



HONG KONG MONETARY AUTHORITY

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

6 November 2017



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

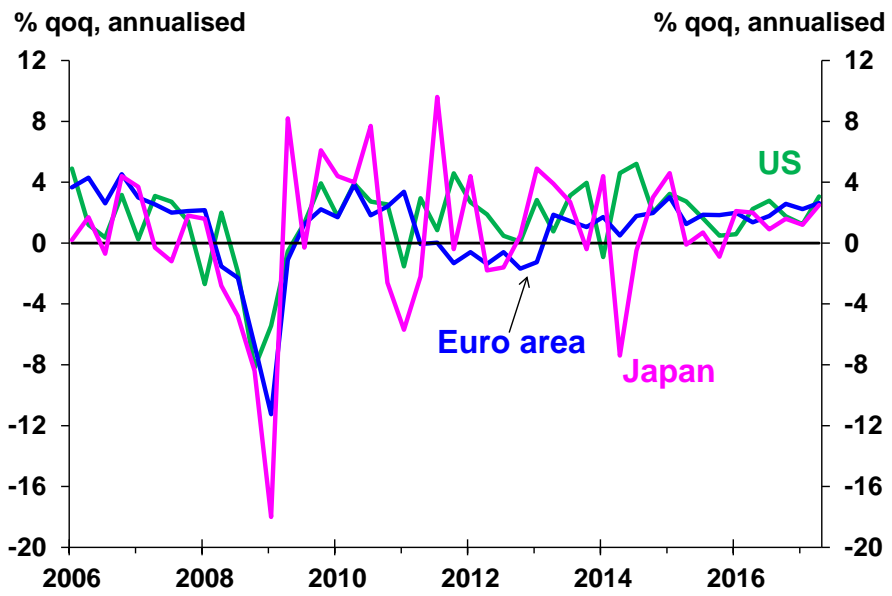
(% year-on-year)

	2016	2017 Forecasts	2018 Forecasts
US	1.5	2.2	2.4
Euro area	1.8	2.2	1.8
Japan	1.0	1.6	1.2
Asia (ex-Japan)	5.8	5.8	5.7
Mainland China	6.7	6.8	6.4
Hong Kong	2.0	3.4	2.5

