Government/ Supranational bonds (GSB) issued by governments or supranational organisations, Exchange Fund Notes (EFNs) issued by the Hong Kong Monetary Authority (HKMA) and bonds issued by private and public corporations. By feature, bonds can be classified into plain vanilla bonds[27], convertible bonds, asset-backed securities, etc.

In contrast to the Mainland market, the bond repo market is not well developed in Hong Kong. In the OTC market, there is the lack of a large volume of government securities or central bank papers for banks to conduct repo transactions in Hong Kong dollars[28]. In the listed market on the SEHK, standardised bond repo instruments are not yet available. Listed bonds, particularly bonds issued to professional investors only, are usually not deposited in the SEHK's securities clearing and settlement system — Central Clearing and Settlement System (CCASS), but with Euroclear and Clearstream and/or the Central Moneymarkets Unit (CMU) operated by the HKMA, which has linkages with Euroclear and Clearstream (see Section 2.5). This makes it difficult for the transfer of bonds between depositories as collateral for repo transactions, if available, in the listed bond market.

2.2 Investor eligibility

Bonds listed on the SEHK may be classified into two categories by investor eligibility, governed by different sets of listing requirements:

(1) Debt securities listed under Chapter 22 to Chapter 36 of the Main Board Listing Rules (MBLR) of the SEHK[29] — this kind of debt securities can be invested by public investors (referred to as "bonds for public investors"); and

[27] Plain vanilla bonds generally refer to the most basic type of bond which has pre-determined coupon rate, maturity and face value without embedded options.

[28] See *ASEAN+3 Bond Market Guide: Hong Kong, China*, published on the Asian Development Bank (ADB)'s website, November 2016.

[29] Listing of a bond with public offering is possible under GEM Listing Rules of the SEHK. However, no issuer may list its debt securities on GEM unless its equity securities, or the equity securities of its holding company, are already or will be listed on GEM at the same time as the issuer's debt securities. There has been no such bond listing so far.

(2) Debt securities listed under Chapter 37 of the MBLR[30] — this kind of debt securities are offered to professional investors only and not to public investors (referred to as "bonds issued to professional investors only").

For investors in Hong Kong, a professional investor for the purpose of Chapter 37 of the MBLR is defined in the Securities and Futures Ordinance (SFO) (Chapter 571 of the Laws of Hong Kong), excluding those prescribed by rules made under section 397 of the SFO. These would include authorised financial institutions, insurers and collective investment schemes[31]. For investors outside Hong Kong, a professional investor is a person to whom securities may be sold in accordance with a relevant exemption from public offer regulations in that jurisdiction. Professional investors can participate in the primary and secondary markets of all types of listed bonds.

2.3 Bond issuance and listing

Different types of bond may adopt different issuance methods[32]:

- **Tendering[33]:** Primary dealers can submit tender price at the issuance of bonds. Under the *Institutional Bond Issuance Programme of Hong Kong Government Bonds*, government bonds are issued through competitive tender on a bid-price basis. The Hong Kong government issued 3-year, 5-year, 10-year and 15-year bonds in 2018 through the programme. Separately, the HKMA issues EFNs through competitive tender on a bid-price basis or through non-competitive tender. The underwriting arrangements are in place by primary dealers, who may be required to subscribe for bonds that have not otherwise been subscribed pursuant to valid tenders.
- **Public offering:** Bonds are offered to public investors for subscription through public offerings. Public offering of bonds requires a more comprehensive and detailed prospectus, compared to a relatively simple form of offer document or term sheet for private placement. For government bonds issued by the Hong Kong Special Administrative Region (HKSAR) Government, there is a programme circular on the *Retail Bond Issuance Programme of Hong Kong Government Bonds*, which describes the features of the retail bond programme. An issue circular will be published by HKSAR Government on the terms for each series of retail bonds to be issued[34].
- **Private placement:** Bonds can be issued to a small group of professional investors through private placement. The regulatory requirements on information disclosure in the offer document is less stringent in this case than in the case of public offering.

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30 There was a recent consultation relating to Chapter 37 of the MBLR. The requirements of Chapter 37 of the MBLR set out in this paper reflect the requirements of Chapter 37 of the MBLR as of the date of this paper (see Section 2.3). The changes to Chapter 37 of the MBLR, which will take effect on 1 November 2020, include raising the existing issuer's minimum net assets requirement from HK$100 million to HK$1 billion and introducing a minimum issuance size of HK$100 million. For details, please see "Exchange Publishes Chapter 37 Consultation Conclusions and Guidance on Disclosures in Listing Documents and Continuing Obligations under Chapter 37", news release on HKEX's website, 21 August 2020.

31 See Part 1 of Schedule 1 to the SFO and the "Qualification of professional investors" webpage on the Chin Family website of The Investor and Financial Education Council (IFEC), 31 October 2018.

32 See *ASEAN+3 Bond Market Guide: Hong Kong, China*, published on the ADB's website, November 2016.

33 See *Information Memorandum for the Institutional Bond Issuance Programme*, published on the website of Hong Kong Government Bond Programme, 6 January 2020; and *Information Memorandum of Exchange Fund Notes Programme*, published on the website of HKMA, July 2017.

34 HKSAR Government may update or supplement the programme circular. The issue circular for a particular series of retail government bonds may vary and/or supplement the terms described in the programme circular that are to be applicable for that particular series.

The listing of bonds in Hong Kong is governed by the MBLR of the SEHK. Specific rules in the MBLR governing bonds issued to professional investors only differ from those governing bonds issued to public investors.

(1) Bonds issued to professional investors only

A bond offered to professional investors only can be listed if it satisfies the requirements stipulated in Chapter 37 of the MBLR, which have been streamlined in November 2011[35]. The bond issuer can be a corporate, state, state corporation or supranational and the investors are limited to professional investors only. The minimum denomination is HK$500,000 or equivalent foreign currency. For a corporate bond issuer, the general eligibility criteria include the minimum requirement of HK$100 million of net assets and two years of audited accounts unless exemption is available to the issuer according to the MBLR[36]. The issuer may issue guaranteed debt securities if it is wholly owned by a company that meets the requirements specified in the MBLR and the guarantee is provided by its owner in compliance with the MBLR. As noted in the MBLR, an eligibility letter will be issued by the SEHK to the issuer within five business days for a routine application[37]. A one-off listing fee in the range of HK$7,000 to HK$90,000 is payable for a bond listing while there are no annual listing fees.

(2) Bonds for public investors

The listing of these bonds is governed by Chapters 22 to 36 of the MBLR. Prospective issuers should contact Listing Division of HKEX to seek guidance as to the eligibility of a proposed issue for listing at the earliest possible opportunity. Both professional and public investors can invest in these bonds. The method of listing can be “offer for subscription”, “offer for sale” or other methods as prescribed in Chapter 22 of the MBLR[38]. The typical process for the listing of bonds with public offering is summarised in Figure 14. The general qualifications of issuers include HK$100 million of shareholders’ funds, a minimum amount of HK$50 million of funds raised and audited accounts for three financial years[39]. The specific qualifications (or exemptions available) vary across different types of issuer as prescribed in the respective Chapters of the MBLR for mineral companies, states, supranationals, state corporations and banks. The general disclosure requirements in the listing document for a bond include the general information about the issuer as well as its capital, business activities and management, information about the bonds to be listed and financial information as set out in Chapter 25 and Appendix 1 Part C of the MBLR. In addition, if the issuer is a company (incorporated in Hong Kong or overseas), the listing document is regarded as a prospectus under the Laws of Hong Kong and will have to comply with the content requirements under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Chapter 32 of the Laws of Hong Kong) and be registered with the Companies Registry.

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35 See “Consultation conclusion — Proposed changes to requirements for the listing of debt issues to professional investors only”, published on HKEX’s website, October 2011.

36 Certain listing requirements stipulated in Chapter 37 of the MBLR will be changed with effect from 1 November 2020, pursuant to a recent consultation. See “Exchange Publishes Chapter 37 Consultation Conclusions and Guidance on Disclosures in Listing Documents and Continuing Obligations under Chapter 37”, news release on HKEX’s website, 21 August 2020.

37 In practice, for applications that do not involve novel features, HKEX will, under normal circumstances, issue the listing approval letter or eligibility letter within one business day for issues involving a Hong Kong listed company; or within two business days for other issuers.

38 According to Chapter 22 of the MBLR, other methods of listing include “placing”, “exchange” or “exercise of options, warrants or similar rights”.

39 For new applicants, the financial period of the accountant’s report should not have ended more than 9 months before the date of the listing document. For overseas issuers, the accountant’s reports should conform with accounting standards such as the International Financial Reporting Standards (IFRS).

Figure 14. Illustrative flow chart for the typical process of listing a bond with public offering

Hong Kong Government Bonds (HKGBs) are issued to institutional investors through tendering and to retail investors through public offering. EFNs are issued to institutional and retail investors through tendering. Certain HKGBs and EFNs, mainly those issued to retail investors, are listed on the SEHK. For corporate bonds to be listed on the SEHK, they are usually issued through private placement to professional investors only. Nevertheless, CCASS can facilitate the public offering of corporate bonds to retail investors. In 2019, Agricultural Development Bank of China (ADBC), one of China's three policy banks, issued the first listed non-government bond offered to public (retail) investors through CCASS only, along with private placement to professional investors[40].

