HONG KONG MONETARY AUTHORITY
香港金融管理局

ANNUAL REPORT 2009

Hong Kong Monetary Authority

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
- to promote the stability and integrity of the financial system, including the banking system
- to help maintain Hong Kong's status as an international financial centre, including the maintenance and development of Hong Kong's financial infrastructure
- to manage the Exchange Fund.

The HKMA is part of the Hong Kong Special Administrative Region Government but operates with a high degree of autonomy, complemented by a high degree of accountability and transparency. The HKMA is accountable to the people of Hong Kong through the Financial Secretary and through the laws passed by the Legislative Council that set out the Monetary Authority's powers and responsibilities. In his control of the Exchange Fund, the Financial Secretary is advised by the Exchange Fund Advisory Committee.

The HKMA's offices are at

55/F, Two International Finance Centre,
8 Finance Street,
Central,
Hong Kong
Telephone : (852) 2878 8196
Facsimile : (852) 2878 8197
E-mail : hkma@hkma.gov.hk

The HKMA Information Centre is located at 55/F, Two International Finance Centre, 8 Finance Street, Central, Hong Kong and is open from 10:00 a.m. to 6:00 p.m. Monday to Friday and 10:00 a.m. to 1:00 p.m. on Saturday (except public holidays). The Centre consists of an exhibition area and a library containing materials on Hong Kong's monetary, banking and financial affairs and central banking topics.

The HKMA's bilingual website (www.hkma.gov.hk) provides comprehensive information about the HKMA including its main publications and many other materials.

Contents

The chapter on Banking Stability in this Annual Report is the report on the working of the Banking Ordinance and the activities of the office of the Monetary Authority during 2009 submitted by the Monetary Authority to the Financial Secretary in accordance with section 9 of the Banking Ordinance.

The full text of this Report is available on the HKMA website.

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

Highlights of 2009

Economic and Banking Environment

Real GDP in 2009 declines by 2.7% but the economy picks up in the second half of the year.

The banking sector remains stable and well capitalised. Asset quality deteriorates but remains high by historical standards.

Monetary Stability

The Hong Kong dollar remains stable against the US dollar despite strong inflows of funds and large swings in the US dollar exchange rate against other currencies.

Hong Kong's money market largely returns to normal following the introduction of temporary liquidity measures by the HKMA in 2008. Exit from these measures in March goes smoothly.

Banking Stability

The banking sector comes through the global financial crisis, continuing to be strong and robust.

The HKMA finishes its investigation work on nearly 80% of the Lehman-related complaint cases and reaches agreements with the SFC and the distributing banks on the repurchase of financial products issued by Lehman Brothers.

Following a guideline issued by the HKMA, authorized institutions lower the maximum loan-to-value ratio for properties with a value of $20 million or more from 70% to 60%.

Financial Infrastructure

Phase I of the migration of the RTGS and CMU systems to the SWIFTNet open platform is completed.

The HKMA launches multi-currency cross-border payment arrangements between the Mainland and Hong Kong and upgrades the renminbi RTGS system.

The HKMA designs and launches the Government Bond Programme, putting two issues of bonds to the market for institutional investors.

International Financial Centre

The HKMA implements the pilot scheme for settlement of cross-border trades using renminbi.

More renminbi bonds are issued in Hong Kong, including RMB6 billion by the Ministry of Finance, the first such issuance outside the Mainland.

The Chiang Mai Initiative Multilateralisation Agreement is signed, signifying Hong Kong's separate participation in this regional defensive initiative.

Moody's upgrades the outlook for Hong Kong's local and foreign-currency ratings.

Reserves Management

The Exchange Fund records an investment income of $106.9 billion, a return of 5.9%.

Total assets of the Exchange Fund reach $2,149.4 billion at the end of 2009.

Chief Executive's Statement

What a turbulent year of 2009! The world experienced the most serious financial crisis since at least the Second World War and, although the worst effects of the crisis lessened during the year, there was a high degree of concern at how the world economy and financial system were coping, and what the effects on Hong Kong would be.

It was therefore not hard to identify my priorities when I took over as Chief Executive of the HKMA on 1 October, and I announced them to the community on my first day.

First, maintaining monetary stability in Hong Kong through the Linked Exchange Rate system. The latest crisis has demonstrated, once again, the value of the Link in ensuring monetary stability, which is of such importance to an open and highly externally oriented economy like ours. In its 26-year history, the link to the US dollar has provided an anchor for the economy through a number of crises. It continues to be the best guarantee of financial stability. 2009 saw unprecedentedly large inflows of funds into the Hong Kong dollar – around HK$640 billion between the last quarter of 2008 and the end of 2009 – as investors viewed Asia, and especially China, as the area that would recover first and most strongly from the global recession. As a result, Hong Kong's Monetary Base exceeded one trillion dollars at the end of the year, and the HKMA issued an additional $374.4 billion in Exchange Fund Bills during the year to meet demand from authorized institutions for liquidity management. The markets reacted calmly to the exit in March from the temporary liquidity-assistance measures introduced in September 2008.

Secondly, maintaining the stability of the banking system and the smooth functioning of credit markets. The Hong Kong banking system has come through the latest crisis in much better shape than many of its counterparts in the US and Europe. The aggregate capital adequacy ratio of the banking sector at the end of 2009 stood at 16.9% and the liquidity ratio at 47.8%. The classified loan ratio, despite an increase from 2008, remained low at 1.35% and other asset-quality indicators continued to be favourable.

Following the liquidity measures taken in 2008, the Hong Kong interbank market largely returned to normal functioning in 2009 with interbank interest rates declining to very low levels in line with their US-dollar counterparts. Confidence in the local banking system was greatly strengthened while access to bank finance by corporates, including the small and medium-sized enterprises, has largely been restored with the help of the Government loan guarantee schemes. However, we need to guard against the risk of a credit fuelled asset bubble in Hong Kong that would threaten banking and financial stability. This was why the HKMA tightened the loan-to-value ratio for the top end of the property market (those valued at $20 million or more) to 60% in late October.

Another major task for the HKMA in 2009 was continuing to deal with the over 21,000 complaints from bank customers in relation to the sale by banks of investment products related to the failed US investment bank Lehman Brothers. In July the HKMA and the Securities and Futures Commission, following extensive investigations by both regulators, reached a settlement agreement with 16 banks with regard to the sale of the Lehman Minibonds. The agreement allowed the vast majority of the banks' affected customers to get back at least 60% of their principal and those aged 65 or above to receive 70%. By the end of the year, the HKMA had finished its investigation work on 77% of the Lehman-related complaint cases. Our aim is to complete the investigation of the bulk of those remaining by the end of March 2010.

Thirdly, continuing with the prudent investment of the Exchange Fund. The global financial markets continued its nose dive in the first quarter, resulting in substantial losses of the Exchange Fund. However, the sharp rebound in global equity markets from the second quarter helped the Fund to achieve eventually an investment return of $106.9 billion or 5.9% in 2009, more than recouping the $75 billion investment loss in 2008. Given the considerable uncertainties surrounding the global financial markets, the HKMA will continue to manage the Exchange Fund prudently in accordance with the investment objectives determined by the Financial Secretary on the advice of the Exchange Fund Advisory Committee.

Finally, developing Hong Kong further as an international financial centre. With the increasing size of the Mainland economy and its influence in the global economy, our ability to intermediate renminbi fund flows is essential for Hong Kong's future competitiveness as the leading international financial centre in the region. A major breakthrough was achieved in July 2009, with the introduction of the pilot scheme for settlement of cross-border trades in renminbi, followed by the issuance of several renminbi bonds in Hong Kong. The Ministry of Finance of China issued in Hong Kong the first sovereign bond outside the Mainland.

Of course, a great deal of other work was undertaken by the HKMA during a very busy and challenging year, and the details are set out in the following chapters. I should add that much of the achievements of the HKMA in 2009, and for that matter in the years before, would not have been possible without the very solid foundation laid by my predecessor, Mr Joseph Yam, who had been at the helm for 16 years since the HKMA was set up in 1993. Under Joseph's capable leadership, the HKMA has gained respect and recognition locally and internationally as a highly professional central banking institution with an outstanding track record in coping with successive crises over the years. I am sure that my colleagues in the HKMA will join me in thanking Joseph for his leadership and contributions to the HKMA.

Looking ahead, we will continue to face numerous challenges. The global economic outlook for 2010 seems far from certain: a recovery appears to be underway but its strength and sustainability remain to be seen. The fiscal positions of the major economies and the timing and pace of their exits from monetary easing make the way ahead difficult to discern. Uncertainty about the direction and size of movements in interest rates and fund flows are likely to mean that financial markets will remain volatile. The HKMA will exercise great caution and vigilance both as regulator of the banking system and manager of the Exchange Fund. As Chief Executive, I am acutely aware of the need not just to discharge our duties effectively but also to be able to explain clearly to the community what we do and to gain their trust and support!

Norman T.L. CHAN
Chief Executive

About the HKMA

The Hong Kong Monetary Authority is Hong Kong's central banking institution. The HKMA has four main functions: maintaining currency stability within the framework of the Linked Exchange Rate system; promoting the stability and integrity of the financial system, including the banking system; helping to maintain Hong Kong's status as an international financial centre, including the maintenance and development of Hong Kong's financial infrastructure; and managing the Exchange Fund.

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 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 co-operation 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.

About the HKMA

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. Further information on the HKMA's media work, publications and public education programmes is contained in the chapter on Professional and Corporate Services.

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 reports on Currency Board operations. The supervisory policies and guidelines on banking have been published on the website since 1996.

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. 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.

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 include 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 2009 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.

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 2009 to consider a range of subjects including the HKMA's expenditure budget, the HKMA's performance assessment, the annual pay review, the *HKMA Annual Report*, and strategic planning matters. The Sub-Committee also received regular reports on the work of the HKMA.

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. None of the members of the Sub-Committee performs any executive functions in the HKMA. The Sub-Committee met twice in 2009 and received reports on the work of the Internal Audit Division.

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 reports on Currency Board operations submitted to the Sub-Committee are published. In 2009 the Sub-Committee met three times.

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 2009.

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 2009 the Sub-Committee met twice and received regular reports on development of financial infrastructure.

Brief biographies of EFAC Members 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.

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.

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.

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.

Advisory Committees

THE EXCHANGE FUND ADVISORY COMMITTEE

Chairman

The Honourable John TSANG Chun-wah, JP
The Financial Secretary

Members

Mr Norman T.L. CHAN, SBS, JP
The Monetary Authority
(from 1 October 2009)

The Honourable Joseph YAM, GBM, GBS, JP
The Monetary Authority
(until 30 September 2009)

Mr Christopher CHENG Wai-chee, GBS, JP
Chairman
USI Holdings Limited

Mr HE Guangbei, JP
Vice Chairman and Chief Executive
Bank of China (Hong Kong) Limited

Mr Henry FAN Hung-ling, SBS, JP
(Mr Fan has taken a leave of absence)

Mr Simon IP Sik-on, JP

Mr Thomas KWOK Ping-kwong, SBS, JP
Vice Chairman and Managing Director
Sun Hung Kai Properties Limited

Mr Vincent CHENG Hoi-chuen, GBS, JP
Chairman
The Hongkong and Shanghai Banking Corporation Limited

Dr Patrick FUNG Yuk-bun, JP
Chairman and Chief Executive
Wing Hang Bank Limited

Professor the Honourable Lawrence J. LAU, JP
Vice-Chancellor
The Chinese University of Hong Kong

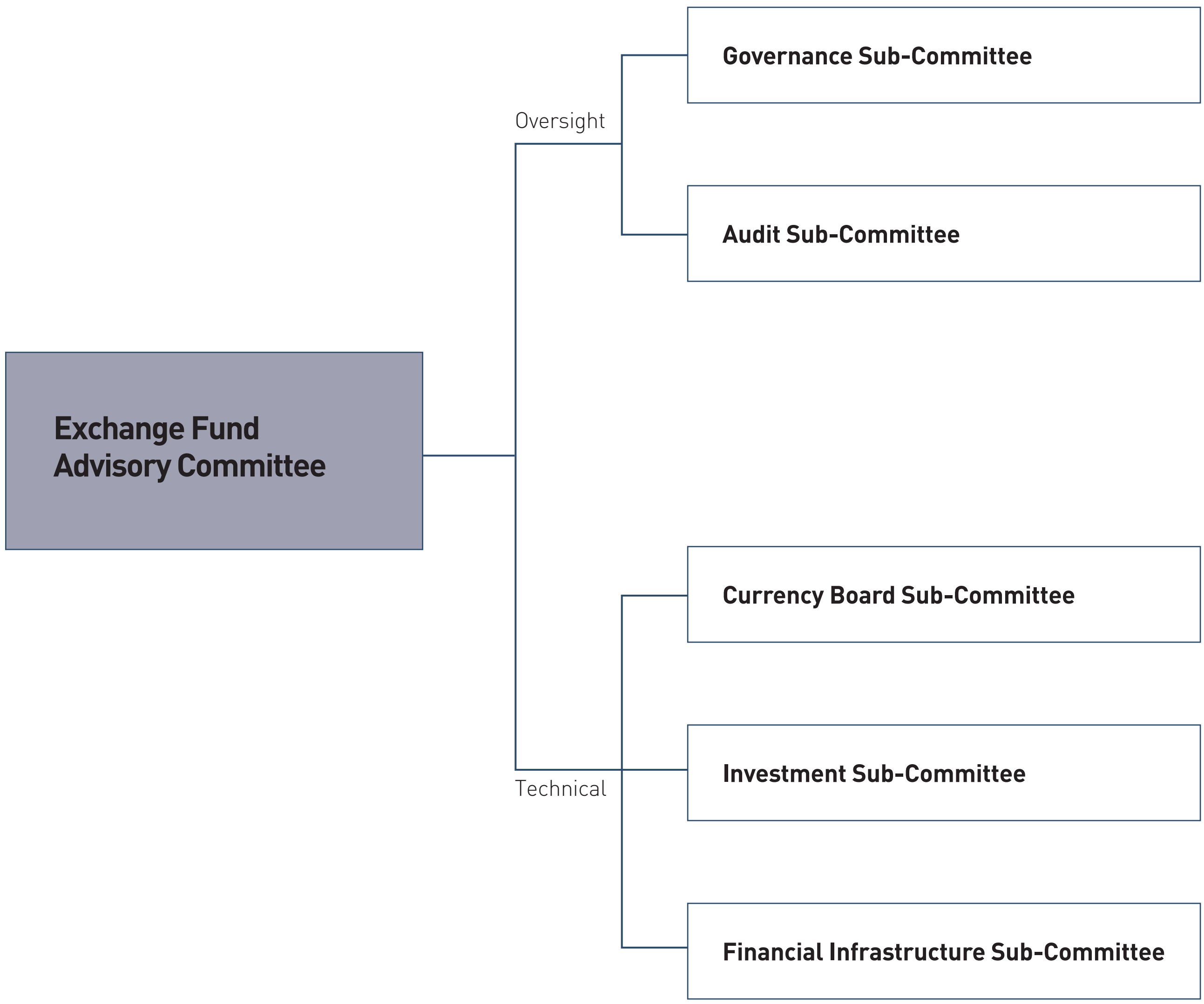
Mr David SUN Tak-kei, BBS, JP
Far East Area Chairman and Managing Partner
Ernst & Young

Mr John CHAN Cho-chak, GBS, JP
Chairman
The Hong Kong Jockey Club

Mr Benjamin HUNG Pi-cheng
Executive Director and Chief Executive Officer
Standard Chartered Bank (Hong Kong) Limited

Secretary
Mr Trevor KEEN

THE EXCHANGE FUND ADVISORY COMMITTEE SUB-COMMITTEE STRUCTURE



THE EXCHANGE FUND ADVISORY COMMITTEE GOVERNANCE SUB-COMMITTEE

Chairman

Mr Christopher CHENG Wai-chee, GBS, JP
Chairman
USI Holdings Limited

Members

Mr Simon IP Sik-on, JP

Professor the Honourable Lawrence J. LAU, JP
Vice-Chancellor
The Chinese University of Hong Kong

Mr John CHAN Cho-chak, GBS, JP
Chairman
The Hong Kong Jockey Club
(from 1 April 2009)

Mr Thomas KWOK Ping-kwong, SBS, JP
Vice Chairman and Managing Director
Sun Hung Kai Properties Limited

Mr David SUN Tak-kei, BBS, JP
Far East Area Chairman and Managing Partner
Ernst & Young

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 EXCHANGE FUND ADVISORY COMMITTEE AUDIT SUB-COMMITTEE

Chairman

Mr David SUN Tak-kei, BBS, JP
Far East Area Chairman and Managing Partner
Ernst & Young

Members

Mr HE Guangbei, JP
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

Mr Simon IP Sik-on, JP

Mr Benjamin HUNG Pi-cheng
Executive Director and Chief Executive Officer
Standard Chartered Bank (Hong Kong) Limited

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 EXCHANGE FUND ADVISORY COMMITTEE CURRENCY BOARD SUB-COMMITTEE

Chairman

Mr Norman T.L. CHAN, SBS, JP
The Monetary Authority
(from 1 October 2009)

The Honourable Joseph YAM, GBM, GBS, JP
The Monetary Authority
(until 30 September 2009)

Members

Mr Peter PANG, JP
Deputy Chief Executive
Hong Kong Monetary Authority

Mr Y K CHOI, JP
Deputy Chief Executive
Hong Kong Monetary Authority
(until 31 December 2009)

Mr Eddie YUE, JP
Deputy Chief Executive
Hong Kong Monetary Authority

Mr Arthur YUEN, JP
Deputy Chief Executive
Hong Kong Monetary Authority
(from 1 January 2010)

Mr John GREENWOOD
Group Chief Economist
INVESCO Asset Management Limited

Professor TSANG Shu-ki
Department of Economics
Hong Kong Baptist University

Professor the Honourable Lawrence J. LAU, JP
Vice-Chancellor
The Chinese University of Hong Kong

Mr Peter WONG Tung-shun, JP
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 EXCHANGE FUND ADVISORY COMMITTEE INVESTMENT SUB-COMMITTEE

Chairman

Mr Norman T.L. CHAN, SBS, JP
The Monetary Authority
(from 1 October 2009)

The Honourable Joseph YAM, GBM, GBS, JP
The Monetary Authority
(until 30 September 2009)

Members

Mr Eddie YUE, JP
Deputy Chief Executive
Hong Kong Monetary Authority

Mr HE Guangbei, JP
Vice Chairman and Chief Executive
Bank of China (Hong Kong) Limited

Mr Benjamin HUNG Pi-cheng
Executive Director and Chief Executive Officer
Standard Chartered Bank (Hong Kong) Limited

Mr Christopher CHENG Wai-chee, GBS, JP
Chairman
USI Holdings Limited

Mr Vincent CHENG Hoi-chuen, GBS, JP
Chairman
The Hongkong and Shanghai Banking Corporation Limited

Mr John CHAN Cho-chak, GBS, JP
Chairman
The Hong Kong Jockey Club
(from 18 June 2009)

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 EXCHANGE FUND ADVISORY COMMITTEE FINANCIAL INFRASTRUCTURE SUB-COMMITTEE

Chairman

Mr Norman T.L. CHAN, SBS, JP
The Monetary Authority
(from 1 October 2009)

The Honourable Joseph YAM, GBM, GBS, JP
The Monetary Authority
(until 30 September 2009)

Members

Mr Eddie YUE, JP
Deputy Chief Executive
Hong Kong Monetary Authority

Mr HE Guangbei, JP
Vice Chairman and Chief Executive
Bank of China (Hong Kong) Limited

Dr Patrick FUNG Yuk-bun, JP
Chairman and Chief Executive
Wing Hang Bank Limited

Mr Christopher CHENG Wai-chee, GBS, JP
Chairman
USI Holdings 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 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.

Advisory Committees

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The Honourable John TSANG Chun-wah, JP
The Financial Secretary

Ex Officio Member

Mr Norman T.L. CHAN, SBS, JP
The Monetary Authority
(from 1 October 2009)

The Honourable Joseph YAM, GBM, GBS, JP
The Monetary Authority
(until 30 September 2009)

Members

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Secretary for Financial Services and the Treasury

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Vice Chairman and Chief Executive
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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 Benjamin HUNG Pi-cheng
Executive Director and Chief Executive Officer
Standard Chartered Bank (Hong Kong) Limited
Representing Standard Chartered Bank (Hong Kong) Limited

Mr Eddy C FONG, GBS, JP
Chairman
Securities and Futures Commission
Representing Securities and Futures Commission
(from 1 June 2009)

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Mrs Mignonne CHENG
Head of North and East Asia
BNP Paribas

Mr James C K WONG
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Dah Sing Life Assurance Company Limited

Mr Stanley Y F WONG, JP
Director and Deputy General Manager
Industrial and Commercial Bank of China (Asia) Limited

Mr Eiichi YOSHIKAWA
Executive Officer, Regional Head for Hong Kong and General Manager
The Bank of Tokyo-Mitsubishi UFJ, Ltd.
Hong Kong Branch

Secretary

Ms Theresa KWAN

THE DEPOSIT-TAKING COMPANIES ADVISORY COMMITTEE

Chairman

The Honourable John TSANG Chun-wah, JP
The Financial Secretary

Ex Officio Member

Mr Norman T.L. CHAN, SBS, JP
The Monetary Authority
(from 1 October 2009)

The Honourable Joseph YAM, GBM, GBS, JP
The Monetary Authority
(until 30 September 2009)

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Secretary for Financial Services and the Treasury

Mr Martin WHEATLEY
Chief Executive Officer
Securities and Futures Commission
Representing the Securities and Futures Commission
(until 31 May 2009)

Mr Geoffrey J MANSFIELD
Chairman
The DTC Association (The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies)
Representing The DTC Association
(until 3 December 2009)

Mr Ryan FUNG
Chairman
The DTC Association (The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies)
Representing The DTC Association
(from 4 December 2009)

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Chief Executive
Consumer Council
Representing the Consumer Council

Mr Frank J WANG
Executive Director and Deputy Chief Executive
Wing Hang Finance Company Limited
(until 31 May 2009)

Mr Mervyn JACOB
Partner
Assurance, Financial Services Practice
PricewaterhouseCoopers

Ms Kitty IU Pui-pui
Managing Director
Scotiabank (Hong Kong) Limited

The Honourable CHAN Kam-lam, SBS, JP
Member
Legislative Council

Mr Michael CHANG Ming-yuen
Chairman
Fubon Credit (Hong Kong) Limited
(until 31 May 2009)

Mr Frederick CHIN
Chief Executive
Banc of America Securities Asia Limited

Mr Kazunori OKIMOTO
Chairman and Chief Executive Officer
Orix Asia Limited

Mr LEE Huat-oon
General Manager/Chief Executive
Public Finance Limited
(from 26 August 2009)

Secretary

Ms Theresa KWAN

Chief Executive's Committee

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Chief Executive
(from 1 October 2009)

Joseph YAM, GBM, GBS, JP
Chief Executive
(until 30 September 2009)

Peter PANG, JP
Deputy Chief Executive

Y K CHOI, JP
Deputy Chief Executive
(until 31 December 2009)

Eddie YUE, JP
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Arthur YUEN, JP
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(from 1 January 2010)

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Hans GENBERG
Executive Director (Research)
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Nelson MAN
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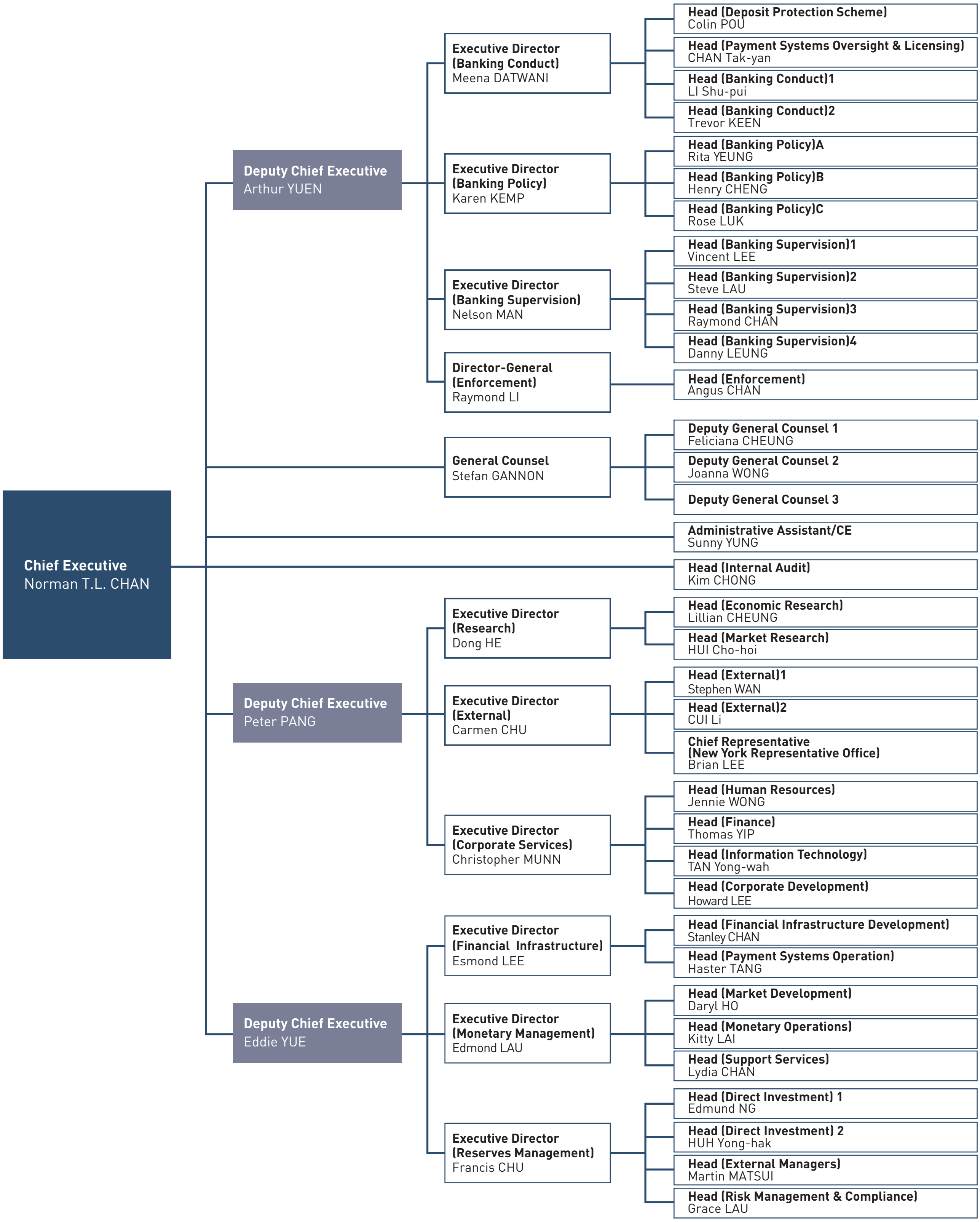
Dong HE
Executive Director (Research)
(from 7 August 2009)

James H LAU Jr, JP
Chief Executive Officer
Hong Kong Mortgage Corporation

HKMA Organisation Chart

1 April 2010



Economic and Banking Environment

The Hong Kong economy emerged from recession in mid-2009 with a gradual recovery in domestic and external demand helped by significant and timely government stimulus programmes. Labour market conditions stabilised with the unemployment rate moderating. Consumer-price inflation was contained given the tapering off of food and fuel prices and continuing weak demand. Economic recovery is expected to strengthen in 2010, but risks remain because of the fragile recovery in developed economies and uncertainties about their exit strategies from the unconventional stimulus measures introduced to combat the global financial crisis.

THE ECONOMY IN REVIEW

Overview

The Hong Kong economy experienced a difficult year in 2009 as the worst global recession in more than 60 years unfolded. While a turnaround was finally observed in the second half, real GDP fell by 2.7% for the year, marking the first outright contraction since the Asian financial crisis more than a decade ago. The downturn, especially the severe decline in external demand, weakened domestic private consumption and investment (Table 1). Labour market conditions deteriorated with a steep rise in the unemployment rate to a three-year high by mid-year, although stabilising somewhat thereafter alongside a gradual pick-up in economic activity. Consumer-price inflation receded with food and fuel prices tapering off, a drop in rental costs, and weak demand conditions. On the other hand, asset market activities were buoyed by sharp increases in stock and housing prices from the early part of the year.

The money and foreign-exchange markets weathered the global recession and the financial crisis reasonably well. The Hong Kong dollar spot exchange rate stayed close to 7.75 throughout the year with repeated triggering of the strong-side Convertibility Undertaking. This was not related to speculation against the Linked Exchange Rate system; instead, it was attributable to the repatriation of funds by Hong Kong residents and investment portfolio inflows. The Aggregate Balance increased markedly as a result, while the short-term interbank rates, savings rates and deposit rates all edged down to very low levels. On the back of strong inflows and a gradual economic recovery, Hong Kong dollar deposits and money supply grew at a faster rate over the year. However, domestic credit expansion was modest despite some easing in credit conditions.

Domestic demand

As the recession abated, domestic demand swung from decline to growth in 2009. With the overall improvement in economic prospects and stabilisation in the labour market, private consumption bottomed out in the third quarter and increased in the final quarter. Despite this, the significant drag of the first two quarters still resulted in private consumption decreasing by 0.3% over the full year. Investment spending also declined by 2.2% in 2009 despite some recovery in the second half. Public investment was strong as the Government sought to expedite public sector projects, while private investment remained weak owing to slack capacity and cautious business sentiment. The Government's move to shore up demand in the economy

Table 1 Contribution to real GDP growth by expenditure components (% yoy)

	2009					2008				
	Q1	**Q2**	**Q3**	**Q4**	**Overall**	Q1	Q2	Q3	Q4	Overall
Private Consumption Expenditure	-3.7	-0.5	0.3	2.9	-0.2	5.2	2.5	0.4	-1.9	1.4
Government Consumption Expenditure	0.1	0.2	0.2	0.1	0.2	0.1	0.2	0.2	0.2	0.1
Gross Domestic Fixed Capital Formation	-2.3	-2.7	0.5	2.5	-0.4	2.3	1.3	0.8	-3.3	0.2
Change in Inventories	-1.4	-1.9	4.0	3.7	1.2	-0.5	-0.2	0.4	-1.0	-0.3
Net Exports of Goods	0.0	2.2	-7.8	-9.5	-3.9	-0.9	-1.4	-1.3	3.2	0.0
Net Exports of Services	-0.2	-1.0	0.5	2.8	0.6	0.8	1.5	0.6	0.2	0.8
GDP	**-7.5**	**-3.7**	**-2.2**	**2.6**	**-2.7**	7.0	4.0	1.1	-2.7	2.1

Figures may not add up to total because of rounding.

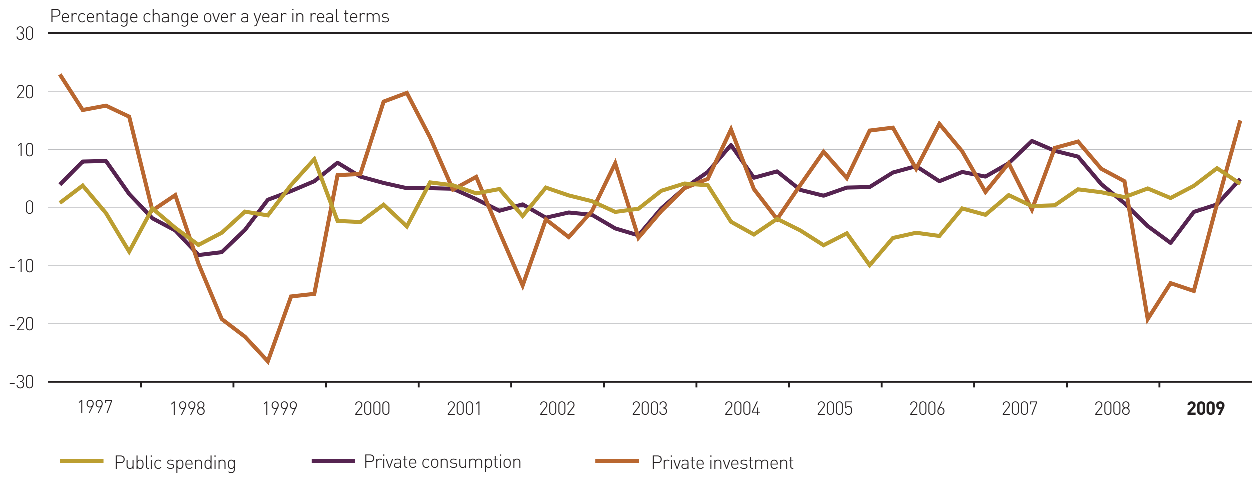
Source: Census and Statistics Department.

was reflected in the steady 2.0% increase in government consumption in 2009 (Chart 1).

External demand

External demand faltered in 2009 with the world economy in a deep downturn. Merchandise exports fell in value terms by 12.6% from 2008, although they increased in the final two months of the year. Broad-based declines were recorded across all major export destinations including Mainland China, the US and other industrialised economies (Table 2). Moving into the second half, the swift turnaround in the Mainland and regional economies helped bolster Hong Kong's exports to some extent, resulting in smaller yearly declines for these destinations than for others. Exports of services likewise weakened due to falling offshore trading activity and transportation services that outweighed the notable pick-up in inbound tourism and financial activities during the second half. For 2009 as a whole, exports of services decreased in value terms by 6.6%. Imports of goods and services fared progressively better with the strengthening of domestic demand, although still posting yearly declines of 11.0% and 6.1% respectively in value terms. Taken together, there

Chart 1 Domestic demand



Source: Census and Statistics Department.

Table 2 Merchandise exports by major trading partners (in value terms)[1]

	Share	2009					2008				
	%	**Q1**	**Q2**	**Q3**	**Q4**	**Overall**	Q1	Q2	Q3	Q4	Overall
Mainland China	51	-24	-5	-8	4	-8	11	8	4	-2	5
United States	12	-21	-21	-24	-16	-21	-1	-1	1	-7	-2
European Union	12	-18	-22	-26	-15	-20	8	8	10	-1	6
Japan	4	-13	-18	-8	-2	-10	-2	-1	3	4	1
ASEAN5[2] + Korea	7	-32	-25	-18	-3	-20	15	9	3	-8	4
Taiwan	2	-26	-6	3	25	-1	3	7	5	0	4
Others	12	-17	-18	-18	0	-13	30	24	17	4	18
Total	**100**	**-22**	**-13**	**-14**	**-2**	**-13**	10	8	6	-2	5

[1] Figures are percentage changes over a year ago except for major export markets' shares in Hong Kong's total exports.
[2] ASEAN5 includes the Philippines, Malaysia, Indonesia, Singapore and Thailand.

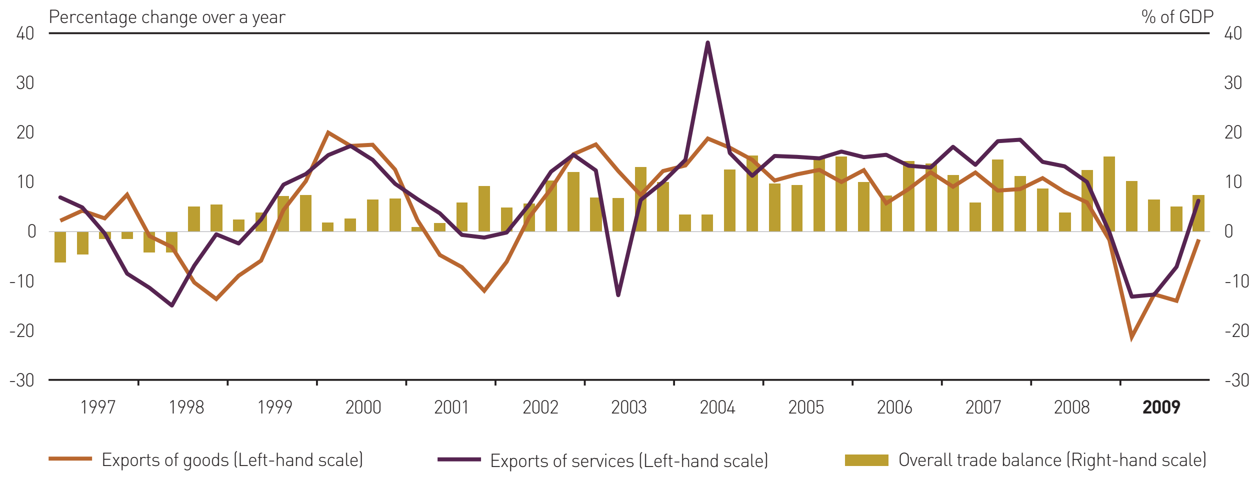
Source: Census and Statistics Department.

was an overall trade surplus of 7.2% of GDP, compared with a surplus of 10.2% of GDP in 2008 (Chart 2).

Inflation

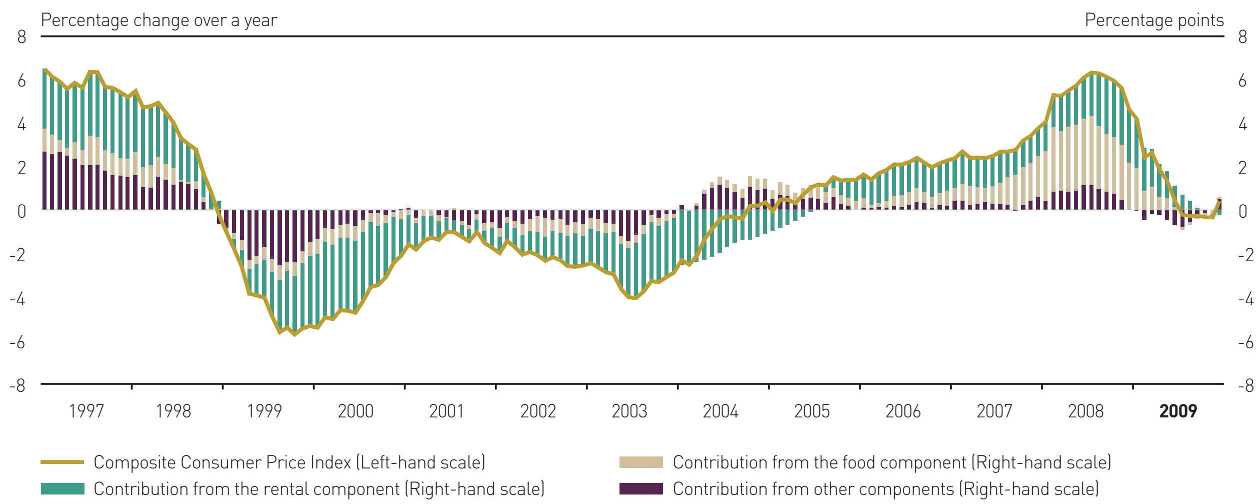
Inflationary pressure remained soft in 2009, following a moderation in the second half of 2008. Netting out the effects of government relief measures, the year-on-year underlying inflation rate turned moderately negative for a brief period due to the tapering off in food and rental costs, but it later revived to positive 0.3% in December. The downward price pressure in the economy indeed dissipated towards the end of 2009, with the three-month-on-three-month annualised underlying inflation rate turning positive in October, and reaching 2.0% in December. Fading deflationary pressure was also evident in the headline inflation rate, which showed signs of picking-up in the fourth quarter, reaching 1.3% year on year in December from a year-low of-1.6% in August. For 2009 as a whole, the underlying CCPI inflation rate slowed to 1.0% from 5.6% in 2008, while the headline CCPI inflation rate similarly dropped to 0.5% from 4.3% the previous year (Chart 3).

Chart 2 Overall trade balance and export growth (in nominal terms)



Source: Census and Statistics Department.

Chart 3 Consumer prices[1]



[1] The Composite Consumer Price Index and its component indices are adjusted for the effects of special relief measures.

Sources: Census and Statistics Department, and staff estimates.

Labour market

The labour market continued to worsen in the first half of 2009, with the seasonally adjusted three-month moving average unemployment rate climbing to a three-year high of 5.4% in June. However, the pace of deterioration slowed successively, with the quarter-on-quarter increase in the rate dropping substantially to 0.2% in the second quarter after a sharp rise of 1.1% in the first quarter. Signs of stabilisation became firmer in the third quarter, with the unemployment rate starting to decline in September, and reaching 4.9% in December (Chart 4). A breakdown of the data indicated a broad-based improvement in labour market conditions, reaffirming the view that stabilisation of the market was in place. Despite the encouraging development, employment conditions remained relatively weak, as some 172,800 people were unemployed in December, a net increase of more than 50,000 people since the onset of the global financial crisis.

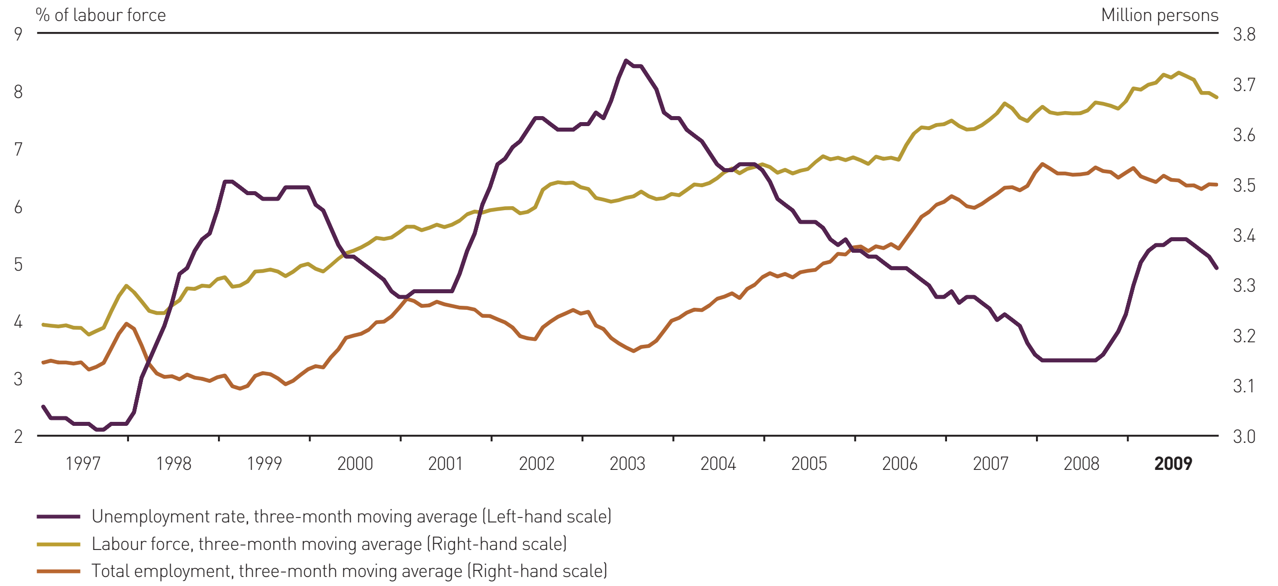
Stock market

The local stock market entered 2009 on a weak note but rallied from March onwards, fuelled by strong capital inflows, an increased risk appetite among market participants and an improving economic outlook for Hong Kong and the Mainland. The Hang Seng Index bounced back after bottoming out in early March, closing the year at 21,873, up 52.0% from the end of 2008. Its movement was broadly in line with other Asian benchmark indices, suggesting a growing interest in investment in the region as a whole. The average daily turnover in the local stock market revived to about $69 billion after falling to $45 billion in the first quarter. Equity IPO activities also picked up in the second half of the year, led by Mainland enterprises.

Property market

After falling to a near standstill towards the end of 2008, the residential property market was buoyed in 2009 with a strong run-up in prices and transaction volumes. Activity was spurred on by the sustained low interest rate environment, tight supply, resurgent sentiment and increased buying interest from high net-worth individuals (including those from the Mainland and overseas). Flat prices rose cumulatively by an average of 27.6% in 2009, although most of the gains were made in the first three quarters of the year. The buying spree slowed in the fourth quarter amid prospective buyers' concerns over home affordability and the issuance of the HKMA's new guidelines on loan-to-value ratios for residential mortgages on high-value flats. Despite this, the total number of transactions showed a notable increase of 20.0% in 2009 over 2008.

Chart 4 Labour market conditions



Source: Census and Statistics Department.

OUTLOOK FOR THE ECONOMY

Economic environment

Recent economic data releases suggest the domestic economic environment will continue to improve in 2010. Stabilising labour market conditions, higher asset prices, and strengthening consumer confidence should provide some support to consumption spending. Private investment may remain weak in the presence of excess capacity, while public investment may strengthen with several major infrastructure projects ready to proceed. External demand is expected to pick up gradually, as many countries have resumed positive economic growth since the second and third quarters of 2009, following swift policy responses to the crisis. The latest market consensus points to real GDP growth of 4.9% in 2010, with the International Monetary Fund projecting 5.0% and Asian Development Bank projecting 3.5%.

Inflation and the labour market

Consumer-price inflation is likely to remain subdued in 2010, given the possibility of moderate local cost pressures and import-price inflation. The sharp increase in property prices and rentals since early 2009, however, will inevitably feed into the rental component of the Consumer Price Index, perhaps as early as the second half of 2010. Therefore, consumer-price inflation may pick up in the second half of the year. The market consensus predicts the headline inflation rate at 2.6% in 2010, compared with 0.5% in 2009. The consensus forecast of the unemployment rate is 4.7% in 2010, a slight drop from 5.2% in 2009. The projected fall in the unemployment rate is in line with recent declines and the pick-up in hiring sentiment as evidenced by the Purchasing Managers' Index employment sub-index.

Uncertainties and risks

Among the possible sources of risk in the economic outlook, some deserve special attention.

The implementation of timely and sizable monetary and fiscal stimuli in response to the crisis helped prevent an economic meltdown in many countries, and financial markets rebounded strongly on the back of abundant liquidity around the globe. However, the real economy and financial markets have remained fragile. For example, the unexpected debt problems in Dubai caused financial markets around the world to drop on renewed concerns about the health of the international financial system. And there is still a risk that the global recovery may falter, resulting in a double-dip recession if worsening labour markets in advanced economies lead to renewed weakness in aggregate demand, and if the effects of various stimulus measures begin to fade.

The implementation of unconventional policy measures also raised market concerns over expanded central bank balance sheets and significantly deteriorating fiscal positions in many countries. As an indirect manifestation of the abundant liquidity associated with the expanded central bank balance sheets, worldwide asset markets have increased substantially. If the lagged effects of the loose monetary conditions become stronger and more prolonged than markets expect, there will be a renewed risk of another asset bubble, particularly if credit resumes strong growth in the major economies fuelling economic and financial market activities. Indeed, Hong Kong's asset markets have absorbed some of the excess global liquidity, raising concerns among the public about the rapid increase in local property prices.

On the other hand, there may be an unexpected and sudden reversal of capital flows into Hong Kong which could result in substantial volatilities on financial markets. In addition to the two scenarios of a double-dip recession and the bursting of a new asset bubble, there are two other possible events that could trigger a reversal of fund flows: a tightening of US monetary policy, or a reversal of the weakening of the US dollar. This latter scenario, in particular, could cause a sudden unwinding of US dollar-funded carry trades, which have become a prominent funding source for various financial assets as a result of the easy monetary conditions in the US. In such a case, declines in global financial markets may overshoot and fund flows may reverse abruptly.

Overall, the local economy is at a turning point. The risks of a double-dip recession and of a tightening in monetary policy amid strong growth are both present. The possibility of the formation of a new asset bubble also deserves attention.

Economic and Banking Environment

NOTES AND COINS

At the end of 2009, the total value of banknotes in circulation was $200.2 billion, an increase of 13% from a year earlier (Charts 5, 6 and 7). The total value of government-issued notes and coins in circulation amounted to $8.2 billion, up 2% (Charts 8 and 9). The value of $10 notes issued by the Government in circulation (both paper and polymer notes) reached $2.7 billion, an increase of 0.9% from 2008.

Chart 5 Banknotes in circulation by note-issuing banks at the end of 2009

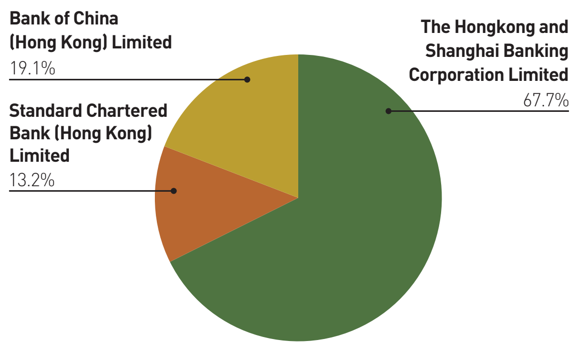
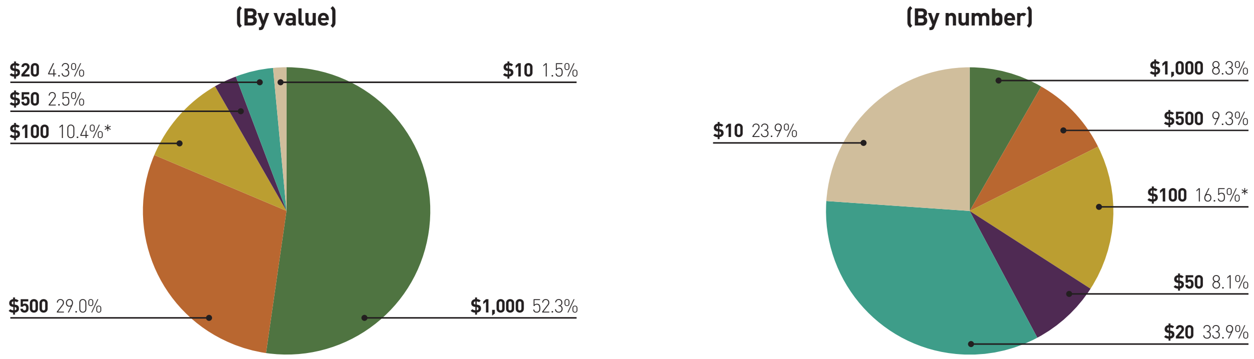


Chart 6 Distribution of banknotes in circulation at the end of 2009



* Includes 0.1 percentage points contributed by the $150 banknotes.

