



HONG KONG MONETARY AUTHORITY

**Briefing to the Legislative Council
Panel on Financial Affairs**

15 November 2013



DISCUSSION TOPICS

Updates on

- Financial and Economic Environment
- Currency Stability
- Banking Stability
- Financial Infrastructure
- Hong Kong as an International Financial Centre
- Investment Environment and Performance of The Exchange Fund
- Hong Kong Mortgage Corporation



FINANCIAL AND ECONOMIC ENVIRONMENT



GLOBAL ECONOMIC GROWTH FORECASTS

Real GDP Growth

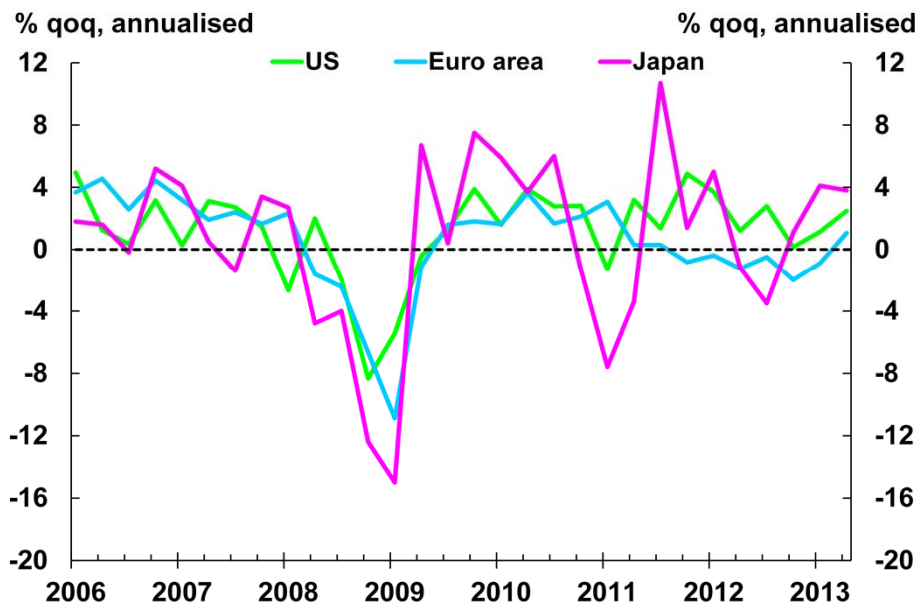
(% year-on-year)

	2012	2013 Forecasts	2014 Forecasts
US	2.8	1.6	2.6
Euro area	-0.6	-0.3	0.9
Japan	2.0	1.9	1.7
Asia (ex-Japan)	6.1	6.0	6.2
Mainland China	7.7	7.6	7.4
Hong Kong	1.5	3.0	3.6

Sources: October Consensus Forecasts and CEIC



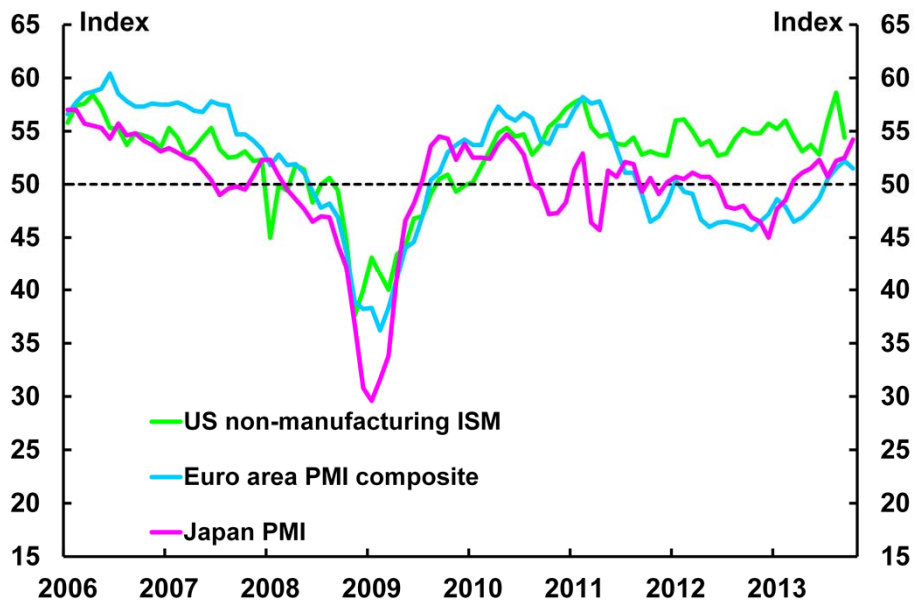
REAL GDP GROWTH IN MAJOR COUNTRIES



Source: Bloomberg



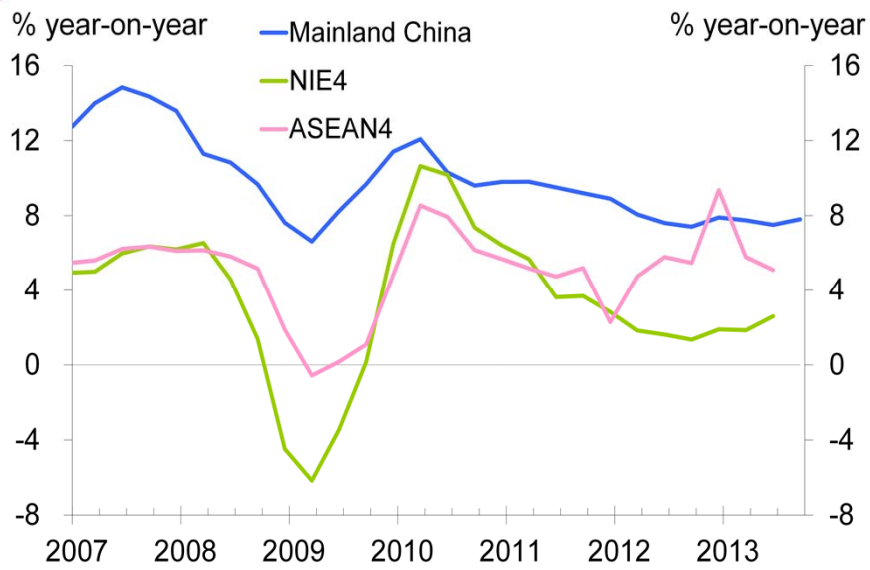
PURCHASING MANAGERS' INDEX IN MAJOR ECONOMIES



Source: Bloomberg



ASIA: REAL GDP GROWTH



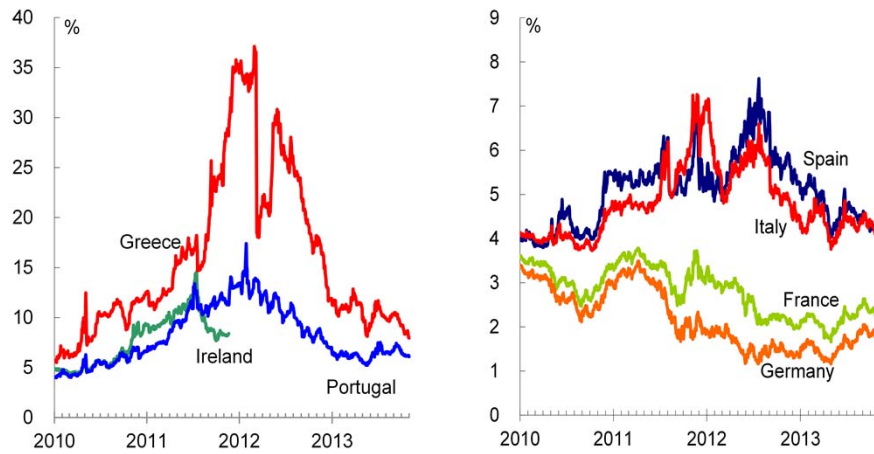
Note: NIE4 includes Hong Kong, Singapore, South Korea and Taiwan; ASEAN4 includes Indonesia, Malaysia, the Philippines and Thailand.

Sources: CEIC, IMF and HKMA staff estimates



EUROPE: SOVEREIGN BOND YIELDS

10-year sovereign bond yield

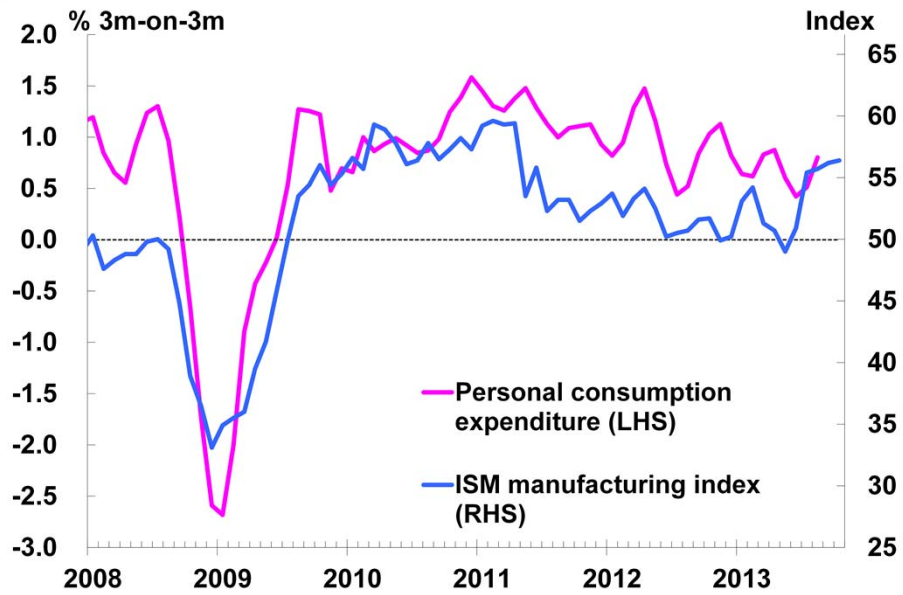


Sources: Bloomberg and EcoWin

Note: EcoWin has stopped publishing Ireland's 10-year bond yield since 22 Nov, 2011



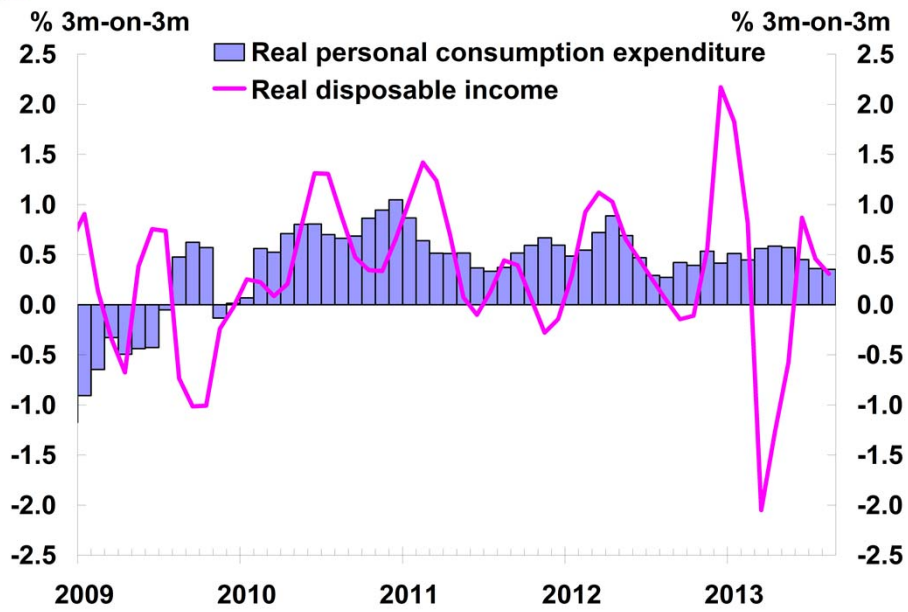
US: CONSUMPTION GROWTH & BUSINESS ACTIVITY