2.4 Bond trading

The trading arrangement for listed bonds in Hong Kong is largely the same as for stocks on the Main Board. Trading is conducted on HKEX's "Orion Trading Platform – Securities Market" (OTP-C) that provides for the execution of "exchange trades" and the reporting of "manual trades" conducted off-exchange.

- **Exchange trades:** Listed bonds are available for automatched trading during Pre-Opening Session (POS) and Continuous Trading Session (CTS)[41], but not during Closing Auction Session (CAS) which is currently opened for the trading of equities and ETFs only. Listed bonds are normally quoted in multiples of 100 currency units of their nominal values[42] and the minimum price fluctuation is 0.05 of the currency unit. Investors can place orders through Exchange Participants (EPs), who will then submit the orders to OTP-C for auto-matching. The types of order include limit orders, enhanced limit orders and special limit orders during CTS, and at-auction orders and at-auction limit orders during POS[43], subject to the 9-time quotation rules[44]. Margin trading is allowed but short selling is not.

[40] See "HKEX welcomes first non-government retail bonds", news release on HKEX's website, 23 May 2019. Subscription for the retail tranche of the bond issue of ADBC in 2019 could only be applied via CCASS. There was a previous case of retail bond offering through CCASS in 2004 (the bonds of Hong Kong Link 2004 Limited), but the application of this retail bond could be made through retail banks in addition to through CCASS.

[41] Bonds will only be traded during CTS but not during POS after the implementation of POS enhancement later in 2020. See "POS enhancements initiative", HKEX's website, viewed on 28 July 2020.

[42] For bonds denominated in Japanese yen (JPY), the quotation is in multiples of JPY100,000. See Rules 524 and 525 in Chapter 5 of *Rules of the Exchange*, issued by HKEX, 24 August 2020.

[43] During CTS, a limit order will allow matching only at the specified price and an enhanced limit order is similar to a limit order except that it will allow matching of up to 10 price queues at one time provided that the traded price is not worse than the input price. During POS (available to bond trading before POS enhancement later in 2020), an at-auction order is an order with no specified price and is entered into the trading system for execution at the final indicative equilibrium price (IEP) and an at-auction limit order is an order with a specified price. See "Trading mechanism" webpage on HKEX's website, viewed on 28 July 2020.

[44] The quotation of an order should not be above or below 9 times of the nominal price. See Chapter 5 of *Rules of the Exchange*, issued by HKEX, 24 August 2020.

- **Manual trades:** Block trades or odd-lot trades can be manually executed off-exchange. There is no volume threshold for these manual trades. These trades must be reported to the SEHK as manual trades within 15 minutes of trade execution of the same trading day and no later than 9:45 am on the next trading day.

For listed bonds issued to professional investors only, the professional investors (typically institutions) usually trade the bonds off-exchange with other professional investors. EPs are required to report all off-exchange transactions executed to the SEHK even if the counterparty of the transaction is not an EP. The trading records in the SEHK's system would include also transactions conducted off-exchange by EPs with each other.

2.5 Clearing and settlement[45]

The settlement of listed debt securities can be done in real-time or end-of-day mode for delivery-versus-payment (DVP) or free-of-payment (FOP). The settlement is on a gross basis for real-time settlement and on a net basis for end-of-day settlement. At the choice of the issuer, the listed debt securities may be admitted to CCASS and/or CMU after issuance. For those admitted to CCASS, the settlement is done through CCASS which has established linkages with the Real Time Gross Settlement (RTGS) systems of the HKMA for HKD, USD and RMB. Some of the listed bonds are cleared and settled through CMU, which has system linkages with international central securities depositories (ICSDs) such as Euroclear and Clearstream. This enables international investors to hold and settle bonds through these networks.

3. CHARACTERISTICS OF THE MAINLAND ON-EXCHANGE BOND MARKET

China's bond market is dominated by the CIBM in terms of issue amount and trading value, in particular for treasury bonds and policy bank bonds. Nevertheless, the on-exchange bond market has grown significantly since 2015, offering a wide range of debt instruments issued by listed and unlisted companies, and serving more diverse types of Mainland institutions and investors than the CIBM (see sub-sections below).

3.1 Types of bond

The on-exchange bond market in the Mainland provides a wide range of bonds issued mainly by Chinese issuers, including the central government and local government bodies, policy banks, financial institutions and corporations. The China Securities Regulatory Commission (CSRC) and relevant authorities are exploring the formulation of specialised rules for the issuance and listing of panda bonds[46]. In the Mainland, the issuance of bonds is subject to the approval of different authorities depending on the types of bond. The characteristics of the different types of on-exchange bond on SSE and SZSE are summarised in Table 1. These can be classified broadly into two major categories:

(1) Government or government-backed bonds

These comprise treasury bonds, local government bonds and policy bank financial bonds. These bonds have high credit ratings. All of them can be traded by not only sophisticated investors with A-share accounts in the Mainland ("qualified investors") but also public investors with A-share accounts ("public investors"). Treasury bonds and local

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45 See "FAQs on debt securities", published on HKEX's website, 24 June 2020.

46 Panda bonds are RMB-denominated bonds issued by foreign issuers in the Mainland market. A number of on-exchange panda bonds were issued since 2014 in accordance with the rules on the issuance of corporate bonds. See: Tang, Y. (2017) "The fragmentation of panda bond market and the competition and cooperation of securities regulations"(〈熊貓債市場分割和證券監管競爭與統一〉), *Securities Law Review* (《證券法苑》), Vol. 22, pp.111-138.

government bonds can be traded either on the exchange market or on the CIBM as the custody of these bonds can be transferred from the China Securities Depository and Clearing Corporation Limited (CSDC) for trading on SSE and SZSE to the China Central Depository & Clearing Company Limited (CCDC) for trading on the CIBM. For the exchange market, bond trades are cleared and settled through CSDC only; for the CIBM, bond trades can be cleared and settled through CCDC or the Shanghai Clearing House (SCH) (see Section 3.5).

(2) Credit bonds

These are bonds issued by corporate issuers, comprising corporate bonds, enterprise bonds, convertible bonds, exchangeable bonds and asset-backed securities.

- ***Corporate bonds*** can be issued by all corporate entities including listed or unlisted companies. The public offering of a corporate bond requires application to the stock exchange for approval and registration with the CSRC. In contrast, ***enterprise bonds*** are mainly issued by state-owned enterprises or LGFVs for infrastructure project financing, subject to the approval by the National Development and Reform Commission (NDRC). The custody of enterprise bonds can be transferred from CSDC to CCDC[47] such that enterprise bonds can be traded on either the exchange market or the CIBM, like treasury bonds or local government bonds mentioned above. Notably, an increasing number of bonds issued by corporate issuers are issued with green labels (green bonds) subject to additional requirement on information disclosure (e.g. the green use of proceeds)[48].
- ***Convertible bonds*** can be issued by listed companies with embedded options to exchange for newly issued shares of the issuing companies while ***exchangeable bonds*** are issued by shareholders of listed companies with embedded options to exchange for shares held by the shareholders (e.g. a parent company can issue an exchangeable bond with an embedded option to exchange for shares of its subsidiary)[49]. The issuance of these bonds are subject to the approval by the CSRC and the exchange.
- ***Asset-backed securities (ABS)*** include corporate/enterprise ABS with income backed by underlying assets of non-financial institutions and credit ABS backed by underlying credit assets of financial institutions. These types of bond are on the rise and being promoted by the Mainland government. As a policy support initiative, issuance processes for the various types of ABS have been streamlined in November 2014[50] after which the issue amount rose significantly[51].

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47 The transfer of custody of enterprise bonds from CCDC for trading on the CIBM to CSDC for trading on the exchange market takes possibly three days. See: Fixed Income Department of Haitong Securities (2016) "The current developments, challenges and suggestions of on-exchange bond market" (〈交易所債券市場的發展現狀、問題及建議〉), *China Securities* (《中國證券》), 2016, Vol. 5, pp.2-7.

48 See HKEX research report, "The green bond trend: Global, Mainland China and Hong Kong", published on HKEX's website, 13 December 2018.

49 See "What are the differences between convertible bonds and exchangeable bonds?" (〈可轉換債券與可交換債券的區別是什麼？〉), published on the Securities Association of China (SAC)'s website, 21 November 2018.

50 See *Notice Concerning the Work Flow for Filing and Registration of Credit Asset Securitisation* (《中國銀行業監督管理委員會辦公廳關於信貸資產證券化備案登記工作流程的通知》), issued by the then China Banking Regulatory Commission (CBRC, now restructured into the China Banking and Insurance Regulatory Commission, CBIRC), 20 November 2014 and *Regulations for the Administration of Asset Securitisation Operations of Securities Companies and Subsidiaries of Fund Management Companies (Document No. 49)* (《證券公司及基金管理公司子公司資產證券化業務管理規定》), issued by the CSRC, November 2014.

51 See Schipke, A., M. Rodlauer and L. Zhang (2019) "Chapter 8 Asset-backed securities", *The Future of China's Bond Market*, International Monetary Fund.

