

AN INTRODUCTION TO THE
HONG KONG MONETARY AUTHORITY
2007 EDITION

Incorporating the Summary Version of the HKMA Annual Report 2006



THE HONG KONG MONETARY AUTHORITY

Established in April 1993, the Hong Kong Monetary Authority (HKMA) is the government authority in Hong Kong responsible for maintaining monetary and banking stability. The HKMA's policy objectives are

- to maintain currency stability, within the framework of the Linked Exchange Rate system, through sound management of the Exchange Fund, monetary policy operations and other means deemed necessary
- to promote the safety and stability of the banking system through the regulation of banking business and the business of taking deposits, and the supervision of authorized institutions
- to enhance the efficiency, integrity and development of the financial system, particularly payment and settlement arrangements.

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The first part of this booklet introduces the work and policies of the HKMA. The second part contains a summary of the HKMA's Annual Report for 2006. The full Annual Report is available on the HKMA website both in interactive form and on PDF files. Hard copies may also be purchased from the HKMA: see Reference Resources on page 56 for details.

This booklet makes reference to documents and other materials available on the HKMA website www.hkma.gov.hk. These references appear as , followed by navigation guidance from the HKMA homepage.

All amounts in this booklet are in Hong Kong dollars unless otherwise stated.

About the HKMA

The Hong Kong Monetary Authority is Hong Kong's central banking institution. The HKMA has four main functions: maintaining the stability of the Hong Kong dollar; promoting the safety of Hong Kong's banking system; managing Hong Kong's official reserves; and maintaining and developing Hong Kong's financial infrastructure.

THE HKMA'S LEGAL MANDATE

The HKMA was established on 1 April 1993 after the Legislative Council passed amendments to the Exchange Fund Ordinance in 1992 empowering the Financial Secretary to appoint a Monetary Authority.

The powers, functions and responsibilities of the Monetary Authority are set out in the Exchange Fund Ordinance, the Banking Ordinance, the Deposit Protection Scheme Ordinance, the Clearing and Settlement Systems Ordinance and other relevant Ordinances. The division of functions and responsibilities in monetary and financial affairs between the Financial Secretary and the Monetary Authority is set out in an Exchange of Letters between them dated 25 June 2003. This Exchange of Letters also discloses the delegations made by the Financial Secretary to the Monetary Authority under these Ordinances. The letters are public documents and may be found on the HKMA website.

The Exchange Fund Ordinance establishes the Exchange Fund under the control of the Financial Secretary. According to the Ordinance, the Fund shall be used primarily for affecting the exchange value of the Hong Kong dollar. It

may also be used for maintaining the stability and integrity of the monetary and financial systems of Hong Kong, with a view to maintaining Hong Kong as an international financial centre.

The Monetary Authority is appointed under the Exchange Fund Ordinance to assist the Financial Secretary in performing his functions under the Exchange Fund Ordinance and to perform such other functions as are assigned by other Ordinances or by the Financial Secretary. The office of the Monetary Authority is known as the HKMA, and the Monetary Authority is the Chief Executive of the HKMA.

The Banking Ordinance provides the Monetary Authority with the responsibility and powers for regulating and supervising banking business and the business of taking deposits. Under the Ordinance, the Monetary Authority is responsible for the authorization of licensed banks, restricted licence banks, and deposit-taking companies in Hong Kong.

The Clearing and Settlement Systems Ordinance provides a statutory regime for the Monetary Authority to designate and oversee clearing and settlement systems that are material to the monetary or financial stability of Hong Kong or to the functioning of Hong Kong as an international financial centre.

Under the Deposit Protection Scheme Ordinance the Monetary Authority is charged with implementing the decisions of the Hong Kong Deposit Protection Board, such as deciding whether compensation should be paid to the depositors of a failed scheme bank pursuant to the Ordinance.

 > The HKMA

THE HKMA AND THE HONG KONG SPECIAL ADMINISTRATIVE REGION GOVERNMENT

The HKMA is an integral part of the Hong Kong Government, but is able to employ staff on terms different from those of the civil service in order to attract personnel of the right experience and expertise. The Chief Executive of the HKMA and his staff are public officers. In its day-to-day work the HKMA operates with a high degree of autonomy within the relevant statutory powers conferred upon, or delegated to, the Monetary Authority.

The Financial Secretary is responsible for determining the monetary policy objective and the structure of the monetary system of Hong Kong: a letter from the Financial Secretary to the Monetary Authority dated 25 June 2003 specifies that these should be currency stability defined as a stable exchange value at around HK\$7.80 to one US dollar maintained by Currency Board arrangements. The Monetary Authority is on his own responsible for achieving the monetary policy objective, including determining the strategy, instruments and operational means for doing so. He is also responsible for maintaining the stability and integrity of the monetary system of Hong Kong.

The Financial Secretary, assisted by the Secretary for Financial Services and the Treasury, has responsibility for policies for maintaining the stability and integrity of Hong Kong's financial system and the status of Hong Kong as an international financial centre. In support of these policies, the Monetary Authority's responsibilities include

- promoting the general stability and effective working of the banking system
- promoting the development of the debt market, in cooperation with other relevant bodies
- matters relating to the issuance and circulation of legal tender notes and coins
- promoting the safety and efficiency of the financial infrastructure through the development of payment, clearing and settlement systems and, where appropriate, the operation of these systems
- seeking to promote, in co-operation with other relevant bodies, confidence in Hong Kong's monetary and financial systems, and market development initiatives to help strengthen the international competitiveness of Hong Kong's financial services.

The Exchange Fund is under the control of the Financial Secretary. The Monetary Authority, under delegation from the Financial Secretary, is responsible to the Financial Secretary for the use of the Exchange Fund, and for the investment management of the Fund.

ACCOUNTABILITY AND TRANSPARENCY

The autonomy given to the HKMA in its day-to-day operations, and in the methods it uses to pursue policy objectives determined by the Government, is complemented by a high degree of accountability and transparency.

The HKMA serves Hong Kong by promoting monetary and banking stability, by managing the official reserves effectively, and by developing and overseeing a robust and diverse financial infrastructure. These processes help to strengthen Hong Kong's role as an international financial centre and to foster Hong Kong's economic well-being. The HKMA must have the confidence of the community if it is to perform its duties well. The HKMA therefore takes seriously the duty of explaining its policies and work to the general public and makes every effort to address any concerns within the community relevant to the HKMA's responsibilities.

The HKMA is accountable to the people of Hong Kong through the Financial Secretary, who appoints the Monetary Authority, and through the laws passed by the Legislative Council that set out the Monetary Authority's powers and responsibilities. The HKMA also recognises a broader responsibility to promote a better understanding of its roles and objectives and to keep itself informed of community concerns. In its day-to-day operations and in its wider contacts with the community, the HKMA pursues a policy of transparency and accessibility. This policy has two main objectives:

- to keep the financial industry and the public as fully informed about the work of the HKMA as possible, subject to considerations of market sensitivity, commercial confidentiality and statutory restrictions on disclosure of confidential information
- to ensure that the HKMA is in touch with, and responsive to, the community it serves.

The HKMA seeks to follow international best practices in its transparency arrangements. It maintains extensive relations with the mass media and produces a range of regular and special publications in both English and Chinese. The HKMA's bilingual website (www.hkma.gov.hk) carries a large number of HKMA publications, press releases, speeches and presentations, in addition to special sections on research, statistics, consumer information and other topics. The HKMA maintains an Information Centre at its offices, consisting of a library and an exhibition area, which is open to the public six days a week. The HKMA also organises public education programmes to inform the public, and in particular students, about the work of the HKMA through seminars and guided tours at the Information Centre. The HKMA's weekly *Viewpoint* column, carried on the HKMA website and in several Hong Kong newspapers, informs the public about aspects of the HKMA's work. Further information on the HKMA's media work, publications and public education programmes is contained in the Chapter on Professional and Corporate Services.

 > [Viewpoint](#)

 > [HKMA Information Centre](#)

Over the years the HKMA has progressively increased the detail and frequency of its disclosure of information on the Exchange Fund and Currency Board Accounts. Since 1999 the HKMA has participated in the International Monetary Fund's Special Data Dissemination Standard project for central banks. The HKMA publishes records of meetings of the Currency Board Sub-Committee of the Exchange Fund Advisory Committee and the monthly reports on Currency Board operations. The supervisory policies and guidelines on banking have been published on the website since 1996.

 > [Press Releases > Exchange Fund](#)

 > [Supervisory Policy Manual](#)

 > [Guidelines and Circulars](#)

The relations between the HKMA and the Legislative Council play an important part in promoting accountability and transparency. There is a formal commitment from the Chief Executive of the HKMA to appear before the Panel on Financial Affairs of the Legislative Council three times a year to brief Members and to answer questions on the HKMA's work. At one of these briefings, usually in May, the HKMA's Annual Report is presented. Representatives from the HKMA attend Legislative Council Panel meetings from time to time to explain and discuss particular issues, and Committee meetings to assist Members in their scrutiny of draft legislation.

 > [Legislative Council Issues](#)

ADVISORY AND OTHER COMMITTEES

Exchange Fund Advisory Committee

In his control of the Exchange Fund, the Financial Secretary is advised by the Exchange Fund Advisory Committee (EFAC). EFAC is established under Section 3(1) of the Exchange Fund Ordinance, which requires the Financial Secretary to consult the Committee in his exercise of control of the Exchange Fund. The Financial Secretary is ex officio Chairman of EFAC. Other members, including the Monetary Authority, are appointed in a personal capacity by the Financial Secretary under the delegated authority of the Chief Executive of the Hong Kong Special Administrative Region. Members of EFAC are appointed for the expertise and experience that they can bring to the committee. Such expertise and experience includes knowledge of monetary, financial and economic affairs and of investment issues, as well as of accounting, management, business and legal matters.

EFAC advises the Financial Secretary on investment policies and strategies for the Fund and on projects, such as the development of financial infrastructure, that are charged to the Fund. Since the operating and staff costs of the HKMA are also chargeable to the Exchange Fund, EFAC advises the Financial Secretary on the HKMA's annual administration budget and on the terms and conditions of service of HKMA staff. EFAC meets regularly and on other occasions when particular advice is being sought.

EFAC is assisted in its work by five Sub-Committees, which monitor specific areas of the HKMA's work and report and make recommendations to the Financial Secretary through EFAC. The Committee held six meetings in 2006 to discuss the full range of issues relating to the work of the HKMA, most of which had been previously discussed by the relevant Sub-Committees.