Sources: October Consensus Forecasts and Official Statistics



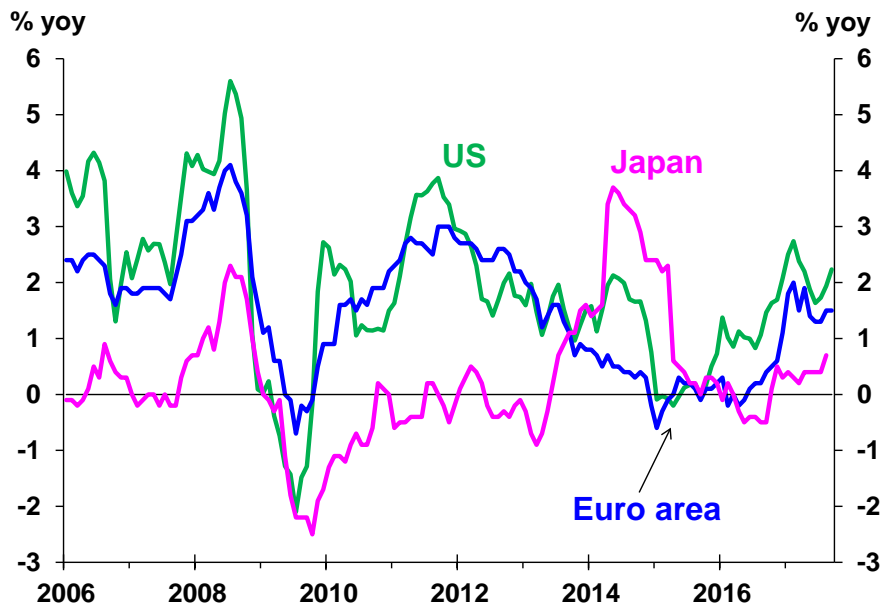
REAL GDP GROWTH IN MAJOR COUNTRIES



Source: Bloomberg



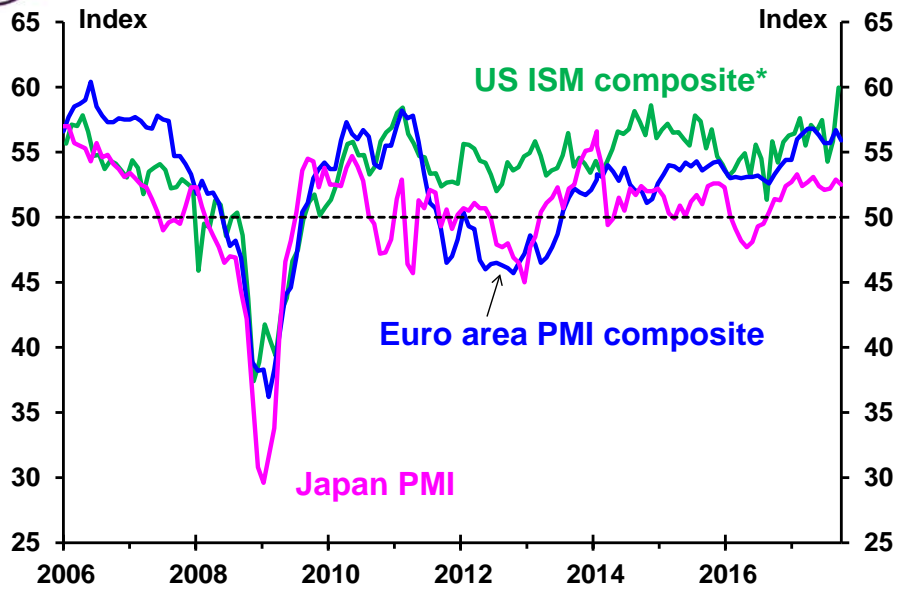
HEADLINE INFLATION IN MAJOR COUNTRIES



Sources: Bloomberg and CEIC



PURCHASING MANAGERS' INDEX IN MAJOR ECONOMIES

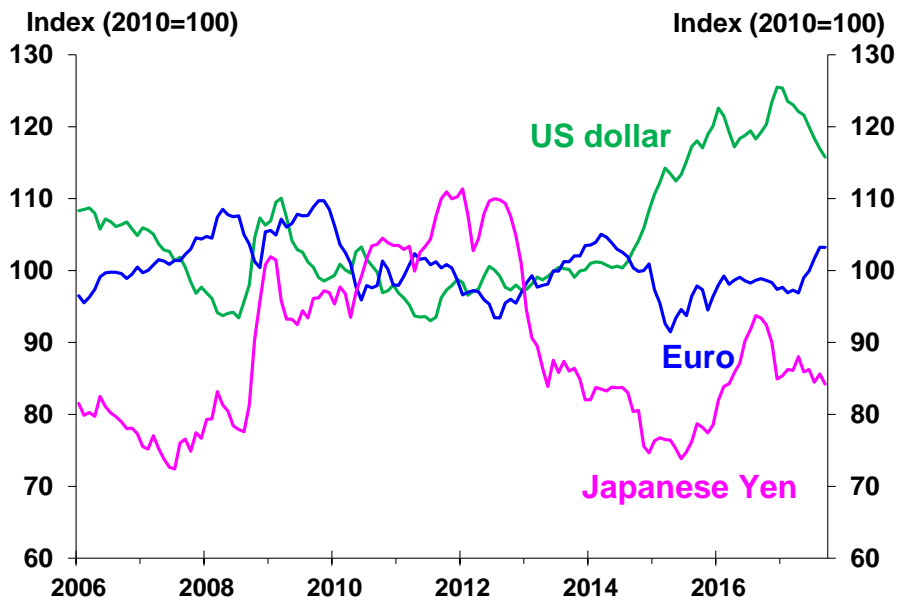


*Weighted average of the ISM manufacturing and non-manufacturing indices

Sources: Bloomberg and CEIC



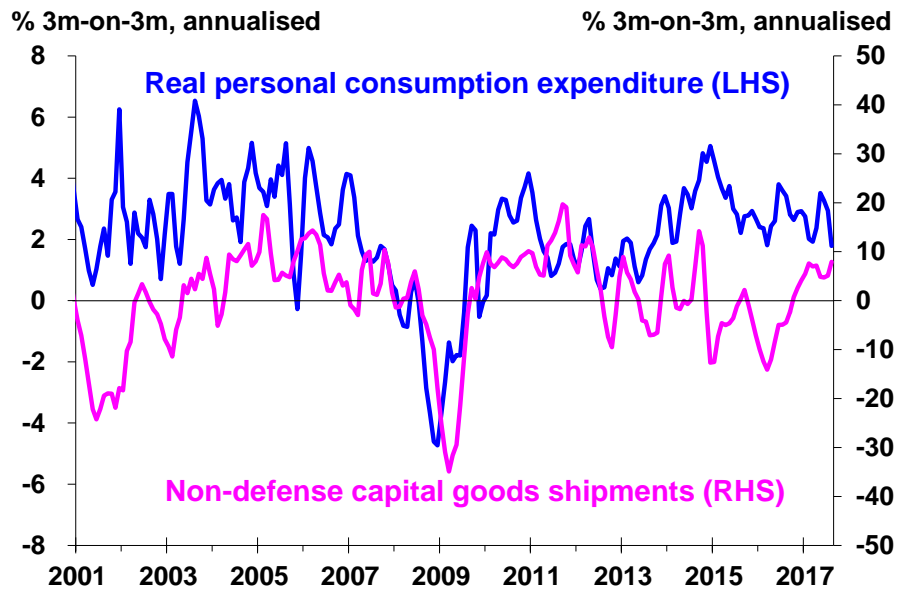
NOMINAL EFFECTIVE EXCHANGE RATE INDEX OF MAJOR CURRENCIES



Source: CEIC



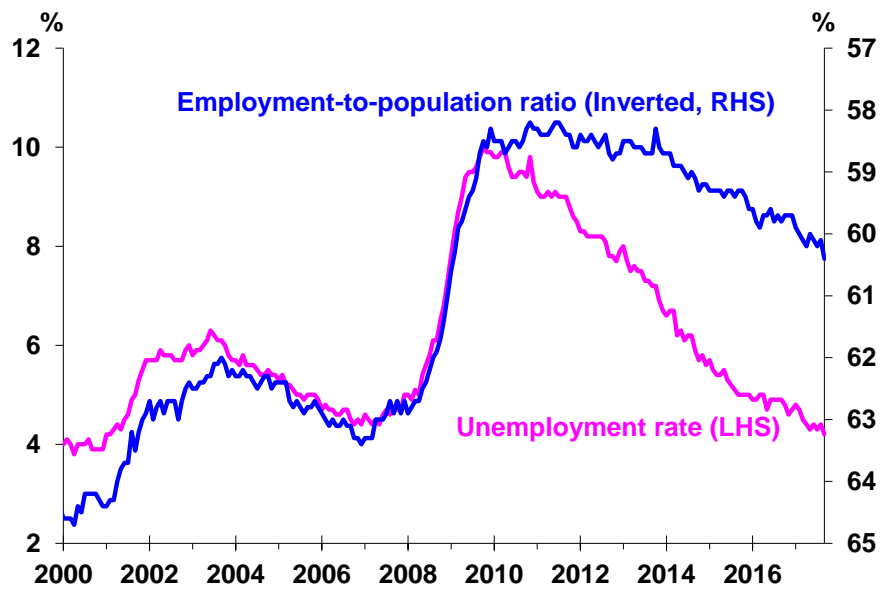
US: CONSUMPTION GROWTH & BUSINESS INVESTMENT ACTIVITY



Source: CEIC



US: LABOUR MARKET SITUATION



Source: CEIC



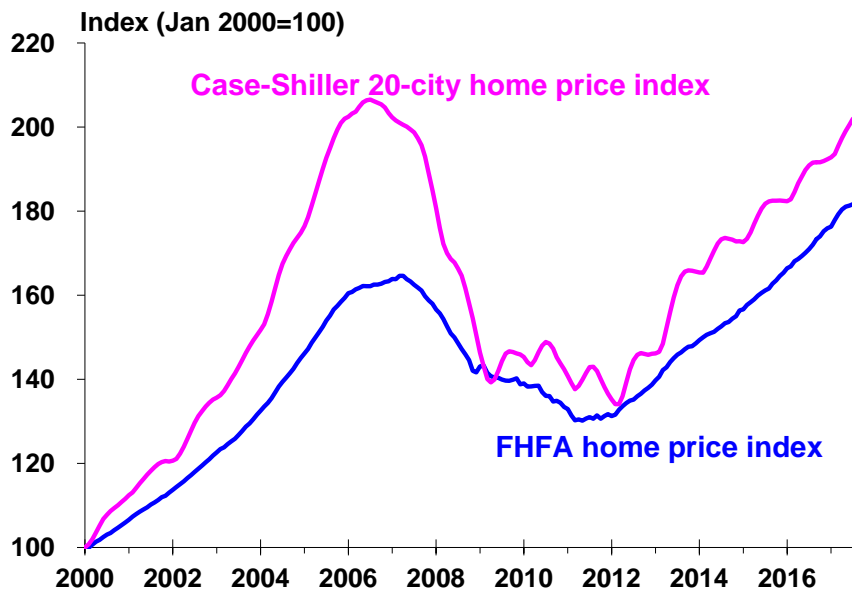
US: LABOUR FORCE PARTICIPATION



Source: CEIC



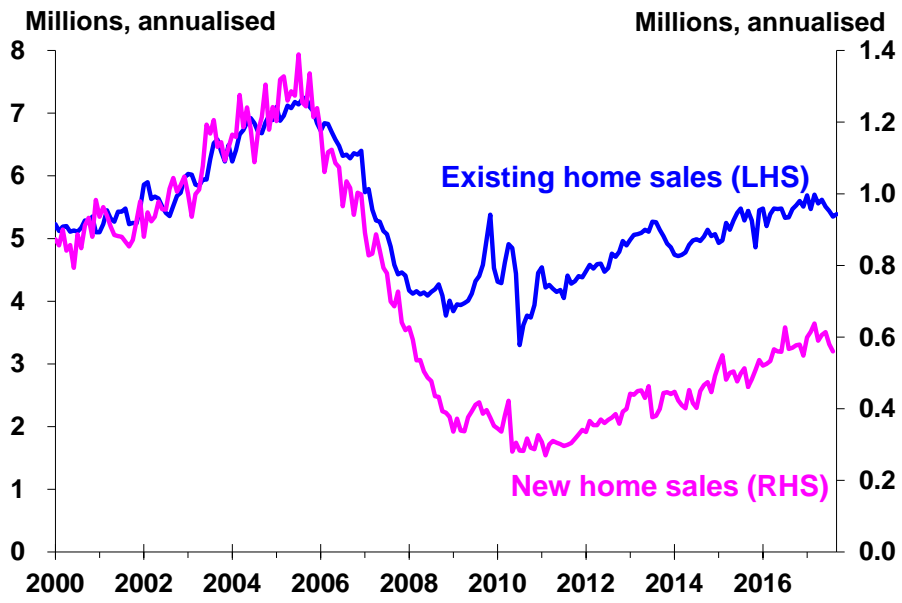
US: HOUSE PRICES



Sources: Standard & Poor's and CEIC



US: HOME SALES

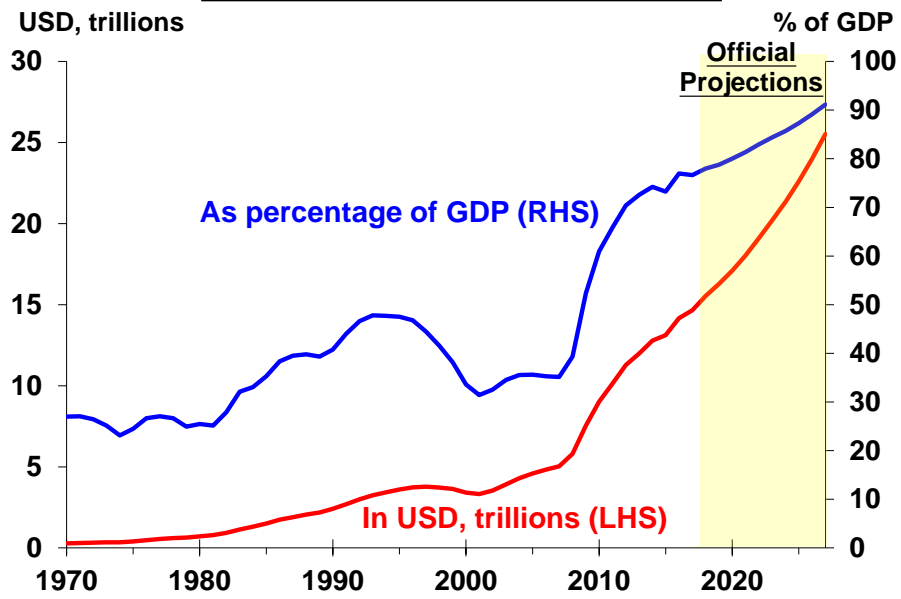


Source: CEIC



US: FEDERAL GOVERNMENT DEBT

US federal debt held by the public

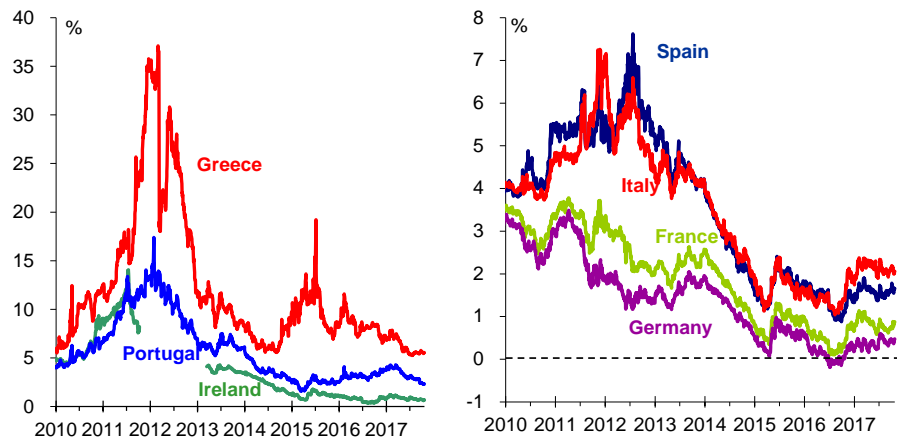


Source: Congressional Budget Office



EURO AREA: SOVEREIGN BOND YIELDS

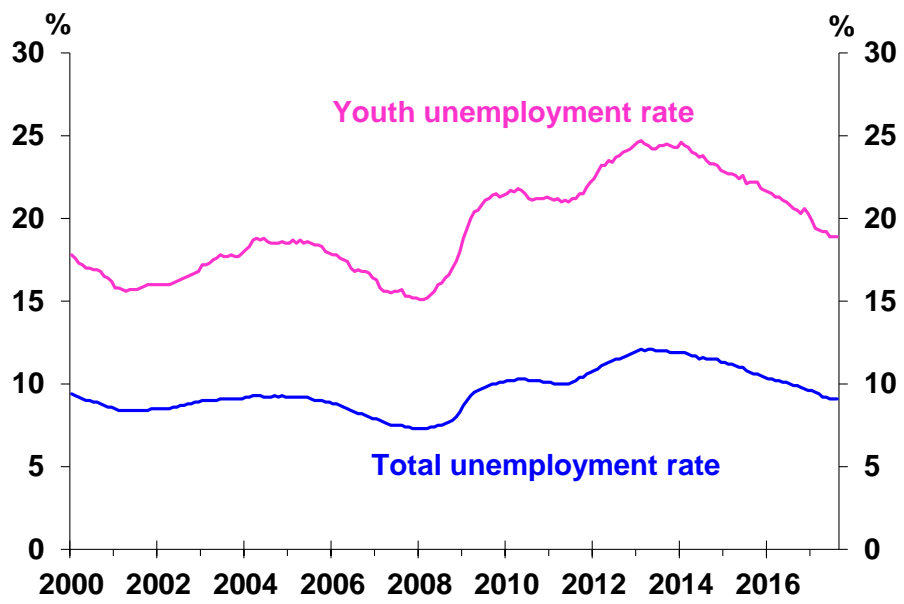
10-year sovereign bond yield



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



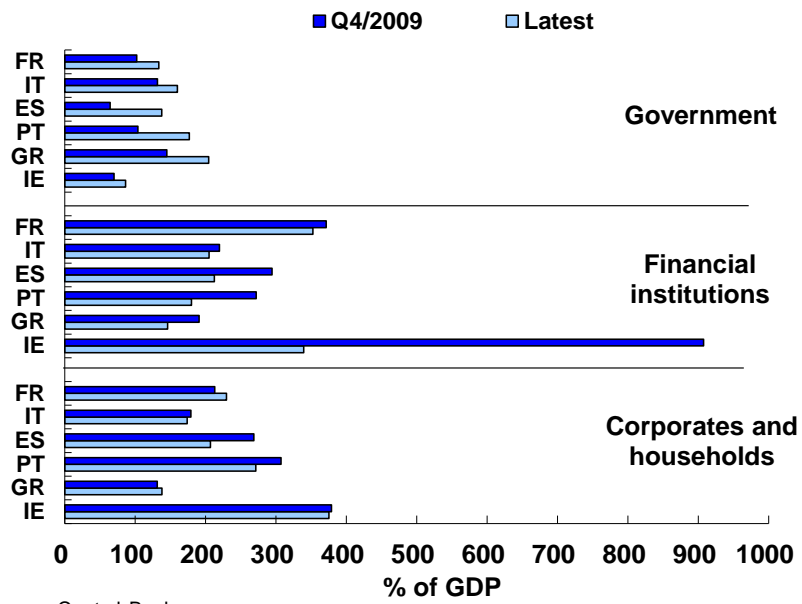
EURO AREA: UNEMPLOYMENT RATE



Source: Bloomberg



EURO AREA: OVERALL INDEBTEDNESS



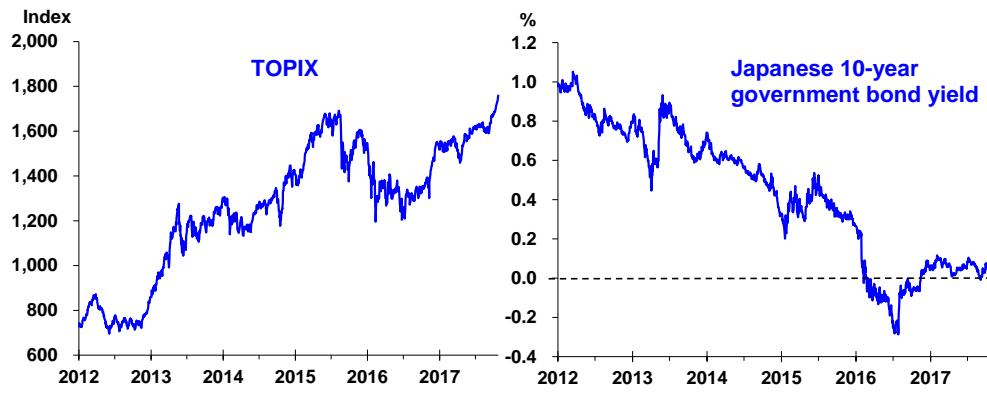
Source: European Central Bank

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

The latest figures for financial institutions are up to Q2/2017 whilst the rest are up to Q1/2017.



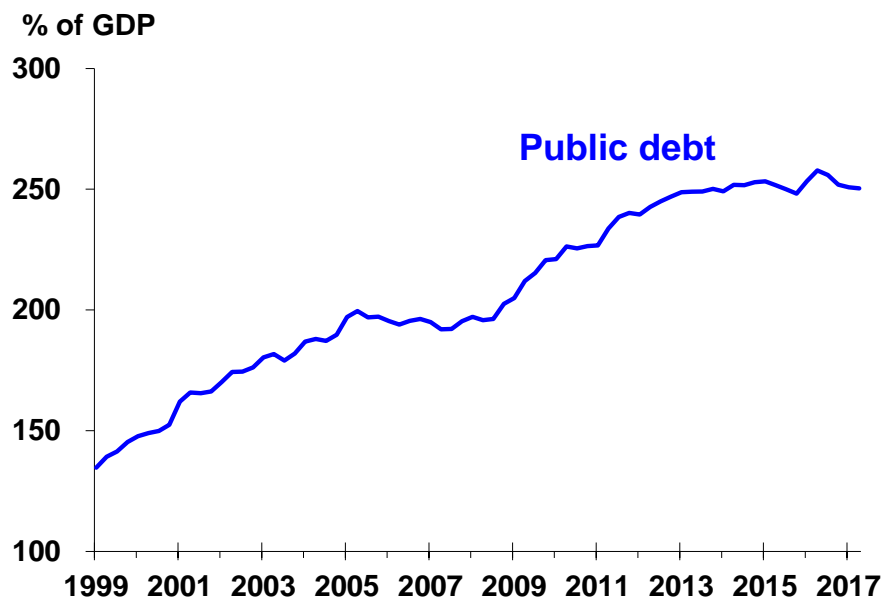
JAPAN: FINANCIAL MARKETS



Source: Bloomberg



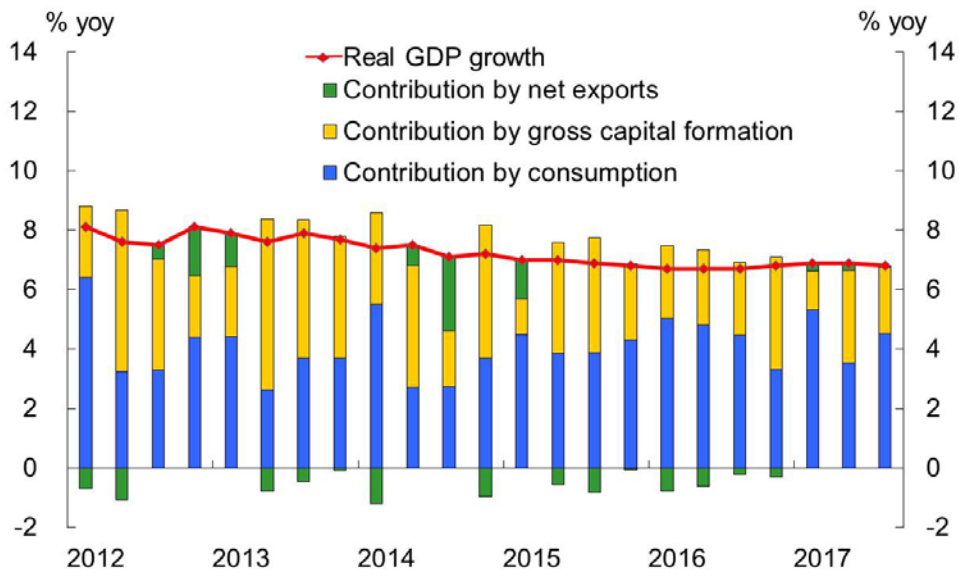
JAPAN: PUBLIC DEBT



Sources: Bank of Japan and CEIC



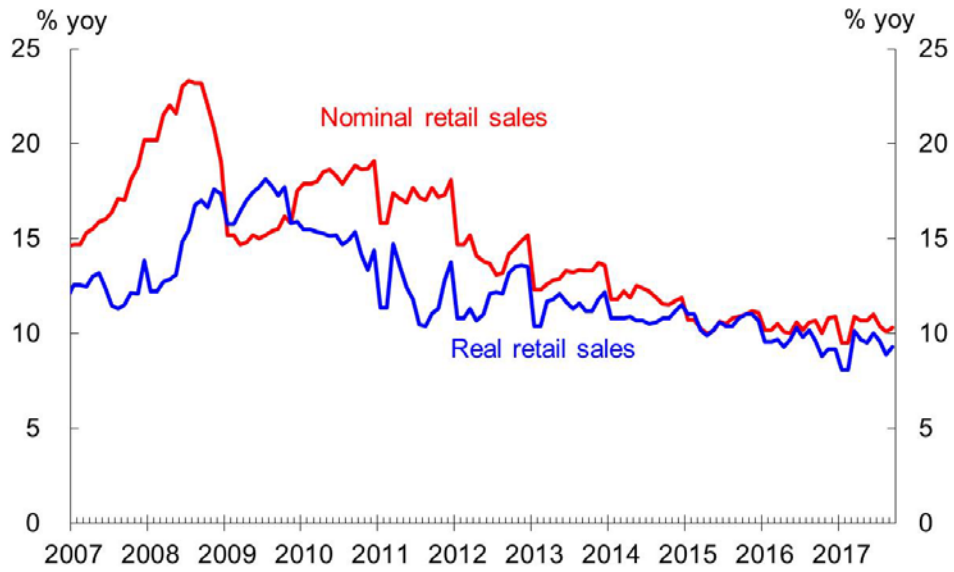
MAINLAND CHINA: REAL GDP GROWTH



Source: CEIC



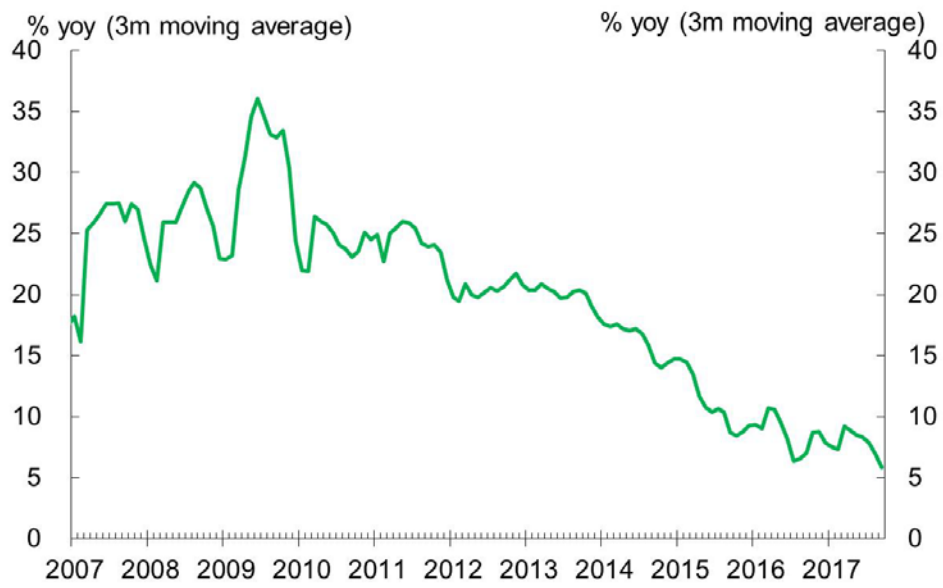
MAINLAND CHINA: RETAIL SALES



Note: January and February figures are the average annual growth rate for the first two months of the year
Sources: WIND and HKMA staff estimates



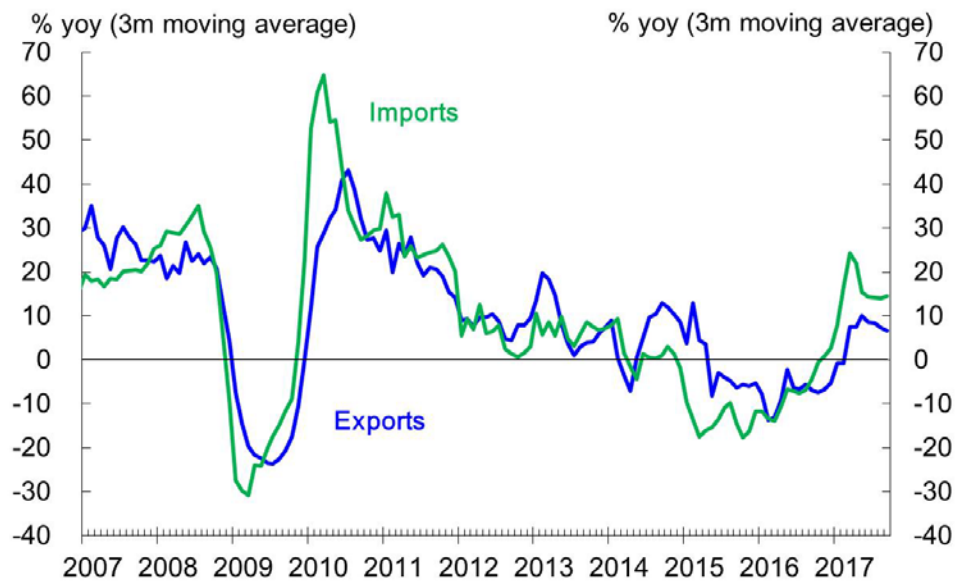
MAINLAND CHINA: FIXED ASSET INVESTMENT



Sources: CEIC and HKMA staff estimates



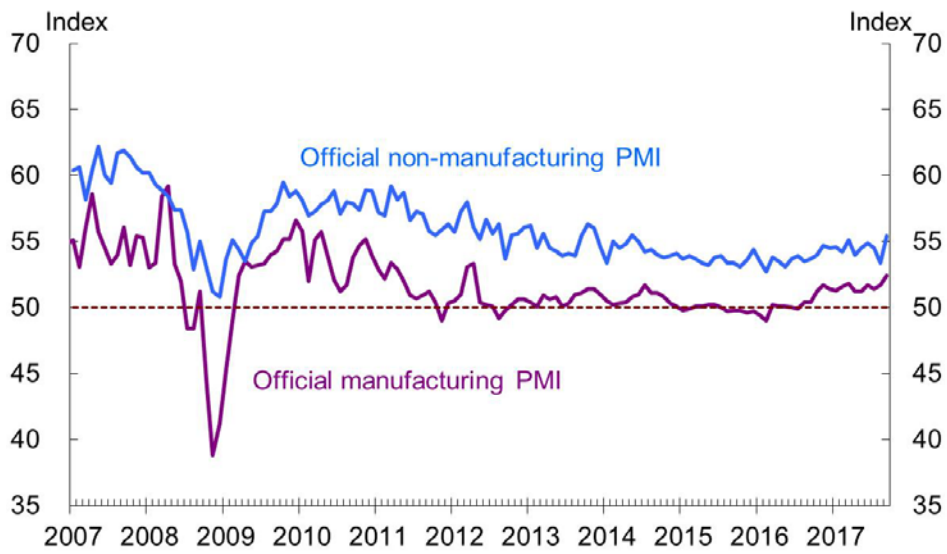
MAINLAND CHINA: IMPORT AND EXPORT GROWTH



