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Prof. K C Chan, GBS, JP  
Secretary for Financial Services and the Treasury  
24/F., Central Government Offices  
2 Tim Mei Avenue  
Tamar  
Hong Kong

Dear K C,

**Belt-and-Road Opportunities for Hong Kong's Financial Services Sector**

I am pleased to enclose the Chamber's proposals on ways Hong Kong can capitalise on the national initiative of Belt and Road to broaden and deepen the international role for one of our key pillar industries - financial services.

We believe that Hong Kong has much to offer in terms of its financial experience and expertise to Belt and Road economies especially those that are at the take-off stage of development. There are win-win opportunities for all those concerned and Hong Kong stands to benefit immensely from the cultivation of new industries and markets.

I hope you will agree that the proposed objectives are both pragmatic and attainable as far as government policy measures are concerned, and will have far-reaching implications in terms of consolidating and augmenting Hong Kong's standing as an international financial centre.

We shall be more than happy to assist with or provide supplementary information as appropriate.

Yours sincerely



Shirley Yuen  
CEO

Encl.

cc Yvonne Choi, Commissioner for Belt and Road (w/ encl)

## **HKGCC proposals on Belt-and-Road Opportunities for Hong Kong's Financial Services Sector**

### ***Background***

1. The Mainland's Belt-and-Road Initiative seeks to promote regional economic growth through economic and trade cooperation among over 60 countries and regions along the Silk Route Economic Belt and 21<sup>st</sup> Century Maritime Silk Road. Of the five major goals, namely, policy coordination, facilities connectivity, trade and investment facilitation, financial integration and people-to-people bonds, facilities connectivity mainly in the form of infrastructure development has emerged as a top priority.
2. According to estimates by the Asian Development Bank (ADB), Asia will require an annual infrastructure investment of around USD750 billion per year until 2020, or a total of USD8 trillion for the period 2010-2020. However, the ADB and the World Bank can only provide total funding of about USD30 billion per year.
3. The Mainland has, together with other country members, established the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank BRICS (NDB BRICS) to support the implementation of the Belt-and-Road Initiative. The Mainland has also unilaterally set up the Silk Road Fund (SRF) for the same purpose. The combined registered capital for the three institutions is estimated to be around USD240 billion.
4. There will still be a large funding shortfall of about USD370 billion per year relative to the USD750 billion in annual investment required after taking into account new funding from the AIIB, NDB BRICS and SRF, as well as contributions from other countries. Therefore, projects along the Belt-and-Road will still need to raise large amounts of monies from the private sector.

*Table 1: Estimation of funding gap for infrastructure investment in Asia*

|                                         | USD bn |
|-----------------------------------------|--------|
| ADB est. investment required per year   | 750    |
| Funding:                                |        |
| World Bank + ADB                        | 34     |
| Countries contribution (USD 200-300 bn) | 250    |
| NDB + AIIB + SRF                        | 48     |
| China (Budgeted USD800 bn)              | 50     |
| Sub-total                               | 382    |
| Funding gap                             | 369    |

*Source: HSBC, Hang Seng Bank, ADB, the State Council Information Office, China Development Bank*