Membership (1 April 2007)

Chairman

The Hon. Henry TANG Ying-yen, GBS, JP

The Financial Secretary

Members

Mr Joseph YAM, GBS, JP

The Monetary Authority

Dr The Hon. Marvin CHEUNG Kin-tung,

DBA Hon., SBS, JP

Mr Christopher CHENG Wai-chee, GBS, JP

Chairman

USI Holdings Limited

The Hon. Victor LO Chung-wing, GBS, JP

Chairman and Chief Executive

Gold Peak Industries (Holdings) Limited

Dr Patrick WANG Shui-chung, JP

Chairman and Chief Executive Officer

Johnson Electric Holdings Limited

Mr HE Guangbei

Vice Chairman and Chief Executive

Bank of China (Hong Kong) Limited

Professor K C CHAN, JP

Dean of Business and Management

Hong Kong University of Science and Technology

The Hon. Henry FAN Hung-ling, SBS, JP

Managing Director

CITIC Pacific Limited

Mr Simon IP Sik-on, JP

Mr Thomas KWOK Ping-kwong, JP

Vice-Chairman and Managing Director

Sun Hung Kai Properties Limited

Mr Peter SULLIVAN

Executive Director and Chief Executive Officer

Standard Chartered Bank (Hong Kong) Limited

Mr Vincent CHENG Hoi-chuen, GBS, JP

Chairman

The Hongkong and Shanghai Banking Corporation Limited

Dr Patrick FUNG Yuk-bun

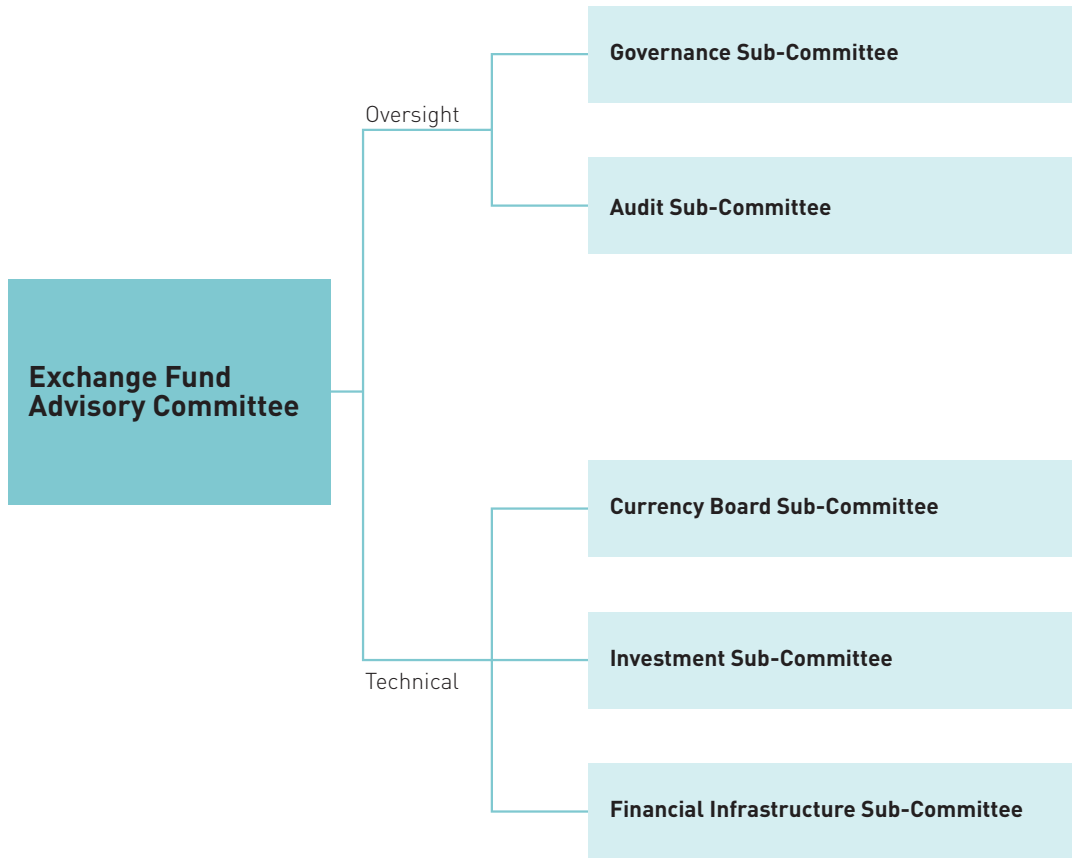
Chairman and Chief Executive

Wing Hang Bank Limited

Secretary

Mr Trevor KEEN

EXCHANGE FUND ADVISORY COMMITTEE SUB-COMMITTEE STRUCTURE



The *Governance Sub-Committee* monitors the performance of the HKMA and makes recommendations on remuneration and human resources policies, and on budgetary, administrative and governance issues. The Sub-Committee met seven times in 2006 to consider a range of subjects including disclosure of information on the HKMA's expenditure budget, the HKMA's performance assessment, the annual pay review, the HKMA Annual Report, business continuity planning, strategic planning matters and post-termination employment arrangements. The Sub-Committee also received regular reports on the work of the HKMA.

Membership (1 April 2007)

Chairman

Dr The Hon. Marvin CHEUNG Kin-tung,

DBA Hon., SBS, JP

Members

Mr Christopher CHENG Wai-chee, GBS, JP

Chairman

USI Holdings Limited

(Mr Cheng was chairman at meetings in the absence of Dr Cheung)

The Hon. Victor LO Chung-wing, GBS, JP

Chairman and Chief Executive

Gold Peak Industries (Holdings) Limited

Dr Patrick WANG Shui-chung, JP

Chairman and Chief Executive Officer

Johnson Electric Holdings Limited

Professor K C CHAN, JP

Dean of Business and Management

Hong Kong University of Science and Technology

The Hon. Henry FAN Hung-ling, SBS, JP

Managing Director

CITIC Pacific Limited

Mr Simon IP Sik-on, JP

Mr Thomas KWOK Ping-kwong, JP

Vice-Chairman and Managing Director

Sun Hung Kai Properties Limited

Secretary

Mr Trevor KEEN

Terms of reference

- (1) To monitor the performance of the HKMA in carrying out its functions and responsibilities and in its use of resources, and to formulate recommendations to the Financial Secretary through the Exchange Fund Advisory Committee (EFAC) on
 - (a) the remuneration and human resources policies of the HKMA;
 - (b) remuneration for HKMA staff, taking account of the Sub-Committee's assessment of the quality and effectiveness of the HKMA's work; and
 - (c) the use of resources of the HKMA, including its annual administrative budget.
- (2) To consider recommendations and provide advice to the Financial Secretary on the appointment and dismissal of staff at the level of Executive Director and above.
- (3) To keep under review the governance arrangements for the HKMA and to make recommendations to the Financial Secretary through EFAC as appropriate.

The *Audit Sub-Committee* reviews and reports on the HKMA's financial reporting process and the adequacy and effectiveness of the internal control systems of the HKMA. The Sub-Committee reviews the HKMA's financial statements, and the composition and accounting principles adopted in such statements. It also examines and reviews with both the external and internal auditors the scope and results of their audits. The Sub-Committee met twice in 2006.

Membership (1 April 2007)

Chairman

Dr The Hon. Marvin CHEUNG Kin-tung,

DBA Hon., SBS, JP

Members

Mr HE Guangbei

Vice Chairman and Chief Executive

Bank of China (Hong Kong) Limited

Mr Peter SULLIVAN

Executive Director and Chief Executive Officer

Standard Chartered Bank (Hong Kong) Limited

Mr Simon IP Sik-on, JP

Mr Vincent CHENG Hoi-chuen, GBS, JP

Chairman

The Hongkong and Shanghai Banking Corporation Limited

The Hon. Henry FAN Hung-ling, SBS, JP

Managing Director

CITIC Pacific Limited

(Mr Fan was chairman at meetings in the absence of Dr Cheung)

Secretary

Mr Trevor KEEN

Terms of reference

- (1) The objectives of the Audit Sub-Committee are as follows:
 - (a) to help Members of the Exchange Fund Advisory Committee to discharge their responsibilities for ensuring the proper and smooth running of the HKMA operations and management of the Exchange Fund;
 - (b) to consider any matters relating to the financial affairs of the HKMA and the internal and external audit of the HKMA's financial statements as the Sub-Committee may think necessary or desirable;
 - (c) to encourage higher quality accounting and audit and provide more credible and objective financial reporting of the HKMA; and
 - (d) to consider any other matters referred to it by the Committee; and to report on all such matters to the Committee.
- (2) The functions of the Sub-Committee include, but are not restricted to, the following:
 - (a) reviewing the HKMA's financial statements, the composition and accounting principles adopted in such statements, whether these are intended to be audited or published or not;
 - (b) advising on the form and content of the financial statements of the HKMA;
 - (c) examining and reviewing with both the external and internal auditors the scope and results of their audits;
 - (d) reviewing the findings, recommendations or criticisms of the auditors, including their annual management letter and management's response;
 - (e) reviewing the HKMA's management procedures to ensure the effectiveness of internal systems of accounting and control, and management's efforts to correct deficiencies discovered in audits; and
 - (f) initiating investigations or audit reviews into any activities of the HKMA which may be of concern or interest to the Sub-Committee.

(3) Authority

The Sub-Committee shall be entitled to obtain any information it requires from any member or employee of the HKMA, and all such members and employees shall be instructed to assist the Sub-Committee to the fullest extent possible. The Sub-Committee may also take such independent legal or other professional advice as it considers necessary. The Sub-Committee shall have no executive powers as regards its findings and recommendations.

(4) Meetings

The Sub-Committee shall meet at least twice a year. The Secretary to the Exchange Fund Advisory Committee shall attend its meetings and take minutes, copies of which shall be circulated to the Committee. The Chief Executive of the HKMA shall be entitled to attend the Sub-Committee's meetings. In all other respects, the Sub-Committee shall decide its own procedures.

The *Currency Board Sub-Committee* monitors and reports on the Currency Board arrangements that underpin Hong Kong's Linked Exchange Rate system. It is responsible for ensuring that Currency Board operations are in accordance with established policy, recommending improvements to the Currency Board system, and ensuring a high degree of transparency in the operation of the system. Records of the Sub-Committee's meetings and the monthly reports on Currency Board operations submitted to the Sub-Committee are published. In 2006 the Sub-Committee met four times. Topics discussed included a review of the Hong Kong dollar effective exchange rate, estimating the demand for narrow money and broad money, Hong Kong's business cycle synchronisation with Mainland China and the US, and the implications of relaxing the three-year tenor issuance restriction on multilateral development banks for monetary stability and market development potential.

 > [Press Releases](#) > [Monetary Policy](#)

Membership (1 April 2007)

Chairman

Mr Joseph YAM, GBS, JP

The Monetary Authority

Members

Mr William RYBACK, JP

Deputy Chief Executive

Hong Kong Monetary Authority

Mr Peter PANG, JP

Deputy Chief Executive

Hong Kong Monetary Authority

Mr Y K CHOI, JP

Deputy Chief Executive

Hong Kong Monetary Authority

Mr John GREENWOOD

Group Chief Economist

INVESCO Asset Management Limited

Professor TSANG Shu-ki

Department of Economics

Hong Kong Baptist University

Professor K C CHAN, JP

Dean of Business and Management

Hong Kong University of Science and Technology

Mr Peter SULLIVAN

Chairman

The Hong Kong Association of Banks

Secretary

Mr Trevor KEEN

Terms of reference

- (1) To ensure that the operation of the Currency Board arrangements in Hong Kong is in accordance with the policies determined by the Financial Secretary in consultation with the Exchange Fund Advisory Committee.
- (2) To report to the Financial Secretary through the Exchange Fund Advisory Committee on the operation of the Currency Board arrangements in Hong Kong.
- (3) To recommend, where appropriate, to the Financial Secretary through the Exchange Fund Advisory Committee, measures to enhance the robustness and effectiveness of the Currency Board arrangements in Hong Kong.
- (4) To ensure a high degree of transparency in the operation of the Currency Board arrangements in Hong Kong through the publication of relevant information on the operation of such arrangements.
- (5) To promote a better understanding of the Currency Board arrangements in Hong Kong.

The *Investment Sub-Committee* monitors the HKMA's investment management work and makes recommendations on the investment policy and strategy of the Exchange Fund and on risk management and other related matters. The Sub-Committee held six meetings during 2006.