Table 1. Characteristics of Mainland on-exchange bonds by bond type

Feature	Type of bond					
	Treasury bond / Local government bond	Financial bond	Enterprise bond	Corporate bond	Convertible/ Exchangeable corporate bond	Asset-backed securities (ABS)
Approving authority for issuance	Ministry of Finance (MOF)	• People's Bank of China (PBOC) • China Banking and Insurance Regulatory Commission (CBIRC)	National Development and Reform Commission (NDRC) and authorities designated by NDRC	CSRC and exchanges	CSRC and exchanges	• Exchange for Enterprise ABS • PBOC and CBIRC for Credit ABS
Issuer type	MOF/Local government	Policy banks	Profitable enterprise (mainly SOEs and LGFVs)	All corporate entities (including shareholding companies and limited liability corporations)	• Listed companies(1) for convertible bonds • Shareholders of listed companies for exchangeable bonds	Beneficial owner of underlying assets
Tenor	Mainly medium to long term	Not limited	Mainly medium to long term (usually 5 years)	More than 1 year (usually 5 years)	1-6 years	Not limited
Credit rating	High	High	Relatively high, mainly rated AA and above	• Relatively high, mainly rated AA and above • Not required for private placement	Relatively high, mainly rated AA and above	Relatively high for senior tranche, mainly rated AA and above
Issue method	Tendering, public offering and private placement	Tendering, public offering and private placement	Tendering, public offering and private placement	Public offering and private placement	Public offering and private placement	Tendering (credit ABS), public offering and private placement
Investors(1)						
Public investors	Allowed	Allowed	Only for bonds meeting certain quality requirements	Only for public offerings by issuers meeting certain quality requirements	Only for public offerings by issuers meeting certain quality requirements	Not allowed
Qualified investors(2)	Allowed	Allowed	Allowed	Allowed	Allowed	Allowed

Table 1. Characteristics of Mainland on-exchange bonds by bond type

Feature	Type of bond					
	Treasury bond / Local government bond	Financial bond	Enterprise bond	Corporate bond	Convertible/ Exchangeable corporate bond	Asset-backed securities (ABS)
Trading arrangements						
Price auction	Allowed	Allowed	Allowed	Only for public offerings meeting specific standards	Only for public offerings meeting specific standards	Not allowed
Block trading	Allowed	Allowed	Allowed	Allowed	Allowed	Allowed
Fixed Income Platform (for SSE only)	Allowed	Allowed	Allowed	Allowed	Allowed	Allowed
Bilateral transfer of custody	Between CSDC and CCDC	Not supported	Between CSDC and CCDC	Not supported	Not supported	Not supported

(1) According to the revised *Administrative Measures on the Issuance and Trading of Corporate Bonds* (《關於就修訂《公司債券發行與交易管理辦法》公開徵求意見的通知》) issued by the CSRC on 7 August 2020 for public consultation, the eligibility requirements of convertible bond issuers and investor suitability requirements are to be revised. Unlisted companies will also be allowed to issue convertible bonds and investors are to be classified as "general investors" and "professional investors" (see Section 3.2).

(2) Qualified investors include qualified institutional investors and qualified individual investors (see Section 3.2 for details and proposed rules changes).

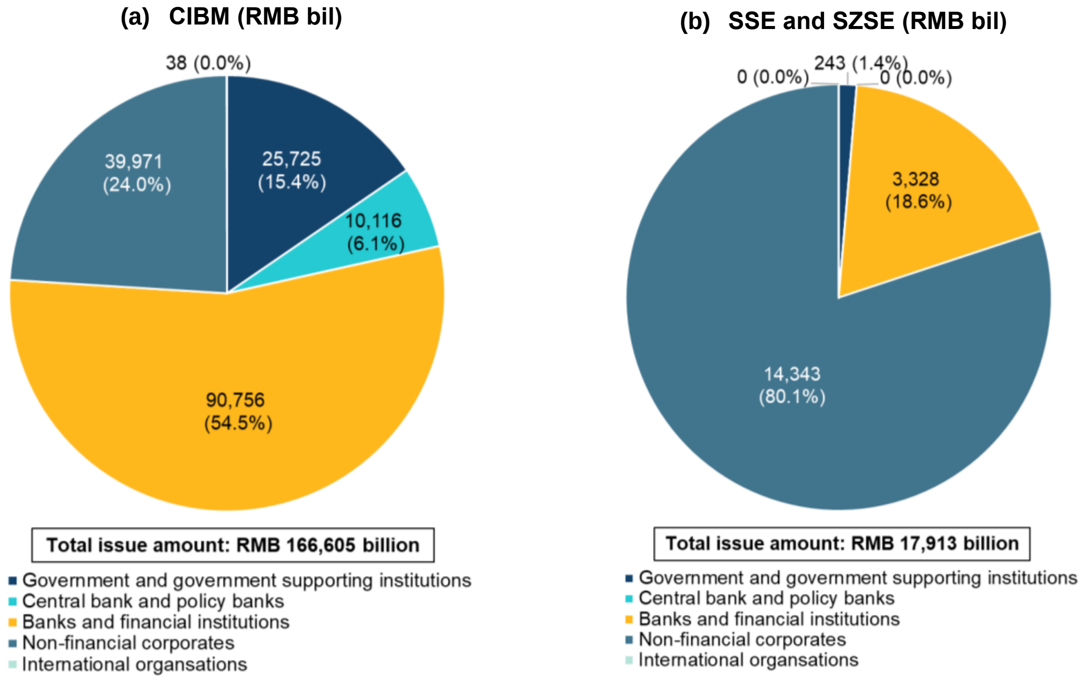
Source: Respective websites of SSE and SZSE, viewed on 24 June 2020.

As observed from the total issue amount during 2010 to 2019, the Mainland on-exchange bond market serves the corporate bond sector more than other issuer sectors. This is different from the issuer composition in the CIBM (see Figure 15). About 80% of bonds issued on the exchange market during 2010 to 2019 were issued by non-financial corporates while bonds issued by banks and financial institutions dominated in the CIBM.

In absolute amount, both the CIBM and the on-exchange bond market were important sources of direct financing for non-financial corporates — an issue amount of RMB 40.0 trillion on the CIBM only and RMB 14.3 trillion on the exchange market only[52] during 2010 to 2019. However, the on-exchange bond market apparently focuses more on serving non-financial corporates, offering direct financing to support the real economy.

[52] Excluding bonds issued on both the CIBM and the exchange market.

Figure 15. Distribution of bond issue amount on the exchange market and CIBM by issuer type (2010 – 2019)



Notes:

(1) Bonds issued on both the CIBM and exchange markets are excluded because separate allocation of issue amount to the CIBM and the exchange market is not possible. These include a large part of treasury bonds, local government bonds and government supporting institution bonds and certain policy bank bonds and enterprise bonds.

(2) Bonds issued by banks and financial institutions include financial bonds issued by banks, insurers, securities companies and other financial institutions, credit ABSs, certificates of deposits and short-term financing bills issued by securities companies. Bonds issued by non-financial corporates include medium-term notes, enterprise bonds, corporate bonds, short-term financing bills, convertible bonds, exchangeable bonds and private placement notes and bonds.

(3) Percentages may not add up to 100% due to rounding.

Source: Wind.

Bond repo trading is available on SSE and SZSE. These include collateralised repo trading and outright repo trading[53]. A collateralised repo transaction refers to a repo transaction where the bondholder uses the bonds as collateral for financing from the counterparty of an amount equal to the value of the standardised bond collateral with a haircut; and on the agreed maturity date, cash will be repaid and claims on the collateral will be returned. An outright repo transaction refers to a repo transaction where the bondholder sells the bonds to the counterparty and agrees to re-purchase the same quantity of bonds at an agreed price on an agreed future date. In 2018, SSE and SZSE launched tri-party collateralised repos[54]. A tri-party collateralised repo transaction is a collateralised repo transaction where the collateral management service is provided by third parties (the exchange and the clearing house).