Sources: CEIC and HKMA staff estimates



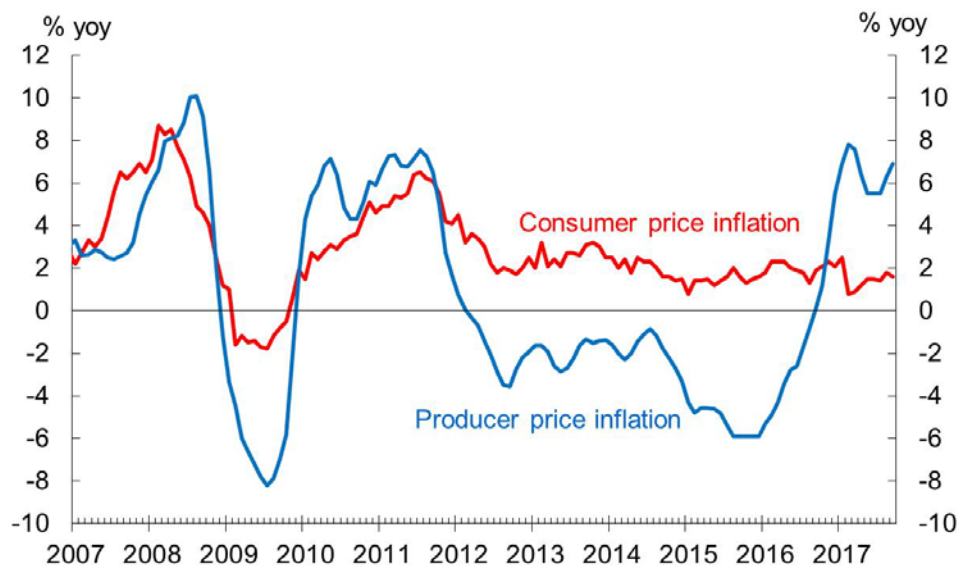
MAINLAND CHINA: PURCHASING MANAGERS' INDEX



Source: CEIC



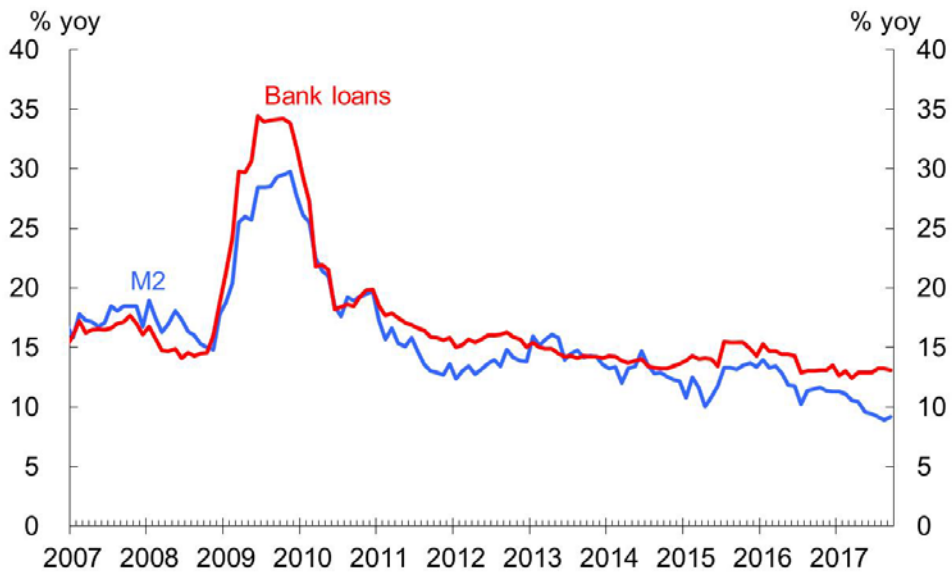
MAINLAND CHINA: INFLATION



Source: CEIC



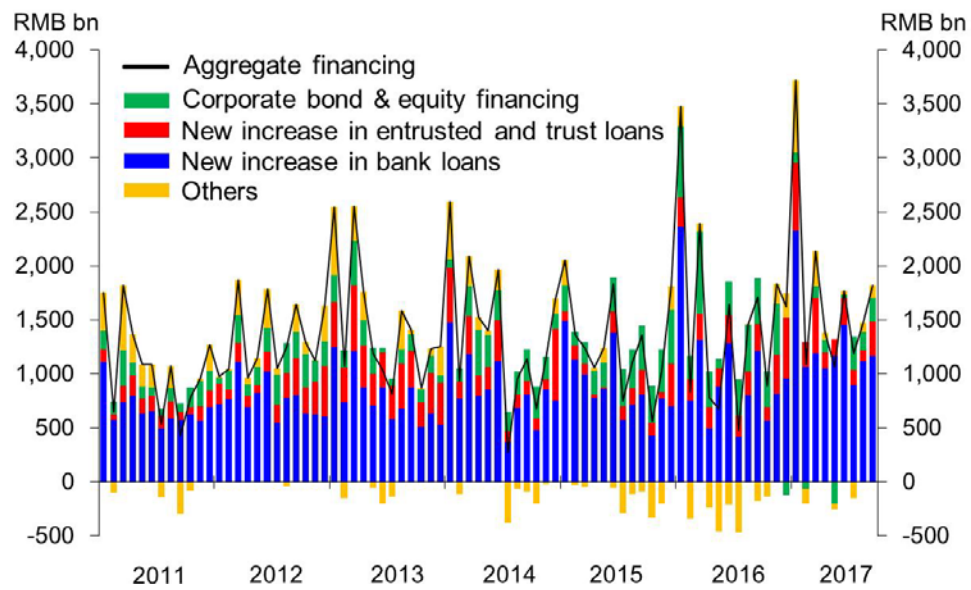
MAINLAND CHINA: MONEY AND LOAN GROWTH



Source: CEIC



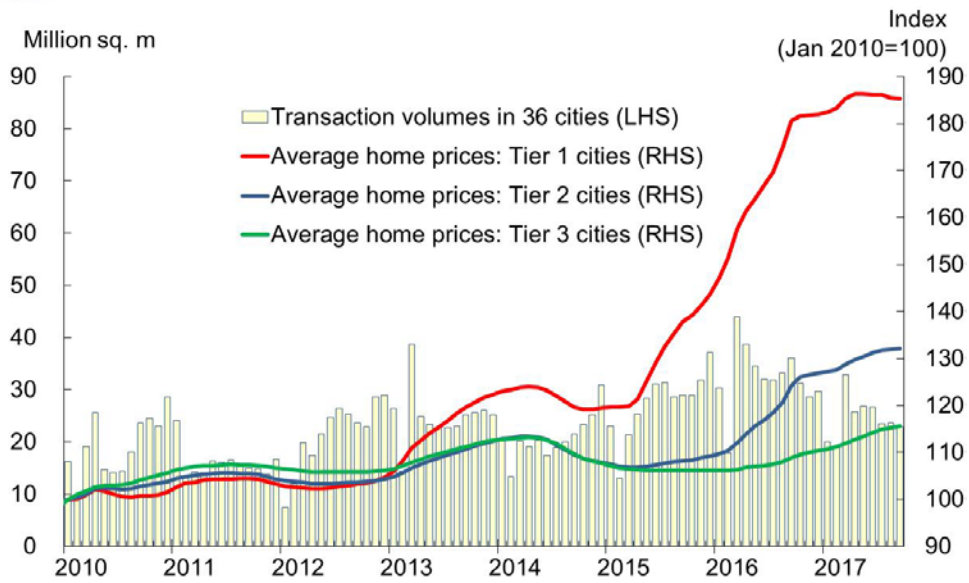
MAINLAND CHINA: AGGREGATE FINANCING FLOW