Membership (1 April 2007)

Chairman

Mr Joseph YAM, GBS, JP

The Monetary Authority

Members

Mr Y K CHOI, JP

Deputy Chief Executive

Hong Kong Monetary Authority

Mr Christopher CHENG Wai-chee, GBS, JP

Chairman

USI Holdings Limited

Mr HE Guangbei

Vice Chairman and Chief Executive

Bank of China (Hong Kong) Limited

Professor K C CHAN, JP

Dean of Business and Management

Hong Kong University of Science and Technology

The Hon. Henry FAN Hung-ling, SBS, JP

Managing Director

CITIC Pacific Limited

Mr Peter SULLIVAN

Executive Director and Chief Executive Officer

Standard Chartered Bank (Hong Kong) Limited

Mr Vincent CHENG Hoi-chuen, GBS, JP

Chairman

The Hongkong and Shanghai Banking Corporation Limited

Secretary

Mr Trevor KEEN

Terms of reference

- (1) To monitor the investment management work of the HKMA.
- (2) To make recommendations to the Financial Secretary, through the Exchange Fund Advisory Committee, on
 - (a) the investment benchmark for the Exchange Fund;
 - (b) the investment policy and risk management of the Fund;
 - (c) the investment strategy for the Fund; and
 - (d) any other matters referred to the Sub-Committee in connection with the investment management of the Exchange Fund.

The *Financial Infrastructure Sub-Committee* monitors the work of the HKMA in relation to the development and operation of the financial infrastructure in Hong Kong and makes recommendations on measures and initiatives relating to the HKMA's responsibilities for promoting the safety, efficiency and development of Hong Kong's financial infrastructure. In 2006 the Sub-Committee met three times.

Membership (1 April 2007)

Chairman

Mr Joseph YAM, GBS, JP

The Monetary Authority

Members

Mr Y K CHOI, JP

Deputy Chief Executive

Hong Kong Monetary Authority

Mr Christopher CHENG Wai-chee, GBS, JP

Chairman

USI Holdings Limited

Dr Patrick WANG Shui-chung, JP

Chairman and Chief Executive Officer

Johnson Electric Holdings Limited

Mr HE Guangbei

Vice Chairman and Chief Executive

Bank of China (Hong Kong) Limited

Mr Vincent CHENG Hoi-chuen, GBS, JP

Chairman

The Hongkong and Shanghai Banking Corporation Limited

Dr Patrick FUNG Yuk-bun

Chairman and Chief Executive

Wing Hang Bank Limited

Secretary

Mr Trevor KEEN

Terms of reference

- (1) To monitor the work of the HKMA in relation to the development and operation of the financial infrastructure in Hong Kong.
- (2) To recommend to the Financial Secretary through the Exchange Fund Advisory Committee
 - (a) measures to promote the safety and efficiency of the financial infrastructure in Hong Kong, particularly payment and settlement arrangements; and
 - (b) initiatives for the HKMA, in discharging its responsibilities for maintaining the stability and integrity of the monetary and financial systems of Hong Kong, to promote the development of the financial infrastructure in Hong Kong with a view to maintaining Hong Kong's status as an international financial centre and helping to strengthen the international competitiveness of Hong Kong's financial services.

The Banking Advisory Committee

The Banking Advisory Committee is established under Section 4(1) of the Banking Ordinance to advise the Chief Executive of the Hong Kong Special Administrative Region on matters relating to the Banking Ordinance, in particular matters relating to banks and the carrying on of banking business. The Committee consists of the Financial Secretary, who is the Chairman, the Monetary Authority, and other persons appointed by the Financial Secretary under the delegated authority of the Chief Executive of the Hong Kong Special Administrative Region.

Membership (1 April 2007)

Chairman

The Hon. Henry TANG Ying-yen, GBS, JP

The Financial Secretary

Ex Officio Member

Mr Joseph YAM, GBS, JP

The Monetary Authority

Members

The Hon. Frederick MA Si-hang, JP

Secretary for Financial Services and the Treasury

Mr HE Guangbei

Vice Chairman and Chief Executive

Bank of China (Hong Kong) Limited

Representing Bank of China (Hong Kong) Limited

Mr Peter WONG Tung-shun, JP

Executive Director

The Hongkong and Shanghai Banking Corporation Limited

Representing The Hongkong and Shanghai Banking

Corporation Limited

Mr Peter SULLIVAN

Executive Director and Chief Executive Officer

Standard Chartered Bank (Hong Kong) Limited

Representing Standard Chartered Bank (Hong Kong) Limited

Mrs Doreen CHAN HUI Dor-lam

President and Chief Executive Officer

CITIC Ka Wah Bank Limited

Mrs Mignonne CHENG

Head of North and East Asia

BNP Paribas

Dr The Hon. David LI Kwok-po, LLD, GBS, JP

Chairman and Chief Executive

The Bank of East Asia Limited

Ms Maria XUEREB

Financial Services Partner

Deloitte Touche Tohmatsu

Mr Ignatius CHAN Tze-ching, JP

Citigroup Country Officer, Hong Kong & Head of Greater China

Corporate and Investment Banking

Citibank, N.A.

Mr Hideo HIYAMA

Director, General Manager & Regional Chief Executive

Sumitomo Mitsui Banking Corporation

Hong Kong Branch

Mr James C K WONG

Chief Executive Officer

Dah Sing Life Assurance Company Limited

Mr Stanley Y F WONG

Director & Deputy General Manager

Industrial and Commercial Bank of China (Asia) Limited

Secretary

Ms Jasmin FUNG

The Deposit-Taking Companies Advisory Committee

The Deposit-Taking Companies Advisory Committee is established under Section 5(1) of the Banking Ordinance to advise the Chief Executive of the Hong Kong Special Administrative Region on matters relating to the Banking Ordinance, in particular matters relating to deposit-taking companies and restricted licence banks and the carrying on of a business of taking deposits by them. The Committee consists of the Financial Secretary, who is the Chairman, the Monetary Authority, and other persons appointed by the Financial Secretary under the delegated authority of the Chief Executive of the Hong Kong Special Administrative Region.

Membership (1 April 2007)

Chairman

The Hon. Henry TANG Ying-yen, GBS, JP

The Financial Secretary

Ex Officio Member

Mr Joseph YAM, GBS, JP

The Monetary Authority

Members

The Hon. Frederick MA Si-hang, JP

Secretary for Financial Services and the Treasury

Mr Martin WHEATLEY

Chief Executive Officer

Securities and Futures Commission

Representing the Securities and Futures Commission

Mr Geoffrey J MANSFIELD

Chairman

The DTC Association (The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies)

Representing The DTC Association

Ms Connie LAU Yin-hing

Chief Executive

Consumer Council

Representing the Consumer Council

Ms Kitty IU Pui-pui

Managing Director

Scotiabank (Hong Kong) Limited

Mr Mervyn JACOB

Partner

Assurance, Financial Services Practice

PricewaterhouseCoopers

Mr Frank J WANG

Executive Director and Deputy Chief Executive

Wing Hang Finance Company Limited

Mr Erik Helge WEINER

Chairman & Chief Executive

JP Morgan Securities (Asia Pacific) Limited

The Hon. CHAN Kam-lam, SBS, JP

Member

Legislative Council

Mr Michael CHANG Ming-yuen

Director

Fubon Credit (Hong Kong) Limited

Mr CHOI Jong Ha

Managing Director and Chief Representative

KDB Asia Limited

Mr Yasuhiro MATSUMURA

Chairman

Mitsubishi UFJ Securities (HK) Capital, Limited

Secretary**Ms Jasmin FUNG****Chief Executive's Committee**

The Chief Executive's Committee comprises the Chief Executive of the HKMA, who chairs the Committee, the Deputy Chief Executives and the Executive Directors of the HKMA. The Committee meets weekly to report to the Chief Executive on the progress of major tasks being undertaken by the various departments of the HKMA and to advise him on policy matters relating to the operations of the HKMA.

Brief biographies of and the Code of Conduct for EFAC Members may be found on the HKMA website. A Register of Members' Interests, which contains the declarations of interests by Members, is available for public inspection from 9:00 a.m. to 5:00 p.m. Monday to Friday (except public holidays) at the HKMA Offices.

 > The HKMA > Advisory Committees

 > The HKMA > The Chief Executive's Committee

Maintaining Monetary Stability

THE LINKED EXCHANGE RATE SYSTEM

The monetary policy objective of Hong Kong is currency stability. This is defined as a stable external exchange value of the Hong Kong dollar in terms of its exchange rate against the US dollar at around HK\$7.80 to one US dollar. The monetary policy objective is achieved through the Linked Exchange Rate system, which has been implemented since 17 October 1983. The Linked Exchange Rate system plays an important part in supporting Hong Kong's role as a trading, service and financial centre.

THE CURRENCY BOARD SYSTEM

Exchange rate stability in Hong Kong is achieved through a Currency Board system. The Monetary Base is fully backed by foreign currency reserves at the fixed exchange rate of HK\$7.80 to US\$1. Any change in the Monetary Base must be fully matched by corresponding changes in foreign currency reserves.

Hong Kong's Monetary Base consists of four components:

- Certificates of Indebtedness, which back the banknotes issued by the three note-issuing banks

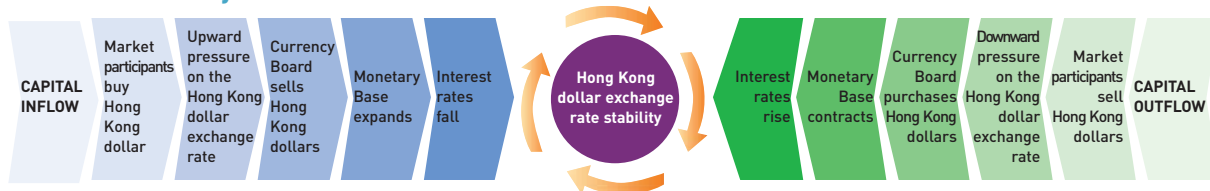
- government-issued currency notes and coins in circulation
- the sum of the balances of the clearing accounts maintained by banks with the HKMA (known as the Aggregate Balance)
- Exchange Fund Bills and Notes, which are issued by the HKMA on behalf of the Government.

Under the Currency Board system, the stability of the Hong Kong dollar exchange rate is maintained through an interest rate adjustment mechanism.

In recent years the Currency Board system has been strengthened to make it more transparent and resilient to external shocks. In particular, the HKMA has provided a clear undertaking to all banks to convert their Hong Kong dollar clearing balances into US dollars at the Convertibility Rate of HK\$7.85 to US\$1, and in the other direction to convert their US dollars into Hong Kong dollars at the Convertibility Rate of HK\$7.75 to US\$1.

 > [Monetary Stability](#) > [Currency Board System](#)

The Currency Board mechanism



Promoting Banking Safety

The principal function of the HKMA as banking supervisor is to promote the general stability and effective working of the banking system in Hong Kong. The HKMA seeks to ensure that banks and deposit-taking companies in Hong Kong operate in an effective, responsible, honest and business-like manner to provide a measure of protection to depositors. The HKMA derives its powers as banking supervisor from the Banking Ordinance.

THE THREE TIERS OF BANKING IN HONG KONG

Hong Kong's banks are divided into three tiers of authorized institutions (AIs). The main distinctions lie in the deposit business each tier of institution is allowed to conduct under the Banking Ordinance.

The HKMA is the licensing authority for AIs under the Banking Ordinance. The HKMA's supervisory approach is based on a policy of continuous supervision. This involves ongoing monitoring of AIs through the use of a variety of techniques, including on-site examinations, off-site reviews, prudential meetings, meetings with boards of directors or board-level committees, co-operation with external auditors, and sharing of information with other supervisors. The aim is to try to ensure that any problems affecting AIs are detected and addressed at an early stage.

The HKMA uses a risk-based supervisory approach to ensure that AIs have the necessary risk management systems to identify, measure, monitor and control the risks inherent in their operations. This enables the HKMA to be more proactive in pre-empting any serious threat to the stability of the banking system.

