The Opening Up of China Bond Market

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Contents

I. China Bond Market Introduction

II. CIBM Opening Up Progress

III. China-HK Bond Connect Business Arrangements

IV. Outlook on Linkage between Financial Market Infrastructures
01

China Bond Market Introduction
At the end of 2017, China’s bond balance was 74 trillion Yuan, around 89.5 % of GDP. By the end of August 2018, China’s bond balance has reached 81.9 trillion Yuan.
1. China Bond Market Introduction

China bond market issuance volume (2009-2018.08)

Issuance of Bonds in China Bond Market (2017)

Data source: SHCH, CCDC, Wind, PBC
China Bond Market is made up of China Inter-Bank Bond Market (CIBM) and Exchange Market.

- From the function perspective, CIBM is an OTC market, which serves the whole-sale trading from institutional investors.
- From the volume perspective, China Inter-Bank Bond Market is around 90% of China Bond Market.
- From the opening up perspective, foreign investor’s holding balance in CIBM is around 90% of the whole foreign investor’s holding balance in China Bond Market.
CIBM Opening Up progress
2. CIBM Opening Up Progress

- 1st foreign issuance in CIBM (panda bond).
- 1st foreign investor entered CIBM.
- CIBM opens to three types of foreign investors: foreign central banks, monetary authorities, RMB clearing banks in Hong Kong SAR and Macau SAR, and RMB offshore participating banks.
- Foreign financial institutions and governmental institutions approved to issue bonds in CIBM.
- RMB clearing banks and offshore participating banks investment scope expanded.
- Foreign Sovereign entities allowed to have more flexible arrangements.
- The Ministry of Finance and Domestic financial institutions issued offshore RMB bonds in HK and other oversea areas.
- Foreign non-financial institutions approved to issue bonds in CIBM
- QFII given access to CIBM investment.
- PBOC[2016] NO. 3 Announcement published, with scope of foreign investors expanded, entry process simplified and investment quota eliminated.
- SDR dominated bonds issued in CIBM
- CIBM to be included in Bloomberg and Citi’s index product.
- July 2017, Launch of Bond Connect.
- PBOC [2017] NO. 7 Announcement published, foreign credit rating institutions allowed to provide rating service in CIBM.
- RMB clearing banks and offshore participating banks investment scope expanded.
- Foreign Sovereign entities allowed to have more flexible arrangements.
At the end of August 2018, the panda bond accumulated issuance volume was nearly 200 billion, and the holding balance of foreign investors was 1751.7 billion.

Data source: SHCH, CCDC, Wind, PBC
HK-China Bond Connect
Business Arrangements
3. Bond Connect

‘It is necessary to further explore the bond market opening up and build Bond Connect trial schemes between Hong Kong and the mainland, to allow foreign capital to buy the mainland bonds from overseas’, said Prime Minister Li Keqiang at the 5th meeting of the NO. 12 National People's Congress.

Joint Announcement of the People’s Bank of China and the Hong Kong Monetary Authority was published, approving CFETS, CCDC, SHCH, HKEx and CMU to establish mutual bond market access between Hong Kong and mainland China (Bond Connect).

PBOC published the Decree [2017] No. 1, and Interim Measures for the Administration of Mutual Bond Market Access between Mainland China and Hong Kong SAR became effective.

PBOC and HKMA published joint announcement, declaring Northbound Trading of Bond Connect to be launched on July 3rd.

‘Hong Kong is the pilot site for the country's opening up trial to the outside world, and Bond Connect will be set up in Hong Kong’, said President Xi Jinping during the celebration of the 20th anniversary congress of Hong Kong's return to the motherland.

Bond Connect officially launched. Launch Ceremony was held jointly by PBOC and HKMA in Hong Kong.
June 23\textsuperscript{rd}, SHCH published *Shanghai Clearing House Detailed Operation Rules for Registration, Custody, Clearing and Settlement of Bond Connect Cooperation between the Mainland and Hong Kong (Trial Implementation)*.

June 30\textsuperscript{th}, SHCH published *Shanghai Clearing House Business Guidelines for Northbound Trading of Bond Connect (Trial Implementation)*.

May 19\textsuperscript{th}, SHCH published joint announcement with HKMA CMU to provide custody and settlement service for Bond Connect.

Enables Mainland and overseas investors to trade bonds tradable in the Mainland and Hong Kong bond markets through connection between the Mainland and Hong Kong Financial Infrastructures.

Includes Northbound and Southbound Trading.

Northbound Trading: overseas investors from Hong Kong and other countries and areas (overseas investors) to invest in the China Interbank Bond Market through mutual access between the Hong Kong and Mainland Financial Infrastructures in respect of trading, custody, settlement etc.
3. Bond Connect - Same Features with Direct Participation to CIBM

1. Entry requirement for foreign investors into CIBM
   (PBOC Announcement [2016] NO.3)

2. Investment Scope for foreign investors
   (all CIBM bonds, currently only cash bond)

3. Hedging the FX risk exposure related to CIBM investment is allowed

4. Adhere to macro prudential management requirements
The Bond Connect adopts the nominee holding arrangement which is widely used in international markets. Foreign investors refer to the actual beneficiaries of the bonds under such an arrangement or end investors who do not hold bonds in their own names on behalf of others. Bond holders include the ones who hold bonds for their own and the ones who hold others’ bonds in their names (i.e., nominees). Nominees should be custodians, such as custodian banks and central securities depositories. The nominees and actual bond holders herein follow international rules and carry the same meaning with the ones under the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect.

Bonds purchased by Overseas Investors through the Northbound Trading shall be registered under the name of the Offshore Depository, and Overseas Investors shall be entitled to the rights and interests of the bonds according to law.
3. Bond Connect - Trial Operation Data

Bond Connect Data Review (SHCH)
July 3rd, 2017 – Aug 30th, 2018

**Primary Markets**
- 32 issuers participated
- 42 Issuances succeeded
- Total Issuance Amount of 112.5 billion RMB
- 57 distributions through Bond Connect
- 9.4 billion RMB settlement volume for distributions

**Secondary Market Settlement**
- 3304 transactions settled through Bond Connect
- 496 billion RMB settled for secondary market transactions

**Income Payment and Redemption**
- 627 interest payments or redemptions
- 143.7 billion RMB involved
Outlook on Linkage between Financial Market Infrastructures
1. Entry Requirement
- **Bond Connect**: foreign investors need to apply for registration to PBOC Shanghai Head Office
- **International Market Practice**: Custodians perform due diligence on foreign investors according to KYC

2. Trading Arrangement
- **Bond Connect**: Trades are entered via the only onshore electronic trading platform. Domestic counterparty should be within the scope.
- **International Market Practice**: Trades could be reached through multiple ways of bilateral inquiry.

3. Holding Structure
- **Bond Connect**: Offshore Depository opens an omnibus account with Onshore Depository, however, segregated Trade ID is mandatory for foreign investors.
- **International Market Practice**: Omnibus accounts are applied between depositories (custodians). Foreign investors could participate all markets connected through one account at local depository.

4. Settlement Instructions
- **Bond Connect**: The onshore electronic trading platform sends trading data to the Onshore Depository for settlement.
- **International Market Practice**: Investors submit settlement instructions through the custody chain to the depository for settlement.
Based on the successful pilot experience of bond connect, Shanghai Clearing House will continue to explore the linkages with both domestic and foreign financial market infrastructures to improve the integrity of different bond markets, and facilitate investors to reach different bond markets more conveniently.