Source: CEIC



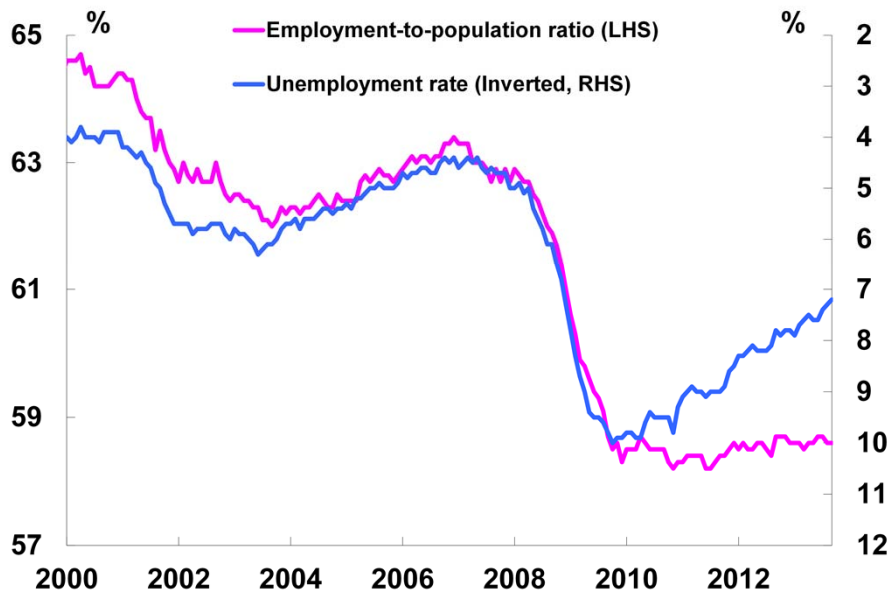
US: CONSUMPTION AND INCOME GROWTH



Source: CEIC



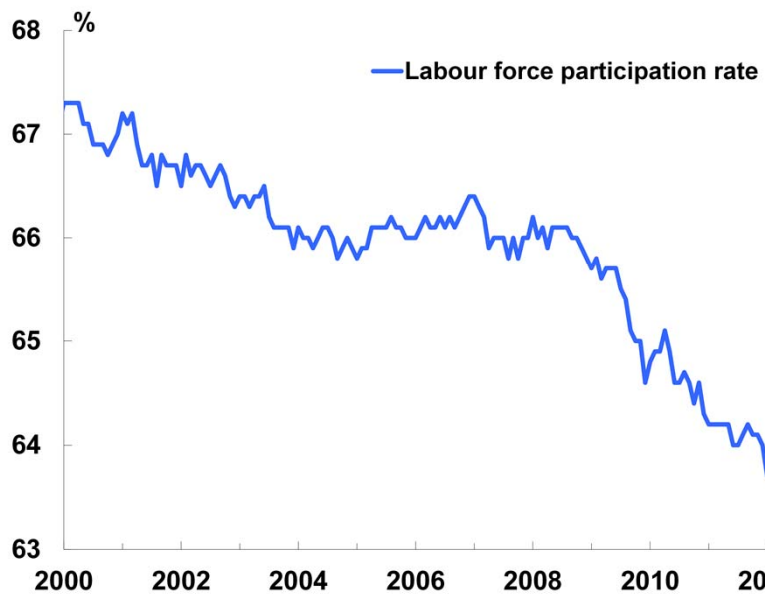
US: LABOUR MARKET SITUATION



Source: CEIC



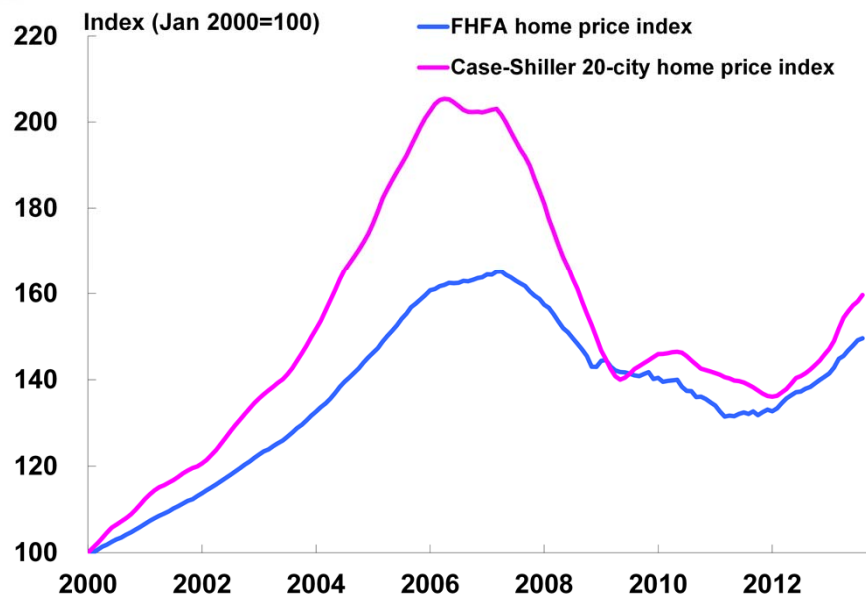
US: LABOUR FORCE PARTICIPATION



Source: CEIC



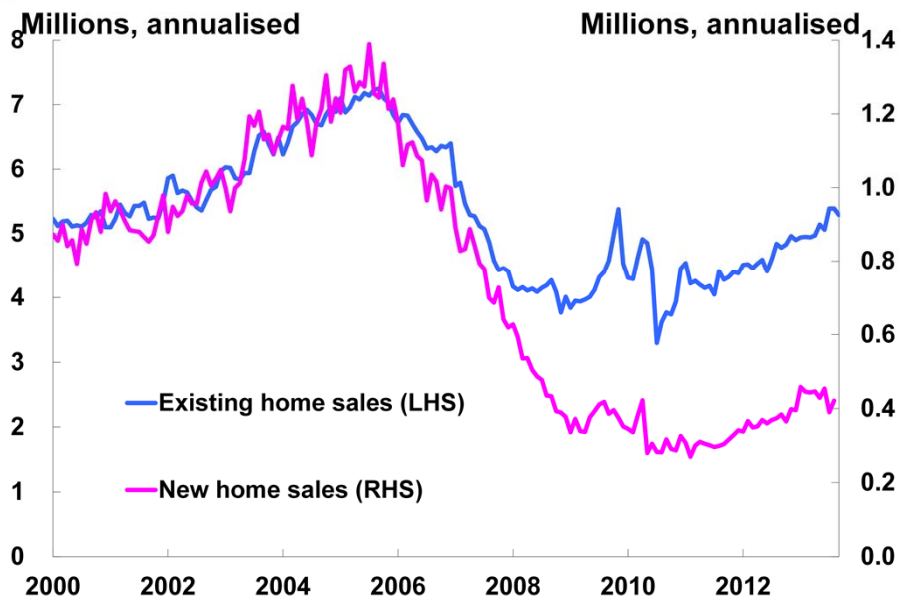
US: HOUSE PRICES



Sources: Standard & Poor's and CEIC



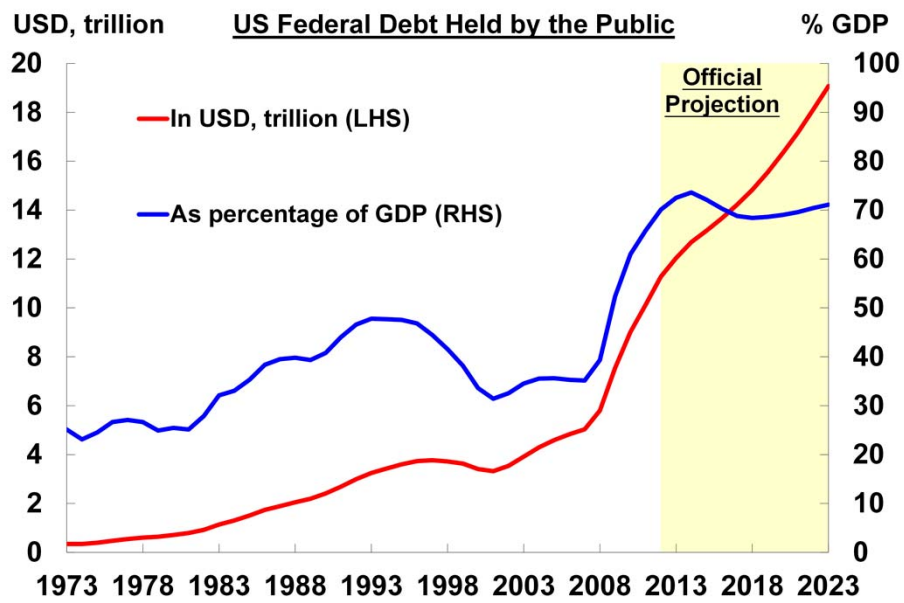
US: HOME SALES



Source: CEIC



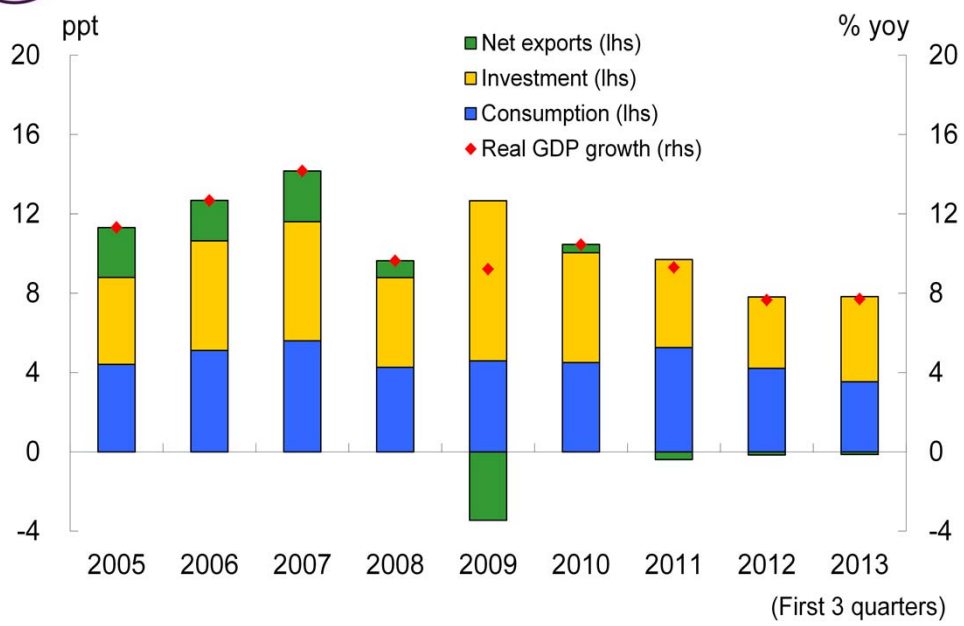
US: FEDERAL GOVERNMENT DEBT



Source: CBO



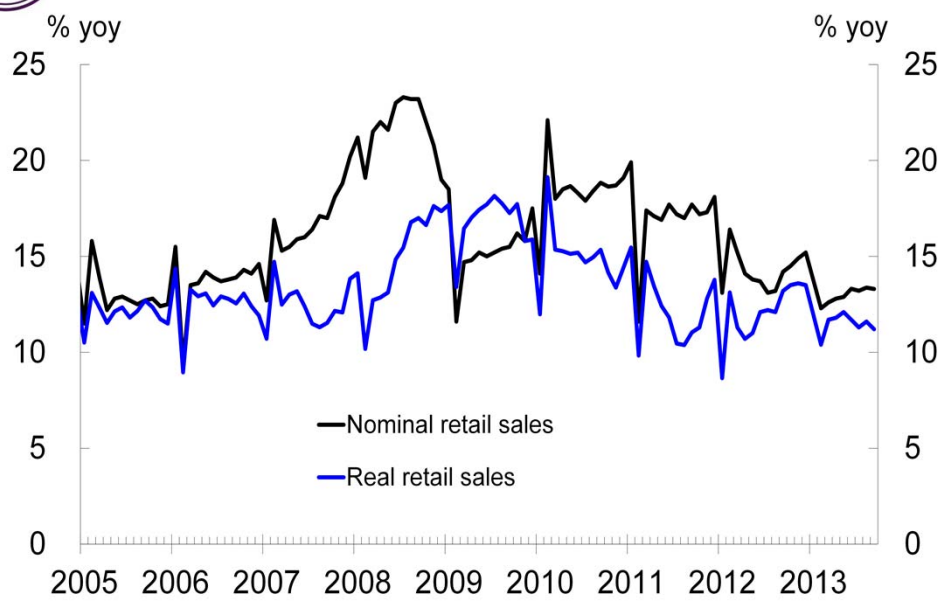
MAINLAND CHINA: REAL GDP GROWTH



Source: CEIC



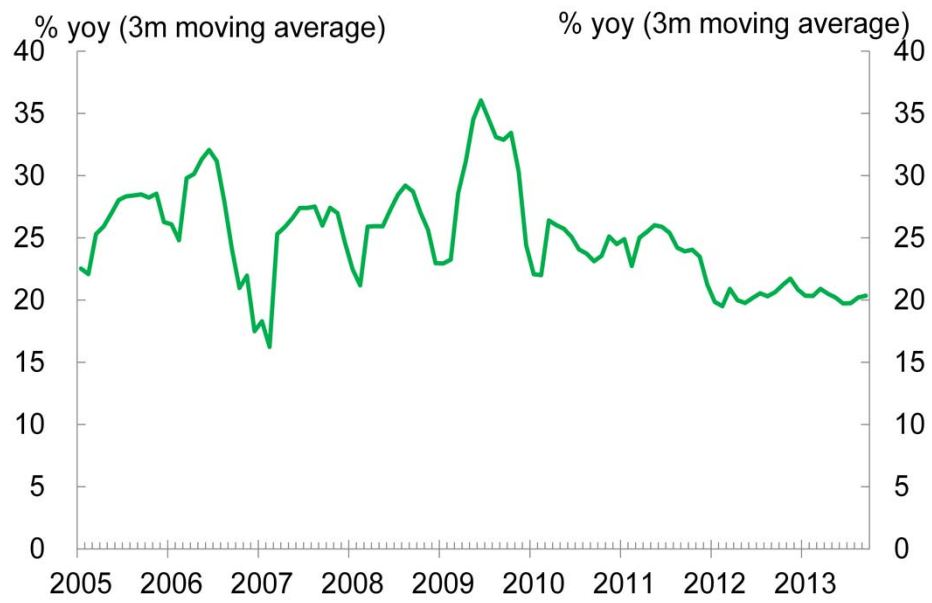
MAINLAND CHINA: RETAIL SALES



Sources: CEIC, WIND and HKMA staff estimates



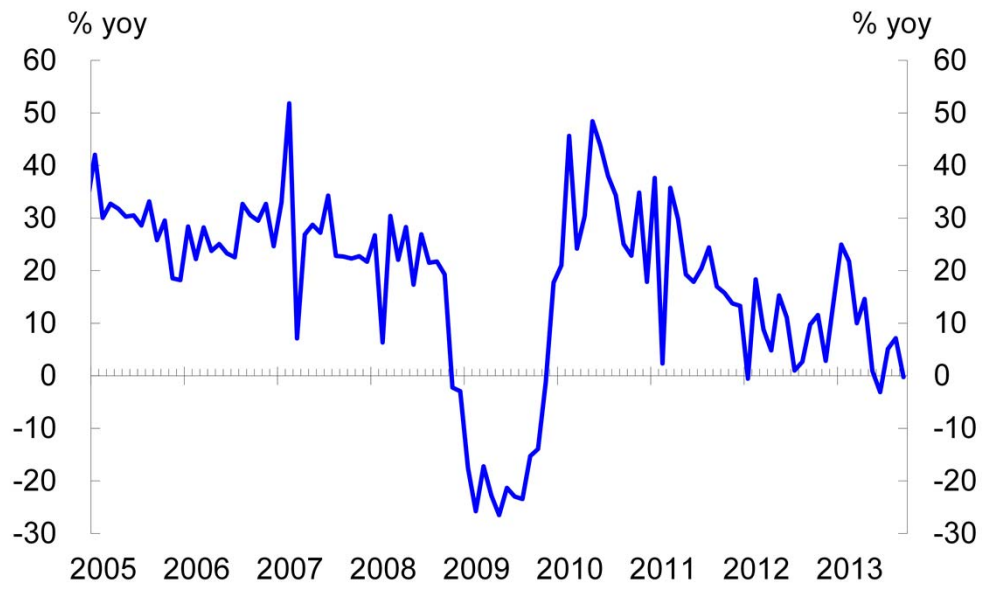
MAINLAND CHINA: FIXED ASSET INVESTMENT



Sources: CEIC and HKMA staff estimates



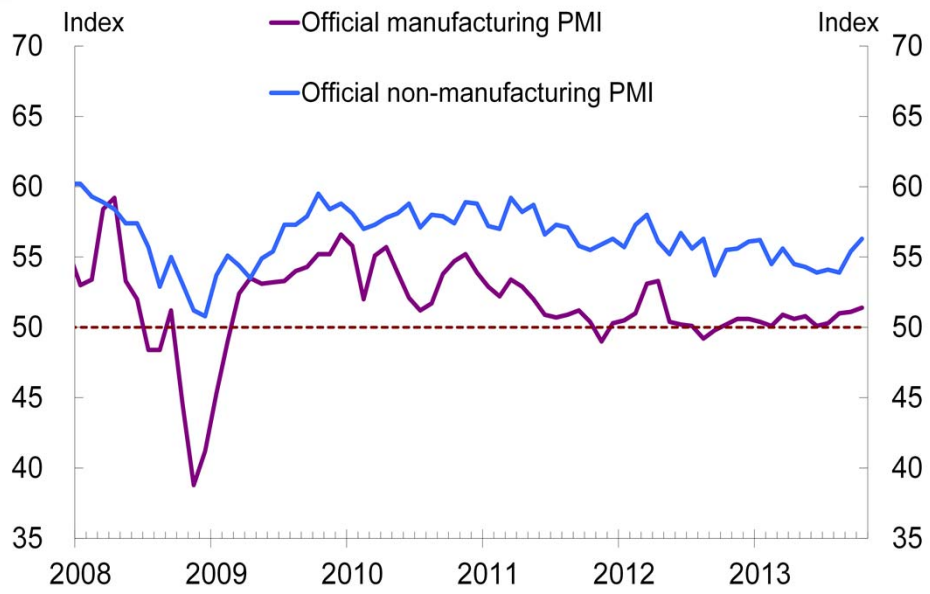
MAINLAND CHINA: EXPORT GROWTH



Sources: CEIC and HKMA staff estimates



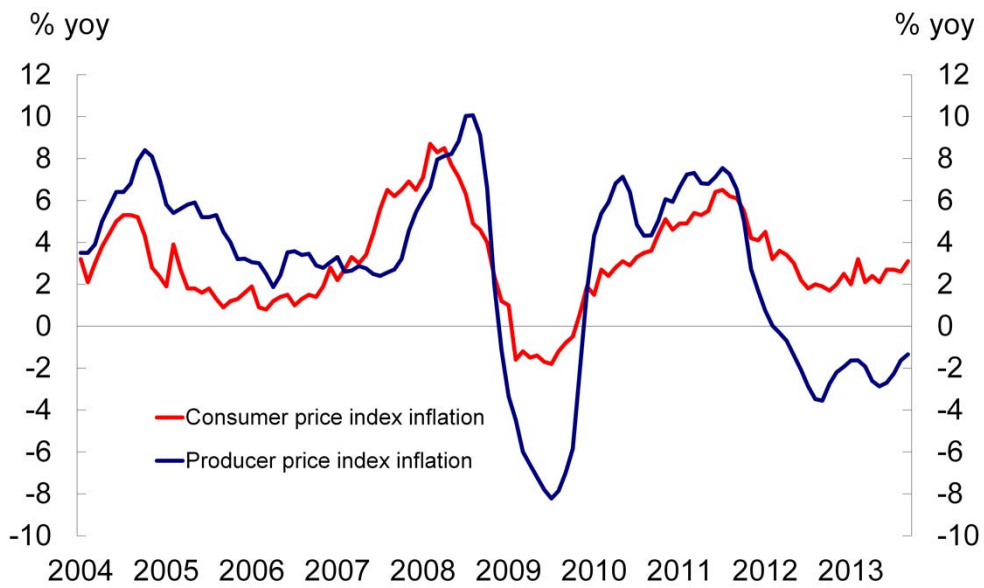
MAINLAND CHINA: PURCHASING MANAGERS' INDEX



Source: CEIC



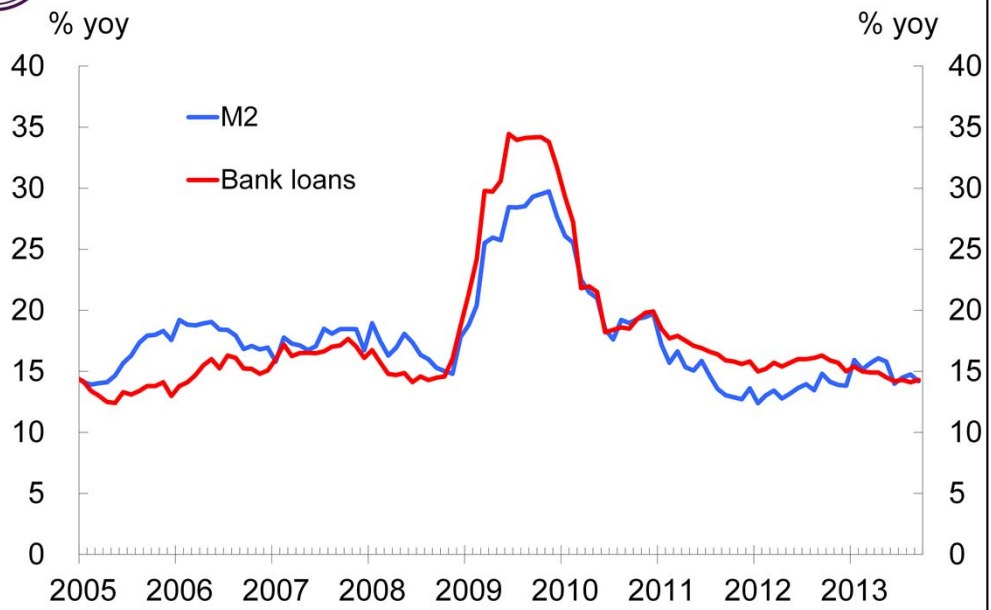
MAINLAND CHINA: INFLATION



Source: CEIC



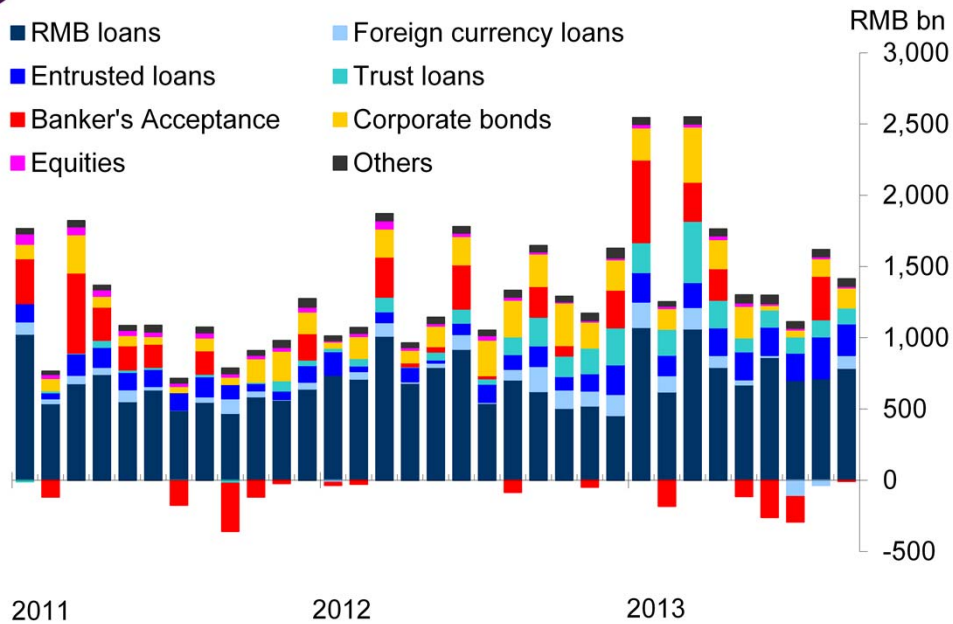
MAINLAND CHINA: MONEY AND LOAN GROWTH