Chart 7 Banknotes in circulation at the end of 2009

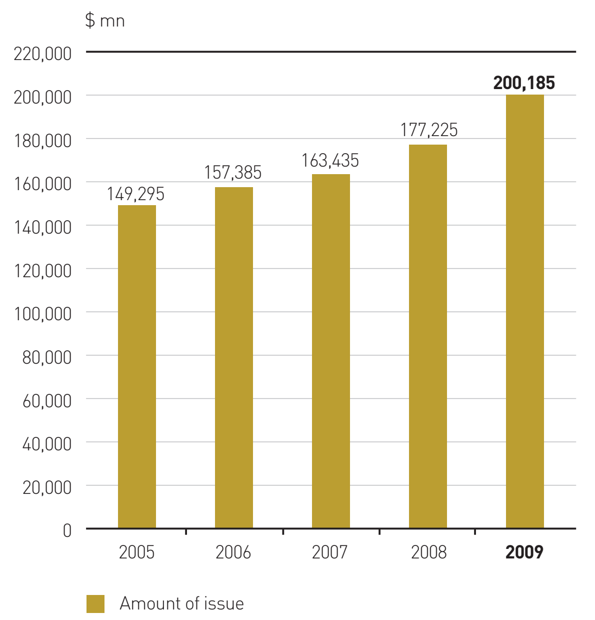


Chart 8 Government-issued notes and coins in circulation at the end of 2009

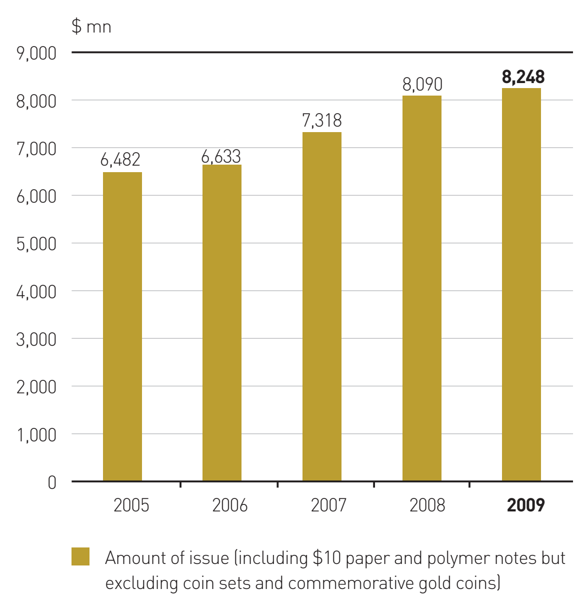
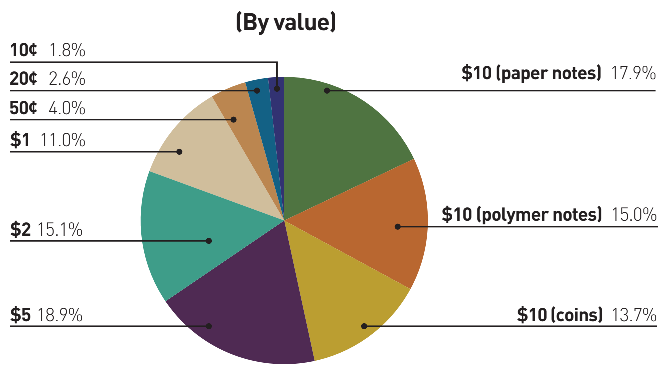


Chart 9 Government-issued notes and coins in circulation at the end of 2009



Hong Kong banknotes

Public education programmes on the security features of the latest series of banknotes issued in 2003 continued to be well received. During the year 23 seminars were organised for over 2,300 bank tellers and retail cashiers, providing them with knowledge and skills for authenticating banknotes.

Standard Chartered Bank (Hong Kong) Limited 150th Anniversary Commemorative Banknote

In October the Standard Chartered Bank (Hong Kong) Limited issued one million $150 banknotes to commemorate the 150th anniversary of the bank's establishment in Hong Kong, raising total net proceeds of $130 million for Hong Kong charities.

Good-as-new notes

To help protect the environment, the HKMA continued its efforts to promote the use of "good-as-new notes", instead of brand new notes, as *lai see* (customary gifts of money given during Chinese New Year). A Chinese couplet competition was held during the year to promote the use of "good-as-new notes" with over 680 entries for the three categories. The winning entry, from the Senior Citizens Category, was "鈔票仍新歡樂年年包利是，金融更旺繁榮處處集禎祥".

$10 polymer note

About 123 million polymer notes were in circulation at the end of 2009, representing 45% of the $10 notes issued by the Government.

Coin replacement programme

The withdrawal of coins bearing the Queen's Head design continued, with 23 million coins being removed from circulation in 2009.

PERFORMANCE OF THE BANKING SECTOR

The Hong Kong banking sector ended the year on a more robust note with a marked strengthening in the capital position of locally incorporated AIs. Deterioration in the quality of loan portfolios was much milder than expected. Delinquency ratios remained at a low level compared with historical standards.

Interest rate trends

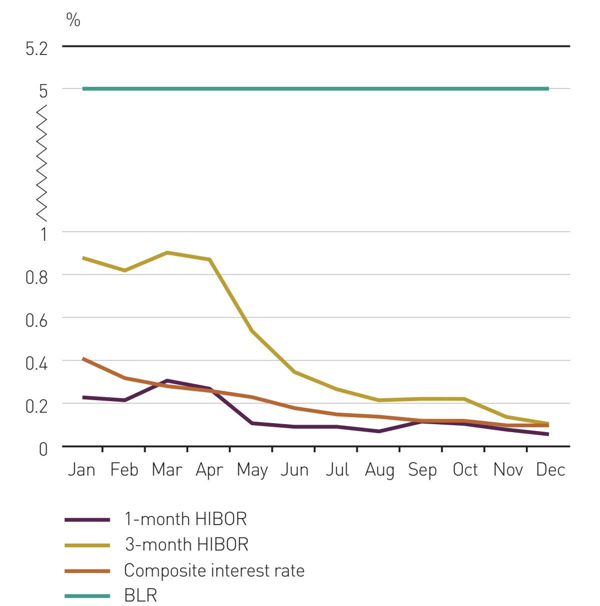
Hong Kong dollar interbank interest rates drifted steadily to nearly zero during the year, driven by exceptionally accommodative monetary policy rates in major advanced economies and ample liquidity in the banking system as a result of substantial fund flows into Hong Kong. The composite interest rate, which reflects the average cost of funds of retail banks, also fell to exceptionally low levels (Chart 10). In March 2009, reflecting the stabilisation of the local interbank market, the HKMA withdrew the temporary measures introduced in September 2008 to provide liquidity assistance to the banking system.

Profitability trends

The net interest margin of retail banks continued to narrow in 2009, falling to 1.48% from 1.84% in 2008 (Chart 11). The narrowing was mainly due to the extraordinarily low interest rate environment. Lingering uncertainties in the credit markets also encouraged retail banks to seek low credit risk exposures (for example, mortgage lending and government bonds), which generally offered lower interest yields.

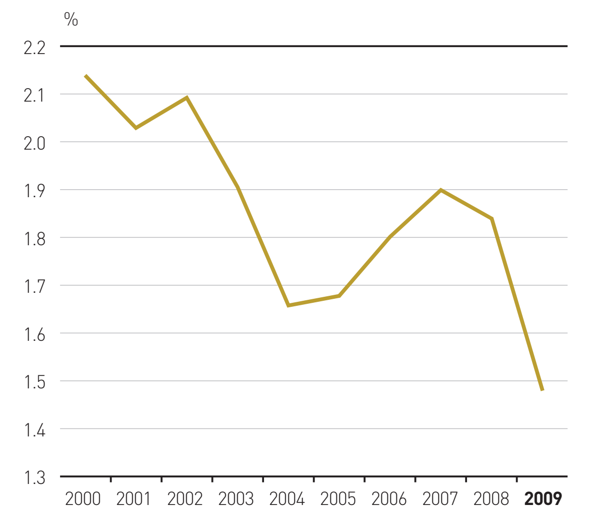
Although interest income declined, retail banks posted an increase in non-interest income in 2009. The normalisation of capital market activities resulted in higher income from trading investment, foreign exchange operations and derivatives. Increased stock market activity during the year, particularly from initial public offerings, also underpinned a strong growth in income from fees and commissions. As a result, the proportion of non-interest income to total income of retail banks rose to 44.9% from 37.4% in 2008.

Chart 10 HIBORs, composite interest rate and BLR



Notes:
1 BLR refers to the best lending rate quoted by The Hongkong and Shanghai Banking Corporation Limited (monthly averages).
2 HIBORs are monthly averages.

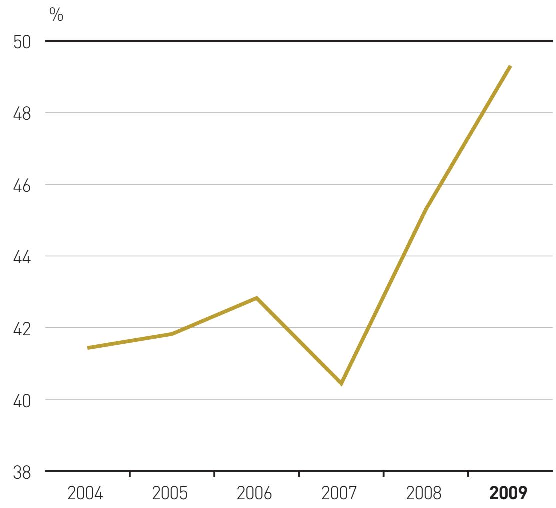
Chart 11 Retail banks' net interest margin (yearly)



The operating costs of retail banks rose by 6.3% in 2009. This increase was partly associated with the expenses related to settlement of cases involving Lehman investment products reported by some retail banks. The cost-to-income ratio rose to 49.3% from 45.3% in 2008 (Chart 12).

Although the credit quality of loan portfolios deteriorated in 2009, the pace of deterioration was milder than originally expected, and there were signs of stabilisation in the second half of the year. Given the better-than-expected credit conditions, the net charge for debt provisions fell to $6.6 billion in 2009 from $10.8 billion a year ago. Impairment allowances for securities holdings were also lower because of the improved credit conditions as shown by a tightening of credit spreads. The net charge for other provisions, most of which related to impairment allowances for securities holdings, improved strongly to $0.1 billion, compared with $12.8 billion in 2008.

Chart 12 Retail banks' cost-to-income ratio



The aggregate pre-tax operating profits of retail banks' Hong Kong offices rebounded by 14.9% in 2009 (Chart 13). The post-tax return on average assets also increased to 0.98% from 0.88% in 2008 (Chart 14).

Chart 13 Retail banks' year-on-year growth of operating profit before tax

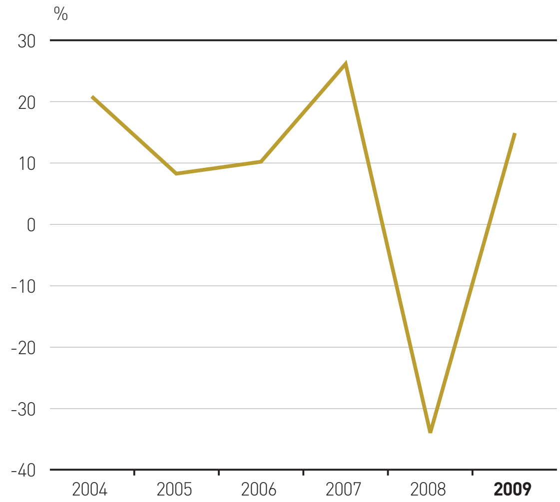
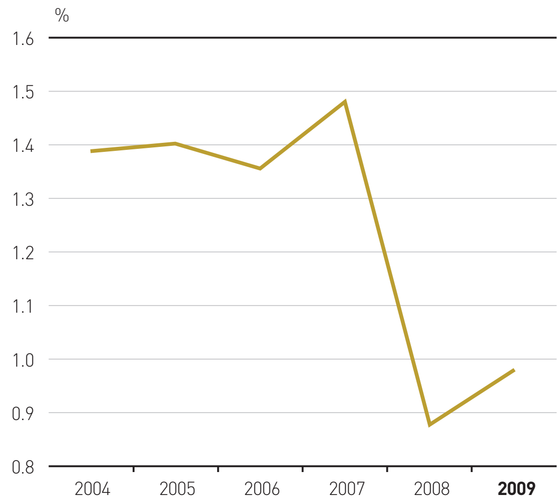


Chart 14 Retail banks' return on assets (after-tax profit)



Asset quality

The asset quality of retail banks deteriorated in 2009, although at a slower pace in the second half of the year. The classified loan ratio increased to 1.35% from 1.24% at the end of 2008 (Chart 15). The combined ratio of overdue and rescheduled loans rose to 0.88% from 0.67% in 2008. However, the ratios are still very low compared with their historical peaks of 10.61% and 8.58% respectively at the end of September 1999.

The quality of non-bank China exposures improved. The classified loan ratio for retail banks' Mainland banking subsidiaries was 0.69% in 2009 compared with 0.98% in 2008.

Retail banks' residential mortgage lending assets remained sound with the delinquency ratio edging down to 0.03% from 0.05% in 2008 (Chart 16). The rescheduled loan ratio declined to 0.09% from 0.14% in 2008. The rebound in property prices reduced the outstanding number of residential mortgage loans in negative equity to 466 cases at the end of 2009 from 10,949 a year earlier.

The results of the HKMA's credit card lending survey showed that the quality of credit card portfolios deteriorated slightly, although the delinquency ratio remained unchanged at 0.34% in 2009 (Chart 16). The combined delinquent and rescheduled ratio rose to 0.46% from 0.41% in 2008 and the charge-off ratio increased to 3.71% from 2.72% a year earlier.

Chart 15 Asset quality of retail banks

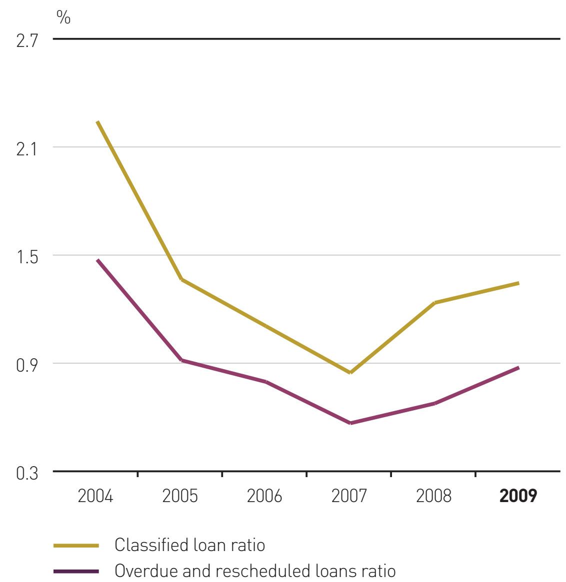
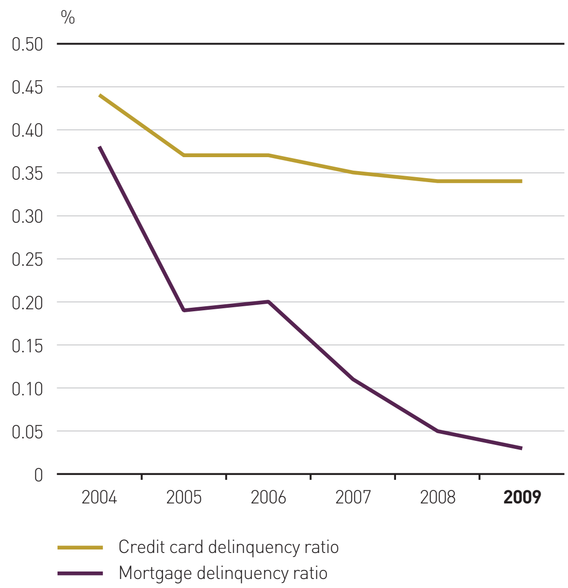


Chart 16 Delinquency ratios of residential mortgages and credit card lending of surveyed institutions



Balance sheet trends

Total loans and advances by retail banks increased by 3.6% in 2009, while total customer deposits grew by 5.8%. The overall loan-to-deposit ratio of retail banks declined to 46.3% from 47.3% in 2008. The Hong Kong dollar loan-to-deposit ratio also declined to 65.2% from 69.4% in 2008 (Chart 17).

The changes in retail banks' loans for use in Hong Kong by selected economic sectors are shown in Chart 18. Property lending grew by 6.7%, and lending to the wholesale and retail sector grew by 6.8%. On the other hand, trade finance declined by 10.6% and lending to the manufacturing sector declined by 2.0%.

Chart 17 Retail banks' Hong Kong dollar loans and customer deposits

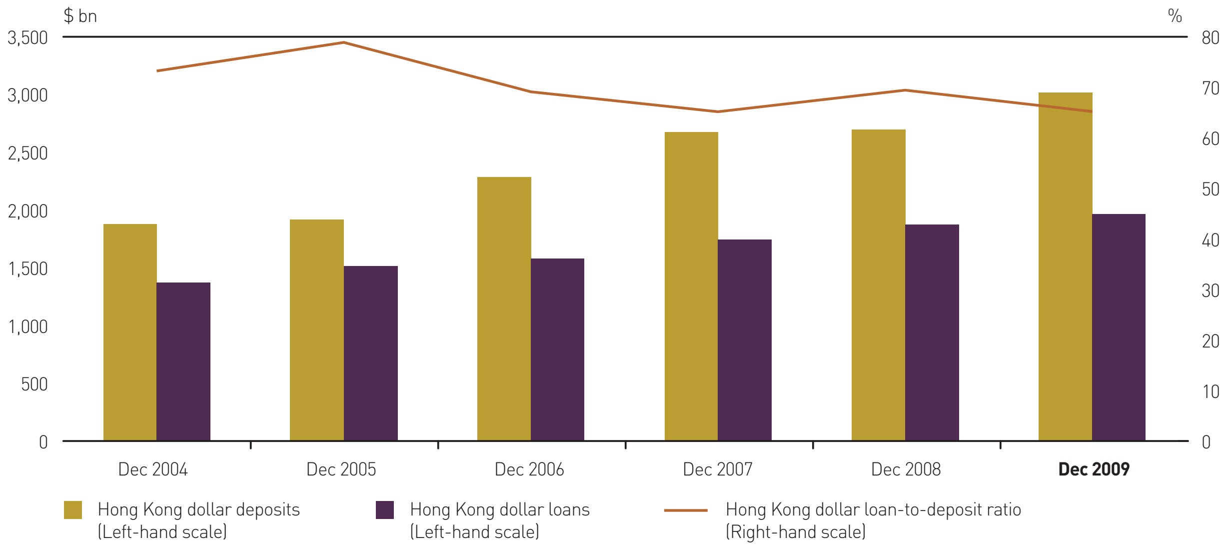
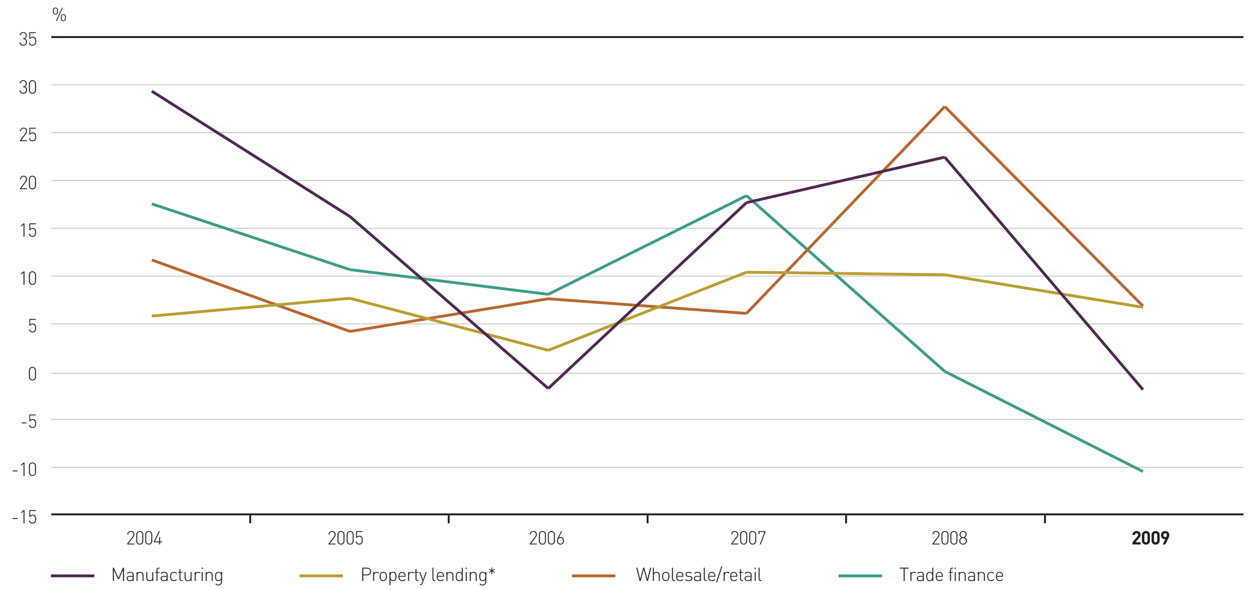


Chart 18 Retail banks' loans for use in Hong Kong by selected sectors (year-on-year growth)



* Property lending denotes lending for property development and investment, and residential mortgage loans (excluding lending under the Home Ownership Scheme, the Private Sector Participation Scheme and the Tenants Purchase Scheme).

Retail banks' total non-bank China exposures[1] rose to $762 billion at the end of 2009 from $639 billion a year earlier. For the banking sector as a whole, non-bank China exposures surged to $1,004 billion from $853 billion in 2008.

Holdings of negotiable debt securities

Retail banks continued to increase their holdings of liquid assets of high credit quality in 2009, with a 31% rise in negotiable debt instruments (NDIs), excluding negotiable certificates of deposit. The share of retail banks' total holdings of NDIs relative to their total assets increased to 28% at the end of 2009 from about 22% a year ago.

Among the holdings of NDIs, 44% were government-issued (32% in 2008), 35% were issued by non-bank corporates (44% in 2008), and 21% were issued by banks (23% in 2008) (Chart 19).

Capital adequacy and liquidity

The capital positions of locally incorporated AIs generally improved, driven mainly by an increase in retained earnings and the issuance of new capital. The consolidated capital adequacy ratio of locally incorporated AIs rose to 16.9% at the end of 2009 from 14.7% a year ago. Tier-one capital ratio increased to 12.9% from 11.0% in 2008 (Chart 20).

Chart 19 Retail banks' holdings of negotiable debt instruments at the end of 2009 (issuer breakdown)

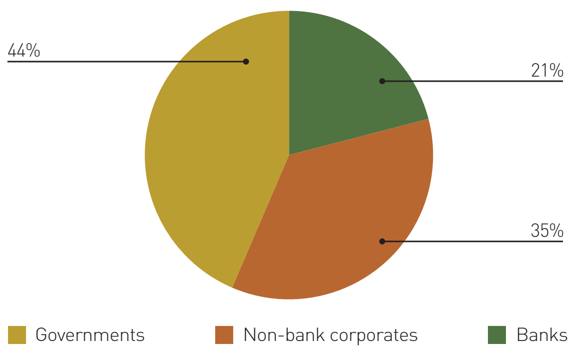
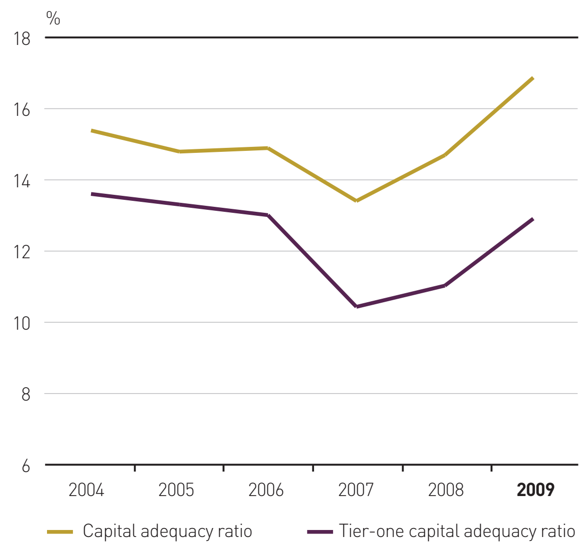


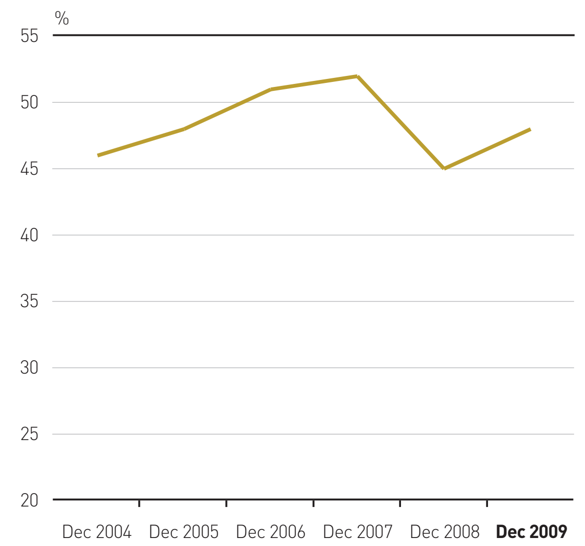
Chart 20 Consolidated capital adequacy ratio of locally incorporated AIs



[1] Including exposures booked in retail banks' banking subsidiaries in Mainland China.

Retail banks generally remained liquid with the quarterly average liquidity ratio at 47.8% in the final quarter of 2009, well above the statutory minimum of 25% (Chart 21).

Chart 21 **Retail banks' liquidity ratio (quarterly average)**



PROSPECTS FOR 2010

Global financial markets stabilised in 2009, due largely to the unprecedented stimulus measures undertaken by governments around the world. While this stability underscored improvement in the real economy and a return to the normal functioning of capital markets, the economic outlook remains uncertain and challenging. Bank profitability remains susceptible to possible setbacks in macroeconomic and market conditions. Uncertainties surrounding the timing of governments' exit strategies from their stimulus measures will, to some degree, restrain banks' credit risk appetite. Banks may continue to compete on pricing in more traditional areas of business, especially in residential mortgage lending, further weighing on their profit margins. The large inflow of funds in 2009 could have potentially significant implications for asset prices in Hong Kong, and banks should exercise prudence in credit decisions, particularly in the valuation of collateral.

Any renewed stress in the capital markets following the ultimate withdrawal of government support initiatives could also be a source of concern. Measures to strengthen the regulatory and supervisory framework are being implemented to improve the resilience of the banking system and banks should remain vigilant in their risk management. Given the continued uncertainty in the operating environment and bearing in mind that new capital and liquidity supervisory requirements are being formulated at the international level, it is imperative that banks maintain adequate capital and liquidity to safeguard against any reversal in funds flow, increases in interest rates, deterioration in the credit environment and possible tightening of supervisory requirements.

Monetary Stability

The Hong Kong dollar exchange rate remained stable against the US dollar despite strong inflows of funds and large swings in the US dollar exchange rate against other currencies. Hong Kong's money market largely returned to normal and the withdrawal of the temporary liquidity measures introduced in 2008 went smoothly.

OBJECTIVES

The overriding objective of Hong Kong's monetary policy is currency stability. This is defined as a stable external exchange value of Hong Kong's currency, in terms of its exchange rate in the foreign-exchange market against the US dollar, within a band of HK$7.75 – 7.85 to US$1. The structure of the monetary system is characterised by Currency Board arrangements, requiring the Monetary Base to be at least 100% backed by US dollar reserves held in the Exchange Fund, and changes in the Monetary Base to be 100% matched by corresponding changes in US dollar reserves.

The Monetary Base (Table 1) comprises

- Certificates of Indebtedness, which provide full backing to the banknotes issued by the three note-issuing banks

- Government-issued notes and coins in circulation

- the Aggregate Balance, which is the sum of clearing account balances of banks kept with the HKMA

- Exchange Fund Bills and Notes issued by the HKMA on behalf of the Government.

The stability of the Hong Kong dollar exchange rate is maintained through an automatic interest rate adjustment mechanism and the firm commitment by the HKMA to honour the Convertibility Undertakings (CUs). When the demand for Hong Kong dollars is greater than the supply and the market exchange rate strengthens to the strong-side CU of HK$7.75 to the US dollar, the HKMA stands ready to sell Hong Kong dollars to banks for US dollars. The Aggregate Balance will then expand to push down Hong Kong dollar interest rates, creating monetary conditions that move the Hong Kong dollar away from the strong-side limit to within the Convertibility Zone of 7.75 to 7.85. Conversely, if the supply of Hong Kong dollars is greater than the demand and the market exchange rate weakens to the weak-side CU of HK$7.85 to the US dollar, the HKMA will buy Hong Kong dollars from banks. The Aggregate Balance will then contract to drive Hong Kong dollar interest rates up, pushing the Hong Kong dollar away from the weak-side limit to stay within the Convertibility Zone.

Table 1 Monetary Base

$ million	**31 Dec 2009**	31 Dec 2008
Certificates of Indebtedness[1]	**200,185**	177,225
Government-issued currency notes and coins in circulation[1]	**8,477**	8,319
Balance of the banking system	**264,567**	158,038
Exchange Fund Bills and Notes issued[2]	**537,429**	163,554
TOTAL	**1,010,658**	507,136

1 The Certificates of Indebtedness and the government-issued notes and coins in circulation shown here are stated at Hong Kong dollar face values. The corresponding items shown in the balance sheet of the Exchange Fund in this Annual Report are in Hong Kong dollars equivalent to the US dollar amounts required for their redemption at the prevailing exchange rates on the balance sheet date. This arrangement is in accordance with the accounting principles generally accepted in Hong Kong.

2 The amount of Exchange Fund Bills and Notes (EFBN) shown here is different from that in the balance sheet of the Exchange Fund in this Annual Report. In accordance with the accounting principles generally accepted in Hong Kong, the EFBN held by the HKMA on behalf of the Exchange Fund in relation to its trading of the EFBN in the secondary market are offset against the EFBN issued, and the net amount is recorded in the balance sheet. The EFBN issued on tender dates, but not yet settled, are included in the balance sheet but excluded from the Monetary Base.

REVIEW OF 2009

Exchange-rate stability

Having withstood the global financial crisis in 2008, the effective functioning of the Linked Exchange Rate system continued to keep the Hong Kong dollar stable in 2009. Despite large swings in the US dollar, activities in the local foreign-exchange market were generally orderly. The Hong Kong dollar market exchange rate stayed close to the strong-side CU for most of the time and moved within a narrow range between 7.7500 and 7.7594 (Chart 1).

Between 20 March and 4 December, the strong-side CU was triggered repeatedly and the HKMA purchased a total of US$59.8 billion in response to banks' offers, creating HK$463.4 billion. The inflows into the Hong Kong dollar were reflected in a rise in the Aggregate Balance and the increased issuance of Exchange Fund Bills consistent with the Currency Board system. The Aggregate Balance rose to $264.6 billion on 31 December from $162.7 billion on 2 January 2009 (Chart 2).

Chart 1 Market exchange rate, January - December 2009

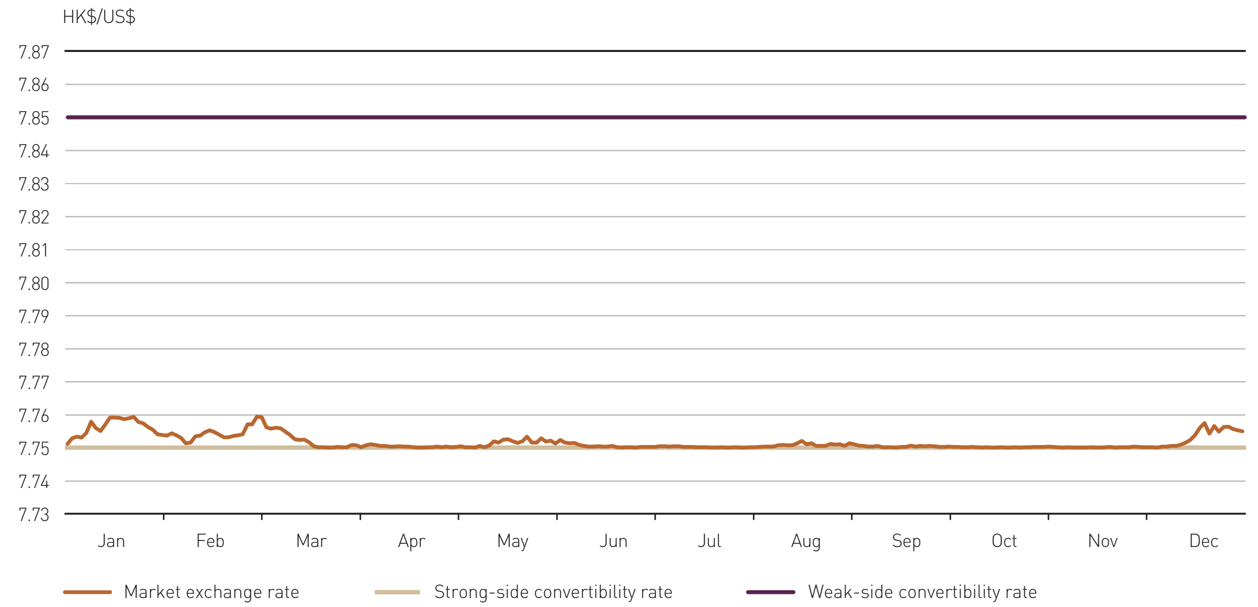


Chart 2 Aggregate Balance, January - December 2009

These strong inflows partly reflected better prospects for recovery in the Hong Kong and Mainland economies than elsewhere. Amid ample liquidity worldwide and capital inflows into the region, the demand for Hong Kong dollar assets also increased alongside a rebound in the regional asset markets. However, the inflows into the Hong Kong dollar did not appear to be related to exchange-rate speculation. During 2009 the Hong Kong dollar forward discounts traded within a narrow range, with the 12-month forward discount fluctuating between 40 and 265 pips (a pip is equivalent to $0.0001).

Money market

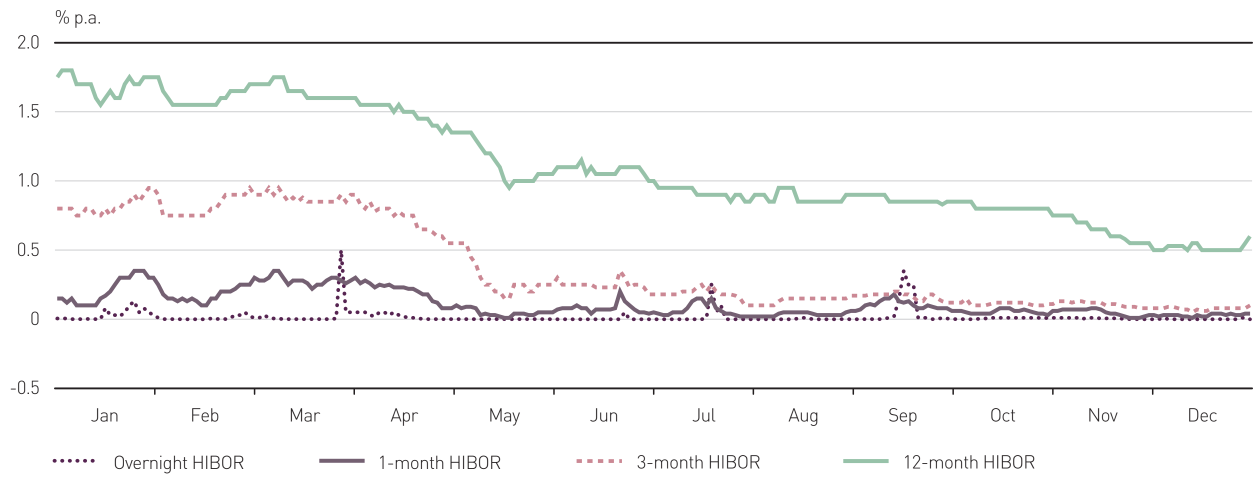
After stabilising towards the end of 2008, the Hong Kong interbank money market largely returned to normal in 2009. The various financial measures taken by the Financial Secretary and the HKMA in 2008 were effective. Liquidity concerns eased significantly and confidence in the local banking system greatly strengthened. Term HIBORs declined to very low levels during the year, reflecting the larger Aggregate Balance and the downward movements in the corresponding US dollar interest rates (Chart 3). The overnight HIBOR also stayed near zero, with occasional increases due to IPO-related funding demand.

While the Hong Kong dollar interbank market largely returned to normal, the demand for high-quality, liquid money-market instruments (a form of local-currency liquidity) remained strong, as shown by activities in the Exchange Fund Bills market. In view of the strong market demand, the HKMA issued additional Exchange Fund Bills amounting to $374.4 billion in 2009. Following the additional issues, the Aggregate Balance contracted accordingly. These market operations were consistent with Currency Board principles and had little impact on the exchange rate and interest rates partly because of the large Aggregate Balance.

Exit strategies

The strong inflows of funds, very low interbank interest rates, and the measures introduced in the global financial crisis helped create an accommodative monetary environment locally. Given the depth of the recession in the Hong Kong economy in early 2009, the easy monetary conditions were appropriate. However, there were risks that, if the policy responses to the crisis were kept in place longer than necessary, they might lead to inflation and excessive fluctuations in asset prices. The measures might also cause distortions to the economy, fostering undesirable household and corporate behaviour. It was therefore important for the HKMA to prepare exit strategies to maintain monetary and financial stability in Hong Kong.

Chart 3 **Hong Kong dollar interest rates, January - December 2009**



Monetary Stability

Following the introduction of the five temporary liquidity-assistance measures in late September 2008, the local interbank money market stabilised and utilisation was mainly confined to the fourth and fifth measures – foreign-exchange swaps and term repurchase agreements with the HKMA. Against this background, and taking into account market views, the HKMA announced on 26 March 2009 that it would incorporate forex swaps and term repos (against securities of acceptable quality to the HKMA) into its framework for market operations after the five temporary measures expired at the end of March 2009. This provided an assurance to individual banks which might need liquidity that it would be available. The HKMA also decided to resume the previous arrangements for the Discount Window (using only Exchange Fund paper for overnight repos) to safeguard exchange-rate stability under the Currency Board system. Following these decisions, the exit from the five temporary liquidity measures in late March 2009 went smoothly and Hong Kong's money market remained calm.

Another arrangement for providing liquidity assistance to banks was the adjustment to the Base Rate formula on 8 October 2008. After a review of the modified Base Rate formula, the HKMA announced on 26 March 2009 that the narrower 50-basis point spread over the US Federal Funds Target Rate would be retained in place of the previous spread of 150 basis points. The HIBOR leg would also be re-instated in the calculation of the Base Rate to facilitate interest rate adjustment under the Currency Board system and encourage banks to prudently manage their day-to-day liquidity. Throughout 2009, the HKMA Base Rate remained unchanged at 0.5% (50 basis points above the lower boundary of the target range of the Federal Funds Target Rate) according to the new formula.

During the year the HKMA also prepared the ground for exiting from the contingent capital facility for banks and the temporary 100% deposit guarantee, although these measures had not had to be used since the local banking sector remained stable. Subject to legislative approval, the Deposit Protection Board proposed to raise the maximum protection limit of the existing Deposit Protection Scheme to $500,000. Under the proposed scheme, about 90% of all depositors will be unaffected by the removal of the deposit guarantee at the end of 2010. In July the HKMA, Bank Negara Malaysia and the Monetary Authority of Singapore established a tripartite working group to facilitate the scheduled exit from the full deposit guarantees by the end of 2010 in their respective jurisdictions.

At the macro level, the exit from the easy monetary environment is largely market-driven. Such an exit might be triggered by a reversal of fund flows due, for example, to a normalisation of US monetary policy. However, the increased foreign reserves built up under the Currency Board arrangements as a result of the original fund inflows would allow the HKMA to sell US dollar assets back to the market, in a manner consistent with the Currency Board principles and the three refinements introduced in 2005. The automatic interest rate adjustment under the Currency Board arrangements would also act as a cushion against downward pressure on the exchange rate. Where appropriate, the HKMA could undertake foreign-exchange operations within the Convertibility Zone to support orderly interest rate adjustments that would maintain exchange-rate stability.

Financial stability and the functioning of the Linked Exchange Rate system

After 26 years of operation, the Linked Exchange Rate system continues to serve as an anchor for Hong Kong's highly externally oriented economy and as a cornerstone of its monetary and financial stability. The recent financial crisis has demonstrated that monetary frameworks that do not take sufficient account of financial stability are seriously flawed. Hong Kong's experience during the crisis shows that the HKMA's approach to monetary and financial stability is serving Hong Kong well.

A sound banking system is a crucial condition for the normal functioning of the Linked Exchange Rate system. On 20 January the HKMA signed a currency swap agreement with the People's Bank of China, providing liquidity support of up to RMB200 billion or HK$227 billion for a period of three years. The bilateral swap agreement will enable both sides to meet the contingent short-term liquidity needs of its own banks in the other jurisdiction, thereby enhancing Hong Kong's banking and financial stability. The HKMA also reviewed and strengthened the Lender of Last Resort framework for individual banks under liquidity stress by expanding the types of assets and facilities eligible for obtaining Hong Kong dollar liquidity through the framework.

The exposure of the banking system to asset markets and the volatility of asset prices were closely monitored during the year. The HKMA took prudential measures to reduce banks' mortgage lending risks to ensure banking stability. It issued a circular to authorized institutions on 23 October requiring them to lower the maximum loan-to-value ratio for properties with a value of $20 million or more to 60%, and to maintain the 70% loan-to-value ratio for properties valued at below $20 million but cap the maximum loan amount at $12 million.

To improve the transparency of the Currency Board Account, a specific portion of Exchange Fund assets has been allocated to back the Monetary Base since October 1998. With the marked expansion in the Monetary Base, the Backing Ratio declined to 105% on 13 November, touching the Lower Trigger Level (Chart 4).[1] This was the first time the Lower Trigger point was reached. Under the arrangements approved by the Financial Secretary in January 2000, US dollar assets were transferred from the Investment Portfolio to the Backing Portfolio of the Exchange Fund to restore the Ratio to 107.5%. The Backing Ratio closed at 107.03% on 31 December.

Other activities

The EFAC Currency Board Sub-Committee monitors and reviews issues relevant to monetary and financial stability in Hong Kong. During the year such issues included dislocation in the foreign-exchange and money markets in Hong Kong; the framework for monitoring capital flows; the effects on Hong Kong's financial markets of the markets in the US and China during the current crisis; and exchange rate regimes and the management of asset price bubbles. Records of discussion of the Sub-Committee on these issues and the reports on Currency Board operations submitted to the Sub-Committee are published on the HKMA website.

The Hong Kong Institute for Monetary Research (HKIMR) continued to sponsor research in the fields of monetary policy, banking and finance. In 2009 the Institute hosted 24 research fellows and seven post-doctoral fellows. It also published 38 working papers.

Chart 4 **Daily movement of the Backing Ratio, January – December 2009**

[1] The expansion in the Monetary Base exerted a downward influence on the Backing Ratio because while the Backing Assets rose by the same amount as the Monetary Base (as required under the Currency Board arrangements), the proportional increase was smaller in the former due to its larger size.

The Institute co-organised four international conferences. The first, held on 12 - 13 January with the Bank for International Settlements' Representative Office for Asia and the Pacific, focused on the relationship between real estate markets and financial markets. The second, (19 - 20 January) with the Asian Development Bank, examined the costs and benefits of regional economic integration in Asia. The third, (11 - 12 May) with Columbia University and Lingnan University, dealt with issues surrounding the global financial turmoil and Asia's evolving financial interdependence. The fourth, (26 - 27 June) with The Hong Kong University of Science and Technology, the National Bureau of Economic Research and other Asian research institutions, studied issues of commodity prices and financial markets. Other programmes included the seventh HKIMR workshop on the Mainland's economy, entitled "Macroeconomic Statistics and Surveillance in Mainland China" in November, the Seventh Annual Summer Workshop in August and the Tsinghua – Columbia Workshop in International Economics 2009 sponsored by the Institute in June. In addition, 46 public seminars were organised during the year on a broad range of economic and monetary issues.

PLANS FOR 2010 AND BEYOND

The external environment remains highly uncertain despite signs of recovery from the global financial crisis. The key issues facing monetary policymakers around the world include when to start tightening, and how to unwind large central bank balance sheets. In the foreign-exchange market, movements in the US dollar remain volatile and a possible resurgence of carry trades, or their sudden unwinding, could affect monetary and financial stability in Hong Kong. Indeed, any sharp reversal in fund flows might lead to market volatility given the considerable gains in asset prices in 2009.

The HKMA will continue to monitor risks and vulnerabilities in the domestic and external environment. In the event of destabilising capital outflows, the HKMA can, if necessary, conduct foreign-exchange operations within the Convertibility Zone, to ensure adjustments are orderly, as long as exchange-rate stability is not affected. Prudential supervision of lending by authorized institutions can also be stepped up to mitigate potential risks to banking stability. The EFAC Currency Board Sub-Committee will continue to examine issues relevant to Hong Kong's monetary and financial stability, review the technical aspects of the Currency Board arrangements and, where appropriate, recommend measures to strengthen them.

Banking Stability

The banking sector weathered the challenges of the global financial crisis ending the year with sound capital and liquidity positions. While there are signs of improving performance, as more stable financial market conditions take hold, the outlook remains uncertain. Further steps were taken in 2009 to implement international initiatives to strengthen banks' capital, liquidity and other risk management standards; and authorized institutions introduced improved measures on investor protection. The HKMA worked with the Government on planned new legislation to upgrade Hong Kong's anti-money laundering regime.

OBJECTIVES

Promoting the safety and stability of the banking system through the regulation of banking and deposit-taking businesses and the supervision of authorized institutions (AIs) is a primary function of the HKMA. The responsibility is shared among three departments:

- the Banking Supervision Department handles the day-to-day supervision of AIs
- the Banking Policy Department formulates supervisory policies to promote the safety and soundness of the banking sector
- the Banking Development Department formulates policies to promote the development of the banking industry.

REVIEW OF 2009

Risk-based supervision

The HKMA continued to fine-tune its risk-based supervisory process to keep pace with developments in the banking industry. Because of the continuing and considerable redeployment of staff resources to investigate the alleged mis-selling of Lehman Brothers-related investment products by banks, the HKMA conducted fewer on-site examinations in 2009 (142), compared with 161 in 2008. The supervisory focus was more on improving vigilance in the off-site surveillance of AIs. More frequent meetings were held in 2009 with senior management and heads of control functions of individual AIs to discuss and address emerging prudential concerns. Greater emphasis was placed on the work of the compliance and internal audit functions of AIs to ensure their business operations complied with the relevant internal control procedures and regulatory requirements. Regular stress tests conducted internally by the HKMA were strengthened to assess the asset quality, profitability and the capital position of retail banks to detect possible vulnerabilities under severe but plausible scenarios, and to identify action to be taken. For branches and subsidiaries of foreign banks, the HKMA maintained close contact with the relevant home supervisors, especially those in jurisdictions whose financial markets were hit hard by the global financial crisis, to understand developments at the banks' head offices.

Following introduction of the full deposit guarantee on all customer deposits held with all AIs in October 2008, and mindful of the potential for moral hazard that might be created by the availability of the guarantee, the monitoring of AIs' deposit movements, liquidity positions and business activities in general was stepped up to pre-empt the emergence of any imprudent business practices.

To cope with the evolving development of financial markets and innovation in financial instruments, a specialised division was established within the HKMA to strengthen the supervision of AIs' treasury activities and to conduct macro financial market surveillance. The initiative has improved the HKMA's ability to anticipate and detect emerging market developments that might give rise to prudential concerns about the banking industry. Treasury on-site examinations were conducted during the year to review the adequacy and effectiveness of AIs' treasury controls and the approval process of new financial products. Because of the volatility of financial markets, resources were also allocated to review AIs' exposures to structured investment products to ensure prudent valuation and mark-to-market adjustments were adopted by AIs to appropriately reflect the impact, if any, on their financial positions.

To better utilise reduced staff resources available for on-site examinations, areas of high supervisory priority were subjected to focused thematic examinations. Of the 142 on-site examinations conducted, 84 were thematic examinations reviewing AIs' asset quality; lending to small and medium-sized enterprises under the Government Loan Guarantee Scheme; compliance with the Representation Rules under the Deposit Protection Scheme; sales of non-Lehman Brothers-related credit-linked investment products; compliance with the restrictions on renminbi trade settlement; and anti-money-laundering (AML) and counter-terrorist-financing (CFT) controls over trade financing activities. The HKMA also conducted 29 risk-based examinations and three overseas examinations on AIs' subsidiaries on the Mainland.

