



HONG KONG MONETARY AUTHORITY

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

4 May 2015



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

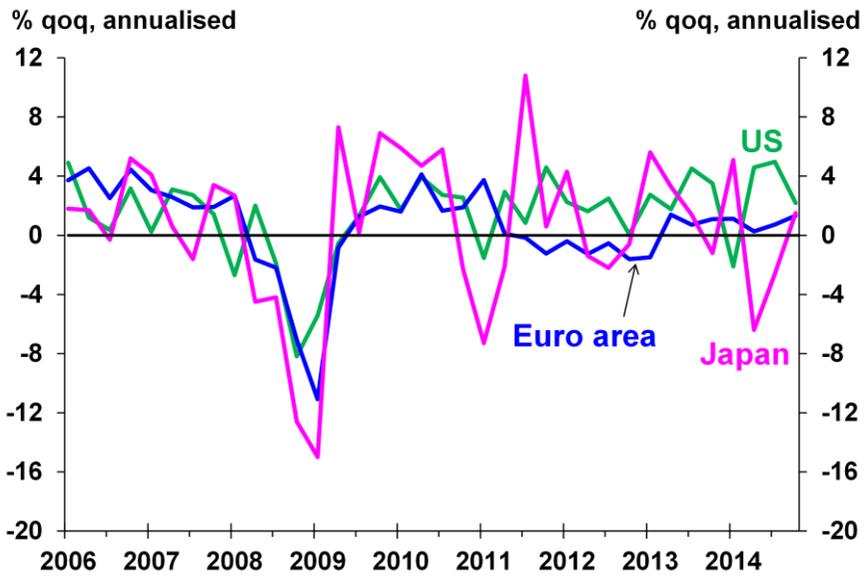
(% year-on-year)

	2014	2015 Forecasts	2016 Forecasts
US	2.4	2.9	2.8
Euro area	0.9	1.5	1.8
Japan	-0.03	1.0	1.7
Asia (ex-Japan)	6.2	6.1	6.1
Mainland China	7.4	6.9	6.8
Hong Kong	2.3	2.5	2.7