## ***Hong Kong's role in the Belt-and-Road Initiative***

### **Corporate Treasury Centre**

5. As the Belt-and-Road Initiative covers over 60 countries, this necessarily implies complex corporate treasury operations that include such elements as cash flow management, foreign exchange, cross-border payments, risks and liability control, among others. Therefore, a regional corporate treasury centre (CTC) would be required to centralize all treasury functions so that multinational corporations can enhance operational efficiency, reduce foreign exchange exposure and risk, as well as achieve economies of scale in treasury operations.
6. Hong Kong is already a premier CTC in Asia. Hong Kong's advantage lies in its well-developed financial infrastructure including but not limited to its deep and liquid foreign exchange and money markets, absence of capital restrictions, stable and free exchange rates, and concentration of the world's leading banks. Furthermore, Hong Kong possesses a simple and competitive tax regime, a common law system, an excellent pool of well-educated labour force and business professionals, as well as world class transport and telecommunications infrastructure. More importantly, its proximity to Mainland China and its position as a premier offshore Renminbi centre makes Hong Kong an ideal and preferred location for fulfilling Belt-and-Road projects. For all the reasons as mentioned in the foregoing, Hong Kong is the first choice by far in Asia for corporations, especially Chinese firms, to raise funds.
7. Singapore, which also shares many of Hong Kong's attributes, is another leading regional CTC in Asia. Compared to Hong Kong (see Table 2), Singapore is more attractive to corporates whose main business is located in South East Asia and India. The city also offers a favourable tax rate of 8% for CTCs, as well as a number of incentive schemes for global treasury businesses. In addition, Singapore has a distinct advantage over Hong Kong in terms of the 80 Double Tax Agreements (DTAs) signed. This is in contrast with the less than 40 DTAs entered into thus far by Hong Kong.

Table 2: Comparison of treasury centers among major financial centers

|                                                        |                  |             | Hong Kong | UK/London                                        | Singapore            |
|--------------------------------------------------------|------------------|-------------|-----------|--------------------------------------------------|----------------------|
| <u>Treasury services</u>                               |                  |             |           |                                                  |                      |
| Presence of authorised institutions                    | Total number     | 2015 latest | 201       | 360                                              | 161                  |
| Presence of foreign banks                              | Total number     | 2015 latest | 143       | 248                                              | 119                  |
| All deposits of all AIs                                | USD bn           | Jun-15      | ^1,361    | 3,700                                            | 408                  |
| Outstanding of cross-border bank lending               | World share %    | Sep-13      | 4         | 17                                               | 3                    |
| Outstanding of cross-border bank borrowing             | World share %    | Sep-13      | 3         | 18                                               | 2                    |
| Share of FX turnover                                   | World share %    | Apr-13      | 4         | 41                                               | 6                    |
| Interest rate OTC derivatives (based on avg daily T/O) | World share %    | Apr-13      | 1         | 49                                               | 1                    |
| Commodities option and futures traded                  | Contracts traded | 2014        | 8,790     | 499,862,700                                      | 489,795              |
| Debt securities markets - Outstanding                  | USD bn           | Latest      | 353       | † 4443                                           | 406                  |
| <u>Offshore-RMB businesses</u>                         |                  |             |           |                                                  |                      |
| --- RMB offshore center                                |                  |             | Yes       | Yes                                              | Yes                  |
| --- RMB deposits                                       | RMB bn           | Jun-15      | 993       | *25.4                                            | 322                  |
| --- Avg. daily RMB foreign exchange turnover           | USD bn           | 2014        | 120       | 62                                               | **76                 |
| --- Global RMB payment settlement                      | World share %    | Aug-15      | 69.8%     | 5.1%                                             | 6.9%                 |
| --- RQFII quota                                        | RMB bn           | As Nov-14   | 270       | 80                                               | 50                   |
| ----- RQFII quota allocated to institutions (used)     | RMB bn           | As Aug-15   | 270       | 21.2                                             | 28.7                 |
| --- Outstanding dim sum bond                           | RMB bn           | 2014        | 381       | ^18.3                                            | 35                   |
| --- Gross issuance of dim sum bonds                    | RMB bn           | 2007-14     | 608       | 16.5                                             | ***21.8              |
| <u>Other infrastructures and taxation</u>              |                  |             |           |                                                  |                      |
| Good banking facilities                                |                  |             | Yes       | Yes                                              | Yes                  |
| Easy access to major stock exchanges                   |                  |             | Yes       | Yes                                              | Yes                  |
| Professional expertise                                 |                  |             | Yes       | Yes                                              | Yes                  |
| Availability of trained personnel                      |                  |             | Yes       | Yes                                              | Yes                  |
| Liberalized capital market                             |                  |             | Yes       | Yes                                              | Yes                  |
| Political stability and favourable regulations         |                  |             | Yes       | Yes                                              | Yes                  |
| Tax on profits allocated to the treasury centers       |                  |             | 8.25%     | 20%                                              | 8%                   |
| Withholding tax on interest, dividend and royalty      |                  |             | Royalty   | Interest, royalty, dividend from tax-exempt REIT | ^^ Interest, royalty |
| Stamp duties for securities transactions               |                  |             | 0.2%      | 0.5%                                             | 0.1%                 |
| VAT                                                    |                  |             | Nil       | 20%                                              | 7%                   |
| Double tax treaty                                      | no. of countries |             | 33        | 135                                              | 80                   |