In addition, the specialist teams carried out 17 examinations of risk management controls covering AIs' treasury and derivatives activities; business continuity planning; migration of the Real Time Gross Settlement and Central Moneymarkets Unit systems to the SWIFTNet infrastructure; customer data protection and operational risk management, e-banking activities and technology risk management and practice; and tier-2 examinations of AIs' AML/CFT controls. Reviews were also performed for selected AIs that had received approval to use the internal ratings-based (IRB) approach for credit risk or the internal models (IMM) approach for general market risk under Basel II to ensure their continuing compliance with the relevant requirements (*see section on Basel II for details*). On the application of one AI, the HKMA conducted a review to assess that bank's readiness to use the IMM model to calculate specific risk under the Basel II market risk framework.

During the year 193 off-site reviews were conducted and 16 tripartite meetings[1] were held. Other duties included regular analysis of statistical returns and the handling of non-compliance with guidelines or statutory requirements. The supervisory teams met the boards or members of the board-level committees of six AIs.

The Banking Supervision Review Committee considered 10 cases in 2009, with seven relating to the licensing of AIs and approval of a money broker, and the other three dealing with revocation of authorization and the exercise of the Monetary Authority's powers under section 52 of the Banking Ordinance. Details of the operational supervisory work performed in 2009 are set out in Table 1.

Table 1 Operational supervision

		2009	2008
1	On-site examinations	**142**	161
	Regular examinations	**32**	57
	– risk-based	**29**	53
	– overseas	**3**	4
	Basel II – IRB and IMM reviews	**9**	8
	– IRB initial recognition assessment and follow-up examinations	**6**	5
	– IRB IT aspects	**–**	3
	– IMM internal model recognition assessment and review	**3**	–
	Credit risk management and asset quality	**26**	24
	Market risk and treasury activities	**6**	13
	Securities and investment-products related conduct examinations	**17**	11
	Compliance with the Deposit Protection Scheme representation rules	**19**	–
	AML/CFT controls	**18**	19
	IT, e-banking and operational risk	**12**	18
	Renminbi business	**3**	11
2	Off-site reviews and prudential interviews	**193**	188
3	Tripartite meetings	**16**	39
4	Meetings with boards of directors or board-level committees of AIs	**6**	2
5	Approval of applications to become controllers, directors, chief executives, alternate chief executives of AIs	**269**	301
6	Reports commissioned under section 59(2) of the Banking Ordinance	**16**	5
7	Cases considered by the Banking Supervision Review Committee	**10**	22
8	AIs that were subject to the exercise of powers under section 52 of the Banking Ordinance	**3**	5

[1] Meetings between the HKMA, the AI and its external auditors.

Sixteen reports were commissioned under section 59(2) of the Banking Ordinance to require 15 AIs to appoint external auditors to review internal control issues and to report their findings to the HKMA. The scope of 10 of these reviews involved the AIs' handling of customer complaints in relation to Lehman Brothers-related investment products. Twelve AIs also voluntarily appointed external auditors to review their controls on selected areas identified by the HKMA. Of these, six were on the selling process of retail investment products by the AIs'.

In 2009 no AI breached the requirements of the Banking Ordinance relating to the capital adequacy ratio (CAR). Due to technical errors, one foreign bank branch was found to have breached the liquidity ratio requirement. It did not pose any threat to the safety and soundness of the institution or to the interests of depositors. There was one breach of the requirements under section 81 relating to large exposures, three under section 83 on connected lending, and two under section 85 on lending to AI's employees. These breaches were assessed to be unintentional. They were rectified promptly by the relevant AIs and did not affect the interests of depositors.

Powers under section 52 of the Banking Ordinance

Octopus Cards Limited

Under section 53F(1) of the Banking Ordinance, the Monetary Authority (MA) revoked, on 23 May 2009, the appointment of an Advisor to advise the management of Octopus Cards Limited (OCL) on matters relating to the protection of Octopus cardholders' interests. The MA, in consultation with the Advisor, considered it no longer necessary for the appointment to remain in force as OCL had taken sufficient measures to ensure that the interests of Octopus cardholders were properly protected and safeguarded in the company's operations, and to address all the significant issues raised in the independent auditor's report on OCL's operational risk control.

Melli Bank plc

The restrictions imposed by the Monetary Authority on 25 June 2008 under section 52(1)(A) of the Banking Ordinance on the affairs, business and property of the Hong Kong Branch of Melli Bank plc remained in force during 2009. The HKMA continued to communicate regularly with the relevant authorities to monitor developments related to the branch and its Head Office in the United Kingdom, and to review the supervisory measures taken to protect the interests of its depositors.

United Commercial Bank

After the Federal Deposit Insurance Corporation (FDIC) and the Department of Financial Institutions in California entered into a consent agreement with United Commercial Bank (UCB) on the issuance of an Order to Cease and Desist ordering UCB to stop a number of unsafe and unsound banking practices and to take relevant remedial action, the Monetary Authority exercised his powers under section 52(1)(A) of the Banking Ordinance to impose restrictions on the affairs, business and property of UCB's Hong Kong Branch (UCBHK) on 11 September 2009 to protect its depositors.

UCB was put into receivership by the FDIC on 6 November 2009. The bank's global operations were subsequently acquired by East West Bank (EWB) in the US under an agreement between the FDIC and EWB. In Hong Kong, the assets and liabilities of UCBHK were being transferred to the Hong Kong Branch of East West Bank. Once the process has been completed, UCB's authorization as a licensed bank will be revoked.

CAMEL rating review

During the year meetings of the CAMEL Approval Committee were held to review and determine the composite CAMEL[2] ratings of 195 AIs. One bank subsequently requested a review of its rating and a meeting of the CAMEL Approval Review Committee, formed by members not involved in the original rating decision, was convened to consider the case.

The CAMEL ratings of licensed banks on 20 October 2009 were used as the supervisory ratings provided to the Hong Kong Deposit Protection Board for the purpose of determining the contributions to be paid by licensed banks in 2010 under the Deposit Protection Scheme.

Specialised supervisory work

Supervision of technology and operational risks

Internet banking, technology risk management and business continuity management

There was steady growth in the use of Internet banking services in 2009 with 63 AIs offering the facility in Hong Kong: the number of personal accounts increased to 6.2 million (from 5.7 million in 2008), and corporate Internet banking accounts totalled 477,000 (up from 401,000 in 2008). Since the 2005 launch of two-factor authentication for high-risk transactions conducted through personal Internet banking, 38 AIs have implemented such a mechanism and some 2.8 million account holders have registered for the service.

In 2009 the HKMA continued to work with the Hong Kong Police Force and the Hong Kong Association of Banks to promote public awareness of Internet banking security. An "e-Fraud seminar" was organised for the banking industry in February to increase the general awareness of emerging fraudulent techniques on Internet banking; and a "Clean PC Day" campaign and an "Online Story Writing Competition" were also held in the second half of the year to educate the public about the importance of computer security.

In the light of the growing number of Internet banking fraud cases reported locally and overseas involving sophisticated fraudulent techniques, the HKMA issued a circular on 13 July requiring AIs to increase their precautionary measures on Internet banking services for retail and corporate customers. In addition, the HKMA issued two circulars in April and June urging AIs to ensure the effectiveness of their business continuity plans and to put in place necessary precautionary and contingency measures because of the increased level of threat from human swine influenza.

The HKMA carried out regular on-site examinations and off-site surveillance of AIs' controls over Internet banking, technology risk management and business continuity planning. To ensure the migration of the RTGS and CMU systems to the SWIFTNet infrastructure was performed in a controlled manner, a review was conducted in May to cover the testing and business continuity arrangement of the systems. Separately, the HKMA extended the coverage of the automated control self-assessment process for technology risk management, Internet banking and business continuity management to 70 AIs (from 63 in 2008).

[2] Comprising the **C**apital adequacy, **A**sset quality, **M**anagement, **E**arnings and **L**iquidity components.

Operational risk management

The HKMA continued to improve the supervisory framework of operational risk management of AIs and assess their compliance with the necessary capital requirements under the Banking (Capital) Rules. The annual self-assessment exercise on operational risk management was extended in 2009 to cover 52 AIs (compared with 23 in 2008), including all locally incorporated licensed banks and some other selected AIs. The contents of the self-assessment template were further improved during the year to collect more operational risk-related information from the participating AIs to facilitate continued assessment and monitoring of individual AIs' risk profiles.

Supervision of securities and insurance business

The HKMA co-operates closely with the Securities and Futures Commission (SFC), the Insurance Authority and the Mandatory Provident Fund Schemes Authority on the supervision of AIs' securities, insurance and MPF-related businesses. Regular contact is made through various channels including frequent regulatory contacts, bilateral meetings as well as under the auspices of the Financial Stability Committee and the Council of Financial Regulators.

To facilitate day-to-day supervision, the HKMA continued to collect and analyse half-yearly returns on AIs' securities and insurance activities. These returns provide a general overview and industry trends of the securities and insurance activities carried out by AIs. The HKMA also invited 65 registered institutions (RIs), 15 more than in 2008, to participate in the self-assessment of compliance with the relevant rules and regulations in relation to the conduct of their regulated activities.

In 2009 the HKMA processed seven applications for registration to become RIs and five applications from RIs to engage in additional regulated activities. It also granted consents to 185 executive officers, who are responsible for supervising the securities activities of RIs; and conducted background checks on 4,828 individuals whose information was submitted by RIs for registration.

In continuation of the credit-linked notes examinations conducted in 2008 and in view of the evolving market conditions, thematic examinations were conducted on 17 RIs to examine their sales of non-Lehman Brothers related credit-linked investment products. As part of these examinations, a customer survey was conducted to gather more information about the selling process of the RIs. The HKMA is following up with the RIs concerned to ensure that areas needing improvements would be promptly addressed. Any possible cases of mis-selling or suspected breaches of regulatory requirements identified in the examinations are referred to the HKMA's Securities Enforcement Division for further action.

The Central Government's Ministry of Finance issued the first renminbi sovereign bonds in Hong Kong in September 2009. The high level of interest from the investing public prompted the banking industry to hold discussions with the HKMA on ways to streamline the selling process for the bonds while maintaining adequate investor protection. On 8 September 2009 the HKMA issued a circular setting out the simplified arrangements for selling renminbi sovereign bonds as the products' features and risks were not difficult for the average investor to understand and the suitability requirement could be achieved under the simplified procedures.

Supervision of treasury activities

To strengthen the HKMA's oversight of AIs' treasury and derivative activities, a specialised division was established in 2009, and market professionals with relevant knowledge were recruited. In addition to examining AIs' treasury activities and new product approval processes, the specialised division devoted considerable resources to monitoring market events with the potential to have an impact on investors of credit-linked notes, reminding banks to take appropriate action to provide assistance to affected investors.

Throughout 2009, the specialised division monitored the latest developments and impact of the global financial crisis on Hong Kong's banking sector. Different stress tests were undertaken to assess individual AIs' ability to weather possible shocks to various exposures and asset classes, including debt securities portfolios. Resources were also applied to establish market contacts and monitor emerging market and product trends with potential market risks or systemic implications.

Mainland-related businesses

Renminbi banking business

At the end of 2009, 60 AIs were conducting renminbi business. The total amount of outstanding deposits was RMB62.7 billion, a 11.9% increase over a year earlier. The amount of renminbi bonds issued in Hong Kong during the year also rose with six new issues, totalling RMB16 billion, including issuances by the Ministry of Finance and the Mainland subsidiaries of two Hong Kong AIs.

The scope of renminbi business conducted by AIs expanded substantially with the start of the renminbi trade settlement pilot scheme in July. All AIs are eligible to participate in the scheme, which covers a range of renminbi services to facilitate trade settlement in renminbi between pilot cities on the Mainland and selected areas including Hong Kong. The services cover deposit-taking, currency exchange, remittance, trade financing, cheques and interbank transfers. The HKMA issued circulars to AIs on related risk management issues and data reporting. At the end of 2009, 52 AIs were engaged in renminbi trade settlement business.

Tapping the Mainland market

A total of 13 locally incorporated banks had business operations in Mainland China. Eight of them were operating through subsidiary banks incorporated on the Mainland. The 13 locally incorporated banks continued to expand their branch network, maintaining over 270 Mainland branches or sub-branches, either directly or through subsidiary banks.

Under the Sixth Supplement to the Closer Economic Partnership Arrangement (CEPA), a new provision, effective from 1 October, was introduced to allow the branches of Hong Kong banks or their Mainland subsidiaries in Guangdong Province (including Shenzhen) to open cross-location sub-branches within the Province, thereby extending their branch network in a more cost-effective way. Four Hong Kong banks had obtained approvals for opening a total of five such sub-branches by the end of the year.

The industry's aggregate on-balance-sheet non-bank exposures to Mainland China amounted to HK$852.5 billion equivalent at the end of 2009, or 7.1% of total assets. These included exposures of HK$313.8 billion equivalent booked in the Mainland subsidiaries of Hong Kong banks. The HKMA maintains regular contact with the China Banking Regulatory Commission (CBRC) to ensure effective cross-border supervisory co-operation and co-ordination relating to these entities.

Effective from January 2009, under CEPA's Fifth Supplement, Mainland-incorporated banking subsidiaries established by Hong Kong banks are allowed to locate and operate their data centres in Hong Kong, subject to certain conditions. The HKMA and the CBRC signed a Supervisory Co-operative Arrangement in May to improve supervision of cross-border data centres in Hong Kong and on the Mainland.

Credit risk management and asset quality

In the light of intense competition for mortgage business, the HKMA issued circulars to AIs on 17 September 2009 and 8 January 2010 reminding them to be prudent in setting mortgage interest rates and to manage their interest rate risk properly.

The price of luxury properties rose during the year, particularly in the third quarter, prompting the HKMA to issue a circular to all AIs on 23 October requiring them to tighten the maximum loan-to-value ratio for properties with a value of $20 million or more from 70% to 60%. The circular also reminded AIs to be prudent in conducting property valuation and in assessing the repayment ability of borrowers. Specifically, the HKMA expects AIs to take into account the potential impact on borrowers if mortgage interest rates returned to more normal levels. The HKMA again wrote to AIs on 30 October setting out the best practices on property valuation and the computation of debt servicing ratios. AIs are required to review and assess their lending practices and, where necessary, take appropriate steps to bring them in line with the best practices set out in the HKMA circular.

In December 2008 the Government launched a Special Loan Guarantee Scheme to support small and medium-sized enterprises during the global financial crisis. To ensure AIs' compliance with the Scheme's requirements, the HKMA is conducting a round of thematic examinations focused on AIs' lending to companies covered by the guarantee. At the end of December 2009, 19 examinations had been completed; and seven more will be conducted in 2010. The results of examinations completed so far indicate AIs have generally put in place effective systems to ensure proper compliance.

Co-operation with overseas supervisors

The onset of the US sub-prime mortgage crisis and the collapse of Lehman Brothers heightened the need for supervisors to strengthen cross-border co-operation on the management of financial crises. The HKMA participated in supervisory meetings organised by the home supervisors for selected individual banking groups with significant operations in Hong Kong to discuss issues of mutual interest, including the progress of these banking groups in adopting the IRB approach. The meetings made advanced preparations for dealing with financial crises, especially in handling severe stress that might have an impact on affected banking groups. In addition, bilateral meetings were held in Hong Kong and abroad with banking supervisory authorities from France, Germany, Indonesia, Japan, Macau, Mainland China, Malaysia, the Netherlands, Singapore, South Korea, Switzerland, Taiwan, Thailand, the UK and the US. There were also regular exchanges of correspondence and other forms of communication with overseas banking supervisory authorities on institution-specific issues as well as developments in financial markets and their impact on individual banking institutions.

Lehman-related investment products

Improvements to the existing supervisory framework

On 31 December 2008 the HKMA submitted a report to the Financial Secretary with observations and information on the lessons learnt and issues identified during investigations into complaints about the sale of Lehman-related investment products. The report detailed various recommendations to further improve the regulatory framework and investor protection. The HKMA issued a circular on 9 January 2009 to require registered institutions (RIs) to implement a number of recommendations in the report, and another circular on 25 March setting out the implementation details after discussions with the banking industry. Recommendations that could be introduced quickly by RIs, such as audio-recording of the selling process, insertion of a "health-warning" statement, and clear segregation between ordinary banking business and retail securities business were implemented by September. In relation to the recommendation to introduce a periodic mystery shopping programme by the regulatory authorities, the HKMA and the SFC jointly commissioned a consultant in the second half of 2009 to prepare a programme. The consultant submitted a report with a number of recommendations to the HKMA and the SFC at the end of 2009.

On 25 September the SFC, in collaboration with the HKMA, issued a public consultation paper on proposals to upgrade protection for the investing public. The proposals included developing a product code handbook and additional requirements concerning the conduct of intermediaries, such as pre-sale disclosure of monetary and non-monetary benefits received by RIs, and a "cooling-off" period for the purchase of investment products. To facilitate the banking industry's understanding of the proposals, the HKMA and the SFC organised a workshop for intermediaries on 7 December.

In addition, the HKMA was involved in assisting the Government in the preparation of the public consultation paper on an Investor Education Council and a Financial Dispute Resolution Centre. It has also been co-operating with the Legislative Council's Subcommittee to Study Issues Arising from Lehman Brothers-related Minibonds and Structured Financial Products by attending meetings and providing information and documents where possible. The HKMA will take into account recommendations from the Subcommittee's review, when completed, to further enhance the regulation of RIs' conduct of regulated activities in Hong Kong.

Resolution of complaints and investigation

Since the collapse of Lehman Brothers in September 2008, the HKMA has received a large number of complaints from customers who purchased Lehman-related investment products from banks. To deal with these complaints, the HKMA expanded its investigation workforce (up to 300 staff) by redeploying some of its own staff resources, hiring contract staff and seconding professionals from external auditing firms. The HKMA also worked closely with the SFC by referring cases to the Commission to facilitate its investigations at the institutional level. By the end of 2009, 77% of Lehman-related complaints were handled or resolved.

Minibonds

The SFC, the HKMA and 16 distributing banks reached an Agreement in July for resolution under section 201 of the Securities and Futures Ordinance on the repurchase of minibonds from eligible customers, who number about 25,000. In accordance with the Agreement, eligible customers received an initial payment of at least 60% (70% for those aged 65 or above) of their original investments in minibonds. Further payments will be made if recoveries from the realisation of the underlying collateral held in respect of minibonds are in excess of the initial payments made by banks. Nearly 98% of eligible customers accepted the repurchase offer. Separately, about 4,800 minibond customers who reached settlements with their banks prior to the section 201 Agreement are eligible for the voluntary offers made by banks in order to bring them to the same position as those eligible for the repurchase offer.

Under the section 201 Agreement, banks are required to strengthen their internal control systems and implement enhanced complaint-handling procedures to resolve complaints relating to the sale and distribution of structured investment products. Independent reviewers are also engaged to review and make recommendations on the banks' systems, processes and procedures in these areas.

Non-minibond products

Following the execution of the section 201 Agreement, the HKMA deployed more resources to the investigation of Lehman-related non-minibond cases. By the end of 2009, it had completed its investigations into almost half of these cases, with disciplinary action taken in one case and 362 cases under disciplinary process.

In December 2009 the SFC and the HKMA reached a resolution with two banks over their sale of certain fixed-coupon principal-protected equity index-linked notes issued by Lehman Brothers, in the light of the section 201 Agreement. The banks offered to repurchase these notes at 80% of the principal amount from individual customers who bought the notes from them on or after a specified date. They also agreed to make ex-gratia payments to customers who had previously reached settlements on terms that were financially less favourable than the repurchase offer, thus bringing them to the same position as those eligible for the repurchase offer.

Investigations into Lehman-related non-minibond cases are continuing and the HKMA aims to substantially complete all the remaining cases by the end of March 2010.

Review of the HKMA's work on banking stability

As a result of the global financial crisis, many issues concerning banking stability have been discussed in various local and international forums. The review of the HKMA's work on banking stability in 2008, and the comments received during the subsequent public consultation, have provided timely and useful information to support the HKMA's participation in these discussions and its formulation of supervisory policies to address issues arising from the crisis. The HKMA will continue to implement measures to cope with the challenges ahead, taking into account recommendations of the review and international and local developments.

Basel II

Enhancements to Basel II

In July 2009 the Basel Committee on Banking Supervision issued a set of enhancements to the Basel II framework to strengthen its risk coverage in the light of lessons drawn from the financial crisis. The improvements raise banks' capital requirements for trading book and securitisation exposures, provide supplemental guidance on risk management principles and strengthen disclosure in corresponding areas.

The HKMA consulted the banking industry in September on its proposals to implement the Basel Committee's enhancements in Hong Kong and, at the same time, introduced a number of refinements to the existing capital framework prompted largely by implementation experience since its introduction in January 2007. Following this consultation, preparations are underway to amend the Banking (Capital) Rules and Banking (Disclosure) Rules.

Because of the importance of the residential mortgage lending business to the local banking sector, the HKMA also consulted the industry on a proposal to retain a 10% floor for the loss-given-default estimates for residential mortgage loans under the IRB approach for calculating credit risk. The floor was originally incorporated into the capital framework as a transitional requirement expiring at the end of 2009. In similar vein, the Basel Committee decided at its meeting in December to retain the 10% floor within the Basel II framework, and work is proceeding on incorporating the amendment into the Banking (Capital) Rules.

Implementation of advanced approaches

During the year the HKMA granted approval to one AI to adopt the IMM approach under the market risk framework of the Banking (Capital) Rules, after assessing the robustness of the AI's internal model and its compliance with the requirements set out in the Rules.

The HKMA conducted follow-up reviews of selected AIs which had previously been approved to use the IRB approach for credit risk or the IMM approach for market risk. These follow-up reviews were to ascertain whether issues identified in previous on-site examinations had been fully addressed, and to ensure the AIs' continuing compliance with the requirements for using the approaches.

To facilitate supervision of AIs under the IRB approach, the HKMA improved its internal systems for analysing risk estimate data. It began conducting a benchmarking exercise to compare the risk estimates used by different AIs to calculate their capital requirements for credit risk exposures with similar or identical risk characteristics. The aim of the benchmarking exercise is to identify any outliers.

Supervisory review process (SRP)

The process provides the HKMA with a comprehensive framework for assessing AIs' capital levels and risks, including non-credit risks such as interest rate risk in the banking book, liquidity risk, and reputation and strategic risks.

The supplemental guidance on risk management principles issued by the Basel Committee in July 2009 was incorporated into the HKMA's SRP framework to further strengthen its robustness. The guidance covers firm-wide risk oversight, risk concentration, off-balance sheet exposures, securitisation and associated reputation risk, valuation of financial instruments, liquidity risk management and compensation practices as well as firm-wide stress-testing practices. The enhanced SRP framework, on which the industry has been widely consulted, is expected to take effect in the first half of 2010 after comments received in the consultation exercise have been addressed.

During the year the HKMA completed the third round of SRP assessments on Hong Kong-incorporated AIs, which included a review of their capital adequacy assessment processes (CAAPs) against supervisory standards and their progress in developing their CAAP capability. The SRP Approval Committee within the HKMA met regularly to review the assessment results for the purpose of considering the appropriate minimum CARs of AIs and other supervisory issues requiring attention. AIs were notified of the results, and were given the opportunity to request a review of their minimum CAR, although none did so in 2009.

Other Basel Committee initiatives

The Basel Committee released two important consultative documents in December: *Strengthening the Resilience of the Banking Sector* and *International Framework for Liquidity Risk Measurement, Standards and Monitoring*. These documents set out proposals to strengthen global capital and liquidity standards by:

- improving the quality, consistency and transparency of the capital base of banks
- strengthening the risk coverage of the Basel II framework in relation to counterparty credit risk
- introducing a leverage ratio to supplement the Basel II risk-based measure and help contain the build-up of excessive leverage in the banking system
- promoting the build-up of counter-cyclical capital buffers within the banking sector outside periods of stress, which can be drawn down as losses are incurred
- introducing a minimum global liquidity standard to enhance the resilience of banks against liquidity stress.

The consultation period is scheduled to end on 16 April 2010. The HKMA encouraged the Hong Kong Association of Banks and the Deposit-taking Companies Association to co-ordinate a response from their members to the Basel Committee. Further amendments to the Banking (Capital) Rules and Banking (Disclosure) Rules will be required for the adoption of these measures in Hong Kong.

Improving the supervisory policy framework

Revision of the liquidity regime

The global financial crisis has highlighted the importance of both sound liquidity risk management systems and the holding of sufficient levels of liquidity within banks to bolster their resilience in stressed situations, particularly those of a severe, prolonged and market-wide nature.

As an initial step to strengthening the local liquidity regime, the HKMA has developed supervisory guidance to implement the systems, controls and disclosure standards contained in the *Principles for Sound Liquidity Risk Management and Supervision* issued by the Basel Committee in September 2008. The HKMA guidance takes into account the results of a self-assessment conducted by AIs in early 2009 to assess their compliance with the Committee's *Principles* as well as other relevant international guidance to address the lessons of the crisis. The guidance will be issued for formal industry consultation in early 2010. In order to monitor and assess AIs' compliance with the enhanced liquidity risk management standards, the HKMA's supervisory process will be correspondingly refined and strengthened.

Compensation practices

To address risk management concerns arising from the design of financial firms' remuneration policies, where incentives for excessive risk-taking have been identified as one of the many factors contributing to the financial crisis, the Financial Stability Board (FSB) issued a set of *Principles for Sound Compensation Practices* in April 2009 and a set of corresponding *Implementation Standards* in September 2009. The HKMA supports the risk management concepts embedded in the FSB's *Principles* and has developed, in consultation with the industry, a draft "Guideline on a Sound Remuneration System" to promote the incorporation of the FSB's *Principles* and *Standards* into AIs' remuneration practices.

Counterparty credit risk (CCR)

Following industry consultation, the HKMA issued a new supervisory guideline on "Counterparty Credit Risk Management" in June. The guideline sets out the risk management standards AIs are expected to have in place, and the HKMA's supervisory approach, for CCR management. AIs were given a nine-month period (from June) to review and make any necessary enhancements to their existing CCR management systems based on the standards contained in the guideline.

Internal audit function

In July the HKMA issued, after consultation with the banking industry, a new supervisory guideline on AIs' "Internal Audit Function" setting out its expectations on the key role, responsibilities and qualities of an AI's internal audit function, and to describe the approach the HKMA will adopt in assessing its effectiveness. The guideline serves to reinforce the importance of the internal audit function in providing an ongoing independent evaluation of the adequacy of an AI's internal control systems, which are essential in addressing new risks in the constantly changing operating environment.

Stress testing

The HKMA regularly performs supervisory stress tests on selected AIs aimed at assessing their resilience to potential risks and vulnerabilities. Although the stress-testing results over the course of the year reflected a satisfactory level of resilience to stress within the banking sector, the HKMA remains vigilant in monitoring individual AIs' financial capacity to weather adverse economic and market conditions.

In the light of the lessons of the global financial crisis and the *Principles for Sound Stress Testing Practices and Supervision* issued by the Basel Committee in May 2009, the HKMA has taken steps to refine and develop its supervisory stress-testing approach. Hypothetical stress scenarios have been streamlined to provide better risk focus and the scope of the stress tests has been expanded to cover AIs' exposures to complex structured products. Bank-specific stress tests were conducted by supervisory staff on selected retail banks to supplement the HKMA's regular sector-wide stress tests, and more use was made of the stress-testing results in determining supervisory plans for individual AIs.

Market risk management

A primary focus in the aftermath of the global financial crisis has been the strengthening of the market risk framework given the significant losses that surfaced in the trading books of some global banks. To bolster market risk management standards in Hong Kong, the HKMA has compiled a new supervisory guideline on "Market Risk Management" that addresses key elements of an effective market risk management system, drawing on recent observations and recommendations arising from the financial crisis. The HKMA plans to release this draft guideline for industry consultation in 2010.

Prevention of money laundering and terrorist financing

Addressing issues on customer due diligence and record keeping identified by the Financial Action Task Force on Money Laundering (FATF) in its *Mutual Evaluation Report of Hong Kong* in 2008, the Government decided to introduce legislation to improve Hong Kong's AML/CFT regime.

The HKMA participated in the working group formed by the Financial Services and the Treasury Bureau to develop the legislative proposals. The Bureau published a conceptual framework in July 2009 for public consultation. After taking into account the comments received, a second consultation paper containing detailed legislative proposals was published in December. The HKMA will continue to provide support during the legislative process.

The HKMA has also been discussing with the Hong Kong Association of Banks and the Deposit-taking Companies Association a series of amendments to the HKMA's *Guideline on Prevention of Money Laundering* and its *Supplement* to address other issues relating to the banking sector identified by FATF in its evaluation. Once finalised, the revised *Guideline* and *Supplement* are expected to be issued in early 2010.

To monitor AIs' compliance with the HKMA's *Guideline* and *Supplement*, the HKMA's AML/CFT specialist teams completed 18 on-site examinations of AIs during the year, including 12 tier-2 examinations and six thematic examinations focusing on preventive measures in relation to trade finance.

International co-operation

The HKMA continues to participate in various international and regional forums for banking supervisors. In June the HKMA became a member of both the Basel Committee and its governing body, the Group of Central Bank Governors and Heads of Supervision. The HKMA also participates in various Basel Committee initiatives through its membership of the Committee's working groups, including the Liquidity Working Group, the Definition of Capital Sub-Group and the Standards Implementation Group.

Regionally, the HKMA chairs the EMEAP Working Group on Banking Supervision, and is a member of the South East Asia, New Zealand and Australia Forum of Banking Supervisors.

Accounting and disclosure

Prudent valuation

Recognising the critical importance of sound valuation to risk management, financial reporting and capital regulation, the Basel Committee published a paper on *Supervisory Guidance for Assessing Banks' Financial Instrument Fair Value Practices* in April 2009. The prudent valuation guidance in the Basel II framework was also revised in July to converge more with existing accounting guidance on fair value measurement and to cover not just trading book positions, but all positions subject to fair value accounting. In addition, the International Accounting Standards Board (IASB) issued an Exposure Draft on *Fair Value Measurement* in May, which is expected to be finalised in 2010. To reflect these developments within its supervisory framework, the HKMA is revising its supervisory guideline on the "Use of Fair Value Option for Financial Instruments". The revised guideline, which is intended to be applicable to all AIs' positions subject to fair value accounting, is expected to be released for industry consultation in the first half of 2010.

Financial instruments and provisioning standards

In response to a call from the G20, the IASB has undertaken a series of initiatives to address issues on accounting standards for financial instruments, fair value measurement, provisioning, off-balance sheet exposures, and the related required disclosures. In November 2009 the IASB published a final standard on the classification and measurement of financial instruments (*IFRS 9: Financial Instruments*). The Hong Kong Institute of Certified Public Accountants (HKICPA) incorporated the standard into the Hong Kong Financial Reporting Standards, also in November, for mandatory application with effect from 1 January 2013 and for non-mandatory application for 2009 year-end reporting. The HKMA will monitor AIs' plans to adopt the standard and assess the impact on their financial reporting.

The IASB is expected to publish in 2010 a new standard on the impairment of financial instruments based on an expected loss model. An Exposure Draft was issued in November 2009 for consultation. Final standards on consolidation and de-recognition to improve the accounting and transparency of off-balance sheet activities are also expected to be issued in 2010.

The HKMA will closely monitor developments in these accounting standards and assess the implications for its supervisory policy framework.

Disclosure

In March additional requirements were incorporated into International Financial Reporting Standard (IFRS) 7 *Financial Instruments: Disclosures* to improve disclosure with respect to fair value measurement and liquidity risks associated with structured credit products, complex financial instruments and off-balance sheet entities.

In their interim reporting in 2008 Hong Kong-incorporated AIs began adopting the recommendations of the Senior Supervisors Group *Report on Leading-Practice Disclosures for Selected Exposures* in respect of their holdings of financial instruments. Following the HKICPA's adoption of the enhancements to *IFRS 7* in March 2009, the AIs will further augment their corresponding disclosures for their financial year-end reporting in 2009 and thereafter. Although the exposure of the Hong Kong banking sector to complex financial instruments is comparatively small, the HKMA requires all AIs to be transparent in their disclosure of any such exposures and to adopt a prudent approach in the valuation, including calculation of the impairment charges, for these exposures in their financial statements.

Credit data sharing

At the end of December 2009, 120 AIs were sharing commercial credit data through the Commercial Credit Reference Agency (CCRA), and the scheme contained the credit data of more than 104,000 business enterprises, about 19% of which were sole proprietorships and partnerships. The continued development of the CCRA has helped to further strengthen the credit risk management capacity of AIs, thereby improving access to credit by the small and medium-sized enterprises.

The HKMA started discussions with the Privacy Commissioner for Personal Data in October on a proposal to expand the scope of consumer credit data sharing to cover positive mortgage data. This will enable AIs to better manage their credit risk and price the credit facilities they offer to their customers more accurately. Borrowers should also benefit. As more information about the overall credit-worthiness of borrowers becomes available to AIs, credit-worthy borrowers will be better positioned to obtain loans more quickly and on better terms.

Consumer protection

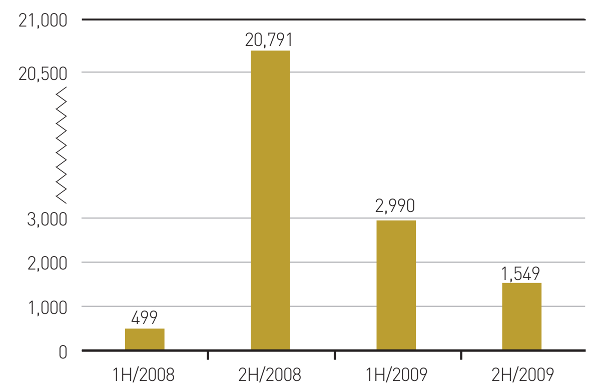
Code of Banking Practice

The industry's overall state of compliance with the Code of Banking Practice remained satisfactory. In the industry's self-assessment covering the period from June 2006 to May 2008, approximately 98% of AIs reported full compliance, or almost full compliance[3], with the Code.

Customer complaints

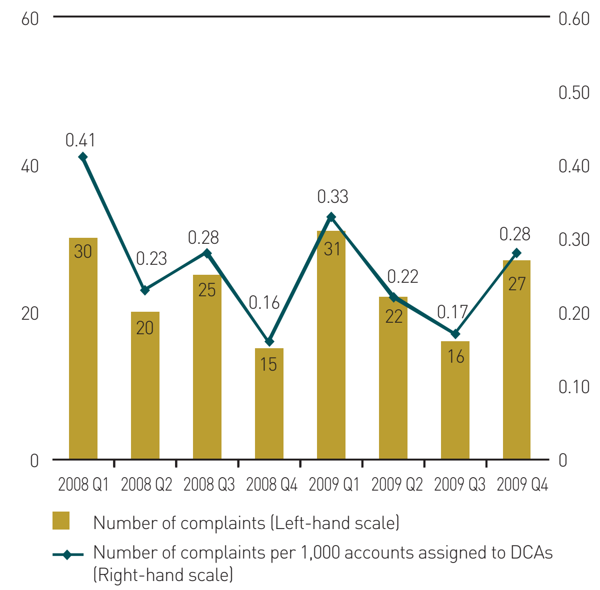
The HKMA received 4,539 complaints about services provided, or products sold, by AIs in 2009, compared with 21,290 the previous year (Chart 1). The significant difference was due to the large number of Lehman-related complaints received in 2008.

Chart 1 Complaints about services or products of AIs received by the HKMA



The number of complaints received by AIs relating to their debt collection agents (DCAs) was 96 in 2009, compared with 90 in 2008 (Chart 2). The HKMA will continue to monitor the situation to ensure that AIs remain vigilant in overseeing the activities of their DCAs.

Chart 2 DCA complaints received by AIs



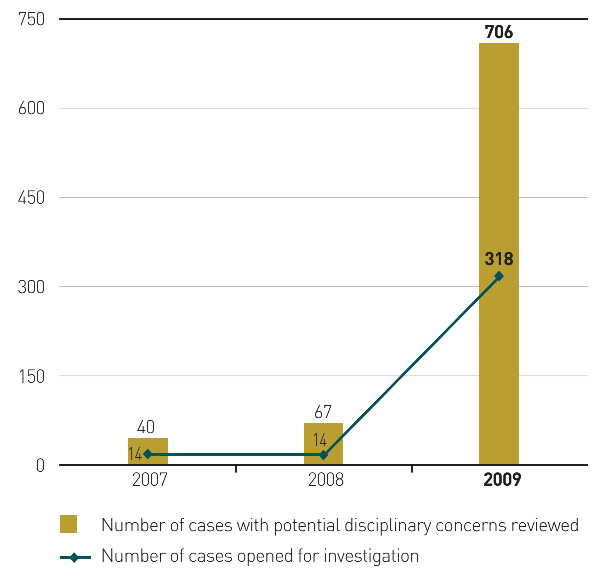
Securities enforcement

The HKMA has a shared responsibility with the SFC for enforcing the rules and regulations on RIs and the executive officers and relevant individuals in the conduct of regulated activities.

[3] With five or fewer instances of non-compliance.

During the year the HKMA reviewed 706 cases (other than those related to Lehman-related investment products) with potential disciplinary concerns and opened investigations into 318 of them (Chart 3). Investigations of seven cases were completed. Five of them were related to unregistered dealings, unauthorised transactions and other misconduct, which the HKMA has either commenced disciplinary proceedings or recommended to the SFC to commence disciplinary proceedings.

Chart 3 Cases with potential disciplinary concerns reviewed by the HKMA



As a result of recommendations made by the HKMA, the SFC banned two former relevant individuals from re-entering the industry for a specified period by exercising its sanctioning power under the Securities and Futures Ordinance.

Deposit Protection Scheme (DPS)

On 14 October 2008 the Financial Secretary announced the use of the Exchange Fund to guarantee the repayment of all customer deposits held in Hong Kong with all AIs with immediate effect until the end of 2010 following the principles of the DPS. To ensure all AIs (including restricted licence banks and deposit-taking companies that are not DPS members) are making appropriate representation in respect of the deposits protected by the deposit guarantee, the HKMA has stepped up monitoring AIs' compliance with the relevant representation requirements. By the end of December 2009, 19 compliance examinations had been conducted, and 19 more will be completed in the first half of 2010. The results of the examinations completed so far showed that AIs had generally established proper policies and procedures to comply with the relevant representation requirements.

With the assistance of the HKMA, the Hong Kong Deposit Protection Board completed the two-phase review of the DPS that began in late 2008 and the public consultation on the recommendations arising from the review. The recommendations, including improvements to protection under the DPS and measures to improve payout efficiency and transparency of its coverage, received broad support. The Board also started drafting legislative amendments to effect the recommendations and aims to implement them immediately after the full deposit guarantee offered by the Exchange Fund expires at the end of 2010.

Apart from reforming the DPS, the Board continued to maintain and enhance the effectiveness and efficiency of its operation under the existing framework. The Board monitored Scheme members' compliance with DPS rules and guidelines through a number of mechanisms, including self-assessments for DPS representation requirements, compliance reviews for standards on Scheme members' information systems and records, and auditor's reports for accuracy of Scheme members' returns for contribution assessment. Simulations and a rehearsal were conducted to promote the readiness of the DPS to pay out. Information systems and procedures for payouts were upgraded and tested. The Board also arranged extensive publicity to raise public awareness and understanding of the deposit protection arrangements in Hong Kong.

The HKMA formed a tripartite working group with Bank Negara Malaysia and the Monetary Authority of Singapore to map out a co-ordinated strategy for the three jurisdictions to exit from their respective full deposit guarantees by the end of 2010 as scheduled.

Licensing

At the end of 2009, Hong Kong had 145 licensed banks, 26 restricted licence banks, 28 deposit-taking companies and 16 approved money brokers. During the year the HKMA granted banking licences to five foreign banks and one deposit-taking company licence to a subsidiary of a foreign bank. The HKMA also granted a certificate of approval to one money broker. Five licensed banks, one restricted licence bank, one deposit-taking company and one money broker revoked their authorization or approval during the year.

PLANS FOR 2010 AND BEYOND

Supervisory focus

Credit risk, capital and liquidity management

The outlook for the global economy remains uncertain. The HKMA will continue to closely monitor the asset quality of individual AIs and assess the adequacy of their systems of internal controls for managing credit risk. AIs must continue to observe prudent lending practices including in property-related lending amid the low interest rate environment and rising asset prices. In the first half of 2010, the HKMA will conduct thematic examinations to ensure AIs' compliance with the reduced maximum loan-to-value ratio for luxurious properties and the best practices on property valuation and assessment of borrowers' repayment ability specified in the relevant HKMA circulars.

AIs must remain vigilant against the risk of significant adjustments in the flow of funds and asset prices, particularly if there is a change in the low interest rates environment or market expectations. The HKMA will ensure that AIs have effective capital and liquidity management processes that are capable of withstanding severe market volatility.

Mainland-related business

The HKMA's supervisory policies and practices will be upgraded as appropriate to ensure new risks arising from AIs' growing business integration with the Mainland are well managed. Because of the growing importance of Mainland operations to local banks in Hong Kong, the HKMA will work with the China Banking Regulatory Commission and conduct on-site examinations of local banks' Mainland subsidiaries to ensure they manage their businesses prudently.

Cross-border supervisory co-operation

The global financial crisis underscored the importance of effective cross-border co-operation among regulators, especially in crisis management. The HKMA will seek to strengthen communication and co-operation with the relevant overseas regulatory authorities. In particular, efforts will be made to improve supervisory contacts for discussion of bank-specific matters and other issues of mutual interest, such as the latest trends of market links between Hong Kong and other major international financial centres, relevant financial market developments and international supervisory policy discussions.

Supervision of technology and operational risks

Internet banking, technology risk management and business continuity management

In 2010 the HKMA plans to conduct thematic examinations to cover controls put in place by AIs over customer data protection to prevent data leakage incidents from happening. Separately, with the growing trend in developing standalone personal computer-based systems and utilising end-users' computer workstations to process sensitive information, examinations are planned to cover AIs' controls over the development and use of critical business systems running on these end-user computer workstations.

In addition, detailed on-site examinations will be conducted on AIs' critical systems supporting the Basel II project. Continuous monitoring of AIs' implementation of Phase II of the SWIFTNet migration project will also be performed through an off-site surveillance programme.

Operational Risk

The operational risk management specialist team will identify and address emerging operational risks of AIs through specialist on-site examinations and off-site reviews. The existing self-assessment on operational risk management is planned to be extended in 2010 to cover certain non-locally incorporated AIs with significant involvement in private banking business in Hong Kong.

Supervision of securities and insurance business

The HKMA will step up its supervisory efforts in both off-site surveillance and on-site examinations of AIs' securities and insurance activities. With this in mind, the HKMA has centralised the supervisory resources into a division focusing on regulating the securities and insurance businesses of AIs with additional manpower being deployed. The HKMA will require major AIs active in this area to complete a regular survey on the sale of investment products to further strengthen the HKMA's off-site surveillance work and risk-based supervision. More risk-based and thematic on-site examinations will be conducted to ensure AIs' compliance with the latest regulatory measures.

The HKMA and the SFC will jointly launch a mystery shopping programme in 2010, following receipt of a consultant's study report in late 2009. An external service provider will be engaged to conduct the exercise with the programme focusing on the sale of unlisted securities and futures products by intermediaries.

The HKMA will also work closely with the SFC and the industry to implement new regulatory measures and streamline the selling process for relatively simple investment products. Co-operation with the Government on the review of the present regulatory framework over securities activities in Hong Kong will also continue.

Supervision of treasury activities

In addition to conducting comprehensive and thematic examinations of AIs' treasury and derivative activities, the specialised division will devote more resources to establishing market contacts to improve the monitoring of emerging market trends and early identification of market risk issues with systemic implications. While the general framework for effective macro-prudential surveillance is still being devised by international regulatory bodies, the specialised division plans to upgrade the HKMA's surveillance in 2010 through various initiatives including:

- a comprehensive review of the existing returns and surveys to identify and rectify information gaps
- refining the scope and coverage of stress-testing of local retail banks
- developing experimental forward-looking indicators for detecting systemic risk, taking into account both experience from the private sector and ongoing developments internationally
- implementing recommendations from the newly created cross-department working group on macro prudential surveillance.

Comprehensive quantitative impact studies

In 2010 the Basel Committee will conduct a comprehensive quantitative impact assessment of the proposed new capital and liquidity standards it issued for consultation in December 2009, to permit calibration of an appropriate total level and quality of capital and appropriate minimum liquidity requirements. The calibrated standards will be phased in as financial conditions improve and the economic recovery is assured, with the aim of implementation by the end of 2012. The Committee will also consider suitable grandfathering arrangements to ensure a smooth transition to the new standards.

The impact assessment will be conducted on banks through banking supervisors in different jurisdictions. The HKMA will participate in this exercise and will also conduct its own impact study on a broader selection of AIs to better understand the likely impact of the new standards and provide a basis for the development of its implementation strategy for the standards in Hong Kong.

Basel II

Amendments to Banking (Capital) Rules & Banking (Disclosure) Rules

The HKMA intends to complete the legislative process to amend the Banking (Capital) Rules and the Banking (Disclosure) Rules within 2010 in respect of the proposals issued for industry consultation in September 2009. The HKMA will also introduce, after appropriate consultation, corresponding changes to the reporting framework to reflect the amendments to the Rules.

Implementation of advanced approaches

The HKMA will continue with the recognition process for AIs applying to adopt the IRB approach and conduct follow-up reviews of selected AIs previously approved to adopt modelling approaches within the Basel II framework, to ensure their satisfactory compliance with the supervisory criteria for using these approaches.

The HKMA will complete its benchmarking of the risk estimates generated for the calculation of credit risk under the IRB approach and discuss the results with individual outlier AIs and recommend adjustment of their risk-component estimates to appropriate levels, if considered necessary.

Capital Adequacy Assessment Process (CAAP)

The HKMA will continue to monitor AIs' progress in developing their internal CAAPs. In addition to reviewing AIs' policies and methodologies, the HKMA will evaluate the effectiveness of their CAAPs, and how they are integrated into AIs' daily risk management processes. Where necessary, more guidance will be provided to assist individual AIs in enhancing their existing systems to implement the CAAP standards.

Revision of liquidity supervisory framework

The HKMA intends to release its enhanced supervisory guidance on systems, controls and disclosure for liquidity risk management, designed to align with the Basel Committee's revised liquidity guidance, within the first half of 2010, after industry consultation. Proposals for other revisions to the existing liquidity regime will continue to be developed and released for consultation. These will include new quantitative liquidity requirements, taking into account the Basel Committee's proposed new global liquidity standard, and a correspondingly revised reporting framework.

Development of supervisory policies

Credit risk transfer

The HKMA will develop a supervisory guideline on "Credit Risk Transfer" to provide more comprehensive guidance on the risk management of credit derivatives and securitisation business, incorporating relevant guidance issued by the Basel Committee as well as the latest international supervisory practices.

Supervisory review process

The HKMA will formally issue a revised guideline on the "Supervisory Review Process" in the first half of 2010 after addressing comments received during the industry consultation conducted towards the end of 2009. In addition, the stress-testing methodologies currently used under the SRP framework will be improved by taking into account new Basel Committee guidance and lessons learned from the financial crisis. The HKMA will also continue to identify areas where the SRP framework can be further improved to ensure it remains current and robust.

Stress testing

The HKMA intends to revise its existing supervisory guideline on "Stress-testing" to incorporate experiences drawn from the financial crisis, and to align the guidance with the recommendations and principles issued by international organisations and supervisory groups, notably the *Principles for Sound Stress Testing Practices and Supervision* issued by the Basel Committee in May 2009.

Other risk management guidance

In addition to a new guideline on market risk management, the HKMA proposes to issue for industry consultation revised guidelines on "General Risk Management Controls", "Reputation Risk Management" and "Strategic Risk Management" to reflect relevant international standards and observed best practices.

Prevention of money laundering and terrorist financing

The HKMA will be closely involved in the legislative process for the proposed new legislation on customer due diligence and record-keeping requirements, and in the drafting of new industry guidance to support the legislation. Efforts will be made to engage the industry at various stages in the process. At the same time, the HKMA will continue to conduct institution-specific and thematic examinations to ensure AIs remain vigilant in the fight against money laundering and terrorist financing.

Accounting and disclosure

Accounting standards

In view of the substantial changes to be made to accounting standards as a result of the IASB's recent initiatives, the HKMA will work with the banking industry to monitor these developments and assess the implications for its supervisory policy framework.

Provisioning

The HKMA is a firm supporter of forward-looking provisioning practices resulting in earlier and more stable provisioning levels. It currently requires Hong Kong-incorporated AIs to maintain non-distributable regulatory reserves in excess of individual and collective impairment allowances to cater for expected future losses. In the light of the release by the IASB of its final standard on impairment of financial instruments and the issue of further guidance on prudent provisioning by the Basel Committee, the HKMA will consider whether (and if so what) changes may be needed to its supervisory regime in meeting the objective of promoting forward-looking provisioning.

Disclosure

In addition to implementing the disclosure requirements contained in the Basel Committee's enhancements to the Basel II framework, issued in July 2009, the HKMA will continue to ensure the disclosure regime for AIs in Hong Kong is in line with the improved disclosure standards published by the HKICPA and observed best practices.

Credit data sharing

Further development of the existing credit data sharing arrangements will be pursued by the HKMA where it considers this will be conducive to the stability of the banking system. One example is the proposed introduction of positive mortgage data sharing. The HKMA will work with the industry to promote credit data sharing, thereby supporting and enhancing the credit risk management capacity of AIs.

Consumer protection

The HKMA will continue to promote improvements in banking practices through its participation in the Code of Banking Practice Committee. It will also monitor AIs' compliance with the Code through periodic self-assessments and the handling of complaints about services and products provided by AIs. The HKMA will keep these arrangements under review and introduce new measures for improved monitoring as appropriate.