Sources: April Consensus Forecasts and Official Statistics



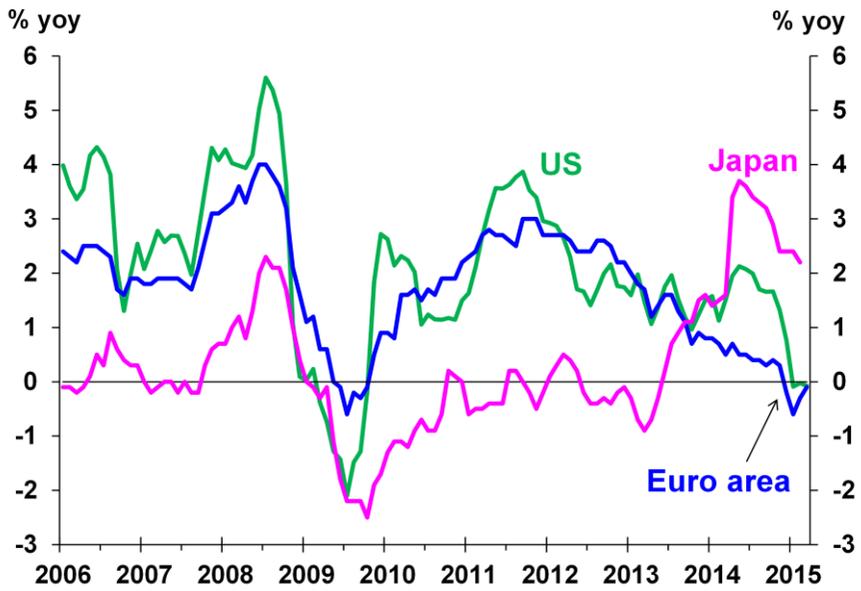
REAL GDP GROWTH IN MAJOR COUNTRIES



Source: Bloomberg



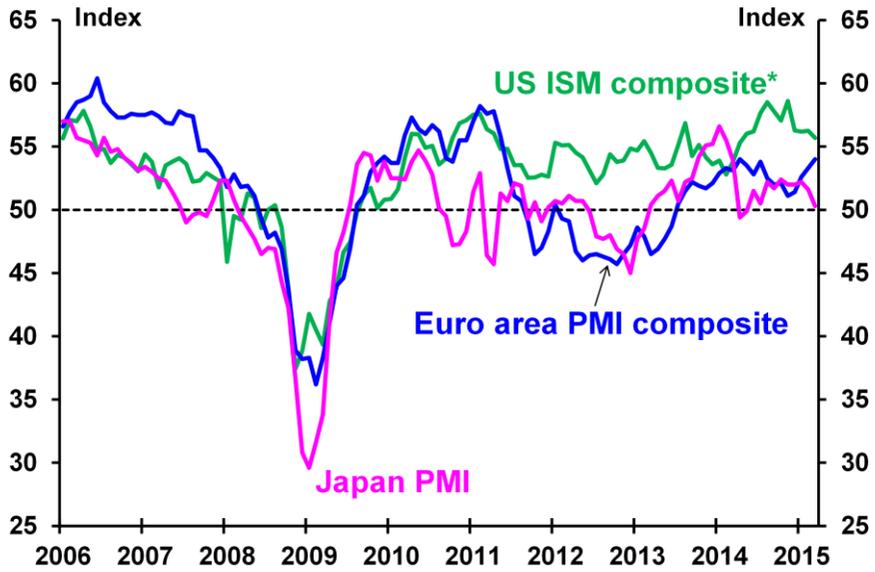
HEADLINE INFLATION IN MAJOR COUNTRIES



Sources: Bloomberg and CEIC



PURCHASING MANAGERS' INDEX IN MAJOR ECONOMIES

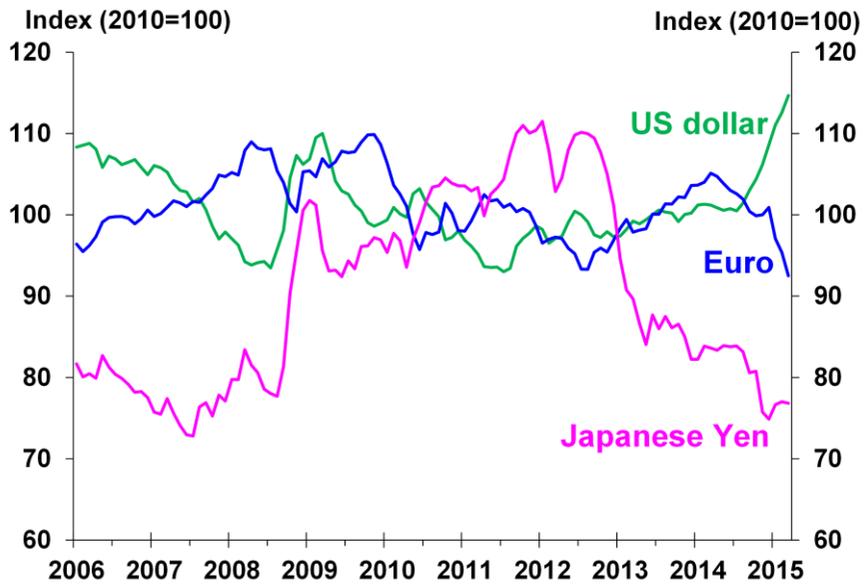


*Weighted average of the ISM manufacturing and non-manufacturing indices

Sources: Bloomberg and CEIC



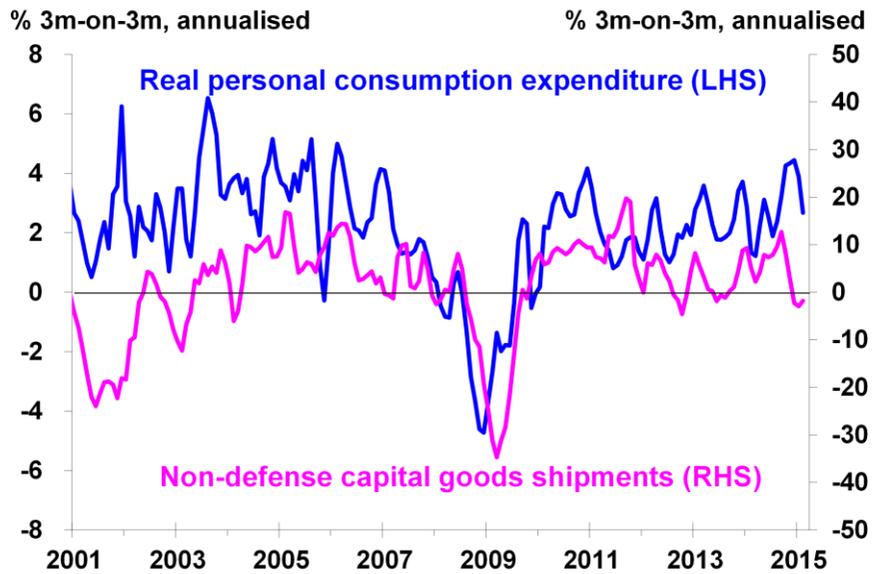
NOMINAL EFFECTIVE EXCHANGE RATE INDEX OF MAJOR CURRENCIES



Source: CEIC



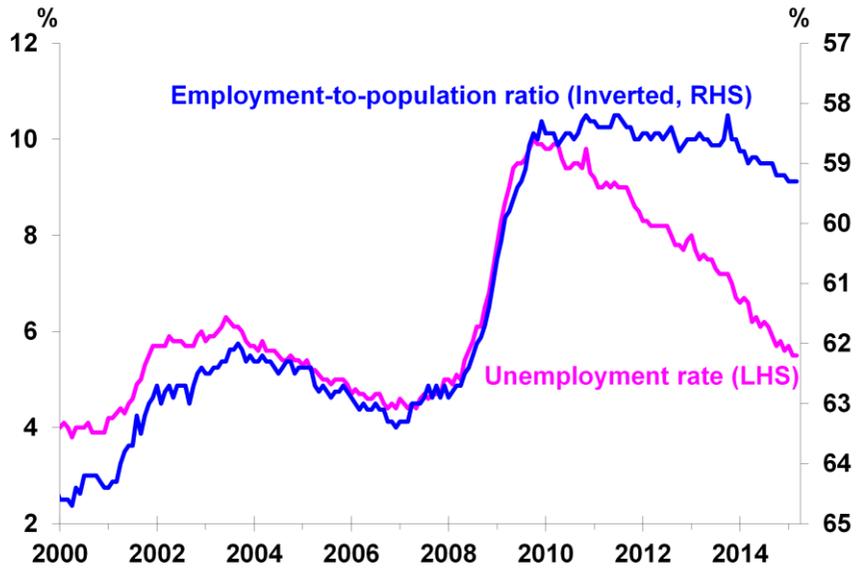
US: CONSUMPTION GROWTH & BUSINESS INVESTMENT ACTIVITY



Source: CEIC



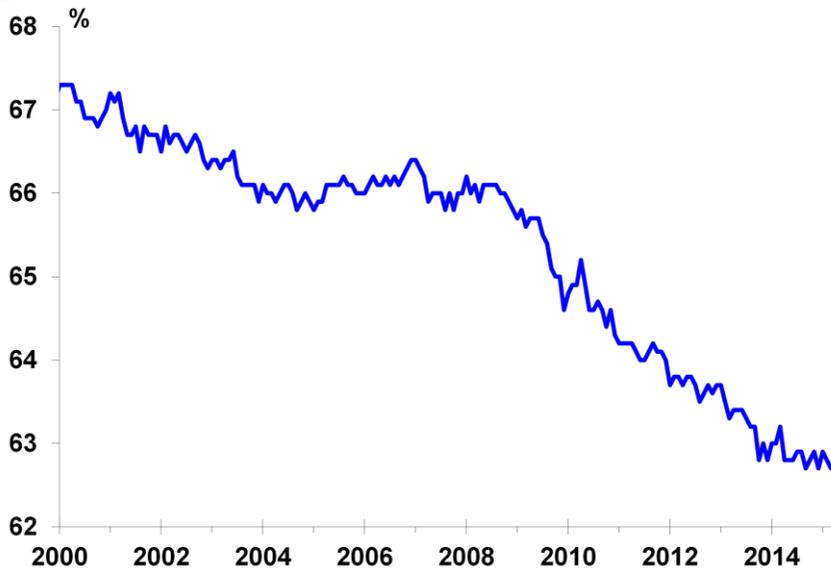
US: LABOUR MARKET SITUATION



Source: CEIC



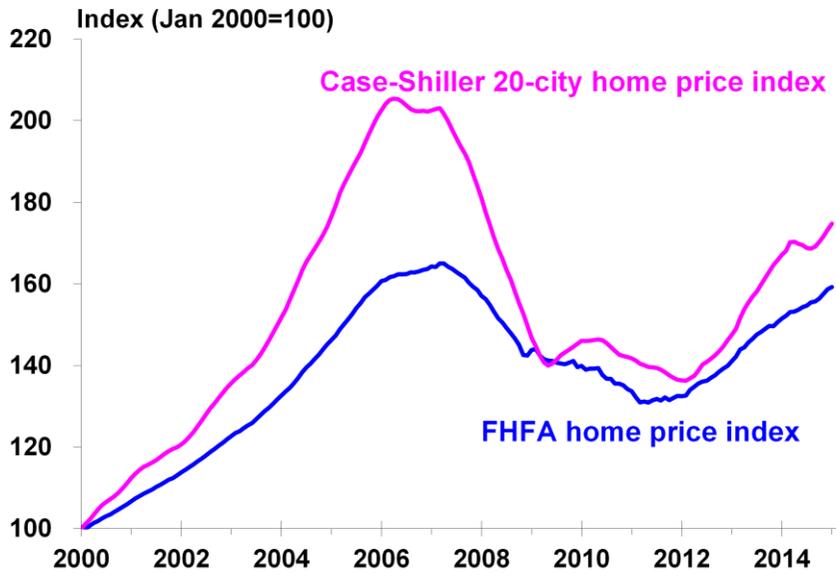
US: LABOUR FORCE PARTICIPATION



Source: CEIC



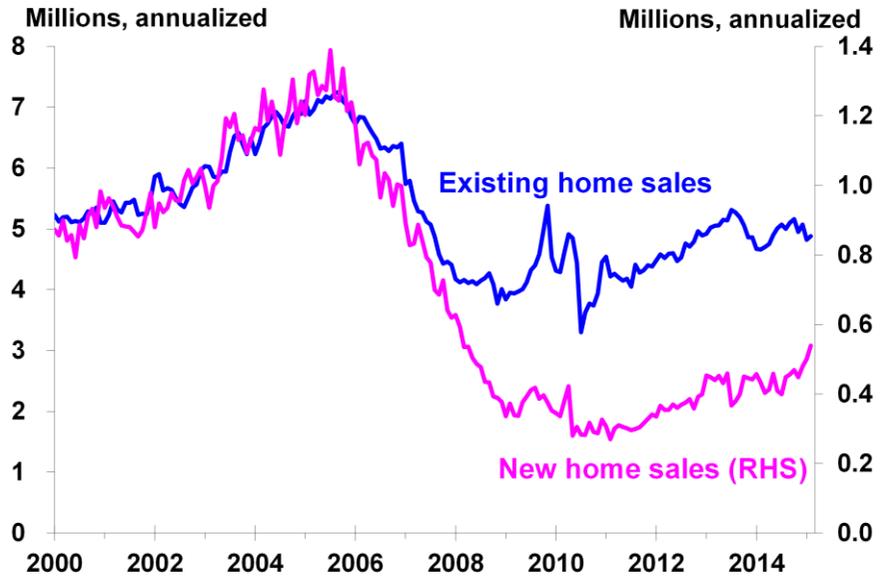
US: HOUSE PRICES



Sources: Standard & Poor's and CEIC



US: HOME SALES

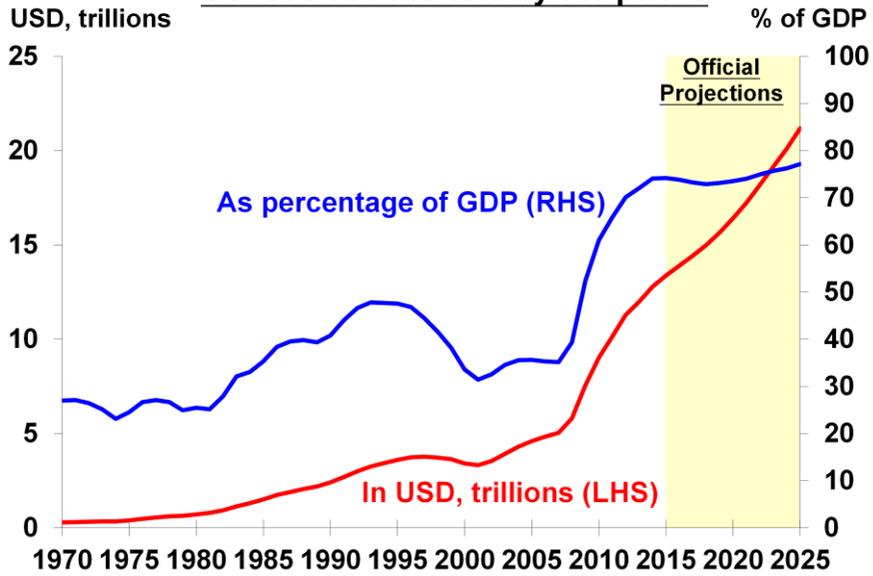


Source: CEIC



US: FEDERAL GOVERNMENT DEBT

US federal debt held by the public

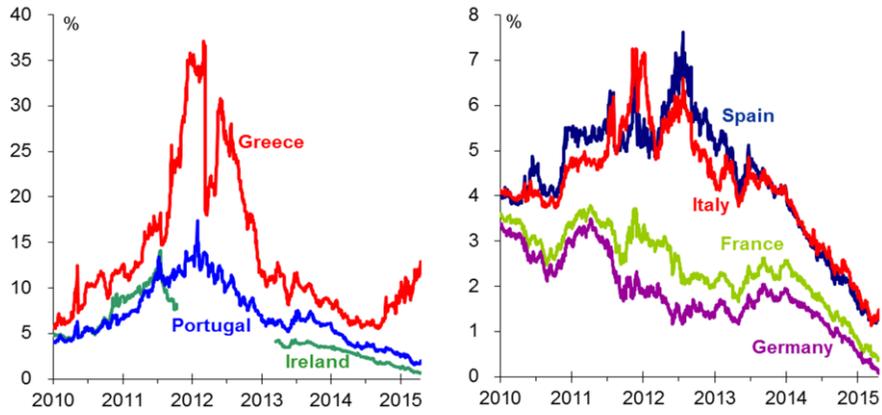


Source: Congressional Budget Office



EURO AREA: SOVEREIGN BOND YIELDS

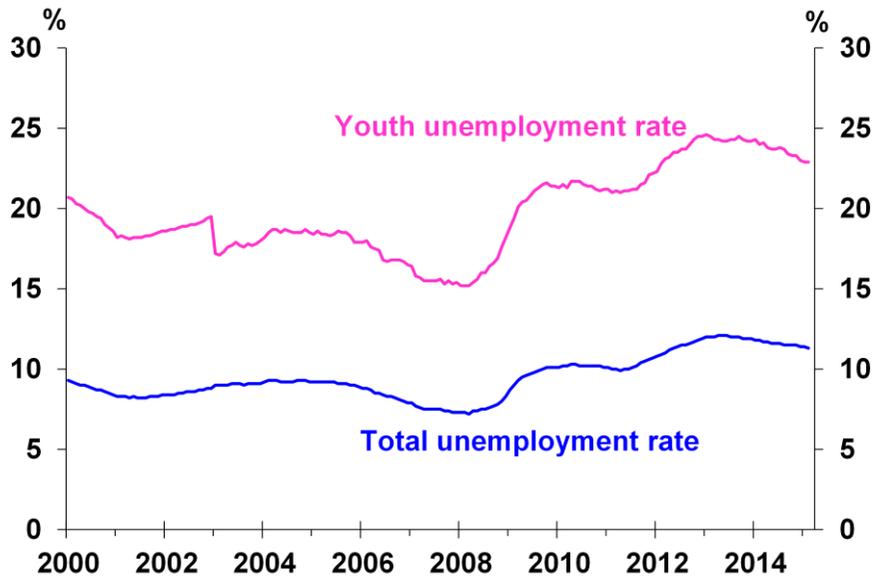
10-year sovereign bond yield



Note: 10-year Irish sovereign bond yield data is not available between 12 Oct 2011 and 14 Mar 2013
Source: Bloomberg



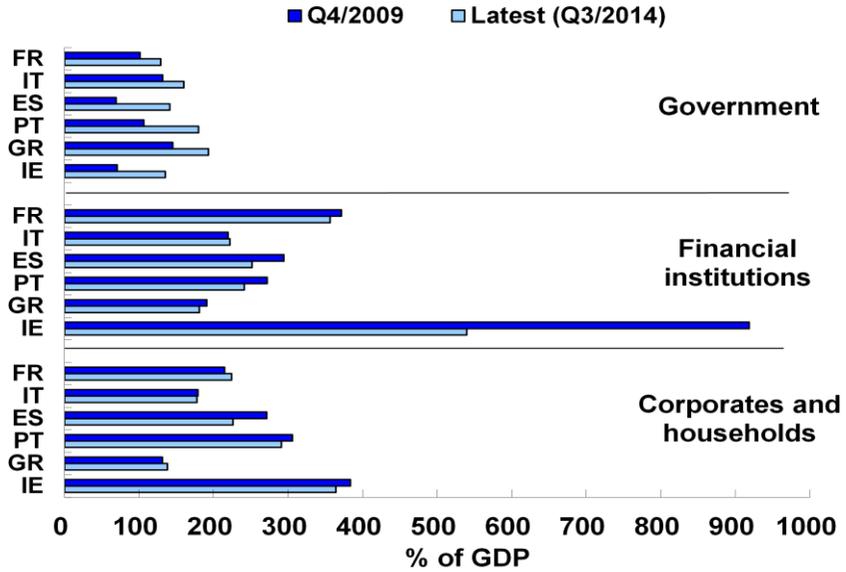
EURO AREA: UNEMPLOYMENT RATE



Source: Bloomberg



EURO AREA: OVERALL INDEBTEDNESS

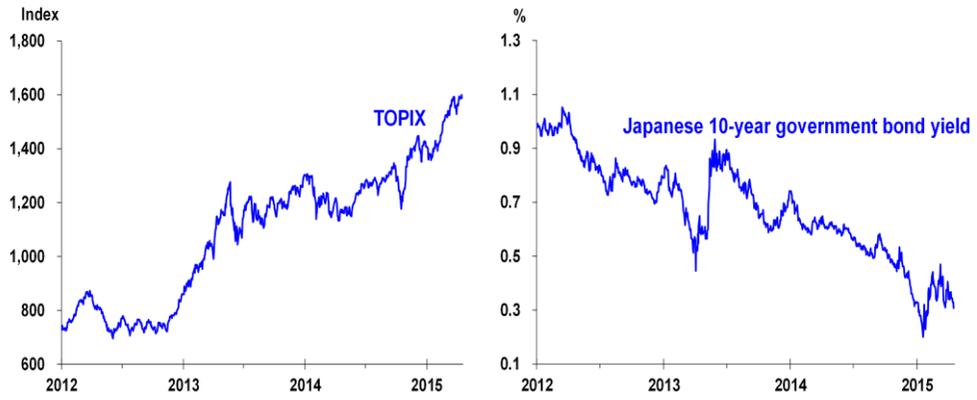


Source: European Central Bank

Note: FR – France, IT – Italy, ES – Spain, PT – Portugal, GR – Greece, IE – Ireland



JAPAN: FINANCIAL MARKETS

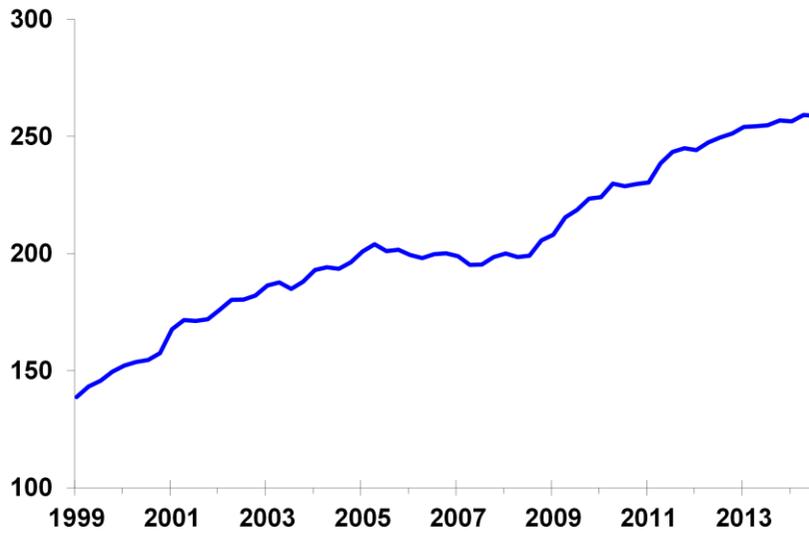


Source: Bloomberg



JAPAN: PUBLIC DEBT

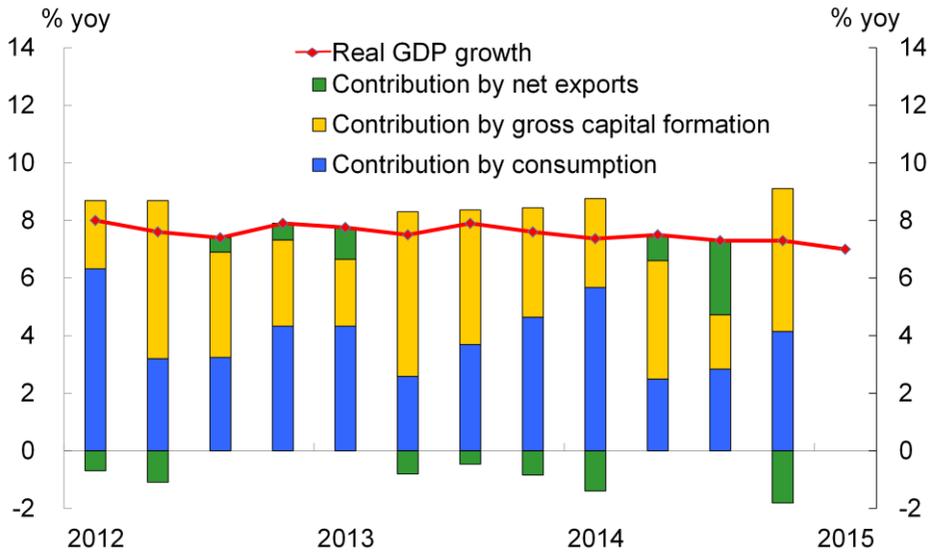
% of GDP



Sources: Bank of Japan and CEIC



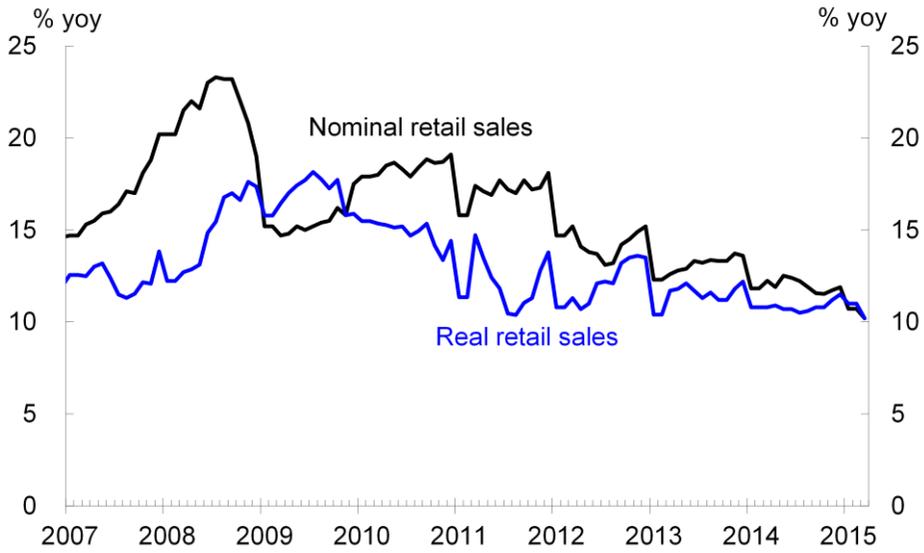
MAINLAND CHINA: REAL GDP GROWTH



Source: CEIC



MAINLAND CHINA: RETAIL SALES

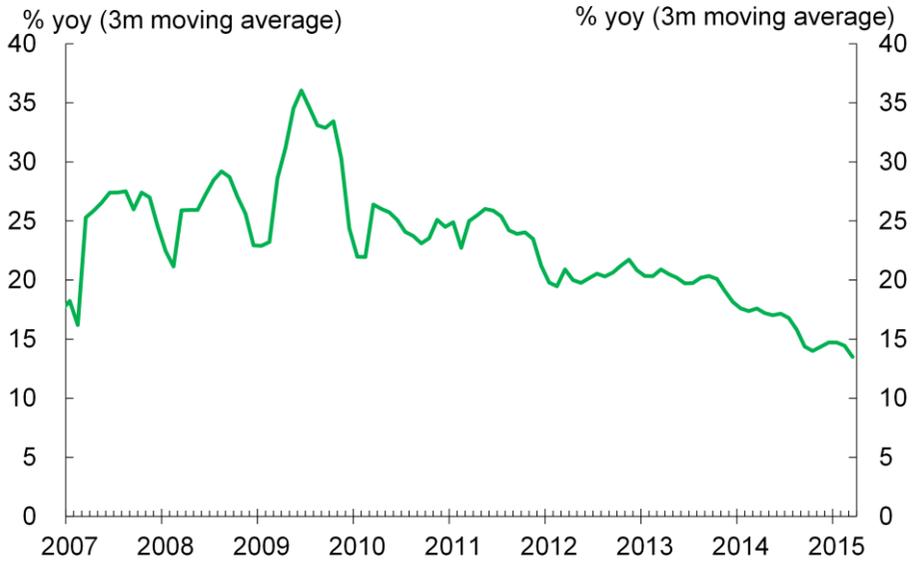


* January and February figures are the average growth rate for the first two months of the year.