 > Banking Stability

| Three tiers of authorized institutions | Deposit business permitted |
|--|--|
| Licensed banks | <ul style="list-style-type: none"> • Current accounts, savings deposits and time deposits of any size and maturity |
| Restricted licence banks | <ul style="list-style-type: none"> • Time deposits of HK\$500,000 or more for any maturity • Savings and current accounts are not permitted |
| Deposit-taking companies | <ul style="list-style-type: none"> • Time deposits of HK\$100,000 or more for at least three months • Savings and current accounts are not permitted |

Managing The Exchange Fund

THE EXCHANGE FUND

The Exchange Fund was established in 1935 with the primary objective to safeguard the exchange value of the Hong Kong dollar. Holding Hong Kong's foreign currency reserves, the Exchange Fund is the cornerstone of maintaining the stability and integrity of monetary and financial systems in Hong Kong, and provides the backing to maintain the Linked Exchange Rate system.

The Exchange Fund Ordinance stipulates the establishment, control and management of the Exchange Fund. According to the Ordinance, the Exchange Fund is under the control of the Financial Secretary, who delegates the management responsibilities of the Exchange Fund to the Monetary Authority, based on the powers and duties conferred on him under the Ordinance. In consultation with the Exchange Fund Advisory Committee, the Financial Secretary determines the investment policies and strategies for the Exchange Fund with its day-to-day management responsibilities rested with the Monetary Authority.

INVESTMENT OBJECTIVES

The investment objectives of the Exchange Fund are

- (a) to preserve capital;
- (b) to ensure that the entire Monetary Base at all times will be fully backed by highly liquid US dollar-denominated securities;
- (c) to ensure sufficient liquidity for the purpose of maintaining monetary and financial stability; and
- (d) subject to (a) - (c) above, to achieve an investment return that will preserve the long-term purchasing power of the Fund.

INVESTMENT PROCESS

The Exchange Fund is divided into two main portfolios - the Backing Portfolio and the Investment Portfolio. The Backing Portfolio is used to hold US dollar denominated assets for the purpose of providing full backing for the Monetary Base of Hong Kong. The Investment Portfolio is used to hold different asset classes aiming at preserving the value and long-term purchasing power of the Fund. Under the Linked Exchange Rate system, all Exchange Fund assets in the Backing Portfolio and the Investment Portfolio can be used to support the Hong Kong dollar exchange rate.

The long-term asset allocation strategy of the Fund is governed by the investment benchmark, which is set by the Financial Secretary on the advice of the Exchange Fund Advisory Committee. The benchmark represents the optimal mix of assets designed to meet the investment objectives.

USE OF EXTERNAL MANAGERS

The Exchange Fund employs global external managers to manage about one third of its total assets, including all of its equity portfolios and other specialised assets. The purpose of appointing external managers is to add value to the investment process by tapping the best of the investment expertise available in the market, to capture a diverse mix of investment styles within the global investment field, and, if possible, to help transfer market knowledge and information to in-house professionals.

Developing Financial Infrastructure

POLICY OBJECTIVE

The HKMA is committed to promoting a safe, efficient and reliable financial market infrastructure to help maintain Hong Kong's status as an international financial centre. The HKMA oversees the important clearing and settlement systems in Hong Kong under the Clearing and Settlement Systems Ordinance. It fosters the local and regional debt markets and develops settlement systems for cross-border transfers of funds and securities. The long-term aim is for Hong Kong to be a leading centre of financial intermediation, where all types of financial transactions, initiated from whatever location or time zone and in whatever currency, whether at the wholesale or retail level, can be executed and settled in real time.

PAYMENT SYSTEMS IN HONG KONG

Since 1996, interbank funds transfers have been settled in real time through the Hong Kong dollar Real Time Gross Settlement (RTGS) system - the Clearing House Automated

Transfer System (CHATS). This means that payment is processed continuously and finality of settlement is instantaneous. The advantages are speed, efficiency and safety.

Building on the technology of the Hong Kong dollar RTGS system, the HKMA introduced a US dollar RTGS system in 2000, a euro RTGS system in 2003 and a renminbi RTGS system in 2007.

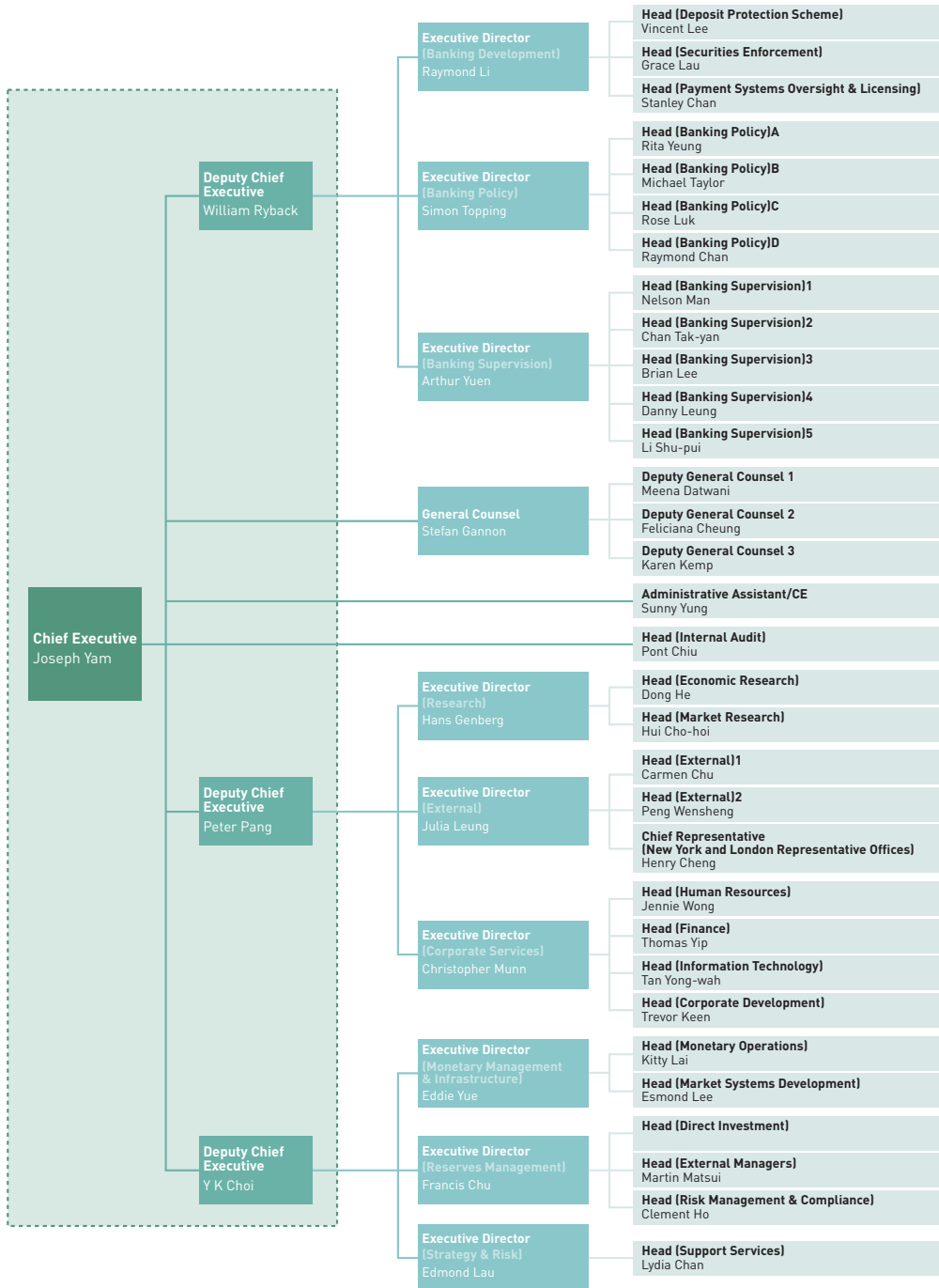
CENTRAL MONEYMARKETS UNIT

The Central Moneymarkets Unit (CMU), operated by the HKMA, provides an efficient clearing, settlement and depository service for both Hong Kong dollar and other international debt securities. Since its establishment in 1990 the CMU has developed links with overseas central securities depositories. Through these links, local investors can hold and settle securities lodged with overseas depositories more efficiently, and overseas investors can do the same in Hong Kong.

 > Financial Infrastructure

HKMA ORGANISATION CHART

1 April 2007



REVIEW OF 2006

Summary Version of the
HKMA Annual Report 2006



Chief Executive's Statement



The HKMA had another busy and, I believe, successful and productive year in 2006: the Hong Kong dollar exchange rate remained stable despite record fund flows, the banking sector remained strong, the Exchange Fund earned a respectable investment return, and some real progress was made in mapping out a strategy for Hong Kong's world-class financial infrastructure to contribute to the further development of China's economy.

Economic trends

Hong Kong's economy grew by 6.8% in 2006, lower than the 7.5% in 2005 but still above trend and very respectable. Monetary conditions eased, reflecting high levels of liquidity in the banking sector, but were broadly neutral. Unemployment declined to its lowest level in six years, while inflation picked up slightly but not yet to levels that would cause concern. Growth in the economy was mainly driven by domestic demand, particularly consumer spending and investment in business equipment. At the same time, exports of goods and services were robust with increases in trade with the Mainland and solid demand from our other major trading partners.

Asset markets performed well: the residential property market was stable after a strong rise in 2005, with little sign of overheating; and the stock market staged a strong rally in the second half of the year, with the Hang Seng Index increasing by 34% to reach a record high of 20,001 on 28 December. This rise was supported by Hong Kong's strong economic performance, the pause in monetary tightening in the US, and large inflows of funds related to initial public offerings, mostly of Mainland stocks.

The Exchange Fund

That the Exchange Fund enjoyed a good year in 2006 is already old news: the Fund earned an investment return of \$103.8 billion, a rate of return of 9.5%. This exceeded the rate of return of the benchmark portfolio approved by the Financial Secretary on the advice of the Exchange Fund Advisory Committee (EFAC) by more than 0.6%. The share of the investment income going to the fiscal reserves placed with the Exchange Fund was \$28.9 billion.

Good results are always welcome, of course. We are glad to have contributed to a healthy investment return for the people of Hong Kong. But we are also very conscious that this is not the primary purpose of the Exchange Fund. The purposes and investment objectives of the Fund are set out in detail in the Reserves Management chapter: in essence, the Fund is there to back the Hong Kong dollar, and to do that it has to be held primarily in liquid US dollar assets and its investment objectives emphasise capital preservation and liquidity. I have said this many times but perhaps it bears repeating once more: the Exchange Fund has to be invested, but it is not an investment fund and investment is not its primary purpose.

The implication of this is that we cannot and should not expect high returns from the Fund every year. Like the savings that many of us hold, the Exchange Fund can be thought of as rainy-day money: we want to get a good return on it but we must always remember that we might need it for some emergency and therefore be prudent in how we invest it. Looking ahead to 2007, I believe that caution is called for. While I believe we did well in outperforming the benchmark, the overall results of 2006 were due in large part to equities and bond markets rising together towards the end of the year and a number of equities markets in particular reaching historic highs. We all understand that markets are cyclical and when you reach high levels, the outlook for the future is uncertain at best.

Hong Kong dollar stability

The Hong Kong dollar exchange rate is always a focus for the HKMA given our mandate to preserve currency stability. I am pleased to say that the Hong Kong dollar remained stable within the Convertibility Zone throughout the year, despite some very large fund flows related to initial public offerings and speculation about the effect on the Hong Kong dollar of the renminbi's appreciation. Looking back at the 2005 Annual Report, I note that last year I talked about record fund flows from initial public offerings: those records were greatly exceeded in 2006 with \$333 billion being raised in the local stock market, including \$125 billion for a single issue.