Source: HSBC: Discussion Paper on Opportunities for Hong Kong's Financial Service Sector under the One-Belt-One-Road Initiative, Singapore Economic Development Board, Inland Revenue Authority of Singapore

^ as on Jul-15; \* as on Jun-14; \*\* as on Dec-14; \*\*\* up to Sep-14; ^^ Withholding tax is exempted on interest payments on loans from non-resident banks as well as loans and deposits from non-resident approved network companies, for Finance & Treasury Centre activities; † includes Eurobonds issued by UK companies

8. Proximity in location is considered an important determining factor for treasury operations to function effectively. To this end, London is less ideal despite its standing as an international CTC due to its distance from the Belt-and-Road countries.
9. In comparison, Hong Kong is an ideal CTC location for Chinese companies that are expanding globally (including those participating in Belt-and-Road projects). It is also the preferred location for MNCs' corporate treasury operations, which are increasingly trading in Renminbi.

### Debt Financing Center

10. As mentioned above in paragraph 4, external financing will be needed to bridge the immense funding gap for Belt-and-Road projects. Debt financing or debt securitisation can be considered a useful means to provide funding for these projects. In contrast to equity funding, this option allows governments to retain control over public projects while providing long term investors with guaranteed returns.
11. This method of financing also has the advantage of supporting another key objective of the Belt-and-Road Initiative, which is to promote the internationalization of the Renminbi. A sizable and market-determined Renminbi-denominated debt market is essential to encourage non-resident corporates and investors to hold and use Renminbi. The absence of large and liquid capital markets (debt, equities, derivative and money markets) offshore has hindered the global expansion of the Renminbi. There is an urgent need for the Mainland to either establish a sizable debt market offshore or open up its onshore debt market as soon as possible. However, as the latter remains heavily regulated and is dominated by public debt, this is unlikely to meet investors' demands in the foreseeable future.
12. This is where Hong Kong can play a role. Hong Kong possesses a well-developed financial infrastructure for both debt securitisation and project financing. Hong Kong also has a diversified investor and issuer base, with foreign currency debts accounting for up to almost half of the local market. Although Singapore shares similar characteristics, Hong Kong has the edge due to a bigger pool of offshore RMB bonds (See Table 3).

*Table 3: Debt securities market by jurisdictions*

| <b>Debt securities market (incl. CB)</b> |        |         | Hong Kong | UK     | Singapore | Taiwan | S. Korea |
|------------------------------------------|--------|---------|-----------|--------|-----------|--------|----------|
| Total outstanding                        | USD bn | Latest  | 353       | 4,443  | 406       | 273    | 1,650    |
| --- Local currency                       | USD bn | Latest  | 187       | 2,433  | 223       | 263    | 1,621    |
| --- Foreign currency                     | USD bn | Latest  | 166       | *2,010 | 183       | 10     | 29       |
| --- Gross issuance of offshore RMB bonds | RMB bn | 2007-14 | 607.5     | 16.5   | **21.8    | 31.4   | <1       |

*Source: HSBC: Discussion Paper on Opportunities for Hong Kong's Financial Service Sector under the One-Belt-One-Road Initiative*

*\* Includes Eurobonds issued by UK companies; \*\* up to Sep-14*

13. In addition, Hong Kong's vast and diverse investor base includes 201 authorized institutions, 158 insurance and reinsurance companies, and 594 Hong Kong-domiciled SFC approved funds. It is perhaps noteworthy that in 2014 more than 70% of the combined fund management businesses with some USD2.3 trillion assets were sourced from overseas investors.