Securities enforcement

The HKMA aims to substantially complete investigations of all outstanding Lehman-related cases by the end of March 2010 and then deploy resources to accelerate investigations into the outstanding non-Lehman-related cases. The HKMA will also continue to assist the Government in reviewing the present regulatory framework governing the sale of investment products to retail investors.

Deposit protection

The HKMA will assist the Hong Kong Deposit Protection Board in operating and improving the DPS. Priority will be given to implementing the recommendations from the review in 2009 so they are ready to take effect, on schedule, at the beginning of 2011 to coincide with the expiry of the Exchange Fund's full deposit guarantee. The Board will provide early guidance to banks on the changes to be made to the various operational aspects of the DPS to enable them to make corresponding adjustments to their systems and processes. It will also launch a comprehensive publicity campaign to draw public attention to the impending changes, including the expiry of the full deposit guarantee.

Financial Infrastructure

To reinforce Hong Kong's position as an international financial centre and a regional payment and settlement hub, the RTGS systems have migrated to the global SWIFTNet open platform; the CMU Fund Order Routing and Settlement Service has been introduced; the foreign-currency RTGS systems and the CMU have extended their operations to include all Hong Kong general holidays, except 1 January; and economic and financial ties between the Mainland and Hong Kong have been strengthened with the establishment of multi-currency cross-border payment arrangements.

OBJECTIVES

An important policy objective of the HKMA is to promote the development of a safe and efficient financial market infrastructure to help maintain financial and monetary stability and Hong Kong's status as an international financial centre. Particular attention is paid to the clearing and settlement systems for the safe and efficient transfer of funds and securities within Hong Kong and between Hong Kong and other Asian cities, including those on the Mainland.

REVIEW OF 2009

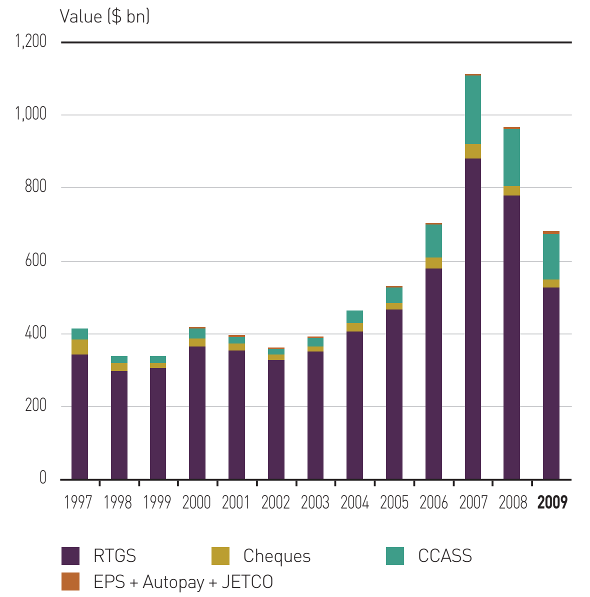
Hong Kong dollar interbank payment system

The Hong Kong dollar Clearing House Automated Transfer System (CHATS), which operates on a Real Time Gross Settlement (RTGS) basis, is responsible for clearing all Hong Kong dollar interbank payments. It has a direct link with the Central Moneymarkets Unit (CMU), which is the debt securities clearing and settlement system operated by the HKMA, to provide both real-time and end-of-day delivery-versus-payment (DvP) settlement services. Hong Kong Interbank Clearing Limited (HKICL), the system operator of CHATS, was established in 1995 and is owned equally by the HKMA and the Hong Kong Association of Banks. In 2009 HKICL processed a daily average of $526 billion in CHATS transactions (20,717 items).

In addition to settling large-value payments, CHATS also handles daily bulk clearings of stock market transactions, credit card transactions, cheques, low-value bulk electronic payment items (EPS, auto-credit and auto-debit transactions), and low-value ATM transfers (Chart 1).

Banks can use their Exchange Fund Bills and Notes (EFBN) to obtain interest-free intraday liquidity through intraday repurchase agreements with the HKMA to settle their interbank payments. On average in 2009, intraday repurchase transactions amounting to $26 billion were carried out each day, representing 5% of the $485 billion in Exchange Fund paper held by banks in December.

Chart 1 Hong Kong dollar payment system daily average turnover



US dollar RTGS system

The US dollar RTGS system has been operating efficiently since its launch in 2000. The Hongkong and Shanghai Banking Corporation is the settlement institution with HKICL as system operator. At the end of 2009, the system had 80 direct and 149 indirect participants, including 105 indirect participants from outside Hong Kong. On average, it handled more than 10,400 transactions amounting to US$8.5 billion a day in 2009 (Chart 2). The system also processed a daily average of 7,377 US dollar cheques with a value of US$214 million.

Euro RTGS system

The euro RTGS system was launched in 2003. The settlement institution is the Standard Chartered Bank (Hong Kong) Limited with HKICL as system operator. At the end of 2009, there were 30 direct and 20 indirect participants, including 11 indirect participants from outside Hong Kong. In 2009 the system handled on average 251 transactions with a total value of €616 million a day (Chart 3).

Chart 2 US dollar clearing system daily average turnover

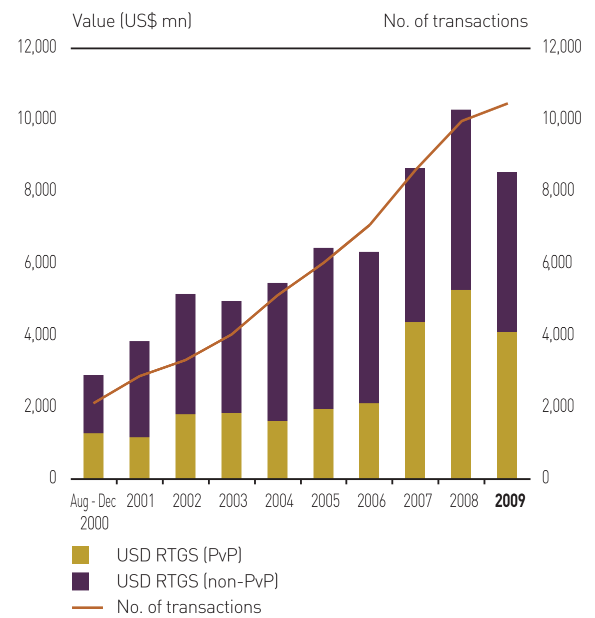
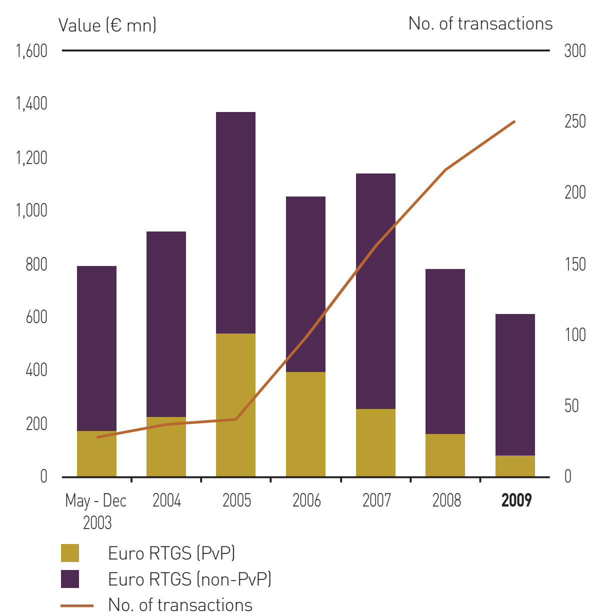


Chart 3 Euro clearing system daily average turnover



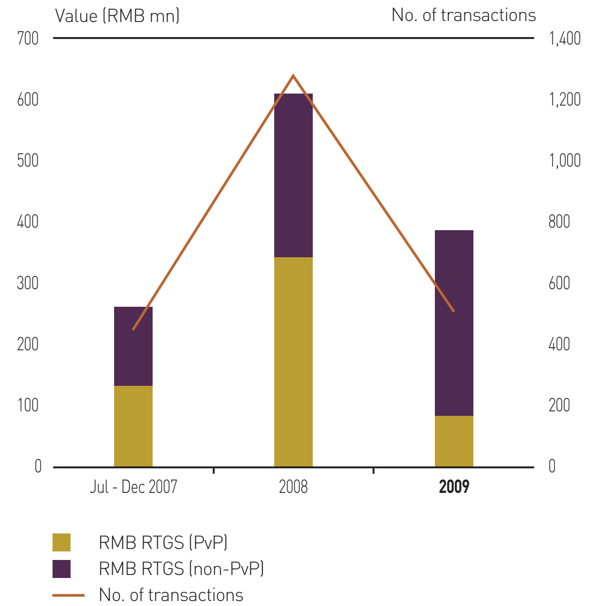
Renminbi RTGS system

The renminbi RTGS system was launched in 2007. The clearing bank is Bank of China (Hong Kong) Limited with HKICL as system operator. At the end of 2009, there were 46 direct participants. On average, it handled 509 transactions with a total value of RMB388 million a day in 2009 (Chart 4).

Payment-versus-payment (PvP)

PvP is a mechanism for settling a foreign-exchange transaction to ensure that payments in the two currencies involved are settled simultaneously. Within Hong Kong, six cross-currency PvP links have been established among the Hong Kong dollar, US dollar, euro and renminbi RTGS systems. A PvP link between Hong Kong's US dollar RTGS and Malaysia's ringgit RTGS systems was established in November 2006. PvP greatly improves settlement efficiency and eliminates settlement risk arising from time lags in settlements and from time-zone differences (known as Herstatt risk). In 2009 the transaction volume of Hong Kong dollar, US dollar, euro and renminbi-related PvP amounted to about $5,142 billion, US$1,026 billion, €20 billion and RMB21 billion respectively.

Chart 4 **RMB clearing system daily average turnover**



Financial Infrastructure

Payment links with the Mainland

The HKMA continues to work closely with Mainland authorities in providing efficient cross-border payment links to meet the growing demand. The use of these services has risen gradually over the years, and in 2009 the daily average turnover handled by the various system links was equivalent to over $1.6 billion, including the RTGS cross-border links with the Mainland's Domestic Foreign Currency Payment Systems launched in March 2009 (Chart 5).

The RTGS system links with Shenzhen and Guangdong handled more than 21,000 transactions during the year, with a total value equivalent to $337 billion. The system allows cross-border payments in Hong Kong dollars and US dollars between banks in Hong Kong and their counterparts in Shenzhen and Guangdong to be settled efficiently and safely.

The two-way joint cheque-clearing facilities processed about 398,000 Hong Kong dollar and US dollar cheques, with a value equivalent to $36 billion, in 2009. The facilities shortened the clearing time for cheques drawn on banks in Hong Kong and presented in Shenzhen and Guangdong, and for cheques drawn on banks in Shenzhen and Guangdong and presented in Hong Kong. Since March 2006, the joint cheque-clearing facilities have been expanded to cover renminbi cheques drawn on banks in Hong Kong, and presented in Shenzhen and Guangdong for consumer spending. In 2009 renminbi cheques with a total value equivalent to $30 million were cleared.

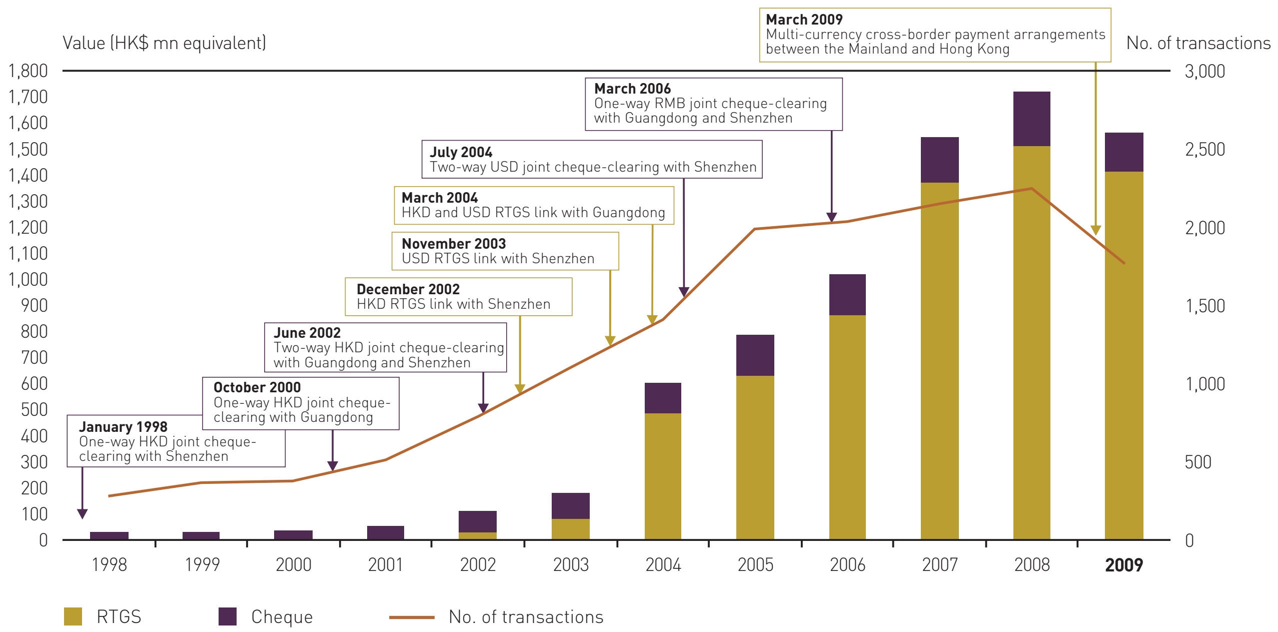
Payment links with Macau

The one-way joint clearing facility for Hong Kong dollar cheques between Hong Kong and Macau was launched in August 2007 and a similar facility for US dollar cheques was launched in June 2008 to meet growing demands. The facilities have reduced the time required for clearing Hong Kong dollar and US dollar cheques issued by banks in Hong Kong and presented in Macau from four or five days to two. In 2009 Hong Kong dollar cheques with a total value of over $9 billion and US dollar cheques with a total value of over US$10 million were cleared.

Debt settlement systems

The CMU provides an efficient, one-stop clearing, settlement and depository service for Hong Kong dollar and foreign-currency denominated debt securities issued in Hong Kong. Since its establishment in 1990, the CMU has developed links with many regional and international central securities depositories. Overseas investors can hold and settle securities lodged with the CMU. It also

Chart 5 Daily average turnover in cross-border links with the Mainland



helps Hong Kong investors to hold and settle foreign securities held with regional and international central securities depositories.

In 2009 the CMU processed a daily average value of $172 billion (242 transactions) in secondary market transactions (Chart 6). Among the debt securities lodged with the CMU at the end of the year, the outstanding amount of EFBN was $534 billion and the total amount of other securities was equivalent to $226 billion.

Development initiatives in 2009

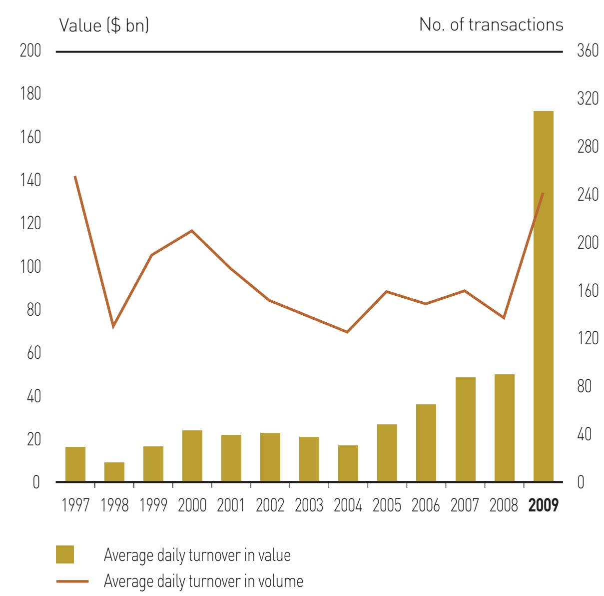
The HKMA completed several development projects and captured new business opportunities during the year to promote the safety and efficiency of the financial infrastructure and develop Hong Kong into a regional payment and settlement hub.

System development

To strengthen co-operation in cross-border financial infrastructure, the People's Bank of China (PBoC) and the HKMA established multi-currency cross-border payment arrangements in March 2009 to settle Hong Kong dollar, US dollar, euro and British pound payments between the Mainland's Domestic Foreign Currency Payment Systems and the Hong Kong dollar, US dollar and euro RTGS systems in Hong Kong. Settlements for transactions denominated in the British pound are through a correspondent bank in Hong Kong. These arrangements enable Mainland and Hong Kong participating banks to manage their liquidity more efficiently and become more competitive in providing cross-border payment services in the Asian time zone, thus reducing settlement risk. While the operating mechanism is similar to that of the Hong Kong dollar and US dollar RTGS links with Shenzhen and Guangdong, the geographical coverage has been expanded considerably to benefit more Mainland cities. From its inception in March 2009 to the end of the year, 809 transactions with a value equivalent to $602 million were handled through these arrangements.

The SWIFTNet migration project, which replaces the proprietary platform of Hong Kong's RTGS systems and the CMU with an open platform, is being implemented in two phases. Phase I, allowing banks to use SWIFT messages for payment instructions on the SWIFTNet platform, was launched on schedule in May 2009. The banking industry has welcomed the migration as it enhances the interoperability between Hong Kong's domestic RTGS systems and the global platform, thus increasing the efficiency of the participating banks. It also helps attract overseas financial institutions to use Hong Kong's RTGS systems with its more open and convenient access. Phase II of the project, covering the migration of the interactive user interfaces for account enquiry and reporting functions to the SWIFTNet platform, is progressing well and is scheduled for completion in July 2010.

Chart 6 CMU secondary market turnover



Financial Infrastructure

A new bulk settlement run was introduced in Hong Kong's US dollar RTGS system in June 2009 for US dollar debit and credit card transactions. The arrangement allows US dollar debit and credit card-related payments between card-issuing banks and merchant-acquiring banks in the Asian region to be settled in the same time zone to improve settlement efficiency and mitigate settlement risks among the banks. Mainland China's biggest card company, China UnionPay, has joined the new service, which facilitates payment in US dollars to its merchant-acquiring banks in Asia for transactions involving its debit and credit cards.

System enhancements were implemented in July 2009 for the launch of the pilot scheme between the Mainland and Hong Kong for cross-border renminbi trade settlements. The enhancements included the establishment of PvP links between Hong Kong's renminbi and US dollar RTGS systems, and between the renminbi and euro RTGS systems to increase competitiveness, safety and efficiency of the renminbi RTGS system.

Investment funds have become an increasingly important international financial intermediation channel. Until recently, however, there was no standardised settlement platform for investment funds in Hong Kong. The non-standardised system previously in use led to high operational risks and back office costs, and could come under pressure particularly at times of heavy IPO activities and financial turmoil. The HKMA therefore launched the CMU Fund Order Routing and Settlement Service in August 2009. The new service provides a standardised platform to streamline and automate investment fund transactions to reduce operational risks. It will further enlarge the coverage and improve the safety and efficiency of Hong Kong's multi-dimensional financial infrastructure.

In late November 2009 Hong Kong's US dollar, euro and renminbi RTGS systems and the CMU began operating on all Hong Kong general holidays, with the exception of 1 January, which is a worldwide holiday. This initiative facilitates local and overseas institutions' use of the RTGS systems in Hong Kong to process their regional payments.

To shorten the settlement cycle for interbank credit transfer items, an additional bulk settlement run in the Hong Kong dollar RTGS system was established in November 2009 to provide same-day settlement services. Facilitating a speedier turnaround of funding availability at interbank level, the arrangement allows bank customers to enjoy same-day interbank money transfers, including payment of wages and salaries, if banks are able to credit the money received from this bulk settlement run to the recipient's account on the same day.

In 2009 the HKMA and Bank Indonesia completed the development of the PvP link between Hong Kong's US dollar RTGS and Indonesia's rupiah RTGS systems. The link was launched in January 2010 and will help improve the settlement efficiency of the US dollar and Indonesian rupiah in the region and reduce Herstatt risk.

Business development

Expanding international links with Hong Kong's RTGS systems and promoting Hong Kong's payment services and financial infrastructure were priority business development areas pursued during the year.

Expanding system links

In 2009 the HKMA participated in a regional task force on Common Platform Model for Asia to improve the debt securities post-trade processing infrastructure through a set of harmonised procedures and shared technology among Asian central securities depositories. The initiative is designed to assist in developing the Asian bond market, making it more attractive to foreign investors.

Promoting the use of Hong Kong's payment platform

Intense promotion of Hong Kong's financial infrastructure continued throughout the year, with the HKMA holding or attending 42 seminars and arranging over 270 marketing calls in various cities in Mainland China, South East Asia, the Indian Sub-continent, the Middle East and Europe.

SIBOS 2009, a renowned exhibition for the payment industry, was held in Hong Kong. Senior officials of the HKMA delivered four speeches and presentations, including the keynote opening address, to promote Hong Kong's financial infrastructure to over 5,800 senior executives from more than 100 countries.

The HKMA built on its partnership with large regional banks to boost the scale and effectiveness of its marketing efforts. For example, with the Bank of China (Hong Kong) Limited, it launched a number of marketing campaigns in Hong Kong, Macau and a number of ASEAN countries to promote Hong Kong's cross-border renminbi trade settlement infrastructure. As a result, 27 overseas banks have indicated an interest to join the renminbi RTGS system. In addition, speeches were delivered at various regional conferences, including the World SME Expo, Asia Risk Congress and SIBOS 2009, to raise awareness among trade enterprises to use the renminbi as a trade-settlement currency. Locally, the HKMA worked closely with major retail banks to promote same-day settlement of electronic funds transfer to the general public.

Oversight of clearing and settlement systems

Oversight of designated systems

The Clearing and Settlement Systems Ordinance (CSSO), which came into force in November 2004, empowers 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. The purpose of the CSSO is to promote the general safety and efficiency of the designated systems: the CMU, Hong Kong dollar CHATS, US dollar CHATS, euro CHATS, renminbi CHATS, and the Continuous Linked Settlement (CLS) System. Except for the CLS System, the HKMA oversees the designated systems through off-site reviews, continuous monitoring, on-site examinations and meetings with management.

All designated systems continued to comply with the safety and efficiency requirements under the CSSO in 2009. In May all local designated systems migrated from the proprietary operating platform to the SWIFTNet infrastructure. The second phase of the migration is scheduled for July 2010. Apart from complying with the requirements under the CSSO, the designated systems are encouraged to comply with internationally recognised standards for payment and settlement. The HKMA assessed the euro CHATS and US dollar CHATS in 2009 against the Core Principles for Systemically Important Payment Systems issued by the Bank for International Settlements. The assessment took into account the existing policies regarding payment and settlement systems of the European Central Bank and the US Federal Reserve under the principles for international co-operative oversight. Assessment of other designated systems against the Core Principles will be conducted and the results published when they are available.

Co-operative oversight arrangements

The CLS System, a designated system in Hong Kong, is operated by CLS Bank, which is primarily regulated by its home supervisor, the US Federal Reserve. The HKMA participates in the international co-operative oversight of the CLS System with the US Federal Reserve and other central banks through the CLS Oversight Committee.

SWIFT, a major global message carrier for payment systems, is subject to co-operative oversight by central banks, with the National Bank of Belgium being the lead overseer since the carrier is incorporated in Belgium. Because the CMU accepts SWIFT messages and all the local designated systems have migrated to the SWIFTNet platform since May 2009, the HKMA has an interest in the oversight of SWIFT and has participated in discussions with the National Bank of Belgium and other central banks on oversight matters.

The HKMA co-operates with other central banks in the oversight of PvP links between payment and settlement systems in Hong Kong and those in other jurisdictions. For example, the HKMA worked with Bank Indonesia in preparing for the oversight of the US dollar/Indonesian Rupiah PvP link launched in January 2010.

Independent tribunal and committee

An independent Clearing and Settlement Systems Appeals Tribunal established under the CSSO hears appeals by any party aggrieved by a decision of the Monetary Authority on designation and related matters. There has been no appeal since the establishment of the Tribunal.

An independent Process Review Committee reviews processes and procedures adopted by the HKMA in applying standards set under the CSSO to systems in which the HKMA has a legal or beneficial interest. The Committee follows the procedures in the Internal Operating Manual in evaluating the designated systems' compliance with the oversight standards and in assessing whether the HKMA has applied the same set of procedures to all designated systems. Regular reports with accompanying management reports summarising the HKMA's oversight activities were submitted to the Committee.

The Committee held two meetings in 2009. It reviewed four regular reports and 23 accompanying oversight activities management reports of the designated systems. The Committee concluded that it was not aware of any case where the HKMA had not duly followed the internal operational procedures, or where the HKMA had not been procedurally fair in carrying out its oversight activities. Under its terms of reference, the Committee submitted its annual report, which is published on the HKMA website, to the Financial Secretary.

Informal oversight of retail payment systems

Compared with large-value interbank payment systems, the retail payment systems generally carry few, if any, systemic risks and, at this stage, the HKMA considers that they are not systemically significant enough to be designated under the CSSO. However, the HKMA encourages the retail payment industry to adopt a self-regulatory approach by issuing codes of practice to promote safety and efficiency.

The HKMA is responsible for monitoring the compliance of Octopus Cards Limited (OCL) with the Code of Practice for Multi-purpose Stored Value Card Operation issued by OCL and endorsed by the HKMA in 2005. In 2009 OCL completed its fourth annual self-assessment against the Code and reported its full compliance. The HKMA will continue to encourage the industry to introduce competition in the market.

The Code of Practice for Payment Card Scheme Operators issued by eight credit and debit card scheme operators with the support of the HKMA in 2006 sets out the principles covering operational reliability, data and network security, and the efficiency and transparency of payment card operations in Hong Kong. The HKMA monitors the payment card scheme operators' compliance with the Code and all operators are required to perform an annual self-assessment and report to the HKMA any incident which may have material and adverse impact on cardholders in Hong Kong. In 2009 the HKMA received the second annual self-assessment for 2008 with the eight card scheme operators reporting full compliance with the Code.

International participation

The HKMA hosted the 21st EMEAP Working Group meeting on Payment and Settlement Systems in Hong Kong on 10 - 11 September 2009. Delegates from the 11 EMEAP member economies discussed a range of issues relating to payment systems. Representatives from the National Bank of Belgium, SWIFT and VISA also participated in different sessions to share views on specific topics. The HKMA participates regularly in meetings of the committees and working groups under the Bank for International Settlements and EMEAP.

Exchange Fund Bills and Notes programme

Persistent capital inflows into Hong Kong during 2009 led to repeated triggering of the strong-side Convertibility Undertaking and a substantial expansion in the Aggregate Balance. With ample liquidity in the interbank market, banks' demand for short-dated Exchange Fund papers for liquidity management increased substantially, as reflected by their very low yields. To address such strong demand, an additional $374.4 billion worth of Exchange Fund Bills were issued during the year (Table 1). The additional issuances covered the three benchmark tenors of 91, 182 and 364 days. The HKMA also continued to fine-tune the maturity mix of the Exchange Fund Bills and Notes with increased issuance of 5-, 10- and 15-year Exchange Fund Notes.

An electronic trading platform was launched in December 2007 to increase the price transparency and streamline the trading process of the Bills and Notes. The daily turnover involving the use of the platform increased steadily to a monthly average of 57% of the total market turnover in December 2009.

Table 1 Outstanding issues of Exchange Fund Bills and Notes

	2009	2008
	(in millions of dollars)	
Exchange Fund Bills (by original maturity)		
91 days	**299,162**	56,953
182 days	**123,000**	16,900
364 days	**42,200**	16,900
Sub-total	**464,362**	90,753
Exchange Fund Notes (by remaining tenor)		
1 year or below	**16,200**	13,600
Over 1 year and up to 3 years	**29,200**	28,400
Over 3 years and up to 5 years	**13,600**	14,800
Over 5 years and up to 10 years	**7,700**	8,300
Over 10 years	**3,000**	1,800
Sub-total	**69,700**	66,900
Total	**534,062**	157,653

Debt-market development

The HKMA continued to implement the recommendations arising from the second phase of its review on debt-market development. The recommendations aim to attract more issuers and broaden the investor base by looking at the issues relating to the regulatory process, investment benchmarks and guidelines, and the tax treatment of debt. In particular, the HKMA conducted a study of the Qualifying Debt Instruments Programme in Hong Kong and put forward recommendations to improve the offering of tax concessions for qualifying debt securities to make Hong Kong's bond market more competitive. These proposals were submitted to the Government in June 2009 and the HKMA will provide further input to assist in policy deliberations.

Government Bond Programme

In his 2009-10 Budget Speech, the Financial Secretary announced the Government's intention to implement a Government Bond Programme to issue government bonds systematically. The Programme is designed to promote further and sustainable development of the local bond market, making it an effective channel for financial intermediation, complementing the equity market and banking sector.

The necessary resolutions to implement the Programme were passed by the Legislative Council on 8 July 2009. The Government was authorised to issue bonds with aggregate outstanding principal up to an amount equivalent to $100 billion, and to set up a fund to manage the money raised. The Financial Secretary has directed the HKMA, as representative of the Government, to assist in the implementation of the Programme and to co-ordinate the offering of government bonds.

The Government Bond Programme consists of institutional bond issuance and retail bond issuance programmes. For the institutional programme, the HKMA appointed 12 Primary Dealers and more than 100 Recognized Dealers to take part in the programme. Two issues of government bonds were tendered under the programme in 2009, attracting a diverse group of institutional investors. The HKMA will maintain close contact with market players and consider further measures to expand and improve the programme. On the retail front, co-arranger banks will help arrange and manage offerings of retail government bonds. The HKMA will take into account the advice of the co-arranger banks and the prevailing market conditions in drawing up the timing and details of the retail issues.

Islamic finance

In collaboration with government agencies and the private sector, progress was made in 2009 in the promotion and development of Islamic finance in Hong Kong. A four-part strategy has been adopted: establishing the necessary market infrastructure; enhancing Hong Kong's international profile as an emerging Islamic finance centre; promoting market awareness and market knowledge of Islamic finance; and encouraging product development.

In February 2009 the Financial Secretary announced in his Budget Speech the Government's intention to submit to the Legislative Council a proposal to level the playing field between Islamic and conventional financial products with regard to taxation. The proposal will include changes or clarifications to the arrangements for stamp duty, profits tax and property tax. The HKMA is assisting the Government in preparing the legislative proposals and collecting market views through the Treasury Markets Association (TMA). The HKMA has also assisted the Government in preparing an information package, including a procedural flowchart and an outline of the key issues, detailing the interim arrangements for the application of a tax exemption for sukuk prior to passage of the legislative amendments. The information package was disseminated to market players in late November 2009 through various industry bodies including the TMA.

There has also been significant progress in promoting Hong Kong's international profile and building closer ties with overseas Islamic financial centres. Highlights include signing a Memorandum of Understanding with Bank Negara Malaysia to enter into a long-term strategic partnership to strengthen co-operation in Islamic finance; participating in a range of international forums, such as the Islamic Financial Services Board (IFSB) Annual Summit; and hosting several large-scale events including the inaugural Asia Sukuk Summit and the IFSB Technical Committee Meeting. The HKMA is also promoting market awareness by working with industry associations to provide training for market participants.

Financial-sector development

As one of the initiatives to further increase the international competitiveness of Hong Kong's financial markets, the HKMA provided input to the Government's study on strengthening Hong Kong's position as a major asset management centre. In conjunction with other regulatory authorities, it will assist the Government in its efforts to provide a more favourable tax and regulatory environment to attract asset management business to Hong Kong.

Treasury Markets Association

The Association's mission is to further promote the professionalism and competitiveness of Hong Kong's treasury markets. The HKMA provides strategic support to the TMA and works closely with the market to strengthen collaboration between the public and private sectors. The TMA is chaired by the HKMA's Deputy Chief Executive, Mr Eddie Yue. The Association has some 1,740 individual and 74 institutional members from banks, investment houses, insurance companies, money brokers and large corporations.

To encourage professionalism and raise professional standards, the TMA launched its Associate Member Upgrading Scheme on 1 January 2009 to help Associate Members qualify for full TMA membership. It also launched a number of professional training courses in conjunction with various universities in 2009, including the Professional Certificate in Treasury Markets (Derivatives and Structured Products) programme, the Certificate Programme in Treasury Markets (Risk Management for Financial Institutions), the Professional Course in Back Office Operations of Treasury Markets and a Private Banking Training course organised for an institutional member. A series of e-learning programmes has also been launched to promote distance learning and to upgrade the Association's educational capacity on the Mainland and in Asia. During the year more than 130 individuals took professional courses under the auspices of the TMA; and some 50 seminars, workshops and talks were organised for individual members and staff of institutional members to keep them abreast of market trends and developments.

The TMA and the HKMA jointly organised the Treasury Markets Summit in Beijing in July to provide a forum for Mainland and Hong Kong participants to understand more about the major themes driving treasury market development. The Summit was attended by 200 participants from 100 organisations including regulatory bodies, financial institutions, corporations and the media. During the year the TMA also supported a number of high-level international events, including the Asia Sukuk Summit, the third Annual Conference of the Hong Kong Investment Funds Association, and the Open Programme of the Institute of International Finance. As in previous years, representatives of the Association took part in major international forums to maintain close contact with their overseas counterparts.

PLANS FOR 2010 AND BEYOND

The scheduled delivery of Phase II of the SWIFTNet migration project and the improvement of the debt securities post-trade processing infrastructure in Asia are two key projects in 2010. The HKMA will also explore ways to further develop links with other economies and increase the settlement efficiency of Hong Kong's wholesale and retail payment systems.

The Exchange Fund Bills and Notes programme will be constantly reviewed as part of efforts to keep the programme in line with market developments.

The HKMA will support the Government's initiatives to

- further develop the debt market, Islamic financial market and asset management industry in Hong Kong
- consider and implement initiatives that will reinforce the competitiveness of Hong Kong's financial markets.

As the overseer of designated systems under the CSSO, the HKMA will be involved in promoting and ensuring the safety and efficiency of these systems; and will continue to monitor the performance of the operators of retail payment systems under their self-regulatory codes of practice.

The HKMA will monitor developments in Hong Kong's payment industry and participate in international forums to keep abreast of global trends in the oversight of payment and settlement systems, and to improve the current oversight regime where necessary.

International Financial Centre

While the world economic recovery is expected to strengthen in 2010, challenges remain in supporting strong, sustainable and balanced growth. And more actions are needed to build a sound and more resilient international financial system. The HKMA has been involved through regional surveillance and co-operation to promote financial stability; participating in international discussions on reforms to the global financial system; and strengthened research on Mainland developments. Renminbi business in Hong Kong further expanded in 2009, including renminbi trade settlement and renminbi bonds offered by a wider range of issuers. The outlook for Hong Kong's credit rating was upgraded by Moody's to "Positive" from "Stable".

OVERVIEW

The world economy and global financial markets stabilised in 2009 on strong support by individual governments and the international financial community. Regional economies, led by Mainland China, were firmly on the path to recovery in the second half of 2009, and major industrial economies showed increasing signs of improving economic prospects towards the end of the year. Financial markets were also slowly returning to normal.

Nevertheless, promoting financial stability in the region was still challenging, and the HKMA remained fully committed to the task. It hosted the 14th Executives' Meeting of East Asia-Pacific Central Banks (EMEAP)[1] Governors' Meeting from 21 to 23 July 2009, which endorsed the HKMA's continuing role in co-ordinating the macro-monitoring for the Monetary and Financial Stability Committee (MFSC). The HKMA also took part in meetings and forums of multilateral organisations, notably the Financial Stability Board (FSB)[2], which is playing an increasingly important role in the reform of the international financial system. As part of its efforts to foster financial co-operation in the region, the HKMA has been involved in the development of a regional joint-defence mechanism against financial instability, known as the "Chiang Mai Initiative Multilateralisation" (CMIM), under the aegis of ASEAN+3.[3] Hong Kong participates in this framework of mutual assistance to provide short-term US dollar support to participants facing liquidity shortages.

The HKMA's co-operation on financial initiatives with the Mainland has included implementation of the Action Agenda on "China's 11th Five-Year Plan and the Development of Hong Kong". Significant progress has also been made in other areas, such as the additional issuance of renminbi bonds in Hong Kong, especially renminbi sovereign bonds by the Ministry of Finance; further expansion of renminbi business in Hong Kong to cover settlement of trade transactions; the establishment of a swap facility between the HKMA and the People's Bank of China (PBoC) to facilitate liquidity support to banks and to promote trade settlement in the renminbi; and a new measure under the Closer Economic Partnership Arrangement (CEPA) to facilitate Hong Kong banks' expansion of branch networks in Guangdong Province (*see separate box on Financial co-operation with the Mainland for details*). Research on economic and financial developments in Mainland China has also been strengthened.

REVIEW OF 2009

Regional co-operation and participation in multilateral institutions

With increasing globalisation, and closer economic and financial integration in Asia, the HKMA organises and participates in international and regional initiatives and discussions on a wide range of issues.

The HKMA attended meetings of the Asia-Pacific Economic Co-operation (APEC) organisation, the FSB and the Bank for International Settlements. These forums provide useful

[1] EMEAP is a co-operative forum of 11 central banks and monetary authorities in the East Asia and Pacific region comprising the Reserve Bank of Australia, the People's Bank of China, the Hong Kong Monetary Authority, Bank Indonesia, the Bank of Japan, the Bank of Korea, Bank Negara Malaysia, the Reserve Bank of New Zealand, Bangko Sentral ng Pilipinas, the Monetary Authority of Singapore and the Bank of Thailand.

[2] The FSB was established in April 2009 as the successor to the Financial Stability Forum to address vulnerabilities in global financial systems, and to develop and implement strong regulatory, supervisory and other policies in the interest of financial stability. Its membership comprises senior representatives of national financial authorities (central banks, regulatory and supervisory authorities and ministries of finance), international financial institutions, standard-setting bodies, and committees of central bank experts.

[3] ASEAN+3 comprises the 10 ASEAN member countries (Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam), together with China, Japan and Korea.

channels for the exchange of views with the international community and promote a better understanding of monetary and financial issues, particularly from a policy perspective, in Asia and Hong Kong.

In 2009 much of the work of the international financial community was devoted to promoting strong, sustainable and balanced global growth, and strengthening and reforming the international financial system. The initiative, led principally by the Group of Twenty (G20), has made great achievements in areas such as providing fiscal stimuli to restore growth, increasing the resources of international financial institutions, and enhancing financial regulation.[4] Hong Kong actively participates in international forums and groups that play a central role in carrying out the G20's initiatives and recommendations. This includes the HKMA's participation as the Hong Kong representative on FSB Plenary, and Standing Committees on Assessment of Vulnerabilities and on Supervisory and Regulatory Co-operation.[5] In 2009 the HKMA became a member of the Basel Committee on Banking Supervision, an international forum for co-operation on banking supervisory matters.

In contributing to the reform of the international financial system, the HKMA is pursuing the implementation in Hong Kong of the relevant recommendations and best practices that are appropriate to local circumstances.

Promoting monetary and financial stability in Asia

The HKMA hosted the 14th EMEAP Governors' Meeting in July. The HKMA's role in co-ordinating macro surveillance for the MFSC was highly regarded, and the Governors agreed the HKMA should continue with this role, and to expand the MFSC's bi-annual Macro-Monitoring Report to cover economic trends, development and stability issues in regional economies. The HKMA has further developed its multi-region dynamic stochastic general equilibrium model to study the risks and vulnerabilities in EMEAP economies. As chair of the EMEAP Working Group on Banking Supervision, the HKMA co-ordinated the Group's efforts in monitoring implementation of the G20's recommendations that are relevant to banking supervision in the region, and assessing how the regulatory systems and standards could be further improved.

In the margins of the EMEAP Governors' Meeting, the HKMA, Bank Negara Malaysia and the Monetary Authority of Singapore established a tripartite working group to map out a co-ordinated strategy for the scheduled exit from the full deposit guarantees in their respective jurisdictions by the end of 2010.

In December 2009 the Finance Ministers and Central Bank Governors of the ASEAN+3 countries and the Monetary Authority announced the signing of the CMIM Agreement – an advanced framework for regional emergency liquidity support. Effective in March 2010 and with a total amount of US$120 billion, the CMIM will supplement existing international financial arrangements and help guard against financial contagion in the region. Hong Kong has undertaken to commit up to US$4.2 billion on a callable basis. Hong Kong's participation in this initiative is a demonstration of its autonomy in international financial affairs under the "One Country, Two Systems" principle.

Upgrading Hong Kong's sovereign credit ratings

The HKMA works closely with the Government to present a balanced assessment of Hong Kong's economic and financial developments to international credit rating agencies (CRAs). A better sovereign credit rating helps lower funding costs for Hong Kong debt issuers and increase market confidence in the Linked Exchange Rate system and financial stability in Hong Kong.

4 Hong Kong participates in the G20 as a member of the China delegation.

5 The Standing Committee on Assessment of Vulnerabilities is responsible for assessing and monitoring vulnerabilities in the financial system and proposing action plans needed to address them. The Standing Committee on Supervisory and Regulatory Co-operation is responsible for addressing co-ordination issues among supervisors and regulators. It is also involved in issues pertaining to cross-border crisis management.

In 2009 the focus of discussions with CRAs was Hong Kong's resilience during the global financial crisis. Through comparative analyses, Hong Kong was shown to possess AAA credit qualities, and outperform the AAA-median economy in key rating variables including fiscal strengths and external positions. It was also demonstrated that Hong Kong's out-performance of some AAA economies was likely to grow after it emerged well from the global financial crisis underpinned by its strong economic fundamentals, sound banking system, and the Mainland's robust growth and supportive measures to Hong Kong. Quantitative and qualitative analyses also suggest that the risks from the Mainland are unlikely to have a significantly adverse impact on Hong Kong, while the upside potential of the Mainland benefitting Hong Kong is tremendous.

These efforts contributed to Moody's decision to upgrade the outlook for Hong Kong's local and foreign currency ratings (both at Aa2) from "Stable" to "Positive". This reflected the agency's recognition of Hong Kong's credit strengths, particularly its strong external asset position and healthy public finances. Moody's also acknowledged the positive impact of the Mainland on Hong Kong, and noted that the hypothetical risk emanating from Mainland China had lessened. Other major international CRAs affirmed Hong Kong's ratings (in the range of AA to AA+).

Financial co-operation with the Mainland

Communications and co-operation between the HKMA and PBoC and other Mainland authorities were strengthened during the year.

The pilot scheme for cross-border trade settlement in the renminbi permits selected companies in certain Mainland regions to settle trade among Hong Kong, Macau and ASEAN economies in renminbi. Authorized institutions (AIs) in Hong Kong can offer a range of renminbi banking services to enterprises, including deposit-taking, currency exchange, remittance, trade finance, and interbank transactions. The scheme represents a significant step in expanding the scope and base of renminbi banking services in Hong Kong, which previously comprised mainly personal banking business. The PBoC and the HKMA signed a supplementary Memorandum of Co-operation on the scheme in June.

The renminbi bond market in Hong Kong continued to grow, with six issues of renminbi bonds during the year, totalling RMB16 billion. This brought the total amount of renminbi bonds issued in Hong Kong to RMB38 billion. The Ministry of Finance issued RMB6 billion worth of sovereign bonds in October, the first such issuance outside the Mainland. The issuance of sovereign bonds set the stage for the development of benchmark interest rates on the renminbi, making the pricing of other renminbi financial products more efficient.

Renminbi business in Hong Kong continued to operate smoothly. At the end of 2009, renminbi deposits totalled RMB62.7 billion and the number of accounts reached 1.3 million. Sixty AIs in Hong Kong were offering renminbi banking services.

In January 2009 the HKMA and the PBoC entered into a RMB200 billion (HK$227 billion) currency swap agreement to provide short-term liquidity support to the Mainland operations of Hong Kong banks and the Hong Kong operations of Mainland banks in case of need. The arrangement not only enhances financial stability in the region, but also helps promote the development of renminbi-denominated trade transactions between Hong Kong and the Mainland.

A new measure for the banking sector was added under the Sixth Supplement of CEPA. With effect from 1 October 2009, Hong Kong banks, through their branches or wholly owned subsidiaries on the Mainland, can apply to establish "cross-location" sub-branches (in locations different from the municipality where the original branch is opened) within Guangdong Province. This measure enables Hong Kong banks to expand their branch networks in Guangdong in a more cost-effective way.

Strengthening research on Mainland economic and financial issues

With financial-market liberalisation gathering pace in Mainland China, the HKMA has strengthened research into related policy issues, while continuing to closely monitor economic and financial developments. A number of research projects were conducted in 2009 to study the prospects of wider external use of the renminbi, particularly in cross-border trade settlement, and its implications for Hong Kong. These studies demonstrated the potential demand for the renminbi as the trade settlement currency, even though it will take time to develop the required financial infrastructure and for merchants to switch currencies. An international conference held in October discussed the nexus between financial liberalisation and currency internationalisation in Mainland China, and the role Hong Kong could play in increasing the external use of the renminbi. The conference, involving researchers and policymakers from research institutes, central banks and international organisations across the globe, was well received. Other Mainland-related studies included the impact of exports on the Mainland's economic growth and compilation of different monetary measures to accurately assess the Mainland's monetary policy. These reports are published in the *China Economic Issues* section of the HKMA website.

The HKMA also examined the potential role of Hong Kong in supporting the financial liberalisation of Mainland China and the prospects of further expansion of renminbi business in Hong Kong and other possible areas of financial co-operation. These studies are aimed at identifying key policy areas to facilitate financial intermediation between the Mainland and the rest of the world through Hong Kong, and to use Hong Kong as a platform to increase the use of renminbi outside the Mainland.

Training

Training programmes are conducted in Hong Kong and the Mainland for officials of the PBoC and the China Banking Regulatory Commission. During the year 857 officials from the Mainland attended 17 courses (2,436 man-days) covering monetary policy, financial stability, banking supervision, human resources management, internal control management, accounting management, macroeconomic analysis, financial risk management, and prevention of money laundering.

The HKMA also provided training on request to other external parties, including a regional course on bank fraud detection under the APEC financial regulators' training initiative, and other courses for Mainland commercial banks and regulators in the region. A total of 201 participants attended these seminars in 2009.

PLANS FOR 2010 AND BEYOND

The expectation of further volatility in global financial markets in 2010 again highlights the importance of regional co-operation for improving financial stability and surveillance. The HKMA will continue to spearhead the macro-monitoring work for the EMEAP MFSC, including expanding the Macro-Monitoring Report and strengthening the macroeconomic model. The HKMA will also host the EMEAP MFSC and Deputies' Meetings in the second half of 2010. Participation in central banking and international financial forums remains a priority of the HKMA to ensure Hong Kong's views and concerns are heard, and to keep abreast of the latest developments. The HKMA will also pursue further upgrades of Hong Kong's credit ratings.

To further strengthen financial co-operation between Hong Kong and the Mainland, the HKMA will continue to discuss with Mainland authorities relevant proposals set out in the Action Agenda on "China's 11th Five-Year Plan and the Development of Hong Kong". Liaising with Mainland authorities on the further expansion of renminbi business in Hong Kong remains a major task of the HKMA in 2010; while the monitoring of economic, financial and monetary developments in Mainland China, and their implications for Hong Kong, will be strengthened. Training courses for staff of Mainland authorities and other external parties will continue to strengthen technical support in the region.

Reserves Management

The Exchange Fund recorded an investment return of 5.9% in 2009. This was achieved in extremely volatile markets affected by the global financial crisis.

THE EXCHANGE FUND

The Exchange Fund's primary objective, as laid down in the Exchange Fund Ordinance, is to affect, either directly or indirectly, the exchange value of the currency of Hong Kong. The Fund may also be used to maintain the stability and integrity of Hong Kong's monetary and financial systems to help maintain Hong Kong as an international financial centre. The Exchange Fund is under the control of the Financial Secretary and may be invested in any securities or other assets he considers appropriate, after consulting the Exchange Fund Advisory Committee (EFAC).

MANAGEMENT OF THE EXCHANGE FUND

Investment objectives and benchmark

EFAC has set the following investment objectives for the Exchange Fund:

(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 that sufficient liquidity will be available for the purposes of maintaining monetary and financial stability; and

(d) subject to (a) – (c), to achieve an investment return that will preserve the long-term purchasing power of the Fund.

These objectives take full account of the statutory purposes of the Exchange Fund, and are incorporated into the investment benchmark of the Fund, which guides its long-term strategic asset allocation. Currently the bond-to-equity ratio of the benchmark is 75:25. In terms of currency mix, 86% of the benchmark is allocated to the US dollar and other currencies (which include the Hong Kong dollar) and the remaining 14% to other currencies (which include mainly the euro, yen and sterling).

The Exchange Fund is managed as two distinct portfolios – the Backing Portfolio and the Investment Portfolio. The Backing Portfolio holds highly liquid US dollar-denominated securities to provide full backing to the Monetary Base as required under the Currency Board arrangements. The Investment Portfolio is invested primarily in the bond and equity markets of the member countries of the Organisation for Economic Co-operation and Development to preserve the value and long-term purchasing power of the assets.

In 2007 a Strategic Portfolio was established to hold shares in Hong Kong Exchanges and Clearing Limited acquired by the Government for the account of the Exchange Fund for strategic purposes. Because of the unique nature of this Portfolio, it is not included in the assessment of the investment performance of the Exchange Fund.