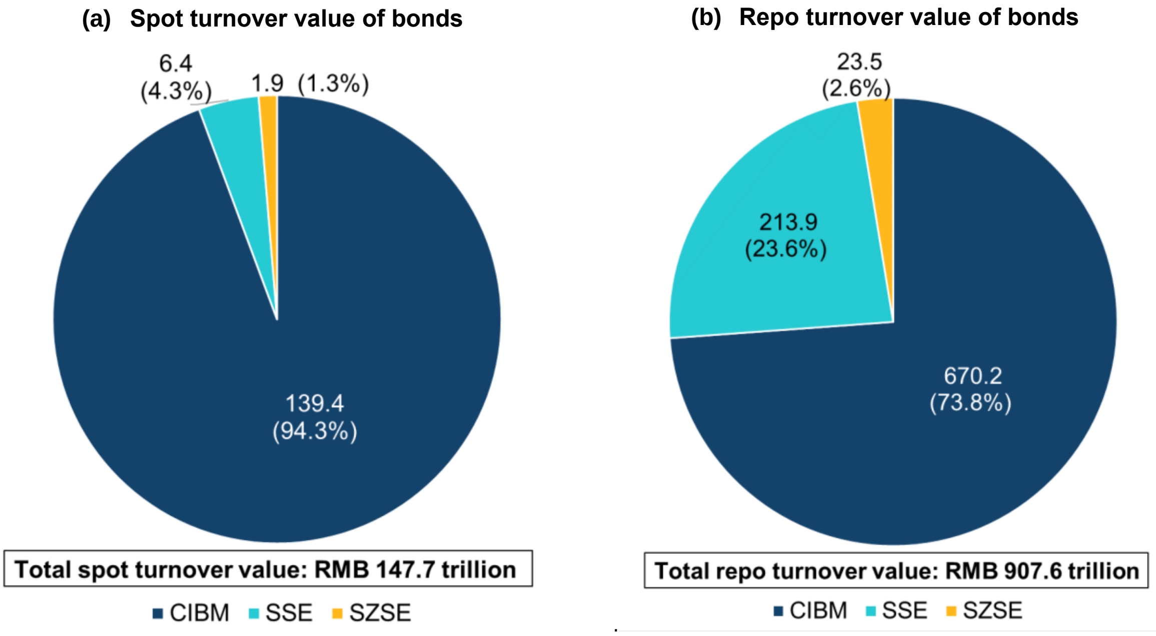
Bond repo trading on the exchanges is relatively more active than spot bond trading. While the combined share of SSE and SZSE in terms of spot trading value of bonds in the Mainland market was low (below 6% of total bond trading on the CIBM and the exchange market in 2019) (see Figure 16a), their combined share was about 26% of total bond repo trading on the CIBM and the exchange market in 2019 (see Figure 16b). This is attributable to the high acceptance of credit bonds (e.g. enterprise bonds and corporate bonds) as collateral with an

[53] Source: Websites of SSE and SZSE.

[54] See *SSE and CSDC Interim Measures on Collateralised Tri-party Bond Repo Trading and Settlement* (《上海證券交易所、中國證券登記結算有限責任公司債券質押式三方回購交易及結算暫行辦法》), issued by SSE and CSDC, 24 April 2018; *SZSE and CSDC Interim Measures on Collateralised Tri-party Bond Repo Trading and Settlement* (《深圳證券交易所 中國證券登記結算有限責任公司債券質押式三方回購交易及結算暫行辦法》), issued by SZSE and CSDC, 13 July 2018.

average discount ratio at 80% for repo transactions on the exchange market while lenders in the CIBM usually do not accept these as collateral because of the difficulty in valuation[55].

Figure 16. Bond spot turnover and repo turnover in the Mainland by market (2019)



Note: Percentages may not add up to 100% due to rounding.

Source: Monthly statistics of SSE and SZSE on their websites for the exchanges' data; CCDC's website (Chinabond.com.cn*)* for CIBM data.

3.2 Investor eligibility

The Mainland securities market adopts an "investor suitability management" model for the purpose of investor protection under which relatively more risky investment instruments shall be marketed only to investors meeting certain qualification requirements including asset size and investment experience. The two main categories of investor for on-exchange bonds in the Mainland have been named qualified investors and public investors[56]. On 7 August 2020, the CSRC issued for public consultation the draft revised version of the rules on corporate bond issuance and trading[57] (hereinafter referred to as the "2020 Draft Revised Rules") pursuant to the implementation of the revised Securities Law since 1 March 2020. According to the 2020 Draft Revised Rules, investors of corporate bonds will be re-classified as "general investors" and "professional investors" (instead of "qualified investors"). The criteria of professional investors have to comply with related rules on investor eligibility[58] formulated by the CSRC.

55 See Luo, J., "Looking at the mechanism and infrastructure of CIBM from the perspective of repo market" (〈由回購交易的市場分布看銀行間債券市場機制建設〉), *Bond* (《債券》), November 2012.

56 See *Administrative Measures of SSE Bond Market Investor Suitability Management (2017 Revised)* (《上海證券交易所債券市場投資者適當性管理辦法（2017 年修訂）》), issued by the SSE, 28 June 2017; *Administrative Measures of SZSE Bond Market Investor Suitability Management* (《深圳證券交易所債券市場投資者適當性管理辦法》), issued by the SZSE, 28 June 2017.

57 See *Notice of Public Consultation on the Revision of the Administrative Measures for the Issuance and Trading of Corporate Bonds* (《關於就修訂《公司債券發行與交易管理辦法》公開徵求意見的通知》), issued by the CSRC, 7 August 2020.

58 *Administrative Measures on Securities and Futures Investor Suitability* (《證券期貨投資者適當性管理辦法》), issued by the CSRC on 12 December 2016, effective on 1 July 2017.

(1) Qualified investors (to be renamed "professional investors")

Institutions and individuals may be qualified to invest in certain types of bond not available to public investors, but subject to different eligible scopes. Qualified institutions are allowed to participate in the primary and secondary markets of all types of bond, which include bonds with a rating below AAA and in the non-public offerings of corporate and enterprise bonds, ABS and defaulted bonds, which are not available to public investors. Qualified institutions are also eligible for pre-issuance of treasury bonds, and can trade treasury bonds before the tender during the issuance process (during 1 to 4 working days prior to the tender date)[59]. Qualified individual investors can invest in those bond types eligible for public investors and corporate bonds with an AAA rating issued through public offering to qualified investors only. This requirement on qualified individual investors is to be amended according to the 2020 Draft Revised Rules[60].

- **Qualified institutions** include financial institutions and their wealth management products (WMPs) issued to investors, Qualified Foreign Institutional Investors (QFIIs) and RMB QFIIs (RQFIIs), the National Social Security Fund and pension funds, and other eligible institutions with at least RMB 20 million of net assets and at least RMB 10 million of financial assets as of the latest year-end and at least 2 years of investment experience in securities, funds, gold or foreign exchange, etc.
- **Qualified individuals** are individuals with a minimum RMB 5 million of investment assets during the past 20 trading days or a minimum of RMB 500,000 of annual income for the recent 3 years as well as at least 2 years of investment experience in securities, funds, gold or foreign exchange, etc.

(2) Public investors (to be renamed "general investors")

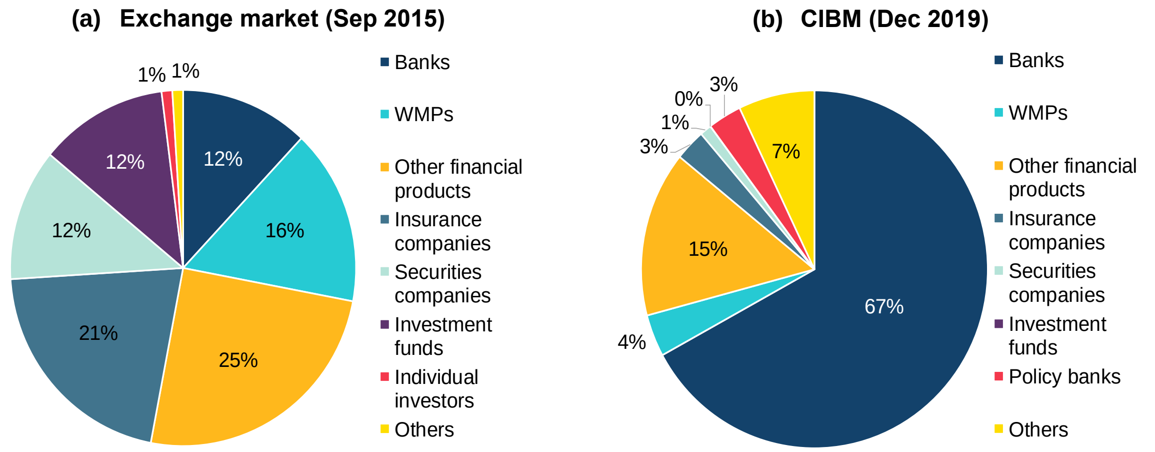
They are allowed to participate in the primary and secondary markets of treasury bonds, local government bonds, policy bank financial bonds, and corporate bonds and convertible bonds issued through public offering. Public investors can also be the lending side of collateralised bond repos.

The investor mix of the Mainland on-exchange bond market was found to be more balanced than that of the CIBM which was dominated by banks. Banks accounted for about 67% of total bond holdings on the CIBM as of December 2019 while they accounted for only 12% of total bond holdings on the exchange market as of September 2015 (see Figure 17). Other types of institutional investor on the exchange market which had at least the share of banks as of the same date include insurance companies, securities companies, investment funds, WMPs and other financial products (e.g. social security funds (SSFs), QFIIs/RQFIIs, trusts and enterprise pensions).

59 See *Notice of the MoF, the PBOC, and the CSRC on Carrying out the Pilot Programme of Pre-issuance of Treasury Bonds* (《財政部、中國人民銀行、中國證券監督管理委員會關於開展國債預發行試點的通知》), issued by Ministry of Finance (MoF), People's Bank of China (PBOC) and China Securities Regulation Commission (CSRC), 13 March 2013.

60 According to the 2020 Draft Revised Rules, the eligibility threshold of AAA rating of publicly offered corporate bonds for investment by "public investors" (referred to as "general investors under the new rules) will be removed. General investors will be allowed to invest in publicly offered corporate bonds irrespective of the credit rating provided that the issuer of the bond meets the requirements set in the rules (see Section 3.3).