Source: CEIC



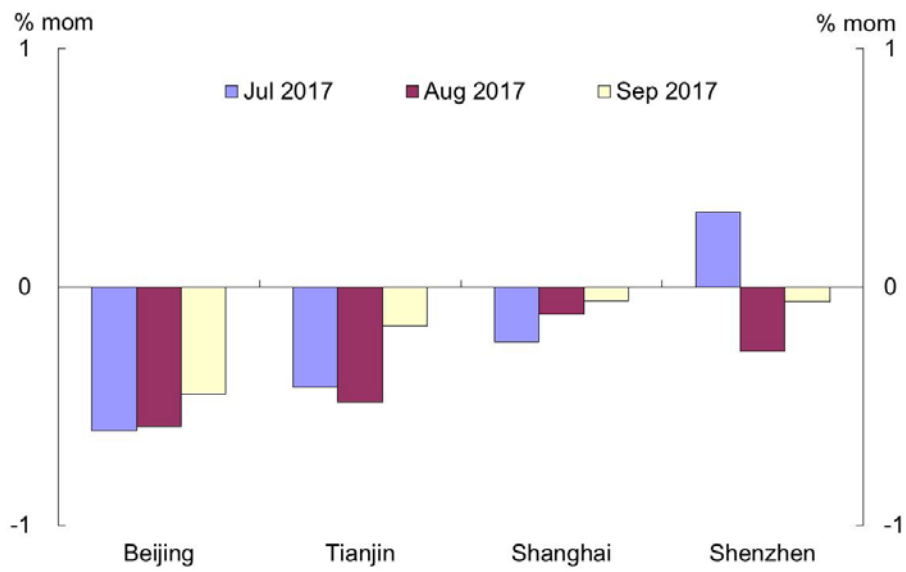
MAINLAND CHINA: PROPERTY PRICE AND TRANSACTION VOLUME



Sources: CEIC, WIND and HKMA staff estimates



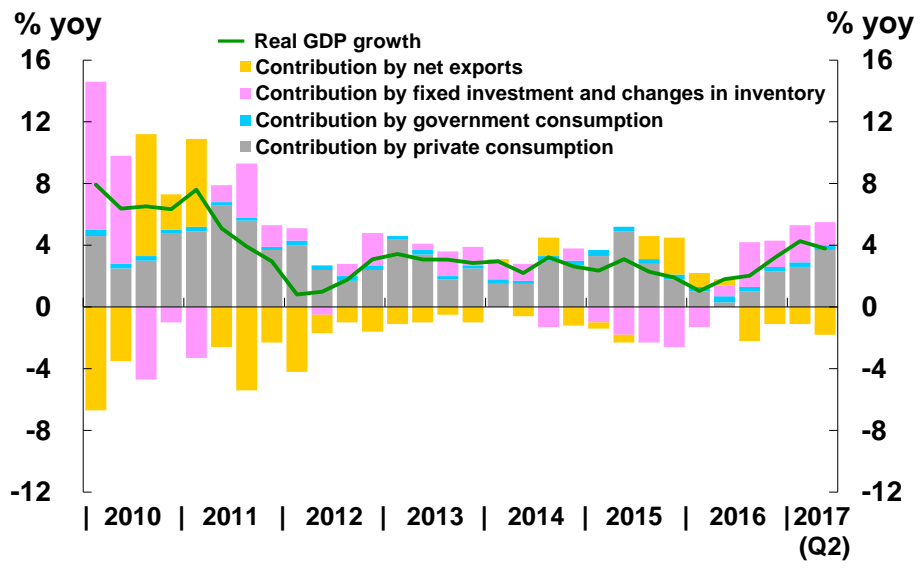
MAINLAND CHINA: HOUSING PRICE CHANGES IN MAJOR CITIES



Sources: CEIC, WIND and HKMA staff estimates



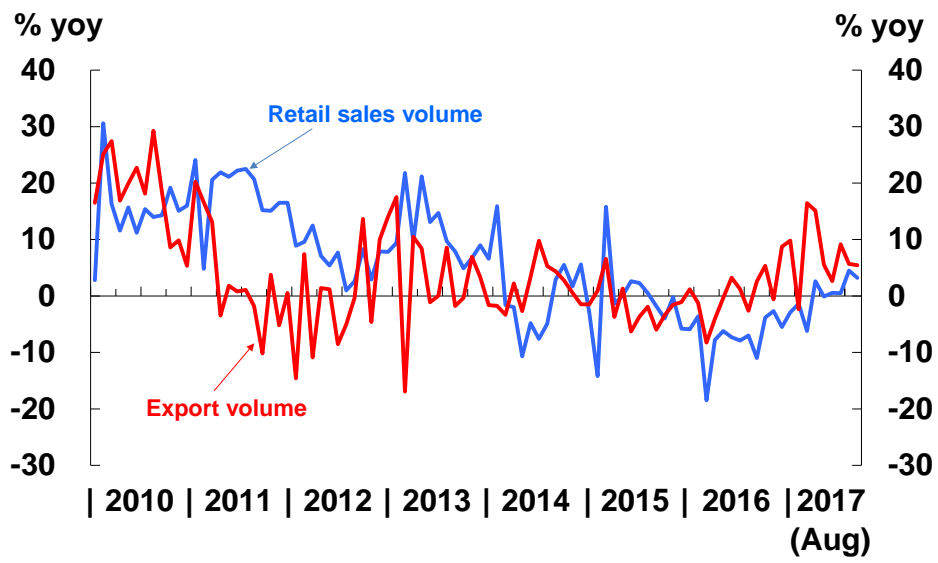
HONG KONG: REAL GDP GROWTH



Source: C&SD



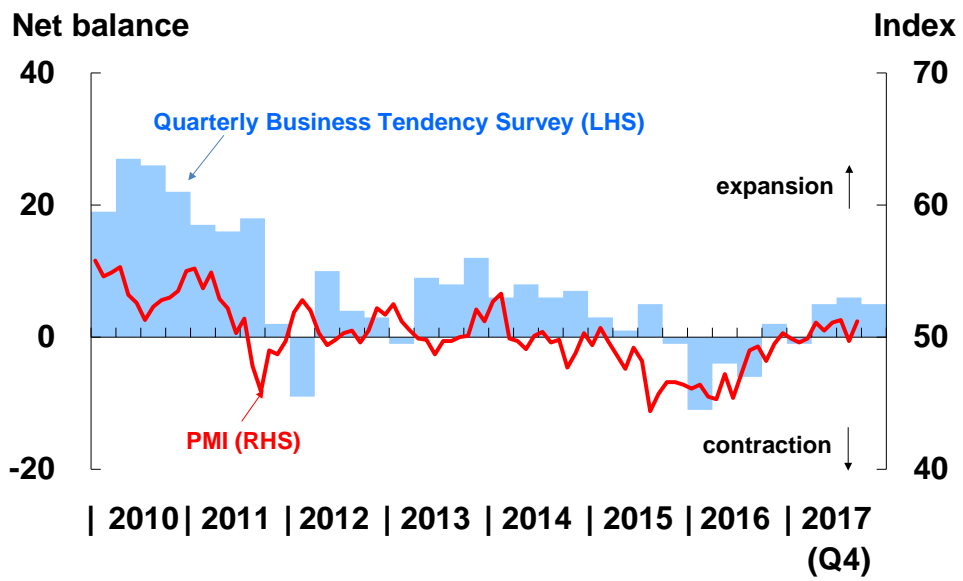
HONG KONG: ECONOMIC ACTIVITY



Source: C&SD



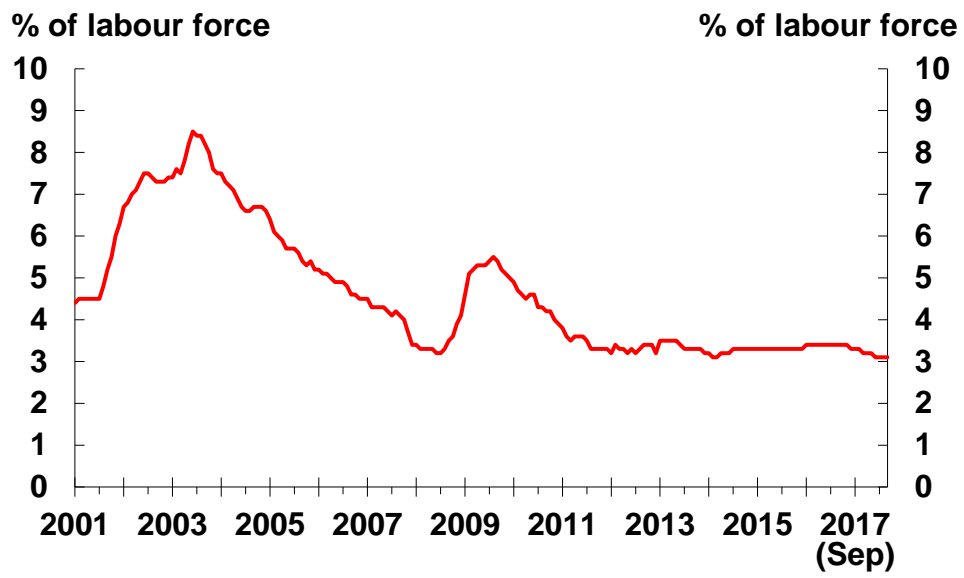
HONG KONG: BUSINESS OUTLOOK



Sources: C&SD and Markit Economics



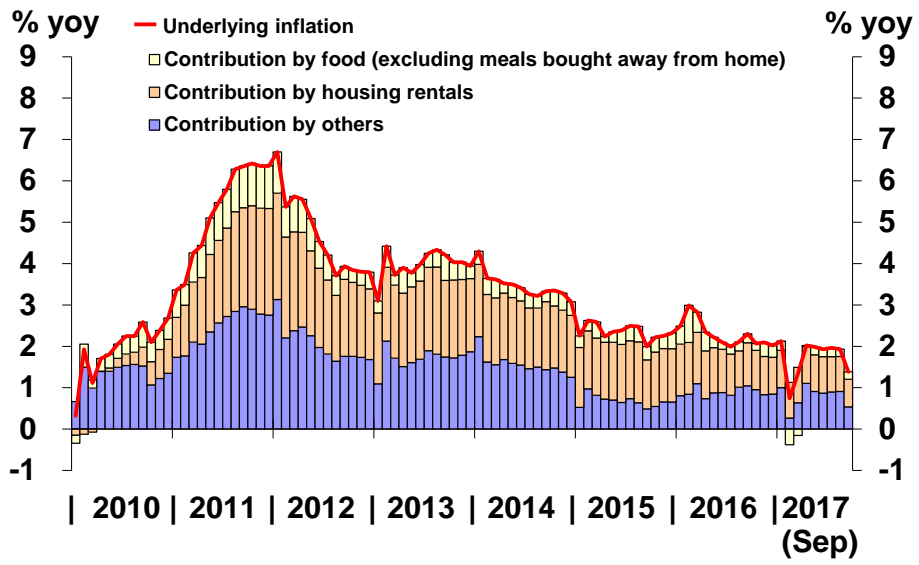
HONG KONG: UNEMPLOYMENT RATE



Source: C&SD



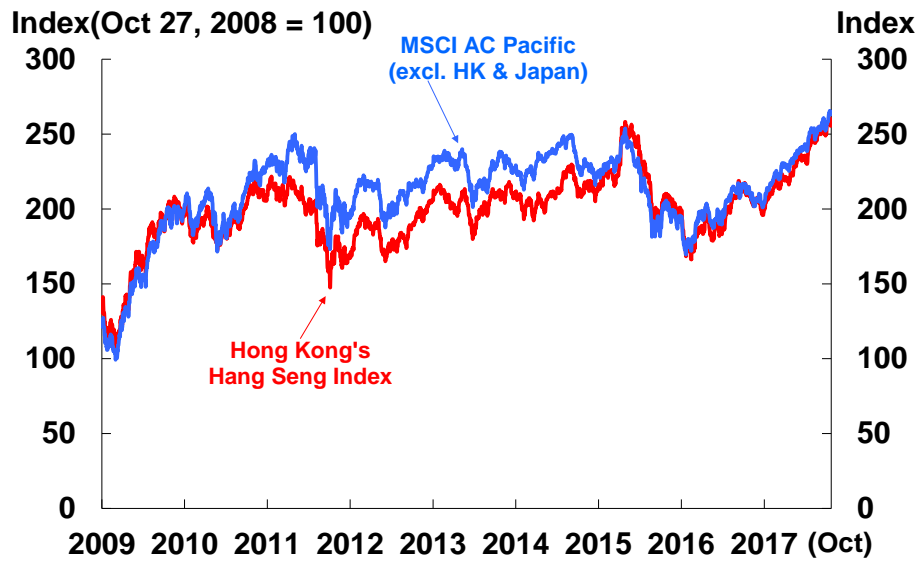
HONG KONG: INFLATION



Sources: C&SD and HKMA staff estimates



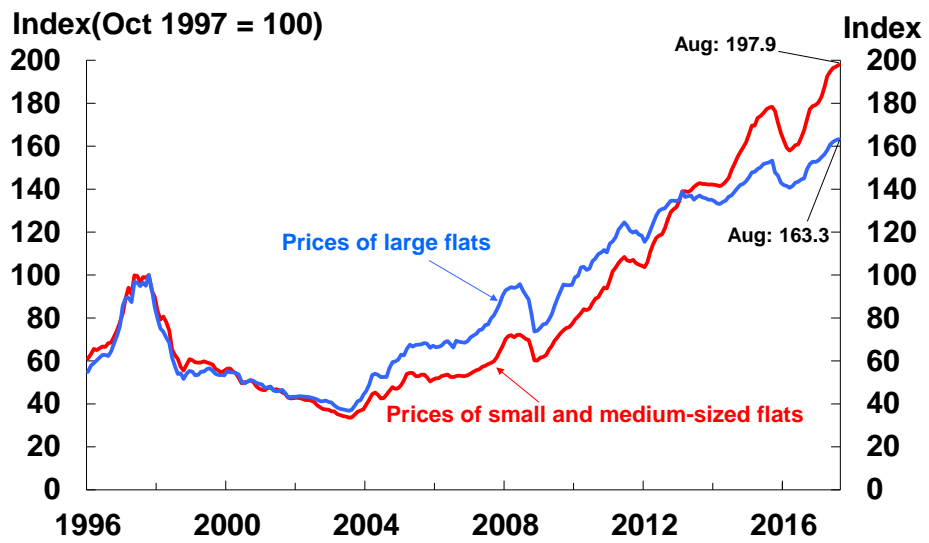
HONG KONG: EQUITY MARKET



Source: Bloomberg



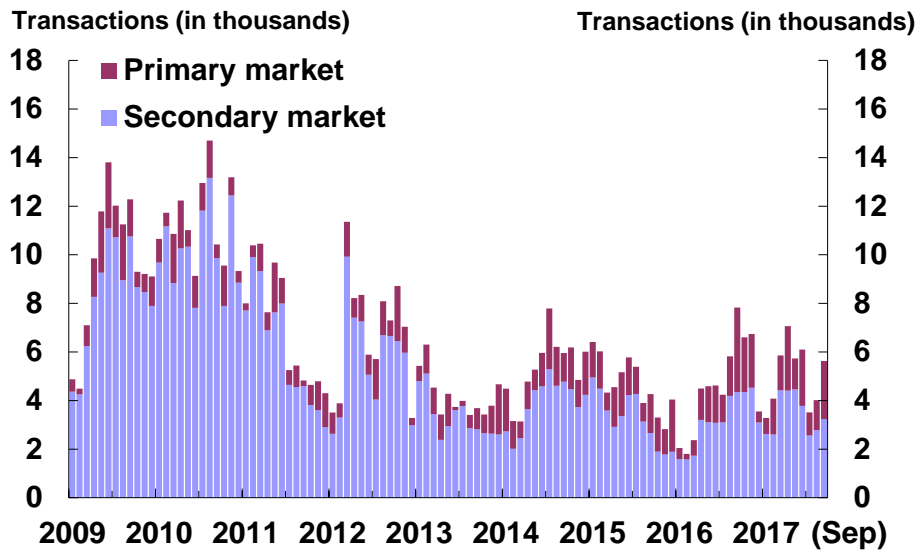
HONG KONG: RESIDENTIAL PROPERTY PRICES



Source: Rating and Valuation Department



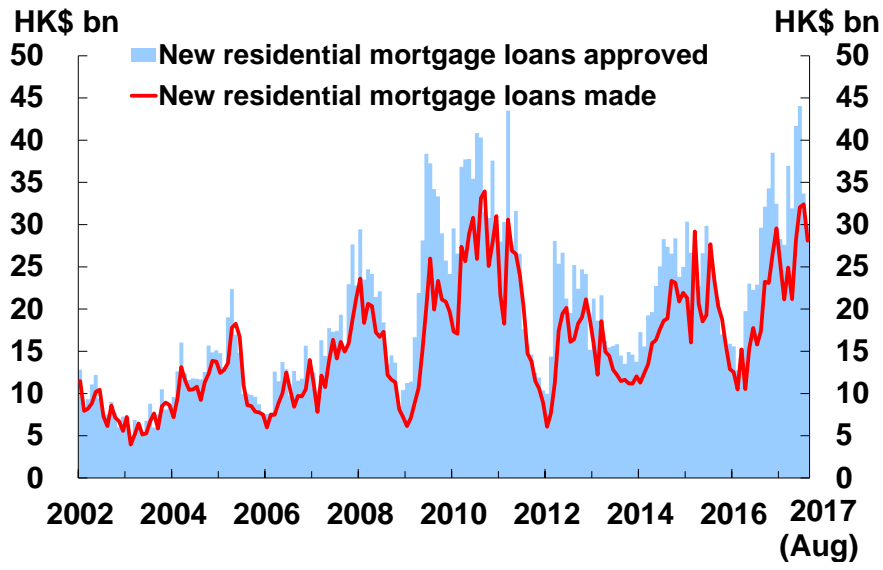
HONG KONG: TRANSACTION VOLUME IN THE PRIMARY AND SECONDARY MARKETS



Source: The Land Registry



HONG KONG: NEW RESIDENTIAL MORTGAGE LOANS

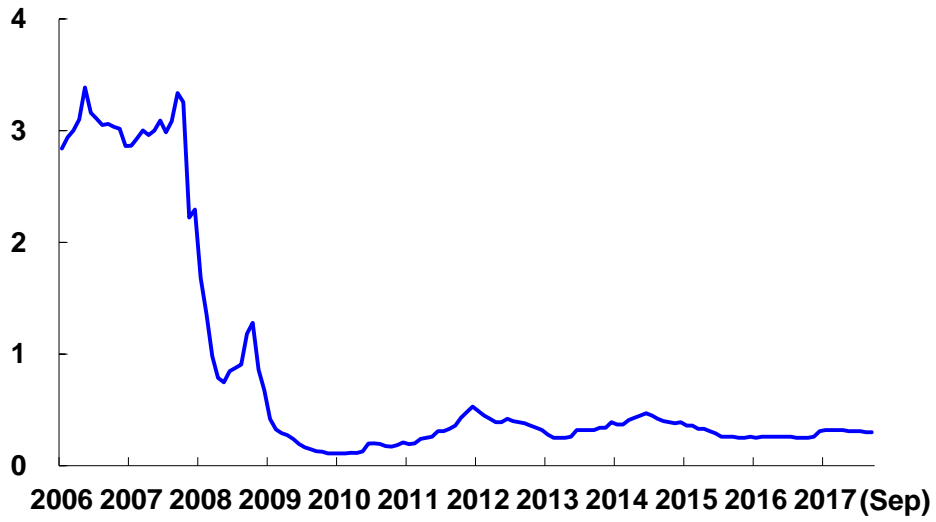


Source: HKMA



HONG KONG: COMPOSITE INTEREST RATE

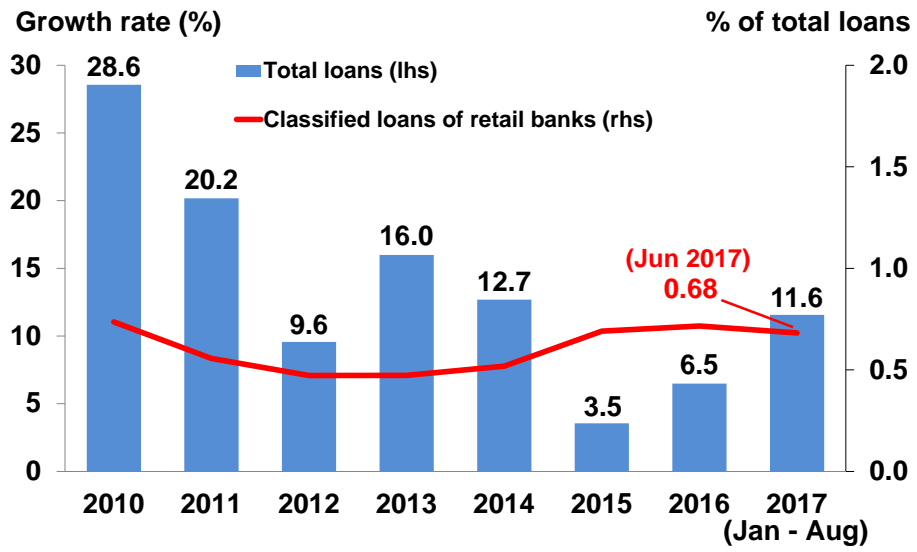
% p.a.



Source: HKMA



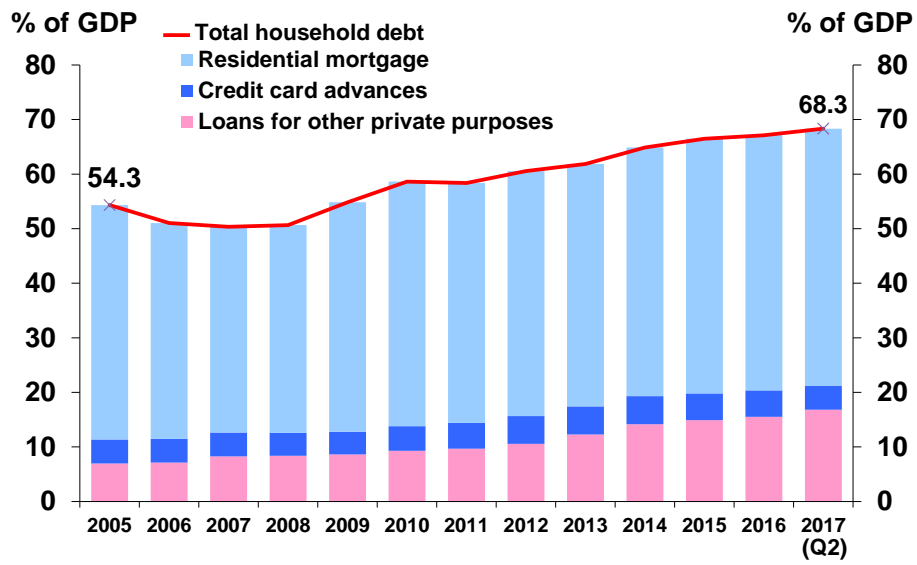
HONG KONG: LOAN GROWTH AND ASSET QUALITY