Sources: WIND and HKMA staff estimates



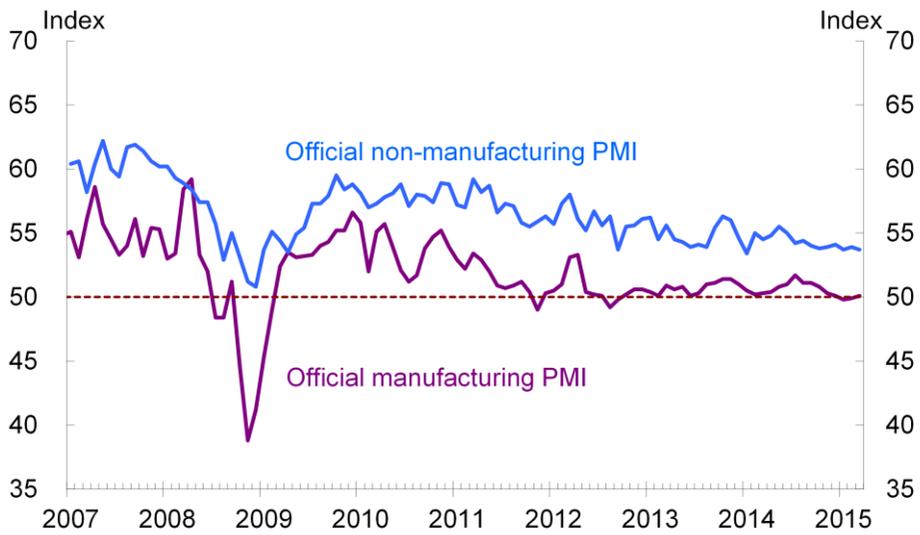
MAINLAND CHINA: FIXED ASSET INVESTMENT



Sources: CEIC and HKMA staff estimates



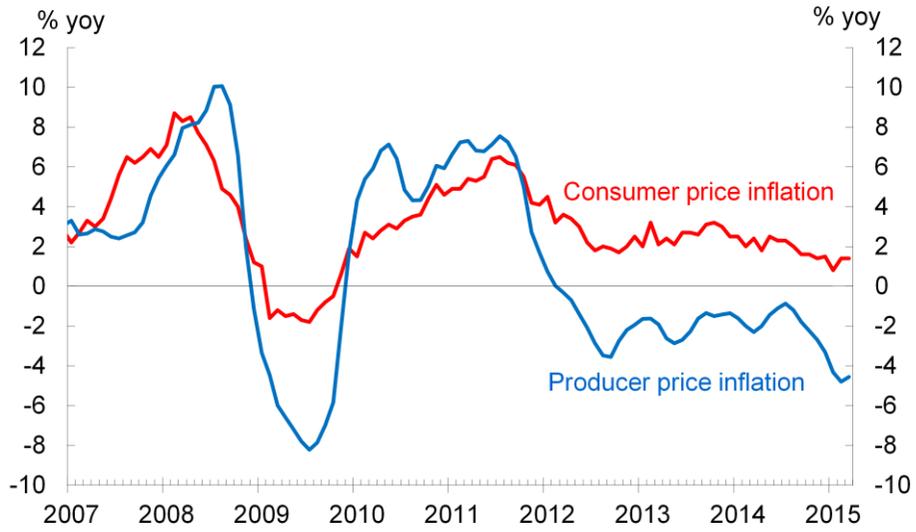
MAINLAND CHINA: PURCHASING MANAGERS' INDEX



Source: CEIC



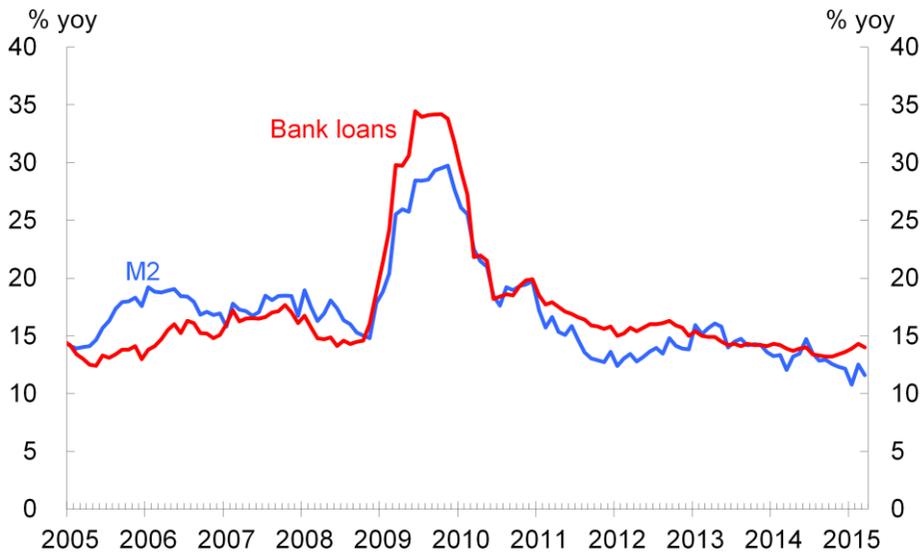
MAINLAND CHINA: INFLATION



Source: CEIC



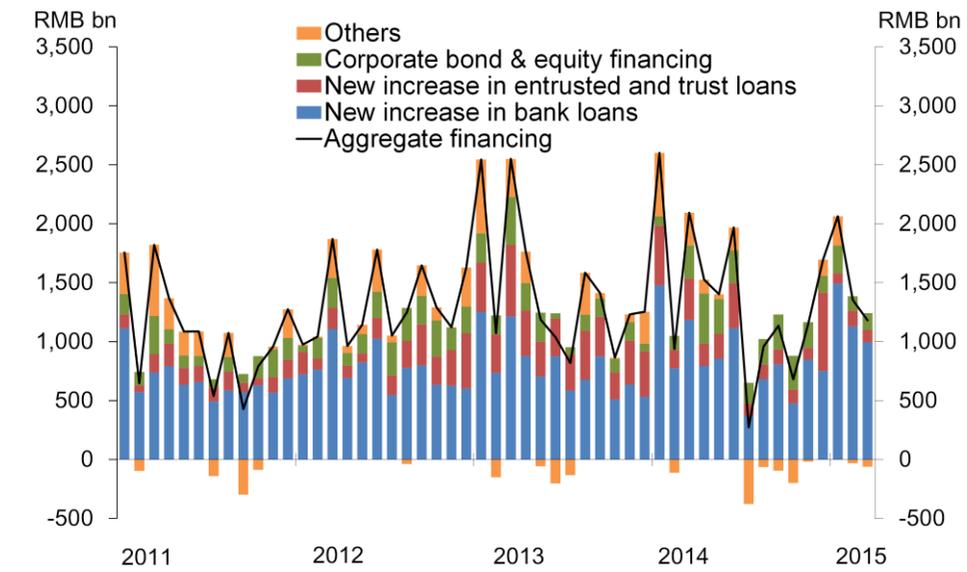
MAINLAND CHINA: MONEY AND LOAN GROWTH



Source: CEIC



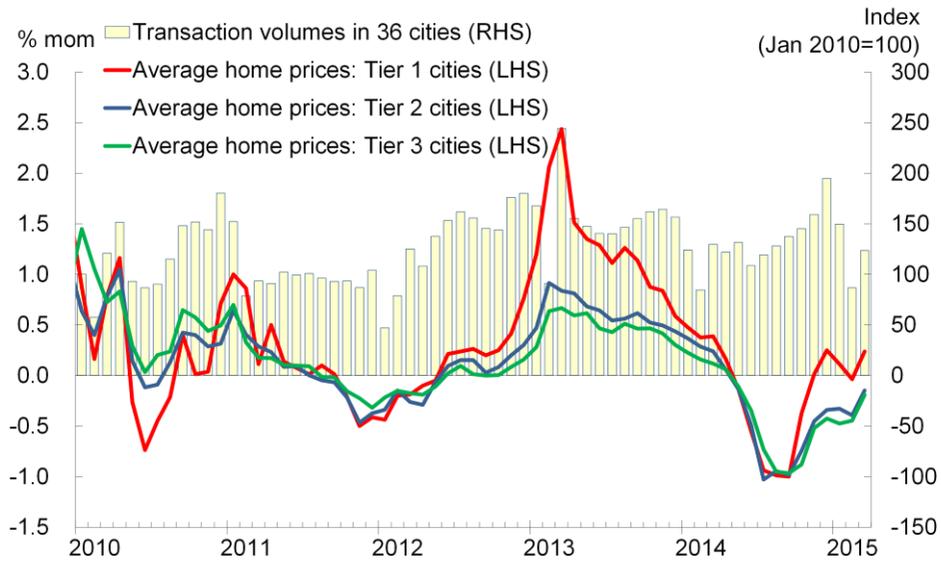
MAINLAND CHINA: AGGREGATE FINANCING FLOW