Source: CEIC



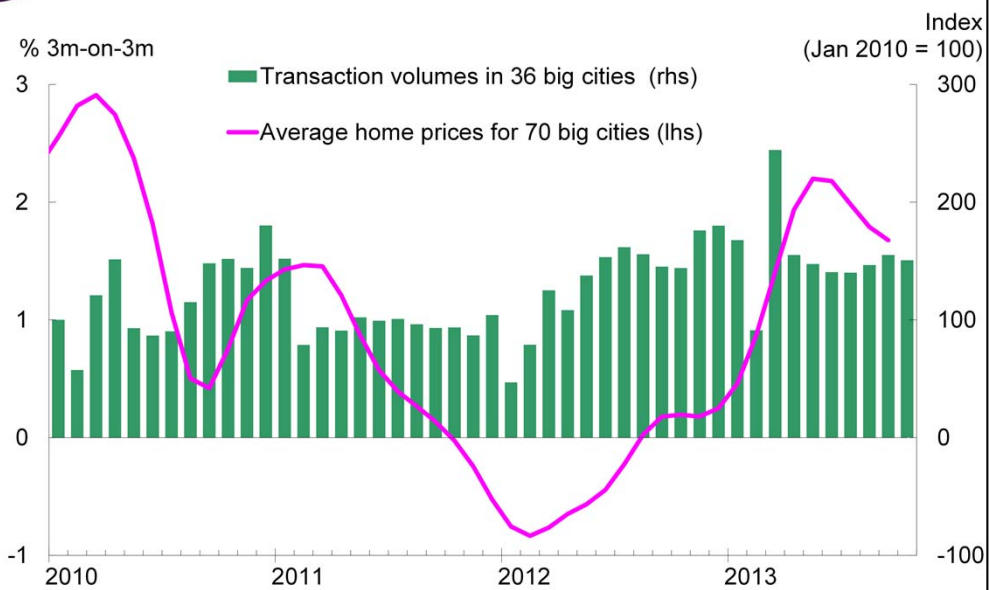
MAINLAND CHINA: TOTAL SOCIAL FINANCING



Source: CEIC



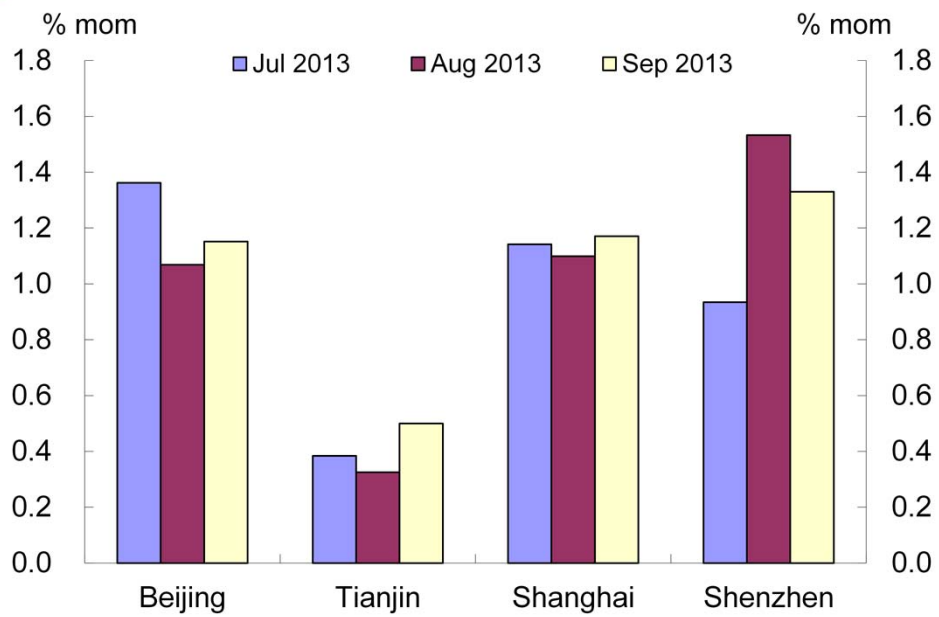
MAINLAND CHINA: PROPERTY TRANSACTION VOLUME AND PRICE CHANGES IN BIG CITIES



Sources: CEIC, WIND and HKMA staff estimates



MAINLAND CHINA: HOUSING PRICE CHANGES IN MAJOR CITIES

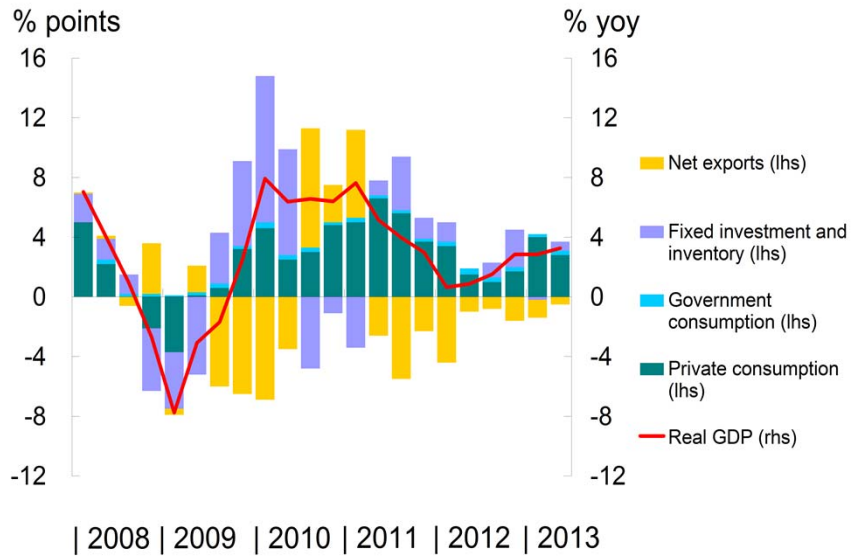


Sources: CEIC, WIND and HKMA staff estimates



HONG KONG: REAL GDP GROWTH

Changes in Real GDP and contributions by major components

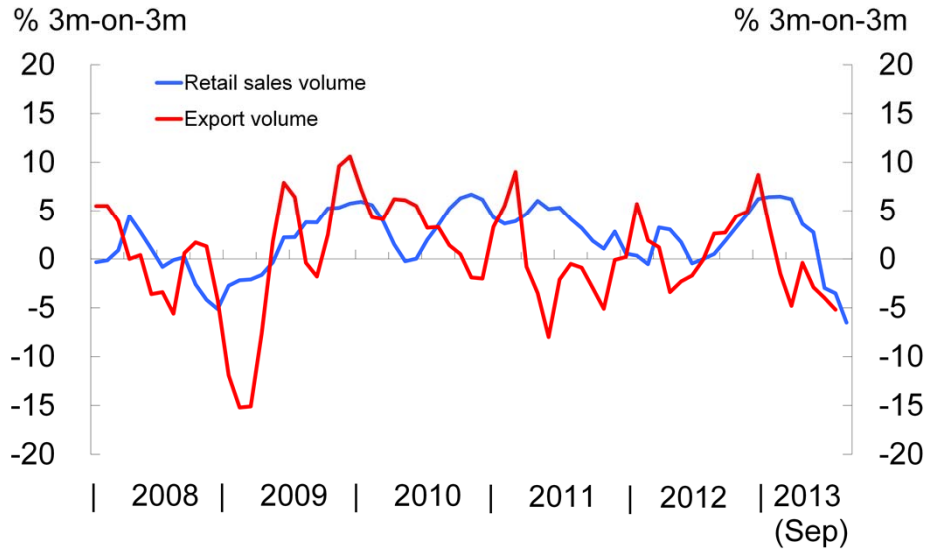


Source: C&SD



HONG KONG: ECONOMIC ACTIVITY

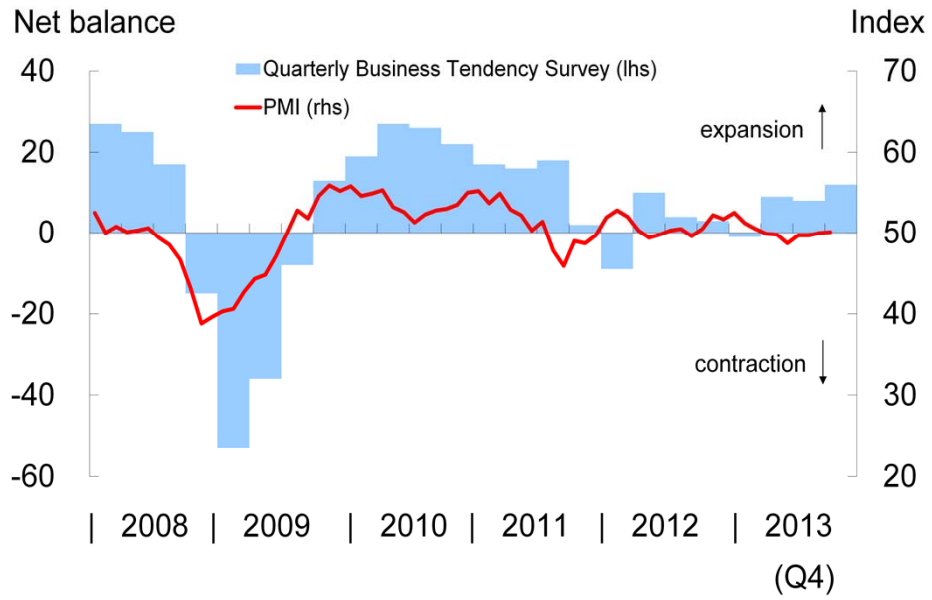
Retail Sales and Exports



Source: C&SD



HONG KONG: BUSINESS OUTLOOK

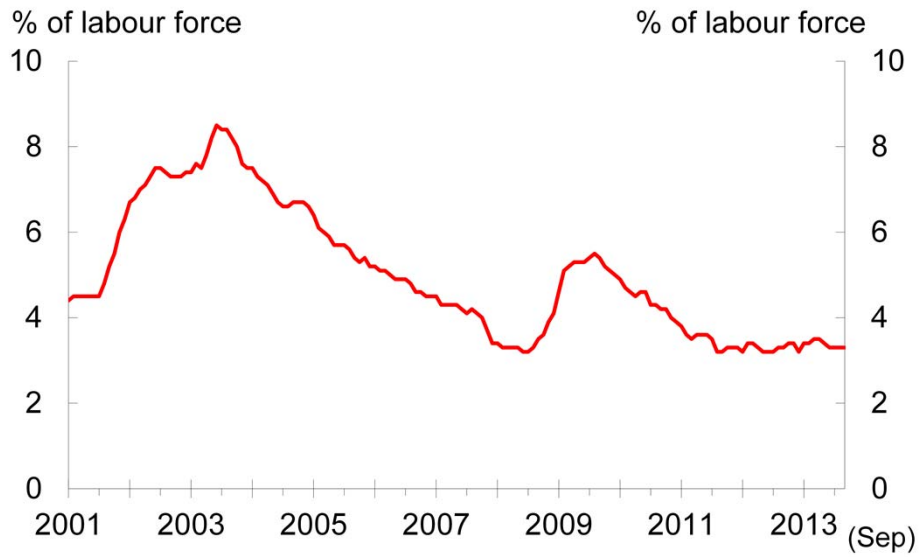


Sources: C&SD and Markit Economics



HONG KONG: LABOUR MARKET

Unemployment rate

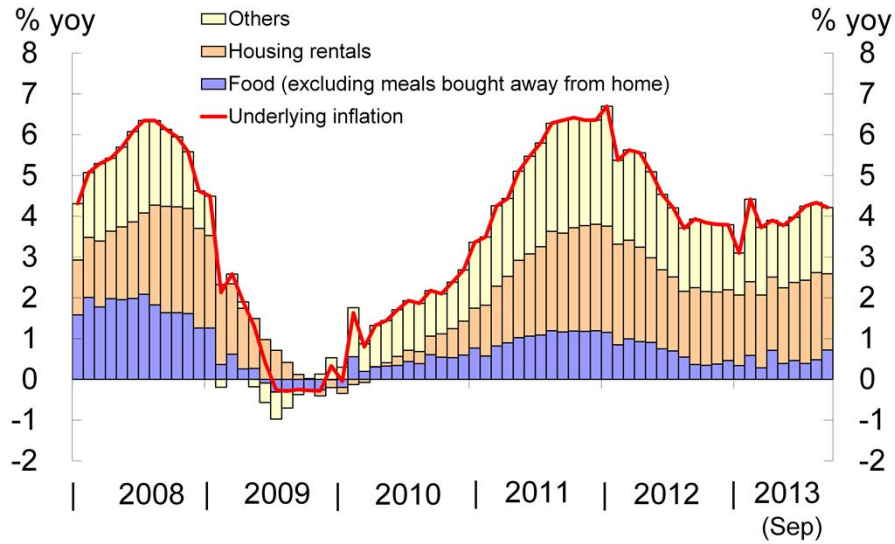


Source: C&SD



HONG KONG: INFLATION

Underlying inflation and contributions of its components

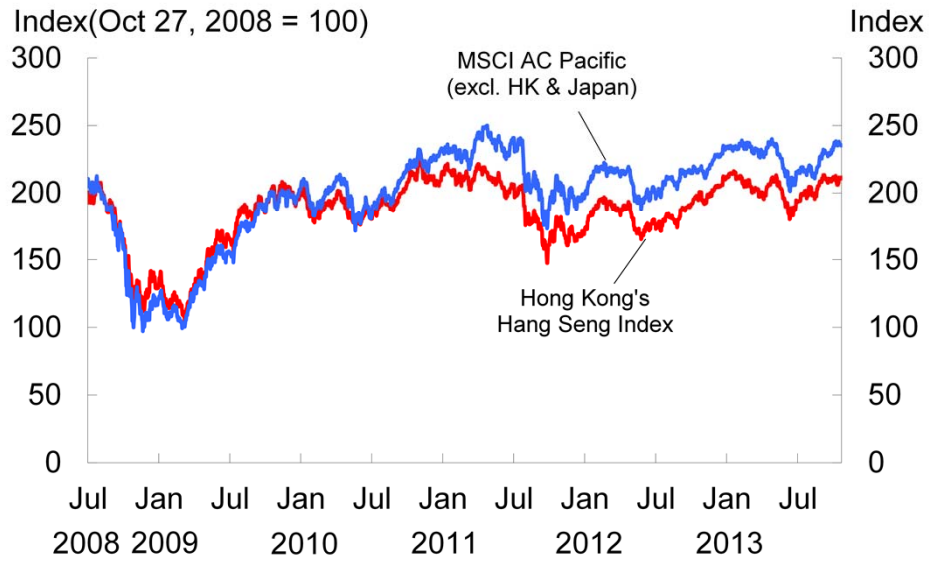


* Underlying inflation: Netting out the effects of all Government's one-off relief measures from headline inflation
Sources: C&SD and HKMA staff estimates



HONG KONG: EQUITY MARKET

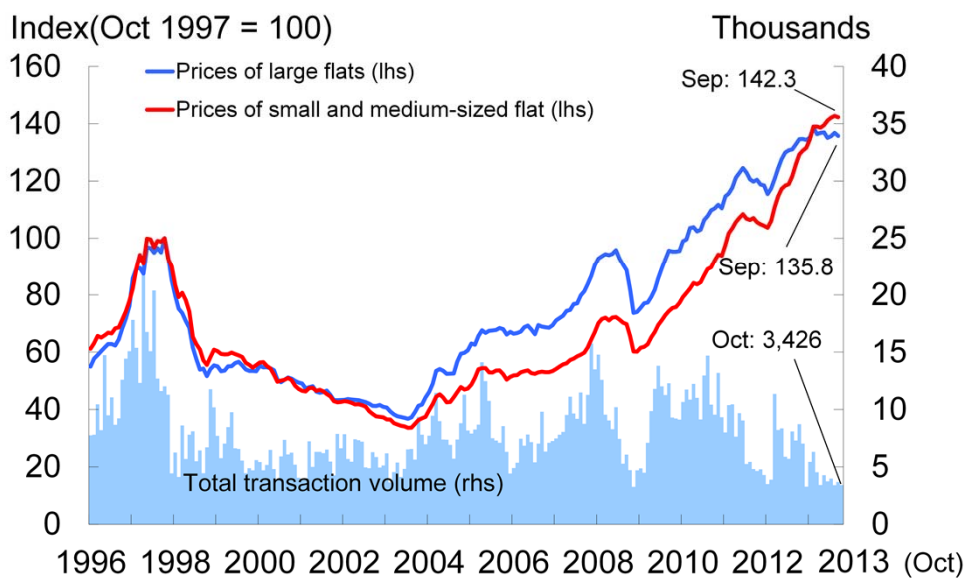