Earlier in the year, many in the financial markets seemed to believe that the Hong Kong dollar would follow the renminbi in appreciating against the US dollar and other major currencies, and there was speculation that we would abandon the Linked Exchange Rate system. Quite why anyone should think that we would give up an anchor that has served us well and helped to maintain stability through some very difficult and potentially destabilising times over the last 23 years is something of a mystery. But the HKMA's job is to ensure stability and if people found my repeated statements that there was no plan or intention to abandon the link to the US dollar a little boring, then I do not mind very much. Dullness can be a virtue in our business. We spent a lot of time explaining to the markets and the wider community that the strengthening of the renminbi to parity with the Hong Kong dollar and beyond would not affect the Hong Kong dollar exchange rate, although we of course could not rule out short-term psychological effects on the financial markets. We also explained that, given the correlation of the business cycles in Hong Kong and the US and the fact that an overwhelming amount of our external trade is denominated in US dollars, the link with the US dollar remained appropriate for the Hong Kong economy and the best way to ensure stability. In the event, the markets largely shared this view and the renminbi passed through various psychologically significant levels without causing any ripples to the stability of the Hong Kong dollar: the Currency Board system functioned normally and we were not required to take any action to stabilise the exchange rate.

The banking sector

Hong Kong continues to have a robust banking system despite a very competitive operating environment. The profitability of the banks improved because of higher net interest margins and loan growth, leading to higher net interest income. Income from fees and commissions also increased, more than offsetting lower treasury income and an increase in provisions. Overall asset quality remained good: although the credit card portfolio weakened slightly, the decline in quality was from a level many other markets would regard with envy and the resulting increase in provisions was small by historical standards. The local banking sector is well placed to continue to support economic growth.

But that does not mean the HKMA should not remain active and vigilant in its role of promoting the safety and stability of the banking sector. In addition to the continuing day-to-day regulation work, largely unseen by the public but of great importance to ensuring a stable banking industry, the HKMA has been working hard to make improvements in this area. In 2006 my colleagues in the banking departments continued to develop risk-based supervision and completed the enormous volume of work related to the implementation of the Basel II arrangements, which formally began on 1 January this year when the *Banking (Capital) Rules* and the *Banking (Disclosure) Rules* came into force. Hong Kong is among the first jurisdictions in the world to implement Basel II and this makes us very much a leader in the region. A great deal more detailed and painstaking work lies ahead of us.

The Deposit Protection Scheme commenced operations on 25 September and the evidence so far suggests that the Scheme, which provides a measure of protection to depositors, is already helping to increase confidence in the banking sector. Another area where we increased our efforts in 2006 is in monitoring controls on money laundering and terrorist financing: sad to say, these problems are going to be with us for the foreseeable future and we have had to devote more resources to them. It would be a brave person who would say that we can prevent such dealings, but we are committed to doing everything we can to make it harder for criminals to abuse our financial systems.

Hong Kong as an international financial centre

The year saw a number of highlights in the development of Hong Kong as an international financial centre. The international credit rating agencies upgraded Hong Kong's sovereign ratings to AA, the highest they have ever been. The HKMA, working with the Government, played an important role in helping the agencies achieve a better understanding of Hong Kong's economic and financial strengths. We also worked hard during the year with the Mainland authorities on the expansion of renminbi business in Hong Kong, leading in January this year to the State Council's agreement to the issuance of renminbi bonds in Hong Kong by Mainland institutions, the first time that such instruments will be issued outside the Mainland.

The HKMA also developed a blueprint for the financial development of Hong Kong that was adopted as part of the report by the Focus Group on Financial Services set up by the Chief Executive's Economic Summit on "China's 11th Five-Year Plan and the Development of Hong Kong". The blueprint aims to set out how Hong Kong's already developed financial systems can contribute to the development of the nation's economy and give China the kind of international financial centre the world's fourth-largest and fastest-growing economy ought to have. This is a long-term goal and I have no doubt the strategy will need to be revised from time to time and progress will sometimes seem slower than we would like. But it is surely something worth achieving and we should all commit ourselves to it.

A safe and efficient financial infrastructure

An aspect of Hong Kong's financial system that receives very little public attention is its world-class financial infrastructure. Efficient and safe payment and settlement systems are often taken for granted and few people not directly involved know much about them: people just assume that when they commit funds to a transaction, the money will arrive safely and on time at the other end. This is not the place for a detailed explanation of what are very complex systems but I will just note that on a single day, 27 October 2006, \$1.37 trillion, roughly equivalent to Hong Kong's annual gross domestic product, passed through the clearing-house system without any problems. There were also no settlement failures during the year. This does not just happen: a lot of people work very hard to ensure that the systems operate efficiently and the HKMA puts a great deal of effort not just into maintaining the systems but also into making sure that they are developed and improved to keep ahead of the demands placed upon them.

Governance and transparency

I am always conscious that the HKMA bears a great responsibility in the stewardship of public resources. We manage a very large amount of public money and perform functions that directly affect Hong Kong's financial well-being. The HKMA maintains a degree of separation from the rest of the Hong Kong Special Administrative Region Government, although we are an integral part of it. We have a certain level of autonomy in our day-to-day operations, in our funding arrangements, and in the employment of staff on terms different from those of the civil service. These arrangements are consistent with the generally accepted principle that central banking institutions should have resource independence to allow them to carry out their functions without political interference. But this does not mean that the HKMA should not be accountable for how it performs those functions and we are in fact accountable to the Financial Secretary through EFAC and to the community, both directly and through the Legislative Council. EFAC and its Sub-Committees, especially the Governance Sub-Committee, continue to keep a close eye on our operations and to offer us much valuable advice and guidance. We have adopted a policy of transparency that compares favourably with those of the major central banks around the world. I brief the Legislative Council's Panel on Financial Affairs three times a year on the work of the HKMA and matters affecting the economy. This Annual Report is also an important part of our transparency policy and this year we have included a number of improvements and additional items of information that I hope will help the community better understand what we do and how we do it.

Finally, I would like to thank my colleagues for their continued hard work and dedication during the year, and we are all grateful to the Members of EFAC who give up so much of their time and energy to provide us with their guidance.



Joseph Yam
Chief Executive

Economic and Banking Environment in 2006

ECONOMIC PERFORMANCE

The Hong Kong economy grew above trend for the third consecutive year in 2006. Real GDP increased by 6.8% after expanding by 7.5% in 2005 and 8.6% in 2004. Strong domestic demand and expansion in exports supported growth. Reflecting rising aggregate demand and higher housing rents, consumer price inflation picked up gradually in 2006. Labour market conditions continued to improve, with the unemployment rate declining to 4.4% in the fourth quarter of 2006.

PROSPECTS FOR 2007

The outlook for 2007 remains favourable. The Hong Kong economy will continue to benefit from strong economic performance in Mainland China. The market expects real GDP growth in 2007 to moderate, reflecting a slowdown in global demand. Consumer price inflation is expected to pick up modestly in 2007, partly reflecting rising domestic demand and higher import prices. A number of uncertainties, however, surround the benign outlook. They include a sharper-than-expected slowdown in the US economy, further tightening of monetary policy in industrialised economies, and significant reversal of international capital flows. Other medium-term risks include large global imbalances, rising trade protectionism and overheating on the Mainland.

PERFORMANCE OF THE BANKING SECTOR

The banking sector achieved another year of solid results in 2006 despite the operating environment remaining intensely competitive. Retail banks' pre-tax operating profits in 2006 increased by 10.1% from the previous year, mainly supported by improved net interest margins and loan growth.

PROSPECTS FOR THE BANKING SECTOR IN 2007

Banks' capital and liquidity positions prepare them well to continue to support economic growth. Attention needs to be paid to liquidity and interest rate risks, however, because the liquidity position seen in 2006 may not persist in 2007. Attention also needs to be paid to pricing risks properly and maintaining credit underwriting standards as competition continues to remain intense. Banks are likely to continue to look for business opportunities in Mainland China, placing a particularly high premium on their ability to identify, manage and control the associated risks.

CURRENCY

At the end of 2006, the total value of notes and coins in circulation reached more than \$164 billion, an increase of more than 5.2% from 2005. To help strengthen awareness of counterfeiting, 37 education seminars were organised during the year for about 2,800 bank cashiers and retailers. These education efforts will continue in 2007.

 > [Consumer Information](#) > [Notes and Coins](#)

HONG KONG'S ECONOMY

| | 2005 | 2006 |
|---|--------|---------------------------|
| Economic growth and inflation | | |
| Real growth in Gross Domestic Product (%) | 7.5 | 6.8 ^(a) |
| of which: | | |
| Real growth in private consumption expenditure (%) | 3.3 | 5.1 ^(a) |
| Real growth in gross domestic fixed capital formation (%) | 4.6 | 7.9 ^(a) |
| Real growth in exports (%) | 11.2 | 9.9 ^(a) |
| Real growth in imports (%) | 8.5 | 9.7 ^(a) |
| Composite Consumer Price Index (annual change, %) | 1.0 | 2.0 |
| Labour market | | |
| Employment (annual change, %) | 2.0 | 2.1 |
| Unemployment rate (annual average, %) | 5.6 | 4.8 |
| Money supply (annual change, %) | | |
| Hong Kong dollar money supply (M1) | -15.6 | 11.4 |
| Hong Kong dollar money supply (M2) ^(b) | 5.5 | 19.2 |
| Hong Kong dollar money supply (M3) ^(b) | 5.7 | 19.2 |
| Interest rates (end of year, %) | | |
| Three-month interbank rate | 4.16 | 3.84 |
| Savings deposit rate | 2.32 | 2.26 |
| Best lending rate | 7.75 | 7.75 |
| Composite rate | 2.88 | 2.86 |
| Exchange rates (end of year) | | |
| Hong Kong dollar/US dollar | 7.753 | 7.775 |
| Trade-weighted effective exchange rate index (Jan 2000=100) | 98.4 | 94.3 |
| Hang Seng Index (end of year) | | |
| | 14,876 | 19,965 |

(a) The estimates are preliminary.

(b) Adjusted to include foreign currency swap deposits.

PERFORMANCE RATIOS OF HONG KONG'S BANKING SECTOR

| | 2005 % | 2006 % | 2005 % | 2006 % |
|--|-----------|-------------|-------------------------------------|--------------|
| | All AIs | | Retail banks* | |
| Profitability^(a) | | | | |
| Growth of pre-tax operating profit | N.A. | N.A. | 8.28 | 10.14 |
| Return on assets (operating profit before tax) | 1.07 | 1.13 | 1.55 | 1.53 |
| Return on assets (post-tax profit) | 0.97 | 1.00 | 1.40 | 1.35 |
| Net interest margin | 1.18 | 1.29 | 1.68 | 1.80 |
| Bad debt charge to average total assets | 0.01 | 0.03 | -0.01 | 0.01 |
| Business profile^(a) | | | | |
| Growth in loans to customers | 7.2 | 6.7 | 9.8 | 4.0 |
| Growth in customer deposits (all currencies) | 5.2 | 17.2 | 3.1 | 15.6 |
| Hong Kong dollar loan to deposit ^(b) ratio | 84.3 | 74.7 | 78.8 | 69.1 |
| Asset quality^(c) | | | | |
| Classified loans ^(d) as percentage of total loans | 1.34 | 1.05 | 1.37 | 1.11 |
| | | | All locally incorporated AIs | |
| Capital Adequacy Ratio (consolidated) | | | 14.8 | 15.0 |

Notes:

(a) Figures are related to Hong Kong office(s) only.

(b) Includes swap deposits.

(c) Figures are related to Hong Kong office(s) and, in the case of local AIs, include overseas branches.

(d) Denotes loans graded as "substandard", "doubtful" or "loss".