Figure 17. Distribution of bond holdings on the exchange market and CIBM by investor type



Note: Other financial products holding bonds on the exchange market include SSFs, QFIIs/RQFIIs, trusts and enterprise pensions.

Source: Data for the exchange market from "The challenge in investor structure of China's bond market: How to develop both institutional and retail investors" (〈中國債市投資者結構缺陷：機構和個人投資者如何並舉〉), published on *21jingji.com*, 17 December 2015; data for CIBM is from CCDC's website (Chinabond.com.cn).

3.3 Bond issuance and listing[61]

The channels of bond issuance include issuance through non-public offerings (i.e. private placements) to designated qualified investors and issuance through public offerings (i.e. proxy sale, underwriting, tendering or auction) to qualified investors and/or public investors. The issuance process of on-exchange bonds may vary across different bond types.

Take corporate bonds as an example. The issuance shall comply with the requirements in applicable rules and regulations, which include issuer and investor eligibility requirements. Corporate bonds may be issued through public offering[62] or private placement.

Upon the implementation of the registration-based securities issuance regime pursuant to the revised Securities Law which became effective on 1 March 2020, issuances of corporate and enterprise bonds through public offering have to be registered respectively with the CSRC and NDRC[63]. Corporate bonds registered with the CSRC are to be approved by stock exchanges for public issuance and listing. The requirements for public offerings of corporate bonds have been streamlined in March 2020 to remove the limits on minimum net assets of an issuer while there remains the requirement that the recent three-year average annual distributable profits shall not be less than the issuer's annual bond interest payments[64]. According to the 2020

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61 This is governed by various rules and regulations issued by different authorities, including the *People's Republic of China (PRC) Securities Law (Effective from 1 March 2020)* (〈中華人民共和國證券法（自 2020 年 3 月 1 日起施行）〉), 28 December 2019; the *PRC Companies Law* and the *Administrative Measures for the Issuance and Trading of Corporate Bonds* (《公司債券發行與交易管理辦法》), issued by the CSRC, 15 January 2015; *Notice of Public Consultation on the Revision of the Administrative Measures for the Issuance and Trading of Corporate Bonds* (《關於就修訂《公司債券發行與交易管理辦法》公開徵求意見的通知》), issued by the CSRC, 7 August 2020.

62 Prior to the implementation of rules changes under the 2020 Draft Revised Rules, public offerings of corporate bonds are classified into "large public offering" under which the bonds are offered to both qualified and public investors and "small public offering" under which the bonds are offered to qualified investors only. See "What are the differences among 'large' public offering, 'small' public offering and private placement of corporate bonds?" (〈大公募、小公募、私募公司債有什麼區別？〉), published on the CSRC's website, 14 December 2016.

63 See *NDRC's Notice of the Related Issues of the Implementation of Registration-based Regime of Enterprise Bonds* 《國家發展改革委關於企業債券發行實施註冊制有關事項的通知》), issued by the NDRC, 1 March 2020; *Notice of the Related Issues of the Implementation of Registration-based Regime of Publicly Offered Corporate Bonds* (《關於公開發行公司債券實施註冊制有關事項的通知》), issued by the CSRC, 1 March 2020.

64 See "SSE's Q&As on the implementation of registration-based regime for public offering of corporate bonds" (〈上交所就公開發行公司債券實施註冊制答記者問〉), published on SSE's website, 2 March 2020; "(Authorised release) People's Republic of China Securities Law" (〈（受權發佈）中華人民共和國證券法〉), *xinhuanet.com*, 29 December 2019.

Draft Revised Rules, the requirements for an issuer of a corporate bond issued through public offering to professional and general investors include (1) no records of default or delayed payments in recent three years, (2) the recent three-year average annual distributable profits not being less than 1.5 times of the issuer's annual bond interest payments, (3) net assets of at least RMB 25 billion, and (4) at least three issues of publicly offered bonds with an issue amount in aggregate of not less than RMB 10 billion in recent 36 months.

Private placements of corporate bonds require filing with the Securities Association of China (SAC) within 5 business days after issuance. In a private placement, the corporate bond is issued to not more than 200 qualified investors (to be renamed professional investors), and not to public investors (to be renamed general investors). There are no pre-set rules on an issuer's credit rating and financial conditions. However, the issuer must make adequate disclosure as agreed with investors.

The issuer of a corporate bond shall apply to the exchange for listing of the bond. The listing requirements include continuous disclosure obligations. The advice on whether the listing is approved will be issued by the exchange within five trading days upon receiving the application.

3.4 Bond trading

Bond trading on exchanges can be conducted through price auction, block trading and quote-driven trading[65]. In particular, SSE operates a specialised trading platform (Fixed Income Platform) for the trading of bonds. Like trading A shares, the trading currency of bonds is limited to the RMB only and trade orders are subject to pre-trade checking on cash and securities balances in investors' account to avoid settlement failure. Bonds are one of the few product types on stock exchanges which can be traded on a T+0 basis (i.e. bonds can be bought and then sold within the same day).

- **Price auction:** The securities trading platforms of SSE and SZSE provide for the collective auction session at pre-opening (9:15-9:25) and the continuous auction session (9:30-11:30 and 13:00-15:00). For bonds, the minimum trading unit is 10 units (or one board lot) and the face value of one unit is RMB 100. The minimum price fluctuation is RMB 0.01 on SSE and RMB 0.001 for SZSE. On SSE, the price fluctuation is subject to a price cage[66]. On SZSE, the price fluctuation is subject to ±10% of the last traded price (and ±30% of the issue price for the collective auction price on the listing date). This mode of trading is limited to high-rating bonds and publicly offered corporate bonds that meet certain specific requirements.

- **Block trading (or negotiated trades):** SSE and SZSE each provides a dedicated platform for block trading of securities, including bonds. Block trading for bonds on SSE and SZSE is done in the same way as for A shares on the respective exchanges. On both SSE and SZSE, the types of input for block trades are "intent orders", "execution orders" and "fixed-price orders". "Intention orders" show the intention of block trades and "execution orders" are reported negotiated block trades while "fixed-price orders" are

65 Currently, certain corporate bonds are allowed to be traded off-exchange among institutional investors on the Inter-institutional Privately Offered Product Quotation and Service System (InterOTC System). According to the 2020 Draft Revised Rules, corporate bonds can no longer be traded on the InterOTC System.

66 For opening auction, the order price must be within the range of 70%-150% of the previous close. For continuous auction, the order price must be within 110% of the latest highest ask price and 90% of the latest lowest bid price and also within ±30% of the average of the latest highest and lowest order quotation. See Rules 3.4.15 and 3.4.16 of the *SSE Trading Rules (2020 Second Edition)* (《上海證券交易所交易規則(2020 年第二次修訂)》), issued by SSE, 13 March 2020.

orders with the price fixed at either the market closing price or volume weighted average price (VWAP)[67].

- For block trading of bonds on SSE, the minimum size is RMB 10 million for treasury bonds and local government bonds, and 10,000 units or RMB 1 million for corporate bonds. "Intent orders" can be submitted during 9:30-11:30 and 13:00-15:30 while "execution orders" and "fixed-price orders" can be submitted during 15:00-15:30.
- For block trading of bonds on SZSE, the minimum size is 5,000 units or RMB 500,000 for a single bond. "Intent orders" and "execution orders" can be submitted during 9:15-11:30 and 13:00-15:30 while "fixed-price orders" can be submitted during 15:05-15:30.

- **SSE's Fixed Income Platform:** This special platform of SSE operates like an OTC market that allows requests for quote (RFQ) and negotiated trades. It supports the spot trading and repo transactions of bonds. The trading hours are 9:30-11:30 and 13:00-15:00. The minimum price fluctuation is RMB 0.001. The quotation size is fixed at RMB 5 million for treasury bonds and RMB 1 million for corporate bonds. For specific counterparty quote, the minimum size is RMB 100,000 for treasury bonds and corporate bonds and RMB 50,000 for non-publicly offered bonds issued by small and medium-sized enterprises (SMEs).

Pursuant to the announcement jointly made by the PBOC and the CSRC in July 2020[68], an infrastructure connection mechanism between the CIBM and the on-exchange bond market will be launched to enable qualified investors to trade bonds on one market through the other market's infrastructure (including trading, clearing and settlement, and custody and registration systems). The implementation of this mechanism (details are not yet announced) is expected to facilitate bond trading in both the CIBM and the on-exchange bond market.

3.5 Clearing and settlement

CSDC is the central securities depository and custodian of on-exchange bonds. The settlement of on-exchange bonds is conducted DVP through CSDC on a net basis[69]. In comparison, the settlement of bond trades on the CIBM through CCDC and SCH is on a gross DVP basis. The settlement currency is limited to the RMB only. Under the CIBM and on-exchange bond market Connect mechanism (see Section 3.4 above), the clearing and settlement infrastructure of the CIBM will be connected with that of the on-exchange bond market to serve bond trading under the Connect mechanism.

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67 Fixed-price orders at VWAP are allowed on the SZSE but these are suspended on the SSE at the moment according to the *Notice on Revising the Trading Rules of the Shanghai Stock Exchange* (《關於修訂《上海證券交易所交易規則》的通知》), issued by the SSE, 13 March 2020.