Reserves Management

The investment process

The investment process of the Exchange Fund is underpinned by decisions on two types of asset allocation – the strategic asset allocation and the tactical asset allocation. The strategic asset allocation, reflected in the investment benchmark, represents the long-term optimal asset allocation given the investment objectives of the Exchange Fund. Guided by the strategic allocation, assets are tactically allocated in an attempt to achieve an excess return over the benchmark. This often means the actual allocation is different from the benchmark, or strategic, allocation. The differences between the actual and the benchmark allocations are known as "tactical deviations". While the benchmark and the limits for tactical deviations are determined by the Financial Secretary in consultation with EFAC, tactical decisions are made by the HKMA under delegated authority. Within the limits allowed for tactical deviations, portfolio managers may take positions to take advantage of short-term market movements.

Investment management

Direct Investment

HKMA staff in the Reserves Management Department directly manage the investment of about 80% of the Exchange Fund, which includes the entire Backing Portfolio and part of the Investment Portfolio. This part of the Investment Portfolio is a multi-currency portfolio invested in the major fixed-income markets. The staff also manage positions in financial derivatives to implement investment strategies or control the risks of the Fund.

Use of external managers

In addition to managing assets internally, the HKMA employs external fund managers based in over a dozen international financial centres to manage about 20% of the Exchange Fund's assets, including all of its equity portfolios and other specialised assets. The purpose of appointing external managers is to tap the best investment expertise available in the market, capturing a diverse mix of investment styles, and transfer knowledge and information from the market to in-house professionals.

Expenditures relating to the use of external managers include fund management and custodian fees, transaction costs and withholding and other taxes. They are determined by such things as market factors, and fluctuate from year to year. Details of these expenditure items, including those related to portfolios managed internally by the HKMA, can be found in the Notes to the Financial Statements of the Exchange Fund.

Risk management and compliance

The high volatility of financial markets in recent years has highlighted the importance of risk management. Stringent controls and investment guidelines have been established for both internally and externally managed portfolios, and compliance with guidelines and regulations is closely monitored. Risk-control tools are deployed to assess market risks under both normal and adverse market conditions. The HKMA also conducts detailed performance attribution analyses to make the best use of the investment skills of both internal and external managers.

PERFORMANCE OF THE EXCHANGE FUND

The financial markets in 2009

The global financial crisis extended into 2009 with significant market uncertainty and volatility. In the first quarter, financial market pessimism continued to weigh on risky assets in the midst of weak consumer confidence, worsening employment data and a deepening recession in all developed economies.

However, since March, investor sentiment improved markedly with the unprecedented monetary easing by major central banks, and the generous fiscal and monetary policy measures introduced earlier. Through various credit easing programmes and government guarantees, the US Federal Reserve initiated the purchase of government bonds issued by the US Treasury, creating abundant liquidity in the financial system. Market optimism was further supported by signs of economic stabilisation in the second half of the year. The GDP of major economies recorded growth during the third quarter and business and consumer confidence improved.

Investors gradually moved away from the extreme caution shown in 2008 and their risk appetite returned in 2009, prompting the unwinding of risk aversion trades, especially in the second half of the year as investors sought better returns in a low-interest-rate environment. Global stock markets staged a strong rebound and major equity indices recovered about 50% of the losses incurred since the start of the financial crisis. Bond yields moved substantially higher from their depressed levels in late 2008, partly due to a reversal of the risk aversion mentality, and partly due to the fear of a big increase in the supply of government bonds. The US dollar also weakened during the year, falling about 17% against major currencies as safe-haven flows disappeared. Nevertheless, towards the end of 2009, investors again became more cautious about the sustainability of the global economic recovery, particularly after the emergence of the debt crisis involving Dubai World.

The performance of major currency, bond and equity markets in 2009 are shown in Table 1.

Table 1 **2009 market returns**

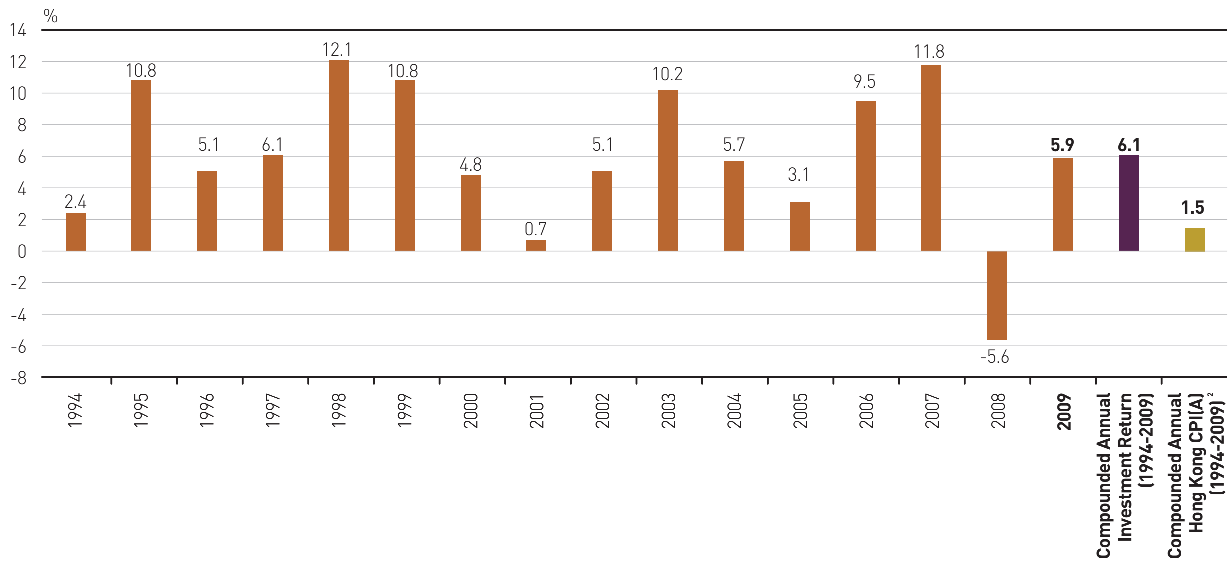
Currencies	
Appreciation (+)/depreciation (-) against US dollar	
Euro	+3.2%
Yen	-2.6%
Bond markets	
Relevant US Government Bond (1 - 3 years) Index	+0.8%
Equity markets	
Standard & Poor's 500 Index	+23.5%
Hang Seng Index	+52.0%

The Exchange Fund's performance

The Exchange Fund recorded an investment income of $106.9 billion in 2009, comprising gains of $48.9 billion from Hong Kong equities and gains of $48.8 billion from foreign equities, a $9.8 billion gain from foreign exchange revaluation, and a valuation loss, net of interest, of $0.6 billion from bond and other investments. Apart from this $106.9 billion investment income, the valuation gain and dividend income of the Strategic Portfolio amounted to $4.4 billion. The investment income after excluding the Strategic Portfolio represented an investment return of 5.9%.

The annual return of the Exchange Fund from 1994 to 2009 is set out in Chart 1. Table 2 shows the 2009 investment return of the Exchange Fund and the average investment returns of the Fund over a number of different time horizons. The average return was 3.8% over the last three years, 4.8% over the last five years, 5.0% over the last 10 years and 6.1% since 1994.[1] These returns compare favourably with the average inflation rate during the corresponding period. Table 3 shows the currency mix of the Fund's assets on 31 December 2009.

Chart 1 Investment return of the Exchange Fund (1994 - 2009) [1]



[1] Investment return calculation excludes the holdings in the Strategic Portfolio.
[2] CPI(A) denotes the 2004/2005-based series of the CPI(A).

[1] Averages over different time horizons are calculated on an annually compounded basis.

Table 2	Investment return of the Exchange Fund in Hong Kong dollar terms [1]		
	Investment return [2 & 3]	**CPI(A) [3 & 4]**	**Excess return over benchmark**
2009	5.9%	1.7%	122 bps
3-year average (2007 - 2009)	3.8%	2.1%	24 bps
5-year average (2005 - 2009)	4.8%	1.9%	N/A [5]
10-year average (2000 - 2009)	5.0%	0.1%	N/A [5]
Average since 1994	6.1%	1.5%	N/A [5]

1 The investment returns for 2001 to 2003 are in US dollar terms.
2 Investment return calculation excludes the holdings in the Strategic Portfolio.
3 Averages over different time horizons are calculated on an annually compounded basis.
4 CPI(A) denotes the 2004/2005-based series of the CPI(A).
5 N/A denotes not applicable. Compilation of active returns for individual portfolios started in 2006.

Table 3	Currency mix of the Exchange Fund's assets on 31 December 2009 – including forward transactions	
	HK$ billion	**%**
US dollar and other currencies [1]	1,765.2	82.1
Hong Kong dollar	150.2	7.0
Euro, yen, sterling and other currencies [2]	234.0	10.9
Total	**2,149.4**	**100.0**

1 Including mainly Australian dollar, Canadian dollar and Singapore dollar.
2 Including mainly Swiss franc, Swedish krona, Norwegian krone and Danish krone.

Professional and Corporate Services

The Corporate Services Department, Office of the General Counsel and Internal Audit Division provide professional, administrative and technical support to the HKMA in carrying out its policy objectives.

THE HKMA IN THE COMMUNITY

The HKMA places great emphasis on transparency and accessibility in its operations. Its work in this area is co-ordinated by the Corporate Development Division within the Corporate Services Department. The Division provides media, publications, public communication, translation and administrative services to the HKMA. It also supports the Exchange Fund Advisory Committee (EFAC) and its Sub-Committees.

Media relations

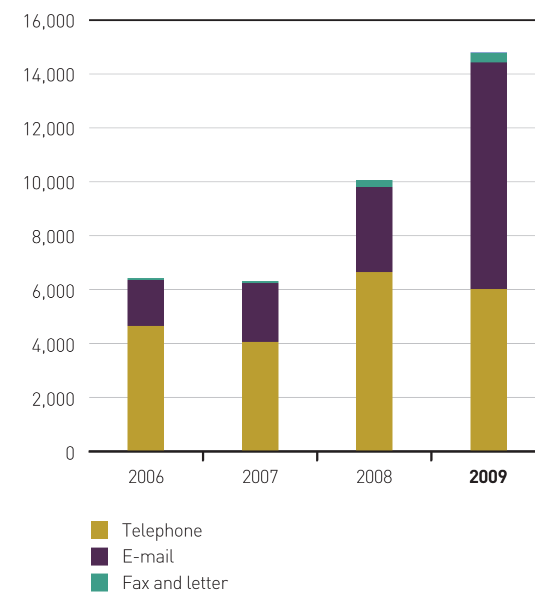
In a year during which the global financial crisis was followed by a modest recovery, the HKMA continued to maintain close contacts with the print, broadcast and internet media to communicate its latest policies and initiatives to the community in a timely and effective way. In 2009 the HKMA held four press conferences and gave 28 media interviews and 25 stand-up interviews. An average of 45 media enquiries were handled each day. A total of 310 bilingual press releases were issued, an increase of 14% over 2008 as a result of the weekly announcement of the progress of the HKMA's investigations into complaints about investment products related to Lehman Brothers. To facilitate better understanding of the HKMA's initiatives, five media briefings were organised to explain issues covering new banking policies, progress in the investigation of Lehman-related cases, the launch of the Government Bond Programme and the HKMA's role in international and regional financial co-operation. A media tour to Hong Kong Note Printing Limited was arranged to familiarise reporters with the process of banknote printing and highlight the importance of up-to-date security features.

Public enquiries

Public interest in banking-related issues rose considerably following the outbreak of the global financial crisis, resulting in a substantial increase in the number of enquiries handled by the HKMA's Public Enquiry Service. The number of enquiries increased by 47% to a record high of 14,741 in 2009, compared with 10,034 in 2008.

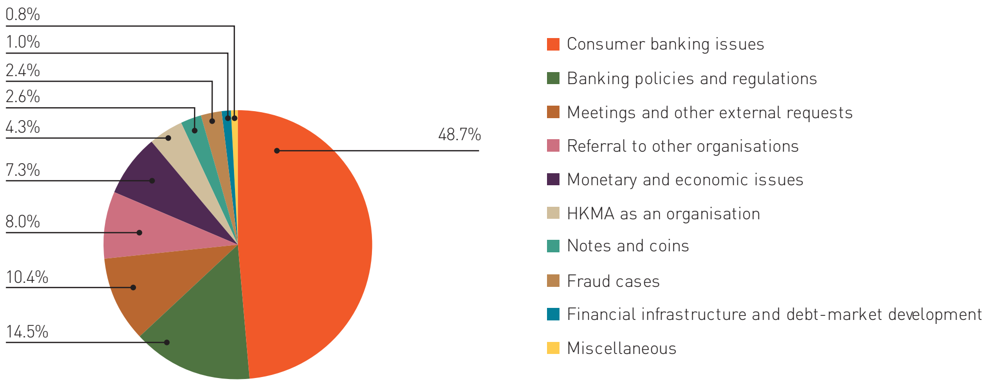
Among the enquiries received in 2009, around half were related to consumer banking issues including Lehman-related issues, banking products and services, and the Deposit Protection Scheme. Questions about banking policies and regulations accounted for another 14.5% of the total. Chart 1 shows the numbers of enquiries received since 2006 while Chart 2 breaks down the enquiries in 2009 by type.

Chart 1 **Numbers of public enquiries**



Professional and Corporate Services

Chart 2 **Enquiries received by nature in 2009**



Publications

The *HKMA Annual Report*, *Half-Yearly Monetary and Financial Stability Report, Quarterly Bulletin* and *Monthly Statistical Bulletin* are the major sources of information on monetary, banking and economic issues in Hong Kong. The HKMA has also published five background briefs introducing the HKMA and its work on maintaining monetary and banking stability.

The *HKMA Annual Report 2008* won a Silver Prize in the Hong Kong Management Association's Best Annual Reports Award.

The HKMA website

The HKMA website (www.hkma.gov.hk) provides comprehensive and accessible news and information about the HKMA. All the main HKMA publications together with a great deal of other information are available on the website.

Public education programme

The HKMA Information Centre on the 55th Floor of Two International Finance Centre is an important resource for explaining the HKMA's work to the community and public education on monetary and banking matters. The Centre consists of an exhibition area and a library, and is open to the public six days a week.

The Centre presents a survey of the history of money and banking in Hong Kong and the key policy objectives of the HKMA, and provides information on Hong Kong banknotes, Internet banking security and payment systems in Hong Kong. Daily guided tours are organised for visitors. During the year more than 40,000 people visited the Centre and more than 500 guided tours were organised for schools and other groups. 300,000 people have visited the Centre since it opened in December 2003.

The Library, situated just beyond the Exhibition Area, contains materials for detailed study of Hong Kong's monetary, banking and financial affairs and of central banking topics. It also houses an electronic register of authorized institutions in Hong Kong, maintained under section 20 of the Banking Ordinance.

The HKMA continued to organise public education seminars of topics related to its work. In 2009, three seminars, with the Linked Exchange Rate system as the main theme, were organised for more than 3,000 students, teachers and members of the public. Since the launch of the education programme in 1998, more than 42,000 people have participated in the seminars.

HUMAN RESOURCES

The HKMA is a compact organisation that requires high-quality staff with specialist skills in a variety of areas. It needs to recruit, develop and maintain a professional and highly qualified workforce to carry out its policy objectives and respond flexibly to changing work priorities. The HKMA is an integral part of the 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. As a public organisation, the HKMA aims to maintain a lean and flexible structure and to redeploy staff resources to meet new and increased workload whenever possible.

Staffing in 2009

The establishment of the HKMA at the beginning of the year was 676. To meet the staffing needs arising from the implementation of the Government Bond Programme and the development of the debt market, three new posts were created in August 2009, bringing the establishment to 679 at the end of the year.

During the year about 300 people were deployed to help shoulder the extra workload arising from the investigation of more than 21,000 complaints about the sale by banks of investment products related to Lehman Brothers. These included around 200 temporary staff hired on contracts, while the rest were permanent staff or secondees from an audit firm. The short-term contract appointments do not affect the permanent establishment of the HKMA.

Apart from the substantial deployment of resources to handle banking complaints, there were other staff redeployments during the year to cope with increased activities or workload. For example, a team was redeployed to the Monetary Management Department to provide support in preparation for the launch of the Government Bond Programme before new posts were created later in the year. To ensure that the HKMA has sufficient staff resources to address continuing pressure arising from the increasingly complex and dynamic financial environment, 32 new posts were added to the establishment in January 2010, representing an increase of 4.7%. These new posts will be deployed in the following areas:

- strengthening supervision of AIs' businesses and activities, including their business on the Mainland, and of Mainland banks operating in Hong Kong

- increasing resources for supervising AIs' securities-related, insurance and MPF-intermediary activities, and their e-banking business, IT controls and business contingency planning

- strengthening monitoring of systemic risks and stress-testing of AIs' vulnerability to shocks

- providing research and other support for increased participation in international standard-setting bodies arising from the global financial crisis, and for implementing new international standards in Hong Kong

- strengthening resources to prevent money-laundering, including strengthening on-site examinations and developing an enforcement framework to support the introduction of new legislation by the Government

- strengthening resources for exploring and developing opportunities to enhance returns and diversify risks in managing the Exchange Fund

- monitoring and following up on the recommendations of G20 and the Financial Stability Board on monetary management and refining contingency plans as appropriate

- strengthening support functions, including settlement, legal services, media relations and research.

The HKMA seconds staff to other organisations, such as the International Monetary Fund, to help co-ordinate activities or policy initiatives in which Hong Kong has an interest. A number of staff are also redeployed full-time or part-time to provide operational support to the Hong Kong Deposit Protection Board and the Treasury Markets Association.

Organisational and senior staff changes in 2009

In January 2009 the Market Development Division was formed under the Monetary Management Department to permit a more focused effort in developing the debt market, fund management, and Islamic finance in Hong Kong. The new Division also took over the Treasury Markets Association team from the Financial Infrastructure Department. In May 2009 the treasury and financial market surveillance functions of the Banking Supervision Department were put under a new, specialised Division.

Mr Norman Chan was appointed Chief Executive of the HKMA on 1 October 2009, following the retirement of Mr Joseph Yam. Mr Arthur Yuen, the Executive Director in charge of the External Department, was promoted on 1 January 2010 to replace Mr Y K Choi as Deputy Chief Executive (Banking) upon Mr Choi's retirement.

Table 1 gives a breakdown of the establishment and strength of the HKMA.

Table 1 Establishment and strength of the HKMA on 1 January 2010

Department	Functions	Senior staff Establishment	Senior staff Strength	Others Establishment	Others Strength
Chief Executive's and Deputy Chief Executives' Offices	Top management of the HKMA.	4	4	7	7
Banking Development	To formulate policies for the development of the banking industry, and to facilitate settlement for transactions executed by the HKMA for the Exchange Fund.	1	1	78	70
Banking Policy	To formulate supervisory policies for promoting the safety and soundness of the banking sector.	1	1	46	42
Banking Supervision	To supervise day-to-day operations of authorized institutions.	1	1	166	144
External	To help develop and promote Hong Kong as an international financial centre and to foster regional monetary co-operation through active participation in the international central banking and financial community.	1	0	52	50
Financial Infrastructure	To develop and enhance the financial market infrastructure important for maintaining and strengthening Hong Kong as an international financial centre.	1	1	28	26
Monetary Management	To maintain currency stability through monitoring of market operations and development issues, and to ensure adequate supply of banknotes and coins.	1	1	30	30
Research	To conduct research and analysis on economic and international financial market development, both in Hong Kong and in other economies.	1	1	36	33
Reserves Management	To manage reserves to achieve investment returns in line with established guidelines and to enhance the quality of return by diversifying into different investment markets and asset types.	1	1	75	69
Office of the General Counsel	To provide in-house legal support and advice.	1	1	19	16
Corporate Services	To provide support services in the form of administrative, finance, HR, IT, and secretariat services, and to handle media and community relations.	1	1	152	151
Internal Audit	To provide audit services through assisting the management in controlling risks, monitoring compliance, and improving the efficiency of internal control systems and procedures.	0	0	8	8
Total		**14**	**13**	**697**	**646**

Remuneration policies and pay review mechanism

The Financial Secretary determines the pay and conditions of service for HKMA staff on the advice of EFAC and its Governance Sub-Committee (GSC) having regard to prevailing market rates and practices. The HKMA remuneration package is a total cash package with minimal benefits in kind and a Provident Fund Scheme. The HKMA pay package consists of two elements: Fixed Pay, which is payable monthly, and Variable Pay, which may be awarded to individual staff members as a lump sum once a year depending on performance.

Pay for HKMA staff is reviewed annually by the Financial Secretary in the light of recommendations made to him through EFAC by the GSC, taking into account the findings of independent consultants on pay trends and pay levels in the financial sector, the GSC's assessment of the performance of the HKMA during the preceding year, and other factors considered appropriate. The performance of individual staff is taken into account in distributing any approved overall pay awards.

Remuneration of senior staff

The remuneration packages of the senior staff in 2009 are shown in Table 2.

Table 2 Remuneration packages of HKMA senior staff in 2009 [1]

	Chief Executive [2]		Deputy Chief Executive	Executive Director
$'000	Joseph Yam	Norman Chan	(average)	(average)
Number of staff [3]	1	1	3	12
Annualised pay				
Fixed pay	7,942	6,000	5,087	3,211
Variable pay [2]	2,485	–	1,192	549
Other benefits [4]	720	668	538	383

Notes :

1 Except for annual leave accrued, the actual remuneration received by staff during 2009 but not serving a full year is annualised for the purpose of calculating the average annual package for the rank.

2 Mr Norman T.L. Chan took over from Mr Joseph C.K. Yam as Chief Executive of the Hong Kong Monetary Authority on 1 October 2009. Mr Chan did not receive any Variable Pay in 2009. The maximum level of his Variable Pay is set at $1.5 million for the first year.

3 The number of staff in this table at the Executive Director rank reflects staff movements during the year and includes the Chief Executive Officer of the Hong Kong Mortgage Corporation. The established number of posts at the Executive Director level is 11 (including the CEO of the Hong Kong Mortgage Corporation).

4 Other benefits include provident funds or gratuity as the case may be, medical and life insurance and annual leave accrued during the year. The provision of these benefits varies among senior staff depending on individual terms of service.

Training and development

The HKMA places special emphasis on the training and development of staff. Training is designed to equip staff with the necessary knowledge and skills to fulfil their duties and to prepare them for posting and career development. It is provided along two dimensions: horizontal training focusing on general skills common to staff of the same rank and vertical training covering specialised skills specific to individual departments. A total of 2,772 training days were provided in 2009, comprising 1,170 days of horizontal training and 1,602 days of vertical training. Each staff member received an average of 4.3 days of training during the year.

As part of the horizontal training programme, courses on central banking and the work of the HKMA were organised for new staff. Courses on English writing skills were conducted for Assistant Managers and support staff, while training sessions on PC skills were attended by over 150 colleagues from various ranks. Putonghua and Cantonese classes were offered to staff according to their needs. Workshops on communication, time management, project management and strategy development were conducted for Senior Managers and Managers. The HKMA also sponsors executive courses for senior staff. In 2009 a number of senior staff attended an advanced national studies course in Beijing specially organised for Hong Kong senior government officials, a seminar on global economic issues, and short courses on executive development conducted by well-known overseas universities and training institutions.

The HKMA organised a comprehensive two-week in-house training programme for 35 new Assistant Managers in the banking departments. The course covered core banking supervisory topics including supervisory approaches, core principles for effective banking supervision, the Banking Ordinance and regulatory framework, CAMEL rating, statutory returns, Basel II, e-banking, capital adequacy and major banking risks, on-site examination and off-site review.

Other training courses, organised throughout the year, covered the latest developments on specific topics of interest for staff in the banking departments. Topics included renminbi trade settlement scheme, liquidity risk management and credit risk modelling. Suitable training courses offered by multilateral organisations and other central banks that were not available in Hong Kong were also identified for colleagues.

Apart from formal training, regular briefings were conducted by the senior executives to keep the staff up to date on a range of topics relating to the HKMA's work.

The HKMA runs a Training Sponsorship Scheme, which provides sponsorship for the pursuit of degree or diploma studies, professional qualifications or other short courses relevant to the work of the HKMA. Partial reimbursement of membership dues of relevant professional bodies is also provided.

FINANCE

The Finance Division's main objective is to achieve an efficient allocation of resources within the HKMA and to observe best practices in financial reporting.

Annual budget

The HKMA draws up its annual budget to ensure that sufficient resources are available for carrying out its functions. Budgeting takes into account both the continuing operations of the HKMA and its strategic development set out in a three-year plan approved by the Financial Secretary on the advice of EFAC. During the budgeting process, departments are required to assess their needs for the coming year and to consider where savings in staffing and expenditure can be achieved. This requires departments to critically assess each year the value of existing services and the cost-effectiveness of different methods of delivering them. The Finance Division scrutinises all budget requests and discusses with individual departments before submitting a consolidated draft budget for scrutiny by the senior management. The Governance Sub-Committee of EFAC then deliberates on the budget and recommends any changes it believes are necessary, before putting it through EFAC to the Financial Secretary for his approval.

Professional and Corporate Services

After the budget is approved, all expenditure under it is subject to procurement rules and guidelines and stringent financial controls. Compliance with these guidelines and procedures is subject to internal audit and is reviewed by independent auditors during the annual audit of the Exchange Fund.

The administrative expenditure in 2009 and the budgeted expenditure for core activities in 2010 are shown in Table 3. The difference between the 2009 actual expenditure and the 2010 budget arises mainly from an increase in staff costs, reflecting the full-year effects of staff increases in 2009, and the increase of 32 posts approved for 2010 by the Financial Secretary on the advice of EFAC to meet the increasing quantity and complexity of the HKMA's work, especially for the reorganisation of the banking departments to handle increased workload in key areas including supervision of AIs' business on the Mainland and of Mainland banks operating in Hong Kong and further strengthening of the supervision of securities, insurance and MPF activities of AIs.

In 2009 expenditures relating to the handling of complaints about banking services, mostly for the hiring external professional staff and renting the necessary office accommodation, amounted to $113 million. An additional operational expenditure of $149 million is required in 2010, mostly for the continuing employment of contract staff to continue this work and consequential increases in a number of other expenditure items including premises expenses, communication services, and professional and other services. The additional expenditure for this work will be limited to the period necessary for completion of the investigations. Because of the exceptional nature of this work, this additional budget is shown separately in Table 4.

Expenses related to premises for international organisations, whose presence in Hong Kong reflects its status as an international financial centre, are expected to remain stable in 2010. Expenditure continued in 2009 in relation to the programme to upgrade Hong Kong's financial infrastructure, including the migration of the Real Time Gross Settlement systems and the Central Moneymarkets Unit from the existing proprietary platform to SWIFTNet, which is an open browser-based platform. This spending will continue in 2010. Spending on financial infrastructure is not related to the HKMA's own operations, but to providing and expanding payment and other systems to enable markets to function efficiently. These expenses are shown in Table 5. The HKMA also provides operational support to the Hong Kong Deposit Protection Board in the areas of investment, accounting and settlement on a cost-recovery basis endorsed by the Financial Secretary.

Table 3 **Administrative expenditure (2009 and 2010 budgeted)**

$ million	2009 Budget*	2009 Actual	2010 Budget*
Staff costs	656		698
Salaries and other staff costs		584	
Retirement benefit costs		48	
Premises expenses			
Operating lease charges	7	7	8
Other premises expenses (including utility charges and management fees)	36	35	40
General operating costs			
Maintenance of office and computer equipment	38	34	37
Financial information and communication services (including trading, dealing terminals and data link charges)	40	32	41
External relations (including international meetings)	28	17	29
Professional and other services	21	13	27
Training	7	5	9
Others	6	5	6
Total HKMA administrative expenditure	**839**	**780**	**895**

* Includes supplementary budget and relevant provisions in project budgets for the year.

Table 4 **Expenses related to investigation of complaints about banking services (2009 and 2010 budgeted)**

$ million	2009 Budget	2009 Actual	2010 Budget
Handling of complaints about banking services			
Staff costs	84	63	95
Premises expenses	7	10	17
General operating costs			
Maintenance of office and computer equipment	–	5	–
Communication services	3	2	3
Professional and other services	43	32	31
Others	1	1	3
Total	**138**	**113**	**149**

Table 5 **Additional expenses (2009 and 2010 budgeted)**

$ million	2009 Budget*	2009 Actual	2010 Budget*
Subsidy to the Hong Kong Institute for Monetary Research	18	15	19
Premises expenses of international financial organisations in Hong Kong	26	26	29
Service fees for financial infrastructure	54	40	55

* Includes supplementary budget and relevant provisions in project budgets for the year.

Professional and Corporate Services

In addition to investment income from managing the Exchange Fund, the HKMA earns revenue mainly through licence fees paid by AIs, and custodian and transaction fees from users of the Central Moneymarkets Unit. The HKMA also received reimbursement from the Hong Kong Deposit Protection Board for providing operational support to the Board according to section 6 of the Deposit Protection Scheme Ordinance. In 2010 licence fees are estimated at $132.7 million (2009: $134.1 million) and the other income components (excluding investment income) at $63.7 million (2009: $87.7 million), mainly due to decreases in rental income with termination of leases in Two International Finance Centre since July 2009.

Financial disclosure

The HKMA adopts best practices in financial disclosure as far as these are consistent with central banking operations. These standards include the reporting requirements laid down by the International Monetary Fund's Special Data Dissemination Standard. In the absence of specific reporting requirements applicable to central banking institutions, the HKMA adopts the disclosure requirements applicable to commercial entities as far as possible in order to achieve a high level of transparency. Working with the external auditor and other accounting professionals, the Finance Division prepares and presents the group financial statements in accordance with the Hong Kong Financial Reporting Standards as far as these are applicable to central banking operations. In this regard, the *HKMA Annual Report* compares favourably with those of other central banking institutions and monetary authorities: it contains detailed disclosure and thorough analyses of a wide range of expense items and budgetary information. Detailed information relating to the investment management of the Exchange Fund can be found in the chapter on Reserves Management, while information on the expenditure relating to investment management is shown in the Notes to the Financial Statements.

Substantial inflows of funds led to some changes to the balance sheet of the Exchange Fund. In response to the continuous capital inflows into the Hong Kong dollar and in accordance with the Currency Board system, the Exchange Fund bought US dollars against Hong Kong dollars, thus increasing the liquidity of the banking system. These changes are reflected on the liability side of the balance sheet in increases in the *Balance of the banking system* and *Exchange Fund Bills and Notes issued*. The US dollars received as a result of market operations were invested in *Financial assets designated at fair value*, which include Treasury Bills and commercial paper.

General administration

The HKMA continued to streamline its work wherever possible to improve efficiency and cost-effectiveness. Business continuity plans are kept under constant review. An evacuation drill and a drill of activation of the back-up office are held every year.

The HKMA's environmental policy is designed to promote staff awareness of environmental protection. Although the number of staff increased last year, as a result of the enhanced energy saving measures the average electricity consumption per staff in the HKMA offices[1] decreased by 1% in 2009. The HKMA also supports and encourages recycling, organising regular campaigns to collect unwanted clothes, toys and other reusable items from staff for donation to charities. Waste paper and used printer cartridges are also collected for recycling.

1 Excluding the data centres, which house critical IT facilities.

During 2009 HKMA staff participated in a number of charity events. The HKMA Volunteer Team gave more than 330 hours of their free time to voluntary services in 2009. They assisted in organising activities for the Chak Yan Centre, the Society of Boys' Centres, the Circus Day Camp for TREATS and participated in the East Asia Games Volunteer Programme organised by the Agency for Volunteer Service. HKMA staff also took part in the Raleigh Wilson Trail Challenge, the Sowers Action Charity Marathon, and the Community Chest's Dress Special Day, Green Day and Love Teeth Day. In recognition of the HKMA's commitment to corporate citizenship, the Hong Kong Council of Social Service awarded the Caring Organisation Logo to the HKMA.

INFORMATION TECHNOLOGY

The IT Division continued to upgrade the IT infrastructure and application systems in 2009 with the expansion of the computer centre and replacement of aging printers and portable computers.

The first phase of migration of the RTGS system to SWIFTNet platform was completed in 2009. The settlement system was upgraded to support trade settlements denominated in renminbi. The banking complaints database has also been expanded. The Division also provided technical support to the Deposit Protection Board in upgrading the payout system and launching other new initiatives.

SETTLEMENT SERVICES

The Settlement Section supports reserves management, monetary operations and other activities of the HKMA requiring transfers of funds or assets of the Exchange Fund, and is responsible for ensuring that the settlement standards adopted by the HKMA are in line with the best market practice. It also provides professional advice to other departments of the HKMA on projects that have implications for settlement functions.

The Settlement Section reports to one of the Division Heads and the Executive Director of the Banking Development Department. Since the Banking Department is separated from the monetary operations and reserves management functions of the HKMA, this arrangement achieves a segregation of duties and helps avoid potential conflicts of interest.

OFFICE OF THE GENERAL COUNSEL

The Office of the General Counsel is responsible for providing legal advice to the HKMA with regard to all aspects of the HKMA's work. There are 13 lawyers providing the full range of legal services to the HKMA's line departments. They participate in meetings and conferences for central bankers and the banking community, concerning such issues as money laundering, risk management and crisis management. They also take part in teleconferences with their counterparts in other central banks to discuss and resolve topics of current legal concern.

Professional and Corporate Services

INTERNAL AUDIT

The Internal Audit Division performs independent assessment of the adequacy and effectiveness of risk management and control, and advises on opportunities for improvement. The Division reports directly to the Chief Executive of the HKMA and the Audit Sub-Committee of EFAC.

During the year the Division co-ordinated the annual organisation-wide risk assessment and reported the results to the Risk Committee. Using a risk-based approach, the Division conducted operational audits and system security reviews covering all the significant risks in various business units in the HKMA. The Division advised on major system development projects and responded to management requests on internal-control matters from time to time. The Division also reviewed the operations of the Hong Kong Deposit Protection Board.

The Division attaches great importance to keeping abreast of the latest development in practices in the internal audit profession and other central banks. In 2009 the Division shared views and experience in risk management and audit matters in an international conference organised by the Bank for International Settlements for heads of internal audit of central banks and monetary authorities. The professional staff of the Division also attended seminars and training courses on the latest risk-management practices and audit techniques.

RISK MANAGEMENT

One of the most important tasks of the HKMA is to manage risks to the monetary and banking systems. Risk management is undertaken both at a working level in the day-to-day operations of the HKMA and at a higher level through strategic planning.

The Chief Executive chairs a high-level Risk Committee established to

- identify potential risks and threats to the organisation and the monetary and financial systems more broadly, and devise strategies to reduce the impact of these risks and threats
- review the existing systems for managing risks across different departments to identify possible gaps and significant risks, and ensure the adequacy of measures to address them
- harmonise the criteria and methods of risk management and prioritise the resource management of risks identified
- encourage a stronger risk-management culture, which promotes the proper levels of authorisation and controls.

The Committee meets regularly to review the risk assessments made by the business units and the adequacy of controls, and to identify potential or emerging risks and devise mitigating strategies.

EXTERNAL AUDITOR

In accordance with section 7 of the Exchange Fund Ordinance, the Audit Commission of the Government of the Hong Kong Special Administrative Region audits the financial statements of the Exchange Fund. The Commission does not charge for this service.

The Exchange Fund

Audit Commission
The Government of the Hong Kong Special Administrative Region

Independent Audit Report

To the Financial Secretary

I certify that I have audited the financial statements of the Exchange Fund set out on pages 112 to 193, which comprise the balance sheets of the Exchange Fund and of the Group as at 31 December 2009, and their income and expenditure accounts, statements of comprehensive income, statements of changes in equity and statements of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Monetary Authority's responsibility for the financial statements

The Monetary Authority is responsible for the preparation and the true and fair presentation of these financial statements in accordance with the directive of the Chief Executive made under section 7 of the Exchange Fund Ordinance (Cap. 66) and Hong Kong Financial Reporting Standards. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the directive of the Chief Executive made under section 7 of the Exchange Fund Ordinance and the Audit Commission auditing standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Monetary Authority, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Report of the Director of Audit (cont.)

Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the Exchange Fund and of the Group as at 31 December 2009 and of their financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the directive of the Chief Executive made under section 7 of the Exchange Fund Ordinance.

Benjamin Tang
Director of Audit

Audit Commission
26th Floor
Immigration Tower
7 Gloucester Road
Wanchai, Hong Kong

1 April 2010

Exchange Fund – Income and Expenditure Account

for the year ended 31 December 2009

(Expressed in millions of Hong Kong dollars)	Notes	Group		Fund	
		2009	2008	**2009**	2008
INCOME					
Interest income		**22,628**	37,491	**21,303**	35,665
Dividend income		**7,181**	8,219	**7,379**	8,442
Net realised and revaluation gains/(losses)		**72,810**	(115,604)	**72,777**	(115,587)
Net exchange gains/(losses)		**9,762**	(12,484)	**9,772**	(12,440)
Investment income/(loss)	4(a)	**112,381**	(82,378)	**111,231**	(83,920)
Bank licence fees		**134**	141	**134**	141
Other income		**388**	329	**127**	106
TOTAL INCOME/(LOSS)		**112,903**	(81,908)	**111,492**	(83,673)
EXPENDITURE					
Interest expense	4(b)	**(36,063)**	(51,248)	**(35,784)**	(50,138)
Operating expenses	4(c)	**(2,622)**	(2,657)	**(2,403)**	(2,455)
Note and coin expenses	4(d)	**(333)**	(229)	**(333)**	(229)
Write back of impairment losses on loans/ (Impairment losses on loans)		**37**	(36)	**-**	-
TOTAL EXPENDITURE		**(38,981)**	(54,170)	**(38,520)**	(52,822)
SURPLUS/(DEFICIT) BEFORE SHARE OF PROFIT OF ASSOCIATE AND JOINT VENTURE		**73,922**	(136,078)	**72,972**	(136,495)
Share of profit of associate and joint venture, net of tax		**2**	2	**-**	-
SURPLUS/(DEFICIT) BEFORE TAXATION		**73,924**	(136,076)	**72,972**	(136,495)
Income tax		**(150)**	(35)	**-**	-
SURPLUS/(DEFICIT) FOR THE YEAR		**73,774**	(136,111)	**72,972**	(136,495)
ATTRIBUTABLE TO:					
Owner of the Fund		**73,759**	(136,131)	**72,972**	(136,495)
Minority interests		**15**	20	**-**	-
		73,774	(136,111)	**72,972**	(136,495)

The notes on pages 118 to 193 form part of these financial statements.

Exchange Fund – Statement of Comprehensive Income

for the year ended 31 December 2009

(Expressed in millions of Hong Kong dollars)	Notes	Group 2009	Group 2008	Fund 2009	Fund 2008
SURPLUS / (DEFICIT) FOR THE YEAR		**73,774**	(136,111)	**72,972**	(136,495)
OTHER COMPREHENSIVE INCOME					
Available-for-sale securities					
fair value changes taken to/(from) equity	29	**973**	(147)	**-**	-
fair value changes transferred to income and expenditure account on disposal	29	**(4)**	(25)	**-**	-
tax effect	29	**(37)**	30	**-**	-
Cash flow hedges					
fair value changes taken to/(from) equity	29	**25**	(86)	**-**	-
tax effect	29	**(4)**	14	**-**	-
Currency translation difference subsidiary and joint venture	29	**2**	(9)	**-**	-
OTHER COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR, NET OF TAX		**955**	(223)	**-**	-
TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR		**74,729**	(136,334)	**72,972**	(136,495)
TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR ATTRIBUTABLE TO:					
Owner of the Fund		**74,714**	(136,354)	**72,972**	(136,495)
Minority interests		**15**	20	**-**	-
		74,729	(136,334)	**72,972**	(136,495)

The notes on pages 118 to 193 form part of these financial statements.

Exchange Fund – Balance Sheet

as at 31 December 2009

(Expressed in millions of Hong Kong dollars)	Notes	Group		Fund	
		2009	2008	**2009**	2008
ASSETS					
Cash and money at call	6	**17,736**	19,447	**17,658**	19,383
Placements with banks and other financial institutions	7	**112,732**	156,529	**108,636**	153,395
Derivative financial instruments	8(a)	**5,565**	9,967	**4,247**	7,729
Financial assets designated at fair value	9	**1,995,464**	1,347,499	**1,995,464**	1,347,499
Available-for-sale securities	10	**7,678**	2,545	**493**	493
Held-to-maturity securities	11	**5,883**	5,713	**-**	-
Loan portfolio	12	**43,789**	50,760	**-**	-
Gold	13	**572**	448	**572**	448
Other assets	14	**15,063**	19,578	**14,007**	17,792
Investments in subsidiaries	15	**-**	-	**4,947**	10,145
Interests in associate and joint venture	16	**160**	158	**-**	-
Property, plant and equipment	17(a)	**812**	786	**583**	584
Operating land lease prepayment	18	**2,775**	2,849	**2,775**	2,849
Intangible assets	19	**16**	15	**16**	15
TOTAL ASSETS		**2,208,245**	1,616,294	**2,149,398**	1,560,332
LIABILITIES AND EQUITY					
Certificates of Indebtedness	20	**199,006**	176,093	**199,006**	176,093
Government-issued currency notes and coins in circulation	20	**8,427**	8,266	**8,427**	8,266
Balance of the banking system	21	**264,567**	158,038	**264,567**	158,038
Derivative financial instruments	8(a)	**1,031**	4,149	**873**	3,934
Placements by banks and other financial institutions	22	**28,311**	13,613	**28,311**	13,613
Placements by Fiscal Reserves	23	**504,123**	531,370	**504,123**	531,370
Placements by Hong Kong Special Administrative Region government funds and statutory bodies	24	**41,836**	74	**41,836**	74
Exchange Fund Bills and Notes issued	25	**536,429**	162,554	**536,429**	162,554
Other debt securities issued	26	**44,459**	42,786	**-**	-
Mortgage-backed securities issued	27	**2,021**	3,226	**-**	-
Other liabilities	28	**18,753**	31,570	**12,369**	25,905
Total liabilities		**1,648,963**	1,131,739	**1,595,941**	1,079,847
Accumulated surplus	29	**558,220**	484,461	**553,457**	480,485
Other reserves	29	**858**	(97)	**-**	-
Total equity attributable to owner of the Fund		**559,078**	484,364	**553,457**	480,485
Minority interests	29	**204**	191	**-**	-
Total equity		**559,282**	484,555	**553,457**	480,485
TOTAL LIABILITIES AND EQUITY		**2,208,245**	1,616,294	**2,149,398**	1,560,332

Norman T.L. Chan
Monetary Authority
1 April 2010

The notes on pages 118 to 193 form part of these financial statements.

Exchange Fund – Statement of Changes in Equity

for the year ended 31 December 2009

(Expressed in millions of Hong Kong dollars)	Notes	Group 2009	Group 2008	Fund 2009	Fund 2008
Attributable to owner of the Fund					
Accumulated surplus					
At 1 January		**484,461**	620,592	**480,485**	616,980
Surplus/(Deficit) for the year	29	**73,759**	(136,131)	**72,972**	(136,495)
At 31 December		**558,220**	484,461	**553,457**	480,485
Other reserves					
Revaluation reserve					
At 1 January		**(88)**	126	**-**	-
Other comprehensive income/(loss) for the year	29	**953**	(214)	**-**	-
At 31 December		**865**	(88)	**-**	-
Translation reserve					
At 1 January		**(9)**	-	**-**	-
Other comprehensive income/(loss) for the year	29	**2**	(9)	**-**	-
At 31 December		**(7)**	(9)	**-**	-
		858	(97)	**-**	-
Total equity attributable to owner of the Fund at 31 December		**559,078**	484,364	**553,457**	480,485
Minority interests					
At 1 January		**191**	179	**-**	-
Total comprehensive income for the year	29	**15**	20	**-**	-
Capital injection by minority interests	29	**11**	-	**-**	-
Dividends paid to minority interests	29	**(13)**	(8)	**-**	-
At 31 December		**204**	191	**-**	-
Total equity at 31 December		**559,282**	484,555	**553,457**	480,485

The notes on pages 118 to 193 form part of these financial statements.

Exchange Fund – Statement of Cash Flows

for the year ended 31 December 2009

(Expressed in millions of Hong Kong dollars)	Notes	Group		Fund	
		2009	2008	**2009**	2008
Cash flows from operating activities					
Surplus/(Deficit) before share of profit of associate and joint venture		**73,922**	(136,078)	**72,972**	(136,495)
Adjustments for:					
Interest income	4(a)	**(22,628)**	(37,491)	**(21,303)**	(35,665)
Dividend income	4(a)	**(7,181)**	(8,219)	**(7,379)**	(8,442)
Net gains on available-for-sale securities	4(a)	**(20)**	(26)	**-**	-
Interest expense	4(b)	**36,063**	51,248	**35,784**	50,138
Depreciation and amortisation	4(c)	**140**	142	**106**	110
Elimination of exchange differences and other non-cash items		**(976)**	2,679	**(938)**	2,702
Interest received		**23,934**	38,055	**22,590**	36,272
Interest paid		**(36,063)**	(51,273)	**(35,811)**	(50,201)
Dividends received		**7,214**	8,187	**7,150**	8,146
Income tax paid		**(64)**	(23)	**-**	-
		74,341	(132,799)	**73,171**	(133,435)
Change in fair value of derivatives and other debt securities issued		**451**	(1,237)	**390**	(1,287)
Change in placements with banks and other financial institutions		**(879)**	65	**(931)**	180
Change in financial assets designated at fair value		**(592,838)**	(142,551)	**(592,838)**	(142,551)
Change in loan portfolio		**7,008**	(16,337)	**-**	-
Change in gold		**(124)**	(12)	**(124)**	(12)
Change in other assets		**3,181**	(470)	**2,492**	(11)
Change in Certificates of Indebtedness, government-issued currency notes and coins in circulation		**23,074**	13,433	**23,074**	13,433
Change in balance of the banking system		**106,529**	147,399	**106,529**	147,399
Change in placements by banks and other financial institutions		**14,698**	13,613	**14,698**	13,613
Change in placements by Fiscal Reserves		**(27,247)**	66,785	**(27,247)**	66,785
Change in placements by Hong Kong Special Administrative Region government funds and statutory bodies		**41,762**	44	**41,762**	44
Change in Exchange Fund Bills and Notes issued		**373,875**	20,787	**373,875**	20,787
Change in other liabilities		**(12,874)**	17,355	**(13,509)**	17,072
Net cash from/(used in) operating activities		**10,957**	(13,925)	**1,342**	2,017

Exchange Fund – Statement of Cash Flows (cont.)

for the year ended 31 December 2009

(Expressed in millions of Hong Kong dollars)	Notes	Group 2009	Group 2008	Fund 2009	Fund 2008
Cash flows from investing activities					
Loan to a subsidiary		**-**	-	**(2,802)**	(8,000)
Loan repayments received from a subsidiary		**-**	-	**8,000**	-
(Increase)/Decrease in investment in joint venture		**2**	(122)	**-**	-
Proceeds from sale or redemption of available-for-sale securities		**1,845**	18,566	**-**	-
Purchase of available-for-sale securities		**(5,982)**	(17,311)	**-**	-
Proceeds from redemption of held-to-maturity securities		**2,817**	3,538	**-**	-
Purchase of held-to-maturity securities		**(2,978)**	(3,048)	**-**	-
Purchase of property, plant and equipment and intangible assets		**(95)**	(40)	**(32)**	(27)
Dividends received from subsidiaries		**-**	-	**266**	259
Net cash from/(used in) investing activities		**(4,391)**	1,583	**5,432**	(7,768)
Cash flows from financing activities					
Proceeds from issue of other debt securities		**22,061**	24,349	**-**	-
Redemption of other debt securities issued		**(19,652)**	(16,343)	**-**	-
Redemption of mortgage-backed securities issued		**(1,172)**	(1,055)	**-**	-
Capital injection by minority interests		**11**	-	**-**	-
Dividends paid to minority interests		**(13)**	(8)	**-**	-
Net cash from financing activities		**1,235**	6,943	**-**	-
Net increase/(decrease) in cash and cash equivalents		**7,801**	(5,399)	**6,774**	(5,751)
Cash and cash equivalents at 1 January		**199,380**	207,487	**196,537**	204,990
Effect of foreign exchange rate changes		**939**	(2,708)	**938**	(2,702)
Cash and cash equivalents at 31 December	30	**208,120**	199,380	**204,249**	196,537

The notes on pages 118 to 193 form part of these financial statements.

1 PRINCIPAL ACTIVITIES

The Monetary Authority, under delegated authority from the Financial Secretary as Controller of the Exchange Fund (the Fund), manages the Fund in accordance with the provisions of the Exchange Fund Ordinance. The principal activities of the Fund are safeguarding the exchange value of the currency of Hong Kong and maintaining the stability and integrity of Hong Kong's monetary and financial systems. The consolidated financial statements of the Group comprise the Fund and its subsidiaries (together referred to as the Group) and the Group's interests in an associate and a joint venture. The principal activities of the principal subsidiaries, the associate and the joint venture are shown in notes 15 and 16.

The assets of the Fund are managed as three distinct portfolios: the Backing Portfolio, the Investment Portfolio and the Strategic Portfolio. The assets of the Backing Portfolio fully match the Monetary Base, under Hong Kong's Currency Board system. The Strategic Portfolio holds shares in Hong Kong Exchanges and Clearing Limited acquired by the Hong Kong Special Administrative Region (HKSAR) Government for the account of the Fund for strategic purposes. The balance of the Fund's assets constitutes the Investment Portfolio. Operating segment information is set out in note 31.