Hong Kong and Asia Pacific equity market performance



Source: Bloomberg



HONG KONG: RESIDENTIAL PROPERTY PRICES AND TRANSACTION VOLUME

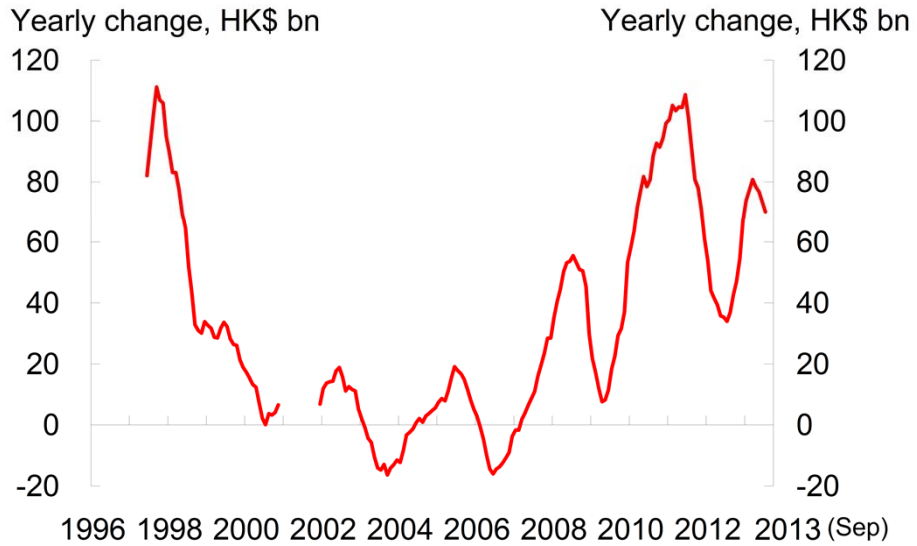


Source: Rating and Valuation Department



HONG KONG: OUTSTANDING RESIDENTIAL MORTGAGE LOANS

Changes in outstanding residential mortgage loans

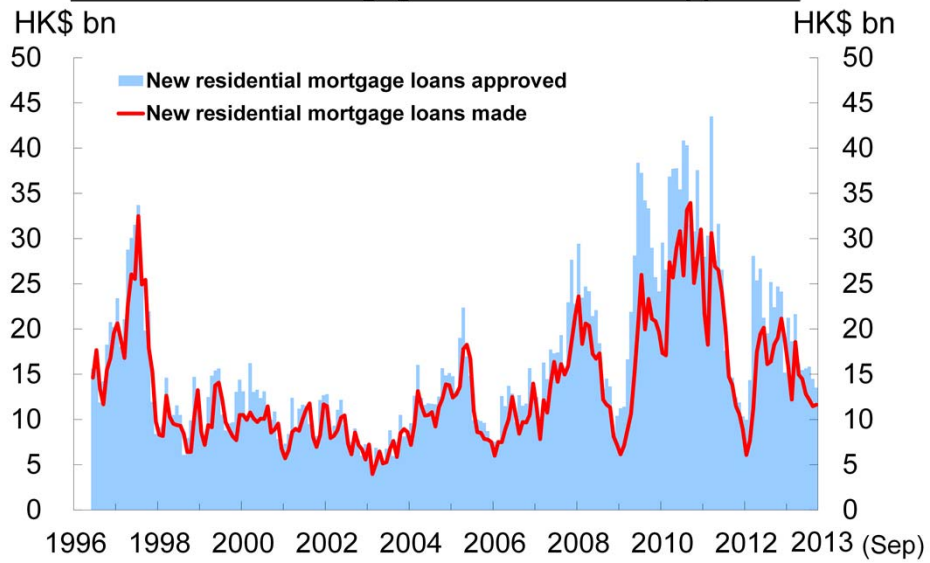


* There is a break in data series at December 2000 due to an increase in the number of surveyed institutions
Source: HKMA



HONG KONG: NEW RESIDENTIAL MORTGAGE LOANS

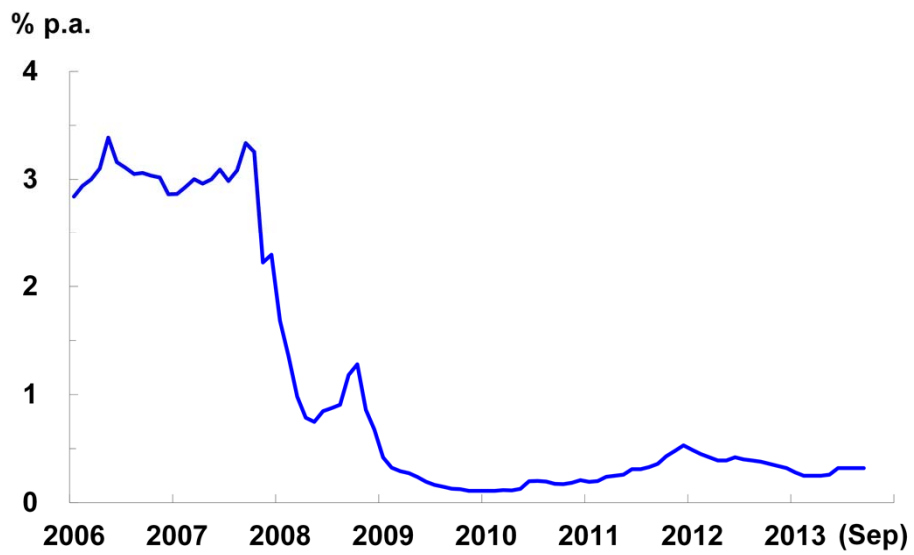
New residential mortgage loans made and approved



* There is a break in data series at December 2000 due to an increase in the number of surveyed institutions
Source: HKMA



HONG KONG: COMPOSITE INTEREST RATE



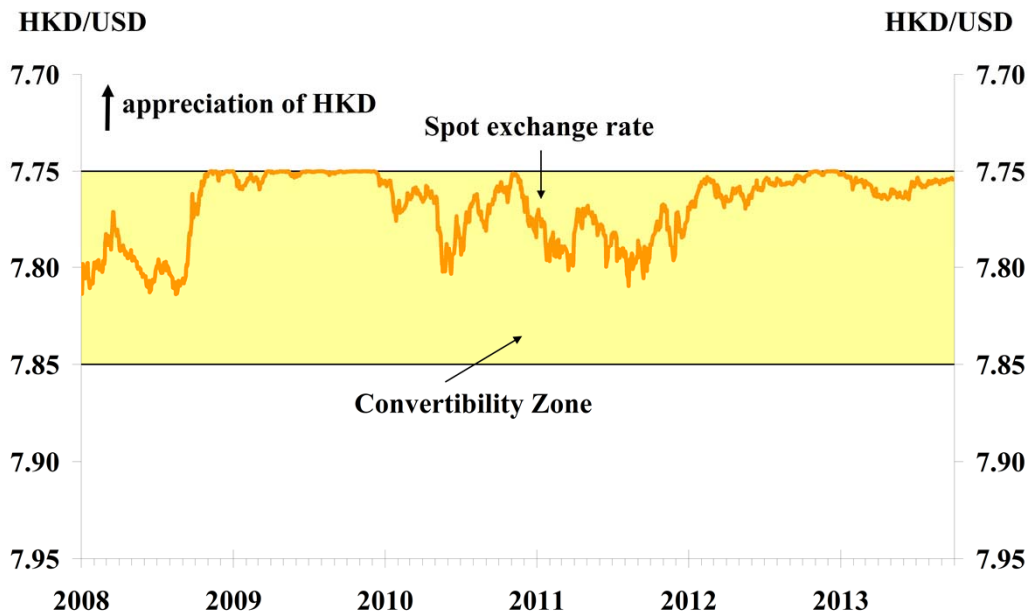
Source: HKMA



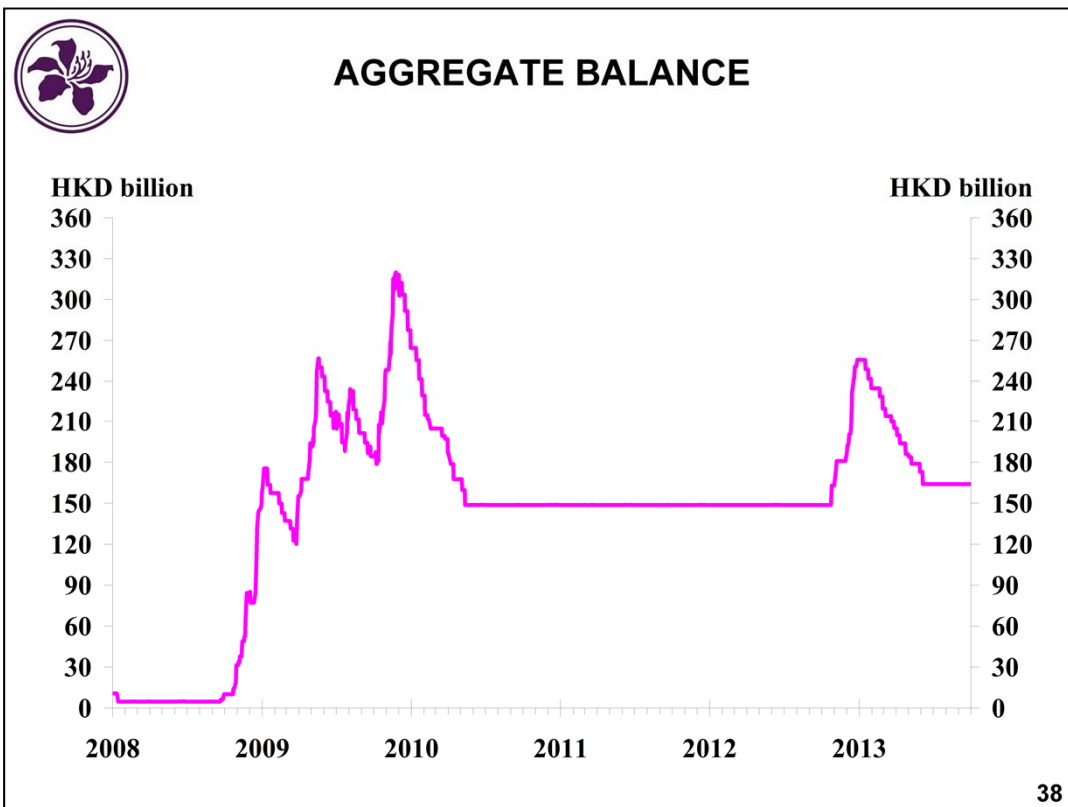
CURRENCY STABILITY



HONG KONG DOLLAR SPOT EXCHANGE RATE



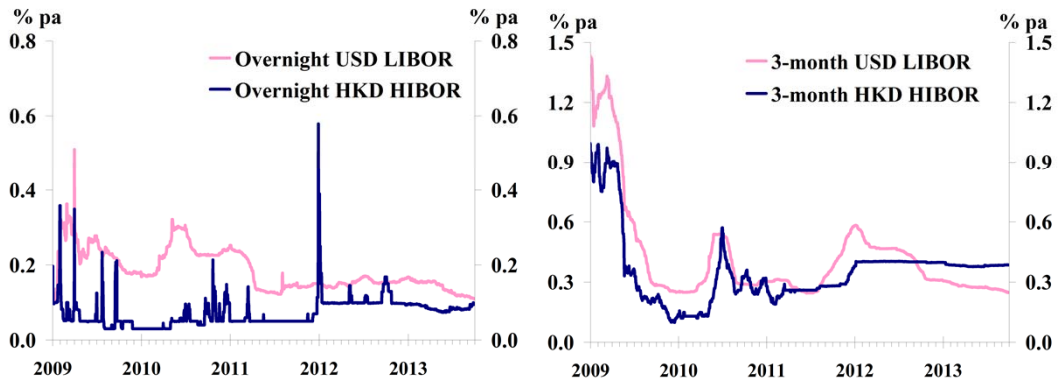
- Despite the spikes in volatility in some Asian currencies, the Hong Kong dollar spot exchange rate has been in a steady to firmer tone against US dollar since June.
- There has been no triggering of the strong-side Convertibility Undertaking so far this year.