* This comprises all the locally incorporated banks plus a number of the large foreign banks which are not locally incorporated but whose operations are similar to those of the locally incorporated banks, in that they operate a branch network and are active in retail banking.

Monetary Conditions in 2006

REVIEW OF 2006

Hong Kong's foreign exchange and money markets were stable in 2006. The Hong Kong dollar spot exchange rate fluctuated between the Linked Rate of 7.8 to one US dollar and the strong-side Convertibility Undertaking of 7.75 during the year.

Movements in Hong Kong dollar interbank interest rates largely followed those in their US dollar counterparts. The Hong Kong Interbank Offered Rates rose in the first half of the year, tracking increases in the US federal funds target rate. Since the US Fed stopped raising the target rate in August, Hong Kong dollar interest rates have been steady, moving between four and five per cent.

Amid ample liquidity, Hong Kong dollar interbank interest rates stayed below their US dollar counterparts during the year. But the negative interest rate spreads in 2006 were not large compared to historical standards. From a macroeconomic perspective, monetary conditions in 2006 were broadly neutral.

The Convertibility Undertakings were not triggered in 2006, and the HKMA did not conduct any foreign exchange operations. The Aggregate Balance remained stable at around \$1.3 billion, and interest rate volatility continued to remain low.

ACTIVITIES AT THE HKMA

The Currency Board Sub-Committee of the Exchange Fund Advisory Committee continued to oversee the operation of the Currency Board system and examine issues affecting monetary and financial stability in Hong Kong.

The Hong Kong Institute for Monetary Research conducts research in monetary policy and banking and finance issues that are of strategic importance to Hong Kong and the region, and promotes central bank co-operation in research.

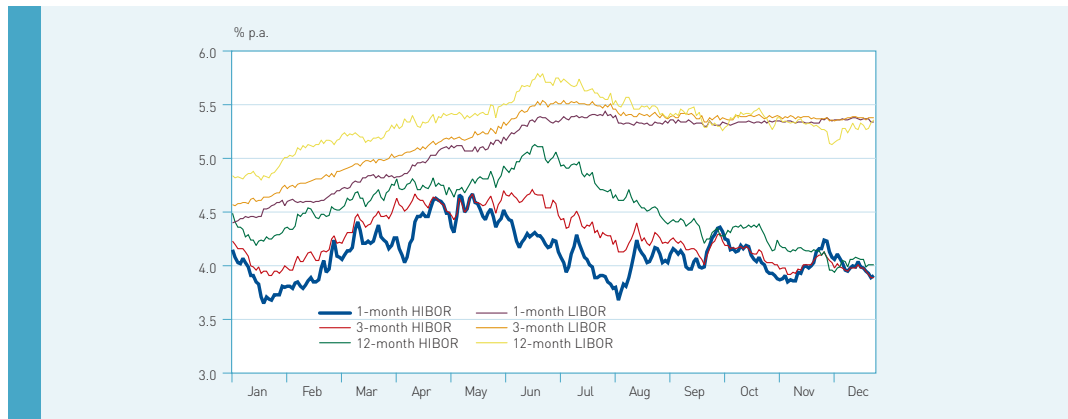
 [Press Releases](#) > [Monetary Policy](#)

 [Research Memorandums](#)

Chart 1. Market exchange rate, January-December 2006



Chart 2. HIBORs and LIBORs, January-December 2006



Banking Policy and Supervisory Issues in 2006

RISK-BASED SUPERVISION

In 2006 the HKMA further developed its risk-based supervisory approach. More resources were allocated to thematic examinations of selected authorized institutions. Benchmarking the risk management and internal control of authorized institutions were the supervisory focus during the year. The HKMA also helped the banks to identify emerging risks, and issued guidance on sound industry practices in these areas.

Table 1. Operational Supervision

| | 2005 | 2006 |
|---|------|-----------------------|
| 1. On-site examinations | 228 | 247 |
| <i>Regular examinations</i> | | |
| – risk-based | 92 | 86 |
| – overseas | 11 | 10 |
| <i>Specialised examinations</i> | | |
| – treasury and derivatives activities | 8 | 9 |
| – securities (tier-2) | 5 | 7 |
| – e-banking activities and technology risk management | 17 | 5 |
| – AML/CFT controls (tier-2) | – | 4 |
| – business continuity plan | 17 | 15[#] |
| <i>Thematic examinations</i> | | |
| – renminbi banking business | 18 | 25 |
| – implementation of the standardized (credit risk) approach and the IRB approach under Basel II | – | 17 |
| – AML/CFT controls over correspondent banking and private banking | – | 22 |
| – controls for protecting customer data | – | 15 |
| – retail wealth management | 14 | 22 |
| – investment advisory activities | – | 10 |
| – trade financing | 22 | – |
| – residential mortgage | 24 | – |
| 2. Off-site reviews and prudential interviews | 187 | 185 |
| 3. Tripartite meetings | 71 | 51 |
| 4. Meetings with boards of directors or board-level committees of AIs | 18 | 21 |
| 5. Approval of applications to become controllers, directors, chief executives, alternate chief executives of AIs | 332 | 278 |
| 6. Reports commissioned under Section 59(2) of the Banking Ordinance | 4 | 1 |
| 7. Cases considered by the Banking Supervision Review Committee | 7 | 15 |

[#] In 2006, the examinations focused on assessing AIs' preparedness for a possible pandemic.

DEPOSIT PROTECTION SCHEME

The Scheme was launched on 25 September 2006. Eligible depositors are now entitled to compensation of up to \$100,000 in the event of a bank failure. The Deposit Protection Board, with the assistance of the HKMA, launched an extensive publicity programme about the Scheme.

BASEL II

Following extensive consultation, the Banking (Capital) Rules and Banking (Disclosure) Rules were passed by the Legislative Council in November 2006, enabling Basel II to be implemented in Hong Kong on 1 January 2007.

CONSUMER PROTECTION

One hundred and seventy-two authorized institutions providing personal banking services completed the annual self-assessment of compliance with the *Code of Banking Practice* covering the period from June 2005 to May 2006. More than 87% reported full compliance with the Code. Non-compliances were mainly related to the advance of loans and overdrafts, and the terms and conditions of banking services. The HKMA required authorized institutions to take prompt remedial actions to address any non-compliance.

In 2006 the HKMA received 292 complaints about banking services provided by authorized institutions, compared with 328 in 2005. The decline applies to all types of banking services, including complaints against the use of debt collection agencies by authorized institutions.

 > Banking Stability

 > Consumer Information

Market Infrastructure in 2006

OPERATION OF PAYMENT SYSTEMS

The Hong Kong dollar, US dollar and euro payment systems continued to function efficiently in 2006. The daily average turnover of the Hong Kong dollar system reached record highs during the year, mainly because of a number of well-received initial public offerings

in the stock market, which increased flows of Hong Kong dollars.

In 2006 the HKMA made encouraging progress in implementing the recommendations of the review of the financial infrastructure of Hong Kong conducted in 2005. Projects completed during the year include the CMU Bond Price Bulletin, the Renminbi Settlement System, and the payment-versus-payment link between Hong Kong's US dollar and Malaysia's ringgit RTGS systems.

Chart 1. Hong Kong dollar payment system daily average turnover

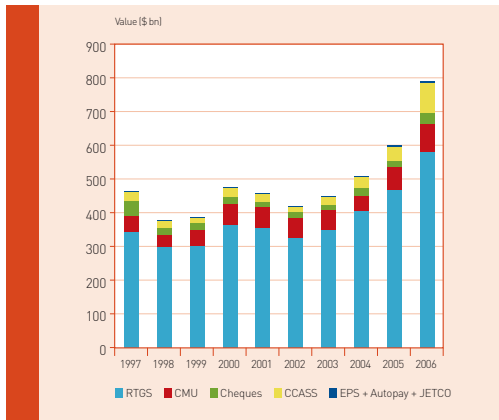


Chart 2. US dollar clearing system daily average turnover

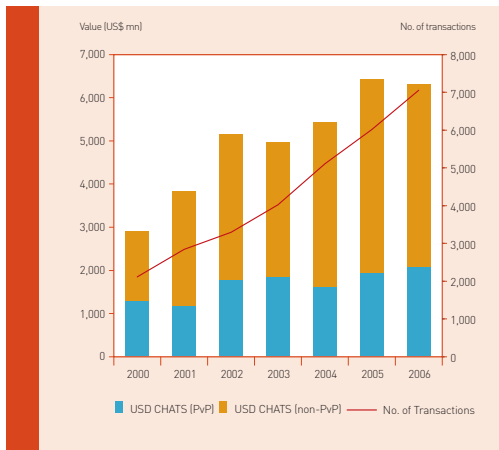


Chart 3. Euro clearing system daily average turnover



OVERSIGHT OF CLEARING AND SETTLEMENT SYSTEMS

In 2006 all designated systems under the *Clearing and Settlement Systems Ordinance* continued to be in compliance with the safety and efficiency requirements of the Ordinance. The HKMA assessed the Euro CHATS, one of the designated systems, and concluded that it generally observes the Core Principles for Systemically Important Payment Systems developed by the Committee on Payment and Settlement Systems of the Bank for International Settlements.

Assisted by the HKMA, eight credit and debit card scheme operators issued a *Code of Practice for Payment Card Scheme Operators* in December 2006. The Code sets out the principles on operational reliability, data and network security, and the efficiency and transparency of payment card operations in Hong Kong. The HKMA endorsed the Code and is responsible for monitoring the operators' compliance with it.

EXCHANGE FUND BILLS AND NOTES PROGRAMME

The HKMA completed a review of the programme in 2006. A number of recommendations to improve market efficiency were identified. Among these recommendations, a league table of the most active market makers was published for the first time in December. The HKMA has also removed the rule imposed in 1998 restricting the issuance of Hong Kong dollar bonds by multilateral development banks to tenors of three years or longer.

TREASURY MARKETS ASSOCIATION

The Association completed its first full year of operation. The HKMA continued to provide strategic support to develop Hong Kong into the hub of treasury market business in the region. More than 2,000 individual and 74 institutional members from virtually all sectors of the treasury markets have now joined the Association. To promote members' qualifications, new certificate programmes were developed jointly with the Hong Kong Institute of Bankers and the University of Science and Technology. The Association organised seminars, workshops and talks for market professionals, and launched new financial products to help develop the treasury markets.

 > Financial Infrastructure

International Financial Centre

HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

The HKMA has enhanced its research and monitoring work on regional and Mainland economic and financial issues, with the aim of promoting greater financial stability in Asia including Hong Kong. It maintained contacts with the international central banking and financial community to promote international understanding of, and confidence in, Hong Kong's monetary and financial systems. Co-operation with Mainland authorities was also strengthened to promote further integration of the financial markets of the two places and to advance Hong Kong's status as an international financial centre for China. In 2006, the HKMA

- formulated a development strategy for enhancing the status of Hong Kong as an international financial centre through close financial co-operation with the Mainland
- pursued the expansion of the renminbi business in Hong Kong, as well as the use of Hong Kong's financial platform for orderly portfolio investment outflows from the Mainland

- continued to provide leadership and intellectual contributions to regional initiatives to strengthen co-operation in developing the bond market and enhancing monetary and financial stability in the region
- conducted in-depth research for further strengthening the monitoring work on Mainland and regional issues
- worked closely with Government bureaux to launch a targeted strategy towards international credit rating agencies in nurturing a better understanding of Hong Kong's economic and financial strengths.

THE 1-3-5 FINANCIAL DEVELOPMENT BLUEPRINT

In response to China's 11th Five-Year Plan promulgated in March, the HKMA proposed a blueprint to position Hong Kong as China's international financial centre. It is called "1-3-5" because it encompasses one strategic positioning, three institutional dimensions and five practical areas. The blueprint was adopted by the Focus Group on Financial Services set up by the Government under the HKSAR Chief Executive's Economic Summit on China's 11th Five-Year Plan and the Development of Hong Kong.