Source: CEIC



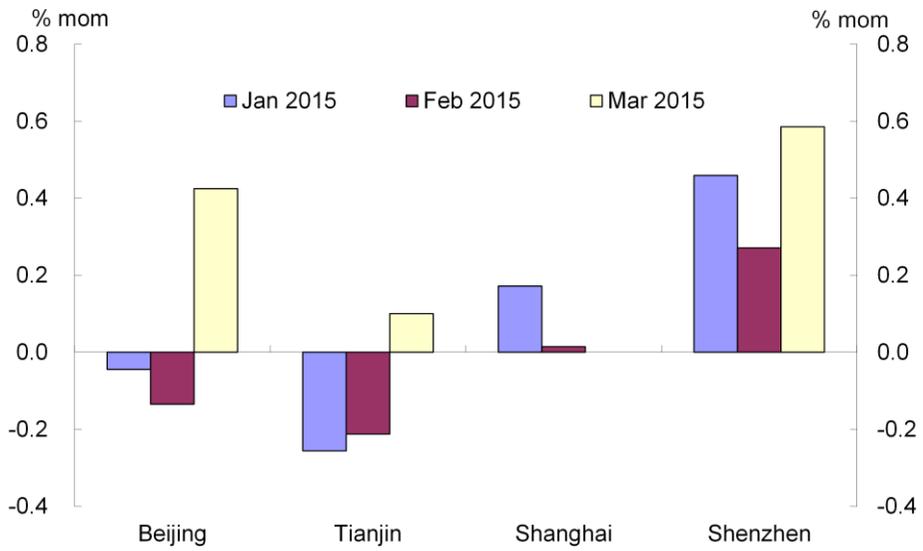
MAINLAND CHINA: PROPERTY PRICE AND TRANSACTION VOLUME



Sources: CEIC, WIND and HKMA staff estimates



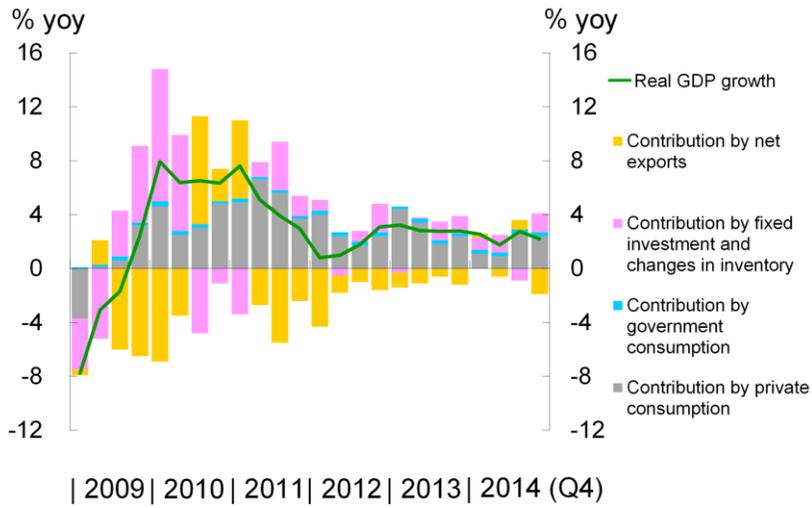
MAINLAND CHINA: HOUSING PRICE CHANGES IN MAJOR CITIES



Sources: CEIC, WIND and HKMA staff estimates



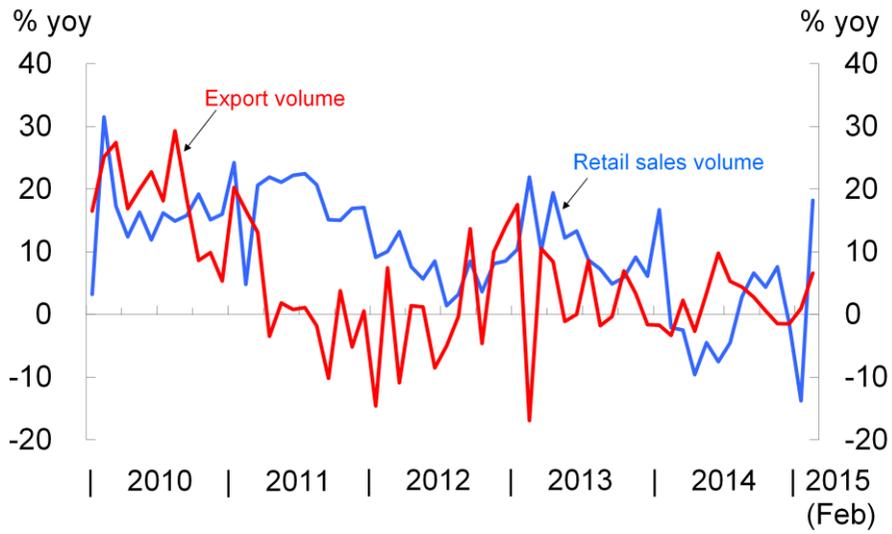
HONG KONG: REAL GDP GROWTH



Source: C&SD



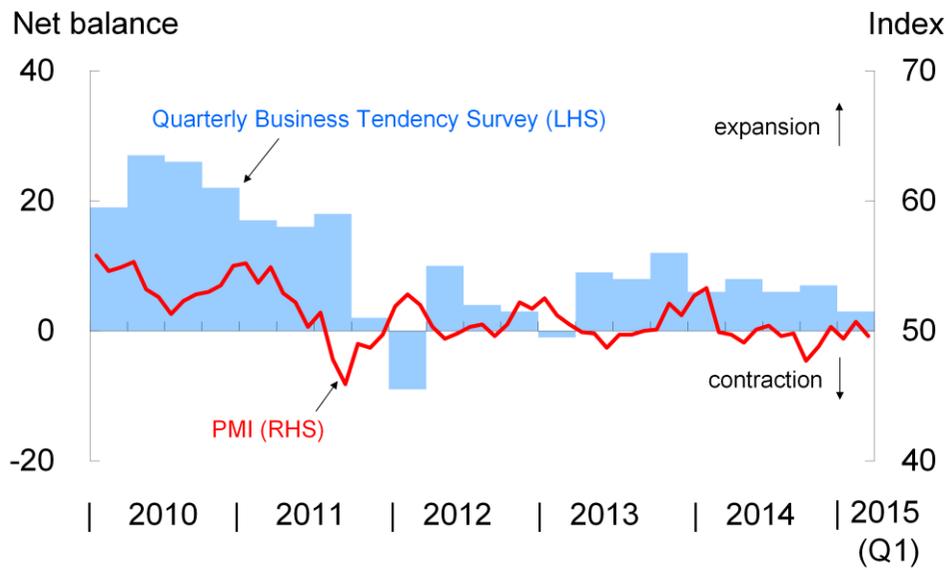
HONG KONG: ECONOMIC ACTIVITY



Source: C&SD



HONG KONG: BUSINESS OUTLOOK



Sources: C&SD and Markit Economics



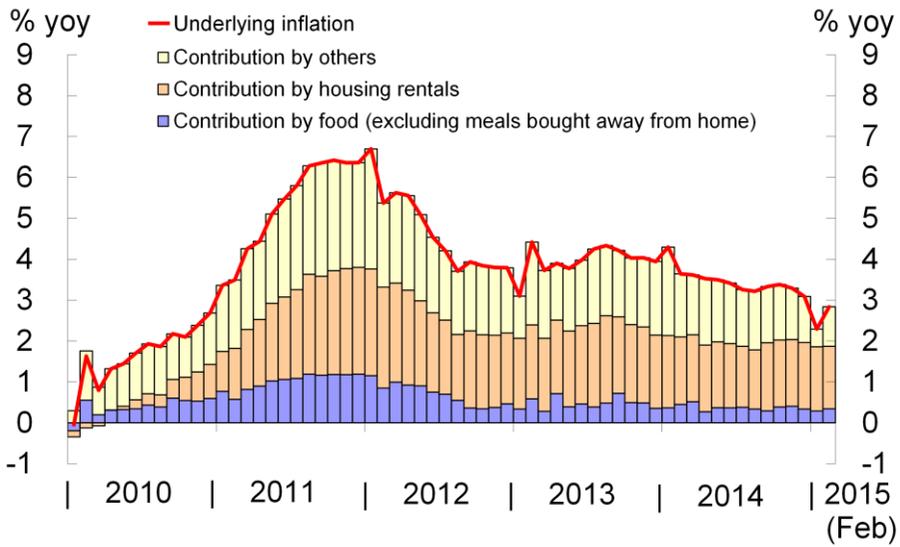
HONG KONG: UNEMPLOYMENT RATE



Source: C&SD



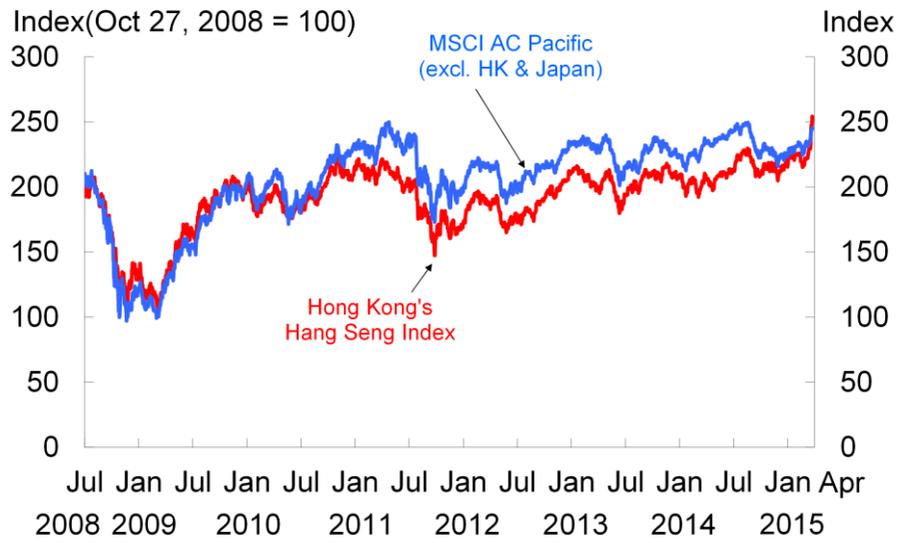
HONG KONG: INFLATION



Sources: C&SD and HKMA staff estimates



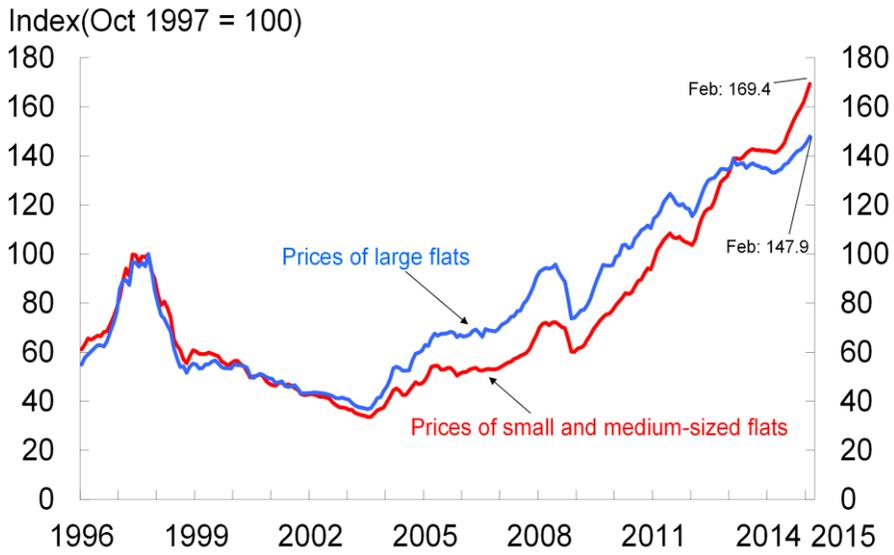
HONG KONG: EQUITY MARKET



Source: Bloomberg



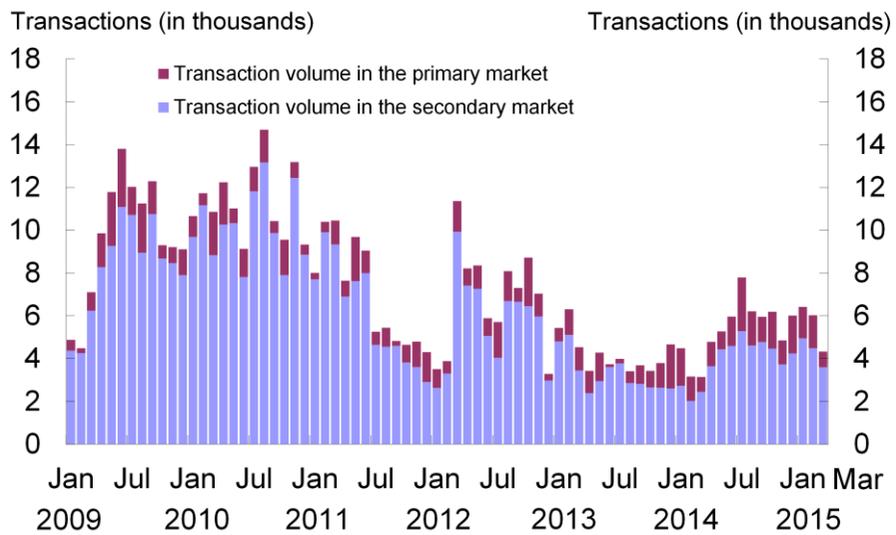
HONG KONG: RESIDENTIAL PROPERTY PRICES



Source: Rating and Valuation Department



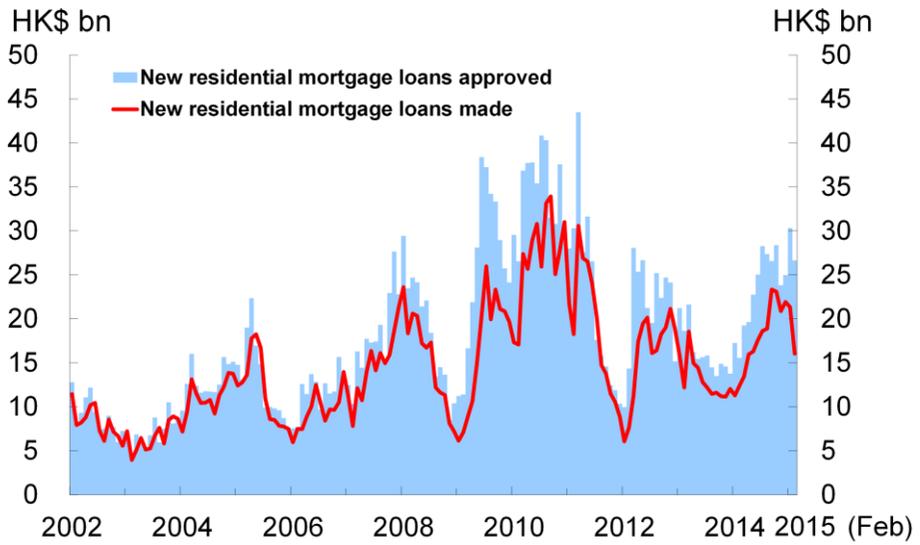
HONG KONG: TRANSACTION VOLUME IN THE PRIMARY AND SECONDARY MARKETS



Source: The Land Registry



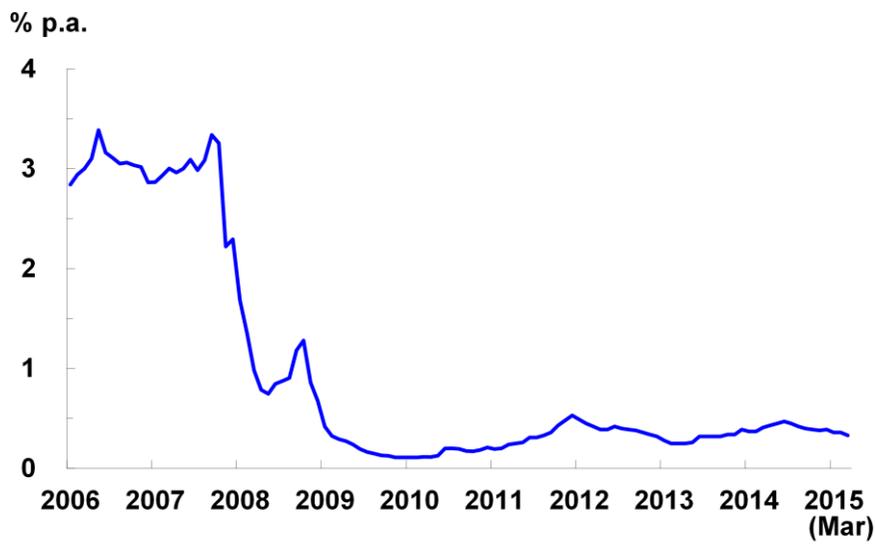
HONG KONG: NEW RESIDENTIAL MORTGAGE LOANS