- Liquidity remained abundant in the interbank market.
- Additional Exchange Fund bills were issued from January to June this year to meet banks' demand, leading to a corresponding decline in the Aggregate Balance. The Aggregate Balance stood at HK\$163.9 billion by the end of September.



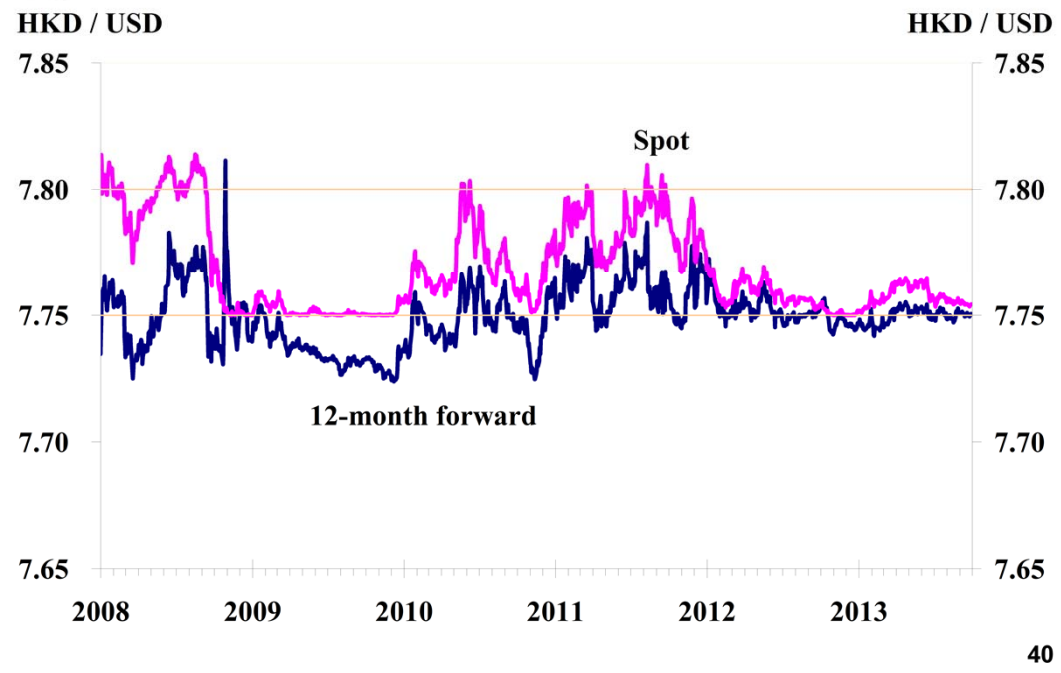
DOMESTIC INTEREST RATES



- Short-term Hong Kong dollar interbank interest rates remained steady at near-zero levels.



HONG KONG DOLLAR FORWARD EXCHANGE RATE

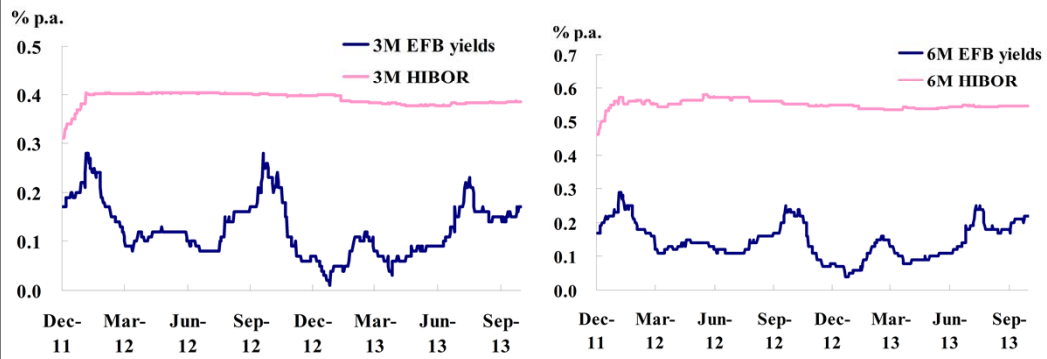


- HKD 12-month forward exchange rate was broadly steady.



YIELDS OF EXCHANGE FUND BILLS

- The HKMA issued a total of HK\$92 billion of additional EFBs between January and June 2013 to meet the demand of banks for EFBs for liquidity management. Bills yields have remained broadly steady





COIN COLLECTION MOBILE KIOSKS PILOT SCHEME

- Aims at providing the public with a convenient and free channel of exchanging coins to enhance circulation and reduce minting cost
- Users receive banknotes in exchange of coins, or they can choose to add value to Octopus cards
- Two mobile kiosks will collect coins at various locations throughout Hong Kong on a rotational basis
- Target launch date: mid-2014
- The HKMA will announce coin collection locations and schedule in advance

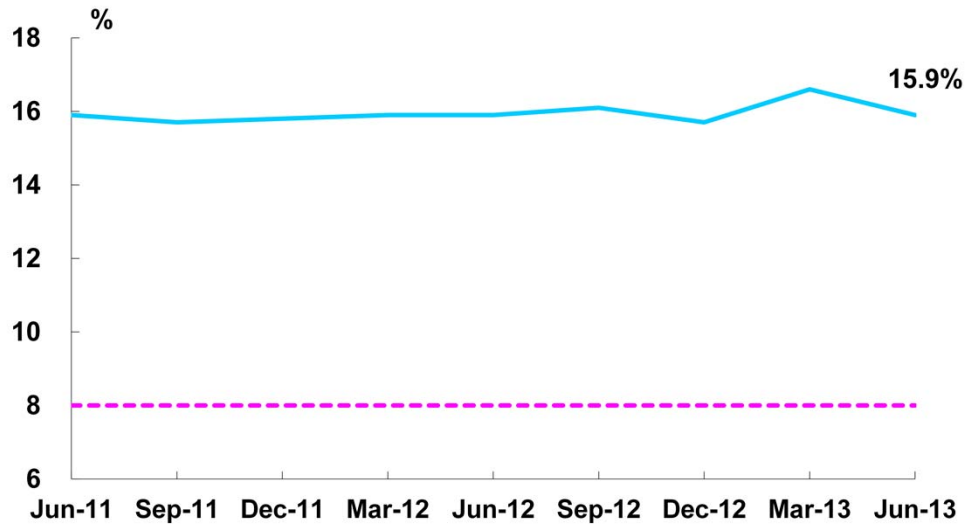


BANKING STABILITY



BANKING SECTOR PERFORMANCE

Locally incorporated AIs continued to be well capitalised



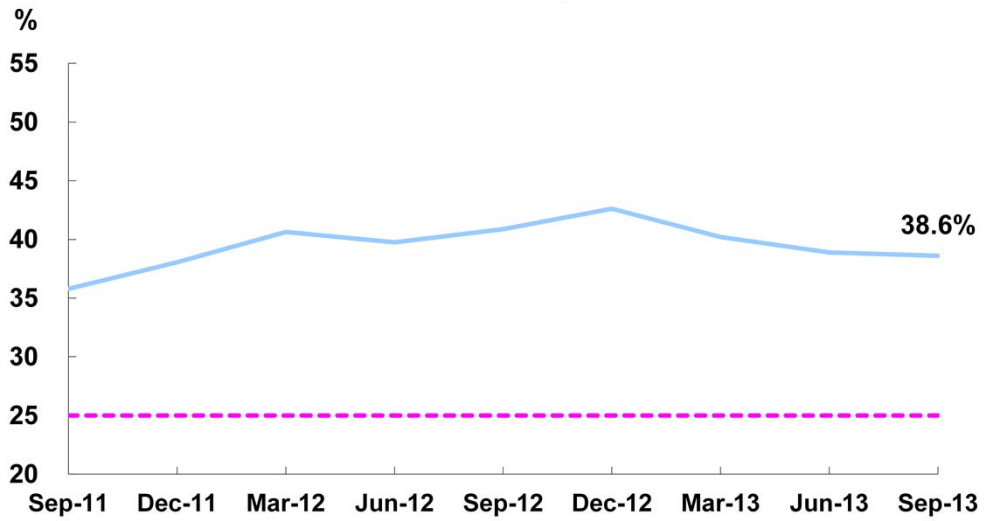
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- The consolidated capital adequacy ratio (CAR) of locally incorporated AIs declined to 15.9% at end-June 2013 from 16.6% at end-March 2013 due to reasons such as dividend payment, increase in capital expenditure and loan growth. The consolidated CAR remained well above the international standard of 8%.



BANKING SECTOR PERFORMANCE

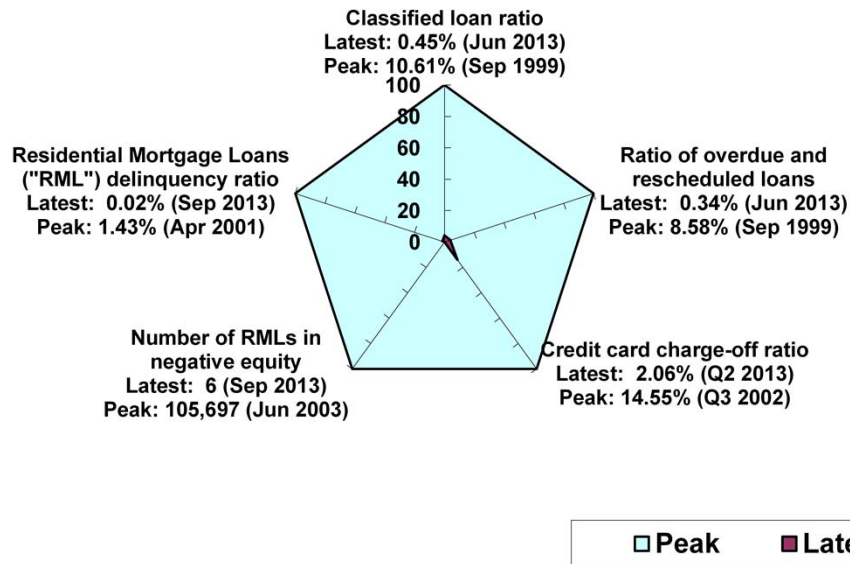
Quarterly average liquidity ratio of retail banks remained well above statutory minimum of 25%



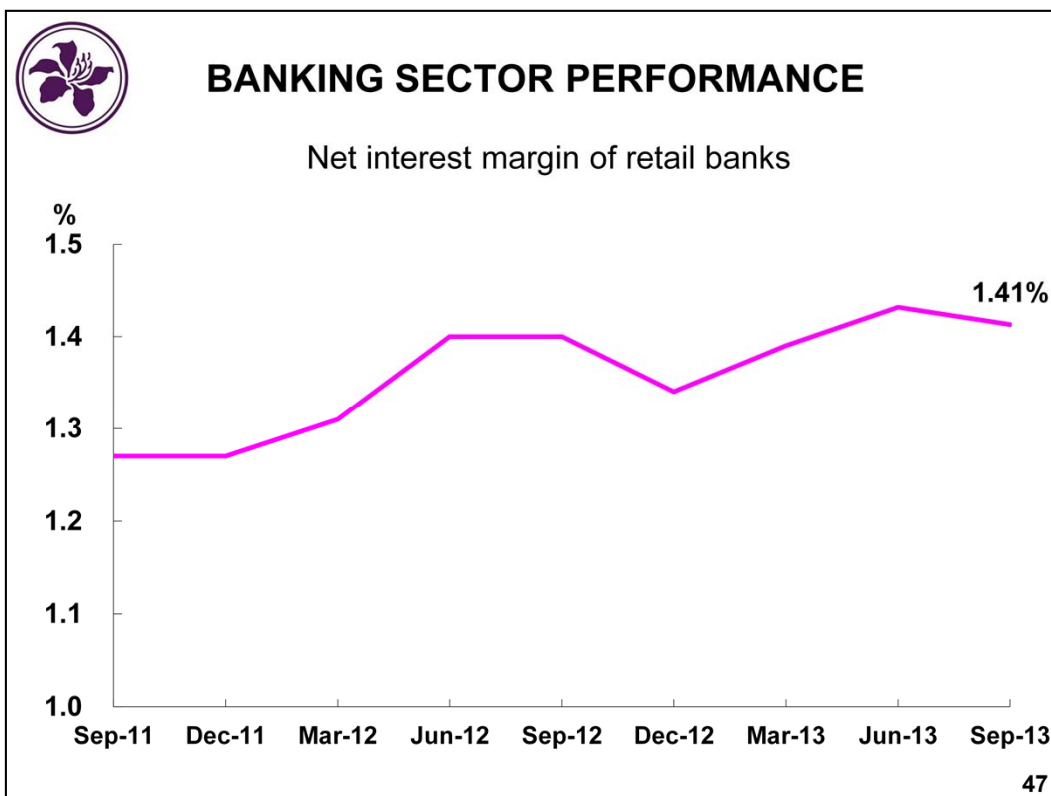


BANKING SECTOR PERFORMANCE

Asset quality remained good compared with historical standards



- The HKMA will continue to monitor closely the asset quality of retail banks' loan portfolios.

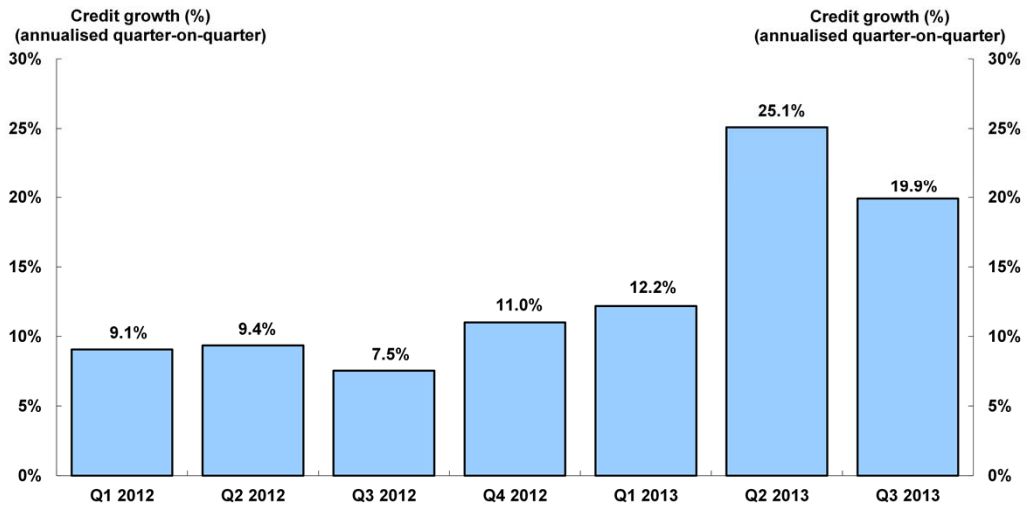


- The quarter-on-quarter annualised net interest margin of retail banks' Hong Kong offices improved from 1.39% in Q1/2013 to 1.43% in Q2/2013 while edged down to 1.41% in Q3/2013. The widening of net interest margin was mainly due to a 5% increase in retail banks' net interest income in the second quarter and 2% increase in the third quarter. The year-to-date annualised net interest margin also widened to 1.41% in Q1-Q3/2013 from 1.37% in Q1-Q3/2012.
- The aggregate pre-tax operating profit of retail banks' Hong Kong offices in Q1-Q3/2013 increased by 17.9% compared with Q1-Q3/2012. Moderate increases in both net interest income (+11.4%) and in non-interest income (+14.1%) contributed to the profit growth.