EXPANSION OF RENMINBI BUSINESS

Considerable progress was made in pursuing a further expansion of the renminbi business in Hong Kong. The State Council announced in January 2007 that financial institutions on the Mainland, subject to approval, can issue renminbi bonds in Hong Kong. This will bring a new asset class for investment by renminbi depositors in Hong Kong, and help the diversification of banks' assets and liabilities in renminbi. It is a further step forward in building up Hong Kong's capacity of conducting renminbi denominated transactions, which is important for Hong Kong to play an increasing role in financial intermediation on the Mainland and the use of the renminbi in international transactions.

UPGRADING HONG KONG'S SOVEREIGN CREDIT RATING

The HKMA worked with the Government to foster a better understanding of Hong Kong's economic and financial strengths among international credit rating agencies. The strategy proved to be effective and contributed to a number of upgrades in 2006, putting Hong Kong in the AA category by all major international rating agencies - the highest rating that has ever been assigned to Hong Kong. Standard and Poor's acknowledged in a study published in January 2007 that Hong Kong's credit strengths were comparable with those of many economies with AAA ratings.

RESEARCH ON MAINLAND ECONOMIC AND FINANCIAL ISSUES

The HKMA introduced a dedicated research series, *China Economic Issues*, in 2006 to complement the existing in-house monitoring and analytical work, as well as research exchanges with Mainland academics and think-tanks. The series provides detailed analysis of topics such as the Mainland's interest rate structure and the development of renminbi derivatives and commodity futures markets. Selected issues of *China Economic Issues* are available on the HKMA website www.hkma.gov.hk.

 > [Monetary Stability](#) > [External Relations](#)

 > [China Economic Issues](#)

Exchange Fund Performance in 2006

The Exchange Fund achieved an investment return of 9.5%, or 0.6% above that of the investment benchmark, in 2006. The Fund earned a gross investment income of \$103.8 billion, comprising

- \$31.9 billion from bond investments
- \$35.9 billion from Hong Kong equities
- \$18.7 billion from foreign equities
- a foreign exchange revaluation gain of \$17.3 billion.

Table 1. 2006 market returns

| Currencies | |
|---|--------|
| Appreciation (+)/depreciation (-) against US dollar | |
| Euro | +11.8% |
| Yen | -0.9% |
| Bond markets | |
| US Government Bond (1-3 years) Index | +3.9% |
| Equity markets | |
| Standard & Poor's 500 Index | +13.6% |
| Hang Seng Index | +34.2% |

Table 2. Gross investment return of the Exchange Fund in Hong Kong dollar terms¹

| | Return on total assets | Return on investment benchmark ² | Alpha | CPI (A) ³ |
|---------------------------|---------------------------|---|-------|-------------------------|
| 2006 | 9.5% | 8.9% | +0.6% | +1.9% |
| 2005 | 3.1% | 2.9% | +0.2% | +1.3% |
| 1999 – 2006 annualised | 6.2% | 5.0% | +1.2% | -1.0% |
| 1994 – 2006 annualised | 6.6% | N/A | N/A | +1.3% |

¹ For the Annual Reports from 2001 to 2003, return on total assets and return on investment benchmark are in US dollar terms.
² Established in January 1999.
³ December year-on-year percentage change in the HK-CPI(A) index. CPI(A) is calculated based on the 2004/2005 base new series.

Table 3. Currency mix of the Exchange Fund's assets on 31 December 2006 – including forward transactions

| | HK\$ billion | % |
|------------------------|--------------|-------|
| US dollar bloc | | |
| US dollar ¹ | 909.8 | 77.4 |
| Hong Kong dollar | 130.9 | 11.1 |
| Non-US dollar bloc | 135.7 | 11.5 |
| Total | 1,176.4 | 100.0 |

¹ Includes Canadian dollar, Australian dollar and New Zealand dollar.

Since 1994, the Exchange Fund has generated a compounded annual return of 6.6%, which exceeds the compounded annual inflation rate of 1.3% over the period. The investment return of the Exchange Fund has exceeded the

benchmark return in every year for the past eight years, except in 2004 when the actual investment return was the same as the benchmark return.

 > [Monetary Stability](#) > [Exchange Fund](#)

Chart 1. Investment return of the Exchange Fund (1994-2006)

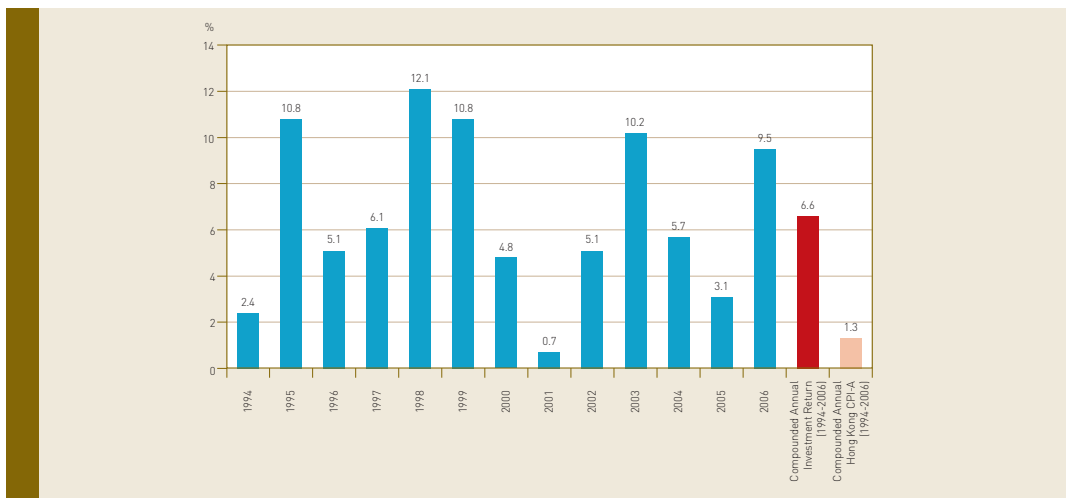
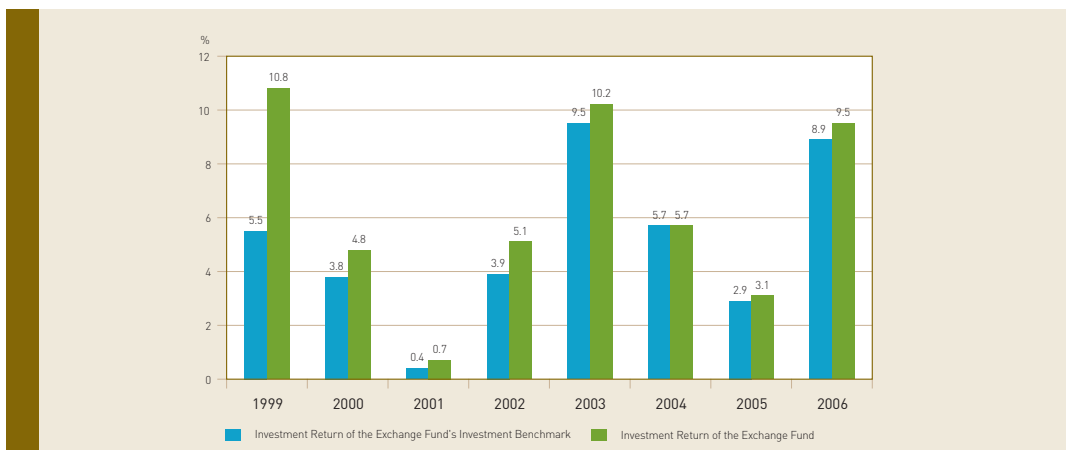


Chart 2. Investment return of the Exchange Fund and the Exchange Fund's investment benchmark (1999-2006)



The Exchange Fund

The audited full statement of accounts of the Exchange Fund for 2006 may be found in the HKMA Annual Report 2006.

EXCHANGE FUND - INCOME AND EXPENDITURE ACCOUNT

for the year ended 31 December 2006

| | Group | | Fund | |
|--|-----------------|--------------------|-----------------|-----------------|
| | 2006 | 2005 (restated) | 2006 | 2005 |
| (Expressed in millions of Hong Kong dollars) | | | | |
| INCOME | | | | |
| Interest income | 43,483 | 31,496 | 41,184 | 29,719 |
| Dividend income | 6,162 | 5,165 | 6,429 | 5,430 |
| Net realised and revaluation gains | 38,799 | 22,173 | 38,806 | 22,182 |
| Net exchange gains/(losses) | 17,360 | (19,468) | 17,338 | (19,474) |
| Investment income | 105,804 | 39,366 | 103,757 | 37,857 |
| Bank licence fees | 132 | 129 | 132 | 129 |
| Other income | 277 | 269 | 64 | 36 |
| TOTAL INCOME | 106,213 | 39,764 | 103,953 | 38,022 |
| EXPENDITURE | | | | |
| Interest expense | (38,996) | (17,137) | (37,421) | (16,026) |
| Operating expenses | (1,986) | (1,628) | (1,810) | (1,463) |
| Note and coin expenses | (160) | (208) | (160) | (208) |
| Write back of impairment losses on loans | 8 | 19 | - | - |
| TOTAL EXPENDITURE | (41,134) | (18,954) | (39,391) | (17,697) |
| SURPLUS BEFORE SHARE OF PROFIT OF ASSOCIATE | 65,079 | 20,810 | 64,562 | 20,325 |
| Share of profit of associate, net of tax | 8 | 3 | - | - |
| SURPLUS BEFORE TAXATION | 65,087 | 20,813 | 64,562 | 20,325 |
| Income tax | (86) | (100) | - | - |
| SURPLUS FOR THE YEAR | 65,001 | 20,713 | 64,562 | 20,325 |
| ATTRIBUTABLE TO: | | | | |
| Owner of the Fund | 64,987 | 20,690 | 64,562 | 20,325 |
| Minority interests | 14 | 23 | - | - |
| | 65,001 | 20,713 | 64,562 | 20,325 |