Source: HKMA



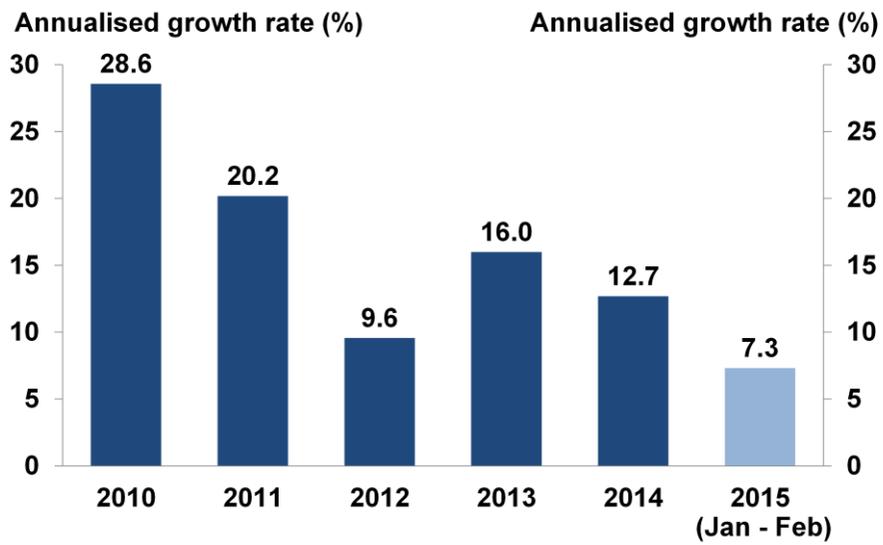
HONG KONG: COMPOSITE INTEREST RATE



Source: HKMA



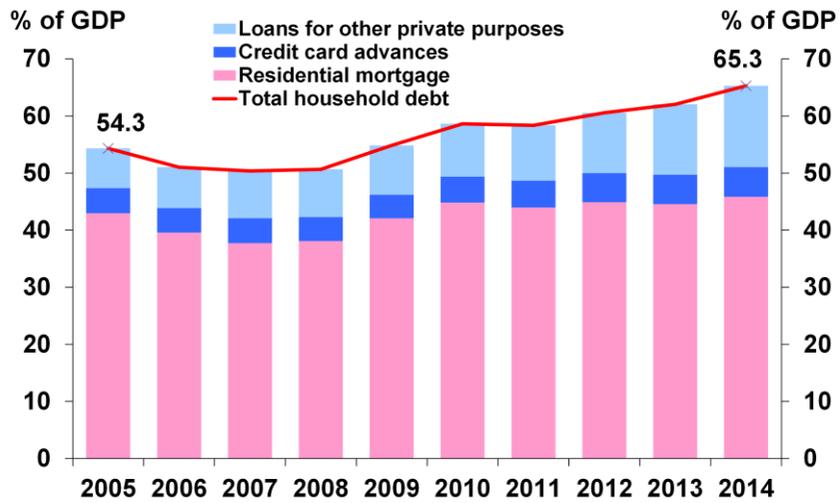
HONG KONG: LOAN GROWTH



Source: HKMA



HONG KONG: HOUSEHOLD DEBT



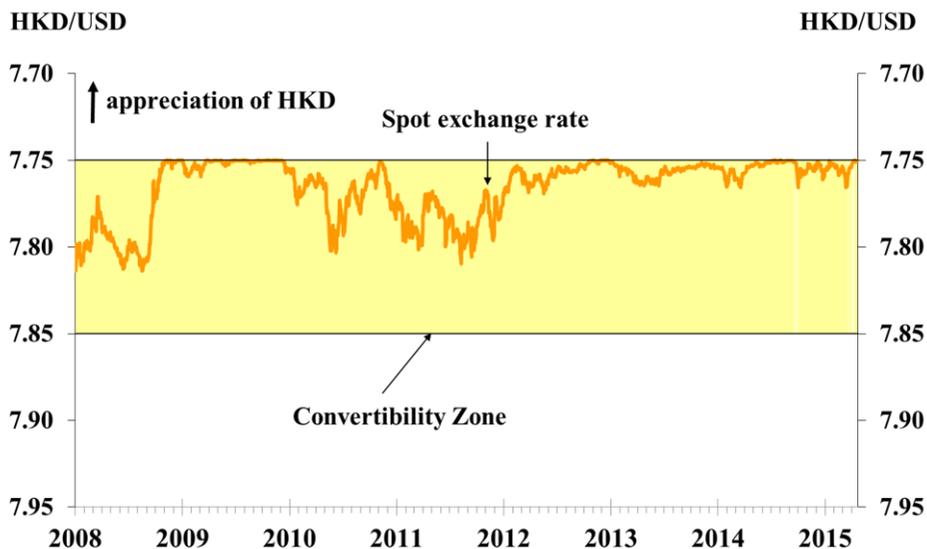
Sources: HKMA



CURRENCY STABILITY



HONG KONG DOLLAR SPOT EXCHANGE RATE

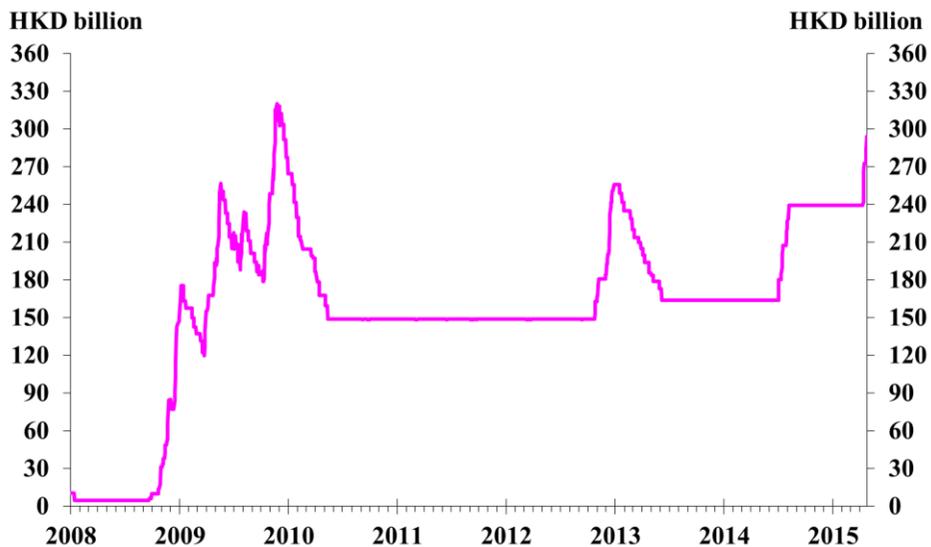


43

- The Hong Kong dollar spot exchange rate against the US dollar eased from 7.755 in late February to 7.765 in mid-March, alongside weakness in Asian currencies. It later rebounded to 7.755 in late March.
- The strong-side Convertibility Undertaking (CU) was triggered multiple times between 9 and 22 April 2015, as the Hong Kong dollar strengthened to 7.75 against the US dollar amid buoyancy of the stock market and demand for Hong Kong dollar arising from commercial activities.



AGGREGATE BALANCE

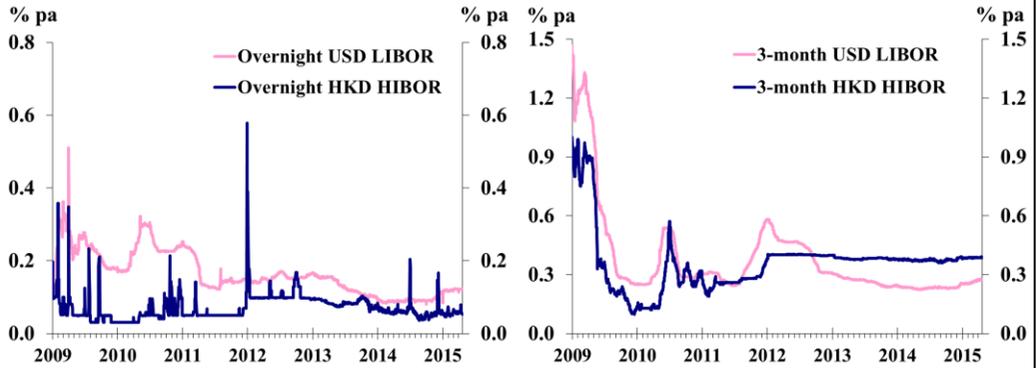


44

- The strong-side Convertibility Undertaking was triggered multiple times between 9 and 22 April 2015 and the HKMA purchased a total of 7.055 billion US dollars in response to demand from banks. As a result, the Aggregate Balance rose by HK\$54.68 billion from HK\$239 billion in early April to HK\$293.9 billion on 24 April 2015.



DOMESTIC INTEREST RATES

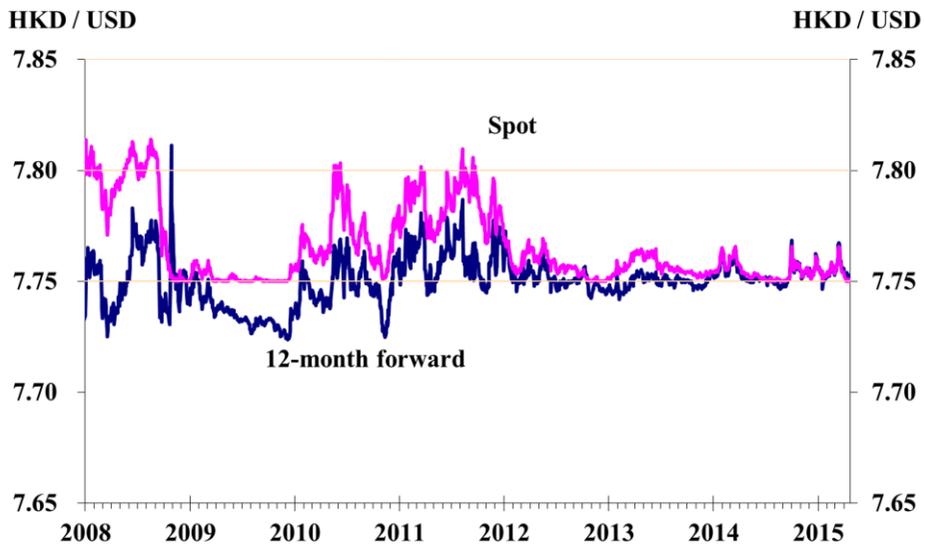


45

- Since January 2015, the short-term interbank interest rates were broadly steady at low levels.



HONG KONG DOLLAR FORWARD EXCHANGE RATE



46

- Hong Kong dollar forward exchange rate tracked closely the movements in the US dollar spot rate over the last few months.

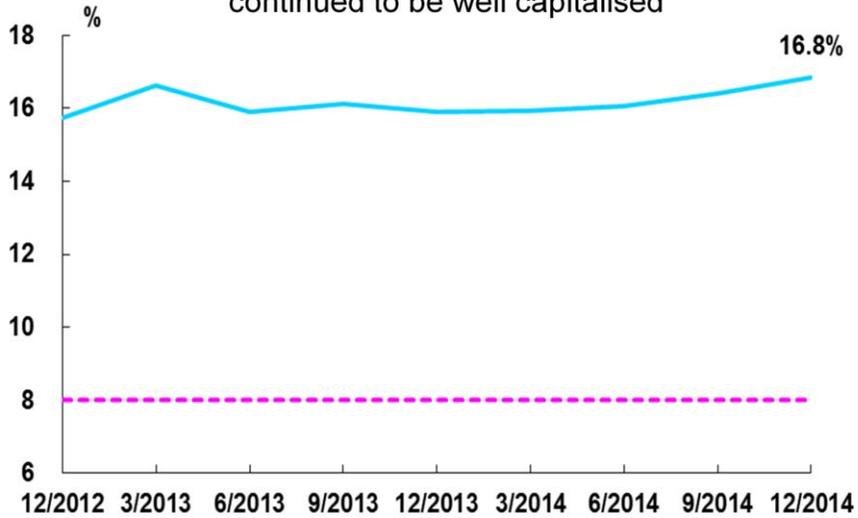


BANKING STABILITY



BANKING SECTOR PERFORMANCE

Locally incorporated Authorized Institutions (AIs)
continued to be well capitalised



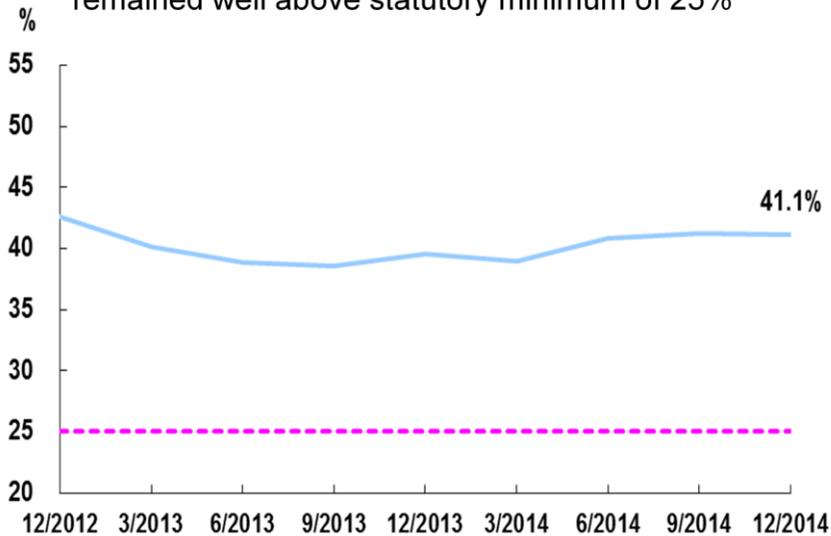
48

- The consolidated capital adequacy ratio (CAR) of locally incorporated AIs increased to 16.8% at end-December 2014 from 16.4% at end-September 2014 because the growth of capital base (+3.9%) outpaced that of risk-weighted amount (+1.2%). The consolidated CAR remained well above the international minimum standard of 8%.



BANKING SECTOR PERFORMANCE

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



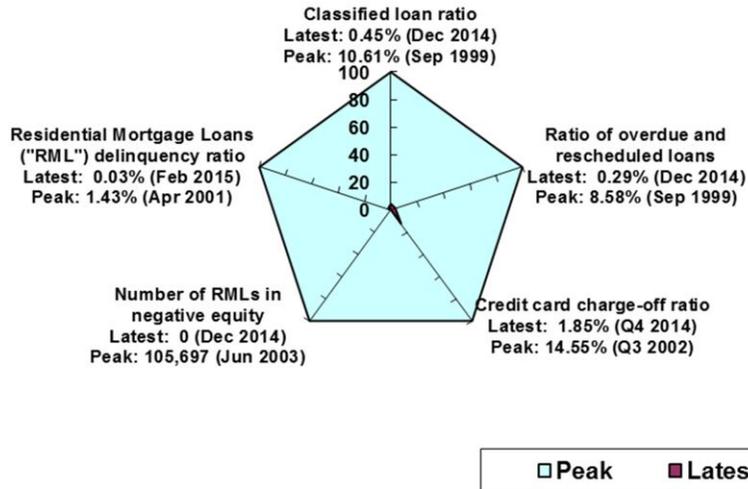
49

- With effect from 1 January 2015, authorized institutions in Hong Kong began implementing the new liquidity requirements under Basel III, with their liquidity being measured by the Liquidity Coverage Ratio and the Liquidity Maintenance Ratio.



BANKING SECTOR PERFORMANCE

Asset quality remained good compared with historical standards



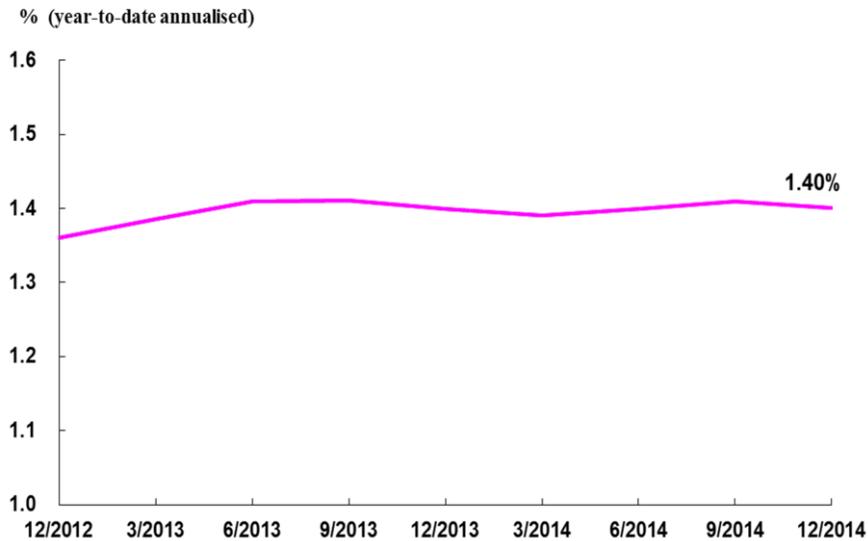
50

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



BANKING SECTOR PERFORMANCE

Net interest margin of retail banks remained stable



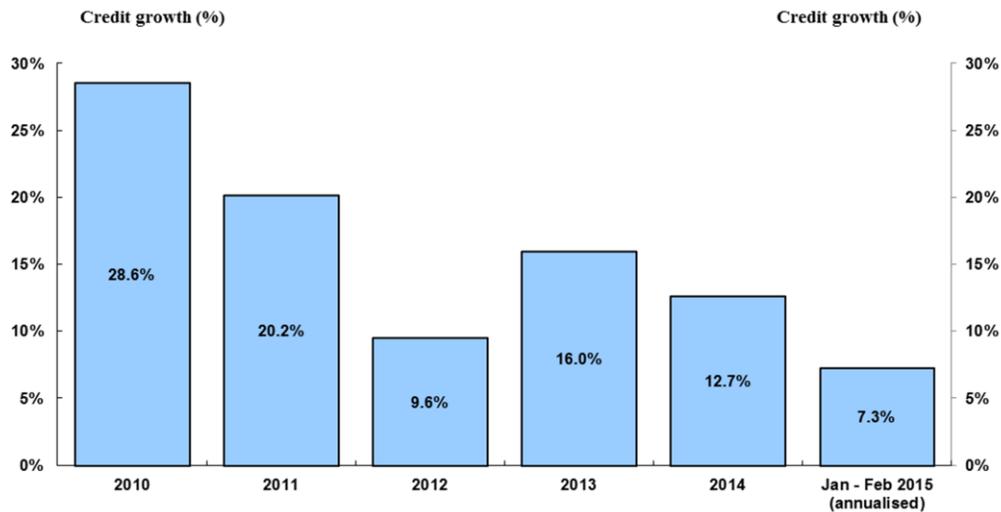
51

- The net interest margin (NIM) of retail banks' Hong Kong offices was 1.40% in 2014, same as previous year.
- The aggregate pre-tax operating profit of retail banks' Hong Kong offices registered a modest growth of 3.6% in 2014 as the 14.0% growth in net interest income was partly offset by a 9.1% increase in operating costs (mainly a rise in staff expenses) and a 2.1% reduction in non-interest income (mainly a drop in foreign exchange related income).