14. Hong Kong is also favoured as a major offshore RMB debt center for infrastructure investments, including both structured debts and infrastructure bonds, compared to some 20 offshore RMB clearing centers around the world, including Singapore and London. By end-2015, the total value of outstanding Dim Sum bonds in Hong Kong amounted to around RMB368 billion, which far outpaced its second placed rival, Singapore, which accounted for some RMB50 billion (Q2-2015). There is also strong local appetite for diversified and longer-term investment vehicles such as debt, given that the offshore Renminbi loan-to-deposit ratio in Hong Kong is still very low at 29.4%<sup>1</sup> in 2015 (versus the overall loan ratio of around 70%). Moreover, continuous improvement of the offshore Renminbi market infrastructure in Hong Kong will help attract global investors to trade debt in Hong Kong (See Table 4).

*Table 4: Overview of Hong Kong's debt market vs. the UK and Singapore*

| <b>Banking sector</b>                    |              |             | Hong Kong | UK        | Singapore |
|------------------------------------------|--------------|-------------|-----------|-----------|-----------|
| No. of authorised institutions (AIs)     | Total number | 2015 latest | 201       | 360       | 161       |
| All deposits of all AIs                  | USD bn       | Jun-15      | ^1,361    | 3,700     | 408       |
| --- % of GDP                             | %            | Jun-15      | 452       | 128       | 139       |
| All loans                                | USD bn       | Jun-15      | 990       | 3,553     | 451       |
| Loan-to-deposit ratio                    | %            | Jun-15      | 72.7%     | 96.0%     | 110.6%    |
| <b>Offshore RMB</b>                      |              |             |           |           |           |
| --- RMB deposits (incl. CD)              | RMB bn       | 2014        | 1,158     | 20        | 277       |
| --- RMB loan                             | RMB bn       | 2014        | 188       | ^^2.3     | n.a.      |
| --- RMB loan-to-deposit ratio            | %            | 2014        | 16.2%     | 11.5%     | n.a.      |
| <b>Debt securities market (incl. CB)</b> |              |             | Hong Kong | UK        | Singapore |
|                                          |              |             | As Sep-15 | As Dec-15 | As Dec-14 |
| Total outstanding                        | USD bn       | Latest      | 353       | 4,443     | 406       |
| --- Local currency                       | USD bn       | Latest      | 187       | 2,433     | 223       |
| --- Foreign currency                     | USD bn       | Latest      | 166       | *2,010    | 183       |
| --- Offshore RMB bond outstanding        | RMB bn       | 2015        | 368       | ^ 18.3    | ^^^ 50    |
| --- Gross issuance of offshore RMB bonds | RMB bn       | 2007-14     | 607.5     | 16.5      | **21.8    |

*Source: HSBC: Discussion Paper on Opportunities for Hong Kong's Financial Service Sector under the One-Belt-One-Road Initiative*

<sup>^</sup> As Jul-15; <sup>^^</sup> Only corporate lending; <sup>^^^</sup> As Q215; \* includes Eurobonds issued by UK companies; \*\* up to Sep-14

## **Recommendations**

### Corporate Treasury Center

15. The Hong Kong SAR Government should lobby the AIIB to set up its treasury centre in Hong Kong. This would give rise to a cluster effect by encouraging other enterprises that possess or are planning to set up a CTC to choose Hong Kong for their operations as transactions would be more cost effective when conducted in one place;