68 *Notice of the People's Bank of China and the CSRC (2020) No. 7* (《中國人民銀行 中國證券監督管理委員會公告〔2020〕第 7 號》), 19 July 2020.

69 See "Information on transaction flows and settlement infrastructures", *ASEAN+3 Bond Market Forum Sub-Forum 2 (ABMF SF2)*, published on ADB's website, December 2013; "ASEAN+3 bond market guide: Exchange bond market in the People's Republic of China", published on ADB's website, October 2019.

4. OPPORTUNITIES AND BENEFITS OF COOPERATION BETWEEN THE HONG KONG AND MAINLAND ON-EXCHANGE BOND MARKETS

Through different development paths, the Mainland and Hong Kong on-exchange bond markets differ a lot in terms of the structure of issuers and investors, bond types and pace of growth. A comparison of market structures of HKEX, SSE and SZSE is summarised in the Appendix.

In respect of issuer structure, listed bonds in Hong Kong are issued by global issuers in a wide range of currencies while Mainland's exchange-traded bonds are issued by predominantly Chinese issuers and are mainly in RMB[70], with less than 1% being issued by foreign issuers in RMB (i.e. panda bonds)[71].

In respect of investor structure, the Hong Kong market is freely open to global investors while the Mainland market is dominated by Chinese institutional investors with limited foreign participation — for the on-exchange market, access is limited to QFIIs / RQFIIs only.

In respect of bond types, plain vanilla bonds, convertible bonds and asset-backed securities can be found on exchanges in both Hong Kong and the Mainland. In addition, the Mainland market offers exchangeable bonds and repo trading which are not available in Hong Kong. The average issue size was about US$475 million for all outstanding bonds listed in Hong Kong as of 31 December 2019[72]. This was comparable to the average issue size for bonds on the Mainland exchanges in 2019 — RMB 2,054 million (US$297.4 million) for SSE and RMB 3,411 million (US$493.8 million) for SZSE[73].

In respect of the pace of growth, both issue amount and trading value in Hong Kong and the Mainland have grown significantly. It is worth noting that the trading value has grown faster than the issue amount in Hong Kong but vice versa in the Mainland (see Section 1). This hints at the growing demand for bond investment in Hong Kong by global investors.

In the light of the differences, the development of the Mainland and Hong Kong bond markets can be complementary to each other to achieve a more balanced mix of issuers, investors and product types. The cooperation between the Mainland and Hong Kong markets may offer better opportunities to market participants on both sides. Riding on the Mainland-Hong Kong Mutual Market Access ("MMA") programme, which has been a success in the stock market two-way connectivity and Northbound connectivity to the CIBM, the mutual market access of on-exchange bond markets in the Mainland and Hong Kong[74] is expected to help accelerate the growth of both markets. As stated in the 2019-2020 Annual Report of the Securities and Futures Commission (SFC), following on the Stock Connect scheme, the SFC "will work towards introducing other Connect programmes beginning with a new initiative for the cross-border trading of listed bonds"[75]. Such connectivity, if effected in respect of both the primary and secondary on-exchange bond markets across the border, could bring about the benefits of enlarged issuer and investor base, enhanced liquidity and product variety as well as synergy of risk management. These are elaborated in the sub-section below.

70 Only six asset-backed securities on SSE are traded in USD. Source: Wind, as of 28 August 2020.

71 Since the pilot programme of exchange-traded panda bonds launched in December 2015, the cumulative issue amount of panda bonds on the Mainland on-exchange bond market was RMB 128.3 billion from 26 issuers as of end-July 2020. Source: Wind.

72 Based on the total number of 1,388 in number and the outstanding value of US$659.9 billion as of 31 December 2019 of all listed bonds on HKEX (source: List of debt securities obtained from HKEX's website).

73 Calculated from the issue amount of individual bonds issued on SSE and SZSE in 2019 (source: Wind).

74 Subject to regulatory approval.

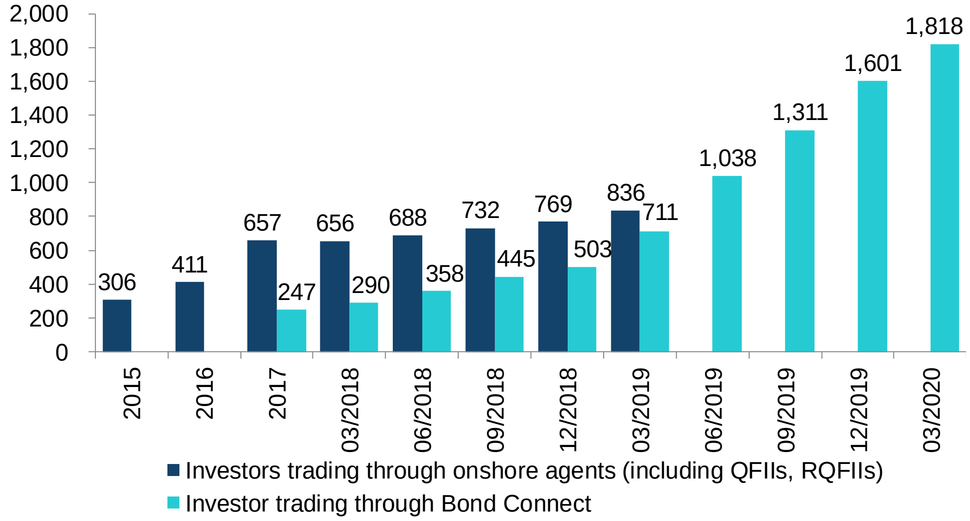
75 Source: *SFC Annual Report 2019-2020*, published on the website of the SFC, 24 June 2020.

4.1 Potential benefits to the Mainland

First, the investor base can be further widened to cover more global institutions. For the on-exchange bond market, foreign investor access is limited to QFII and RQFII channels only. For the CIBM, Northbound Bond Connect is complementary to other channels for foreign investors to invest in onshore bonds, including the QFII and RQFII schemes, while having less restrictive requirements for eligible participants than other channels[76].

The experience of the CIBM is that Northbound Bond Connect has effectively expanded its investor base. The number of offshore institutional investors investing through Northbound Bond Connect increased significantly from 247 institutions as of end-2017 to 1,818 institutions as of end-March 2020 (see Figure 18). Recognising the success of Northbound connectivity to the CIBM, the CSRC is exploring the MMA of on-exchange bond markets[77]. This will be conducive to a wider global access to the Mainland's on-exchange bond market.

Figure 18. Number of offshore institutional investors in the CIBM (2015 – Mar 2020)



Note: The number of offshore institutions through onshore agents after March 2019 is not available.

Source: *Xinhua08.com* for the number trading through onshore agents; Bond Connect Company Limited (BCCL) for the number trading through Bond Connect.

Supported by policy incentives (e.g. tax on interest and income from bonds being exempted for offshore investors for three years since November 2018) and the admission of Chinese bonds into global bond indices like Bloomberg Barclays Global Aggregate Index since April 2019, the enlarged foreign investor base in the CIBM has boosted its liquidity. Through the Northbound Bond Connect, the average daily turnover of foreign investors increased from RMB 3.1 billion in April 2018 to RMB 20.1 billion in June 2020 (see Figure 19). A further increase of foreign funds inflows is expected — a study[78] gave an expectation of an inflow of US$600 billion over the long-term into Chinese bonds when these bonds are fully included into the global indices. Along with the expected growing needs of asset allocation to Chinese bonds by global investors, particularly passive bond index funds, a continued growth in the trading of bonds in the Mainland market is expected. The on-exchange bond market is expected to benefit as well if MMA is opened for it.

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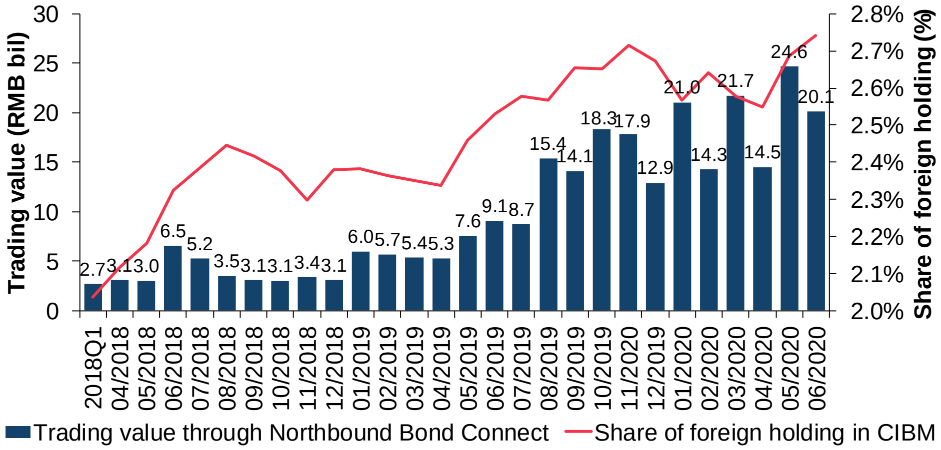
76 See HKEX research report, "Supporting the opening up of the Mainland financial market — Innovations and implications of Bond Connect", published on HKEX's website, 15 November 2017.