CREDIT GROWTH

Credit growth remained at a moderate level



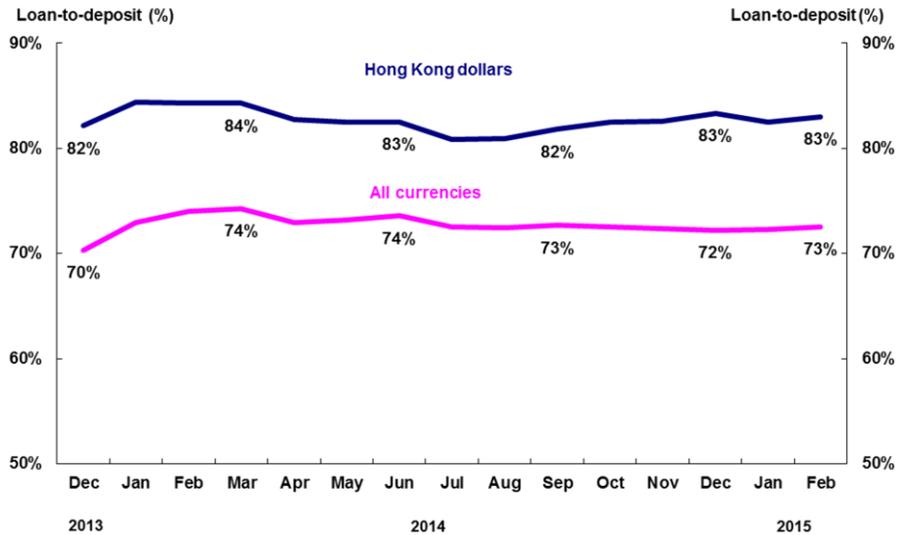
52

- After reaching a high in the first quarter of 2014, the pace of credit growth began to moderate and registered a 7.3% increase in an annualised term in the first two months of 2015.
- The HKMA has been monitoring the operation of the Stable Funding Requirement (SFR) since its launch in October 2013. In October 2014, the HKMA completed a review on the SFR with a view to streamlining its operations and reducing Authorized Institutions' (AIs) reporting work. The review has given due consideration to industry feedback as well as our implementation experience. After collecting views from members of industry associations, a circular was issued to all AIs in November 2014 to implement the refined SFR starting January 2015.
- The HKMA will continue to monitor credit growth of the banking sector.



CREDIT GROWTH

Loan-to-deposit ratios of banks in Hong Kong slightly changed



53

- The Hong Kong dollar loan-to-deposit ratio was 83% at end-February 2015, unchanged as compared with end-December 2014.
- The all currencies loan-to-deposit ratio increased slightly to 73% at end-February 2015 from 72% at end-December 2014. This was because the growth of total loans (+1.2%) outpaced that of total deposits (+0.8%).
- The HKMA will continue to monitor the movement of loan-to-deposit ratios.



RISK MANAGEMENT OF PROPERTY MORTGAGE LOANS

HKMA's macro prudential measures introduced on 27 Feb 2015

(1): The maximum loan-to-value (LTV) ratio for self-use residential properties with value below \$7 million lowered by a maximum of 10 percentage points.

(2): The maximum debt-servicing ratio (DSR) for borrowers who buy a second residential property for self-use lowered to 40% from 50%, and the stressed-DSR cap lowered to 50% from 60%.

(3): The maximum DSR of mortgage loans for all non-self use properties, including residential properties, commercial and industrial properties and car park spaces, lowered to 40% from 50%, and the stressed-DSR cap lowered to 50% from 60%.



RISK MANAGEMENT OF PROPERTY MORTGAGE LOANS

HKMA's macro prudential measures introduced on 27 Feb 2015
(Continued)

- In Feb 2013, the HKMA required banks using the Internal Ratings-Based Approach to calculate the capital required for credit risks to introduce a risk-weight floor of 15% for newly approved residential mortgage loans (RMLs).
- New measure introduced to require banks to apply, by end-Jun 2016, the risk-weight floor of 15% across the board to their whole RML portfolio.



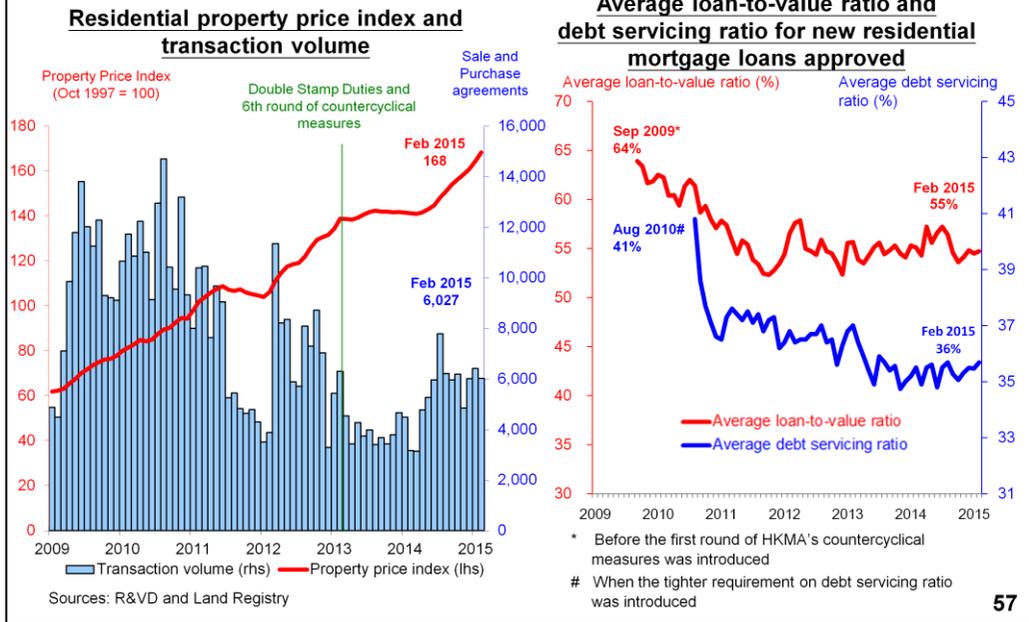
RISK MANAGEMENT OF PROPERTY MORTGAGE LOANS

HKMA's further guidance issued on 2 March 2015

- Required banks to apply a 5-percentage-point knock down on the applicable DSR caps if the total amount of mortgage loans, through any co-financing and mortgage insurance schemes, exceed 20 percentage points over the normal permissible LTV caps set out by the HKMA.
- Reiterated that for banks which lend to money lenders, they should require the money lenders to either comply with the HKMA's guidelines when extending mortgage finance to customers or risk losing the credit relationship with the banking sector.



RISK MANAGEMENT OF PROPERTY MORTGAGE LOANS



Latest statistics for residential mortgage loans (“RMLs”)

	Monthly average in 2013	Monthly average in 2014	Oct 2014	Nov 2014	Dec 2014	Jan 2015	Feb 2015
Number of sale and purchase agreements	4,223	5,317	6,189	4,848	6,009	6,412	6,027
Number of new RML applications	8,694	10,481	11,698	10,118	11,079	13,608	10,393
Number of new RMLs approved	5,952	7,337	8,494	7,258	7,606	9,103	8,147

Latest statistics for residential property prices

Property price index		Period	Property price index
Rating and Valuation Department (10/1997=100)	Latest position	02/2015	168.4
	Recent Peak	02/2015	168.4
	Peak in 1997	10/1997	100.0
Centaline (6/7/1997=100)	Latest position	05/04/2015	142.4
	Recent Peak	05/04/2015	142.4
	Peak in 1997	19/10/1997	102.9

The HKMA will continue to closely monitor the property and mortgage lending markets and will introduce appropriate supervisory measures as and when necessary in response to developments in the property market cycle.



BASEL III IMPLEMENTATION PROGRESS

Second phase implementation

- Legislative amendments effective from 1 January (capital and liquidity) and 31 March (disclosure)
- Announcement of Countercyclical Capital Buffer
- Designation of Domestic Systemically Important Banks

Future Work

- Amendments to capital rules to address Basel Committee's Regulatory Consistency Assessment Programme (RCAP) findings
- Implementing revised standards on:
 - capital treatment of counterparty credit risk exposures and equity investments in funds
 - revised Pillar 3 disclosure requirements

58

Work completed

- Second phase of Basel III standards have been implemented in Hong Kong: (i) legislative amendments for the Basel III capital buffers as well as the liquidity coverage ratio (LCR), became effective from 1 January 2015, and (ii) the associated disclosure requirements (as well as those for the Basel III leverage ratio) became effective from 31 March 2015.
- As mentioned at the last Panel on Financial Affairs meeting in February, the MA made a first announcement of the Hong Kong Countercyclical Capital Buffer (CCyB) on 27 January at a level of 0.625% (in line with the Basel Committee's phase-in provisions, i.e. one fourth of 2.5%). The announced CCyB will become effective on 1 January 2016. The MA considers every quarter, based on updated information, whether any change of the buffer level is required and has decided in March to maintain the previously announced 0.625% level.
- The HKMA set out its approach to assessing which authorized institutions should be regarded as systemically important domestically (i.e. as DSIBs) in February. This is part of the internationally agreed work programme to address the problem of too-big-to-fail banks and the moral hazard associated with their failure. Designated DSIBs will be required to build up an additional capital buffer (a "Higher Loss Absorbency" (HLA) capital requirement) which can be used to absorb losses and reduce probability of them becoming non-viable. They will also be subject to more intensive supervisory measures. The HKMA announced on 16 March the designation of 5 authorized institutions as D-SIBs and their corresponding HLA capital requirements.

Coming consultations in 2015

- Envisaged further changes to the Capital and Disclosure Rules later this year and 2016:
 - This year, we intend to propose some miscellaneous amendments to the Banking (Capital) Rules to address some issues identified during the 2014 RCAP assessment of Hong Kong's capital standards. The RCAP was established by the Basel Committee on Banking Supervision (BCBS) to evaluate the extent of compliance of each member jurisdiction's regulatory framework with the Basel minimum regulatory standards. The overall assessment for Hong Kong was "compliant", with only some minor variations identified due, for instance, to local circumstances or inadvertent interpretative differences.
 - Looking forward to 2016, in order to give effect to a number of revised BCBS capital and disclosure standards which are scheduled for implementation from the beginning of 2017, a further series of amendments to the Banking (Capital) Rules and the Banking (Disclosure) Rules will be necessary.
 - Consultations with the industry on the detailed policy proposals will begin shortly.



CROSS-SECTOR RESOLUTION REGIME FOR FINANCIAL INSTITUTIONS IN HONG KONG

- To meet international standards: Financial Stability Board (FSB)'s "Key Attributes of Effective Resolution Regimes for Financial Institutions"
- Second consultation exercise on legislative reform closed on 20 April 2015
- A third, shorter consultation paper expected around mid-year
- Aim to introduce a Bill into LegCo by Q4 2015

59

- The second consultation on resolution (issued on 21 January) was closed on 20 April 2015.
- The second consultation paper provided further detail on aspects of the proposed regime including governance arrangements (and the appointment of each of the regulators to act as resolution authorities), resolution powers (in particular, for statutory bail-in) and safeguards (including a "no creditor worse off than in liquidation compensation" mechanism).
- We received 27 responses; the responses are, as with the first consultation paper, broadly supportive of the proposals and it is widely accepted that the resolution regime is needed to (i) promote financial stability and (ii) maintain Hong Kong's role as a major international financial centre by enabling the authorities in Hong Kong to cooperate in cross-border resolutions. Respondents' comments focus on the detail of the more complex aspects of the proposals with a view to ensuring they are effective.
- We expect a third, shorter consultation exercise around mid-year, to allow for consideration of anticipated FSB guidance on specific aspects of resolution (including specific requirements for non-bank financial institutions, support for cross-border resolution and the total loss absorbency capacity necessary to enable bail-in as a credible resolution option) in future.
- Otherwise, and subject to the outcome of the consultation exercises, the target remains to introduce a Bill into LegCo in Q4 2015.



INVESTOR AND CONSUMER PROTECTION

- Completed review of the Code of Banking Practice to offer better protection to financial consumers. Revised Code effective from 6 February 2015. Major enhancements include :
 - Extending the coverage of the Code to subsidiaries and affiliated companies of banks
 - Adding internationally recommended principles on financial consumer protection
 - Enhancing disclosure and transparency of banking products and services
 - Enhancing credit card related practices
 - Providing more specific description of the customer due diligence requirements in relation to the opening of accounts
- Published articles on responsible credit card spending and tips on using credit cards when travelling overseas on print media. Co-organised the "Hong Kong Liberal Studies Financial Literacy Championship" to promote financial literacy of senior secondary school students.

60

- The HKMA has worked with the industry to complete a comprehensive review of the Code of Banking Practice. The revised Code is effective from 6 February 2015. Major enhancements include extending the coverage of the Code to subsidiaries and affiliated companies controlled by banks; incorporating the *G20 High-level Principles on Financial Consumer Protection* as general principles for banks to observe when providing products and services to their customers; enhancing the disclosure and transparency about terms and conditions by banks; enhancing credit card related practices of banks; and providing more specific description of the customer due diligence requirements in relation to the opening of accounts.
- Educational articles on responsible credit card spending and tips on using credit cards when travelling overseas were published on newspapers and magazines around the Chinese New Year holidays. The HKMA also co-organises the Hong Kong Liberal Studies Financial Literacy Championship. Launched in April and May and targeting at senior secondary school students, the championship is an online quiz that will help students learn smart tips on using banking services, deepen their knowledge of the financial market, and enhance their capability in financial management.



ENHANCEMENTS TO DEPOSIT PROTECTION SCHEME

- Objective: adopt gross payout basis for swifter payouts
- Completed a 3-month public consultation
- Received wide support; consultation conclusions to be released in Q2
- Preparing a draft amendment Bill to implement the proposals

61

- The three-month public consultation on the proposed enhancements to the Deposit Protection Scheme (DPS) jointly launched by the Financial Services and the Treasury Bureau and the HKMA completed smoothly in December 2014. In view of the benefits of a prompt payout to depositors, banking stability and Hong Kong's status as an international financial centre, wide support was received from the respondents. A report on the consultation conclusions is scheduled for release in Q2 2015.
- Taking into account comments received during the consultation, we are preparing a draft amendment Bill for implementing the enhancement proposals. Subject to the drafting progress, the Bill is planned for introduction into the LegCo by the end of 2015.
- The key legislative proposal is to adopt the "gross payout" approach to determine the DPS compensation as opposed to the existing "net payout" method so as to achieve a faster payout in case of a bank failure. Other proposals include: (1) providing certainty for determining the "Quantification Date" to facilitate compensation determination; and (2) enabling the use of the electronic communication channel by the Hong Kong Deposit Protection Board in addition to the existing paper-form communications for notifying depositors about the payout details.