EXCHANGE FUND - BALANCE SHEET

as at 31 December 2006

| | Group | | Fund | |
|--|------------------|--------------------|------------------|------------------|
| | 2006 | 2005 (restated) | 2006 | 2005 |
| (Expressed in millions of Hong Kong dollars) | | | | |
| ASSETS | | | | |
| Cash and money at call | 19,726 | 15,937 | 19,661 | 15,887 |
| Placements with banks and other financial institutions | 44,670 | 75,667 | 42,766 | 73,120 |
| Derivative financial instruments | 1,490 | 1,953 | 1,227 | 1,865 |
| Financial assets designated at fair value through profit or loss | 1,088,192 | 953,145 | 1,088,192 | 953,145 |
| Available-for-sale securities | 5,107 | 2,483 | 493 | 493 |
| Held-to-maturity securities | 4,753 | 4,585 | - | - |
| Loan portfolio | 32,394 | 33,549 | - | - |
| Gold | 330 | 266 | 330 | 266 |
| Other assets | 18,926 | 17,023 | 17,949 | 16,149 |
| Investments in subsidiaries | - | - | 2,145 | 2,145 |
| Interest in associate | 35 | 26 | - | - |
| Property, plant and equipment | 853 | 888 | 611 | 625 |
| Operating land lease prepayment | 2,997 | 3,071 | 2,997 | 3,071 |
| Intangible assets | 22 | 33 | 22 | 33 |
| TOTAL ASSETS | 1,219,495 | 1,108,626 | 1,176,393 | 1,066,799 |
| LIABILITIES AND EQUITY | | | | |
| Certificates of Indebtedness | 156,926 | 148,406 | 156,926 | 148,406 |
| Government-issued currency notes and coins in circulation | 6,842 | 6,671 | 6,842 | 6,671 |
| Balance of the banking system | 2,035 | 1,561 | 2,035 | 1,561 |
| Derivative financial instruments | 735 | 869 | 572 | 525 |
| Trading liabilities | 2,096 | 7,412 | 2,096 | 7,412 |
| Placements by banks and other financial institutions | 7,572 | 25,712 | 7,572 | 25,712 |
| Placements by other Hong Kong Special Administrative Region government funds | 324,530 | 297,086 | 324,530 | 297,086 |
| Placements by Hong Kong statutory bodies | 26 | - | 26 | - |
| Exchange Fund Bills and Notes issued | 129,139 | 118,134 | 129,139 | 118,134 |
| Other debt securities issued | 28,910 | 27,991 | - | - |
| Mortgage-backed securities issued | 5,341 | 5,145 | - | - |
| Other liabilities | 44,231 | 23,541 | 38,947 | 18,146 |
| Total liabilities | 708,383 | 662,528 | 668,685 | 623,653 |
| Accumulated surplus | 510,813 | 445,826 | 507,708 | 443,146 |
| Available-for-sale securities revaluation reserve | 125 | 94 | - | - |
| Total equity attributable to owner of the Fund | 510,938 | 445,920 | 507,708 | 443,146 |
| Minority interests | 174 | 178 | - | - |
| Total equity | 511,112 | 446,098 | 507,708 | 443,146 |
| TOTAL LIABILITIES AND EQUITY | 1,219,495 | 1,108,626 | 1,176,393 | 1,066,799 |

Major Events 1993-2006

1993

April 1993

The HKMA is established with responsibility for monetary and banking stability, reserves management, and financial infrastructure.



May 1993

The Government starts to replace the Queen's Head coins with those using the new bauhinia design.

July 1993

The Government announces the sale of Overseas Trust Bank for \$4,457 million. The sale of the bank, taken over in June 1985, marks the end of the Government's efforts to rescue banks in the 1980s.



1994

May 1994

The Bank of China issues its first Hong Kong banknotes.



August 1994

The Hang Seng China Enterprises Index is launched to serve as an indicator of the overall performance of Hong Kong-listed, state owned enterprises of the People's Republic of China.

September 1994

The first issue of five-year Exchange Fund Notes is launched. The issue helps extend the benchmark yield curve for Hong Kong dollar debt to the five-year area.

October 1994

The interest rate cap on time deposits is lifted in phases. This marks the beginning of a relaxation of Interest Rate Rules in Hong Kong.

November 1994

Hong Kong issues its first bimetallic coin – the bauhinia \$10 coin.



1995

May 1995

Hong Kong Interbank Clearing Limited is established to provide interbank clearing services in Hong Kong.



June 1995

The HKMA becomes the licensing authority of three types of authorized institutions, following the enactment of the Banking (Amendment) Ordinance 1995.

July 1995

The Companies Ordinance is amended. Depositors are entitled to receive priority payment in the liquidation of banks.

November 1995

The Government decides to publish the size of Hong Kong's foreign exchange reserves (i.e. foreign currency assets of the Exchange Fund) every quarter instead of every six months.

November 1995

The first issue of seven-year Exchange Fund Notes is launched.

1996

January 1996

The Exchange Fund acquires the De La Rue banknote printing plant in Tai Po, which is renamed "Hong Kong Note Printing Limited".



September 1996

The HKMA is invited to join the Bank for International Settlements, the Swiss-based forum promoting co-operation among central banks.

October 1996

The first issue of ten-year Exchange Fund Notes is launched.

December 1996

Real Time Gross Settlement is launched in Hong Kong, enabling interbank payments to be settled in real time.

1997

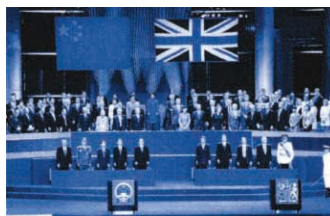
March 1997

The Hong Kong Mortgage Corporation is established. It buys mortgage loans for its own portfolio and issue mortgage-backed securities.



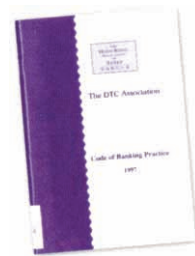
July 1997

Hong Kong becomes a Special Administrative Region of the People's Republic of China.



July 1997

The *Code of Banking Practice* is issued to improve the transparency and quality of banking services in Hong Kong.



July 1997

The assets of the Land Fund are handed over to Hong Kong SAR Government with a net value of \$197 billion. From July 1997 to October 1998 these assets are managed by the HKMA as a separate fund within the fiscal reserves. On 1 November 1998 the assets of the Land Fund are merged with the Exchange Fund and managed as part of the investment portfolio of the Exchange Fund.

September 1997

World Bank/IMF Annual Meetings are held in Hong Kong. Central bank and finance ministry officials from some 180 countries attend the meetings.



1998

July 1998

Hong Kong International Airport opens at Chek Lap Kok.



July 1998

The Bank for International Settlements opens its representative office for Asia and the Pacific in Hong Kong.

August 1998

Using \$118 billion from the Exchange Fund, the Hong Kong SAR Government launches a stock market operation to frustrate manipulation of the money and stock markets.

September 1998

The HKMA introduces seven technical measures to strengthen the Currency Board arrangements.



October 1998

Exchange Fund Investment Limited is established to manage the portfolio of Hang Seng Index constituent stocks acquired by the Exchange Fund in the market operation of August.

1999

January 1999

The foreign currency assets and the balance sheet data of the Exchange Fund are published monthly, in line with the standard set by the International Monetary Fund.

August 1999

Exchange Fund Notes commence listing on the Hong Kong Stock Exchange.

August 1999

The Hong Kong Institute for Monetary Research is established.

November 1999

The Tracker Fund of Hong Kong is established as a vehicle for gradually disposing of the majority of the stocks acquired by the Exchange Fund in the 1998 market operation.



2000

August 2000

Hong Kong processes its first transaction through the new US dollar clearing system.

October 2000

Hong Kong is selected as President for 2001-2002 of the Financial Action Task Force on Money Laundering, an international body.

December 2000

Hong Kong's Mandatory Provident Fund System comes into full operation.

2001

January 2001

The International Monetary Fund opens a sub-office in Hong Kong.

April 2001

The Government approves in principle the proposal to introduce a deposit protection scheme in Hong Kong.

July 2001

Interest Rate Rules are completely deregulated. Banks are free to set interest rates for all types of deposits.

November 2001

All restrictions on the number of branches of foreign banks are lifted.

December 2001

China enters the World Trade Organization.

2002

March 2002

The Securities and Futures Ordinance is passed by the Legislative Council. The Ordinance consolidates and modernises 10 existing ordinances into a single piece of legislation to govern financial and investment products, regulate the securities and futures markets, and protect investors.

May 2002

The Government endorses the HKMA's proposals to relax certain market entry criteria for the banking sector.

September 2002

The Government issues new \$10 currency notes.



2003

March to June 2003

Outbreak of Severe Acute Respiratory Syndrome. 1,755 people in Hong Kong are infected and 299 people die.

April 2003

Hong Kong processes its first transaction through its new euro clearing system.

June 2003

Exchange of letters between the Financial Secretary and the Monetary Authority on functions and responsibilities in monetary and financial affairs.

June 2003

The Mainland and Hong Kong sign the Closer Economic Partnership Arrangement.



December 2003

The three note-issuing banks issue new \$100 and \$500 notes with additional security features.



2004

February 2004

Over 30 banks in Hong Kong introduce renminbi deposit, exchange, remittance, and debit and credit card services.

May 2004

The Deposit Protection Scheme Ordinance is enacted.

July 2004

The Clearing and Settlement Systems Ordinance is enacted.

October 2004

The three note-issuing banks issue new \$20, \$50 and \$1000 notes with additional security features.



November 2004

The Commercial Credit Reference Agency is launched.

2005

May 2005

The HKMA announces three refinements to the operation of the Linked Exchange Rate system.

July 2005

The Banking (Amendment) Ordinance 2005 is passed to provide a legislative framework for the implementation of Basel II in Hong Kong.

July 2005

The People's Bank of China announces reform of the renminbi exchange rate regime.

December 2005

The Sixth Ministerial Conference of the World Trade Organization takes place in Hong Kong.

2006

March 2006

The Renminbi Settlement System is launched. The system provides a safe and efficient clearing and settlement platform to support the further expansion of renminbi business in Hong Kong.

September 2006

The Hong Kong banking industry implements a five-day clearing week.

September 2006

The Deposit Protection Scheme commences operation. The Scheme provides a measure of protection to depositors and contributes to the stability of the financial system.

Abbreviations

| | | |
|--------------|---|--|
| AI | - | Authorized institution |
| AML | - | Anti-money-laundering |
| CFT | - | Counter-terrorist-financing |
| CHATS | - | Clearing House Automated Transfer System |
| CMU | - | Central Moneymarkets Unit |
| CPI | - | Consumer Price Index |
| DTC | - | Deposit-taking companies |
| EFAC | - | Exchange Fund Advisory Committee |
| GDP | - | Gross Domestic Product (in real terms unless otherwise stated) |
| HIBOR | - | Hong Kong Interbank Offer Rate |
| HK | - | Hong Kong |
| HKMA | - | Hong Kong Monetary Authority |
| IMF | - | International Monetary Fund |
| IRB approach | - | Internal Ratings-based approach |
| LIBOR | - | London Interbank Offer Rate |
| N.A. | - | Not applicable |
| PvP | - | Payment-versus-Payment |
| RMB | - | Renminbi |
| RTGS | - | Real Time Gross Settlement |
| SAR | - | Special Administrative Region |
| US | - | United States of America |

Reference Resources

The *HKMA Annual Report* is published in April or May each year. A number of other HKMA publications provide explanatory and background information on the HKMA's policies and functions. These include

HKMA Quarterly Bulletin

(published in March, June, September and December each year)

HKMA Monthly Statistical Bulletin (on-line publication)

(published in two batches on the third and sixth business days of each month)

Guide to Hong Kong Monetary and Banking Terms (Third Edition)

HKMA Background Brief No. 1 - Hong Kong's Linked Exchange Rate System (Second Edition)

HKMA Background Brief No. 2 - Banking Supervision in Hong Kong

HKMA Background Brief No. 3 - Mandate and Governance of the Hong Kong Monetary Authority

HKMA Background Brief No. 4 - Financial Infrastructure in Hong Kong

Money and Banking in Hong Kong: A Historical Timeline

Educational leaflets on various topics including notes and coins and banking issues

HKMA publications may be purchased or obtained from the **HKMA Information Centre**, 55th Floor, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. The HKMA Information Centre consists of an Exhibition Area and a Library. The Centre introduces the work of the HKMA and houses books, journals and other texts on central banking and related subjects. The Centre is open to the public six days a week.

 [HKMA Information Centre](#)

Most HKMA publications are also available for downloading free of charge from the HKMA website (www.hkma.gov.hk). A mail order form for the purchase of print publications can be found on the website.

 [Publications](#)

The main texts of the regular briefings by the HKMA to the Legislative Council Panel on Financial Affairs are available online.

 [Legislative Council Issues](#)

The HKMA website contains detailed and extensive information on the whole range of the HKMA's work. This information includes press releases, statistics, speeches, guidelines and circulars, research reports, and features on topical issues.



The theme of this Annual Report is the five elements of Chinese philosophy – water, wood, fire, earth and gold. The five elements, presented symbolically, suggest tradition, balance, harmony and the operation of an ordered system.

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