Source: HKMA



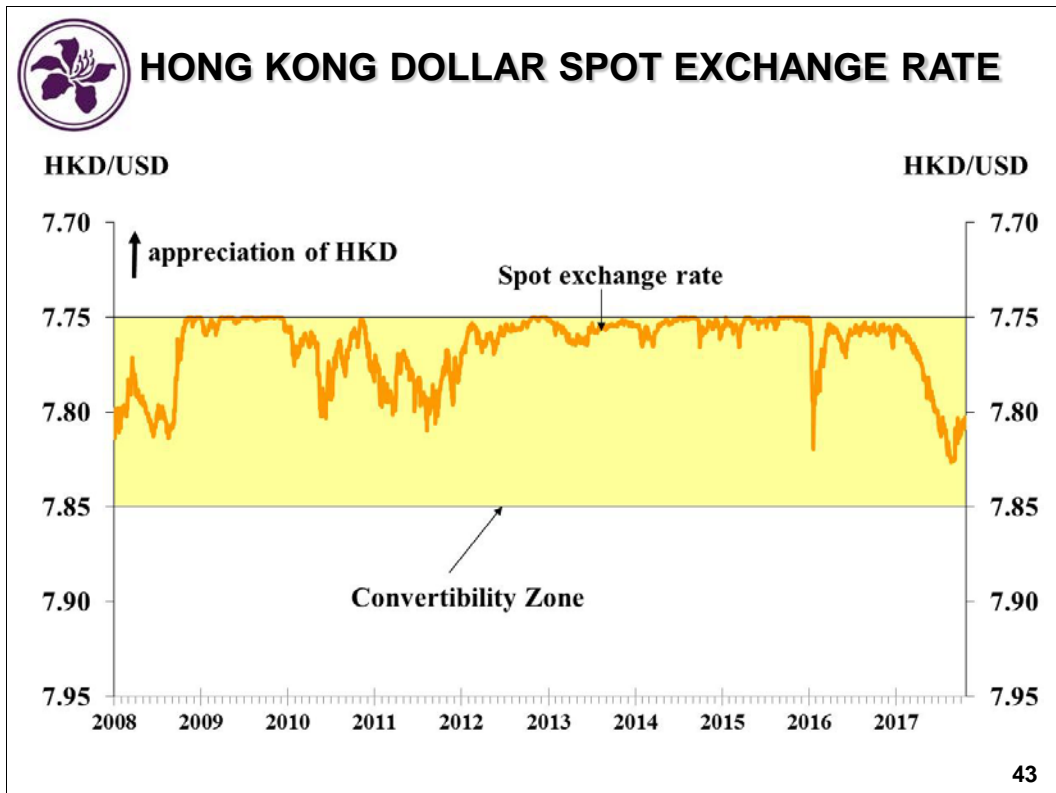
HONG KONG: HOUSEHOLD DEBT



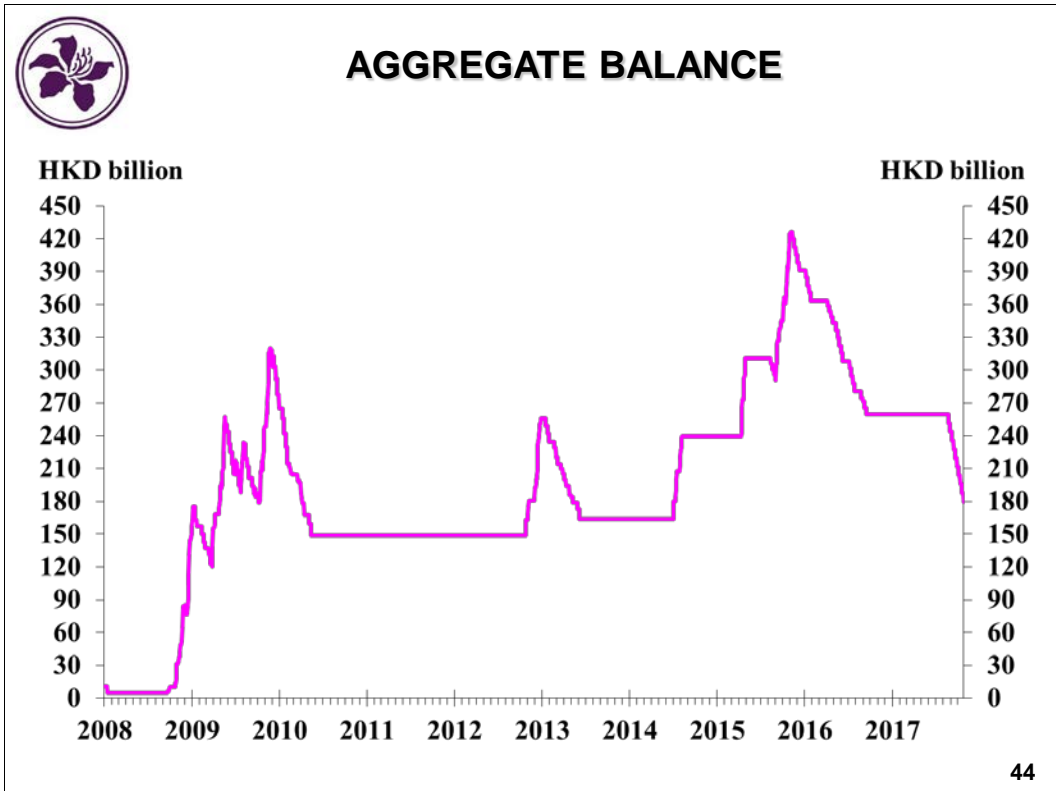
Source: HKMA



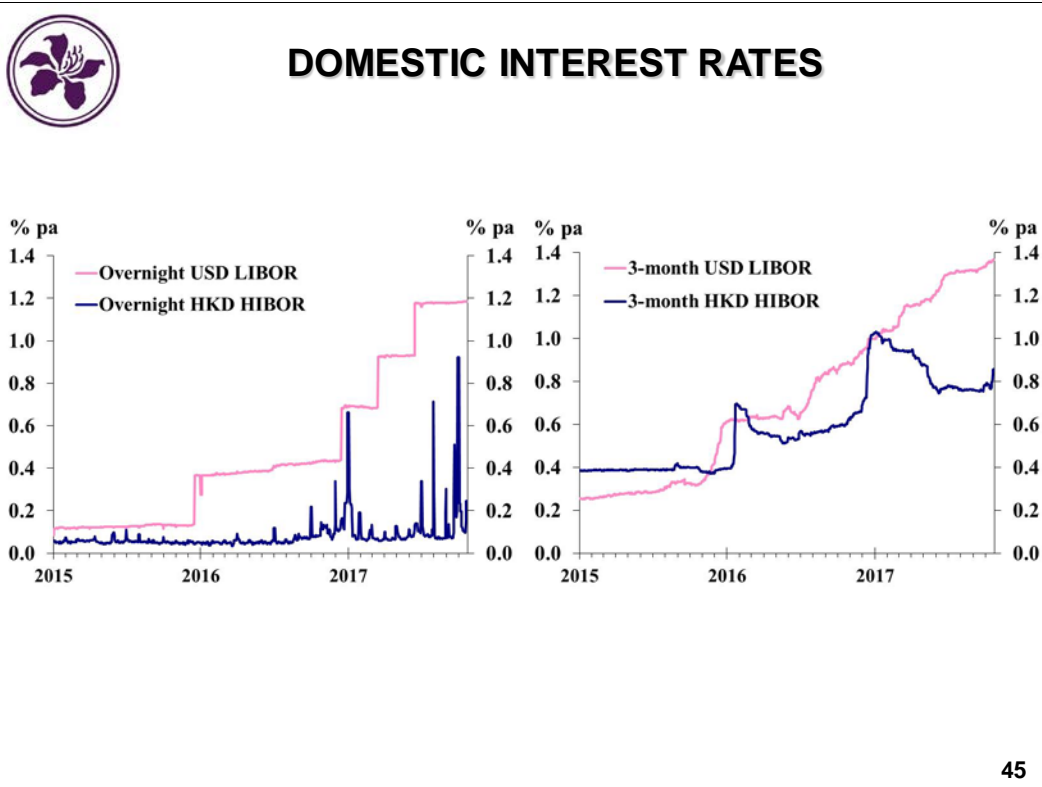
CURRENCY STABILITY



- The Hong Kong dollar spot exchange rate eased in the first seven months of the year, reaching a low of 7.8265 per USD on 22 August, largely driven by the widening interest rate gap between the Hong Kong dollar and the US dollar.
- Afterwards, alongside the notable appreciation of the renminbi and the announcement of additional issuance of Exchange Fund Bills, some market players turned more cautious in holding onto their interest carry positions. This led to an increase in the demand for Hong Kong dollar. The Hong Kong dollar spot exchange rate has rebounded to near 7.80 level against the US dollar recently.



- A total of HK\$80 billion of additional Exchange Fund Bills (EFBs) were issued between August and October to meet banks' strong demand for EFBs for liquidity management purpose. Accordingly, the Aggregate Balance declined from levels close to HK\$260 billion in early August to about HK\$180 billion in late October.



- The Hong Kong dollar interbank interest rates (HIBORs) remained lower than their US dollar counterparts (LIBORs). Owing to a further US interest rate hike in June, the spread between 3-month HIBOR and LIBOR widened from -44 basis points at end-May to about -59 basis points in mid-October. An increase in IPO-related and quarter-end funding demand led to a brief increase in overnight HIBOR at end-September, narrowing the interest rate differential with LIBOR.



- After widening gradually since the beginning of the year, the 12-month Hong Kong dollar forward points appeared to have stabilised and moved largely around -500 pips between June and late October.

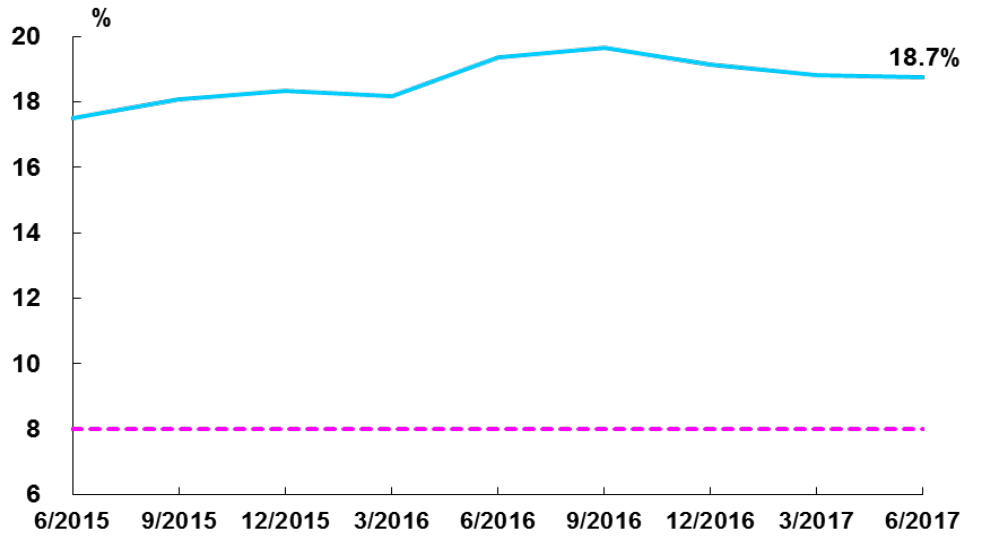


BANKING STABILITY



BANKING SECTOR PERFORMANCE

Locally incorporated authorized institutions (AIs)
remained well capitalised



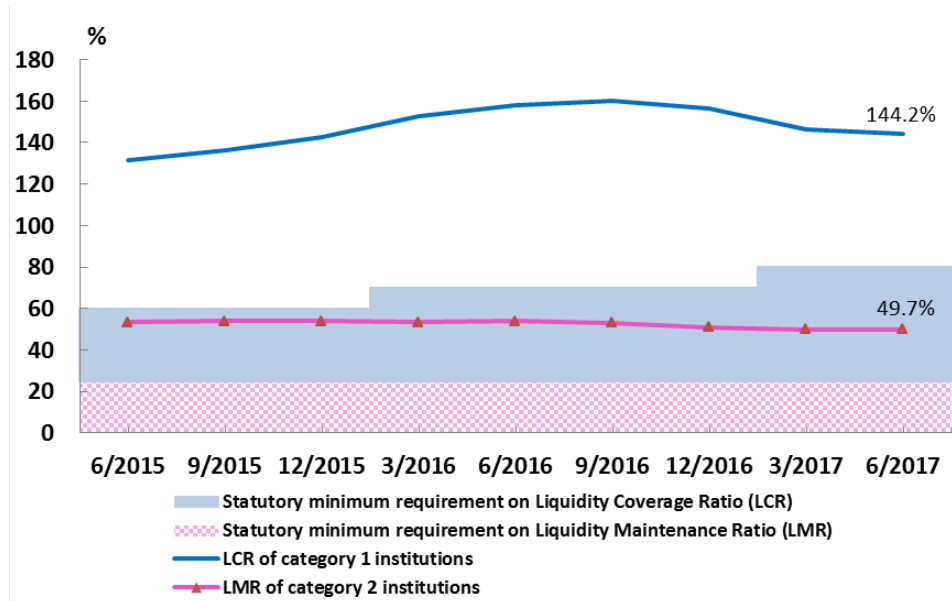
48

- The banking sector continued to be well capitalised. The consolidated capital adequacy ratio of locally incorporated AIs edged down slightly to 18.7% at end-June 2017 from 18.8% a quarter earlier, but remained well above the international minimum requirement of 8%.



BANKING SECTOR PERFORMANCE

Liquidity position remained sound

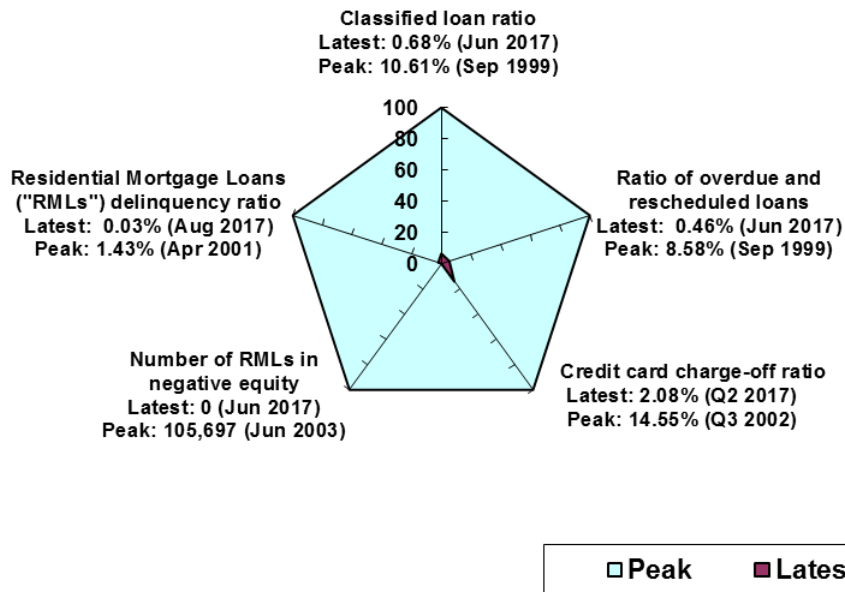


- In the second quarter of 2017, the quarterly average Liquidity Coverage Ratio of category 1 institutions was 144.2%, well above the 80% statutory minimum requirement applicable for 2017. For category 2 institutions, their quarterly average Liquidity Maintenance Ratio was 49.7%, also well above the 25% statutory minimum requirement.



BANKING SECTOR PERFORMANCE

Asset quality stayed healthy



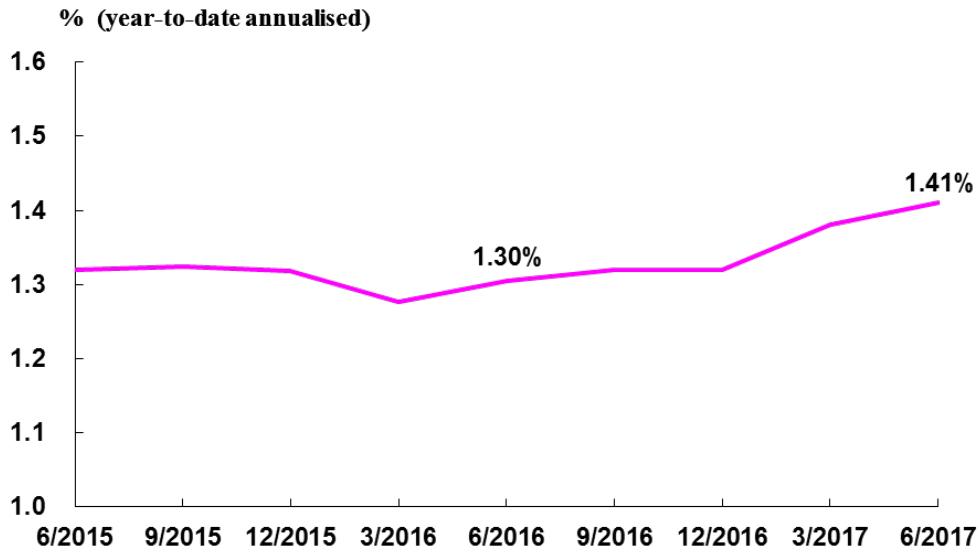
50

- The asset quality of retail banks continued to hold up well. Their classified loan ratio edged down to 0.68% at end-June 2017 from 0.70% a quarter earlier, well below the long-run historical average of 2.3% since 2000. The classified loan ratio of the whole banking sector stood at 0.83% at end-June 2017, unchanged from end-March 2017.



