

Press Release

LCQ22: Development of Islamic bond market in Hong Kong

Wednesday, October 15, 2014

Following is a question by the Hon Kenneth Leung and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (October 15):

Question:

The Government's successful offering of its inaugural US\$1 billion five-year sukuk, i.e. Islamic bonds, in early September this year has enabled Hong Kong to become a platform for sukuk issuances. In this connection, will the Government inform this Council:

(1) as the legal, taxation and regulatory framework of Hong Kong can support the issuance of sukuk, of the authorities' specific plans to encourage more public and private institutions to issue sukuk using Hong Kong's platform; if there is no such plan, the reasons for that;

(2) whether it has analysed the uniqueness and major competitive edges of Hong Kong as a platform for issuing sukuk as compared with other international competitors, particularly neighbouring countries such as Malaysia and Singapore; if so, of the outcome;

(3) of the collaboration plans between the authorities and Bank Negara Malaysia (such as borrowing the latter's experience in regulating the Islamic capital market and training financial talents) to enable Hong Kong to more effectively grasp the opportunities of the rapidly growing Islamic financial market; the objectives and timetables of such plans;

(4) given that among the investors of the inaugural sukuk issued in Hong Kong, almost half of them are from Asia, more than one third from the Middle East and the remaining 17% from Europe and the United States, whether the authorities have any plan to attract more global investors, including those from the Middle East and other Islamic areas, to participate in the bond market of Hong Kong; if so, of the details; and

(5) whether the Government has any plan to set specific targets on the scale of sukuk issuance for the next three years; if so, of the target issue amount each year?

Reply:

President,

(1) The Government and regulators strive to create an enabling environment for the development of an Islamic bond (sukuk) market. The Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Ordinance 2013, enacted by the Legislative Council (LegCo) in July, 2013, provides a comparable taxation framework for sukuk vis-à-vis conventional bonds.

Furthermore, the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) have been in close collaboration with relevant overseas regulators (such as Bank Negara Malaysia (BNM) and Securities Commission Malaysia (SCM)), international organisations (such as the Islamic Financial Services Board and the International Centre for Education in Islamic Finance) and local industry bodies (such as the Treasury Markets Association). They organised a series of seminars and workshops on Islamic finance over the past few years, with a view to enhancing market players' understanding of the sukuk market.

In March 2014, the Loans (Amendment) Ordinance 2014 was enacted by LegCo to enable the issuance of sukuk under the Government Bond Programme. Subsequently in September, the Government successfully offered its inaugural sukuk, with an issuance size of US\$1 billion and a tenor of 5 years, marking the world's first USD-denominated sukuk originated by an AAA-rated government. The sukuk saw a strong demand from global investors, attracting orders exceeding US\$4.7 billion and recording an oversubscription of 4.7 times, allowing a final pricing to be fixed at 2.005%. A pricing at a spread of 23 basis points over the corresponding yield of US Treasuries represents the tightest spread ever achieved so far on a benchmark USD issuance from an Asian (ex-Japan) government, setting an important new benchmark for Hong Kong and the rest of Asia.

The success of this issuance signifies an important milestone in the

development of the Islamic capital market in Hong Kong. It demonstrates that using Hong Kong's platform for sukuk issuance is a viable fund-raising option. Going forward, the Government and regulators will continue to work closely with market players to boost the awareness and knowledge of issuers and investors in Islamic finance. The HKMA will share its experience in sukuk issuance with enterprises which have funding needs, with a view to encouraging them to participate in the local market.

(2) As an international financial centre, Hong Kong has a sound legal system, a transparent regulatory regime, a simple tax system, a deep and liquid capital market, a large number of international financial intermediaries and well-developed financial infrastructure, providing an efficient platform for financial intermediation for market participants from around the world. In particular, many international financial intermediaries have set up strong capital market teams in Hong Kong. With the new taxation framework for sukuk, Hong Kong is better placed to promote Islamic finance.

The rapid economic growth in the Mainland in recent years has also led to strong funding and investment needs. Hong Kong is well-positioned to provide a platform for financial intermediation between Islamic investors and the Mainland, transferring the savings and funds from Islamic investors to Asia (especially the Mainland) for investment, and vice versa. Given that there are strong funding needs for Mainland enterprises, Hong Kong can act as a springboard for them to "go out" and expand their Islamic investor base.

As a leading offshore RMB business centre, Hong Kong has an advantage in developing RMB-denominated sukuk products. In fact, the RMB sukuk launched in the international market over the past few years have been over-subscribed. In particular, the proportion of Hong Kong investors was in a range of 25% to 55%, reflecting a strong demand for RMB sukuk from Hong Kong investors.

(3) Regulators have been maintaining a close partnership with key Islamic financial markets, such as Malaysia and Dubai, etc. For instance, the HKMA and BNM entered into a Memorandum of Understanding in 2008, enabling both sides to exchange experiences on different areas of Islamic finance, including market infrastructure, human capital training, regulation, etc. Besides, the SFC and SCM signed a joint declaration in 2009 to provide a framework

for mutual recognition of Islamic collective investment schemes offered to the public.

Last year, the HKMA and BNM set up a private sector-led Joint Forum on Islamic Finance (the "Joint Forum") to promote closer collaboration between the private sectors in Hong Kong and Malaysia (including banks, funds management firms and exchanges) in the development and promotion of Islamic financial market, with a view to expanding the investor base. The relevant work is ongoing.

(4) The Government and regulators have reached out to international investors to promote the advantages and opportunities presented by Hong Kong as an international financial centre. The strengths of Hong Kong's bond market, including the sukuk market, and our listing platform, are the key features in our promotional work targeting international investors.

Apart from the above, the inaugural sukuk issuance by the Government is expected to attract more sukuk issuers and investors to participate in the market. The global roadshow in Riyadh, Dubai, Abu Dhabi, Doha, Kuala Lumpur, Hong Kong, Singapore, London and New York in September has provided an ideal opportunity for us to showcase Hong Kong's Islamic finance platform to the international market. Indeed, the inaugural sukuk issuance by the Government has attracted interest from international investors in the Middle East / other Islamic countries who rarely participated in Hong Kong's financial market in the past. We believe that this will have a positive impact on attracting more international investors to our market. Going forward, we will take every possible opportunity to promote Hong Kong's bond market, including the sukuk market, when meeting with institutional investors, issuers and asset managers.

(5) The global sukuk market has registered a rapid growth in recent years. Ten years ago, new sukuk issuance amounted to US\$5 billion modestly. Last year, the annual sukuk issuance has already surpassed US\$100 billion in 2013, more than 20 times higher than that in 2003.

The legal, taxation and regulatory frameworks in Hong Kong are already in place to support sukuk issuance. The pace of development of the sukuk market in Hong Kong will be market-driven, subject to various factors

including the development of global sukuk market, investor demand, funding cost, the availability of different fund-raising channels, etc.

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