FINANCIAL INFRASTRUCTURE



REGULATORY DEVELOPMENT OF THE OTC DERIVATIVES MARKET

- The Securities and Futures (Amendment) Ordinance 2014 was enacted by the LegCo in Q1 2014. Detailed rules are now being prepared for implementing the regulatory regime for the over-the-counter (OTC) derivatives market in Hong Kong
- Public consultation on the first set of draft rules, which focused on the mandatory reporting and related record keeping obligations, was conducted in Q3 2014. The HKMA and the Securities and Futures Commission issued the consultation conclusions in Q4 2014. The target is to introduce the proposed rules into LegCo in Q2 2015

63

- As an interim measure before the new legislation comes into effect, the HKMA has mandated the reporting of specified OTC derivative transactions between licensed banks to the trade repository set up by the HKMA since 5 August 2013.
- The regulatory regime for the OTC derivatives market in Hong Kong is expected to take effect around mid-2015, with the mandatory reporting and related record keeping obligations taking effect first.



GOVERNMENT BOND PROGRAMME

Institutional part

- Debut issuance of 15-year Hong Kong dollar institutional bonds in July to extend the HKSAR Government benchmark yield curve. Total value is HK\$0.6 billion.

Retail part

- The Government will launch an iBond issue of up to \$10 billion with a maturity of three years. Following the existing practice, the issuance will target Hong Kong residents. Interest will be paid to bond holders every six months at a rate linked to the inflation rates of the last half-year period. The HKMA has commenced preparatory work and will announce the details when issuance is ready.



PROMOTING ASSET MANAGEMENT BUSINESS

- Working closely with other Government agencies and the private sector 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 will continue to improve our platform and keep up with the latest developments in the asset management industry

65

- Over the past few years, our outreach team held over 920 meetings with over 500 financial institutions to showcase the unique competitive advantages of Hong Kong as an international financial centre.
- Our outreach campaign has had very encouraging results, with some notable asset owners and asset managers choosing to set up their Asia headquarters in Hong Kong. Being an asset owner ourselves, the HKMA has a unique advantage in relating to other asset owners on their criteria in choosing an overseas investment hub.
- On platform building, the HKMA conducts reviews of legal, regulatory, tax and other issues to inform policy formulation concerning the development of Hong Kong's asset management industry. The HKMA also provides necessary support to the Financial Services and the Treasury Bureau and other government agencies in taking forward policy decisions by the Financial Secretary, such as the proposed extension of profits tax exemption to offshore private equity funds and the exemption of stamp duty for the transfer of all exchange traded funds shares or units. The relevant legislative amendments for the exemption of stamp duty for all ETFs were passed by LegCo and have become effective since February 2015.



CONTINUED DEVELOPMENT AS AN INTERNATIONAL ASSET MANAGEMENT CENTRE

- The combined fund management business in Hong Kong hit a record high of US\$ 2.1 trillion at the end of 2013, a 27% increase over 2012
- Continued increase in the number of licensed corporations and licensed individuals for asset management
- Over 60 of the 100 largest global money managers have offices in Hong Kong
- In terms of private banking, 20 private banks have opened for business in Hong Kong since 2009, bringing the total to 46 banks offering private wealth management services in Hong Kong as of March 2015

66

- According to the Securities and Futures Commission (SFC)'s survey, 72% of the combined fund management business in Hong Kong was sourced from non-Hong Kong investors in 2013, attesting to the fact that Hong Kong is 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 1,031 in December 2014.
- Over 60 of the 100 largest global money managers (ranked by assets under management as of end 2013) have offices in Hong Kong, and about 60 of them are licensed by the SFC.
- Achieved leading positions as an asset management centre in Asia Pacific:
 1. Hong Kong is the second largest private equity hub in Asia. The total capital under management in private equity funds in Hong Kong reached US\$114.6 billion at end 2014, recording a year-on-year increase of 16%.
 2. Over 60% of Qualified Foreign Institutional Investor managers, over 70% Mainland fund management and securities firms with Qualified Domestic Institutional Investor license and Renminbi Qualified Foreign Institutional Investor managers have a presence in Hong Kong as of February 2015.
 3. Hong Kong is also the largest hub for Asian hedge funds, with the number of funds increased from 676 in 2012 to 778 as of 30 September 2014.



DEVELOPMENT OF ISLAMIC FINANCE

- Following the success of the inaugural US\$1 billion sukuk last year, the Government is actively considering a further sukuk issuance when market conditions are favourable, in a bid to attract more issuers and investors to the local market.
- The HKMA has commenced preparatory work and is considering the structure and issuance arrangements of this sukuk, in order to achieve maximum readiness for issuance as soon as practicable.



DEVELOPING HONG KONG AS A CTC HUB

- Corporate treasury centres (CTCs) set up by multinational and Mainland enterprises will bring more banking, financing and risk management activities in Hong Kong, deepen our capital markets and provide impetus to the development of headquarters economy in Hong Kong.
- The Financial Secretary announced in the 2015-16 Budget that the Government will amend the Inland Revenue Ordinance to (i) allow, under specified conditions, interest deductions under profits tax for CTCs and (ii) reduce profits tax for specified treasury activities by 50%.
- Working closely with the Financial Services and the Treasury Bureau, Inland Revenue Department, and Department of Justice on drafting the relevant Bill, which will be introduced in the 2015-16 legislative session. The industry will be consulted on the detailed legislative proposal later this year.
- To continue to engage the industry and step up marketing effort to promote Hong Kong as a preferred regional location for CTCs.

68

- Developing Hong Kong into a regional hub for corporate treasury centres (CTC) has been one of the important areas of work of the HKMA in recent years. With their vast, global business networks, multinational corporations (MNCs) process numerous large-value payments on a daily basis. Under their treasury management systems, it is common for cash management, receipt/payment processing, financing and risk management, etc. to be centralised to facilitate management of these corporate treasury functions. The development of Hong Kong as a CTC hub would complement many of Hong Kong's existing strengths, such as the offshore RMB market, capital formation, banking capabilities, etc., thereby reinforcing Hong Kong's status as an international financial centre and enhancing the development of headquarters economy in Hong Kong.
- Following the 2014-15 Budget, the Government had set up a task force, of which the HKMA is a member, to review the relevant tax requirement under the Inland Revenue Ordinance with a view to enhancing Hong Kong's competitiveness as a regional destination for CTCs. Upon the Government Task Force's recommendations, the Financial Secretary announced in the 2015-16 Budget to relax the interest deduction rules and reduce profits tax by 50% for qualifying corporate treasury activities. The HKMA is working closely with the Financial Services and the Treasury Bureau, Inland Revenue Department, and Department of Justice in drafting the relevant bill, which will be introduced in the 2015-16 legislative session.
- The HKMA is working closely with the private sector and other Government agencies in organising various marketing activities to promote Hong Kong as a preferred regional destination for CTCs.



FINANCIAL BENCHMARK REFORM IN HONG KONG

- International bodies such as the International Organization of Securities Commissions (IOSCO) and the Financial Stability Board (FSB) have made recommendations to enhance the transparency and robustness of the major interest rate and foreign exchange (FX) benchmarks that are widely used in the global financial markets
- Hong Kong has been reviewing the need and feasibility in reforming our financial benchmarks along the international recommendations having regard to local market conditions
- The HKMA is studying the feasibility in this regard, and will work with relevant industry associations such as the Treasury Markets Association (TMA) to consult stakeholders on any proposed way forward

69

- Financial benchmarks, especially the interest rate (commonly referred to as the “Interbank Offered Rates (IBORs)”) and FX benchmarks, are referred to in many financial contracts. Their robustness is crucial to the proper functioning of the financial market. In view of the London Interbank Offered Rate (LIBOR) incident in 2012, various international bodies have made recommendations to enhance the transparency and robustness of those benchmarks that are widely used in the global financial markets.
- In July 2013, the IOSCO promulgated a set of principles, containing an overarching framework of recommended practices for financial benchmarks in general. The FSB also established the Official Sector Steering Group (OSSG) and the Foreign Exchange Benchmark Group (FXBG) to review, and make recommendations on, those interest rate benchmarks (the three major IBORs, i.e. LIBOR, Euro Interbank Offered Rate (EURIBOR) and Tokyo Interbank Offered Rate (TIBOR)) and FX benchmarks (WM/Reuters 4pm London fix) that are widely used in the global financial markets.
- The main thrust of the international recommendations is that if market conditions permit, financial benchmarks should be calculated based on actual transactions only. In implementing the relevant recommendations, both IOSCO and FSB recognised that there is no one-size-fits-all method. Individual jurisdictions should implement the recommendations in a manner commensurate with the size and risks of the relevant benchmark-setting processes.
- In this connection, the HKMA is working with the administrator of Hong Kong’s financial benchmarks, the TMA, to assess the extent to which the Hong Kong Interbank Offered Rates (HIBOR), as well as the Spot USD/HKD Fixing and Spot USD/CNY(HK) Fixing could be reformed. Stakeholders will be consulted to ensure that the market’s views are reflected as appropriate.



FINANCIAL INFRASTRUCTURE

- Continue to maintain safety and efficiency of financial infrastructure
- Reporting to the over-the-counter (OTC) derivatives trade repository (TR) of the HKMA has been smooth. The TR will be further developed to meet local reporting requirements and international standards

70

Operation of financial infrastructure

- The Hong Kong Dollar, US dollar, Euro and RMB Real Time Gross Settlement systems, the Central Moneymarkets Unit (CMU) and the TR for OTC derivatives have been operating smoothly.

OTC derivatives Trade Repository

- Since the reporting function of the TR was launched in July 2013, reporting by banks to the TR has been smooth.
- Preparations are being made to support the commencement in 2015 of the mandatory reporting under the new OTC derivatives market regulatory regime.



Financial Infrastructure Development: Progress Update

- Legislative framework for Stored Value Facilities (SVF) and Retail Payment Systems (RPS)
 - The Clearing and Settlement Systems (Amendment) Bill was introduced into the LegCo on 4 February 2015.
 - The Bill seeks to put in place a legal framework for regulating SVF and RPS to ensure adequate protection of users' float maintained with SVF issuers and the security and soundness of the operations of SVF and RPS in Hong Kong.
 - The Bill is currently being scrutinized by the Bills Committee.
 - So far three Bills Committee meetings have been held on 2 March, 23 March and 13 April 2015 respectively, including a meeting with deputations from the industry and public.
- E-cheque: system development has progressed as planned
 - Promotion campaign will be carried out in the second half of 2015 to raise the public awareness of e-cheque.
 - A three-month pilot run of the service will commence in December 2015.

71

The Bill includes provisions to:

- implement a licensing regime for SVF covering both device-based and non-device based SVF with a series of licensing criteria including physical presence in Hong Kong; principal business has to be SVF issuing; financial strength; float safeguarding and management; fitness and propriety of ownership and management; anti-money laundering and counter terrorist financing requirements; security and soundness of system and business scheme, etc.;
- implement a designation regime for RPS under which RPS that are important to the public and financial stability of Hong Kong will be so designated by the HKMA and subject to the HKMA's regulation;
- empower the HKMA to exercise necessary supervisory functions on SVF and designated RPS including powers to conduct on-site and off-site supervision; gather information; make regulations; issue guidelines; impose operating rules; and give directions, etc.;
- empower the HKMA to exercise necessary enforcement actions on SVF and RPS including the conduct of investigation;
- with reference to other legislation including the Banking Ordinance, Securities and Futures Ordinance and the Anti-Money Laundering and Counter Terrorists Financing (Financial Institutions) Ordinance, introduce relevant offenses and sanctions for contravention of the the Clearing and Settlement Systems Ordinance (CSSO) including minor sanctions such as caution, warning and reprimand; and
- enhance the existing appeal mechanism under the CSSO to enable persons aggrieved by a reviewable decision of the HKMA made under the CSSO to refer the decision to an Appeal Tribunal for review.

E-Cheque

- The objective of e-cheque is to provide an additional safe and efficient option of payment instrument for the public. E-cheque is an "end-to-end" electronic payment instrument without the use of paper or the need of physical delivery or presentment throughout the process. It will be issued through the internet banking platform of the paying bank, and presented either through the internet banking platform of the collecting bank or the centralised presentment portal operated by Hong Kong Interbank Clearing Limited (the clearing house in Hong Kong).
- 17 banks have indicated interest to provide e-cheque services to their customers while all banks accepting paper cheque deposit nowadays are required to accept e-cheque deposit once the service is launched.
- The system development of both e-cheque clearing platform and centralised presentment portal has progressed as planned. A three-month pilot run is scheduled for launch in December 2015, followed by a commercial launch in March 2016. To enhance the public awareness of e-cheque, the HKMA will collaborate with HKAB to conduct promotion programmes in the second half of this year.

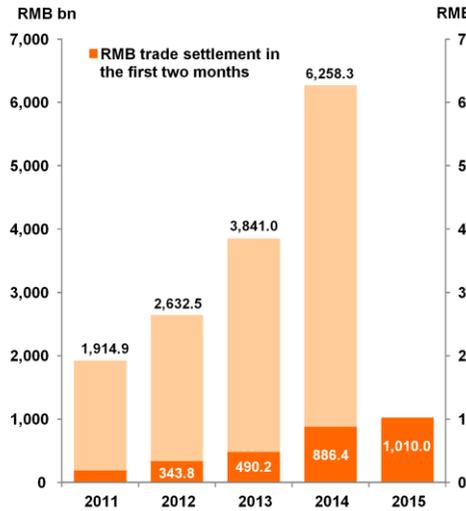


HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

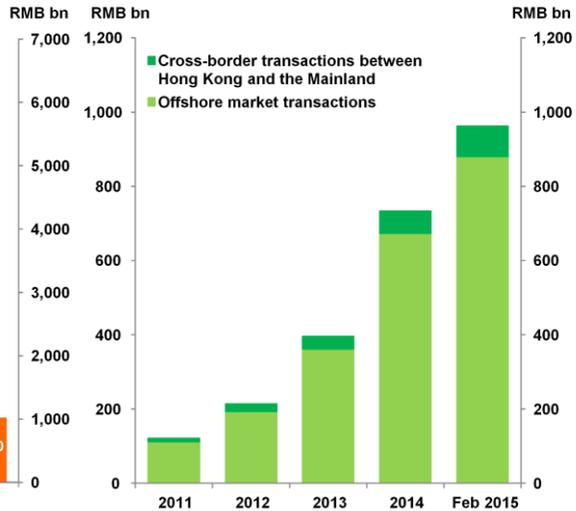


CONTINUED GROWTH IN RMB TRADE SETTLEMENT AND PAYMENTS

**RMB trade settlement
handled by banks in Hong Kong**



**Average daily turnover of Hong Kong
RMB RTGS System**



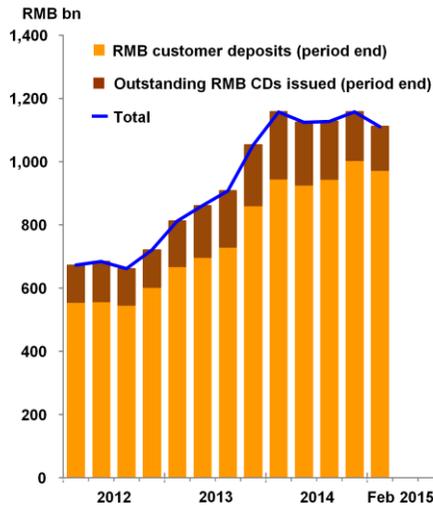
73

- In the first two months of 2015, RMB trade settlement handled by banks in Hong Kong amounted to RMB1,010.0 billion, up 14% compared with the same period in 2014.
- Transactions handled by Hong Kong RMB Real Time Gross Settlement (RTGS) system increased further, with daily average turnover reaching RMB962.9 billion in February 2015.