BANKING SECTOR PERFORMANCE

Net interest margin continued to improve



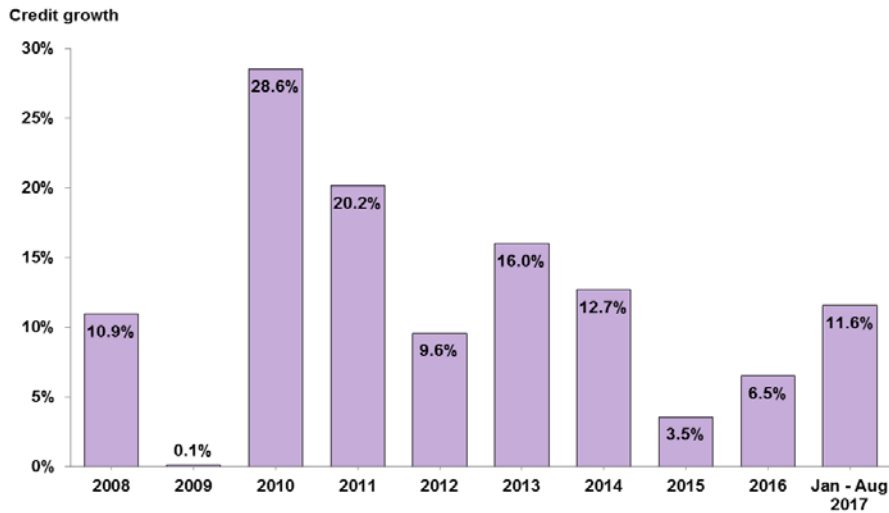
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- The net interest margin of retail banks' Hong Kong offices rose to 1.41% in the first half of 2017 from 1.30% in the same period last year.



BANKING SECTOR PERFORMANCE

Credit growth showed signs of moderation in the third quarter



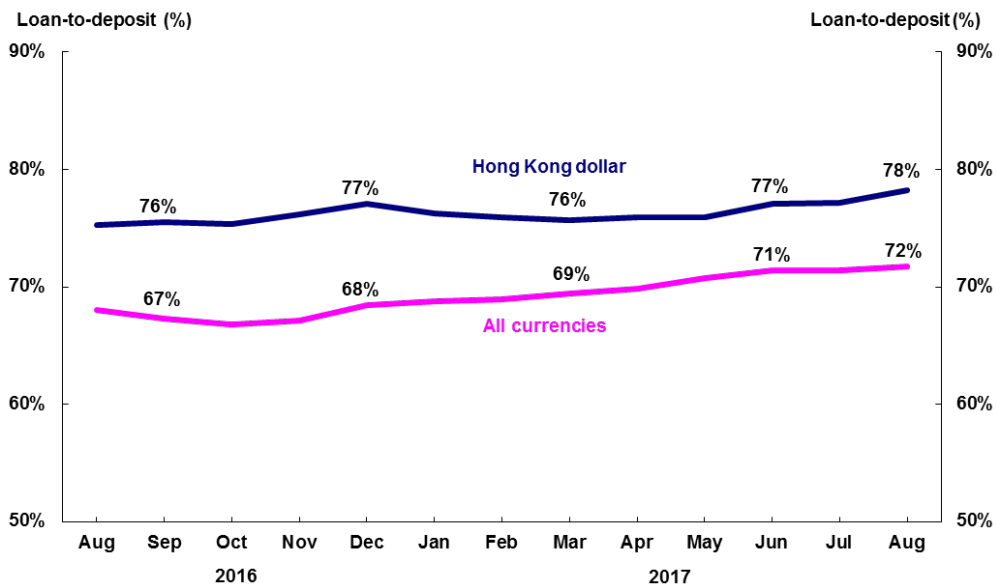
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- As compared to the end of 2016, total loans of the Hong Kong banking sector grew by 11.6% to around HK\$9 trillion at end-August 2017. Entering the third quarter, loan growth showed signs of moderation. The month-on-month loan growth rates in July and August were 1.0% and 0.2% respectively. If this trend continues, it is expected that the quarter-on-quarter loan growth rate in the third quarter will slow to 2.3% as compared to 5.4% in the second quarter.
- The loan growth in the first 8 months was broad-based. Loans for use in Hong Kong (year-to-date growth: +11.4%), loans for use outside Hong Kong (year-to-date growth: +12.5%) and trade finance (year-to-date growth: +9.1%) all recorded growth during the period.



BANKING SECTOR PERFORMANCE

Loan-to-deposit ratios increased slightly



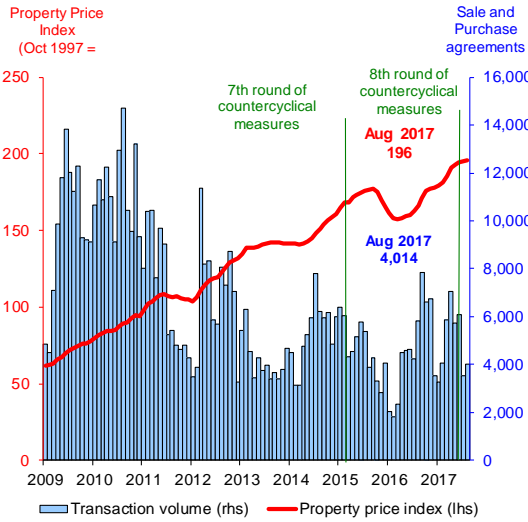
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- Hong Kong-dollar loan-to-deposit ratio edged up to 78% at end-August 2017 from 77% at end-June 2017. Similarly, all currencies loan-to-deposit ratio increased slightly to 72% from 71% during the same period.



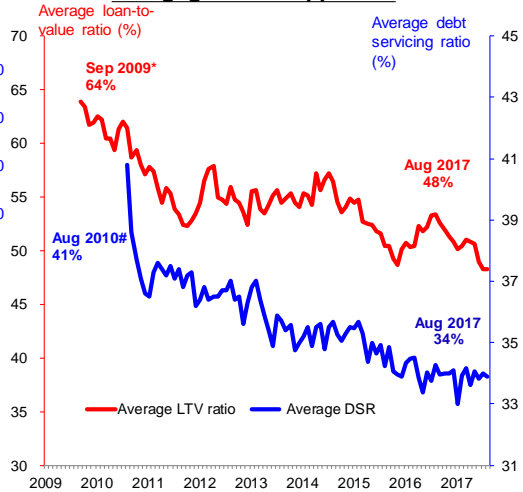
RISK MANAGEMENT OF PROPERTY MORTGAGE LOANS

Residential property price index and transaction volume



Sources: R&VD and Land Registry

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



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

When the tighter requirement on debt servicing ratio was introduced by the HKMA

Latest statistics for residential mortgage loans (RMLs)

	Monthly average in 2015	Monthly average in 2016	Mar 2017	Apr 2017	May 2017	Jun 2017	Jul 2017	Aug 2017
Number of sale and purchase agreements	4,665	4,558	5,856	7,060	5,732	6,100	3,515	4,014
Number of new RML applications	9,626	10,294	15,603	13,027	14,825	14,654	9,090	10,908
Number of new RMLs approved	7,059	7,290	9,940	8,164	10,845	11,459	8,878	7,997

Latest statistics for residential property prices

Property price index		Period	Property price index
Rating and Valuation Department (10/1997=100)	Latest position	08/2017	196.1
	Recent Peak	08/2017	196.1
	Peak in 1997	10/1997	100.0
Centaline (6/7/1997=100)	Latest position	10/09/2017	161.0
	Recent Peak	27/08/2017	161.4
	Peak in 1997	19/10/1997	102.9



INTERNATIONAL STANDARDS IMPLEMENTATION

- Banking (Capital) (Amendment) Rules 2017 and Banking (Liquidity) (Amendment) Rules 2017
- Banking (Amendment) Bill 2017

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On 25 October, we submitted to the Legislative Council (LegCo) for approval some legislative amendments to implement international banking regulatory standards aimed at strengthening the financial soundness and resilience of banks and the banking sector. These comprise:

- Banking (Capital) (Amendment) Rules 2017 (BCAR 2017) and Banking (Liquidity) (Amendment) Rules 2017, which will implement the Basel III Leverage Ratio and Net Stable Funding Ratio requirements. Also included in the BCAR 2017 are proposed rules on the Basel revised securitisation framework and (interim) capital treatment of expected loss provisioning under Hong Kong Financial Reporting Standard 9.
- In addition, following a decision of the Basel Committee in November 2016, we take this opportunity to propose an amendment to the Banking (Specification of Multilateral Development Bank) Notice to include a member of the World Bank Group (the International Development Association) as a Multilateral Development Bank for preferential capital and liquidity treatment.
- Subject to negative vetting by LegCo, these regulatory changes will take effect from 1 January 2018.
- Banking (Amendment) Bill 2017, which seeks to empower the Monetary Authority to prescribe recovery planning requirements and financial exposure limits for authorized institutions to reflect the latest international regulatory standards.



ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING

- Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Bill 2017
 - expand the Ordinance to cover some non-financial sectors (e.g. solicitors, accountants)
 - fine-tune some customer due diligence requirements for financial institutions

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- The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Bill 2017 was introduced into the Legislative Council (LegCo) on 28 June 2017. While the main objective of the bill is to expand the anti-money laundering and counter-terrorist financing regime to cover certain non-financial sectors (i.e. solicitors, accountants, real estate agents, and trust or company service providers), a number of existing requirements applicable to banks will also be amended to streamline the customer due diligence requirements. Subject to the passage of the bill by LegCo, the proposed amendments will come into effect on 1 March 2018.



HONG KONG RESOLUTION REGIME

- Main provisions of Financial Institutions (Resolution) Ordinance (FIRO) came into force on 7 July 2017 along with Protected Arrangements Regulation (PAR)
- Developing subsidiary legislation under FIRO as well as other relevant legislation, including:
 - Loss-absorbing capacity (LAC) rules for authorized institutions (AIs), and amendment to the Inland Revenue Ordinance (IRO) to clarify tax treatment of LAC instruments
 - Rules made by the Chief Justice regulating Court practice and procedure on (i) remuneration clawback; and (ii) presentation of winding up petition for within scope entities

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- The FIRO (Commencement) Notice and the Financial Institutions (Resolution) (Protected Arrangements) Regulation were tabled before the Legislative Council (LegCo) on 17 May. Following completion of the LegCo negative vetting procedure, the main provisions of the FIRO and PAR came into force on 7 July 2017.
- To increase market understanding on how the Monetary Authority (MA) as a resolution authority will carry out its core functions under FIRO, a number of chapters of the Code of Practice (made pursuant to section 196 of FIRO) were issued by the HKMA on 7 July. These were chapters in respect of: (i) the operational independence of the MA as a resolution authority (“RA-1”); (ii) how the MA plans to carry out its statutory functions as a resolution authority for banks in Hong Kong (“RA-2”); and (iii) the resolution planning core information requirements on authorized institutions (“CI-1”). The HKMA will issue more chapters in due course, including the chapter on setting resolvability standards for banks.
- The next key legislative priority is the development of rules to be made by the MA as a resolution authority under FIRO to set LAC requirements for AIs (including to implement the Financial Stability Board’s standard on Total LAC). Consultation paper is expected to be issued around the end of 2017 / start of 2018, following which the rules are expected to be introduced into LegCo in the second quarter of 2018.

- Because of the loss-absorbing characteristics of LAC instruments, they may not be treated as debt for tax purposes under the IRO, and thereby related interest expenses would not be tax deductible. The IRO was amended in 2015 to address this issue for Additional Tier 1 and Tier 2 capital instruments. A further amendment is required to deal with LAC instruments to address the same issue. A joint consultation will be conducted on IRO amendment and development of the LAC rules. It is expected that the IRO amendment bill will be introduced into LegCo in the second quarter of 2018.
- Other relevant legislation that is currently being pursued relates to rules to be made by the Chief Justice regulating the practice and procedure of the court in relation to (i) clawback of remuneration and (ii) presentation of winding up petition for within scope entities under FIRO. Our expectation is that these rules will be introduced into LegCo around the second quarter of 2018.



ENHANCED COMPETENCY FRAMEWORK (ECF) FOR BANKING PRACTITIONERS

- Continue the development of the ECF professional level module on anti-money laundering and counter-financing of terrorism
- Completed industry consultation and are preparing for the launch of the ECF modules on retail wealth management and treasury management

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- The HKMA continues to work with the banking industry to develop the professional level module of ECF on Anti-Money Laundering/Counter-Financing of Terrorism (AML/CFT) for more experienced practitioners. The structure and syllabus of the professional level training programme has been set and the development of the learning materials is in progress. It is expected that the professional level module will be launched in early 2018.
- Following completion of the formal industry consultation for the two new ECF modules on retail wealth management and treasury management, the HKMA continues to coordinate with the industry and relevant professional bodies (i.e. the Hong Kong Institute of Bankers and the Treasury Markets Association) to prepare for the implementation of the aforementioned two modules at the beginning of 2018.



CONSUMER EDUCATION PROGRAMME

- Launched a thematic education campaign on credit card chargeback mechanism
- Conducted cross-media publicity to promote smart use of credit cards, ATM cards and internet banking services, and advocate responsible attitude in taking on a loan

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- The HKMA launched a thematic education campaign to enhance the public awareness and understanding of the credit card chargeback mechanism, and remind the public to think carefully before making prepayment. Cross-media promotion via TV, radio, print, web and mobile platforms is arranged to disseminate the messages to the public.
- The HKMA also conducted cross-media publicity to promote smart use of credit cards, ATM cards and internet banking services, and advocate responsible attitude in taking on a loan. Relevant educational messages are conveyed to the public through TV, radio, public transport, out-of-home TV network, newspapers, popular websites and smartphone apps.



DEPOSIT PROTECTION SCHEME (DPS)

- Completed a full-scope payout rehearsal to test the overall payout readiness under the gross payout approach
- Updating the payout system to enhance the overall system resilience
- Maintain high public awareness through the new publicity campaign and community education activities



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- A full-scope payout rehearsal was conducted in October 2017. The rehearsal involved the members of the Hong Kong Deposit Protection Board and all payout agents in a “close to actual” bank failure situation to test the command, control and communication of a payout operation. The results illustrate that the seven-day payout target can be met.
- To further improve the operational effectiveness and efficiency of payouts, the payout system is being updated to enhance the overall system resilience. It is expected to be completed by the end of 2018.
- Publicity initiatives and community education activities were carried out to promote the public understanding of the DPS coverage and appreciation of the value of DPS protection, including a new set of TV and radio advertisements, publicity on out-of-home and digital platforms, educational talks as well as school workshops.



BANK CONSUMER PROTECTION

- Launched and implemented a Treat Customers Fairly (TCF) Charter for private wealth management (PWM) industry
- Further enhance supervisory collaboration with fellow financial regulators on selling of investment and insurance products

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- To promote a customer-centric culture for the PWM industry in Hong Kong, the HKMA has worked with Private Wealth Management Association (PWMA) in developing and implementing a TCF Charter for the PWM industry in June. All 47 PWMA members have committed to implementing the Charter. The HKMA also issued a circular in June to elucidate its expectation for all private banks to follow the principles. The HKMA and the PWMA have taken collective efforts to implement several initiatives to support the Charter, including a pilot apprenticeship programme to train up new talents to be competent and ethical practitioners to provide professional services and ensure fair treatment of customers.
- The HKMA has been working closely with other financial regulators in Hong Kong in providing guidance and supervising selling of investment and insurance products by authorized institutions. Our enhanced cooperation covered various aspects involving financial groups or regulated entities with close business relationships across different sectors in the financial services industry to ensure more co-ordinated and effective supervisory work. Besides, the HKMA will work closely with the Insurance Authority (IA) to prepare for the implementation of the relevant regulatory regime for insurance intermediaries under the new Insurance Ordinance.
- After consulting the IA and the banking industry, the HKMA launched a new half-yearly survey on AIs' sale of insurance products to gather more comprehensive information and risk indicators for supervision in light of the growing volume and complexity of insurance products sold by authorized institutions in recent years. Authorized institutions are given sufficient time for system modification before the first reporting period in the second half of 2018.