CREDIT GROWTH

Credit growth eased after rapid growth in Q2/2013



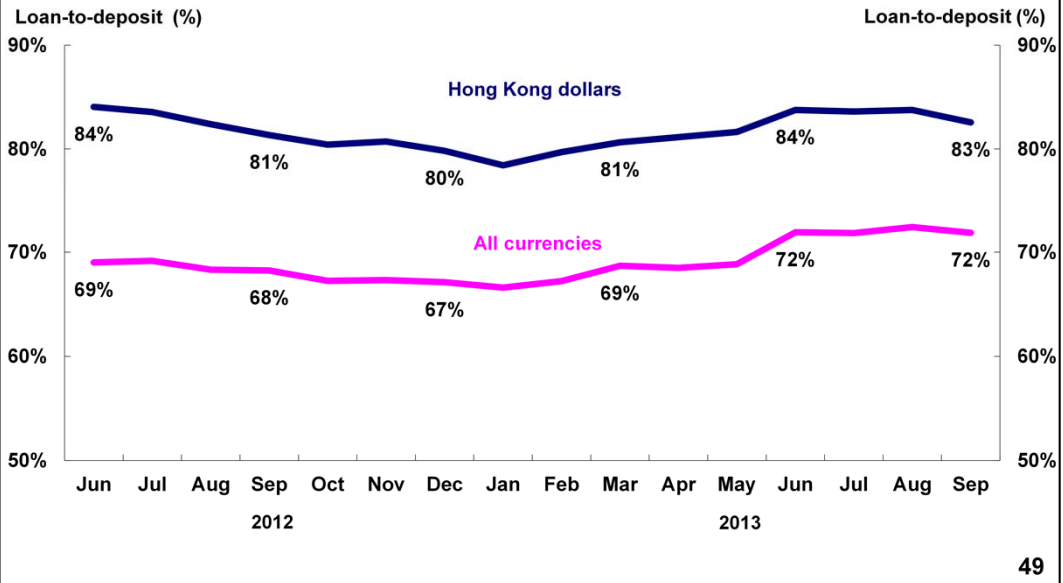
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- In Q3/2013, credit growth was 5.0% or 19.9% on an annualised basis. The accelerated credit growth was contributed by loans for use outside Hong Kong (+8.5%), trade finance (+7.8%) and loans for use in Hong Kong (+3.0%).
- The HKMA will continue to monitor credit growth of the banking sector.



CREDIT GROWTH

Loan-to-deposit ratios of banks in Hong Kong remained stable



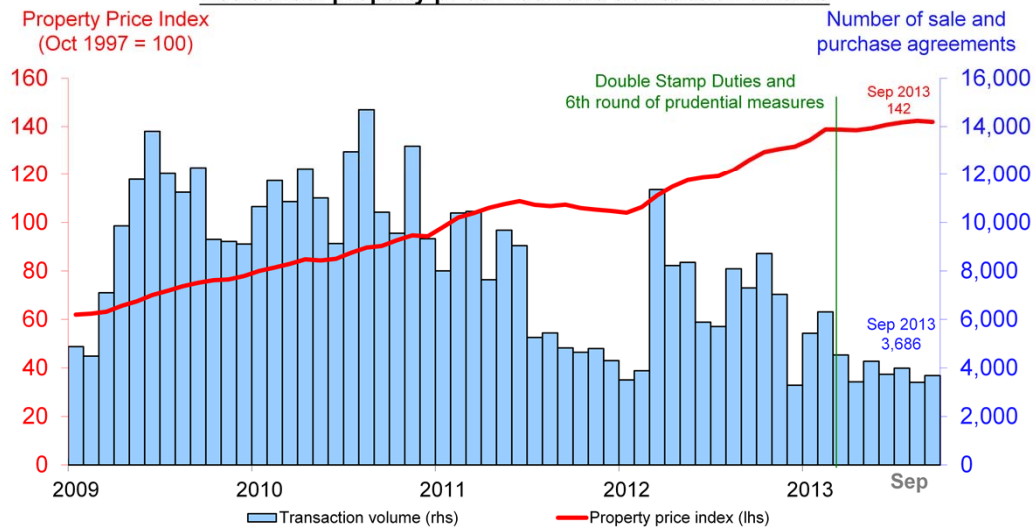
- Hong Kong dollar loan-to-deposit ratio slightly reduced to 83% at end-September 2013 from 84% at end-June 2013.
- The HKMA will continue to monitor movement of the loan-to-deposit ratio.



RISK MANAGEMENT OF PROPERTY MORTGAGE LOANS

Transaction volume dropped and property prices remained at high level after introduction of property measures in February 2013.

Residential property price index and transaction volume



Sources: R&VD and Land Registry

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Latest statistics for residential mortgage loans (“RMLs”)

	Monthly average in 2011	Monthly average In 2012	6/2013	7/2013	8/2013	9/2013
Number of sale and purchase agreements	7,039	6,778	3,740	3,986	3,407	3,686
Number of new RML applications	12,644	11,634	9,301	8,424	8,043	7,526
Number of new RMLs approved	9,224	8,210	5,925	6,140	5,399	4,904

Latest statistics for residential property prices

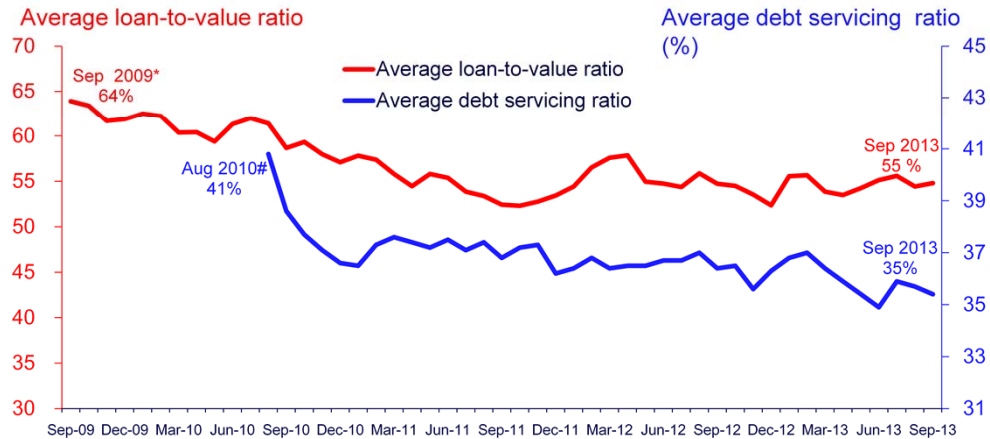
Property price index		Period	Property price index
R&VD (10/1997=100)	Recent Peak	8/2013	142
	Peak in 1997	10/1997	100
Centaline (6/7/1997=100)	Recent Peak	8/9/2013	122
	Peak in 1997	19/10/1997	103



RISK MANAGEMENT OF PROPERTY MORTGAGE LOANS

HKMA's prudential measures are taking effect in containing the risks of the property mortgage loans of the banking system in Hong Kong.

Average loan-to-value ratio and debt servicing ratio for new residential mortgage loans approved



* Before the first round of HKMA's prudential measures was introduced

When the tighter requirement on debt servicing ratio was introduced

- The HKMA will continue to closely monitor mortgage market developments and introduce appropriate measures as and when necessary to safeguard banking stability.



Basel III IMPLEMENTATION PROGRESS

Capital standards

- 1st phase (minimum capital ratios)
 - Associated disclosure
 - Supplementary guidance
 - On-going monitoring
- 2nd phase
 - Capital buffers
 - Higher loss absorbency for global systemically important banks / domestic systemically important banks

Liquidity standards

- Liquidity Coverage Ratio

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Capital standards

- 1st phase implementation:
 - Further to the Basel III minimum capital requirements taking effect on 1 January, Banking (Disclosure) Rules to implement the associated disclosure standards took effect from 30 June. All 1st phase standards have therefore been successfully implemented in Hong Kong.
 - Supplementary guidance has been issued to facilitate implementation. This includes common disclosure templates to ensure consistent disclosures and interpretative guidance in the form of FAQs on certain technical areas relating to the calculation of the minimum ratios.
 - Capital position of local AIs remains relatively strong under Basel III, their Common Equity Tier 1 ratios averaging above 13% and total CAR around 16% as of end-June.
- 2nd phase implementation:
 - Consultative proposals are being developed for industry consultation within Q4. These will cover (i) the mechanism to operationalise the two Basel III capital buffer requirements and (ii) the framework for the identification of and application of the “higher loss absorbency requirements” to systemically important banks. HK is not the home regulator of any of the global systemically important banks (GSIBs) but we do have DSIBs (domestic systemically important banks).
 - The 2nd phase Basel III standards are scheduled to take effect from Jan 2016 but legal framework is required to be in place one year before (i.e. from Jan 2015). We will soon be preparing draft rules next year and will brief members on our proposals in this regard in due course.

Liquidity standards

- HKMA launched a third round of consultation in July on proposals to implement the Basel III Liquidity Coverage Ratio in Hong Kong, taking into account industry comments received in the first two rounds of consultation.
- The consultation results will be incorporated into the rule-making process in 2014 to ensure timely implementation of the LCR standard in 2015. We will brief members on the contents of the draft rules next year.



INVESTOR AND CONSUMER PROTECTION

- Developing an enhanced competency framework for private wealth management practitioners
- Continued to participate in the work of the Organisation for Economic Co-operation and Development Task Force on Financial Consumer Protection to support the implementation of the G20 High-Level Principles on Financial Consumer Protection
- Worked with the industry to introduce the Treat Customers Fairly Charter

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- With a view to raising the competence and ethics of industry practitioners and to developing and maintaining a pool of professional talents for the private wealth management (PWM) industry in Hong Kong, the HKMA has been providing advice and assistance to the industry and the local professional bodies to develop an enhanced competency framework (ECF) covering the requisite level of competence and on-going professional development of PWM practitioners. Industry consultation on a high-level proposal closed in April, with general support from the respondents for the ECF. Taking into account the comments received, details of the ECF have been developed and further industry consultation is now in progress. Meanwhile, preparatory work in relation to the provision and accreditation of relevant training programme is underway.
- The HKMA is a member of the Task Force on Financial Consumer Protection of the Organisation for Economic Co-operation and Development (OECD) (the Task Force) and has been participating actively in the development of the G20 High-level Principles on Financial Consumer Protection. Following the publication of the Principles in October 2011, the Task Force has been developing effective approaches to support the implementation of the Principles. The Task Force's summary report on effective approaches to support the implementation of the three priority principles (namely, "Disclosure and Transparency", "Responsible Business Conduct of Financial Services Providers and Authorised Agents", and "Complaints Handling and Redress") was endorsed in the G20 Summit held in September 2013. The Task Force is now developing the effective approaches to support the implementation of the remaining 7 principles. The HKMA will continue to contribute to the work of the Task Force.
- The HKMA is of the view that consumer confidence and trust are the cornerstone for sustainable development of the banking sector, which in turn promotes banking stability. In order to build up consumer confidence and trust, banks should demonstrate to customers that they are treating customers fairly and taking into account customers' interests when they do business. Against this background, the HKMA worked with the industry to introduce a Treat Customers Fairly Charter, which seeks to cultivate a culture of treating customers fairly at all levels of the bank particularly at the senior management and board level. The Charter has drawn from good practices locally and overseas and from the G20 High-Level Principles on Financial Consumer Protection. It comprises five high-level principles about treating customers fairly. All of the 22 retail banks in Hong Kong have signed up to the Charter on 28 October 2013, pledging to support and implement the principles.



BANKING CUSTOMER EDUCATION

- More efforts to educate the public to be “smart and responsible” in the use of banking services:
 - First phase of the campaign covers:
 - safety in using e-banking services / ATMs
 - smart and responsible use of credit cards
 - understanding of bank fees and charges
 - Messages to be broadcast through radio, newspapers, travel magazines, roving exhibitions and other outreach activities
 - Working closely with Investor Education Centre on investment products / financial planning

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- We will launch a campaign to educate the public to be smart and responsible in the use of banking services. To maximise the benefits of our campaign, we have set up a taskforce with key stakeholders such as the Hong Kong Association of Banks, Consumer Council, Education Bureau, the Police and the Investor Education Centre (IEC). The main themes of the first phase of the campaign include: (i) safety in the use of e-banking services / ATMs; (ii) smart and responsible use of credit cards; and (iii) understanding of bank fees and charges.
- To begin with, radio broadcasting, print materials and roving exhibitions at shopping malls are our key initiatives to deliver our educational messages to the public. Also, a series of thematic advertorials will be published in newspapers and travel magazines to remind the general public of smart and responsible spending in the upcoming Christmas and Lunar New Year.
- On the youth side, we have partnered with the IEC to co-organize a territory-wide multi-media creative competition and a series of outreach workshops in tertiary institutions and youth centres in the academic year of 2013/14 to cultivate young adults with a proper attitude towards money management and financial planning. Public education seminars for senior secondary school students will also be held by us to promote responsible spending.
- The HKMA continues to provide full support and collaborate with the IEC in different projects for promoting financial literacy in Hong Kong.



DEPOSIT PROTECTION

- HKMA and Hong Kong Deposit Protection Board (HKDPB) have agreed to foster closer cooperation to enable faster payout as need arises
- Concluded the amendments to the information system guideline to tighten information submission requirements by banks

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- Under the agreed arrangements, the HKMA would notify the HKDPB in advance of a payout based on designated supervisory triggers and collect relevant information from the problem bank to facilitate assessment and preparation to enable a faster payout.
- The information system guideline and compliance review programme were revised in September 2013. The amendments will improve the comprehensiveness and quality of the information to be provided by banks for making prompt compensation payments to depositors.



FINANCIAL INFRASTRUCTURE



REFORMING OTC DERIVATIVES MARKET

G20 Commitments

- All standardised OTC derivative contracts should be traded on exchanges/electronic trading platforms and cleared through central counterparties
- OTC derivative contracts should be reported to trade repositories

Implementation

- **Regulation:**
 - Introduced the Securities and Futures (Amendment) Bill 2013 into the Legislative Council in July 2013 to implement the clearing and reporting requirements
 - Interim Reporting Requirements :
 - As an interim measure before the new legislation comes into effect, the HKMA issued a circular letter in end-June 2013 to require the reporting of specified OTC derivative transactions between licensed banks to the trade repository developed by the HKMA. The interim reporting requirements took effect from 5 August 2013
- **Central Counterparty:**
 - HKEx is building a local central counterparty for OTC derivatives, which is at the final approval stage and is expected to commence operation in Q4 2013
- **Trade Repository:**
 - The HKMA launched the trade repository (TR) for OTC derivatives as scheduled. The TR serves the dual functions of facilitating central clearing at the central counterparty (CCP) of the HKEx and supporting implementation of mandatory TR reporting in Hong Kong

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- Following the public consultation on the proposed regulatory regime for the OTC derivatives market in October 2011, the HKMA and SFC published the consultation conclusions to respond to the comments received from the consultation and issued a supplemental consultation paper on the proposed scope of new/expanded regulated activities and the oversight of systemically important participants in July 2012. In September 2013, the HKMA and SFC jointly published the supplemental consultation conclusions.
- The detailed requirements of the new regulatory regime will be set out in the subsidiary legislation in the form of rules. The HKMA and SFC aim to conduct a public consultation on the draft subsidiary legislation late 2013/early 2014.
- The Financial Stability Board has requested its member jurisdictions to provide confirmation by July 2013 that legislation and regulation have been in place to require reporting of OTC derivative transactions to trade repositories. In this connection, as an interim measure before the new legislation comes into effect, the HKMA issued a circular letter on 28 June 2013, which require the reporting of specified OTC derivative transactions (i.e. interest rate swaps and non-deliverable forwards) between licensed banks to the trade repository developed by the HKMA. The interim reporting requirements took effect from 5 August 2013, and certain transitional arrangements are in place to allow for a smooth transition.
- The local TR was launched in two stages – the first stage was launched in December 2012 to support central clearing; the second stage was launched in July 2013 to support mandatory reporting.