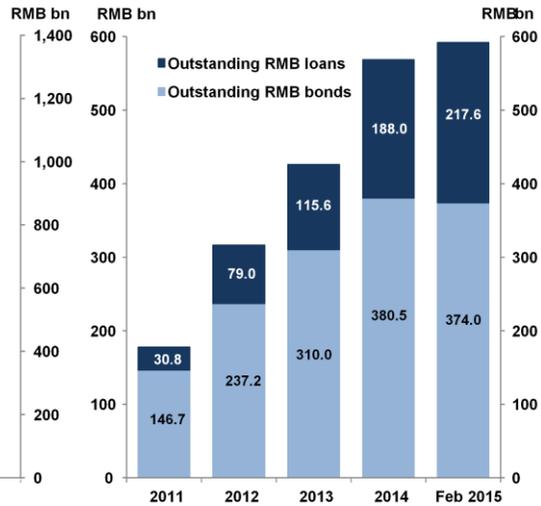


STEADY DEVELOPMENT OF RMB FINANCING ACTIVITIES

RMB customer deposits and certificates of deposit (CDs)



RMB financing activities



74

- At end February 2015, RMB customer deposits and outstanding RMB CDs amounted to RMB973.0 billion and RMB137.7 billion respectively, totaling RMB1,110.6 billion, a 4% decline from the end of 2014. The drop in customer deposits in early 2015 was mainly attributable to a net outflow of RMB from Hong Kong to the Mainland under trade settlement, and a net sale of RMB by corporations through banks, leading to a decrease in corporate deposits. Deposits held by personal customers were steady.
- RMB dim sum bond issuance was moderated, with issuance in the first two months of 2015 totalling RMB4.9 billion. Outstanding dim sum bonds amounted to some RMB374.0 billion at end February 2015. On the other hand, RMB bank lending continued to grow, with outstanding amount of RMB loans increased by 16% to RMB217.6 billion at end February 2015 from the end of 2014.



STRENGTHENING RMB BUSINESS LINKS WITH OVERSEAS MARKETS

	Feb 2015	2014	2013	2012
1 No. of participating banks of Hong Kong's RMB clearing platform	224	225	216	204
Of which:	199	200	191	181
Branches and subsidiaries of overseas banks and overseas presence of Mainland banks				
2 Amount due to overseas banks (RMB billion)	145.9	145.2	166.0	99.1
3 Amount due from overseas banks (RMB billion)	163.9	193.3	164.5	117.1

75

- The HKMA continued to enhance RMB business collaboration and exchanges between Hong Kong and other markets. The HKMA also continued to promote Hong Kong's RMB business platform to overseas corporations and financial institutions. Following the fourth meeting of the Hong Kong-London RMB Forum in November 2014, the HKMA and Bank Negara Malaysia led the Second Hong Kong-Malaysia Private Sector Dialogue on Offshore RMB Business in March this year.



INVESTMENT ENVIRONMENT AND PERFORMANCE OF THE EXCHANGE FUND

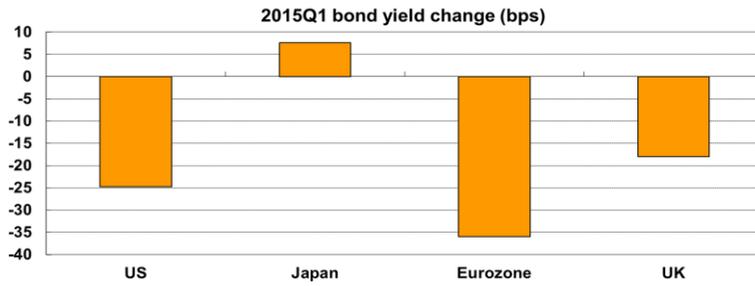
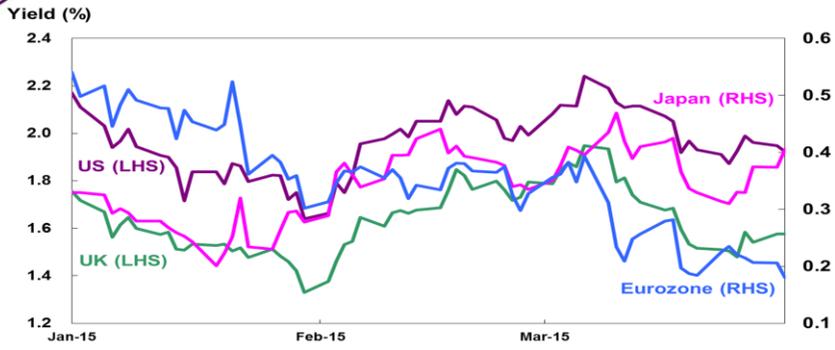


INVESTMENT ENVIRONMENT IN Q1 2015

- **Interest rates:** Major European government bond yields fell sharply in Q1 2015, on the back of the European Central Bank's (ECB) aggressive quantitative easing (QE) programme. Longer term US Treasury and UK Gilt bond yields also fell in tandem
- **Equity markets:** DAX outperformed other major equity markets and recorded an impressive gain in Q1 2015, supported by the ECB's QE programme and the signs of green shoots in the Eurozone economy. Other major equity markets were also bolstered by the positive risk sentiment and the accommodative stance of major central banks
- **Exchange rates:** Euro weakened significantly against the US dollar in Q1 2015, as a result of the ECB's QE programme. Yen, however, stayed in a range against the US dollar over the same period



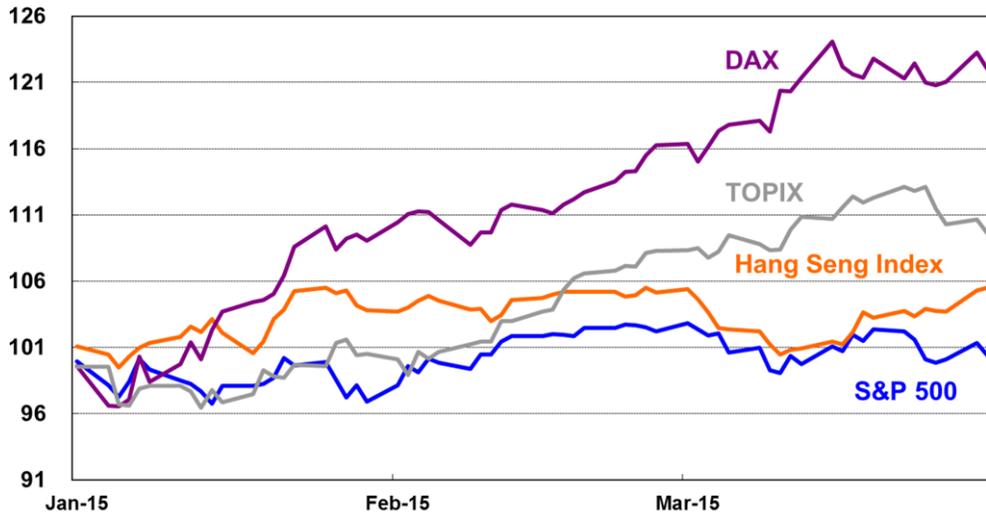
CHANGES IN 10-YEAR GOVERNMENT BOND YIELDS IN Q1 2015





EQUITY MARKETS IN Q1 2015

Normalized Index Level (2014 year-end = 100)





INVESTMENT INCOME

(HK\$ billion)	2015 Q1*	2014 Full Year	2013 Full Year
Hong Kong equities[ⓐ]	9.1	6.5	10.1
Other equities	18.5	33.7	71.8
Bonds	12.2	47.3	(19.1)
Other investments[Ⓢ]	-	9.9	16.8
Foreign exchange	<u>(33.2)</u>	<u>(52.7)</u>	<u>1.6</u>
Investment income	6.6	44.7	81.2

* Unaudited figures

ⓐ Excluding valuation changes of the Strategic Portfolio

Ⓢ Including valuation changes of private equity and real estate investments held by Exchange Fund's investment holding subsidiaries. The figure for the latest quarter is not yet available.



INCOME AND EXPENDITURE

(HK\$ billion)	2015	2014	2013
	Q1*	Full Year	Full Year
Investment income	6.6	44.7	81.2
Other income	-	0.2	0.2
Interest and other expenses	<u>(1.0)</u>	<u>(5.2)</u>	<u>(4.9)</u>
Net income	5.6	39.7	76.5
Fee paid/payable to Fiscal Reserves#	11.4	27.5	36.8
Fee paid/payable to HKSAR government funds and statutory bodies#	3.5	8.6	9.3

* Unaudited figures

The fixed rate of fee payment is 5.5% for 2015 and 3.6% for 2014.



EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)	31 Mar 2015 (Unaudited)	31 Dec 2014	31 Dec 2013
ASSETS			
Deposits	312.8	315.6	292.8
Debt securities	2,198.2	2,146.3	2,080.0
Hong Kong equities	166.4	156.8	152.9
Other equities	448.4	416.3	370.6
Other assets*	<u>153.7</u>	<u>114.0</u>	<u>136.5</u>
Total assets	<u>3,279.5</u> =====	<u>3,149.0</u> =====	<u>3,032.8</u> =====
LIABILITIES AND FUND EQUITY			
Certificates of Indebtedness	349.0	340.2	327.4
Government-issued currency notes & coins in circulation	11.4	11.0	10.6
Balance of the banking system	239.2	239.2	164.1
Exchange Fund Bills and Notes issued	796.3	752.4	782.6
Placements by banks and other financial institutions	63.2	64.0	50.7
Placements by Fiscal Reserves	838.3	788.7	773.9
Placements by HKSAR government funds and statutory bodies	268.8	261.1	214.9
Other liabilities	<u>86.2</u>	<u>56.9</u>	<u>71.1</u>
Total liabilities	<u>2,652.4</u>	<u>2,513.5</u>	<u>2,395.3</u>
Accumulated Surplus	<u>627.1</u>	<u>635.5</u>	<u>637.5</u>
Total liabilities and fund equity	<u>3,279.5</u> =====	<u>3,149.0</u> =====	<u>3,032.8</u> =====

* Including fund injection to Exchange Fund's investment holding subsidiaries at a carrying amount of HK\$82.6 billion at 31 Mar 2015 (HK\$82.6 billion at 31 Dec 2014 and HK\$66.4 billion at 31 Dec 2013)



HONG KONG MORTGAGE CORPORATION



MORTGAGE INSURANCE PROGRAMME (MIP)

- Since the launch in March 1999, the MIP has helped over 113,500 families attain home ownership
- In the first three months of 2015, the total drawdown amount under the MIP was HK\$4.2 billion and the average loan size was HK\$3.4 million
- About 92% of drawn down loans were for secondary market properties

85

The Hong Kong Mortgage Corporation (HKMC) introduced some revisions to the Mortgage Insurance Programme (MIP) on 27 February 2015 and the latest programme details are as follows:

1. The maximum property value is HK\$6 million;
2. After revisions, the HKMC will only provide the MIP coverage for applications of mortgage loans starting from 60% loan-to-value (LTV) ratio (Note: The applications of mortgage loans starting from 70% LTV ratio are suspended);
3. The maximum LTV ratio for eligible properties is reduced from 90% to 80%;
4. Applicants may still be eligible for the maximum LTV ratio up to 90% for the property value below HK\$4.5 million where (a) all homebuyers (i.e. mortgagors) are not holding any residential properties in Hong Kong at the time of application, (b) all applicants are regular salaried persons and (c) maximum debt-to-income ratio is 45%; and
5. The revisions are applicable to mortgage loan applications with provisional sale and purchase agreement executed on or after 28 February 2015.



REVERSE MORTGAGE PROGRAMME

- By end of March 2015, 814 applications have been received:
 - Average age of borrowers: 69 years old
 - Average monthly payout: HK\$14,300
 - Payment terms: 10-year (30%), 15-year (17%), 20-year (14%), life (39%)
 - Average property value: HK\$4.8 million
 - Average property age: 30 years

86

The Hong Kong Mortgage Corporation introduced the following new enhancements to the Reverse Mortgage Programme (**RMP**), with effect from 12 March 2015:

1. Properties provided as security under the RMP are no longer required to be the borrower's principal residence;
2. More than one property can be used as security for application of a reverse mortgage loan;
3. The maximum number of joint borrowers is increased from two to three; and
4. Assignment of life insurance policy to the bank as additional collateral under the RMP is allowed.



SME FINANCING GUARANTEE SCHEME (SFGS)

- Hong Kong's external trade performance is affected by a host of uncertainties this year. To support small and medium enterprises and hence drive domestic demand with a view to maintaining economic vibrancy and preserving employment, the Financial Secretary announced in the 2015-16 Budget Speech the extension of application period for the 80% loan guarantee product for one year to end on 29 February 2016.
- The 80% loan guarantee product has been well received by the market. As at end-March 2015, 9,989 applications were approved, involving a total loan amount of HK\$40.9 billion. Key data of the approved applications are as follows:

Average guarantee period	4.7 years	Average loan size	HK\$4.09 million
Proportion of application from manufacturing and non-manufacturing industries	25% and 75% (in terms of applications approved)	Average loan interest rate and average guarantee fee rate	4.83% p.a. 0.54% p.a.
Enterprises with less than 50 employees	91%	Benefitted enterprises and the related no. of employees	6,453 enterprises and 165,956 employees

87

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

Manufacturing sector –	24.9%
– Textiles and clothing	4.9%
– Electronics	2.3%
– Plastics	1.9%
– Printing and publishing	1.7%
Non-manufacturing sector –	75.1%
– Trading	45.9%
– Wholesales and retail	8.6%
– Engineering	2.8%
– Construction	2.7%



MICROFINANCE SCHEME

- Launched in June 2012 for a trial period of 3 years with a tentative maximum aggregate loan amount of HK\$100 million
- As at end of March 2015, the Scheme received 305 formal loan applications. Out of the vetted applications, 146 have been approved with the total loan amount of HK\$37.22 million. The approval rate is around 51%
- For the approved applications, the average loan size was about HK\$255,000 and the average loan tenor was 4.5 years

88

- Industry types for the approved start-up loans and self-employment loans (but excluding 2 self-enhancement loans):
 - Retailing 60 cases (42%)
 - Servicing 50 cases (35%)
 - Wholesales 18 cases (13%)
 - IT related 8 cases (6%)
 - Manufacturing 7 cases (5%)
 - Others 1 case (1%)
- * Component percentages in the table above may not add up to 100% due to rounding.