<sup>1</sup> Includes certificate of deposits in RMB

16. Although the Hong Kong SAR Government has introduced a 50% cut on corporate tax rate for profits (i.e. 8.25%) by eligible CTCs that are established in Hong Kong, this is contingent on such CTCs being standalone corporate entities or those satisfying the safe harbour rule under the current regime. It is recommended that this requirement be removed so that multinationals do not have to alter their corporate structure to enjoy the tax benefit. To do otherwise would undermine the benefit of and objective behind the tax concession.
17. Furthermore, the Hong Kong SAR Government should enter into more regional DTAs to enhance its competitiveness versus Singapore. Presently, some 47 countries have signed a DTA with Singapore but not Hong Kong. Many of these countries are located along the Belt-and-Road. A special unit under the Office of Financial Secretary should be set up to lead and oversee the negotiation process, with the aim of expediting the expansion of Hong Kong's DTA network.

*Table 5: Countries that have signed a DTA with Singapore but not Hong Kong*

|    |             |    |                    |    |            |
|----|-------------|----|--------------------|----|------------|
| 1  | Albania     | 21 | Latvia             | 41 | Slovenia   |
| 2  | Australia   | 22 | Libya              | 42 | Sri Lanka  |
| 3  | Bahrain     | 23 | Lithuania          | 43 | Sweden     |
| 4  | Bangladesh  | 24 | Mauritius          | 44 | Taiwan     |
| 5  | Barbados    | 25 | Mongolia           | 45 | Turkey     |
| 6  | Belarus     | 26 | Morocco            | 46 | Ukraine    |
| 7  | Bulgaria    | 27 | Myanmar            | 47 | Uzbekistan |
| 8  | Cyprus      | 28 | Norway             |    |            |
| 9  | Denmark     | 29 | Oman               |    |            |
| 10 | Ecuador     | 30 | Pakistan           |    |            |
| 11 | Egypt       | 31 | Panama             |    |            |
| 12 | Estonia     | 32 | Papua New Guinea   |    |            |
| 13 | Fiji        | 33 | Philippines        |    |            |
| 14 | Finland     | 34 | Poland             |    |            |
| 15 | Georgia     | 35 | Russian Federation |    |            |
| 16 | Germany     | 36 | Rwanda             |    |            |
| 17 | India       | 37 | San Marino         |    |            |
| 18 | Isle of Man | 38 | Saudi Arabia       |    |            |
| 19 | Israel      | 39 | Seychelles         |    |            |
| 20 | Kazakhstan  | 40 | Slovak Republic    |    |            |

Countries along the B&R

*Source: Inland Revenue Department of the HKSAR Government, Inland Revenue Authority of Singapore*

Debt financing center

18. In view of the vast potential in debt financing for Belt-and-Road projects, Hong Kong is presented with an invaluable opportunity to build up an enviable debt market that is comparable in size to that of the UK. The Hong Kong SAR Government should, in conjunction with the private sector, proactively lobby the AIIB, NDB BRICS and SRF to issue foreign currency bonds, Dim Sum bonds and infrastructure bonds in Hong Kong. The role of the Infrastructure Financing Facilitation Office under the Hong Kong Monetary Authority should be expanded to include the function of a marketing agency for attracting more of such activities to Hong Kong; and
19. The Hong Kong SAR Government should consider providing tax incentives (such as deductibility of interest income on corporate tax) for companies to hold debt. This includes the extension of tax exemption on interest income and profits derived from debt instruments issued by governments and multilateral agencies in all types of currencies. Currently, under the Qualifying Debt Instrument (QDI) scheme, interest income and trading profits arising from certain debt instruments are exempted from profits tax in Hong Kong according to Sections 14A and 26A of the Inland Revenue Ordinance (Cap 112). This includes RMB-denominated bonds issued by the Central People's Government of the People's Republic of China in Hong Kong, Exchange Fund Bills and Notes, Hong Kong Government Bonds and Hong Kong dollar-denominated multilateral agency debt instruments. In addition, the Government can also consider exempting profits tax on interest income and trading profits from debt securities issued by specific funds for infrastructure projects.

HKGCC Secretariat  
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