GOVERNMENT BOND PROGRAMME

Institutional Bond Issuance Programme:

- 15 issues totalling HK\$74.5 billion were issued
- A yield curve from two years to ten years is established to form the basis for other issuers to price their issues

Retail Bond Issuance Programme:

- Three iBonds totalling HK\$30 billion were issued
- The third issue of iBond was offered in June
- The number of applications set another record in the retail bond market

Expansion of the Government Bond Programme:

- Size of the Programme expanded from HK\$100 billion to HK\$200 billion following necessary approval from LegCo in May

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- The primary objective of the Government Bond Programme (GBP) is to promote the further and sustainable development of Hong Kong's bond market through systematic issuance of government bonds. It can also help promote financial stability by making our debt market an effective channel of financial intermediation, complementing the equity markets and the banking sector.
- The GBP is a long-term programme comprising an Institutional Bond Issuance Programme and a Retail Bond Issuance Programme.
- By enlarging the investor base, the GBP in the longer term is expected to improve liquidity and attract more issuers to raise funds via the bond market. This will help increase the breadth and depth of our bond market, thereby consolidating our role as an international financial centre.
- Subsequent to the two very successful issuances of iBonds in 2011 and 2012, the Financial Secretary (FS) announced in his 2013-14 Budget Speech that up to HK\$10 billion of a third iBond would be issued to Hong Kong residents to maintain the growth momentum. Subscription for the issue started on 4 June and ended on 13 June. Over 520,000 valid applications were received for around HK\$39.6 billion principal amount of bonds. The number of applications set new record in the local retail bond market. The final issue size was HK\$10 billion. The bond was issued on 24 June and listed on 25 June.
- The Financial Secretary announced in the 2013-14 Budget Speech that it is his intention to expand the size of the GBP from HK\$100 billion to HK\$200 billion in order to meet the sustained growth in demand. Necessary approval from the LegCo was obtained on 22 May.



PROMOTING ASSET MANAGEMENT BUSINESS

- Working closely with other Government agencies and the private sector to explore ways to strengthen the competitiveness of Hong Kong's asset management industry and reinforce Hong Kong's position as a leading asset management centre
- Stepping up marketing efforts to proactively promote Hong Kong's financial platform to overseas and Mainland asset owners and asset managers
- Building on the feedback from our regular dialogues with industry players, we continue to improve our platform and keep pace with the latest developments in the asset management industry

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- With the promising growth prospects of the Asian region, there has been increasing interest for overseas asset managers to expand into Asia. To capitalise on this trend and attract more asset managers into Hong Kong, the HKMA is working in conjunction with other Government agencies and market players to promote Hong Kong's asset management business, thereby reinforcing Hong Kong's role as a premier international financial centre.
- Since 2010, HKMA has held hundreds of meetings with financial institutions in Hong Kong and overseas to explain the opportunities and advantages presented by Hong Kong as an asset management centre.
- The outreach campaigns of the HKMA have generated positive results, with about one-third of the financial institutions met indicating a commitment to devote resources to Hong Kong, either by pursuing a Hong Kong presence if they are not yet in the city, or by expanding their existing operations in Hong Kong. Going forward, HKMA will continue to leverage on our unique role as a regulator and institutional investor to promote the development of Hong Kong's asset management business.
- On platform building, HKMA conducts reviews of legal, regulatory, tax and other issues to inform policy formulation concerning the development of Hong Kong's asset management industry. HKMA also provides necessary support to the Financial Services and the Treasury Bureau and other agencies in taking forward new initiatives announced by the Financial Secretary in the 2013-14 Budget, such as the proposed extension of profits tax exemption to offshore private equity funds.



CONTINUED DEVELOPMENT AS AN INTERNATIONAL ASSET MANAGEMENT CENTRE

- The combined fund management business in Hong Kong hit a record high of US\$ 1.6 trillion in 2012, a 39% increase over 2011
- Continued increase in the number of licensed corporations and licensed individuals for asset management
- Around 80 of the 100 largest global money managers have offices in Hong Kong
- In terms of private banking, fifteen private banks have opened for business since 2009, bringing the total to 45 banks offering wealth management services in Hong Kong today

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- According to the SFC survey, 65% of the combined fund management business in Hong Kong was sourced from non-Hong Kong investors in 2012, attesting to the fact that Hong Kong is still a preferred location for asset management business in the region.
- The number of licensed corporations for asset management has increased from 680 in 2008 to 914 in June 2013
- The number of licensed individuals for asset management has also increased from 4,893 in 2008 to 6,908 in June 2013
- Achieved leadership positions as an asset management centre in the region. Hong Kong is a leading hub for:
 1. Hong Kong is the second largest private equity hub in Asia with 375 private equity firms as of September 2013
 2. Hong Kong is Asia's second most active Exchange-Traded Funds (ETF) market with annual turnover US\$67.3 billion in 2012.
 3. Over 60% of Qualified Foreign Institutional Investor and Qualified Domestic Institutional Investor managers and all Renminbi Qualified Foreign Institutional Investor managers have a presence in Hong Kong.
 4. Hong Kong is also the largest hub for Asian hedge funds, with the number of funds increasing from 538 in 2010 to 676 as of 30 September 2012.



DEVELOPMENT OF ISLAMIC FINANCE

- The Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Ordinance 2013 was passed by LegCo and came into effect on 19 July 2013 to provide a comparable tax regime for common types of Islamic bonds vis-à-vis conventional bonds. This helps to create a conducive environment for the sukuk market to grow in Hong Kong
- Agreed with Bank Negara Malaysia to set up a private-sector led joint forum with a view to opening up new business opportunities in Islamic finance in both Hong Kong and Malaysia. The first meeting of the joint forum is scheduled to be held in Hong Kong later this year
- Organised a series of Islamic finance seminars and panel discussions over the past few months to promote awareness of Islamic finance among Hong Kong market players



FINANCIAL INFRASTRUCTURE

- Continue to maintain safety and efficiency of financial infrastructure
- Launched the trade repository for over-the-counter derivatives trades to enhance market surveillance and transparency, and bring Hong Kong in line with international standards

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Operation of financial infrastructure

- The HKD, USD, EUR and RMB Real Time Gross Settlement (RTGS) systems and the Central Moneymarkets Unit (CMU) have been operating smoothly.

Trade Repository

- Launched the matching and confirmation function in December 2012 to facilitate local central clearing of OTC derivatives transactions. Launched the reporting function of the TR in July 2013 to support the implementation of the interim reporting requirements in August 2013



RETAIL PAYMENT INITIATIVES

Electronic Bill Presentment and Payment (EBPP) service

- Starting from December 2013, the general public can subscribe and benefit from a one-stop EBPP service gradually launched by 23 participating banks
- The scope of services include Business-to-Person (B-2-P) and Business to Business (B-2-B) e-billing and e-payments, cross-border e-billing and e-payments, and e-donation and presentment of e-receipt. It will also handle multi-currency e-bills and e-payments such as HKD, RMB and USD.
- Publicity campaigns will commence at the end of this year

NFC mobile payment service

- A task force established by the HKMA and HKAB will promulgate a set of standards and guidelines by the end of November 2013 for banks to follow
- A shared infrastructure to support multiple banks will be ready by the end of 2013

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Electronic Bill Presentment and Payment (EBPP) service

- Since the HKMA announced the roadmap of enhancing the retail payment infrastructure and instruments in September 2012, we have made encouraging progress in the implementation of various retail payment initiatives with the support of the banking sector.
- Among others, the Electronic Bill Presentment and Payment (EBPP) service will be launched in December 2013. As of today, 23 banks including almost all retail banks have confirmed to offer the service in the end of this year or next year for their customers to benefit from the convenience of the service.
- The EBPP service offers a variety of multi-dimensional and multi-currency services. These include Business-to-Person (B-2-P) and Business-to-Business (B-2-B) e-billing and e-payment, cross-border e-billing and e-payment, and e-donation and presentment of e-receipt. It will also handle multi-currency e-bills and e-payments such as HKD, RMB and USD.
- To increase the awareness and deepen the understanding of the public on the EBPP service, the HKMA and the banking sector will launch a series of publicity campaigns starting from the end of this year. These include the production of electronic leaflets and brochures and organisation of launching ceremony, etc.

NFC mobile payment service

- A task force established by the HKMA and HKAB will promulgate a set of standards and guidelines by the end of November 2013 for banks to follow.
- The standards and guidelines will cover three aspects, including interoperability requirements between devices and systems, operation guidelines of NFC mobile payment services, and security requirements.
- The HKMA supports a market-driven approach for shared infrastructure development as it suits the Hong Kong market. A shared infrastructure, developed by certain card associations, will be ready by the end of 2013 to support multiple banks.
- We expect that different types of services will be launched in the market.



LEGISLATIVE FRAMEWORK FOR STORED VALUE FACILITIES AND RETAIL PAYMENT

- Formal industry consultation completed in end-Jan 2013. Market participants generally support the proposed regulatory regime
- FSTB and HKMA jointly conducted a 3-months public consultation on the regulatory proposals in 22 May - 22 Aug 2013
- Received a total of 41 submissions. Comments received are generally supportive. Policy adjustments being considered taking into account comments received where appropriate
- Commenced preparatory work for the drafting of the Bill. Targeting to introduce to LegCo in second half of 2014

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- The proposed legislation seeks to empower HKMA to exercise supervisory and enforcement functions on stored-value facilities (SVF) and oversight function on designated retail payment systems (RPS), with a view to ensuring adequate consumer protection, safety and soundness of such facilities and systems in Hong Kong.
- Taking into account initial comments received from the soft consultation, HKMA completed a formal industry consultation with over 30 industry participants in end-Jan 2013. Feedbacks received indicated that there are general supports among market players to the regulatory proposals.
- Comments received from public consultation are generally supportive to the regulatory proposals. We are analysing the comments and considering appropriate policy adjustments if necessary taking into account comments received.



HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

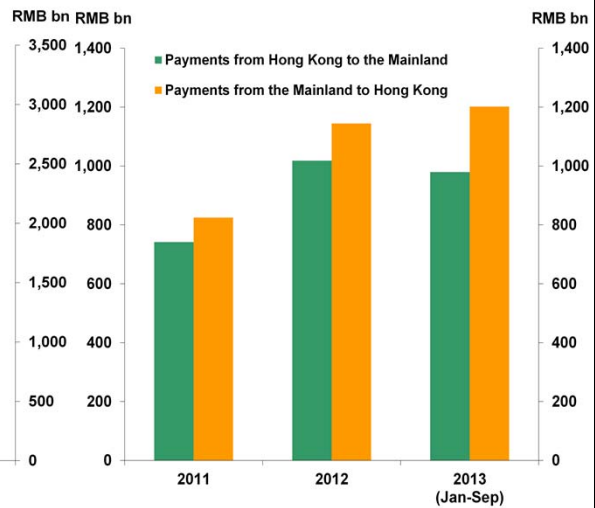


CONTINUED GROWTH IN RMB TRADE SETTLEMENT

RMB trade settlement handled by banks in Hong Kong



Flows of RMB trade settlement between Hong Kong and the Mainland

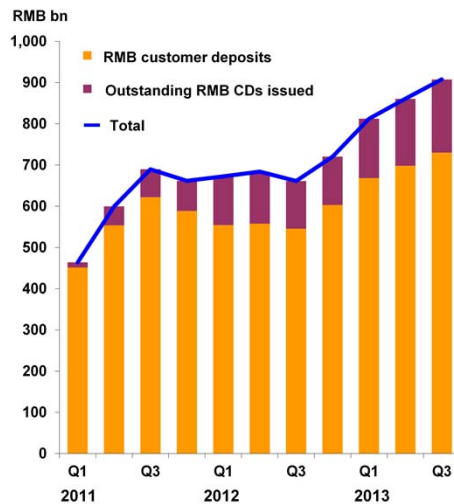


- In the first nine months of 2013, RMB trade settlement handled by banks in Hong Kong amounted to RMB2,616.6 billion, a 36% growth compared with the same period of last year. The ratio of payment flows to and from the Mainland was around 1:1.2 during the said period.

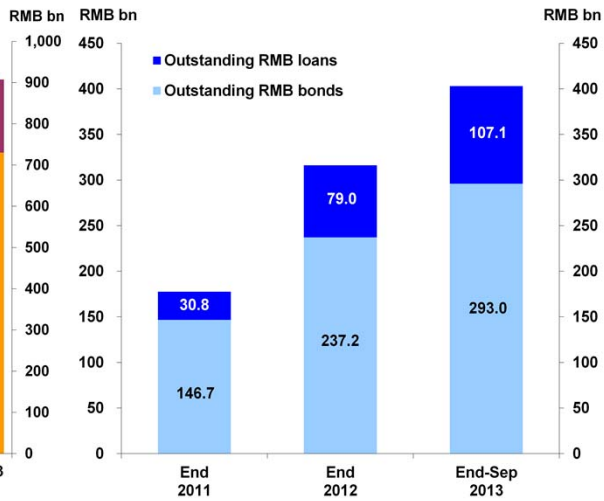


RMB FINANCING ACTIVITIES REMAINING VIBRANT

RMB customer deposits and certificates of deposit (CDs)



RMB financing activities



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- At end September 2013, RMB customer deposits and outstanding RMB certificates of deposits amounted to RMB730.0 billion and RMB177.6 billion respectively, totaling RMB907.6 billion, a 26% growth from RMB720.2 billion at the end of 2012.
- Meanwhile, over 77,000 accounts were opened by non-resident personal customers, with deposits exceeding RMB13 billion.
- The RMB dim sum bond market continued to develop. Notwithstanding a slowdown in July and August due to global market adjustments, dim sum bond issuance started to regain momentum in September. In the first nine months of 2013, dim sum bond issuance amounted to RMB75.4 billion. Outstanding dim sum bonds at end September amounted to RMB293 billion. RMB lending grew further, with outstanding amount of RMB loans increasing to RMB107.1 billion at end September 2013, a 36% growth from the end of last year.



CONTINUED DEVELOPMENT OF HONG KONG'S ROLE IN SUPPORTING OFFSHORE RMB BUSINESS OVERSEAS

	Sep 2013	2012	2011
1 No. of participating banks of Hong Kong's RMB clearing platform	211	204	187
Of which:			
Branches and subsidiaries of overseas banks and overseas presence of Mainland banks	186	181	165
2 Amount due to overseas banks (RMB billion)	144.1	99.1	116.4
3 Amount due from overseas banks (RMB billion)	151.1	117.1	121.7
4 Turnover in Hong Kong's RMB RTGS system (Daily average during the period; RMB billion)	411.0	213.7	121.4

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- The HKMA and UK Treasury jointly facilitated the third meeting of the Hong Kong-London RMB Forum in Hong Kong on 26 September 2013. Representatives of banks participating in the Forum agreed to further enhance the breadth and depth of the offshore RMB market while actively seeking to provide services in response to the opening of more channels for cross-border flows with Mainland China. They also engaged in detailed discussions on future work to enhance RMB trade settlement and banking services, financing and investment, and interbank activities.
- Separately, the Forum also organised a seminar targeting corporates and non-bank financial institutions to enhance their awareness of RMB business opportunities.