77 Source: "CSRC spokesman Q&A on further expansion of opening up the capital market"(《證監會有關負責人就進一步擴大資本市場對外開放答記者問》), issued by the CSRC, 14 June 2019.

78 Chan, P. and E. Liu, "China bonds inclusion in global bond indices", published on Manulife Asset Management's website, 1 April 2019.

Figure 19. Average daily turnover value through Northbound Bond Connect and the share of foreign holding of bonds in CIBM (2018Q1 – Jun 2020)



Note: The average daily turnover is calculated by dividing the total turnover by the number of trading days in each period.

Source: Data for Bond Connect turnover is obtained BCCL's monthly Flash Reports, 2018Q1 – June 2020; data on foreign holding in CIBM is calculated from data obtained from CCDC's and Shanghai Clearing House's websites.

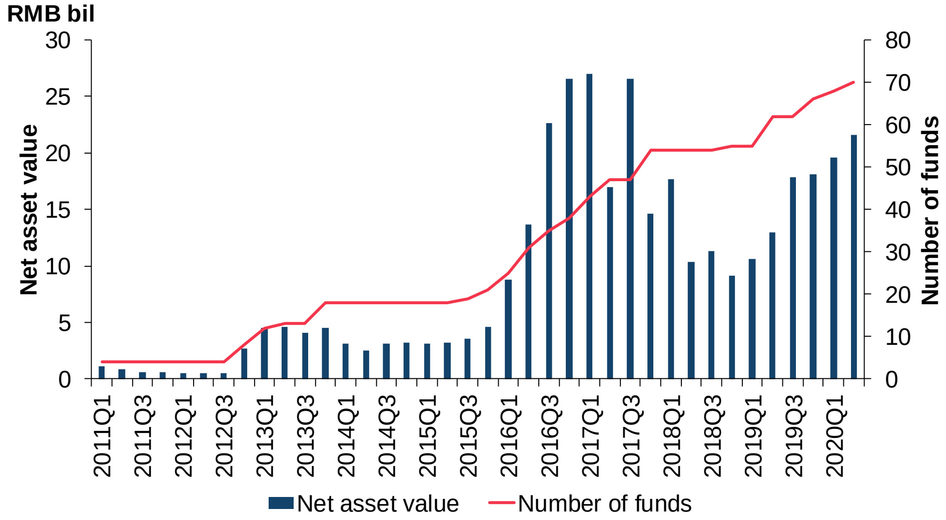
Second, onshore bond issuers can tap into offshore funding in the primary market. Northbound Bond Connect scheme allows bond issuance to offshore investors albeit foreign participation in the Mainland bond market is still low (foreign holding of bonds in the CIBM was 2.7% as of end-June 2020, see Figure 19). To better support the participation of global investors, the Bond Connect Company Limited (BCCL) launched the Primary Market Information Platform (PMIP) in February 2019, which is the first English-language portal for the dissemination of Chinese primary bond market information by issuers and underwriters[79]. As of end-May 2020, 161 newly issued onshore bonds have their pre- and post-issuance information disclosed on PMIP[80]. The channel of onshore bond issuance to offshore investors has diversified the funding source of onshore bond issuers and facilitated further inflows of foreign funds. If this can be expanded to the on-exchange market, onshore bond issuers, especially non-financial corporates, could benefit further, thereby offering stronger support to direct financing of business corporations for the development of the real economy.

Third, Mainland investors can have more channels to access overseas bond markets. Among the limited channels for Mainland investors to invest in overseas bonds, bond funds of Qualified Domestic Institutional Investors (QDII) are a major one. The number of QDII bond funds investing in global bonds increased gradually since 2011 to the record high of 66 funds as of end-2019 and the total net assets of these funds reached RMB 17.5 billion (see Figure 20). This is attributable to the demand of Mainland investors to diversify their investment portfolios into overseas bonds issued by global bond issuers, which can be denominated in multiple currencies. While the MMA through Hong Kong's on-exchange stock market (i.e. the Stock Connect scheme) has been a success to address the needs of Mainland investors for global asset allocation in respect of equity investment in a controllable manner, a possible MMA in respect of the on-exchange bond market could help meet the demand of Mainland investors for their global asset allocation in respect of bond investment.

79 See "BCCL Launches Primary Market Information Platform and Signs MOU with ADBC", News release on the BCCL's website, 22 February 2019.

80 Source: "Bond Connect ADT Sets Record High in May", Flash Report (May 2020) on the BCCL's website.

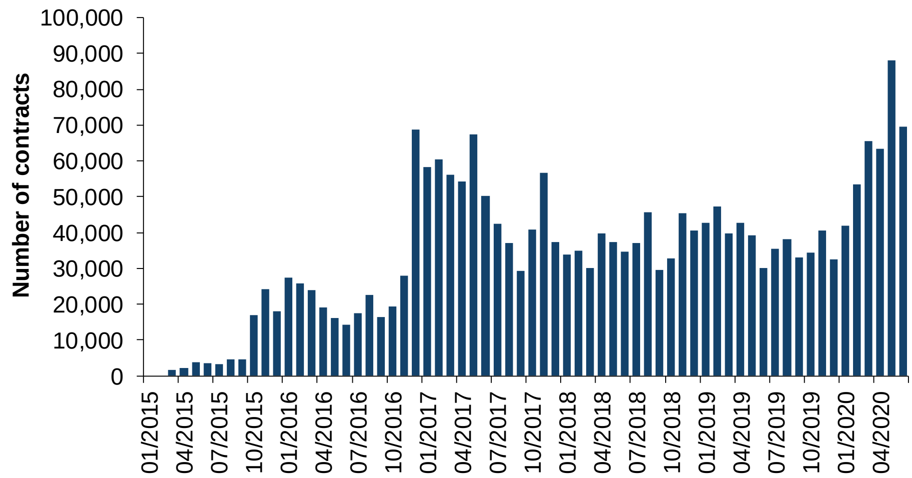
Figure 20. Quarter-end total size and number of QDII bond funds (2011Q1 – 2020Q2)



Source: Wind.

Fourth, synergy effect can be achieved with the development and trading of other listed products, including risk management tools such as bond derivatives. CFFEX's treasury bond futures (T-Bond futures), for example, are used to hedge against the onshore interest rate risk. The 10-year T-Bond futures were found to be the most actively traded contracts among T-Bond futures during 2019 (constituting 71% of the total volume of bond futures on CFFEX)[81]. Since 2017, the trading volume of 10-year T-Bond futures has increased significantly to a higher level than before (see Figure 21). The launch of Northbound Bond Connect has contributed to the increase in onshore bond market liquidity and as a result onshore investors may have higher demand for risk management tools to hedge against their bond portfolios. An expansion of MMA into the on-exchange bond market would expectedly further contribute to the increase in risk management activities for onshore bond investments, thereby boosting the trading volumes of risk management tools further. The different demands of foreign investors may call for introduction of new product types for risk management in the bond market, e.g. currency and interest rate derivatives and credit default swaps.

Figure 21. Average daily volume of CFFEX's 10-year T-Bond futures (Jan 2015 – Jun 2020)



Source: Wind.

81 Source: Wind. CFFEX also provides 2-year and 5-year T-Bond futures.

All the above benefits will be conducive to the comprehensive development of the Mainland bond market, helping to scale up the on-exchange market to be potentially on par with the CIBM. Since an internationalised RMB bond market is an essential attribute that underpins the RMB as an international reserve currency[82], the increased collaboration of the Mainland and Hong Kong markets in respect of the on-exchange bond markets in addition to the CIBM, would further contribute to the internationalisation of the RMB. Moreover, a more internationalised Mainland on-exchange bond market could offers stronger support for direct financing by business corporations in the real economy.

4.2 Potential benefits to Hong Kong

First, the investor base can be expanded to cover more extensively the Mainland investors, thereby boosting liquidity. Although the Hong Kong bond market is not large in size, it is highly open with participation from global issuers and investors. In fact, Hong Kong bond market is on the rise — the bond allocation of assets managed by asset and wealth management businesses in Hong Kong rose from HK$1,883 billion in 2016 to HK$2,055 billion in 2017 and rose further to HK$2,562 billion in 2018[83]. Likely Southbound investment inflows from Mainland investors through possibly MMA can be the potential driver for further growth of the Hong Kong bond market, including the on-exchange bond market. For reference, the trading through Southbound Stock Connect has been in the uptrend — the average daily Southbound trading value (buy and sell) under Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connect schemes almost tripled from HK$3.7 billion in 2016 to HK$10.8 billion in 2019[84].

Second, the issuer base can be further widened to include more global and Mainland issuers. Given a strong expected demand from a wider investor base, more global and Mainland issuers may be interested to issue and list bonds in Hong Kong. This could increase the diversity of bond issuers and the supply of global bonds in Hong Kong, which in turn would increase the attractiveness to global and Mainland investors for diversification of their investment portfolios.

Third, global investors' choices of bond investment via Hong Kong can be broadened for asset management. Possible MMA of the on-exchange bond market will open up global access to the wide range of the Mainland on-exchange bond instruments via the Hong Kong market platform. The cooperation between the Hong Kong and Mainland bond markets will yield a more comprehensive mix of products that can meet investors' different risk appetites.