2 SIGNIFICANT ACCOUNTING POLICIES

2.1 Statement of compliance

These financial statements have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards (HKFRSs), which is a collective term that includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (HKASs) and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (HKICPA), and accounting principles generally accepted in Hong Kong. A summary of the significant accounting policies adopted by the Group is set out below.

The HKICPA has issued certain new and revised HKFRSs that are effective for the current accounting period. Note 3 provides information on the changes in accounting policies resulting from initial adoption of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these financial statements.

2.2 Basis of preparation of the financial statements

The measurement basis used in the preparation of the financial statements is historical cost except that the following assets and liabilities are stated at their fair value as explained in the accounting policies set out below:

- trading financial instruments (note 2.5.2.1);
- financial assets and financial liabilities designated at fair value (note 2.5.2.2);
- available-for-sale securities (note 2.5.2.5); and
- gold (note 2.10).

The preparation of financial statements in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and the reported amounts of assets, liabilities, income and expenditure. The estimates and associated assumptions are based on experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Note 37 contains information about the assumptions relating to fair value estimation of financial instruments. There are no critical accounting judgements involved in the application of the Group's accounting policies except for the valuation of certain financial instruments as set out in note 2.5.3.

2.3 Subsidiaries

A subsidiary is an entity controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are presently exercisable are taken into account.

An investment in a subsidiary is consolidated into the Group financial statements from the date that control commences until the date that control ceases.

Intra-group balances and transactions together with any unrealised profits and losses arising from intra-group transactions are eliminated in full in preparing the Group financial statements.

Minority interests represent the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the Fund, whether directly or indirectly through subsidiaries, and in respect of which the Group has not agreed any additional terms with the holders of those interests which would result in the Group as a whole having a contractual obligation in respect of those interests that meets the definition of a financial liability. Minority interests are presented in the Group balance sheet within equity, separately from equity attributable to the owner of the Fund. Minority interests in the results of the Group are presented on the face of the Group income and expenditure account and the Group statement of comprehensive income as an allocation of the surplus or deficit and total comprehensive income or loss for the year between minority interests and the owner of the Fund.

In the Fund balance sheet, its investments in subsidiaries are stated at cost less impairment losses, if any (note 2.14).

2.4 Associate and joint venture

An associate is an entity in which the Group has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

A joint venture is an entity which operates under a contractual arrangement between the Group and other parties, where the contractual arrangement establishes that the Group and one or more of the other parties share joint control over the economic activity of the entity.

An investment in an associate or a joint venture is accounted for in the Group financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the net assets of the associate or the joint venture and any impairment loss relating to the investment. The Group income and expenditure account includes the Group's share of the post-tax results of the associate and the joint venture for the year.

Unrealised profits and losses resulting from transactions between the Group and its associate and joint venture are eliminated to the extent of the Group's interests in the associate or the joint venture.

In the Fund balance sheet, its investments in associate and joint venture are stated at cost less impairment losses, if any (note 2.14).

2.5 Financial assets and financial liabilities

2.5.1 Initial recognition

The Group classifies its financial assets and financial liabilities into different categories at inception, depending on the purpose for which the assets were acquired or the liabilities were incurred. The categories are: trading financial instruments, financial assets and financial liabilities designated at fair value, loans and receivables, held-to-maturity securities, available-for-sale securities and other financial liabilities.

A reconciliation of the categories of financial assets and financial liabilities to the balance sheet captions is set out in note 5.

Financial assets and financial liabilities are measured initially at fair value, which normally will be equal to the transaction prices plus transaction costs for loans and receivables, held-to-maturity securities, available-for-sale securities and other financial liabilities that are directly attributable to the acquisition of the financial asset or the issue of the financial liability. Transaction costs on trading financial instruments and financial assets and financial liabilities designated at fair value are expensed immediately.

The Group recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument. Purchases or sales of derivative financial instruments are recognised using trade date accounting. Purchases or sales of trading liabilities and financial assets and financial liabilities designated at fair value, which are settled within the time frame established generally by regulation or convention in the market place concerned, are also recognised using trade date accounting. Other financial assets and financial liabilities are recognised using settlement date accounting.

2.5.2 Categorisation

2.5.2.1 Trading financial instruments

The Group does not engage in active trading of financial instruments. However, derivative financial instruments that do not qualify for hedge accounting (note 2.8) and short positions in Exchange Fund Bills and Notes (EFBN) are categorised as "trading" under HKAS 39, Financial Instruments: Recognition and Measurement.

Trading financial instruments are carried at fair value. Changes in the fair value are included in the income and expenditure account in the period in which they arise.

2.5.2.2 Financial assets and financial liabilities designated at fair value

Financial assets and financial liabilities designated at fair value primarily consist of:

- financial assets and financial liabilities that are managed, evaluated and reported internally on a fair value basis; and

- other debt securities issued by the Group through a subsidiary, The Hong Kong Mortgage Corporation Limited (HKMC), which contain embedded derivatives that significantly modify the cash flows that would otherwise be required under the contracts.

Financial assets and financial liabilities under this category are carried at fair value. Changes in the fair value are included in the income and expenditure account in the period in which they arise.

2.5.2.3 Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which the Group has no intention of trading, other than those that the Group, upon initial recognition, designates as at fair value or as available-for-sale. This category includes placements with banks and other financial institutions, cash and money at call, and the loan portfolio purchased by the Group through the HKMC.

Loans and receivables are carried at amortised cost using the effective interest method less impairment losses, if any (note 2.9).

2.5.2.4 Held-to-maturity securities

Held-to-maturity securities are non-derivative financial assets with fixed or determinable payments and fixed maturity which the Group has the positive intention and ability to hold to maturity, other than (a) those that the Group, upon initial recognition, designates as at fair value or as available-for-sale; and (b) those that meet the definition of loans and receivables.

Held-to-maturity securities are carried at amortised cost using the effective interest method less impairment losses, if any (note 2.9).

2.5.2.5 Available-for-sale securities

Available-for-sale securities are non-derivative securities that are designated as available-for-sale or are not classified in any of the other categories above. They include securities intended to be held for an indefinite period of time, but which may be sold in response to needs for liquidity or changes in the market environment.

Available-for-sale securities are carried at fair value. Unrealised gains and losses arising from changes in the fair value are recognised in other comprehensive income and accumulated separately in the revaluation reserve, except for impairment losses, if any (note 2.9). Foreign exchange gains and losses on monetary items are recognised in the income and expenditure account.

The investment by the Fund in shares of the Bank for International Settlements is held in order to participate in it on a long-term basis. As these shares do not have a quoted market price in an active market and the fair value cannot be reliably measured, they are carried at cost less impairment losses, if any (note 2.9).

When available-for-sale securities are sold, gains or losses on disposal include the difference between the net sale proceeds and the carrying amount, and the accumulated fair value adjustments which are released from equity to the income and expenditure account.

2.5.2.6 Other financial liabilities

Other financial liabilities are financial liabilities other than trading liabilities and those designated at fair value.

Other financial liabilities with a fixed maturity are measured at amortised cost using the effective interest method. These include placements by banks and other financial institutions and other debt securities (other than those which contain embedded derivatives) issued by the Group through the HKMC.

Other financial liabilities are stated at the principal amount payable. These include Certificates of Indebtedness and government-issued currency notes and coins in circulation (note 2.5.2.7), the balance of the banking system, placements by Fiscal Reserves and placements by HKSAR government funds and statutory bodies.

2.5.2.7 Certificates of Indebtedness and government-issued currency notes and coins in circulation

As backing for the banknote issues, each note-issuing bank is required to hold a non-interest-bearing Certificate of Indebtedness issued by the Financial Secretary, which is redeemable on demand. Payments for the issue and redemption of banknotes against these Certificates are made in US dollars at the fixed exchange rate of US$1 = HK$7.80. Consistent with the requirement for backing banknote issues with US dollars, the issue and redemption of government-issued currency notes and coins are conducted with an agent bank against US dollars at the fixed exchange rate of US$1 = HK$7.80.

The Group's liabilities in respect of Certificates of Indebtedness represent the US dollars payable to the note-issuing banks on redemption of the Certificates. The Group's liabilities in respect of government-issued currency notes and coins represent the US dollars payable to the agent bank when they are redeemed. Certificates of Indebtedness in issue and government-issued currency notes and coins in circulation are stated in the financial statements at the Hong Kong dollars equivalent of the US dollars required for their redemption at the exchange rate ruling at the balance sheet date.

2.5.3 Fair value measurement principles

The fair value of financial instruments is based on their quoted market prices at the balance sheet date without any deduction for estimated future selling costs. Financial assets are priced at current bid prices, while financial liabilities are priced at current asking prices.

If there is no publicly available latest traded price nor a quoted market price on a recognised stock exchange or a price from a broker/dealer for non-exchange-traded financial instruments, or if the market for it is not active, the fair value of that financial asset or financial liability is estimated using valuation techniques that provide a reliable estimate of prices which could be obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the balance sheet date applicable for an instrument with similar terms and conditions. Where other pricing models are used, inputs are based on market data at the balance sheet date.

The Group's investments in unlisted investment funds and unlisted equity securities, except for the holding of unlisted shares in the Bank for International Settlements (note 10), are stated at fair value by making reference to valuation reports provided by investment managers. These fair values approximate the net asset values of the investments. The net asset values of the investments are computed based on valuation methods and techniques generally recognised within the industry. The Group regularly assesses the appropriateness of assumptions, methods and techniques applied by the investment managers for determining the most suitable and consistent model for valuation.

2.5.4 Derecognition

A financial asset is derecognised when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset together with substantially all the risks and rewards of ownership have been transferred.

The Group uses the weighted average method to determine realised gains and losses to be recognised in the income and expenditure account on derecognition.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

Liabilities for EFBN in issue are derecognised when they are repurchased as a result of market making activities. The repurchase is considered a redemption of the debt.

2.5.5 Offsetting

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet where there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

2.5.6 Embedded derivatives

An embedded derivative is a component of a hybrid (combined) instrument that includes both the derivative and a host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

Embedded derivatives are separated from the host contract and accounted for as a derivative when (a) the economic characteristics and risks of the embedded derivative are not closely related to the host contract; and (b) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in the income and expenditure account.

Where the embedded derivative is separated, the host contract is accounted for according to its category (note 2.5.2).

2.6 Repurchase and reverse repurchase transactions

Securities sold subject to a simultaneous agreement to repurchase these securities at a certain later date at a fixed price (repurchase agreements) are retained on the balance sheet and measured in accordance with the measurement principles as stated in note 2.5.2.2. The proceeds from the sale are reported as liabilities in "placements by banks and other financial institutions" and are carried at amortised cost.

Conversely, securities purchased under agreements to resell (reverse repurchase agreements) are reported not as purchases of the securities, but as receivables in "placements with banks and other financial institutions" and are carried in the balance sheet at amortised cost.

Interest earned on reverse repurchase agreements and interest incurred on repurchase agreements are recognised as interest income and interest expense respectively, over the life of each agreement using the effective interest method.

2.7 Securities lending agreements

Where securities are loaned with the receipt of cash or securities as collateral, they are retained on the balance sheet and measured in accordance with the measurement principles as stated in note 2.5.2.2. Where cash collateral is received, a liability is recorded in respect of the cash received in "placements by banks and other financial institutions". Securities received as collateral are not recognised in the financial statements.

2.8 Hedging

Hedge accounting recognises the offsetting effects on income and expenditure of changes in the fair values of the hedging instrument and the hedged item.

The Group assesses and documents whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items attributable to the hedged risks both at hedge inception and on an ongoing basis. The Group discontinues prospectively hedge accounting when (a) the hedging instrument expires or is sold, terminated or exercised; (b) the hedge no longer meets the criteria for hedge accounting; or (c) the Group revokes the designation.

2.8.1 Fair value hedge

A fair value hedge seeks to offset risks of changes in the fair value of recognised asset or liability that will give rise to a gain or loss being recognised in the income and expenditure account.

Derivatives that qualify as fair value hedges are measured at fair value, with fair value changes recognised in the income and expenditure account, together with any changes in the fair value of the hedged item attributable to the risk being hedged.

When a hedging instrument expires or is sold, terminated or exercised, the hedge no longer meets the criteria for hedge accounting, or the Group revokes designation of the hedge relationship, any adjustment up to that point, to a hedged item for which the effective interest method is used, is amortised to the income and expenditure account at the recalculated effective interest rate over its remaining life.

2.8.2 Cash flow hedge

Where a derivative is designated as a hedge of the variability in cash flows of a recognised asset or liability or a highly probable forecast transaction, the effective part of any gain or loss on remeasurement of the derivative to fair value is recognised in other comprehensive income and accumulated separately in equity. The ineffective portion of any gain or loss is recognised immediately in the income and expenditure account.

Amounts previously recognised in other comprehensive income and accumulated in equity are recycled to the income and expenditure account in the periods in which the hedged item will affect the income and expenditure account.

When a hedging instrument expires or is sold, terminated or exercised, the hedge no longer meets the criteria for hedge accounting, or the Group revokes designation of the hedge relationship, any cumulative gain or loss existing in equity at that time remains in equity until the forecast transaction is ultimately recognised in the income and expenditure account. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income and expenditure account.

2.9 Impairment of financial assets

The carrying amount of loans and receivables, held-to-maturity securities and available-for-sale securities are reviewed at each balance sheet date to determine whether there is objective evidence of impairment.

For loans and receivables and held-to-maturity securities, if any such evidence exists, an impairment loss is recognised in the income and expenditure account as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. If in a subsequent period the amount of such impairment loss decreases and the decrease can be linked objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income and expenditure account. A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years.

For available-for-sale securities carried at fair value, the cumulative loss – measured as the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss on that financial asset previously recognised in the income and expenditure account – is removed from equity and recognised in the income and expenditure account. Impairment losses for debt securities are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in the income and expenditure account. Impairment losses for equity securities are not reversed through the income and expenditure account. Any subsequent increase in the fair value of such assets is recognised in other comprehensive income.

For available-for-sale equity securities carried at cost, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar instrument. Such impairment losses are not reversed.

2.10 Gold

Gold is carried at market value. Changes in the market value of gold are included in the income and expenditure account in the period in which they arise.

2.11 Property, plant and equipment

The following items of property, plant and equipment are stated in the balance sheet at cost less accumulated depreciation and any impairment losses (note 2.14):

- a building held for own use situated on freehold land;

- a building held for own use situated on leasehold land, where the fair value of the leasehold interest in the land and building can be measured separately at the inception of the lease. The land element is treated as an operating land lease prepayment (note 2.12); and

- plant and equipment, including plant, machinery, furniture, fixtures, equipment, motor vehicles and personal computers.

Depreciation is calculated to write off the cost of items of property, plant and equipment, less their estimated residual value, if any, on a straight-line basis over their estimated useful lives as follows:

– Freehold land not depreciated	
– Building situated on freehold land	39 years
– Buildings situated on leasehold land depreciated over the shorter of the unexpired term of lease and their estimated useful lives	
– Plant and equipment	2-15 years

Gain or loss arising from the disposal of an item of property, plant and equipment is determined as the difference between the net disposal proceeds and the carrying amount of the asset and is recognised in the income and expenditure account on the date of disposal.

2.12 Operating land lease prepayment

Operating land lease prepayment is the land element of the payment for a building held for own use situated on leasehold land, the fair value of which could be measured separately from the fair value of the building at the inception of the lease. The valuation was carried out by an independent professional valuer who estimated the value of the building element using the "net replacement cost" method and took the residual figure as the value of the land element. The land element, accounted for as an operating lease, is stated in the balance sheet at cost less accumulated amortisation and any impairment losses (note 2.14). The land element is amortised on a straight-line basis over the unexpired term of the lease.

2.13 Intangible assets

Intangible assets include acquired computer software licences and capitalised development costs of computer software programmes. Expenditure on development of computer software programmes is capitalised if the programmes are technically and commercially feasible and the Group has sufficient resources and intention to complete development. The expenditure capitalised includes the direct labour and costs of materials. Intangible assets are stated at cost less accumulated amortisation and any impairment losses (note 2.14).

Amortisation of intangible assets is charged to the income and expenditure account on a straight-line basis over the assets' estimated useful lives of 3 to 5 years. Both the period and method of amortisation are reviewed annually.

2.14 Impairment of other assets

The carrying amount of other assets, including investments in subsidiaries, investments in associate and joint venture, property, plant and equipment and intangible assets, are reviewed at each balance sheet date to identify any indication of impairment.

If any such indication exists, an impairment loss is recognised in the income and expenditure account whenever the carrying amount of an asset exceeds its recoverable amount. The recoverable amount of an asset is the greater of its fair value less costs to sell and value in use.

2.15 Cash equivalents

Cash equivalents include money at call, placements with banks and other financial institutions and short-term highly liquid investments that are readily convertible to known amounts of cash and subject to an insignificant risk of changes in value, having been within three months of maturity when placed or acquired.

2.16 Revenue and expenditure recognition

2.16.1 Interest income and expense

Interest on the majority of the placements by Fiscal Reserves, placements by HKSAR government funds and statutory bodies is payable at a fixed rate determined annually (notes 23 and 24). Interest on these placements is recognised daily in the income and expenditure account on an accrual basis, using the effective interest method.

Interest income and expense for all other interest-bearing financial assets and financial liabilities is recognised in the income and expenditure account on an accrual basis, using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instruments (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is thereafter recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

2.16.2 Net realised and revaluation gains/(losses)

Realised gains or losses on financial instruments are recognised in the income and expenditure account when the financial instruments are derecognised.

Changes in fair value of trading financial instruments and financial assets and financial liabilities designated at fair value are recognised as revaluation gains or losses in the income and expenditure account in the period in which they arise.

2.16.3 Dividend and other income

Dividend income from listed equity securities is recognised when the share price is quoted ex-dividend. Dividend income from unlisted equity securities is recognised when the shareholder's right to receive payment is established.

Bank licence fees are fees receivable from authorized institutions under the Banking Ordinance and are accounted for in the period when the fees become receivable.

Other income includes rental income, income from the sale of withdrawn coins and Central Moneymarkets Unit fee income. Rental income is recognised on a straight-line basis over the lease term. The other income is accounted for in the period when it becomes receivable.

2.16.4 Contributions to staff retirement schemes

The Group operates several defined contribution schemes, including the Mandatory Provident Fund Scheme. Under these schemes, contributions payable each year are charged to the income and expenditure account. The assets of the staff retirement schemes are held separately from those of the Group.

2.16.5 Rental payments under operating leases

Leases where substantially all the rewards and risks of ownership remain with the leasing company are classified as operating leases. Rental payments made under operating leases are charged to the income and expenditure account on a straight-line basis over the period of the relevant leases.

2.16.6 Income tax

The Fund is exempt from income tax. Income tax payable on profits of subsidiaries is recognised as an expense in the period in which profits arise.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the asset can be utilised. Deferred tax liabilities are provided in full.

2.17 Foreign currency translation

The financial statements are presented in Hong Kong dollars, which is the Fund's functional currency.

Foreign currency transactions during the year are translated into Hong Kong dollars at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the exchange rates ruling at the balance sheet date.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated into Hong Kong dollars using the exchange rates ruling at the transaction dates. Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated into Hong Kong dollars using the exchange rates ruling at the dates when the fair value was determined.

All exchange differences are presented in aggregate as "net exchange gains/(losses)" in the income and expenditure account. Although it is not practicable to disclose separately the net exchange gains/(losses) on financial assets and financial liabilities designated at fair value or on trading financial instruments, the majority of the exchange gains/(losses) relate to these two categories of financial instruments.

2.18 Related parties

For the purposes of these financial statements, a party is considered to be related to the Group if:

(a) the party has the ability, directly or indirectly, to control the Group or exercise significant influence over the Group in making financial and operating policy decisions, or has joint control over the Group;

(b) the Group and the party are subject to common control;

(c) the party is an associate of the Group or a joint venture in which the Group is a venturer;

(d) the party is a member of key management personnel of the Group, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals;

(e) the party is a close family member of a party referred to in (a) or is an entity under the control, joint control or significant influence of such individuals; or

(f) the party is a post-employment benefit plan which is for the benefit of employees of the Group or of any entity that is a related party of the Group.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity.

2.19 Operating segments

Operating segments are reported in a manner consistent with the internal management reports provided to the chief operating decision maker. The Group comprises the following operating segments:

- management of funds under the Currency Board Operations, including the Backing Portfolio;
- management of funds representing the general reserve assets of the Fund, including the Investment Portfolio and the Strategic Portfolio; and
- maintaining the stability and integrity of monetary and financial systems of Hong Kong, which includes banking supervision and monetary management, and the activities of the Hong Kong Mortgage Corporation Limited and the Hong Kong Note Printing Limited.

Details of the operating segments of the Group are set out in note 31.

3 CHANGES IN ACCOUNTING POLICIES

The HKICPA has issued certain new and revised HKFRSs that are effective for the current accounting period. There have been no significant changes to the accounting policies applied in these financial statements for the years presented as a result of these developments. However, as a result of adopting HKAS 1 (Revised), Amendments to HKAS 32 and HKAS 1 (Revised), Amendments to HKFRS 7 and HKFRS 8, there are changes to the presentation of these financial statements.

The Group has not applied any new standard that is not yet effective for the current accounting period (note 39).

3.1 HKAS 1 (Revised), Presentation of Financial Statements

The revised standard separates owner and non-owner changes in equity. The statement of changes in equity includes only details of transactions with owners, with non-owner changes in equity presented in a reconciliation of each component of equity. In addition, the standard introduces the statement of comprehensive income and presents all items of recognised income and expense, either in one single statement, or in two linked statements. The Group has elected to present two statements. The standard also introduced terminology changes to titles for the financial statements. While the Group has changed the "Cash Flow Statement" to "Statement of Cash Flows", it has elected to retain the titles of "Income and Expenditure Account" and "Balance Sheet".

3.2 Amendments to HKAS 32, Financial Instruments: Presentation and HKAS 1 (Revised), Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation

The amendments are related to the classification of certain financial instruments. Puttable financial instruments that represent a residual interest in the net assets of the entity are now classified as equity provided that certain conditions are met. As a result of the adoption of the amendments by the issuers of certain investments held by the Fund, debt securities with carrying value of HK$26,412 million at 31 December 2008 were reclassified as equity securities (note 9).

3.3 Amendments to HKFRS 7, Financial Instruments: Disclosures – Improving Disclosures about Financial Instruments

The amendments require enhanced disclosures about fair value measurements and liquidity risk. The amendments introduce a three-level hierarchy (note 37(b)) for fair value measurement disclosures about financial instruments and require some specific quantitative disclosures for those instruments classified in the lowest level in the hierarchy. These disclosures will help improve comparability between entities about the effects of fair value measurements. In addition, the amendments clarify and enhance the existing requirements for the disclosure of liquidity risk primarily requiring a separate liquidity risk analysis for derivative and non-derivative financial liabilities. The Group has applied the amendments in 2009. The amendments do not require the provision of comparative figures.

3.4 HKFRS 8, Operating Segments

HKFRS 8 replaces HKAS 14, Segment reporting. It requires a "management approach" under which segment information is presented on the same basis as that used for internal reporting purposes. Operating segments are components of an entity regularly reviewed by an entity's chief operating decision maker. Items are reported based on internal reporting. As the business segments reported by the Group in accordance with the requirements of HKAS 14 are the same as the operating segments provided to the chief operating decision maker as required by HKFRS 8, there are no changes to the presentation of operating segments and the results of operating segments on the adoption of HKFRS 8.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

4 INCOME AND EXPENDITURE

(a) Investment income/(loss)

	Group		Fund	
	2009	2008	**2009**	2008
Interest income				
– from derivative financial instruments	**293**	185	**293**	185
– from financial assets designated at fair value	**20,637**	31,721	**20,637**	31,721
– from other financial assets	**1,698**	5,585	**373**	3,759
	22,628	37,491	**21,303**	35,665
Dividend income				
– from financial assets designated at fair value	**7,102**	8,162	**7,102**	8,162
– from other financial assets	**79**	57	**14**	14
– from subsidiaries	**–**	–	**263**	266
	7,181	8,219	**7,379**	8,442
Net realised and revaluation gains/(losses)				
– on derivative financial instruments	**5,390**	(12,984)	**6,204**	(14,471)
– on financial assets and financial liabilities designated at fair value	**67,400**	(102,646)	**66,573**	(101,116)
– on available-for-sale securities	**20**	26	**–**	–
	72,810	(115,604)	**72,777**	(115,587)
Net exchange gains/(losses)	**9,762**	(12,484)	**9,772**	(12,440)
Total	**112,381**	(82,378)	**111,231**	(83,920)

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

(b) Interest expense

	Group		Fund	
	2009	2008	**2009**	2008
Interest expense on derivative financial instruments	**94**	–	**94**	–
Interest expense on Exchange Fund Bills and Notes and other debt securities issued designated at fair value and trading liabilities	**1,166**	2,725	**940**	2,326
Interest expense on other financial liabilities	**34,803**	48,523	**34,750**	47,812
Total	**36,063**	51,248	**35,784**	50,138
Comprises:				
Interest on placements by Fiscal Reserves				
– at a fixed rate determined annually	**33,486**	46,360	**33,486**	46,360
– at market-based rates	**1**	4	**1**	4
Interest on placements by HKSAR government funds and statutory bodies				
– at a fixed rate determined annually	**1,245**	–	**1,245**	–
– at market-based rates	**–**	2	**–**	2
Interest on Exchange Fund Bills and Notes issued	**940**	2,326	**940**	2,326
Other interest expense	**391**	2,556	**112**	1,446
	36,063	51,248	**35,784**	50,138

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

(c) Operating expenses

	Group		Fund	
	2009	2008	**2009**	2008
Staff costs				
Salaries and other staff costs	**785**	713	**645**	584
Retirement benefit costs	**57**	43	**50**	36
Premises and equipment expenses				
Depreciation and amortisation	**140**	142	**106**	110
Rental expenses under operating leases	**37**	28	**36**	28
Other premises expenses	**51**	45	**42**	36
General operating costs				
Maintenance of office and computer equipment	**46**	39	**39**	33
Financial information and communication services	**39**	36	**34**	30
External relations	**19**	18	**17**	17
Service fees for financial infrastructure	**40**	18	**40**	17
Other professional services	**58**	43	**45**	30
Training	**6**	6	**5**	5
Others	**18**	14	**21**	19
Investment management and custodian fees				
Management and custodian fees	**688**	752	**688**	752
Transaction costs	**239**	268	**236**	266
Withholding tax	**382**	481	**382**	481
Others	**17**	11	**17**	11
Total	**2,622**	2,657	**2,403**	2,455

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

The aggregate emoluments of senior staff (Executive Directors and above) of the Group were as follows:

	Group	
	2009	2008
Fixed pay	**58.3**	58.7
Variable pay	**14.5**	16.0
Other benefits	**6.8**	6.5
	79.6	81.2

Other benefits shown above included provident funds, medical and life insurance, gratuity and annual leave accrued during the year. There were no other allowances or benefits-in-kind.

The number of senior staff (Executive Directors and above) of the Group whose emoluments fell within the following bands were:

	Group	
HK$	**2009**	2008
1,500,000 or below	**1**	1
1,500,001 to 2,000,000	**1**	1
3,000,001 to 3,500,000	**2**	1
3,500,001 to 4,000,000	**3**	3
4,000,001 to 4,500,000	**5**	5
4,500,001 to 5,000,000	**–**	2
5,000,001 to 5,500,000	**1**	–
6,500,001 to 7,000,000	**1**	1
7,000,001 to 7,500,000	**1**	2
7,500,001 to 8,000,000	**1**	–
10,000,001 to 10,500,000	**1**	–
11,500,001 to 12,000,000	**–**	1
	17	17

(d) Note and coin expenses

These represent reimbursements to the note-issuing banks in respect of note-issuing expenses and expenses incurred directly by the Fund in issuing government-issued currency notes and coins.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

5 CATEGORIES OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

				Group – 2009				
	Notes	Total	Trading financial instruments (including hedging instruments)	Financial assets and financial liabilities designated at fair value	Loans and receivables	Held-to-maturity securities	Available-for-sale securities	Other financial liabilities
Cash and money at call	6	**17,736**	-	-	17,736	-	-	-
Placements with banks and other financial institutions	7	**112,732**	-	-	112,732	-	-	-
Derivative financial instruments	8(a)	**5,565**	5,565	-	-	-	-	-
Financial assets designated at fair value	9	**1,995,464**	-	1,995,464	-	-	-	-
Available-for-sale securities	10	**7,678**	-	-	-	-	7,678	-
Held-to-maturity securities	11	**5,883**	-	-	-	5,883	-	-
Loan portfolio	12	**43,789**	-	-	43,789	-	-	-
Other assets	14	**15,063**	-	-	15,063	-	-	-
Financial assets		**2,203,910**	5,565	1,995,464	189,320	5,883	7,678	-
Certificates of Indebtedness	20	**199,006**	-	-	-	-	-	199,006
Government-issued currency notes and coins in circulation	20	**8,427**	-	-	-	-	-	8,427
Balance of the banking system	21	**264,567**	-	-	-	-	-	264,567
Derivative financial instruments	8(a)	**1,031**	1,031	-	-	-	-	-
Placements by banks and other financial institutions	22	**28,311**	-	-	-	-	-	28,311
Placements by Fiscal Reserves	23	**504,123**	-	-	-	-	-	504,123
Placements by HKSAR government funds and statutory bodies	24	**41,836**	-	-	-	-	-	41,836
Exchange Fund Bills and Notes issued	25	**536,429**	-	536,429	-	-	-	-
Other debt securities issued	26	**44,459**	-	2,846	-	-	-	41,613
Mortgage-backed securities issued	27	**2,021**	-	-	-	-	-	2,021
Other liabilities	28	**18,753**	-	-	-	-	-	18,753
Financial liabilities		**1,648,963**	1,031	539,275	-	-	-	1,108,657

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

					Group – 2008			
	Notes	Total	Trading financial instruments (including hedging instruments)	Financial assets and financial liabilities designated at fair value	Loans and receivables	Held-to-maturity securities	Available-for-sale securities	Other financial liabilities
Cash and money at call	6	19,447	–	–	19,447	–	–	–
Placements with banks and other financial institutions	7	156,529	–	–	156,529	–	–	–
Derivative financial instruments	8(a)	9,967	9,967	–	–	–	–	–
Financial assets designated at fair value	9	1,347,499	–	1,347,499	–	–	–	–
Available-for-sale securities	10	2,545	–	–	–	–	2,545	–
Held-to-maturity securities	11	5,713	–	–	–	5,713	–	–
Loan portfolio	12	50,760	–	–	50,760	–	–	–
Other assets	14	19,578	–	–	19,578	–	–	–
Financial assets		1,612,038	9,967	1,347,499	246,314	5,713	2,545	–
Certificates of Indebtedness	20	176,093	–	–	–	–	–	176,093
Government-issued currency notes and coins in circulation	20	8,266	–	–	–	–	–	8,266
Balance of the banking system	21	158,038	–	–	–	–	–	158,038
Derivative financial instruments	8(a)	4,149	4,149	–	–	–	–	–
Placements by banks and other financial institutions	22	13,613	–	–	–	–	–	13,613
Placements by Fiscal Reserves	23	531,370	–	–	–	–	–	531,370
Placements by HKSAR government funds and statutory bodies	24	74	–	–	–	–	–	74
Exchange Fund Bills and Notes issued	25	162,554	–	162,554	–	–	–	–
Other debt securities issued	26	42,786	–	4,713	–	–	–	38,073
Mortgage-backed securities issued	27	3,226	–	–	–	–	–	3,226
Other liabilities	28	31,570	–	–	–	–	–	31,570
Financial liabilities		1,131,739	4,149	167,267	–	–	–	960,323

Exchange Fund – Notes to the Financial Statements (cont.)

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

	Notes	Total	Trading financial instruments	Financial assets and financial liabilities designated at fair value	Loans and receivables	Held-to-maturity securities	Available-for-sale securities	Other financial liabilities
					Fund – 2009			
Cash and money at call	6	**17,658**	**–**	**–**	**17,658**	**–**	**–**	**–**
Placements with banks and other financial institutions	7	**108,636**	**–**	**–**	**108,636**	**–**	**–**	**–**
Derivative financial instruments	8(a)	**4,247**	**4,247**	**–**	**–**	**–**	**–**	**–**
Financial assets designated at fair value	9	**1,995,464**	**–**	**1,995,464**	**–**	**–**	**–**	**–**
Available-for-sale securities	10	**493**	**–**	**–**	**–**	**–**	**493**	**–**
Other assets	14	**14,007**	**–**	**–**	**14,007**	**–**	**–**	**–**
Financial assets		**2,140,505**	**4,247**	**1,995,464**	**140,301**	**–**	**493**	**–**
Certificates of Indebtedness	20	**199,006**	**–**	**–**	**–**	**–**	**–**	**199,006**
Government-issued currency notes and coins in circulation	20	**8,427**	**–**	**–**	**–**	**–**	**–**	**8,427**
Balance of the banking system	21	**264,567**	**–**	**–**	**–**	**–**	**–**	**264,567**
Derivative financial instruments	8(a)	**873**	**873**	**–**	**–**	**–**	**–**	**–**
Placements by banks and other financial institutions	22	**28,311**	**–**	**–**	**–**	**–**	**–**	**28,311**
Placements by Fiscal Reserves	23	**504,123**	**–**	**–**	**–**	**–**	**–**	**504,123**
Placements by HKSAR government funds and statutory bodies	24	**41,836**	**–**	**–**	**–**	**–**	**–**	**41,836**
Exchange Fund Bills and Notes issued	25	**536,429**	**–**	**536,429**	**–**	**–**	**–**	**–**
Other liabilities	28	**12,369**	**–**	**–**	**–**	**–**	**–**	**12,369**
Financial liabilities		**1,595,941**	**873**	**536,429**	**–**	**–**	**–**	**1,058,639**

Exchange Fund – Notes to the Financial Statements (cont.)

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

					Fund – 2008			
	Notes	Total	Trading financial instruments	Financial assets and financial liabilities designated at fair value	Loans and receivables	Held-to-maturity securities	Available-for-sale securities	Other financial liabilities
Cash and money at call	6	19,383	–	–	19,383	–	–	–
Placements with banks and other financial institutions	7	153,395	–	–	153,395	–	–	–
Derivative financial instruments	8(a)	7,729	7,729	–	–	–	–	–
Financial assets designated at fair value	9	1,347,499	–	1,347,499	–	–	–	–
Available-for-sale securities	10	493	–	–	–	–	493	–
Other assets	14	17,792	–	–	17,792	–	–	–
Financial assets		1,546,291	7,729	1,347,499	190,570	–	493	–
Certificates of Indebtedness	20	176,093	–	–	–	–	–	176,093
Government-issued currency notes and coins in circulation	20	8,266	–	–	–	–	–	8,266
Balance of the banking system	21	158,038	–	–	–	–	–	158,038
Derivative financial instruments	8(a)	3,934	3,934	–	–	–	–	–
Placements by banks and other financial institutions	22	13,613	–	–	–	–	–	13,613
Placements by Fiscal Reserves	23	531,370	–	–	–	–	–	531,370
Placements by HKSAR government funds and statutory bodies	24	74	–	–	–	–	–	74
Exchange Fund Bills and Notes issued	25	162,554	–	162,554	–	–	–	–
Other liabilities	28	25,905	–	–	–	–	–	25,905
Financial liabilities		1,079,847	3,934	162,554	–	–	–	913,359

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

6 CASH AND MONEY AT CALL

	Group		Fund	
	2009	2008	**2009**	2008
At amortised cost				
Balance with central banks	**1,339**	1,231	**1,339**	1,231
Balance with banks	**16,397**	18,216	**16,319**	18,152
Total	**17,736**	19,447	**17,658**	19,383

7 PLACEMENTS WITH BANKS AND OTHER FINANCIAL INSTITUTIONS

	Group		Fund	
	2009	2008	**2009**	2008
At amortised cost				
Placements in respect of reverse repurchase agreements				
– with central banks	**38,795**	17,489	**38,795**	17,489
– with banks and other financial institutions	**1,916**	6,119	**1,916**	6,119
Other placements with banks	**72,021**	132,921	**67,925**	129,787
Total	**112,732**	156,529	**108,636**	153,395

8 DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments refer to financial contracts whose value depends on the value of one or more underlying assets or indices with settlement at a future date.

The Group uses derivative financial instruments to manage its exposures to market risk and to facilitate the implementation of investment strategies. The principal derivative financial instruments used are interest rate and currency swap contracts, forward foreign exchange contracts, and currency and bond options contracts, which are primarily over-the-counter derivatives, as well as exchange-traded futures contracts.

Market risk arising from derivative financial instruments is included as part of the overall market risk exposure. The credit risk arising from these transactions is marked against the overall credit exposure to individual counterparties. The financial risk management approaches are outlined in note 36.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

(a) Fair values of derivative financial instruments

Analysis of the fair values of derivative financial instruments held by product type is set out below:

	Group				Fund			
	2009		2008		2009		2008	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Derivatives categorised as trading financial instruments								
Interest rate derivatives								
Interest rate swap contracts	812	308	1,276	150	685	201	1,059	–
Interest rate futures contracts	6	–	–	–	6	–	–	–
Currency derivatives								
Forward foreign exchange contracts	3,550	483	5,506	3,917	3,550	482	5,504	3,917
Others								
Stock index futures contracts	–	161	1,113	–	–	161	1,113	–
Bond futures contracts	6	6	53	17	6	6	53	17
Bond options contracts	–	23	–	–	–	23	–	–
	4,374	981	7,948	4,084	4,247	873	7,729	3,934
Derivatives designated as hedging instruments in fair value hedges								
Interest rate derivatives								
Interest rate swap contracts	1,035	3	1,866	–	–	–	–	–
Currency derivatives								
Currency swap contracts	134	40	124	53	–	–	–	–
	1,169	43	1,990	53	–	–	–	–
Derivatives designated as hedging instruments in cash flow hedges								
Currency derivatives								
Currency swap contracts	22	7	29	12	–	–	–	–
Total	5,565	1,031	9,967	4,149	4,247	873	7,729	3,934

The fair value hedges consist of currency and interest rate swap contracts that are used to protect against changes in the fair value of certain fixed-rate securities due to movements in market interest rates.

The cash flow hedges consist of currency swap contracts that are used to hedge the currency risk arising from foreign currency loan portfolios.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

(b) Notional amounts of derivative financial instruments

Analysis of the notional amounts of derivative financial instruments held based on the remaining periods to settlement at the balance sheet date is set out below. The notional amounts of these instruments indicate the volume of outstanding transactions and do not represent amounts at risk.

	Group Notional amounts with remaining life of									
	2009					2008				
	Total	Up to 3 months	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Total	Up to 3 months	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years
Derivatives categorised as trading financial instruments										
Interest rate derivatives										
Interest rate swap contracts	**63,366**	**3,382**	**11,171**	**39,834**	**8,979**	48,418	20,206	8,758	16,209	3,245
Interest rate futures contracts	**12,724**	**601**	**11,525**	**598**	**-**	-	-	-	-	-
Currency derivatives										
Forward foreign exchange contracts	**161,442**	**156,198**	**5,244**	**-**	**-**	150,129	145,494	4,635	-	-
Others										
Stock index futures contracts	**17,029**	**17,029**	**-**	**-**	**-**	53,812	53,812	-	-	-
Bond futures contracts	**5,923**	**5,923**	**-**	**-**	**-**	17,913	17,913	-	-	-
Bond options contracts	**3,102**	**3,102**	**-**	**-**	**-**	-	-	-	-	-
	263,586	**186,235**	**27,940**	**40,432**	**8,979**	270,272	237,425	13,393	16,209	3,245
Derivatives designated as hedging instruments in fair value hedges										
Interest rate derivatives										
Interest rate swap contracts	**31,373**	**2,968**	**5,724**	**18,406**	**4,275**	25,357	3,287	3,502	13,574	4,994
Currency derivatives										
Currency swap contracts	**8,629**	**740**	**876**	**7,013**	**-**	4,953	227	-	4,266	460
	40,002	**3,708**	**6,600**	**25,419**	**4,275**	30,310	3,514	3,502	17,840	5,454
Derivatives designated as hedging instruments in cash flow hedges										
Currency derivatives										
Currency swap contracts	**11,761**	**861**	**-**	**10,900**	**-**	14,770	253	-	-	14,517
Total	**315,349**	**190,804**	**34,540**	**76,751**	**13,254**	315,352	241,192	16,895	34,049	23,216

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

	Fund Notional amounts with remaining life of									
	2009					2008				
	Total	Up to 3 months	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Total	Up to 3 months	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years
Derivatives categorised as trading financial instruments										
Interest rate derivatives										
Interest rate swap contracts	**42,629**	**-**	**-**	**33,853**	**8,776**	7,550	-	-	4,550	3,000
Interest rate futures contracts	**12,724**	**601**	**11,525**	**598**	**-**	-	-	-	-	-
Currency derivatives										
Forward foreign exchange contracts	**160,540**	**155,989**	**4,551**	**-**	**-**	140,214	136,717	3,497	-	-
Others										
Stock index futures contracts	**17,029**	**17,029**	**-**	**-**	**-**	53,812	53,812	-	-	-
Bond futures contracts	**5,923**	**5,923**	**-**	**-**	**-**	17,913	17,913	-	-	-
Bond options contracts	**3,102**	**3,102**	**-**	**-**	**-**	-	-	-	-	-
Total	**241,947**	**182,644**	**16,076**	**34,451**	**8,776**	219,489	208,442	3,497	4,550	3,000

9 FINANCIAL ASSETS DESIGNATED AT FAIR VALUE

	Group and Fund	
	2009	2008 (restated)
At fair value		
Debt securities		
Treasury bills and commercial paper		
Listed outside Hong Kong	**3,324**	–
Unlisted	**873,782**	285,076
Other debt securities		
Listed outside Hong Kong	**403,258**	416,601
Unlisted	**357,240**	423,194
Total debt securities	**1,637,604**	1,124,871
Equity securities		
Listed		
– in Hong Kong	**142,939**	92,870
– outside Hong Kong	**168,180**	103,346
Unlisted	**46,741**	26,412
Total equity securities	**357,860**	222,628
Total	**1,995,464**	1,347,499

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

10 AVAILABLE-FOR-SALE SECURITIES

	Group		Fund	
	2009	2008	**2009**	2008
Debt securities, at fair value				
Listed				
– in Hong Kong	**78**	49	**–**	–
– outside Hong Kong	**57**	–	**–**	–
Unlisted	**2,452**	1,161	**–**	–
	2,587	1,210	**–**	–
Equity securities				
Listed in Hong Kong, at fair value	**1,026**	842	**–**	–
Unlisted, at cost	**493**	493	**493**	493
	1,519	1,335	**493**	493
Investment funds, at fair value				
Unlisted	**3,572**	–	**–**	–
Total	**7,678**	2,545	**493**	493

The Group's investment in unlisted equity securities at 31 December 2009 represents a holding of 4,285 shares (2008: 4,285 shares) in the Bank for International Settlements. The nominal value of each share is 5,000 Special Drawing Rights and is 25% paid up (also note 34(a)). Fair value has not been ascertained for these shares as they are not freely transferable.

11 HELD-TO-MATURITY SECURITIES

	Group		Fund	
	2009	2008	**2009**	2008
At amortised cost				
Debt securities				
Listed				
– in Hong Kong	**1,167**	1,147	**–**	–
– outside Hong Kong	**2,244**	1,138	**–**	–
Unlisted	**2,472**	3,428	**–**	–
Total	**5,883**	5,713	**–**	–

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

12 LOAN PORTFOLIO

	Group		Fund	
	2009	2008	**2009**	2008
Mortgage loans, at amortised cost	**42,736**	49,408	**–**	–
Non-mortgage loans, at amortised cost	**1,067**	1,403	**–**	–
Allowance for loan impairment	**(14)**	(51)	**–**	–
Total	**43,789**	50,760	**–**	–

13 GOLD

	Group and Fund	
	2009	2008
Gold, at market value		
66,798 ounces (2008: 66,798 ounces)	**572**	448

14 OTHER ASSETS

	Group		Fund	
	2009	2008	**2009**	2008
Interest and dividends receivable	**9,996**	11,306	**9,323**	10,616
Unsettled sales and redemption of securities	**3,698**	6,084	**3,698**	6,084
Prepayments, receivables and other assets	**1,122**	1,882	**739**	815
Staff housing loans	**247**	277	**247**	277
Deferred tax assets	**–**	29	**–**	–
Total	**15,063**	19,578	**14,007**	17,792

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

15 INVESTMENTS IN SUBSIDIARIES

	Fund	
	2009	2008
Unlisted shares, at cost	**2,145**	2,145
Loan to a subsidiary	**2,802**	8,000
Total	**4,947**	10,145

The following is a list of the principal subsidiaries as at 31 December 2009:

Name of company	Place of incorporation and operation	Principal activities	Issued equity capital	Group's interest in equity capital
Hong Kong Note Printing Limited	Hong Kong	Banknote printing	HK$255,000,000	55%
The Hong Kong Mortgage Corporation Limited	Hong Kong	Investment in mortgages and loans, mortgage securitisation and guarantee	HK$2,000,000,000	100%
Eight Finance Investment Company Limited	Hong Kong	Investment holding	HK$1	100%
Bauhinia HKMC Corporation Limited	PRC	Mortgage guarantee business	RMB100,000,000	90%

The HKMC has unissued authorised share capital of HK$1 billion (2008: HK$1 billion), which is callable from the Fund.

Loan to the Eight Finance Investment Company Limited at 31 December 2009 is an unsecured, interest-free loan and repayable on demand. The outstanding loan to the HKMC at 31 December 2008 has been fully repaid.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

16 INTERESTS IN ASSOCIATE AND JOINT VENTURE

	Group		Fund	
	2009	2008	**2009**	2008
Associate				
Unlisted shares, at cost	**–**	–	**–**	–
Share of net assets	**45**	45	**–**	–
	45	45	**–**	–
Joint venture				
Unlisted shares, at cost	**120**	120	**–**	–
Due from a joint venture	**–**	2	**–**	–
Share of net assets	**2**	–	**–**	–
Currency translation difference	**(7)**	(9)	**–**	–
	115	113	**–**	–
Total	**160**	158	**–**	–

Investment in associate comprises unlisted shares of Hong Kong Interbank Clearing Limited directly held by the Fund at a cost of HK$5,000 (2008: HK$5,000). Investment in joint venture comprises unlisted shares of Cagamas HKMC Berhad held by the Group through the HKMC. Details of the associate and joint venture are as follows:

Name of company	Place of incorporation and operation	Principal activities	Issued equity capital	Group's interest in equity capital
Associate				
Hong Kong Interbank Clearing Limited	Hong Kong	Interbank clearing	HK$10,000	50%
Joint venture				
Cagamas HKMC Berhad	Malaysia	Mortgage guarantee business	RM100,000,000	50%

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

17 PROPERTY, PLANT AND EQUIPMENT

(a)

	Group		
	Premises	Plant and equipment	Total
Cost			
At 1 January 2008	624	639	1,263
Additions	–	31	31
Disposals	–	(4)	(4)
At 31 December 2008	624	666	1,290
At 1 January 2009	**624**	**666**	**1,290**
Additions	**–**	**89**	**89**
Disposals	**(3)**	**(7)**	**(10)**
At 31 December 2009	**621**	**748**	**1,369**
Accumulated depreciation			
At 1 January 2008	61	386	447
Charge for the year	14	47	61
Written back on disposal	–	(4)	(4)
At 31 December 2008	75	429	504
At 1 January 2009	**75**	**429**	**504**
Charge for the year	**14**	**47**	**61**
Written back on disposal	**(1)**	**(7)**	**(8)**
At 31 December 2009	**88**	**469**	**557**
Net book value			
At 31 December 2009	**533**	**279**	**812**
At 31 December 2008	549	237	786

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

	Fund		
	Premises	Plant and equipment	Total
Cost			
At 1 January 2008	612	209	821
Additions	–	18	18
Disposals	–	(3)	(3)
At 31 December 2008	612	224	836
At 1 January 2009	**612**	**224**	**836**
Additions	**–**	**26**	**26**
Disposals	**–**	**(6)**	**(6)**
At 31 December 2009	**612**	**244**	**856**
Accumulated depreciation			
At 1 January 2008	58	168	226
Charge for the year	13	16	29
Written back on disposal	–	(3)	(3)
At 31 December 2008	71	181	252
At 1 January 2009	**71**	**181**	**252**
Charge for the year	**14**	**13**	**27**
Written back on disposal	**–**	**(6)**	**(6)**
At 31 December 2009	**85**	**188**	**273**
Net book value			
At 31 December 2009	**527**	**56**	**583**
At 31 December 2008	541	43	584

(b) The net book value of premises comprises:

	Group		Fund	
	2009	2008	**2009**	2008
In Hong Kong Buildings situated on land held on medium-term leases (between 10 and 50 years)	**510**	525	**504**	517
Outside Hong Kong Freehold land and the building situated thereon	**23**	24	**23**	24
Total	**533**	549	**527**	541

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

18 OPERATING LAND LEASE PREPAYMENT

	Group and Fund	
	2009	2008
Cost		
At 1 January and 31 December	**3,231**	3,231
Accumulated amortisation		
At 1 January	**382**	308
Charge for the year	**74**	74
At 31 December	**456**	382
Net book value		
At 31 December	**2,775**	2,849

19 INTANGIBLE ASSETS

	Group and Fund	
	Computer software licences and system development costs	
	2009	2008
Cost		
At 1 January	**246**	237
Additions	**6**	9
At 31 December	**252**	246
Accumulated amortisation		
At 1 January	**231**	224
Charge for the year	**5**	7
At 31 December	**236**	231
Net book value		
At 31 December	**16**	15

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

20 CERTIFICATES OF INDEBTEDNESS, GOVERNMENT-ISSUED CURRENCY NOTES AND COINS IN CIRCULATION

	Group and Fund			
	Certificates of Indebtedness		Government-issued currency notes and coins in circulation	
	2009	2008	**2009**	2008
Carrying amount	**199,006**	176,093	**8,427**	8,266
Reconciliation with face value:				
Hong Kong dollar face value	**HK$200,185**	HK$177,225	**HK$8,477**	HK$8,319
Linked exchange rate for calculating the US dollars required for redemption	**US$1 = HK$7.80**	US$1 = HK$7.80	**US$1 = HK$7.80**	US$1 = HK$7.80
US dollars required for redemption	**US$25,665**	US$22,721	**US$1,087**	US$1,067
Market exchange rate for translation into Hong Kong dollars	**US$1 = HK$7.75405**	US$1 = HK$7.7502	**US$1 = HK$7.75405**	US$1 = HK$7.7502
Carrying amount	**HK$199,006**	HK$176,093	**HK$8,427**	HK$8,266

21 BALANCE OF THE BANKING SYSTEM

Under the interbank payment system based on Real Time Gross Settlement principles, all licensed banks maintain a Hong Kong dollar clearing account with the Hong Kong Monetary Authority (HKMA) for the account of the Fund. The aggregate amount in these clearing accounts, which must not have a negative balance, represents the total level of liquidity in the interbank market.