INCREASING REGIONAL AND INTERNATIONAL FINANCIAL CO-OPERATION

Financial Stability Board (FSB)

- HKMA attended the FSB Plenary Meeting on 24 June 2013 and two other conference calls. Members discussed vulnerabilities affecting the global financial system and progress in various financial regulatory reform areas, including ending the “too-big-to-fail” problem, OTC derivatives market reforms, and strengthening oversight and regulation of shadow banking

Executives' Meeting of East Asia-Pacific Central Banks (EMEAP)

- HKMA chaired the EMEAP Monetary and Financial Stability Committee (MFSC) Meeting on 28 October 2013. The Committee reviewed recent economic and financial developments in the region and their policy implications. It also discussed the impact of implementation of global financial regulatory reforms for Asian markets

Bilateral Meeting with Bank Negara Malaysia (BNM)

- HKMA and BNM held a bilateral meeting on 28 August 2013. Both sides agreed to strengthen their co-operation in promoting financial market developments including in the areas of offshore renminbi business and the internationalisation of Islamic finance



INVESTMENT ENVIRONMENT AND PERFORMANCE OF THE EXCHANGE FUND



INVESTMENT ENVIRONMENT IN Q1 – Q3 2013

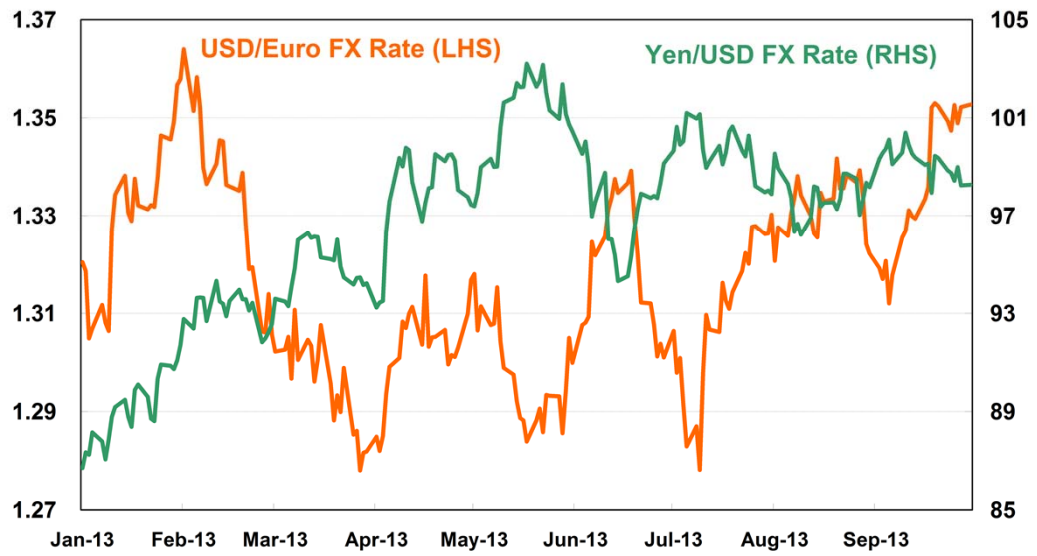
- **Exchange rates:** The euro strengthened against the dollar in Q2 – Q3, erasing most of the losses in Q1, as markets regained confidence in the Euro as a result of the recovering economy and receding debt crisis. The yen continued to weaken against the dollar, on the back of Abe's aggressive monetary easing policy introduced in April
- **Equity markets:** Major stock markets continued to post gains, as supported by the risk-favouring sentiment, abundance of liquidity and improving economic fundamentals. Emerging market equities however lagged behind the performance of developed market equities, due to heightened concern of massive capital outflow
- **Interest rates:** US Treasury yields rallied, with 10-year yield rising from the period low of 1.61% to as high as 3%, on concern of the Fed's QE tapering. Other major government bond yields, except for JGB yields, rose in tandem



CURRENCY MARKETS

USD/Euro FX Rate

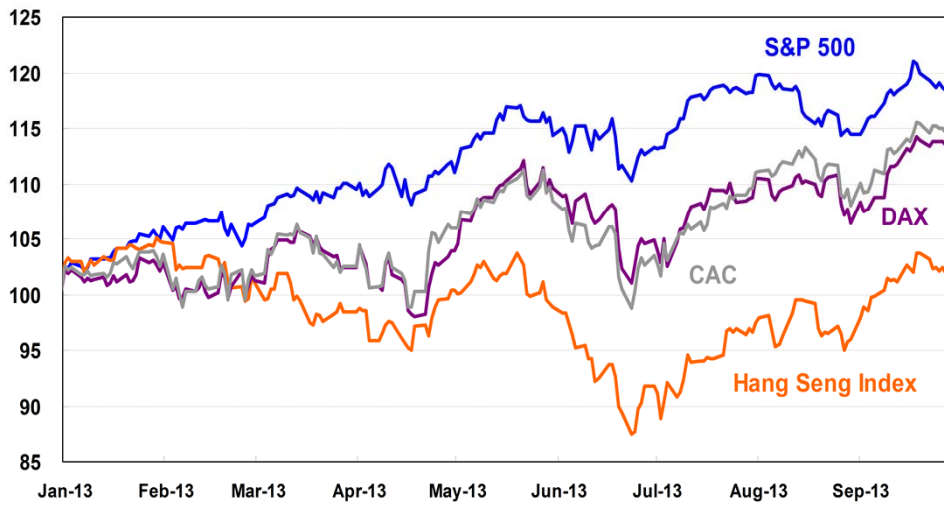
Yen/USD FX Rate





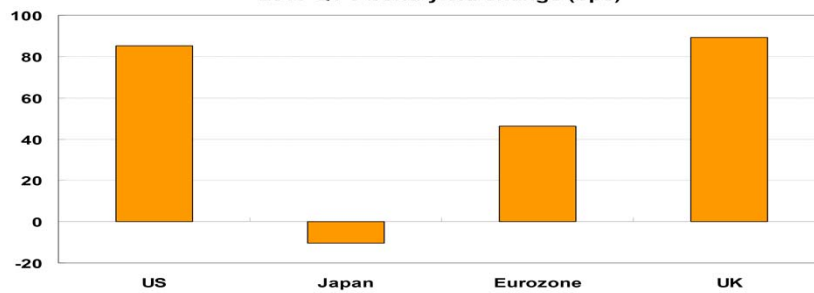
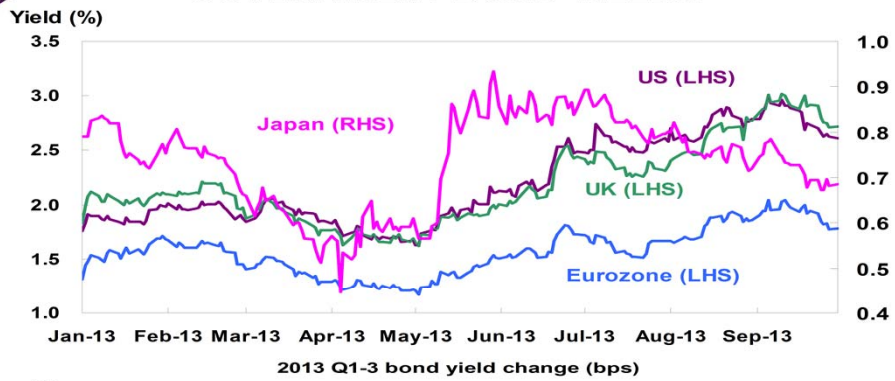
EQUITY MARKETS

Normalized Index Level (2012 year-end = 100)





CHANGES IN 10-YEAR GOVERNMENT BOND YIELDS





INVESTMENT INCOME

	← 2013 →		2012	2011	2010
(HK\$ billion)	Jan - Sep*	Q3*	Full Year	Full Year	Full Year
Hong Kong equities^{^@}	6.2	13.7	30.7	(24.2)	11.6
Other equities[^]	49.0	17.9	42.8	(12.2)	27.1
Bonds[#]	(15.0)	1.8	33.1	71.9	42.1
Other investments^{&}	4.8	-	6.4	0.7	1.7
Foreign exchange	<u>(0.1)</u>	<u>15.6</u>	<u>(1.4)</u>	<u>(9.1)</u>	<u>(3.1)</u>
Investment income^{@&}	44.9	49.0	111.6	27.1	79.4

* Unaudited figures

[^] Including dividends

[#] Including interest

[@] Excluding valuation changes in Strategic Portfolio

[&] Including valuation changes of investment held by EF's investment holding subsidiaries

(Valuation of EF's investment holding subsidiaries is undertaken predominantly on a quarterly basis.

The above figures reflect the latest available valuations.)



CHANGE IN INVESTMENT INCOME, PAYMENT TO FISCAL RESERVES AND ACCUMULATED SURPLUS

(HK\$ billion)	2013				2012
	Jan – Sep*	Q3*	Q2	Q1	Full year
Investment income/(loss)	44.9	49.0	(23.2)	19.1	111.6
Other income	0.2	0.1	0.1	-	0.2
Interest and other expenses	<u>(3.7)</u>	<u>(1.3)</u>	<u>(1.5)</u>	<u>(0.9)</u>	<u>(4.4)</u>
Net income/(loss)	41.4	47.8	(24.6)	18.2	107.4
Payment to Fiscal Reserves#	(27.8)	(9.0)	(9.5)	(9.3)	(37.8)
Payment to HKSAR government funds and statutory bodies#	(6.7)	(2.5)	(2.1)	(2.1)	(8.0)
Valuation change of Strategic Portfolio less valuation change of investment held by EF's investment holding subsidiaries^	<u>(5.1)</u>	<u>0.6</u>	<u>(3.1)</u>	<u>(2.6)</u>	<u>(5.6)</u>
Increase/(Decrease) in EF Accumulated Surplus	1.8	36.9	(39.3)	4.2	56.0

* Unaudited figures

The fixed rate of fee payment for 2013 and 2012 are 5.0% and 5.6% respectively

^ Including dividends



HISTORICAL INVESTMENT INCOME

(HK\$ billion)

Year	Full Year	Q4	Q3	Q2	Q1
2001	7.4	13.6	10.4	(2.0)	(14.6)
2002	47.0	26.3	(2.1)	26.5	(3.7)
2003	89.7	33.5	8.4	41.1	6.7
2004	56.7	33.0	14.1	(7.2)	16.8
2005	37.8	7.3	19.0	13.6	(2.1)
2006	103.8	36.0	37.1	12.5	18.2
2007*	142.2	33.4	61.8	26.3	20.7
2008*	(75.0)	8.3	(48.3)	(20.4)	(14.6)
2009*&	107.7	10.6	71.9	58.7	(33.5)
2010*&	79.4	5.9	74.5	(12.1)	11.1
2011*&	27.1	22.1	(41.4)	21.6	24.8
2012*&	111.6	30.3	42.4	(5.6)	44.5
2013* ^{&#}	N/A	N/A	49.0	(23.2)	19.1

* Excluding valuation changes in the Strategic Portfolio

& Including valuation changes of investment held by EF's investment holding subsidiaries (Valuation of EF's investment holding subsidiaries is undertaken predominantly on a quarterly basis. The above figures reflect the latest available valuations.)

Unaudited figures

N/A: Not Applicable



EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)	At 30 Sep 2013*	At 31 Dec 2012	At 31 Dec 2011
ASSETS			
Deposits	294.1	188.3	221.7
Debt securities	2,027.6	2,048.5	1,844.4
Hong Kong equities ⁽¹⁾	149.1	148.0	120.6
Other equities	334.2	283.3	238.2
Other assets ⁽²⁾	<u>129.8</u>	<u>113.0</u>	<u>63.1</u>
Total assets	<u>2,934.8</u> =====	<u>2,781.1</u> =====	<u>2,488.0</u> =====
LIABILITIES AND FUND EQUITY			
Certificates of Indebtedness	317.3	289.8	258.7
Government-issued currency notes & coins in circulation	10.4	9.9	9.9
Balance of the banking system	164.1	255.9	148.7
Exchange Fund Bills and Notes issued	792.1	688.5	655.8
Placements by banks and other financial institutions	65.2	-	24.5
Placements by Fiscal Reserves	684.2	717.5	663.5
Placements by HKSAR government funds and statutory bodies	201.8	167.9	126.2
Other liabilities	<u>74.0</u>	<u>27.7</u>	<u>32.8</u>
Total liabilities	<u>2,309.1</u>	<u>2,157.2</u>	<u>1,920.1</u>
Accumulated Surplus	<u>625.7</u>	<u>623.9</u>	<u>567.9</u>
Total liabilities and fund equity	<u>2,934.8</u> =====	<u>2,781.1</u> =====	<u>2,488.0</u> =====

• Unaudited figures

⁽¹⁾ Hong Kong equities include shares of Hong Kong Exchanges and Clearing Limited in the Strategic Portfolio

⁽²⁾ Including investment in EF's investment holding subsidiaries amounted to HK\$62.2 billion at 30 Sep 2013 (HK\$53.6 billion at 31 Dec 2012 and HK\$31.1 billion at 31 Dec 2011)



HONG KONG MORTGAGE CORPORATION



Reverse Mortgage Programme

- By end-Sep 2013, 472 applications have been received:
 - Average age of borrowers: 69 years old
 - Average monthly payout: HK\$13,600
 - Payment terms: 10-year (33%), 15-year (17%), 20-year (13%), life (37%)
 - Average property value: HK\$4.3 million
 - Average property age: 30 years

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3 enhancements were launched in November 2012:

- Lowering the minimum age of borrowers from 60 to 55.
- Increasing the maximum specified property value for payout calculation from HK\$8 million to HK\$15 million.
- Increasing the maximum lump-sum payout amount.

Market response to the 3 enhancements:

In November 2012, 3 enhancements were launched. As of September 2013:

- About 24% of the new applications are aged below 60.
- Separately, over 28% of the new applications are with lump-sum payouts, compared with 14% in the pre-enhancement period.
- There are 37 cases with appraised property valued over HK\$8 million, of which 24 applications received after the enhancements.



SME Financing Guarantee Scheme

- The Financial Secretary announced in the 2013-14 Budget Speech the extension of application period of the 80% loan guarantee product for one year up to 28 February 2014
- The 80% loan guarantee product has been well received by the market. As at end-September 2013:
 - More than 7,600 applications were approved, involving total loan amount of HK\$32.7 billion
 - General characteristics of the approved applications are as follows:

Average Guarantee period	4.8 years	Average Loan size	HK\$4.3 million
Manufacturing and Non-manufacturing industries	27% and 73% (45% was from trading industry)	Loan interest rate and Guarantee fee rate	4.7% p.a. 0.5% p.a.
Enterprises with less than 50 employees	91%	Benefitted enterprises and the related employees	More than 5,300 enterprises and 140,000 employees

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- Industry types of approved applications for 80% loan guarantee products:

Manufacturing	# of appl'ns	%
Textiles and clothing	431	5.6
Electronics	198	2.6
Plastics	156	2
Printing and publishing	145	1.9
Metal products	128	1.7
Jewellery, watch and clocks	121	1.6
Toy	119	1.6
Bag / garment accessories	99	1.3
Others	698	9
TOTAL	2,095	27

Non-manufacturing	# of appl'ns	%
Trading	3,438	45
Wholesale and retail	642	8.4
Construction	188	2.4
Engineering	183	2.4
Transportation / logistics	180	2.3
Professional services	91	1.2
Catering services	90	1.2
Interior design / decoration	61	0.8
Others	684	9
TOTAL	5,557	73

- Enhancement in March 2013:** In response to the feedback from the market participants to better meet the financing needs of SMEs, the 80% guarantee product was enhanced in March 2013, the HKMC may exercise its sole and absolute discretion to determine whether an eligible enterprise can be considered separately from its Related Entities when assessing whether the Maximum Facility Amount of HK\$12 million has been exceeded. When exercising its discretion, the HKMC considers the business nature of the eligible enterprise and its Related Entities.



Microfinance Scheme

- Launched in June 2012 for a trial period of 3 years with a tentative aggregate loan amount of HK\$100 million
- 6 banks and 5 non-governmental organisations have joined
- As at end-Sep 2013, the Scheme received 160 formal loan applications. Out of the vetted applications, 89 have been approved with the total loan amount of HK\$23.85 million. The approval rate is around 65%.
- For the approved applications, the average loan size was about HK\$268,000 and the average loan tenor was close to 4.5 years

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1) Industry type for the approved cases

- Servicing 42 cases (47%)
- Retailing 29 cases (33%)
- Wholesales 12 cases (13%)
- IT related 3 cases (3%)
- Manufacturing 2 cases (2%)
- Others 1 case (1%)

* Component percentages in the table above may not add up to 100% due to rounding.