FINANCIAL INCLUSION

Bank Branch Network

- Implementing the plan for setting up more physical branches
- Working with the banking industry to issue practical guidance on barrier-free banking services

Difficulties in Opening Bank Account

- Conduct mystery shopping programme and thematic onsite examinations
- Exploring the use of new technology to enhance efficiency of customer due diligence process
- On-going communication with relevant stakeholders

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- The HKMA has been following up and coordinating with retail banks to further enhance the coverage of banking networks in remote areas and public housing estates (PHEs). Positive responses were received from banks. Eight banks have earlier indicated their plans to set up a total of ten branches and three mobile branches in 2017 and 2018. As of the end of September, five branches have already started operations in Tin Shui Wai North and Sha Tin respectively, and two additional mobile branches have also been put into service for 12 PHEs.
- The HKMA continues to work closely with the banking industry and business community on the important issue of account opening and maintenance. Following the collaboration with InvestHK in April, the HKMA has also jointly organised with the Trade and Industry Department a briefing cum networking session in June to share with the business community the changing international landscape and improvement measures related to account opening and maintenance introduced by banks. Since the launch of the HKMA's dedicated webpage and email account, we have been receiving useful comments which are being followed up by a dedicated team.
- We will continue to work with the banking industry, business community and relevant stakeholders to further enhance customer experience.



FINANCIAL INFRASTRUCTURE



FINANCIAL INFRASTRUCTURE

- Continue to maintain safety and efficiency of financial market infrastructure
- Promote Bond Connect to overseas investors and handle relevant bond settlement operations
- Continue the enhancements of the over-the-counter (OTC) derivatives trade repository (TR) according to the relevant local and international standards

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Operation of financial infrastructure

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

Bond Connect

- Since the launch of Bond Connect on 3 July 2017, related daily settlement operations performed by the CMU has been smooth.
- The HKMA has also participated in roadshows to major financial centres in Asia, Europe and North America to actively promote Bond Connect to overseas investors.

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.
- A series of system operation training, system testing sessions and regulation briefings have been organised to support the Securities and Futures (OTC Derivatives Transactions-Reporting and Record Keeping Obligations) Rules which came into force on 10 July 2015. Similar events continued to be organised to support the Securities and Futures (OTC Derivatives Transactions-Reporting and Record Keeping Obligations) (Amendment) Rules, which came into force on 1 July 2017.



LATEST FINTECH DEVELOPMENTS

Smart Banking Initiatives

- The HKMA announced on 29 September 2017 the launch of seven new initiatives to prepare Hong Kong's banking industry to move into a new era of smart banking

Fintech Day on 25 October

- Organised by the HKMA, attracted about 1,100 participants globally
- Published the second whitepaper on Distributed Ledger Technology (DLT) at the event

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Smart Banking

- The HKMA announced on 29 September 2017 the launch of seven new initiatives with a view to preparing Hong Kong to move into a new era of smart banking. The seven initiatives include Faster Payment System, enhanced Fintech Supervisory Sandbox 2.0, promotion of virtual banking, Banking Made Easy initiative, Open Application Programming Interface (Open API), closer cross-border collaboration, and enhanced research and talent development.

Fintech Day

- The HKMA organised the HKMA Fintech Day at the Hong Kong Convention and Exhibition Centre on 25 October, with about 1,100 participants attending the event. The Fintech Day featured a series of activities including speeches, discussion panels, Fintech demonstrations, and technical workshops on payment technology, DLT and Open API.
- The second whitepaper on DLT was released at the event, revealing more detailed findings on control principles, and regulatory and legal implications.



LATEST FINTECH DEVELOPMENTS

Cross-border cooperation

- To cooperate with Shenzhen in aspects such as reciprocal soft-landing support, internship opportunities and Fintech events
- To discuss cooperation on digital trade finance platform with Singapore

Fintech Supervisory Sandbox (FSS)

- 25 new technology products have been tested in the FSS
- To be upgraded to FSS 2.0 with a new chatroom feature

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Cross-border cooperation

Cooperation with Shenzhen

- In June 2017, the HKMA and the Office of Financial Development Service, the People's Government of Shenzhen Municipality (SZ OFDS) agreed to promote cooperation between Hong Kong and Shenzhen, with a view to creating a more favourable environment for the development and use of fintech by banks and other financial institutions in both cities. The HKMA and SZ OFDS will promote cooperation on three fronts, which include providing reciprocal soft-landing support for fintech firms, offering internship opportunities and organising fintech events.

Cooperation with Singapore

- Several banks in Hong Kong are now developing a DLT-based local trade finance platform to digitalise paper-based documents and automate the trade finance process. In order to maximise the benefits of the trade finance platform, the HKMA is in discussion with Singapore authorities on building a cross-border infrastructure to connect the platform with a similar trade platform in Singapore.

Fintech Supervisory Sandbox

- The FSS is in good progress. As of mid-October 2017, 25 new technology products have been tested in the FSS, covering biometric authentication, securities trading services, Application Programming Interface services, blockchain, chatbot and soft tokens.
- FSS 2.0 introduced three new features: (i) a Fintech Supervisory Chatroom will be set up; (ii) tech firms may have direct access to the FSS through the Chatroom; (iii) the sandboxes of the HKMA, the Securities and Futures Commission and the Insurance Authority will be linked up.



FASTER PAYMENT SYSTEM (FPS)

FPS will be launched in September 2018

- Payment and settlement on a real-time basis
- 24x7 operation
- Multi-currency: covering Hong Kong dollar and renminbi
- Support mobile numbers or email addresses for receiving payments
- Covering both individuals and corporations
- A single common QR code standard to be implemented for different payment schemes

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Faster Payment System

- The FPS would bring along the following benefits: (i) enhancing payment convenience and efficiency, (ii) providing a level-playing field between banks and non-bank payment service providers as the FPS supports both sectors; and (iii) reinforcing Hong Kong's status as an international financial centre.
- FPS is a multi-currency system. In light of the practical needs of the market, the system will first support Hong Kong dollar and renminbi at the initial stage.
- Upon its commencement of service in September 2018, the system will cover real-time credit transfer, real-time direct debit, addressing service (which supports the use of an account proxy including mobile number and email address for receiving payments) and electronic direct debit authorisation.

QR Code Standard

- A working group on QR code standard, which comprises major credit card scheme operators, banks, stored value facility licensees and merchant acquirers, has been established with an aim of developing a common QR code standard for QR code payments by the end of 2017.
- A common QR code standard enables a merchant to use a single QR code, to accept QR code payment solutions from multiple payment service providers. Consumers would find it more convenient to make QR code payments.



REGULATORY REGIME FOR STORED VALUE FACILITIES (SVFs) AND RETAIL PAYMENT SYSTEMS (RPSs)

- SVF licensees are actively expanding service and customer reach. In the second quarter of 2017, the total number of SVF accounts in use was 43.5 million, the total number of SVF transactions in the quarter was around 1.4 billion, and the total transaction value was HK\$31.8 billion
- The four RPSs designated under the Payment Systems and Stored Value Facilities Ordinance in August 2017 are required to operate in a safe and efficient manner and are subject to the HKMA's oversight



REGULATORY DEVELOPMENT OF THE OVER-THE-COUNTER (OTC) DERIVATIVES MARKET

- Following the amendment of the Securities and Futures Ordinance in 2014 which provides for the regulatory regime for the OTC derivatives market, we continue to develop concrete regulatory requirements covering different aspects
- The second phase rules for the reporting and related record keeping obligations came into effect on 1 July 2017



FINANCIAL BENCHMARK REFORM IN HONG KONG

- Major reforms on foreign exchange (FX) benchmarks have been completed
- For interest rate benchmarks, the HKMA has completed an analysis on reform feasibility, and is working with the industry to consult stakeholders on the proposed way forward

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- Having regard to local market conditions, Hong Kong has been reviewing the need and feasibility in reforming major interest rate and FX benchmarks along international recommendations promulgated to enhance the transparency and robustness of benchmarks that are widely used in the global financial markets.
- Major reforms on FX benchmarks have been completed. The HKMA is now working with the administrator of Hong Kong's financial benchmarks, namely the Treasury Markets Association, to reform the Hong Kong Interbank Offered Rate and Hong Kong Dollar Overnight Index Average as appropriate. The HKMA will take into account international progress and developments as reference for our local review.

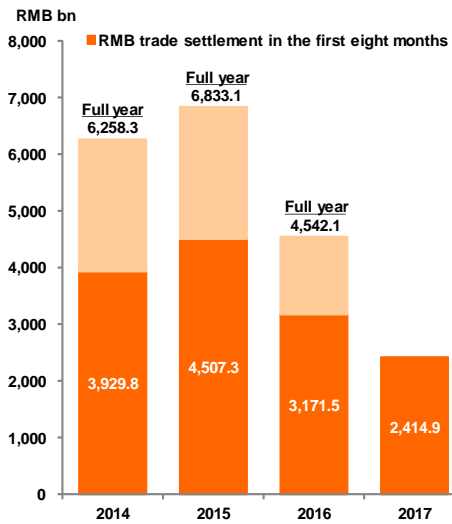


HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

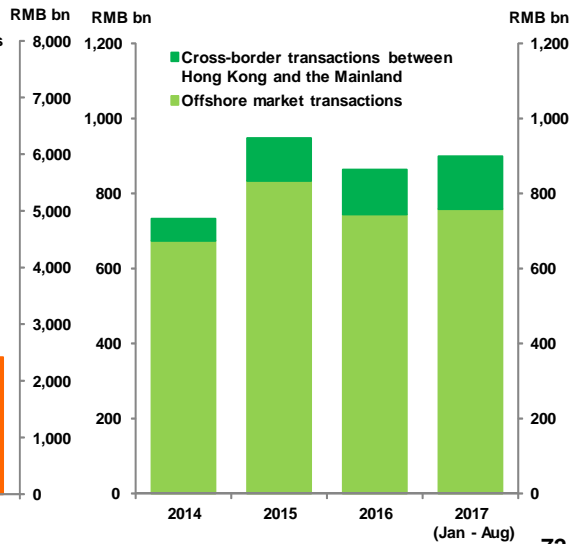


RMB TRADE SETTLEMENT AND PAYMENT

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



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



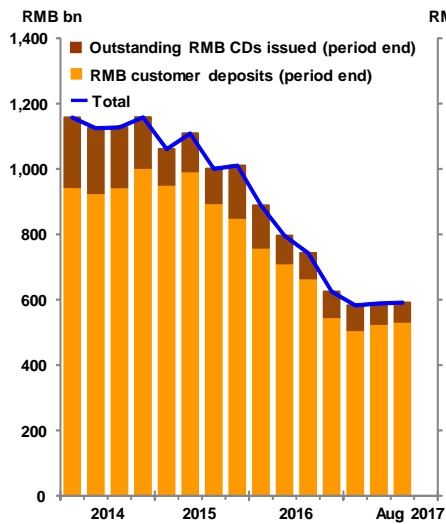
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- In the first eight months of 2017, RMB trade settlement handled by banks in Hong Kong totalled RMB2,414.9 billion.
- In the first eight months of 2017, the average daily turnover of Hong Kong RMB Real Time Gross Settlement (RTGS) system stood at RMB899.3 billion.

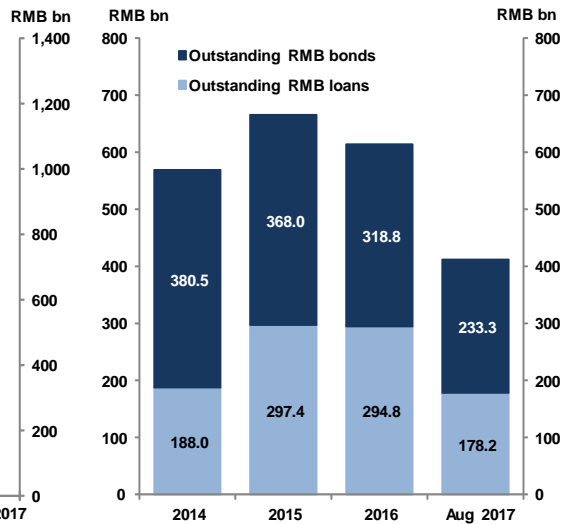


RMB LIQUIDITY POOL AND FINANCING ACTIVITIES

RMB customer deposits and certificates of deposit (CDs)



RMB financing activities



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- At end-August 2017, renminbi customer deposits and outstanding renminbi certificates of deposit amounted to RMB532.8 billion and RMB58.9 billion respectively, totalling RMB591.7 billion.
- At end-August 2017, outstanding renminbi loans amounted to RMB178.2 billion. Outstanding dim sum bonds amounted to RMB233.3 billion. The dim sum bond issuance totalled RMB10.6 billion for the first eight months of 2017.



MAINTAINING RMB BUSINESS LINKS WITH OTHER JURISDICTIONS

	Aug 2017	2016	2015	2014
1 No. of participating banks of Hong Kong's RMB clearing platform	205	210	217	225
Of which:				
Branches and subsidiaries of overseas banks and overseas presence of Mainland banks	180	184	192	200
2 Amount due to overseas banks (RMB billion)	86.9	69.0	105.7	145.2
3 Amount due from overseas banks (RMB billion)	146.2	91.6	132.1	193.3

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- The HKMA maintained ongoing dialogues with other offshore renminbi centres and continued our marketing efforts through active participation in industry events to promote Hong Kong's renminbi business platform and our unique role as a springboard between Mainland China and the rest of the world.
- The First Hong Kong-Switzerland Financial Dialogue was held by the HKMA and the State Secretariat for International Financial Matters (SIF) under the Swiss Federal Department of Finance in Bern, Switzerland on 19 September to promote cooperation on financial market issues, including renminbi internationalisation, wealth management and fintech. The HKMA and Swiss Bankers Association also facilitated an open seminar on the same date, providing a platform for the private sector to exchange views on the latest trends and development in the global financial markets and explore room for collaboration.



DEVELOPING HONG KONG AS A CORPORATE TREASURY CENTRE (CTC) HUB

- Attracting multinational and Mainland enterprises to set up their CTCs in Hong Kong will bring more banking, financing and risk management activities to Hong Kong, deepen our capital markets and provide impetus to the development of headquarters economy in Hong Kong
- The HKMA has been actively engaging the industry to promote Hong Kong's CTC platform
- After launching the tax measures in June 2016, we have reached out to close to 300 corporates, more than 30 of which are actively considering setting up or expanding their CTC operations in Hong Kong

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- Developing Hong Kong into a regional hub for CTCs has been one of the important areas of work of the HKMA in recent years. With their vast global business networks, some multinational corporations process numerous large-value payments on a daily basis. Under their treasury management systems, it is common for cash management, receipt/payment processing, financing, 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 largest global offshore RMB business hub, capital formation, banking network, etc., thereby reinforcing Hong Kong's status as an international financial centre and promoting the development of headquarters economy in Hong Kong.
- The HKMA has been 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. After launching the tax measures in June 2016, the HKMA has reached out to around 300 corporations. Industry feedback has been positive. More than 30 corporations have reflected to the HKMA that they are actively considering establishing or expanding their CTCs in Hong Kong.



DEVELOPING AN ONSHORE PRIVATE EQUITY (PE) FUND PLATFORM

- At present, PE fund activities in Hong Kong are robust. The total capital under management by PE funds in Hong Kong reached US\$126 billion as of the first half of 2017
- PE funds active in Hong Kong generally exist in the form of offshore limited partnerships (LPs), given the local legal framework for LPs was legislated before the PE fund industry emerged, and its stipulations do not cater for PE fund operations. Relevant tax treatments in Hong Kong also pale in comparison with some other jurisdictions
- To maintain Hong Kong as Asia's PE hub, the HKMA is working with the Financial Services and the Treasury Bureau in reviewing the PE fund platform. The review covers the LP legal framework and tax treatments for PE funds, with a view to attracting more PE funds to set up onshore

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- The Financial Secretary has recently indicated that in order to enhance the competitiveness of Hong Kong in developing its fund industry, the Government would comprehensively review the tax treatments applicable under different fund regimes, including the feasibility of introducing a LP platform for PE funds.
- The HKMA fully supports the Administration in taking the above initiative forward. We are reviewing the PE fund platform in Hong Kong. The review covers the LP legal framework and tax treatments for PE funds, with a view to attracting more PE funds to set up onshore.