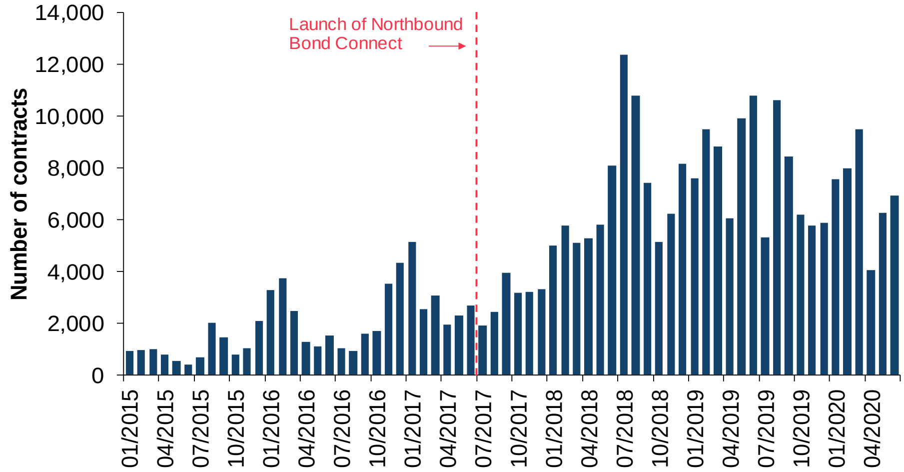
Fourth, synergy effect can be achieved with the trading of risk management tools in Hong Kong. The Hong Kong market offered a wide range of risk management tools to hedge the currency risks by global and Mainland investors. These include deliverable USD/CNH futures and options, cash-settled futures for CNH/USD, EUR/CNH, JPY/CNH, AUD/CNH and INR/CNH exchange rates. Of these, the deliverable USD/CNH futures is the most active among the tools and the trading volume have increased significantly since the launch of Northbound Bond Connect in July 2017 (see Figure 22). The rise of trading volume could possibly be partly attributable to the increase in risk management activities for onshore bond investments. If the Southbound investment flows of Mainland investors are allowed to invest in on-exchange bonds denominated in multiple currencies in Hong Kong, the demand for hedging the exchange rate risks of the RMB is expected to grow further.

82 See HKEX research report, "Tapping into china's domestic bond market — An international perspective", published on the HKEX website, 16 May 207.

83 Source: The SFC's periodic survey, "Asset and Wealth Management Activities Survey", in 2017 (survey report dated July 2018) and 2018 (survey report dated July 2019).

84 Source: HKEX.

Figure 22. Average daily volume of HKEX's USD/CNH futures (Jan 2015 – Jun 2020)



Source: HKEX.

All the above will further strengthen Hong Kong's role as the bridge for connecting Mainland and the world in respect of the capital markets, both in equity and fixed-income segments. This would facilitate the development of an investment ecosystem centred on the single platform in Hong Kong, offering a high variety of products including bond indices and exchange-traded products tracking bonds issued by global and Mainland issuers, and related risk management tools for both global and Mainland investors.

5. CONCLUSION

The on-exchange bond markets in Mainland China and Hong Kong have grown to a combined scale comparable to leading bond markets globally, in terms of number of bonds, bond issue amount and turnover value. The growth has been driven by the rising demand of financing for the real economy, the enhancements in market structure such as more efficient listing regimes, policy incentives including less stringent approval process in the Mainland and tax exemptions in Hong Kong, and the availability of risk management tools.

Given the different characteristics in terms of issuer base, investor base and product types, the on-exchange bond markets in Hong Kong and the Mainland can be complementary to each other in their further development. Riding on the favourable experience of the Stock Connect and Northbound Bond Connect schemes under the Mainland-Hong Kong MMA programme, both the Hong Kong and Mainland on-exchange bond markets could benefit if the MMA programme is extended to cover the primary and secondary markets of this on-exchange product segment. Such benefits include more diverse issuer and investor bases as well as the availability of a greater variety of product types in both the Hong Kong and Mainland markets, bringing about an increase in market liquidity.

In a broader sense, to the Mainland market, such mutual market access could also broaden the overseas financing channels of Mainland issuers, particularly for corporate issuers, to support the real economy and enable Mainland investors to achieve synergy effect by making use of related offshore products including risk management tools. To the Hong Kong market, this could strengthen its role as the bridge for connecting the Mainland and the world in respect of the capital market, both in the equity and fixed-income segments, and facilitate the development of an investment ecosystem centred on a single platform in Hong Kong. This would help better serve the needs of global and Mainland issuers and investors. Moreover, the comprehensive internationalisation of the Mainland bond market covering the on-exchange market could facilitate the process of RMB internationalisation, generating more development opportunities for both Mainland and Hong Kong markets.

APPENDIX. COMPARISON OF BOND MARKET STRUCTURES OF HKEX, SSE AND SZSE

Feature	HKEX	SSE and SZSE
Market openness	Free entry of all global issuers and investors	• Mainly Chinese issuers and investors • Restricted entry of overseas issuers and investors (QFIIs/RQFIIs only)
Types of investors	• **Professional investors** • **Public investors**	• **Qualified investors (to be renamed "professional investors")**, including financial institutions and their wealth management products, pension and social security funds, QFIIs/RQFIIs as well as eligible institutions and individuals meeting requirements on assets and investment experience • **Public investors (to be renamed "general investors")**
Types of bond/issuer and investor access	• Bond issuers: Hong Kong Government (government bonds and Exchange Fund Bills and Notes), state entities, banks, corporations, state corporations and supranationals • Bonds can be issued through private placement to professional investors only or through public offering to public investors	• **For all investors:** treasury bonds, local government bonds, policy bank financial bonds, enterprises and certain corporate bonds, convertibles, and exchangeables • **For professional investors only:** corporate bonds publicly offered to professional investors only, non-publicly offered bonds and ABS
Repo	Currently not available	Collateralised bond repos and outright bond repos
Issuance	• Tendering • Public offering • Private placement	Private placement or public offering upon the approval by relevant authorities (e.g. approved by exchanges and registered with CSRC for publicly offered corporate bonds)
Listing	• Chapter 37 of MBLR for bonds issued to professional investors only • Chapters 22 to 36 of MBLR for bonds issued to public investors	The listing criteria follows the respective CSRC rules on the issuance of different types of exchange-traded bonds, with which the listing requirements of the exchanges are harmonised.
Trading arrangement	• Trading platform: OTP-C • Automatch trades and manual trades are allowed	• **SSE:** Auction, block trading and Fixed Income Platform • **SZSE:** Auction and Integrated Trading platform for block trading
Price limit for spot trading	Within ±9 times of nominal price	• **SSE:** ○ ***Pre-open session***: Within 70%-150% of previous close; ○ ***Continuous trading session***: ≤110% of best ask and ≥ 90% of best bid, and within 70%-130% of the average of the two • **SZSE:** ○ ***Pre-open session***: Within 70%-130% of issue price on the first day listed; within 90%-110% of previous close on other days ○ ***Continuous trading session / closing auction session***: Within 90%-110% of last traded price

Feature	HKEX	SSE and SZSE
Trading hours	• **Automatched trade:** Pre-Opening session (9:00-9:30)* and Continuous Trading Session (9:30-16:00) • **Manual trade:** Conducted any time but reported not later than the next trading day * Pre-opening session will no longer be available to bond trading upon session enhancement later in 2020.	• **Price auction:** 9:15-9:25 for pre-opening and 9:30-11:30 and 13:00-15:00 for continuous auction session • **Block trades or negotiated trades:** o Intent orders: 9:30-11:30 and 13:00-15:30 for SSE; 9:15-11:30 and 13:00-15:30 for SZSE o Execution orders: 15:00-15:30 for SSE 9:15-11:30 and 13:00-15:30 for SZSE o Fixed-price orders: 15:00-15:30 for SSE; 15:05-15:30 for SZSE • **Fixed Income Platform (SSE only):** 9:30-11:30 and 13:00-15:00
Trading units	• **Automatched trade:** board lots in multiples of face value (100 currency units)* • **Manual trade:** No threshold on minimum size * For bonds denominated in Japanese yen (JPY), the quotation is in multiples of JPY100,000	• **Lot size:** o ***SSE:*** 1,000 RMB of face value; o ***SZSE:*** 10 units (100 RMB face value per unit) • **Order volume:** o ***SSE:*** One lot or its integral multiple o ***SZSE:*** 10 units or its integral multiple
Pre-trade checking	Not required	Required for checking available cash and securities in investors' accounts to avoid settlement failure, similar to that for A shares
Trading currency	Multiple currencies including USD, HKD, RMB	Mainly RMB
Clearing house	• Local clearing houses including CCASS and CMU • International clearing houses including Euroclear, Clearstream, Austraclear and DTC	Local clearing house — CSDC

Note: The information in the table is compiled on a best-efforts basis and may not be exhaustive.

Source: HKEX's, SSE's and SZSE's websites; HKEX's MBLR and Rules of the Exchange; SSE's and SZSE's trading rules; "ASEAN+3 bond market guide: Exchange bond market in the People's Republic of China", published on ADB's website, October 2019.

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