Under the weak-side Convertibility Undertaking, the HKMA undertakes to convert Hong Kong dollars in these clearing accounts into US dollars at the fixed exchange rate of US$1 = HK$7.85. Likewise, under the strong-side Convertibility Undertaking, licensed banks can convert US dollars into Hong Kong dollars in these accounts, as the HKMA undertakes to buy US dollars at the fixed exchange rate of US$1 = HK$7.75. Within the Convertibility Zone bounded by the two Convertibility Undertakings, the HKMA may choose to conduct market operations in a manner consistent with Currency Board principles. Such operations can result in matching changes in the balances of these accounts.

The balance of the banking system is repayable on demand, non-interest bearing and is shown at its Hong Kong dollar amount.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

22 PLACEMENTS BY BANKS AND OTHER FINANCIAL INSTITUTIONS

	Group and Fund	
	2009	2008
At amortised cost		
Placements by banks	**28,311**	13,613

23 PLACEMENTS BY FISCAL RESERVES

	Group and Fund	
	2009	2008
Placements with interest payable at a fixed rate determined annually		
General Revenue Account	**269,867**	275,773
Land Fund	**175,846**	164,650
Capital Works Reserve Fund	**22,026**	56,062
Civil Service Pension Reserve Fund	**21,631**	20,254
Disaster Relief Fund	**22**	38
Innovation and Technology Fund	**3,971**	4,298
Lotteries Fund	**7,832**	7,033
Capital Investment Fund	**820**	1,301
Loan Fund	**1,821**	1,644
	503,836	531,053
Placements with interest payable at market-based rates		
General Revenue Account	**276**	253
Loan Fund	**–**	19
Capital Works Reserve Fund	**11**	45
	287	317
Total	**504,123**	531,370

Interest on the majority of the placements by Fiscal Reserves is payable at a fixed rate determined every January. The rate is the average annual investment return of the Fund's Investment Portfolio for the past six years or the average annual yield of three-year Exchange Fund Notes for the previous year subject to a minimum of zero percent, whichever is the higher. This rate has been fixed at 6.3% per annum for 2010 and 6.8% for 2009 (2008: 9.4%).

Placements by Fiscal Reserves are not permanently appropriated for the use of the Fund, and the majority is repayable on demand.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

24 PLACEMENTS BY HONG KONG SPECIAL ADMINISTRATIVE REGION GOVERNMENT FUNDS AND STATUTORY BODIES

	Group and Fund	
	2009	2008
Placements with interest payable at a fixed rate determined annually		
Research Endowment Fund	**15,805**	–
Bond Fund	**5,631**	–
Housing Authority	**20,339**	–
	41,775	–
Placements with interest payable at market-based rates		
Deposit Protection Scheme Fund	**61**	74
Total	**41,836**	74

The fixed rate arrangement related to the placements by Fiscal Reserves is also applied to certain HKSAR government funds and statutory bodies. This rate has been fixed at 6.3% per annum for 2010 and 6.8% for 2009.

25 EXCHANGE FUND BILLS AND NOTES ISSUED

	Group and Fund	
	2009	2008
At fair value		
Exchange Fund Bills and Notes issued		
Exchange Fund Bills	**464,304**	90,745
Exchange Fund Notes	**73,125**	72,809
	537,429	163,554
Exchange Fund Bills held	**(1,000)**	(1,000)
Total	**536,429**	162,554

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

EFBN issued are unsecured obligations of the Fund and are one of the components of the Monetary Base in the Currency Board Account. Exchange Fund Bills are issued by the Fund for maturities not exceeding one year. Exchange Fund Notes are issued by the Fund with 2-year, 3-year, 5-year, 7-year, 10-year and 15-year maturities. EFBN issued are valued at offer prices derived from Reuters fixings adjusted by observed market spreads.

EFBN held by the Fund as a result of market making activities are considered as redemption of the EFBN issued and are derecognised.

Short positions in EFBN resulting from market making activities are categorised as "trading liabilities" in accordance with HKAS 39. As at 31 December 2009, there was no short position in EFBN (2008: Nil).

The reconciliation of the redemption amount of EFBN issued at the beginning and the end of year is set out below:

	Group and Fund			
	2009		2008	
	Exchange Fund Bills	**Exchange Fund Notes**	Exchange Fund Bills	Exchange Fund Notes
Issued by Currency Board Operations segment				
Redemption amount at 1 January	**90,753**	**66,900**	76,612	64,300
Issuance	**1,031,328**	**16,400**	261,387	16,400
Redemption	**(657,719)**	**(13,600)**	(247,246)	(13,800)
Redemption amount at 31 December	**464,362**	**69,700**	90,753	66,900
Long positions held by Financial Stability and Other Activities segment				
Redemption amount at 31 December	**(1,000)**	**–**	(1,000)	–
Total redemption amount	**463,362**	**69,700**	89,753	66,900
Carrying amount, at fair value	**463,304**	**73,125**	89,745	72,809
Difference	**58**	**(3,425)**	8	(5,909)

The fair value changes of EFBN issued are attributable to changes in benchmark interest rates.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

26 OTHER DEBT SECURITIES ISSUED

	Group		Fund	
	2009	2008	**2009**	2008
Debt securities issued, carried at amortised cost				
Notes	**4,218**	8,211	**–**	–
Debt securities hedged under fair value hedges where carrying amount is adjusted for changes in value resulting from the hedged risk				
Notes	**37,395**	29,862	**–**	–
	41,613	38,073	**–**	–
Debt securities issued, designated at fair value				
Notes	**2,846**	4,713	**–**	–
Total	**44,459**	42,786	**–**	–

The reconciliation of the redemption amount of other debt securities issued at the beginning and the end of year is set out below:

	Group		Fund	
	2009	2008	**2009**	2008
Total debt securities issued				
Redemption amount at 1 January	**40,939**	32,938	**–**	–
Issuance	**22,689**	24,378	**–**	–
Redemption	**(19,652)**	(16,343)	**–**	–
Exchange difference	**13**	(34)	**–**	–
Redemption amount at 31 December	**43,989**	40,939	**–**	–
Carrying amount	**44,459**	42,786	**–**	–
Difference	**(470)**	(1,847)	**–**	–
Debt securities issued, designated at fair value				
Redemption amount	**3,427**	4,703	**–**	–
Carrying amount, at fair value	**2,846**	4,713	**–**	–
Difference	**581**	(10)	**–**	–

The fair value changes of debt securities issued designated at fair value are attributable to changes in benchmark interest rates.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

27 MORTGAGE-BACKED SECURITIES ISSUED

	Group		Fund	
	2009	2008	**2009**	2008
Mortgage-backed securities issued, carried at amortised cost	**1,051**	1,258	**–**	–
Mortgage-backed securities hedged under fair value hedges where carrying amount is adjusted for changes in value resulting from the hedged risk	**970**	1,968	**–**	–
Total	**2,021**	3,226	**–**	–

The reconciliation of the redemption amount of mortgage-backed securities issued at the beginning and the end of year is set out below:

	Group		Fund	
	2009	2008	**2009**	2008
Total mortgage-backed securities issued				
Redemption amount at 1 January	**3,148**	4,203	**–**	–
Redemption	**(1,172)**	(1,055)	**–**	–
Redemption amount at 31 December	**1,976**	3,148	**–**	–
Carrying amount	**2,021**	3,226	**–**	–
Difference	**(45)**	(78)	**–**	–

28 OTHER LIABILITIES

	Group		Fund	
	2009	2008	**2009**	2008
Unsettled purchases of securities	**11,428**	24,900	**11,428**	24,900
Accrued charges and other liabilities	**6,321**	5,723	**568**	605
Interest payable	**819**	865	**373**	400
Tax payable	**138**	53	**–**	–
Deferred tax liabilities	**47**	29	**–**	–
Total	**18,753**	31,570	**12,369**	25,905

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

29 EQUITY

	Group		Fund	
	2009	2008	**2009**	2008
Attributable to owner of the Fund				
Accumulated surplus				
At 1 January	**484,461**	620,592	**480,485**	616,980
Surplus/(Deficit) for the year	**73,759**	(136,131)	**72,972**	(136,495)
At 31 December	**558,220**	484,461	**553,457**	480,485
Other reserves				
Revaluation reserve				
At 1 January	**(88)**	126	**–**	–
Fair value changes on available-for-sale securities				
– revaluation	**973**	(147)	**–**	–
– realisation on disposal	**(4)**	(25)	**–**	–
– tax effect	**(37)**	30	**–**	–
Cash flow hedges				
– revaluation	**25**	(86)	**–**	–
– tax effect	**(4)**	14	**–**	–
At 31 December	**865**	(88)	**–**	–
Translation reserve				
At 1 January	**(9)**	–	**–**	–
Currency translation difference				
– subsidiary and joint venture	**2**	(9)	**–**	–
At 31 December	**(7)**	(9)	**–**	–
	858	(97)	**–**	–
	559,078	484,364	**553,457**	480,485
Minority interests				
At 1 January	**191**	179	**–**	–
Total comprehensive income for the year	**15**	20	**–**	–
Capital injection by minority interests	**11**	–	**–**	–
Dividends paid to minority interests	**(13)**	(8)	**–**	–
At 31 December	**204**	191	**–**	–
Total	**559,282**	484,555	**553,457**	480,485

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

30 NOTES TO THE STATEMENT OF CASH FLOWS

Analysis of cash and cash equivalents in the statement of cash flows

	Group		Fund	
	2009	2008	**2009**	2008
Cash and money at call	**17,736**	19,447	**17,658**	19,383
Placements with banks and other financial institutions	**110,898**	155,574	**107,105**	152,795
Treasury bills and commercial paper	**79,486**	24,359	**79,486**	24,359
Total	**208,120**	199,380	**204,249**	196,537

Reconciliation with the balance sheet

		Group		Fund	
	Notes	**2009**	2008	**2009**	2008
Amounts shown in the balance sheet					
Cash and money at call	6	**17,736**	19,447	**17,658**	19,383
Placements with banks and other financial institutions	7	**112,732**	156,529	**108,636**	153,395
Financial assets designated at fair value					
Treasury bills and commercial paper	9	**877,106**	285,076	**877,106**	285,076
		1,007,574	461,052	**1,003,400**	457,854
Less: Amounts with original maturity beyond 3 months		**(799,454)**	(261,672)	**(799,151)**	(261,317)
Cash and cash equivalents in the statement of cash flows		**208,120**	199,380	**204,249**	196,537

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

31 OPERATING SEGMENT INFORMATION

The Group determines its operating segments based on the reports reviewed by the chief operating decision maker. As a central banking institution, the HKMA is responsible for managing the Exchange Fund, maintaining the monetary and banking stability of Hong Kong. The Group comprises operating segments as stated in note 2.19.

	Group									
	Currency Board Operations		Reserves Management		Currency Board Operations and Reserves Management		Financial Stability and Other Activities		Total	
	2009	2008	**2009**	2008	**2009**	2008	**2009**	2008	**2009**	2008
Income/(Loss)	**(1,441)**	22,897	**112,404**	(107,379)	**110,963**	(84,482)	**1,940**	2,574	**112,903**	(81,908)
Expenditure										
Interest expense	**940**	2,325	**34,844**	47,810	**35,784**	50,135	**279**	1,113	**36,063**	51,248
Other expenses (note 31(b))	**–**	–	**–**	–	**1,447**	1,637	**1,471**	1,285	**2,918**	2,922
	940	2,325	**34,844**	47,810	**37,231**	51,772	**1,750**	2,398	**38,981**	54,170
Surplus/(Deficit) before share of profit of associate and joint venture	**(2,381)**	20,572	**77,560**	(155,189)	**73,732**	(136,254)	**190**	176	**73,922**	(136,078)
Share of profit of associate and joint venture	**–**	–	**–**	–	**–**	–	**2**	2	**2**	2
Surplus/(Deficit) before taxation	**(2,381)**	20,572	**77,560**	(155,189)	**73,732**	(136,254)	**192**	178	**73,924**	(136,076)
Income tax	**–**	–	**–**	–	**–**	–	**(150)**	(35)	**(150)**	(35)
Surplus/(Deficit) for the year	**(2,381)**	20,572	**77,560**	(155,189)	**73,732**	(136,254)	**42**	143	**73,774**	(136,111)
Attributable to:										
Owner of the Fund	**(2,381)**	20,572	**77,560**	(155,189)	**73,732**	(136,254)	**27**	123	**73,759**	(136,131)
Minority interests	**–**	–	**–**	–	**–**	–	**15**	20	**15**	20
	(2,381)	20,572	**77,560**	(155,189)	**73,732**	(136,254)	**42**	143	**73,774**	(136,111)

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

	Group											
	Currency Board Operations		Reserves Management		Currency Board Operations and Reserves Management		Financial Stability and Other Activities		Re-allocation (note 31(c) & (d))		Total	
	2009	2008	**2009**	2008	**2009**	2008	**2009**	2008	**2009**	2008	**2009**	2008
Assets												
Backing Assets												
Investment in designated US dollar assets	**1,079,351**	566,950	**-**	-	**1,079,351**	566,950	**-**	-	**-**	-	**1,079,351**	566,950
Interest receivable on designated US dollar assets	**1,738**	1,976	**-**	-	**1,738**	1,976	**-**	-	**-**	-	**1,738**	1,976
Net accounts payable	**-**	(14,328)	**-**	-	**-**	(14,328)	**-**	-	**-**	14,328	**-**	-
Other investments	**-**	-	**1,043,672**	946,096	**1,043,672**	946,096	**61,991**	71,054	**(1,000)**	(1,000)	**1,104,663**	1,016,150
Other assets	**-**	-	**15,742**	22,238	**15,742**	22,238	**6,279**	8,022	**472**	958	**22,493**	31,218
Total assets	**1,081,089**	554,598	**1,059,414**	968,334	**2,140,503**	1,522,932	**68,270**	79,076	**(528)**	14,286	**2,208,245**	1,616,294
Liabilities												
Monetary Base												
Certificates of Indebtedness	**199,006**	176,093	**-**	-	**199,006**	176,093	**-**	-	**-**	-	**199,006**	176,093
Government-issued currency notes and coins in circulation	**8,427**	8,266	**-**	-	**8,427**	8,266	**-**	-	**-**	-	**8,427**	8,266
Balance of the banking system	**264,567**	158,038	**-**	-	**264,567**	158,038	**-**	-	**-**	-	**264,567**	158,038
Exchange Fund Bills and Notes issued	**537,429**	163,554	**-**	-	**537,429**	163,554	**-**	-	**(1,000)**	(1,000)	**536,429**	162,554
Interest payable on Exchange Fund Notes	**373**	398	**-**	-	**373**	398	**-**	-	**-**	-	**373**	398
Net accounts (receivable)/payable	**(336)**	(958)	**-**	-	**(336)**	(958)	**-**	-	**472**	958	**136**	-
Other debt securities issued	**-**	-	**-**	-	**-**	-	**44,459**	42,786	**-**	-	**44,459**	42,786
Mortgage-backed securities issued	**-**	-	**-**	-	**-**	-	**2,021**	3,226	**-**	-	**2,021**	3,226
Placements by banks and other financial institutions	**-**	-	**28,311**	13,613	**28,311**	13,613	**-**	-	**-**	-	**28,311**	13,613
Placements by Fiscal Reserves	**-**	-	**504,123**	531,370	**504,123**	531,370	**-**	-	**-**	-	**504,123**	531,370
Placements by HKSAR government funds and statutory bodies	**-**	-	**41,775**	-	**41,775**	-	**61**	74	**-**	-	**41,836**	74
Other liabilities	**-**	-	**12,615**	14,999	**12,615**	14,999	**6,660**	5,994	**-**	14,328	**19,275**	35,321
Total liabilities	**1,009,466**	505,391	**586,824**	559,982	**1,596,290**	1,065,373	**53,201**	52,080	**(528)**	14,286	**1,648,963**	1,131,739

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

	Group											
	Currency Board Operations		Reserves Management		Currency Board Operations and Reserves Management		Financial Stability and Other Activities		Re-allocation (note 31(c) & (d))		Total	
	2009	2008	**2009**	2008	**2009**	2008	**2009**	2008	**2009**	2008	**2009**	2008
Accumulated surplus												
At 1 January	**49,207**	37,213	**408,352**	559,482	**457,559**	596,695	**26,902**	23,897	**-**	-	**484,461**	620,592
Surplus/(Deficit) for the year attributable to owner of the Fund	**(2,381)**	20,572	**77,560**	(155,189)	**73,732**	(136,254)	**27**	123	**-**	-	**73,759**	(136,131)
Transfer between Currency Board Operations and general reserves (note 31(e))	**24,797**	(8,578)	**(14,065)**	4,059	**12,179**	(2,882)	**(12,179)**	2,882	**-**	-	**-**	-
At 31 December	**71,623**	49,207	**471,847**	408,352	**543,470**	457,559	**14,750**	26,902	**-**	-	**558,220**	484,461
Other reserves	**-**	-	**743**	-	**743**	-	**115**	(97)	**-**	-	**858**	(97)
Minority interests	**-**	-	**-**	-	**-**	-	**204**	191	**-**	-	**204**	191
Total equity	**71,623**	49,207	**472,590**	408,352	**544,213**	457,559	**15,069**	26,996	**-**	-	**559,282**	484,555
Total liabilities and equity	**1,081,089**	554,598	**1,059,414**	968,334	**2,140,503**	1,522,932	**68,270**	79,076	**(528)**	14,286	**2,208,245**	1,616,294

(a) Currency Board Operations

Starting from 1 October 1998, specific US dollar assets of the Fund have been designated to back the Monetary Base, which comprises Certificates of Indebtedness, government-issued currency notes and coins in circulation, the balance of the banking system and EFBN issued. While specific assets of the Fund have been earmarked for backing the Monetary Base, all the Fund's assets have continued to be available for the purpose of supporting the Hong Kong dollar exchange rate under the Linked Exchange Rate system.

(b) Other expenses

"Other expenses" of Currency Board Operations segment and Reserves Management segment are aggregated as there is no meaningful basis to allocate between these two segments.

(c) Re-allocation of assets and liabilities

For the purpose of the Currency Board Operations segment, certain liabilities of the Fund are deducted from the Backing Assets and certain assets are deducted from the Monetary Base in order to allow proper computation of the Backing Ratio. This re-allocation adjustment adds back these items in order to reconcile the segmental information to the Group balance sheet.

As at 31 December 2009, deduction from the Backing Assets comprises:

– "other liabilities" of Nil (2008: HK$14,328 million) – Accounts payable for unsettled purchases of securities are included in "net accounts payable" to offset corresponding investments in the Backing Assets.

As at 31 December 2009, deductions from the Monetary Base comprise:

– "other assets" of HK$472 million (2008: HK$958 million) – As Hong Kong dollar interest rate swaps have been used as a means to manage the cost of issuing Exchange Fund Notes, interest receivable of HK$19 million (2008: HK$11 million) and revaluation gains of HK$453 million (2008: HK$947 million) on these interest rate swaps are included in "net accounts (receivable)/payable" to reduce the Monetary Base.

(d) EFBN held by the Financial Stability and Other Activities segment are treated as redemption of EFBN issued in the Currency Board Operations segment.

(e) In accordance with an arrangement approved by the Financial Secretary in January 2000, assets can be transferred between the Backing Portfolio and general reserves when the Backing Ratio reaches either the upper trigger point (112.5%) or the lower trigger point (105%). This arrangement allows transfer of excess assets out of the Backing Portfolio to maximise their earning potential while ensuring that there are sufficient liquid assets in the Backing Portfolio.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

32 PLEDGED ASSETS

Assets are pledged as margin for stock index and bond futures contracts as well as securities lending agreements, and as securities for issuing mortgage-backed securities. Securities lent do not include EFBN in issue. There are no financial assets pledged against contingent liabilities.

		Group		Fund	
	Notes	**2009**	2008	**2009**	2008
Secured liabilities					
Stock index futures contracts – notional amount	8(b)	**17,029**	53,812	**17,029**	53,812
Bond futures contracts – notional amount	8(b)	**5,923**	17,913	**5,923**	17,913
Interest rate futures contracts – notional amount	8(b)	**12,724**	–	**12,724**	–
Mortgage-backed securities issued	27	**2,021**	3,226	**–**	–
Assets pledged					
Financial assets designated at fair value		**2,457**	8,884	**2,457**	8,884
Held-to-maturity securities		**–**	445	**–**	–
Placements with banks		**34**	36	**–**	–
Mortgage loans		**1,906**	2,622	**–**	–

During the year, the Group entered into collateralised reverse repurchase agreements, repurchase agreements and securities lending transactions that may result in credit exposure in the event that the counterparty to the transaction is unable to fulfil its contractual obligations. The Group controls credit risk associated with these activities by monitoring counterparty credit exposure and collateral values on a daily basis and requiring additional collateral to be deposited with or returned to the Group when deemed necessary.

These transactions are conducted under terms that are usual and customary to standard lending, and securities borrowing and lending activities.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

33 COMMITMENTS

(a) Capital commitments

Capital expenditure authorised but not provided for in the financial statements at the balance sheet date was as follows:

	Group		Fund	
	2009	2008	**2009**	2008
Contracted for	**8**	48	**8**	6
Authorised but not yet contracted for	**161**	189	**136**	159
	169	237	**144**	165

(b) Credit facility to the International Monetary Fund

The Fund has participated in the New Arrangements to Borrow (NAB), a standby credit facility provided to the International Monetary Fund (IMF) for the purpose of managing instability in the international monetary system. At 31 December 2009, the Fund had an undertaking under the NAB to lend foreign currencies to the IMF up to HK$4,133 million equivalent (2008: HK$4,059 million equivalent), in the form of a five-year term loan bearing prevailing market interest rates. As at 31 December 2009, there was no outstanding balance due from the IMF under this NAB facility (2008: Nil).

(c) Credit facility to the Hong Kong Deposit Protection Board

The Fund has provided the Hong Kong Deposit Protection Board (HKDPB) with a standby credit facility of HK$40 billion (2008: HK$40 billion) at prevailing market interest rates for meeting the necessary liquidity required for payment of compensation in the event of a bank failure. As at 31 December 2009, there was no outstanding balance due from the HKDPB under this facility (2008: Nil).

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

(d) Credit facility to The Hong Kong Mortgage Corporation Limited

The Fund has provided the HKMC with a revolving credit facility of HK$30 billion (2008: HK$30 billion) at prevailing market interest rates. As at 31 December 2009, there was no outstanding balance due from the HKMC under this facility (2008: HK$8 billion) (note 15).

(e) Repurchase agreements with other central banks

The Fund has entered into bilateral repurchase agreements with various central banks in Asia and Australasia amounting up to HK$44,586 million equivalent (2008: HK$44,564 million equivalent). The arrangement allows each organisation to enhance the liquidity of its foreign reserve portfolio with minimal additional risk. As at 31 December 2009, there was no outstanding transaction with any central bank under this arrangement (2008: Nil).

(f) Investment commitments

The Group's subsidiary, the Eight Finance Investment Company Limited, had investment commitments of HK$9,351 million at 31 December 2009 (2008: Nil).

(g) Lease commitments

At 31 December 2009, the total future minimum lease payments under non-cancellable operating leases of premises were payable as follows:

	Group		Fund	
	2009	2008	**2009**	2008
Not later than one year	**37**	32	**35**	32
Later than one year and not later than five years	**64**	97	**64**	97
Later than five years	**–**	2	**–**	2
Total	**101**	131	**99**	131

34 CONTINGENT LIABILITIES

(a) At 31 December 2009, the Fund had a contingent liability of up to 16.1 million Special Drawing Rights or HK$195 million equivalent (2008: 16.1 million Special Drawing Rights or HK$192 million equivalent), in respect of the uncalled portion of its 4,285 shares (2008: 4,285 shares) in the Bank for International Settlements (note 10).

(b) To further strengthen confidence in Hong Kong's banking system, the Financial Secretary announced on 14 October 2008 the use of the Fund to guarantee the repayment of all customer deposits held with all authorized institutions in Hong Kong. This guarantee covers all protected deposits as defined in the Deposit Protection Scheme Ordinance, were the Ordinance to apply to all authorized institutions including licensed banks, restricted licence banks and deposit-taking companies. It will cover the amount of deposits in excess of that protected under the Deposit Protection Scheme. This guarantee has not been triggered as of 31 December 2009. The Financial Secretary does not expect that the arrangement will need to be triggered, since the Hong Kong banking sector is fundamentally sound. The guarantee is valid until the end of 2010.

35 MATERIAL RELATED PARTY TRANSACTIONS

Transactions with related parties are conducted at rates determined by the Monetary Authority taking into account the nature of each transaction on a case-by-case basis.

In addition to the transactions and balances disclosed elsewhere in these financial statements, during the year, the Group, through the HKMC, purchased HK$173 million (2008: HK$71 million) of mortgage loans from the HKSAR Government.

The Exchange Fund Advisory Committee (EFAC) through its Sub-Committees advises the Financial Secretary in his control of the Fund. Members of the EFAC and its Sub-Committees are appointed in a personal capacity by the Financial Secretary for the expertise and experience that they can bring to the Committees. It is not appropriate to disclose details of transactions with companies related to Committee members as all such transactions have been conducted as a normal part of the operation of the Group and on terms consistent with its ongoing operations.

36 FINANCIAL RISK MANAGEMENT

This note presents information about the nature and extent of risks to which the Group is exposed, in particular those arising from financial instruments, and the risk management framework of the Group. The principal financial risks the Group is exposed to are credit risk, market risk and liquidity risk.

36.1 Governance

The Financial Secretary is advised by the EFAC in his control of the Fund. The 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 Fund. Members of the EFAC are appointed in a personal capacity by the Financial Secretary under the delegated authority of the Chief Executive of the HKSAR for the expertise and experience that they can bring to the Committee. Such expertise and experience include knowledge of monetary, financial and economic affairs and of investment issues, as well as of accounting, management, business and legal matters.

The 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 the EFAC.

Among these Sub-Committees, the Investment Sub-Committee (ISC) monitors the HKMA's investment management activities and makes recommendations on the investment policy and strategy of the Fund and on risk management and other related matters. Operating within the policies and guidelines endorsed by the EFAC, the Reserves Management Department of the HKMA conducts the day-to-day investment management and risk management of the Fund.

36.2 Investment management and control

Investment activities of the Fund are conducted in accordance with the investment benchmark derived from the Fund's investment objectives. The investment benchmark directs the long-term strategic asset allocation of the Fund and is reviewed on a regular basis to ensure that it consistently meets the investment objectives. Changes to the investment benchmark, if required, must be endorsed by the EFAC.

The Fund's asset allocation and currency mix set out in the investment benchmark were as follows:

	2009 and 2008
Asset type	
Bonds	**75%**
Equities and related investments	**25%**
	100%
Currency	
US dollar and other currencies[1]	**86%**
Euro, yen, sterling and other currencies[2]	**14%**
	100%

1 Including mainly Hong Kong dollar, Australian dollar, Canadian dollar and Singapore dollar.
2 Including mainly Swiss franc, Swedish krona, Norwegian krone and Danish krone.

In addition to the investment benchmark, the EFAC determines the tactical deviation limits governing the extent to which the Fund's asset and currency allocations may deviate from the investment benchmark. The tactical deviation limits are used to guide the medium term investments for the Fund. The tactical deviation limits are derived from a risk-based approach, taking into account the risk tolerance level set by the EFAC and risk contributions of the asset classes and markets that the Fund is allowed to invest in. These risk contributions reflect the neutral allocations of asset markets within the investment benchmark, and the volatility of and correlation across asset markets. Authority to take medium term investment decisions is delegated to senior management of the HKMA down to the Executive Director level.

The Risk Management and Compliance Division (RMC) of the Reserves Management Department is responsible for risk management and compliance monitoring regarding the investments of the Fund. The RMC monitors the risk exposure of the Fund, checks compliance of investment activities against established guidelines and reports and follows up any identified breaches.

36.3 Credit risk

Credit risk is the risk of financial loss when a counterparty or a borrower fails to meet its contractual obligations. It arises principally from the investments of the Fund.

36.3.1 Management of credit risk

The HKMA maintains effective credit risk management over the investments of the Fund. Based on the delegated authority of the EFAC, the Credit Review and Compliance Committee (CRCC) was established within the HKMA with the following responsibilities: (i) to establish and maintain the Credit Exposure Policy to govern the investments of the Fund; (ii) to review the adequacy of the existing credit risk management practices and, where necessary, formulate proposals for amendments; (iii) to conduct analysis of credit risk issues; (iv) to establish and review credit limits for the approved issuers and counterparties; and (v) to monitor the compliance of the investments of the Fund with the established policies and limits, and report and follow up any identified breaches. The CRCC is chaired by the Deputy Chief Executive (Monetary) whose responsibilities are independent of the day-to-day investment activities of the Fund, and includes representatives from both the Reserves Management Department and the Monetary Management Department of the HKMA.

As an on-going effort to strengthen the credit risk management system of the HKMA to be in line with best market practices, refinements have been introduced in 2009 to the methodology by making reference to an expanded set of factors in assessing the credit-worthiness of the HKMA's counterparties and determining their credit limits. The HKMA will remain vigilant in monitoring and controlling the Fund's credit risk exposure, and will sustain the impetus for better credit risk management practices to support the investment activities of the Fund.

Credit limits are established in accordance with in-house methodologies as set out in the Exchange Fund Investment Policy and Credit Exposure Policy to control the exposures to counterparty, issuer and country risks arising from the investments of the Fund.

(a) Counterparty risk

The Fund selects its counterparties in lending, placement, derivatives and trading transactions prudently and objectively. Since the Fund will conduct transactions with a counterparty for a range of financial instruments, credit limits are established to control the overall exposure to each authorised counterparty based on its credit ratings, financial strength, the size of its total assets and capital, and other relevant information.

Counterparty credit exposures are measured according to the risk nature of financial products involved in the transaction. Counterparty credit exposures of derivatives include an estimate for the potential future credit exposure of the derivative contracts, in addition to their positive mark-to-market replacement value.

(b) Issuer risk

Issuer risk arises from investments in debt securities. Credit limits for approved issuers are set on an individual and group level to control the risk of loss caused by the default of debt securities issuers and to prevent undue risk concentration.

Moreover, to be qualified as an approved investment, a new market or financial instrument must meet the minimum credit, security and liquidity requirements of the Fund.

(c) Country risk

Country risk is broadly defined to include both the transfer risk and the sovereign risk. Under the existing framework, country limits are established to control the Fund's overall credit risk exposures to the countries endorsed by the EFAC. These country limits are set to reflect the status of a country's sovereign credit quality and the risks of default of the debt issued by its government.

The above credit limits are reviewed regularly. Credit exposure is monitored against these limits on a daily basis. To ensure prompt identification, proper approval and consistent monitoring of credit risk, the Fund has implemented a unified automated credit monitoring system which provides fully-integrated straight-through-processing linking the front, middle and back office functions. The pre-deal checking takes place in the front office prior to the commitment of any transaction to ensure that the intended transaction will not exceed the credit limits. The end-of-day compliance checking further verifies that the Fund complies with the established credit policies and procedures.

Any breaches of credit limits are reported to the CRCC, the ISC and the EFAC, and are followed up by the RMC in a timely manner. The approval authorities to sanction these breaches are set out in the Credit Exposure Policy.

To manage the exposure to credit risk arising from the loan portfolio and mortgage insurance business, a four-pronged approach is established for (i) selecting Approved Sellers carefully, (ii) adopting prudent mortgage purchasing criteria and insurance eligibility criteria, (iii) conducting effective due diligence reviews and (iv) ensuring adequate protection for higher-risk mortgages.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

36.3.2 Exposure to credit risk

The use of the Fund to guarantee the repayment of all customer deposits held with all authorized institutions in Hong Kong (note 34(b)) gives rise to credit risk. This guarantee has not been triggered as of 31 December 2009. The Financial Secretary does not expect that the arrangement will need to be triggered, since the Hong Kong banking sector is fundamentally sound.

The maximum exposure to credit risk arising from other financial instruments at the balance sheet date without taking into account any collateral held or other credit enhancements is shown below:

		Group		Fund	
	Notes	**2009**	2008 (restated)	**2009**	2008 (restated)
Cash and money at call	6	**17,736**	19,447	**17,658**	19,383
Placements with banks and other financial institutions	7	**112,732**	156,529	**108,636**	153,395
Derivative financial instruments	8(a)	**5,565**	9,967	**4,247**	7,729
Debt securities designated at fair value	9	**1,637,604**	1,124,871	**1,637,604**	1,124,871
Available-for-sale debt securities	10	**2,587**	1,210	**–**	–
Held-to-maturity securities	11	**5,883**	5,713	**–**	–
Loan portfolio	12	**43,789**	50,760	**–**	–
Other assets		**15,063**	19,549	**14,007**	17,792
Loan to a subsidiary	15	**–**	–	**2,802**	8,000
Due from a joint venture	16	**–**	2	**–**	–
Mortgage insurance risk in force	36.6	**14,921**	9,831	**–**	–
Loan commitments and other credit related commitments		**88,719**	88,623	**118,719**	110,623
Total		**1,944,599**	1,486,502	**1,903,673**	1,441,793

The loan portfolio is secured by mortgages on properties. Reserve funds and deferred considerations are also used as an additional form of credit enhancement.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

36.3.3 Credit quality

The Group predominantly invests in liquid Organisation for Economic Co-operation and Development (OECD) government bonds and other quasi-government debt securities issues. As at 31 December 2009, approximately 95% (2008: 96%) of the debt securities held by the Group were rated "triple-A" by Moody's or Standard and Poor's. The credit quality of major financial assets is analysed below:

	Group		Fund	
	2009	2008 (restated)	**2009**	2008 (restated)
Cash and money at call, placements with banks and other financial institutions, by credit rating[1]				
AAA	**40,107**	19,446	**40,107**	19,446
AA- to AA +	**32,035**	95,842	**28,083**	93,861
A- to A +	**57,411**	59,754	**57,191**	58,538
Lower than A- (including un-rated risk)	**915**	934	**913**	933
	130,468	175,976	**126,294**	172,778
Debt securities, by credit rating[1]				
AAA	**1,563,347**	1,087,389	**1,562,078**	1,086,784
AA- to AA +	**28,629**	27,099	**22,273**	21,330
A- to A +	**5,561**	3,732	**4,716**	3,183
Lower than A- (including un-rated risk)	**48,537**	13,574	**48,537**	13,574
	1,646,074	1,131,794	**1,637,604**	1,124,871
Loan portfolio				
Neither past due nor impaired (note (a))	**42,855**	49,761	**–**	–
Past due but not impaired (note (b))	**943**	1,027	**–**	–
Impaired (note (c))	**5**	23	**–**	–
Allowance for loan impairment	**(14)**	(51)	**–**	–
	43,789	50,760	**–**	–
Total	**1,820,331**	1,358,530	**1,763,898**	1,297,649

[1] The lower of ratings designated by rating agencies Moody's and Standard and Poor's.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

(a) Loans that are neither past due nor impaired

An internal rating system is used for assessing the credit quality of the loan portfolio. Grades 1 to 5 are loans that are neither past due nor impaired. Grades 1 to 3 include loans with no past due experience and with different level of credit enhancement in additional to the collateral. Grade 4 includes loans with past due experience and credit enhancement in additional to the collateral. Grade 5 includes loans with past due experience and collateral but without further credit enhancement. The following analysis shows the credit quality of loans that were neither past due nor impaired at the balance sheet date:

	Group		Fund	
	2009	2008	**2009**	2008
Grades				
1 to 3	**42,794**	49,726	**–**	–
4	**–**	2	**–**	–
5	**61**	33	**–**	–
Total	**42,855**	49,761	**–**	–

(b) Loans that are past due but not impaired

These are loans where contractual interest or principal payments are past due but the Group believes that recognising an impairment loss is not appropriate on the basis of the level of collateral held. The following analysis shows the loans that were past due but not impaired at the balance sheet date:

	Group		Fund	
	2009	2008	**2009**	2008
Loans that were past due				
90 days or less	**933**	1,021	**–**	–
91 – 180 days	**5**	4	**–**	–
over 180 days	**5**	2	**–**	–
Total	**943**	1,027	**–**	–
Fair value of collateral and other credit enhancements	**2,753**	2,174	**–**	–

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

(c) Impaired loans

These are loans where the Group determines on an individual basis that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan agreements. At 31 December 2009, the fair value of related collateral held and credit enhancement was HK$9 million (2008: HK$27 million).

36.3.4 Concentration of credit risk

The Group has no significant concentration of credit risk. Credit risk of the Group is spread over a large number of counterparties and countries. The following table analyses the maximum credit risk exposure (note 36.3.2) by industry groups:

	Group		Fund	
	2009	2008 (restated)	**2009**	2008 (restated)
Governments and government agencies[1]	**1,631,417**	1,127,900	**1,631,104**	1,127,556
Supra-nationals	**42,012**	44,674	**41,967**	44,576
States, provinces and public-sector entities[2]	**41,764**	41,636	**70,913**	70,815
Financial institutions	**103,125**	172,362	**92,559**	164,339
Others	**126,281**	99,930	**67,130**	34,507
Total	**1,944,599**	1,486,502	**1,903,673**	1,441,793

1 Including debt securities guaranteed by governments.
2 Including debt securities guaranteed by states.

36.4 Market risk

Market risk is the risk that changes in market variables such as interest rates, equity prices and exchange rates may affect the fair value or cash flows of a financial instrument.

36.4.1 Types of market risk

(a) Interest rate risk

Interest rate risk refers to the risk of loss arising from changes in market interest rates. This can be further classified into fair value interest rate risk and cash flow interest rate risk.

Fair value interest rate risk is the risk that the fair value of a financial instrument will fluctuate because of changes in market interest rates. The Group is exposed to fair value interest rate risk since a substantial portion of its investments is in fixed-rate debt securities. These securities are subject to interest rate risk as their fair values will fall when market interest rates increase. Other significant financial assets and financial liabilities with a fixed interest rate and therefore subject to interest rate risk include placements with banks and other financial institutions and EFBN issued.

Cash flow interest rate risk is the risk that future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Because the Group has no significant floating-rate investments and liabilities other than the loan portfolio, the Group's future cash flows are not materially affected by potential changes in market interest rates.

(b) Currency risk

Currency risk is the risk of loss arising from changes in foreign exchange rates. A large portion of the Group's foreign currency assets is held in US dollars with the remaining in other major international currencies. When the exchange rates of the relevant foreign currencies against the Hong Kong dollar fluctuate, the value of these foreign currency assets expressed in Hong Kong dollar will vary accordingly.

Due to the linked exchange rate of the US dollar relative to the Hong Kong dollar, the Group's currency risk principally arises from its assets and liabilities denominated in foreign currencies other than the US dollar.

(c) Equity price risk

Equity price risk is the risk of loss arising from changes in equity prices. The Group's equity investments are subject to equity price risk since the value of these investments will decline if equity prices fall.

The majority of the equity securities held by the Group are constituent stocks of major stock market indexes and companies with large market capitalisation.

36.4.2 Management of market risk

The market risk of the Fund as a whole is regularly measured and monitored to prevent excessive risk exposure. The investment benchmark and tactical deviation limits of the Fund govern the asset allocation strategies. This, together with the volatility of asset markets, will affect the Fund's market risk exposure. The Fund uses derivative financial instruments to manage its exposures to market risk and to facilitate the implementation of investment strategies. The market risk of the Fund is mainly measured and monitored using the Value-at-Risk (VaR) methodology.

VaR is calculated using the parametric approach based on a 95% confidence level and one-month time horizon. The result represents the maximum expected loss of the Fund over a one-month period under normal market conditions, with a 5% chance that the actual loss may exceed the calculated VaR. The Fund's absolute VaR and the relative VaR (i.e. the VaR of the Fund relative to its investment benchmark), expressed in dollar amounts, are measured by the RMC and reported to management, the ISC and the EFAC on a regular basis.

The relative VaR of the Fund is also used to calculate the actual tracking error of the Fund against its investment benchmark. This is regularly monitored against the tracking error limit endorsed by the EFAC to ensure that the market risk exposure of the Fund is within its limit. The tracking error of a portfolio indicates how well the portfolio tracks its investment benchmark. The smaller the tracking error, the better the portfolio tracks its benchmark. The tracking error limit is established to prevent the Fund from taking unduly large market risk with respect to its investment benchmark. The actual tracking error of the Fund is regularly reported to the ISC and the EFAC, and any breach of the limit is followed up in a timely manner.

VaR is a widely accepted measure of market risk within the financial services industry. It provides users with a single amount to measure market risk and takes into account multiple risks. VaR should however be assessed in the context of some of its inherent limitations. The calculation of VaR involves a number of assumptions that may or may not be valid in a real life scenario, in particular in extreme market conditions. The calculation of VaR assumes that future events can be predicted by historical data, and that changes in risk factors follow a normal distribution. The end-of-day basis does not reflect intraday exposures. In addition, the confidence level on which calculation of VaR is based needs to be taken into account as it indicates the possibility that a larger loss could be realised.

To compensate for some of the limitations of VaR, the HKMA also conducts stress tests to estimate the potential losses under extremely adverse market conditions. This serves to identify the major attributes of market risk under extreme market conditions, and helps to prevent the Fund from being exposed to excessive market risk. The results of the stress tests are also reported to the ISC and the EFAC on a regular basis.

In addition, to manage the interest rate risk arising from the fixed-rate debt securities issued by the Group to fund the purchase of portfolios of loans, a major portion of the risk is hedged using fair value hedges in the form of interest rate swaps by swapping into floating-rate funding to better match the floating-rate assets.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

36.4.3 Exposure to market risk

(a) Interest rate risk

The following tables show the interest rate gap position in respect of the Group's major interest bearing assets and liabilities, including the net repricing effect of interest rate derivatives. The assets and liabilities are stated at carrying amounts and categorised by the earlier of contractual repricing dates or maturity dates.

	Group – 2009 Repricing period							
	Up to 1 month	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	10 years or less but over 5 years	Over 10 years	Interest bearing total	Non-interest bearing
Assets								
Cash and money at call	17,635	-	-	-	-	-	17,635	101
Placements with banks and other financial institutions	111,509	1,135	69	-	-	-	112,713	19
Financial assets designated at fair value	138,840	268,546	553,705	307,874	215,276	149,793	1,634,034	361,430
Available-for-sale securities	1,201	931	455	-	-	-	2,587	5,091
Held-to-maturity securities	502	1,000	763	3,142	476	-	5,883	-
Loan portfolio	36,615	6,978	124	57	15	-	43,789	-
Interest-bearing assets	306,302	278,590	555,116	311,073	215,767	149,793	1,816,641	
Liabilities								
Placements by banks and other financial institutions	28,311	-	-	-	-	-	28,311	-
Placements by Fiscal Reserves with interest payable at market-based rates[1]	287	-	-	-	-	-	287	-
Placements by HKSAR government funds and statutory bodies with interest payable at market-based rates[1]	61	-	-	-	-	-	61	-
Exchange Fund Bills and Notes issued	89,312	268,167	122,334	45,203	8,257	3,156	536,429	-
Other debt securities issued	6,043	6,294	6,658	19,659	4,003	1,802	44,459	-
Mortgage-backed securities issued	1,051	-	229	741	-	-	2,021	-
Interest-bearing liabilities	125,065	274,461	129,221	65,603	12,260	4,958	611,568	
Interest rate derivatives (net position, notional amounts)	(13,406)	11,476	2,617	(6,976)	3,983	2,400	94	
Interest rate sensitivity gap	167,831	15,605	428,512	238,494	207,490	147,235	1,205,167	

[1] Placements by Fiscal Reserves, HKSAR government funds and statutory bodies with interest payable at a fixed rate determined annually are excluded because their interest rate is not fixed directly on the basis of market interest rates (notes 23 and 24). The fixed rate is determined every January. As at 31 December 2009, such placements amounted to HK$545,611 million (2008: HK$531,053 million).

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

	Group – 2008 Repricing period							
	Up to 1 month	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	10 years or less but over 5 years	Over 10 years	Interest bearing total	Non-interest bearing
Assets								
Cash and money at call	19,354	–	–	–	–	–	19,354	93
Placements with banks and other financial institutions	150,528	5,751	232	–	–	–	156,511	18
Financial assets designated at fair value	46,333	72,179	283,998	350,228	204,286	164,543	1,121,567	225,932
Available-for-sale securities	–	1,210	–	–	–	–	1,210	1,335
Held-to-maturity securities	890	406	1,455	2,568	394	–	5,713	–
Loan portfolio	34,856	15,879	14	11	–	–	50,760	–
Interest-bearing assets	251,961	95,425	285,699	352,807	204,680	164,543	1,355,115	
Liabilities								
Placements by banks and other financial institutions	9,738	3,875	–	–	–	–	13,613	–
Placements by Fiscal Reserves with interest payable at market-based rates[1]	317	–	–	–	–	–	317	–
Placements by HKSAR government funds and statutory bodies with interest payable at market-based rates[1]	74	–	–	–	–	–	74	–
Exchange Fund Bills and Notes issued	15,647	51,871	36,106	46,590	9,918	2,422	162,554	–
Other debt securities issued	10,079	5,244	5,792	14,941	4,519	2,211	42,786	–
Mortgage-backed securities issued	1,258	–	990	978	–	–	3,226	–
Interest-bearing liabilities	37,113	60,990	42,888	62,509	14,437	4,633	222,570	
Interest rate derivatives (net position, notional amounts)	(16,563)	(16,273)	6,172	18,524	5,238	2,902	–	
Interest rate sensitivity gap	198,285	18,162	248,983	308,822	195,481	162,812	1,132,545	

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

	Fund – 2009 Repricing period							
	Up to 1 month	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	10 years or less but over 5 years	Over 10 years	Interest bearing total	Non-interest bearing
Assets								
Cash and money at call	17,603	-	-	-	-	-	17,603	55
Placements with banks and other financial institutions	107,860	776	-	-	-	-	108,636	-
Financial assets designated at fair value	138,840	268,546	553,705	307,874	215,276	149,793	1,634,034	361,430
Interest-bearing assets	264,303	269,322	553,705	307,874	215,276	149,793	1,760,273	
Liabilities								
Placements by banks and other financial institutions	28,311	-	-	-	-	-	28,311	-
Placements by Fiscal Reserves with interest payable at market-based rates[1]	287	-	-	-	-	-	287	-
Placements by HKSAR government funds and statutory bodies with interest payable at market-based rates[1]	61	-	-	-	-	-	61	-
Exchange Fund Bills and Notes issued	89,312	268,167	122,334	45,203	8,257	3,156	536,429	-
Interest-bearing liabilities	117,971	268,167	122,334	45,203	8,257	3,156	565,088	
Interest rate derivatives (net position, notional amounts)	-	24,930	(99)	(25,853)	(1,378)	2,400	-	
Interest rate sensitivity gap	146,332	26,085	431,272	236,818	205,641	149,037	1,195,185	

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

	Fund – 2008 Repricing period							
	Up to 1 month	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	10 years or less but over 5 years	Over 10 years	Interest bearing total	Non-interest bearing
Assets								
Cash and money at call	19,316	–	–	–	–	–	19,316	67
Placements with banks and other financial institutions	147,860	5,535	–	–	–	–	153,395	–
Financial assets designated at fair value	46,333	72,179	283,998	350,228	204,286	164,543	1,121,567	225,932
Interest-bearing assets	213,509	77,714	283,998	350,228	204,286	164,543	1,294,278	
Liabilities								
Placements by banks and other financial institutions	9,738	3,875	–	–	–	–	13,613	–
Placements by Fiscal Reserves with interest payable at market-based rates[1]	317	–	–	–	–	–	317	–
Placements by HKSAR government funds and statutory bodies with interest payable at market-based rates[1]	74	–	–	–	–	–	74	–
Exchange Fund Bills and Notes issued	15,647	51,871	36,106	46,590	9,918	2,422	162,554	–
Interest-bearing liabilities	25,776	55,746	36,106	46,590	9,918	2,422	176,558	
Interest rate derivatives (net position, notional amounts)	–	(7,550)	–	4,550	1,800	1,200	–	
Interest rate sensitivity gap	187,733	14,418	247,892	308,188	196,168	163,321	1,117,720	

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

(b) Currency risk

The tables below summarise the currency exposure of the Group.