INFRASTRUCTURE FINANCING FACILITATION OFFICE (IFFO)

- To date, over 70 organisations from Mainland China, Hong Kong and overseas have joined as IFFO partners. They include multilateral financial agencies and development banks, investors, asset managers, banks, insurance companies, infrastructure project developers and operators, professional service firms, etc.
- Since its launch till September 2017, IFFO has organised and participated in over 15 large-scale conferences, seminars and workshops on infrastructure investment and financing, including the Senior Executive Training Program in July, and the Belt and Road Summit and Think Asia Think Hong Kong event in September 2017
- In September 2017, HKMA committed US\$1 billion to International Finance Corporation's (IFC) innovative Managed Co-Lending Portfolio Program (MCP) debt mobilisation platform for emerging markets, supporting IFC in financing projects across more than 100 countries, covering infrastructure, telecom, manufacturing, agribusiness and services

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- IFFO has been proactively facilitating infrastructure investments and their financing since its launch on 4 July 2016. As of September 2017, the number of IFFO partners has grown from 41 at inception to over 70. IFFO has also organised and participated in over 15 large-scale conferences, seminars and workshops on infrastructure investment and financing.
- In particular, IFFO hosted the Senior Executive Training Program on 31 July - 4 August 2017, organised by the IFC in partnership with the Harvard Kennedy School. The Program was attended by 50 senior executives from institutional investors, development and policy banks, project developers and operators, and public officials, who are experienced in advisory and investment areas. The Program's objective is to advance the dialogue on public-private partnerships and project finance to a broad group of experts and decision makers with a view to fostering the development of infrastructure projects that better address the needs of the population and governments of the region.
- The IFFO panel discussion at the Belt & Road Summit on 11 September was moderated by Dr Victor Fung, Advisor of IFFO. The speakers discussed about the infrastructure needs and financing opportunities along the Belt and Road region, and how Hong Kong can position itself to capture these opportunities. The panel discussion was well received and attended by more than 1,000 overseas and local industry leaders from various sectors.

- HKMA Chief Executive moderated a panel discussion at the Think Asia Think Hong Kong event in London. The speakers discussed about the opportunities as well as challenges arising from the Belt and Road Initiative, and how Hong Kong can serve as the gateway to these investment and financing opportunities.
- The HKMA signed an agreement with the IFC, a member of the World Bank Group, on 19 September in London, committing US\$1 billion to the innovative Managed Co-Lending Portfolio Program (MCP) debt mobilisation platform for emerging markets. The HKMA will support IFC in financing projects across more than 100 countries, covering infrastructure, telecom, manufacturing, agribusiness and services.



INVESTMENT ENVIRONMENT AND PERFORMANCE OF THE EXCHANGE FUND

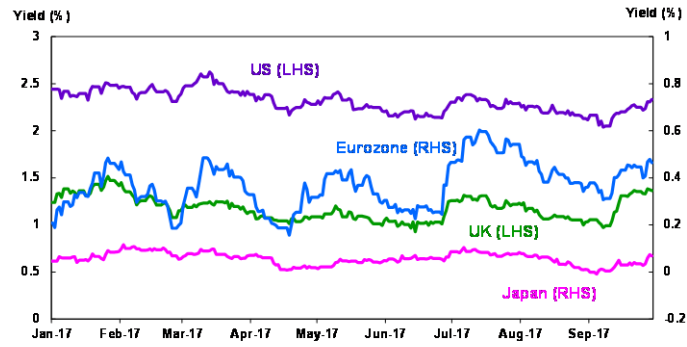


INVESTMENT ENVIRONMENT IN Q3 2017

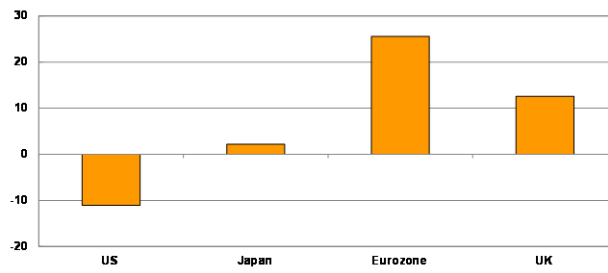
- **Interest rates:** Government bond yields in major developed economies traded lower initially on softer inflation data but started to creep up in September as the market priced in less accommodative monetary policy by major central banks on the back of improving economic growth. This left the government bond yields broadly flat over the third quarter
- **Equity markets:** Major equity markets rallied in the third quarter, with positive investor sentiments supported by the improving global economic growth outlook and stronger corporate earnings
- **Exchange rates:** The US dollar weakened against major currencies in the third quarter on diminishing monetary divergence but rebounded somewhat towards the end of the quarter on growing market expectation of US Federal Reserve rate hike in December



CHANGES IN 10-YEAR GOVERNMENT BOND YIELDS IN Q1-Q3 2017



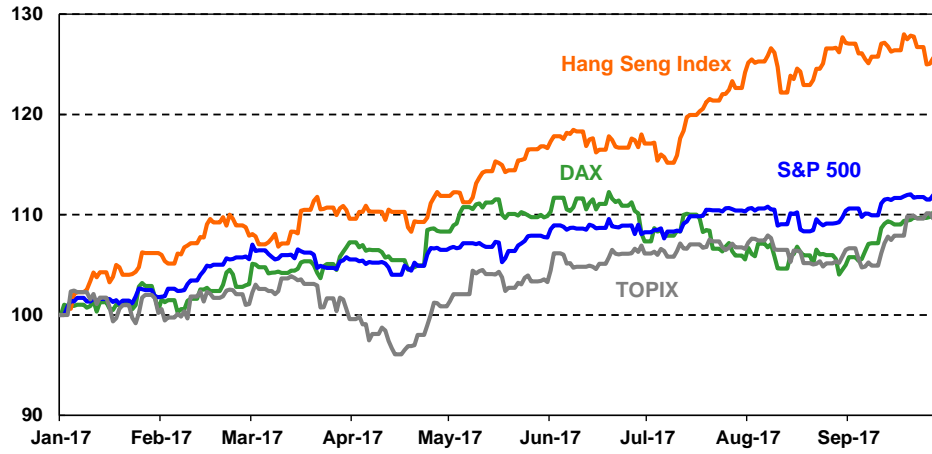
2017Q1-Q3 bond yield change (bps)





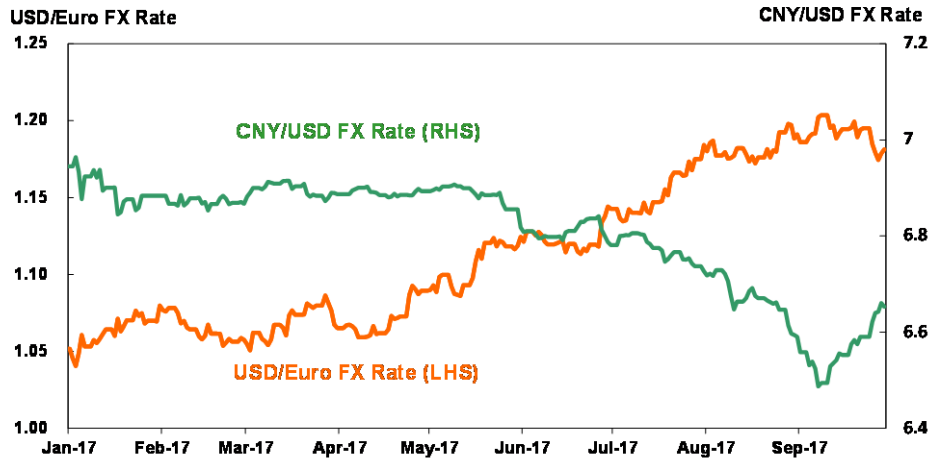
EQUITY MARKETS IN Q1-Q3 2017

Normalised Index Level (2016 year-end = 100)





CURRENCY MARKETS IN Q1-Q3 2017





INVESTMENT INCOME

(HK\$ billion)	← 2017 → (unaudited)				2016	2015
	Jan - Sep	Q3	Q2	Q1	Full Year	Full Year
Hong Kong equities*	42.2	14.4	13.5	14.3	5.3	(5.0)
Other equities	58.9	18.8	15.6	24.5	28.6	7.1
Bonds	27.2	10.7	10.1	6.4	33.1	15.9
Other investments@	17.5	-	9.7	7.8	16.9	11.1
Foreign exchange#	<u>44.0</u>	<u>9.7</u>	<u>22.4</u>	<u>11.9</u>	<u>(15.8)</u>	<u>(44.9)</u>
Investment income/(loss)	189.8	53.6	71.3	64.9	68.1	(15.8)

* Excluding valuation changes of the Strategic Portfolio

@ Including valuation changes of private equity and real estate investments held under the Long-Term Growth Portfolio (LTGP). (The above figures represent valuation changes up to the end of June 2017. Valuations of these investments from July to September are not yet available.)

This is primarily the effect of translating foreign currency assets into Hong Kong dollar after deducting the portion for currency hedging.



INCOME AND EXPENDITURE

(HK\$ billion)	← 2017 → (unaudited)				2016	2015
	Jan - Sep	Q3	Q2	Q1	Full year	Full year
Investment income/(loss)	189.8	53.6	71.3	64.9	68.1	(15.8)
Other income	0.1	0.0	0.1	0.0	0.2	0.2
Interest and other expenses	<u>(7.2)</u>	<u>(2.2)</u>	<u>(2.8)</u>	<u>(2.2)</u>	<u>(6.4)</u>	<u>(4.8)</u>
Net income/(loss)	182.7	51.4	68.6	62.7	61.9	(20.4)
Fee payment to Fiscal Reserves*#	(17.4)	(6.0)	(5.8)	(5.6)	(33.1)	(46.7)
Fee payment to HKSAR government funds and statutory bodies*	(6.5)	(2.2)	(2.2)	(2.1)	(9.6)	(14.7)

* The rate of fee payment is 2.8% for 2017, 3.3% for 2016 and 5.5% for 2015.

This does not include the 2017 fee payment to the Future Fund because such amount will only be disclosed when the composite rate for 2017 is available (For 2016, the composite rate was 4.5% and fee payable to the Future Fund was HK\$10.1 billion).



EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)	At 30 Sep 2017 (Unaudited)	At 31 Dec 2016	At 31 Dec 2015
ASSETS			
Deposits	332.8	386.7	290.5
Debt securities	2,701.8	2,466.1	2,462.0
Hong Kong equities *	186.6	147.3	148.2
Other equities	500.8	429.3	392.4
Other assets #	<u>180.5</u>	<u>189.3</u>	<u>129.8</u>
Total assets	<u>3,902.5</u> =====	<u>3,618.7</u> =====	<u>3,422.9</u> =====
LIABILITIES AND FUND EQUITY			
Certificates of indebtedness	443.7	405.4	357.9
Government-issued currency notes & coins in circulation	12.1	11.9	11.3
Balance of the banking system	211.6	259.6	391.3
Exchange Fund Bills and Notes issued	1,012.7	961.0	827.8
Placements by banks and other financial institutions	56.1	56.1	66.9
Placements by Fiscal Reserves ®	979.9	914.6	833.5
Placements by HKSAR government funds and statutory bodies	306.6	302.5	280.9
Other liabilities	<u>204.0</u>	<u>161.1</u>	<u>108.4</u>
Total liabilities	<u>3,226.7</u>	<u>3,072.2</u>	<u>2,878.0</u>
Accumulated Surplus	<u>675.8</u>	<u>546.5</u>	<u>544.9</u>
Total liabilities and fund equity	<u>3,902.5</u> =====	<u>3,618.7</u> =====	<u>3,422.9</u> =====

* Including shares of the Hong Kong Exchanges and Clearing Limited in the Strategic Portfolio

Including fund injection to Exchange Fund's investment holding subsidiaries at a carrying amount of HK\$125.8 billion at 30 Sep 2017 (HK\$118.8 billion at 31 Dec 2016 and HK\$96.0 billion at 31 Dec 2015)

® Including placements by the Future Fund of HK\$224.5 billion



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**	81.2	30.7	54.7	(23.3)	19.1
2014**	44.7	6.1	(17.8)	43.3	13.1
2015**	(15.8)	21.0	(63.8)	18.7	8.3
2016**	68.1	(23.3)	47.1	18.9	25.4
2017** (unaudited)	N/A	N/A	53.6	71.3	64.9

* Excluding valuation changes of the Strategic Portfolio

Including valuation changes of private equity and real estate investments held under the LTGP



HONG KONG MORTGAGE CORPORATION



MORTGAGE INSURANCE PROGRAMME (MIP)

- Since its launch in March 1999, the MIP has helped over 130,900 families attain home ownership
- In the first nine months of 2017, the total drawdown amount under the MIP was HK\$23.7 billion and the average loan size was HK\$3.7 million
- About 87% of drawn down loans were for secondary market properties



REVERSE MORTGAGE PROGRAMME (RMP)

- As at end-September 2017, 2,142 applications had been received:
 - Average age of borrowers: 69 years old
 - Average monthly payout: HK\$15,000
 - Payment terms: 10-year (27%), 15-year (17%), 20-year (12%), life (44%)
 - Average property value: HK\$5.1 million
 - Average property age: 30 years
- The extension of the RMP to cover subsidised sale flats in October 2016 has been well received by the market

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- Since inception in mid-October 2016, the extension of the RMP to cover subsidised sale flats has been well received by the market. Up to end-September 2017, 341 applications had been received.



SME FINANCING GUARANTEE SCHEME (SFSGS)

- SMEs and banks responded positively to the promotion and communication effort of the HKMC on the SFGS
- Since July 2017, a series of measures has been introduced by the HKMC to further optimise the operation of the SFGS
- As at end-September 2017, 12,459 applications had been approved, involving a total loan amount of around HK\$49.6 billion. Key data of the approved applications are as follows:

Average guarantee period	4.6 years	Average loan size	HK\$3.98 million
Proportion of application from manufacturing and non-manufacturing industries	23% and 77% (in terms of no. of applications approved)	Average loan interest rate and average guarantee fee rate	4.84% p.a. 0.49% p.a.
Enterprises with less than 50 employees	91%	Benefitted enterprises and the related no. of employees	7,467 enterprises and 189,584 employees

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

Manufacturing sector	22.7%
– Textiles and clothing	4.3%
– Electronics	2.1%
– Plastics	1.8%
– Printing and publishing	1.6%
Non-manufacturing sector	77.3%
– Trading	45.8%
– Wholesale and retail	9.2%
– Construction	3.1%
– Engineering	3.1%



MICROFINANCE SCHEME

- Launched in June 2012, trial period up to 2018 and maximum aggregate loan amount up to HK\$200 million
- As at end-September 2017, the Scheme had received 425 formal loan applications. Out of the vetted applications, 196 had been approved with a total loan amount of about HK\$48.8 million. The approval rate was 49%
- For the approved applications, the average loan size was about HK\$249,000 and the average loan tenor was 4.6 years

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- Industry types for the approved start-up loans and self-employment loans (excluding 2 self-enhancement loans):

Some approved applications are classified as more than one of these industry types

- Services	124 cases (47%)
- Retail	71 cases (27%)
- Wholesale	38 cases (15%)
- Manufacturing	20 cases (8%)
- IT related	8 cases (3%)



PREMIUM LOAN INSURANCE SCHEME (PLIS)

- PLIS was launched in September 2015 to provide subsidised housing owners aged 50 or above with an additional financing option to settle land premium payment
- After settling land premium payment, borrowers will have greater flexibility in letting or selling their properties in the open market
- The scheme can help release under-utilised flats and promote market circulation of subsidised housing properties
- As at end-September 2017, over 2,800 enquiries and 11 applications had been received



LIFE ANNUITY SCHEME (LAS)

- The HKMC's Board announced in June that the LAS was tentatively scheduled to be launched by mid-2018
- The LAS aims at providing an additional financial planning option to the elderly citizens. The design of the Scheme is based on three important principles:
 1. Simple and easy to understand and attractive to annuitants
 2. Relevant risks prudently managed by the insurer
 3. Conform with commercial principles; financially viable and sustainable
- The amount offered for subscription will be subject to a quota, tentatively up to HK\$10 billion for the first batch, with actual amount subject to market conditions and prudent risk management principles



TENTATIVE KEY DESIGN FEATURES OF LAS*

- The LAS aims to provide immediate lifetime guaranteed fixed monthly payouts to annuitants aged 65 or above
- The cap and floor of the premium amount are tentatively set at HK\$1 million and HK\$50,000 respectively
- Based on an internal rate of return of 4%, at the entry age of 65 and for HK\$1 million of premium, male and female annuitants will receive fixed monthly payout of about HK\$5,800 and HK\$5,300 respectively
- The HKMC is now proceeding full steam ahead with the application for the necessary regulatory authorisation and developing the sales and distribution arrangements with a view to launching the LAS around mid-next year

* Subject to authorisation by the insurance industry regulatory authority