	Group			
	2009		2008	
	Assets (in HK$ billion)	**Liabilities (in HK$ billion)**	Assets (in HK$ billion)	Liabilities (in HK$ billion)
Hong Kong dollar	**187.5**	**1,418.5**	134.5	908.9
US dollar and other currencies[1]	**1,785.6**	**227.5**	1,265.9	218.2
	1,973.1	**1,646.0**	1,400.4	1,127.1
Euro, yen, sterling and other currencies[2]	**235.2**	**3.0**	215.9	4.6
Total	**2,208.3**	**1,649.0**	1,616.3	1,131.7

	Fund			
	2009		2008	
	Assets (in HK$ billion)	**Liabilities (in HK$ billion)**	Assets (in HK$ billion)	Liabilities (in HK$ billion)
Hong Kong dollar	**150.2**	**1,376.0**	99.5	862.4
US dollar and other currencies[1]	**1,765.2**	**217.4**	1,245.5	213.2
	1,915.4	**1,593.4**	1,345.0	1,075.6
Euro, yen, sterling and other currencies[2]	**234.0**	**2.5**	215.3	4.2
Total	**2,149.4**	**1,595.9**	1,560.3	1,079.8

1 Including mainly Australian dollar, Canadian dollar and Singapore dollar.
2 Including mainly Swiss franc, Swedish krona, Norwegian krone and Danish krone.

(c) Equity price risk

At 31 December 2009 and 2008, the majority of equity investments are reported as "financial assets designated at fair value" as shown in note 9.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

36.4.4 Sensitivity analysis

The VaR positions of the Fund at 31 December and during the year, based on a 95% confidence level and one-month time horizon, were as follows:

	Fund	
	2009	2008
VaR		
At 31 December	**30,324**	63,979
During the year		
Average	**41,435**	42,515
Maximum	**64,131**	70,987
Minimum	**30,324**	28,101

36.5 Liquidity risk

Liquidity risk refers to the risk that the Group may not have sufficient funds available to meet its liabilities as they fall due. In addition, the Group may not be able to liquidate its financial assets at a price close to fair value within a short period of time.

36.5.1 Management of liquidity risk

To ensure sufficient liquidity to meet liabilities and the ability to raise funds to meet exceptional needs, the Group invests primarily in liquid financial markets and instruments that are readily saleable to meet liquidity needs. There are internal investment restrictions to prevent undue concentrations in individual debt securities issues, debt securities issuers, and groups of closely related debt securities issuers. Such restrictions are derived based on various factors such as the nature or maturity of the securities. There are also limitations on the maximum proportion of assets that can be placed in fixed term deposits, and requirements regarding the ability to convert foreign currency assets into cash. All these restrictions and limits are designed to promote the liquidity of assets and consequently minimise the liquidity risk. Compliance with these limits is monitored by the RMC and any breaches are reported to the ISC and the EFAC and are promptly followed up.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

36.5.2 Exposure to liquidity risk

The following tables show the remaining contractual maturities at the balance sheet date of major financial liabilities, commitments and derivative financial liabilities, which are based on contractual undiscounted cash flows and the earliest date on which the Group can be required to pay.

	Group – 2009 Remaining maturity						
	Up to 1 month or on demand	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	10 years or less but over 5 years	Over 10 years	Total
Non-derivative cash outflows							
Certificates of Indebtedness	199,006	–	–	–	–	–	199,006
Government-issued currency notes and coins in circulation	8,427	–	–	–	–	–	8,427
Balance of the banking system	264,567	–	–	–	–	–	264,567
Placements by banks and other financial institutions	28,311	–	–	–	–	–	28,311
Placements by Fiscal Reserves	504,123	–	–	–	–	–	504,123
Placements by HKSAR government funds and statutory bodies	6,836	–	–	–	35,000	–	41,836
Exchange Fund Bills and Notes issued	89,311	268,625	123,823	46,712	8,825	3,344	540,640
Other debt securities issued	1,119	3,715	7,910	28,055	4,604	2,896	48,299
Mortgage-backed securities issued	49	30	402	1,612	–	–	2,093
Other liabilities	17,421	243	223	–	–	–	17,887
Loan commitments and other credit related commitments	88,719	–	–	–	–	–	88,719
Total	1,207,889	272,613	132,358	76,379	48,429	6,240	1,743,908
Derivative cash (inflows)/outflows							
Derivative financial instruments settled:							
– On net basis	179	(10)	102	66	176	54	567
– On gross basis							
Total outflows	24,128	7,053	8,768	15,798	614	–	56,361
Total inflows	(23,714)	(7,010)	(8,741)	(15,793)	(608)	–	(55,866)
Total	593	33	129	71	182	54	1,062

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

	Group – 2008 Remaining maturity						
	Up to 1 month or on demand	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	10 years or less but over 5 years	Over 10 years	Total
Non-derivative cash outflows							
Certificates of Indebtedness	176,093	–	–	–	–	–	176,093
Government-issued currency notes and coins in circulation	8,266	–	–	–	–	–	8,266
Balance of the banking system	158,038	–	–	–	–	–	158,038
Placements by banks and other financial institutions	9,738	3,875	–	–	–	–	13,613
Placements by Fiscal Reserves	531,370	–	–	–	–	–	531,370
Placements by HKSAR government funds and statutory bodies	74	–	–	–	–	–	74
Exchange Fund Bills and Notes issued	15,647	52,342	37,704	47,732	9,397	2,083	164,905
Other debt securities issued	6,660	2,079	3,709	25,793	5,577	1,953	45,771
Mortgage-backed securities issued	13	45	1,137	2,183	–	–	3,378
Other liabilities	30,175	190	311	–	–	–	30,676
Loan commitments and other credit related commitments	88,623	–	–	–	–	–	88,623
Total	1,024,697	58,531	42,861	75,708	14,974	4,036	1,220,807
Derivative cash (inflows)/outflows							
Derivative financial instruments settled:							
– On net basis	9	(6)	64	107	–	–	174
– On gross basis							
Total outflows	20,665	33,808	3,050	9,464	1,053	–	68,040
Total inflows	(19,038)	(31,461)	(2,959)	(9,426)	(1,046)	-	(63,930)
Total	1,636	2,341	155	145	7	–	4,284

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

	Fund – 2009 Remaining maturity						
	Up to 1 month or on demand	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	10 years or less but over 5 years	Over 10 years	Total
Non-derivative cash outflows							
Certificates of Indebtedness	199,006	–	–	–	–	–	199,006
Government-issued currency notes and coins in circulation	8,427	–	–	–	–	–	8,427
Balance of the banking system	264,567	–	–	–	–	–	264,567
Placements by banks and other financial institutions	28,311	–	–	–	–	–	28,311
Placements by Fiscal Reserves	504,123	–	–	–	–	–	504,123
Placements by HKSAR government funds and statutory bodies	6,836	–	–	–	35,000	–	41,836
Exchange Fund Bills and Notes issued	89,311	268,625	123,823	46,712	8,825	3,344	540,640
Other liabilities	11,530	243	223	–	–	–	11,996
Loan commitments and other credit related commitments	118,719	-	–	–	–	–	118,719
Total	1,230,830	268,868	124,046	46,712	43,825	3,344	1,717,625
Derivative cash (inflows)/outflows							
Derivative financial instruments settled:							
– On net basis	167	(16)	18	34	169	54	426
– On gross basis							
Total outflows	22,764	5,777	4,583	–	–	–	33,124
Total inflows	(22,356)	(5,728)	(4,554)	–	–	–	(32,638)
Total	575	33	47	34	169	54	912

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

	Fund – 2008 Remaining maturity						
	Up to 1 month or on demand	3 months or less but over 1 month	1 year or less but over 3 months	5 years or less but over 1 year	10 years or less but over 5 years	Over 10 years	Total
Non-derivative cash outflows							
Certificates of Indebtedness	176,093	–	–	–	–	–	176,093
Government-issued currency notes and coins in circulation	8,266	–	–	–	–	–	8,266
Balance of the banking system	158,038	–	–	–	–	–	158,038
Placements by banks and other financial institutions	9,738	3,875	–	–	–	–	13,613
Placements by Fiscal Reserves	531,370	–	–	–	–	–	531,370
Placements by HKSAR government funds and statutory bodies	74	–	–	–	–	–	74
Exchange Fund Bills and Notes issued	15,647	52,342	37,704	47,732	9,397	2,083	164,905
Other liabilities	25,004	190	311	–	–	–	25,505
Loan commitments and other credit related commitments	110,623	–	–	–	–	–	110,623
Total	1,034,853	56,407	38,015	47,732	9,397	2,083	1,188,487
Derivative cash (inflows)/outflows							
Derivative financial instruments settled:							
– On net basis	17	–	–	–	–	–	17
– On gross basis							
Total outflows	19,843	29,661	755	–	–	–	50,259
Total inflows	(18,252)	(27,319)	(719)	–	–	–	(46,290)
Total	1,608	2,342	36	–	–	–	3,986

36.6 Mortgage insurance risk

In providing mortgage insurance cover to authorized institutions in respect of mortgage loans originated by such authorized institutions and secured by residential properties, the Group faces insurance risk of the uncertainty of the insured event occurring and the uncertainty of the amount of the resulting claim.

Under the Mortgage Insurance Programme, the Group, through the HKMC, offers mortgage insurance that covers approved sellers for credit losses of up to 25% - 30% of the value of properties financed under mortgage loans with loan-to-value ratio below 95% at origination. The Group reinsures the exposure with approved reinsurers. At 31 December 2009, the total risk-in-force was HK$14.92 billion (2008: HK$9.83 billion), of which HK$11.59 billion (2008: HK$5.71 billion) was retained by the Group after reinsurance.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Group faces under its insurance contracts is that the actual claims exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims is greater than estimated. The actual number and amount of claims and benefits will vary year to year from the estimate established using statistical techniques.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. In addition, a more diversified portfolio is less likely to be affected across the board by a change in any subset of the portfolio. The Group has developed a business strategy to diversify the type of mortgage insurance risks accepted and within each of the key categories to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

The frequency and severity of claims can be affected by several factors which cause collateral values fall below the outstanding balance of the mortgage loans. The most significant are a downturn in the economy and a decline in local property values. Economic downturn, which may cause a rise in defaults, affects the frequency of claims.

The Group manages these risks by adopting a set of prudent insurance eligibility criteria. To ensure sufficient provision is set aside for meeting future claim payments, the Group calculates technical reserves on prudent liability valuation assumptions and the methods prescribed in the regulatory guidelines. The Group also takes out quota-share reinsurance from its approved mortgage reinsurers in an effort to limit its risk exposure. The reinsurers are selected according to prudent criteria and their credit ratings are reviewed regularly.

36.7 Operational risk

Operational risk is the risk of direct and indirect loss arising from a wide variety of causes associated with the Group's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements. Operational risks arise from all of the Group's operations and are faced by all business segments.

The Group's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Group's reputation with overall cost-effectiveness and to avoid control procedures that restrict initiative.

The primary responsibility for the development and implementation of controls to address operational risk rests with an internal high-level Risk Committee. The Committee is chaired by the Chief Executive of the HKMA and the three Deputy Chief Executives serve as members. The Risk Committee provides direction and guidance for management in managing operational risk.

The HKMA's operational risk management is supported by a formal risk assessment process. This is conducted on an annual basis and requires each division to assess and rank the potential impact and likelihood of occurrence of financial and operational risks. It also requires the relevant divisions to review the procedures and measures in place to address the identified risks. The assessment and ranking is reviewed by Internal Audit for consistency and reasonableness before being submitted to the Risk Committee, which has the responsibility for ensuring that the identified risks are properly addressed. This risk assessment forms an important basis for the annual Internal Audit plan. Internal Audit will audit the risk areas at various frequencies depending on the levels of risks assigned to the areas.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

Internal Audit reports its findings to the EFAC Audit Sub-Committee and the Chief Executive of the HKMA. It also follows up on outstanding issues to ensure that they are resolved in a proper manner.

37 FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. In the absence of such quoted market prices, fair values are estimated using present value or other valuation techniques, using inputs based on market conditions existing at the balance sheet date. The fair values of unlisted investment funds and unlisted equity securities are estimated by investment managers. These fair values approximate the net asset values of the investments. Depending on the redemption and liquidity features of the investments, the fair values may not necessarily represent the amounts that can be ultimately realised by the Group.

(a) The fair values of held-to-maturity securities, other debt securities and mortgage-backed securities issued that were not designated at fair value, are shown below:

		Group			
		Carrying value		Fair value	
	Notes	**2009**	2008	**2009**	2008
Financial assets					
Held-to-maturity securities	11	**5,883**	5,713	**6,001**	5,743
Financial liabilities					
Other debt securities issued, not designated at fair value	26	**41,613**	38,073	**41,619**	38,079
Mortgage-backed securities issued, not designated at fair value	27	**2,021**	3,226	**2,011**	3,211

All other financial instruments of the Group are stated at fair value or carried at amounts not materially different from their fair values as at 31 December 2009 and 2008.

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

(b) The following table shows the carrying value of financial instruments measured at fair value at the balance sheet date across the three levels of the fair value hierarchy:

	Group - 2009			
	Level 1	Level 2	Level 3	Total
At 31 December 2009				
Assets				
Derivative financial instruments	12	5,553	–	5,565
Financial assets designated at fair value	1,729,460	238,740	27,264	1,995,464
Available-for-sale securities	1,104	2,509	3,572	7,185
	1,730,576	246,802	30,836	2,008,214
Liabilities				
Derivative financial instruments	167	864	–	1,031
Exchange Fund Bills and Notes issued	–	536,429	–	536,429
Other debt securities issued, designated at fair value	–	2,846	–	2,846
	167	540,139	–	540,306

	Fund - 2009			
	Level 1	Level 2	Level 3	Total
At 31 December 2009				
Assets				
Derivative financial instruments	12	4,235	–	4,247
Financial assets designated at fair value	1,729,460	238,740	27,264	1,995,464
	1,729,472	242,975	27,264	1,999,711
Liabilities				
Derivative financial instruments	167	706	–	873
Exchange Fund Bills and Notes issued	–	536,429	–	536,429
	167	537,135	–	537,302

The three levels of the fair value hierarchy are:

Level 1 – fair values of financial instruments are quoted prices in active markets for identical assets or liabilities;

Level 2 – fair values of financial instruments are determined involving inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and

Level 3 – fair values of financial instruments are determined with inputs that are not based on observable market data (unobservable inputs).

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

The following table provides a reconciliation of the movement between opening and closing balances of Level 3 financial instruments, measured at fair value using a valuation technique with significant unobservable inputs:

	Group		Fund	
	Designated at fair value	Available-for-sale	Designated at fair value	Available-for-sale
At 1 January 2009	18,704	–	18,704	–
Net gains recognised in the income and expenditure account	3,583	–	3,583	–
Net gains recognised in other comprehensive income	–	743	–	–
Purchases	13,337	2,848	13,337	–
Sales	(7,460)	(19)	(7,460)	–
Transfers out of Level 3	(900)	–	(900)	–
At 31 December 2009	27,264	3,572	27,264	–
Net gains recognised in the income and expenditure account relating to those assets held at the balance sheet date	3,123	–	3,123	–

During the year, the Group determined that significant unobservable inputs used in fair value measurements for certain financial assets designated at fair value were no longer needed and they were transferred out of Level 3 of the fair value hierarchy.

For financial instruments classified under Level 3 of the fair value hierarchy, if the prices of investments were increased/decreased by 10%, these would have resulted in an increase/decrease in the Group's surplus for the year of HK$2,726 million and in other comprehensive income of HK$357 million.

38 COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the current year's presentation (note 3.2).

(Amounts expressed in millions of Hong Kong dollars, unless otherwise stated.)

39 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE YEAR ENDED 31 DECEMBER 2009

Up to the date of issue of the financial statements, the HKICPA has issued a number of amendments, new standards and interpretations which are not yet effective for the year ended 31 December 2009 and which have not been early adopted in the financial statements.

The Group is in the process of making an assessment of what the impact of these amendments, new standards and interpretations is expected to be in the period of initial adoption. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Group's results of operations and financial position.

The following developments may result in new or amended disclosures in future financial statements:

	Effective for accounting periods beginning on or after
HKAS 27 (Revised), Consolidated and Separate Financial Statements	1 July 2009
Amendment to HKAS 39, Financial Instruments: Recognition and Measurement – Eligible Hedged Items	1 July 2009
Amendment to HKAS 32, Financial Instruments: Presentation – Classification of Rights Issues	1 February 2010
HKAS 24 (Revised), Related Party Disclosures	1 January 2011
HKFRS 9, Financial Instruments	1 January 2013

40 APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the Financial Secretary on the advice of the Exchange Fund Advisory Committee on 1 April 2010.

Calendar of Events 2009

8 January

The HKMA publishes the Report on Issues Concerning the Distribution of Structured Products Connected to Lehman Group Companies submitted to the Financial Secretary on 31 December 2008.

20 January

The HKMA and the People's Bank of China sign a currency swap agreement providing short-term liquidity support to the Mainland operations of Hong Kong banks and the Hong Kong operations of Mainland banks in case of need.

16 March

The multi-currency cross-border payment arrangements between the Mainland and Hong Kong take effect.

26 March

The HKMA announces liquidity arrangements for banks applicable after the temporary liquidity-assistance measures introduced in September 2008 expire on 31 March.

25 May

Phase I of the SWIFTNet migration project is launched, enabling banks to use SWIFT messages for payment instructions.

26 May

The HKMA and De Nederlandsche Bank N.V. jointly announce the signing of a Memorandum of Understanding for a liquidity arrangement for non-routine situations.

6 July

The pilot scheme for cross-border trade settlement in the renminbi commences operation.

21 - 23 July

The HKMA hosts the 14th Executives' Meeting of East Asia-Pacific Central Banks Governors' Meeting.

22 July

The HKMA, Bank Negara Malaysia and the Monetary Authority of Singapore announce the establishment of a tripartite working group to co-ordinate the scheduled exit from the full deposit guarantees by the end of 2010 in their respective jurisdictions.

The Securities and Futures Commission, the HKMA and 16 distributing banks reach an agreement on the repurchase of Lehman Brothers Minibonds from eligible customers.

11 August

The CMU Fund Order Routing and Settlement Service commences operation.

24 August

The HKMA announces the tendering of the first issue of institutional bonds under the Government Bond Programme.

28 September

The Ministry of Finance launches renminbi sovereign bonds totalling RMB6 billion in Hong Kong.

The HKMA and Bank Negara Malaysia jointly announce the signing of a Memorandum of Understanding on co-operation in the development of the financial services industry, particularly Islamic finance.

1 October

A new measure on banking under the Sixth Supplement to the Mainland and Hong Kong Closer Economic Partnership Arrangement becomes effective, allowing the branches of the Hong Kong banks or their Mainland subsidiaries in Guangdong Province to set up "cross-location" sub-branches within the Province.

23 October

The HKMA issues a circular to AIs requiring them to lower the loan-to-value ratio for residential mortgages on properties valued at $20 million or more from 70% to 60%.

29 October

The HKMA consults the Hong Kong Association of Banks and the Deposit-taking Companies Association on its draft "Guideline on a Sound Remuneration System". The consultation closes on 30 November.

9 November

Moody's upgrades Hong Kong's long-term foreign-currency and local-currency rating outlook to "Positive" from "Stable", with ratings at "Aa2".

23 November

Hong Kong's foreign-currency RTGS systems and the Central Moneymarkets Unit extend their operations to include all Hong Kong general holidays, with the exception of 1 January.

3 December

The IMF releases its Staff Report on Hong Kong welcoming the Government's efforts to sustain economic recovery and reiterating its support for the Linked Exchange Rate system.

23 December

The Securities and Futures Commission and the HKMA announce that they have reached a resolution with two banks over their sale of certain fixed-coupon principal-protected equity index-linked notes issued by Lehman Brothers.

28 December

The Finance Ministers and Central Bank Governors of the ASEAN+3 and the Monetary Authority of Hong Kong announce the signing of the Chiang Mai Initiative Multilateralisation Agreement.

Annex and Tables

Annex Authorized Institutions and Local Representative Offices at 31 December 2009

LICENSED BANKS

Incorporated in Hong Kong

Bank of China (Hong Kong) Limited
Bank of East Asia, Limited (The)
China Construction Bank (Asia) Corporation Limited
Chiyu Banking Corporation Limited
Chong Hing Bank Limited
CITIBANK (HONG KONG) LIMITED
CITIC Ka Wah Bank Limited
Dah Sing Bank Limited
DBS BANK (HONG KONG) LIMITED
FUBON BANK (HONG KONG) LIMITED
Hang Seng Bank, Limited
Hongkong & Shanghai Banking Corporation Limited (The)
Industrial and Commercial Bank of China (Asia) Limited
MEVAS Bank Limited
Nanyang Commercial Bank, Limited
PUBLIC BANK (HONG KONG) LIMITED
Shanghai Commercial Bank Limited
Standard Bank Asia Limited
Standard Chartered Bank (Hong Kong) Limited
Tai Sang Bank Limited
Tai Yau Bank, Limited
WING HANG BANK, LIMITED
Wing Lung Bank Limited

Incorporated outside Hong Kong

ABN AMRO Bank N.V.
AGRICULTURAL BANK OF CHINA LIMITED
(formerly known as Agricultural Bank of China)
Allahabad Bank
Australia and New Zealand Banking Group Limited
Axis Bank Limited
Banca Monte dei Paschi di Siena S.p.A.
Banco Bilbao Vizcaya Argentaria S.A.
BANCO DE ORO UNIBANK, INC.
BANCO SANTANDER, S.A.
Bangkok Bank Public Company Limited
Bank of America, National Association
Bank of Baroda
Bank of China Limited
Bank of Communications Co., Ltd.
Bank of India
Bank of Montreal
BANK OF NEW YORK MELLON (THE)
Bank of Nova Scotia (The)
Bank of Scotland plc
BANK OF TAIWAN
Bank of Tokyo-Mitsubishi UFJ, Ltd. (The)
Bank Sarasin & Cie AG #
BANK SINOPAC
Barclays Bank PLC
Bayerische Hypo- und Vereinsbank Aktiengesellschaft
Bayerische Landesbank
BNP PARIBAS
BNP PARIBAS SECURITIES SERVICES #
BNP PARIBAS WEALTH MANAGEMENT
CALYON
Canadian Imperial Bank of Commerce
CANARA BANK
CATHAY BANK
CATHAY UNITED BANK COMPANY, LIMITED
Chang Hwa Commercial Bank Ltd.
Chiba Bank, Ltd. (The)
China Construction Bank Corporation
CHINA DEVELOPMENT BANK CORPORATION #
China Merchants Bank Co., Ltd.
Chinatrust Commercial Bank, Ltd.
Chugoku Bank, Ltd. (The)
Citibank, N.A.
Commerzbank AG
Commonwealth Bank of Australia
Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A.
Credit Suisse AG
(formerly known as Credit Suisse
also known as:
Crédit Suisse
Credito Svizzero
Schweizerische Kreditanstalt)
DBS BANK LTD.
Deutsche Bank Aktiengesellschaft
DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main
E.Sun Commercial Bank, Ltd.
EAST WEST BANK
EFG Bank AG
also known as:
EFG Bank SA
EFG Bank Ltd
(formerly known as EFG Bank)

Addition in 2009

Annex Authorized Institutions and Local Representative Offices at 31 December 2009 (cont.)

ERSTE GROUP BANK AG

Falcon Private Bank AG
also known as:
Falcon Private Bank Ltd.
Falcon Private Bank SA
(formerly known as
AIG Privat Bank AG
also known as:
AIG Private Bank Ltd
Banque Privée AIG SA
Banca Privata AIG SA)

FAR EASTERN INTERNATIONAL BANK

First Commercial Bank, Ltd.

Fortis Bank

Hachijuni Bank, Ltd. (The)

HANA BANK

HDFC BANK LIMITED #

HONG LEONG BANK BERHAD

HSBC BANK INTERNATIONAL LIMITED

HSBC Bank plc

HSBC Bank USA, National Association

HSBC Private Bank (Suisse) SA

Hua Nan Commercial Bank, Ltd.

ICICI BANK LIMITED

Indian Overseas Bank

Industrial and Commercial Bank of China Limited

Industrial Bank of Korea

Industrial Bank of Taiwan Co., Ltd.

ING ASIA PRIVATE BANK LTD

ING Bank N.V.

INTESA SANPAOLO SPA

Iyo Bank, Ltd. (The)

JPMorgan Chase Bank, National Association

KBC Bank N.V.

Korea Exchange Bank

Land Bank of Taiwan Co., Ltd.

Malayan Banking Berhad

MEGA INTERNATIONAL COMMERCIAL BANK CO., LTD.

MELLI BANK PLC

Mitsubishi UFJ Trust and Banking Corporation

Mizuho Corporate Bank, Ltd.

National Australia Bank, Limited

NATIONAL BANK OF ABU DHABI #

National Bank of Pakistan

NATIXIS

NEWEDGE GROUP

Oversea-Chinese Banking Corporation Limited

Philippine National Bank

PT. Bank Negara Indonesia (Persero) Tbk.

Punjab National Bank

RBS Coutts Bank AG
also known as:
RBS Coutts Bank SA
RBS Coutts Bank Ltd

Royal Bank of Canada

Royal Bank of Scotland public limited company (The)

Shanghai Commercial & Savings Bank, Ltd. (The)

Shiga Bank, Ltd. (The)

Shinhan Bank

Shizuoka Bank, Ltd. (The)

Societe Generale

SOCIETE GENERALE BANK & TRUST

Standard Chartered Bank

State Bank of India

State Street Bank and Trust Company

Sumitomo Mitsui Banking Corporation

Svenska Handelsbanken AB (publ)

TAIPEI FUBON COMMERCIAL BANK CO., LTD.

TAISHIN INTERNATIONAL BANK CO., LTD

Taiwan Business Bank

Taiwan Cooperative Bank, Ltd.

Toronto-Dominion Bank

UBS AG
also known as:
UBS SA
UBS Ltd

UCO Bank

UNICREDIT, SOCIETA' PER AZIONI

Union Bank of India

UNITED COMMERCIAL BANK

United Overseas Bank Ltd.

Wells Fargo Bank, National Association

WestLB AG

Westpac Banking Corporation

Woori Bank

Deletion in 2009

American Express Bank Limited

DEPFA BANK plc

HSH Nordbank AG

Public Bank Berhad

Shinkin Central Bank

Addition in 2009

RESTRICTED LICENCE BANKS

Incorporated in Hong Kong

ALLIED BANKING CORPORATION (HONG KONG) LIMITED

Banc of America Securities Asia Limited

Bank of China International Limited (formerly known as BOCI Capital Limited)

CHINA CONSTRUCTION BANK (ASIA) FINANCE LIMITED (formerly known as AIG Finance (Hong Kong) Limited)

Citicorp International Limited

GE Capital (Hong Kong) Limited

J.P. MORGAN SECURITIES (ASIA PACIFIC) LIMITED

KDB Asia Limited

KOOKMIN BANK HONG KONG LIMITED

Mitsubishi UFJ Securities (HK) Capital, Limited

ORIX ASIA LIMITED

SCOTIABANK (HONG KONG) LIMITED

Societe Generale Asia Limited

UBAF (Hong Kong) Limited

Deletion in 2009

Indover Asia Limited (formerly known as Indover bank (Asia) Limited)

Incorporated outside Hong Kong

Bank of Ayudhya Public Company Limited

CIMB BANK BERHAD

Credit Agricole (Suisse) SA

EUROCLEAR BANK

LLOYDS TSB BANK plc

Mashreq Bank - Public Shareholding Company also known as Mashreqbank psc

PT. BANK MANDIRI (PERSERO) Tbk

RBC Dexia Investor Services Bank S.A.

Siam Commercial Bank Public Company Limited (The)

Thanakharn Kasikorn Thai Chamkat (Mahachon) also known as KASIKORNBANK PUBLIC COMPANY LIMITED

TMB Bank Public Company Limited

Wachovia Bank, National Association

Annex Authorized Institutions and Local Representative Offices at 31 December 2009 (cont.)

DEPOSIT-TAKING COMPANIES

Incorporated in Hong Kong

AGRO ENTERPRISES COMPANY LIMITED

BCOM Finance (Hong Kong) Limited

BPI International Finance Limited

Chau's Brothers Finance Company Limited

Chong Hing Finance Limited

Commonwealth Finance Corporation Limited

Corporate Finance (D.T.C.) Limited

FUBON CREDIT (HONG KONG) LIMITED

Gunma Finance (Hong Kong) Limited

Habib Finance International Limited

Hachijuni Asia Limited

HBZ Finance Limited

Henderson International Finance Limited

HKCB Finance Limited

Hung Kai Finance Company Limited

Inchroy Credit Corporation Limited

KEB Asia Finance Limited #

KEXIM ASIA LIMITED

OCTOPUS CARDS LIMITED

ORIENT FIRST CAPITAL LIMITED

PrimeCredit Limited

PUBLIC FINANCE LIMITED

SHINHAN ASIA LIMITED

Sumitomo Trust Finance (H.K.) Limited (The)

Vietnam Finance Company Limited

Wing Hang Finance Company Limited

Wing Lung Finance Limited

WOORI GLOBAL MARKETS ASIA LIMITED

Deletion in 2009

First Metro International Investment Company Limited

Incorporated outside Hong Kong

NIL

Addition in 2009

Annex Authorized Institutions and Local Representative Offices at 31 December 2009 (cont.)

LOCAL REPRESENTATIVE OFFICES

ANTWERPSE DIAMANTBANK NV also known as ANTWERP DIAMOND BANK NV

Arab Bank plc

BANCA POPOLARE COMMERCIO E INDUSTRIA SPA

Banca Popolare dell'Emilia Romagna Soc. Coop. a r.l.

Banca Popolare di Ancona Societa' per azioni

Banca Popolare di Bergamo S.p.A.

Banca Popolare di Novara - Società per Azioni

Banca Popolare di Sondrio Soc. Coop. a r.l.

BANCA POPOLARE DI VICENZA - Società cooperativa per azioni

Banca Regionale Europea S.p.A. #

Banco di Brescia S.p.A. #

Banco do Brasil S.A.

Banco Popolare- Societa' Cooperativa

BANIF - BANCO INTERNACIONAL DO FUNCHAL, S.A. #

Bank Hapoalim (Switzerland) Ltd

Bank Julius Baer & Co. Ltd.

Bank Leumi Le-Israel B.M.

BANK OF BEIJING CO., LTD.

Bank of Fukuoka, Ltd. (The)

Bank of Kyoto, Ltd. (The)

Bank of Yokohama, Ltd. (The)

Banque Cantonale de Genève #

Banque Privee Edmond de Rothschild S.A.

BARCLAYS BANK (SUISSE) S.A.

BSI LTD

CARIPRATO - Cassa di Risparmio di Prato S.p.A.

China Everbright Bank Co., Ltd

CHINA MINSHENG BANKING CORPORATION LIMITED

CLEARSTREAM BANKING S.A.

Corporation Bank

Credit Industriel et Commercial

Credito Bergamasco S.p.A.

D.A.H. Hambros Bank (Channel Islands) Limited

Fiduciary Trust Company International

GUANGDONG DEVELOPMENT BANK CO., LTD.

Habib Bank A.G. Zurich

HSBC Bank Canada

HSBC Trinkaus & Burkhardt (International) S.A.

HSH Nordbank AG #

Investec Bank Limited

Japan Finance Corporation # (traded as Japan Bank for International Cooperation)

Juroku Bank, Ltd. (The)

Korea Development Bank (The)

LGT Bank in Liechtenstein AG
also known as:
LGT Bank in Liechtenstein Ltd.
LGT Banque de Liechtenstein S.A.
LGT Banca di Liechtenstein S.A.

LLOYDS TSB OFFSHORE LIMITED

Merrill Lynch Bank (Suisse) S.A.

Metropolitan Bank and Trust Company

Nanto Bank, Ltd. (The)

National Bank of Canada

Nishi-Nippon City Bank, Ltd. (The)

Norinchukin Bank (The)

Ogaki Kyoritsu Bank, Ltd. (The)

Oita Bank, Ltd. (The)

P.T. Bank Central Asia

P.T. Bank Rakyat Indonesia (Persero)

Raiffeisen Zentralbank Osterreich AG

Resona Bank, Limited

Rothschild Bank AG

Schroder & Co Bank AG
also known as:
Schroder & Co Banque SA
Schroder & Co Banca SA
Schroder & Co Bank Ltd
Schroder & Co Banco SA

Shanghai Pudong Development Bank Co., Ltd.

Shenzhen Development Bank Co., Ltd.

Shinkin Central Bank #

Shoko Chukin Bank, Ltd. (The)

Silicon Valley Bank #

Union Bank of Taiwan

Unione di Banche Italiane Società Cooperativa per Azioni

Veneto Banca S.c.a.r.l.

Verwaltungs- und Privat-Bank Aktiengesellschaft

Yamaguchi Bank, Ltd. (The)

Yamanashi Chuo Bank, Ltd.

Yuanta Commercial Bank Co., Ltd

Deletion in 2009

Banco de Crédito e Inversiones

Banco Popular Español, S.A.

BANK OF SCOTLAND INTERNATIONAL LIMITED

Banque Piguet & Cie SA

China Development Bank

Eurohypo Aktiengesellschaft

HSBC Guyerzeller Bank AG

Landsbanki Íslands hf

Addition in 2009

Table A Major Economic Indicators

		2005	2006	2007	2008	**2009**
I.	**Gross Domestic Product**					
	Real GDP growth (%)	7.1	7.0	6.4	2.1	**(2.7)** [a]
	Nominal GDP growth (%)	7.0	6.7	9.5	3.7	**(2.5)** [a]
	Real growth of major expenditure components of GDP (%)					
	– Private consumption expenditure	3.0	5.9	8.5	2.3	**(0.3)** [a]
	– Government consumption expenditure	(3.2)	0.3	3.0	1.8	**2.0** [a]
	– Gross domestic fixed capital formation	4.1	7.1	3.4	0.8	**(2.2)** [a]
	of which					
	– Building and construction	(7.6)	(7.1)	(0.3)	6.1	**0.0** [a]
	– Machinery, equipment and computer software	12.8	19.2	3.0	(0.8)	**(3.6)** [a]
	– Exports	10.6	9.4	8.3	2.5	**(10.2)** [a]
	– Imports	8.0	9.1	9.1	2.3	**(9.1)** [a]
	GDP at current market prices (US$ billion)	177.8	189.9	207.1	215.1	**210.7** [a]
	Per capita GDP at current market prices (US$)	26,094	27,697	29,899	30,832	**30,088** [a]
II.	**External Trade (HK$ billion)**					
	Merchandise trade [b]					
	– Domestic exports of goods	136.3	138.8	117.2	101.7	**76.4** [a]
	– Re-exports of goods	2,115.4	2,328.6	2,581.7	2,742.3	**2,418.3** [a]
	– Total imports of goods	2,311.1	2,576.3	2,852.5	3,024.1	**2,703.0** [a]
	– Merchandise trade balance	(59.3)	(109.0)	(153.7)	(180.1)	**(208.2)** [a]
	Services trade					
	– Exports of services	495.4	565.1	660.7	717.2	**670.0** [a]
	– Imports of services	264.2	287.9	332.2	366.5	**344.1** [a]
	– Services trade balance	231.2	277.2	328.5	350.8	**325.9** [a]
III.	**Fiscal Expenditure and Revenue (HK$ million, fiscal year)**					
	Total government expenditure [c]	233,071	229,413	234,815	315,112	**294,689** [a]
	Total government revenue	247,035	288,014	358,465	316,562	**308,516** [a]
	Consolidated surplus/deficit	13,964	58,601	123,650	1,450	**13,827** [a]
	Reserve balance as at end of fiscal year [d]	310,663	369,264	492,914	494,364	**508,191** [a]
IV.	**Prices (annual change, %)**					
	Consumer Price Index (A)	1.1	1.7	1.3	3.6	**0.4**
	Composite Consumer Price Index	1.0	2.0	2.0	4.3	**0.5**
	Trade Unit Value Indices					
	– Domestic exports	2.2	(2.1)	0.8	5.1	**(0.2)**
	– Re-exports	1.2	1.1	2.4	3.8	**1.2**
	– Imports	2.7	2.1	2.3	4.4	**(0.1)**
	Property Price Indices					
	– Residential flats	17.9	0.8	11.7	16.5	**0.5** [a]
	– Office premises	33.9	4.7	18.8	20.3	**(9.9)** [a]
	– Retail premises	25.1	2.8	12.4	11.4	**0.0** [a]
	– Flatted factory premises	41.1	26.8	25.9	18.2	**(8.4)** [a]

Table A Major Economic Indicators (cont.)

		2005	2006	2007	2008	**2009**
V.	**Labour**					
	Labour force (annual change, %)	0.6	1.1	1.6	0.5	**1.3**
	Employment (annual change, %)	1.9	1.9	2.4	1.0	**(0.5)**
	Unemployment rate (annual average, %)	5.6	4.8	4.0	3.6	**5.2**
	Underemployment rate (annual average, %)	2.7	2.4	2.2	1.9	**2.4**
	Employment ('000)	3,337	3,401	3,484	3,519	**3,502**
VI.	**Money Supply (HK$ billion)**					
	HK$ money supply					
	– M1	348.2	387.9	454.3	491.1	**671.2**
	– M2 [e]	2,329.7	2,777.7	3,281.0	3,239.9	**3,587.7**
	– M3 [e]	2,345.8	2,795.5	3,300.5	3,261.3	**3,604.8**
	Total money supply					
	– M1	434.7	491.6	616.7	645.8	**901.8**
	– M2	4,379.1	5,054.3	6,106.3	6,269.6	**6,602.3**
	– M3	4,407.2	5,089.7	6,139.8	6,302.3	**6,626.8**
VII.	**Interest Rates (end of period, %)**					
	Three-month interbank rate	4.16	3.84	3.31	0.89	**0.13**
	Savings deposit	2.32	2.26	1.26	0.01	**0.01**
	One-month time deposit	2.68	2.52	1.61	0.04	**0.01**
	Banks' 'Best lending rate'	7.75	7.75	6.75	5.00	**5.00**
	Banks' 'Composite rate'	2.88	2.86	2.29	0.68	**0.11**
VIII.	**Exchange Rates (end of period)**					
	HK$/US$	7.753	7.775	7.802	7.751	**7.756**
	Trade-weighted Effective Exchange Rate Index (Jan 2000 = 100)	98.4	94.3	88.6	88.3	**86.7**
IX.	**Foreign Currency Reserve Assets (US$ billion)** [f]	124.3	133.2	152.7	182.5	**255.8**
X.	**Stock Market (end of period figures)**					
	Hang Seng Index	14,876	19,965	27,813	14,387	**21,873**
	Average price/earnings ratio	15.6	17.4	22.5	7.3	**18.1**
	Market capitalisation (HK$ billion)	8,113.3	13,248.8	20,536.5	10,253.6	**17,769.3**

(a) The estimates are preliminary.
(b) Includes non-monetary gold.
(c) Includes repayment of bonds and notes.
(d) Includes changes in provision for loss in investments with the Exchange Fund.
(e) Adjusted to include foreign currency swap deposits.
(f) Exclude unsettled forward transactions but includes gold.

Table B Performance Ratios of the Banking Sector [(a)]

	All AIs 2005 %	2006 %	2007 %	2008 %	**2009 %**
Asset Quality [(b)]					
As % of total credit exposures [(c)]					
Total outstanding provisions/impairment allowances	0.49	0.38	0.35	0.66	**0.63**
Classified [(d)] exposures:					
– Gross	0.81	0.59	0.48	0.83	**1.08**
– Net of specific provisions/individual impairment allowances	0.54	0.41	0.32	0.39	**0.70**
– Net of all provisions/impairment allowances	0.33	0.21	0.13	0.17	**0.46**
As % of total loans					
Total outstanding provisions/impairment allowances	0.87	0.71	0.59	0.88	**0.95**
Classified [(d)] loans:					
– Gross	1.34	1.05	0.75	1.23	**1.58**
– Net of specific provisions/individual impairment allowances	0.87	0.73	0.52	0.75	**1.05**
– Net of all provisions/impairment allowances	0.47	0.34	0.16	0.35	**0.63**
Overdue > 3 months and rescheduled loans	0.94	0.76	0.51	0.69	**0.92**
Profitability					
Return on assets (operating profit)	1.07	1.13	1.37	0.59	**0.75**
Return on assets (post-tax profit)	0.97	1.01	1.21	0.49	**0.65**
Net interest margin	1.18	1.29	1.32	1.30	**1.11**
Cost-to-income ratio	50.4	50.8	46.7	55.6	**57.5**
Bad debt charge to total assets	0.01	0.03	0.04	0.18	**0.13**
Liquidity					
Loan to deposit ratio (all currencies)	56.8	51.9	50.5	54.2	**51.5**
Loan to deposit [(e)] ratio (Hong Kong dollar)	84.3	74.7	71.0	77.6	**71.2**

Asset Quality
Delinquency ratio of residential mortgage loans
Credit card receivables
– Delinquency ratio
– Charge-off ratio

Profitability
Operating profit to shareholders' funds
Post-tax profit to shareholders' funds
Capital Adequacy
Equity to assets ratio [(b)]

Capital Adequacy Ratio (Consolidated) [(f)]

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

(b) Figures are related to Hong Kong office(s). For the locally incorporated AIs, figures include their overseas branches.

(c) Credit exposures include loans & advances, acceptances & bills of exchange held, investment debt securities issued by others, accrued interest, and commitments and contingent liabilities to or on behalf of non-banks.

(d) Denotes loans or exposures graded as "substandard", "doubtful" or "loss" in the HKMA's Loan Classification System.

(e) Includes swap deposits.

(f) From 1 January 2007, all locally incorporated AIs started to report their capital adequacy positions according to the Banking (Capital) Rules (i.e. the Basel II framework).

Retail Banks				
2005 %	2006 %	2007 %	2008 %	**2009 %**
0.42	0.33	0.33	0.64	**0.56**
0.82	0.63	0.54	0.85	**0.99**
0.60	0.48	0.38	0.42	**0.65**
0.39	0.30	0.21	0.21	**0.43**
0.78	0.63	0.55	0.79	**0.83**
1.37	1.11	0.85	1.24	**1.35**
0.98	0.85	0.65	0.84	**0.90**
0.59	0.48	0.30	0.45	**0.51**
0.92	0.80	0.57	0.67	**0.88**
1.55	1.53	1.66	1.02	**1.10**
1.40	1.36	1.48	0.88	**0.98**
1.68	1.80	1.90	1.84	**1.48**
41.8	42.8	40.5	45.3	**49.3**
(0.01)	0.01	0.04	0.18	**0.10**
53.2	47.9	45.5	47.3	**46.3**
78.8	69.1	65.1	69.4	**65.2**

Surveyed Institutions				
2005 %	2006 %	2007 %	2008 %	**2009 %**
0.19	0.20	0.11	0.05	**0.03**
0.37	0.37	0.35	0.34	**0.34**
2.81	2.91	2.90	2.72	**3.71**

Locally Incorporated Banks				
2005 %	2006 %	2007 %	2008 %	**2009 %**
18.4	18.9	23.8	15.1	**16.3**
16.7	16.7	21.3	13.0	**14.4**
8.1	8.2	8.2	7.2	**8.5**

All Locally Incorporated AIs				
2005 %	2006 %	2007 %	2008 %	**2009 %**
14.8	14.9	13.4	14.7	**16.9**

Table C Authorized Institutions: Domicile and Parentage

	2005	2006	2007	2008	**2009**
Licensed Banks					
(i) Incorporated in Hong Kong	24	24	23	23	**23**
(ii) Incorporated outside Hong Kong	109	114	119	122	**122**
Total	133	138	142	145	**145**
Restricted Licence Banks					
(i) Subsidiaries of licensed banks:					
(a) incorporated in Hong Kong	0	0	0	0	**1**
(b) incorporated outside Hong Kong	8	8	8	6	**5**
(ii) Subsidiaries or branches of foreign banks which are not licensed banks in Hong Kong	21	20	18	17	**16**
(iii) Bank related	1	0	0	0	**1**
(iv) Others	3	3	3	4	**3**
Total	33	31	29	27	**26**
Deposit-taking Companies					
(i) Subsidiaries of licensed banks:					
(a) incorporated in Hong Kong	6	5	5	7	**7**
(b) incorporated outside Hong Kong	2	3	3	3	**4**
(ii) Subsidiaries of foreign banks which are not licensed banks in Hong Kong	13	13	10	8	**7**
(iii) Bank related	3	3	3	2	**2**
(iv) Others	9	9	8	8	**8**
Total	33	33	29	28	**28**
All Authorized Institutions	199	202	200	200	**199**
Local Representative Offices	86	84	79	71	**71**

Table D Authorized Institutions: Region/Economy of Beneficial Ownership

Region/Economy	Licensed Banks					Restricted Licence Banks					Deposit-taking Companies				
	05	06	07	08	**09**	05	06	07	08	**09**	05	06	07	08	**09**
Asia and Pacific															
Hong Kong	12	11	11	10	**10**	1	–	–	–	**–**	11	10	10	9	**9**
Australia	4	4	4	4	**4**	–	–	–	–	**–**	–	–	–	–	**–**
Mainland China	12	13	12	13	**14**	2	2	2	1	**2**	2	2	2	3	**3**
India	5	9	11	11	**12**	1	1	–	–	**–**	2	2	1	1	**1**
Indonesia	1	1	1	1	**1**	2	2	2	2	**1**	1	1	–	–	**–**
Japan	12	11	11	11	**10**	3	2	2	2	**2**	4	4	3	3	**3**
Malaysia	3	4	4	4	**3**	1	1	1	1	**1**	1	1	1	1	**1**
Pakistan	1	1	1	1	**1**	–	–	–	–	**–**	2	2	2	2	**2**
Philippines	2	2	2	2	**2**	1	1	1	1	**1**	3	3	3	3	**2**
Singapore	4	4	4	4	**4**	–	–	–	–	**–**	–	–	–	–	**–**
South Korea	3	3	3	5	**5**	4	5	4	2	**2**	2	3	3	3	**4**
Taiwan	15	15	17	18	**18**	–	–	–	–	**–**	1	1	1	1	**1**
Thailand	1	1	1	1	**1**	4	4	4	4	**4**	–	–	–	–	**–**
Vietnam	–	–	–	–	**–**	–	–	–	–	**–**	1	1	1	1	**1**
Sub-total	75	79	82	85	**85**	19	18	16	13	**13**	30	30	27	27	**27**
Europe															
Austria	1	1	1	1	**1**	–	–	–	–	**–**	–	–	–	–	**–**
Belgium	2	2	2	2	**2**	–	–	–	1	**1**	–	–	–	–	**–**
Denmark	–	–	–	–	**–**	–	–	–	–	**–**	–	–	–	–	**–**
France	5	7	7	7	**8**	2	3	3	3	**3**	–	–	–	–	**–**
Germany	8	7	8	7	**5**	1	–	–	–	**–**	–	–	–	–	**–**
Italy	6	6	4	4	**4**	–	–	–	–	**–**	–	–	–	–	**–**
Luxembourg	–	–	–	–	**–**	1	1	1	1	**1**	–	–	–	–	**–**
Netherlands	3	3	3	4	**5**	–	–	–	–	**–**	–	–	–	–	**–**
Spain	1	1	2	2	**2**	–	–	–	–	**–**	–	–	–	–	**–**
Sweden	1	1	1	1	**1**	–	–	–	–	**–**	–	–	–	–	**–**
Switzerland	3	3	3	3	**3**	–	–	–	–	**–**	–	–	–	–	**–**
United Kingdom	10	10	10	11	**10**	1	1	1	1	**1**	–	–	–	–	**–**
Sub-total	40	41	41	42	**41**	5	5	5	6	**6**	–	–	–	–	**–**
Middle East															
Bahrain	–	–	–	–	**–**	–	–	–	–	**–**	–	–	–	–	**–**
Iran	2	1	1	1	**1**	–	–	–	–	**–**	–	–	–	–	**–**
United Arab Emirates	–	–	–	–	**2**	1	1	1	1	**1**	–	–	–	–	**–**
Sub-total	2	1	1	1	**3**	1	1	1	1	**1**	–	–	–	–	**–**
North America															
Canada	5	5	5	5	**5**	1	1	1	1	**1**	–	–	–	–	**–**
United States	10	11	12	11	**10**	6	6	6	6	**5**	2	2	1	1	**1**
Sub-total	15	16	17	16	**15**	7	7	7	7	**6**	2	2	1	1	**1**
South Africa	1	1	1	1	**1**	1	–	–	–	**–**	–	–	–	–	**–**
Bermuda	–	–	–	–	**–**	–	–	–	–	**–**	–	–	–	–	**–**
Others	–	–	–	–	**–**	–	–	–	–	**–**	1	1	1	–	**–**
Grand Total	133	138	142	145	**145**	33	31	29	27	**26**	33	33	29	28	**28**

Table E Presence of World's Largest 500 Banks in Hong Kong

Positions at 31.12.2009	Number of Overseas Banks [b]					Licensed Banks [c]				
	05	06	07	08	**09**	05	06	07	08	**09**
World Ranking [a]										
1-20	19	20	20	20	**20**	28	33	33	35	**37**
21-50	25	23	22	23	**22**	25	23	22	22	**22**
51-100	27	26	26	26	**28**	23	21	19	23	**21**
101-200	39	37	38	35	**31**	19	20	25	21	**15**
201-500	47	50	46	55	**52**	22	25	23	27	**28**
Sub-total	157	156	152	159	**153**	117	122	122	128	**123**
Others	51	55	59	46	**52**	16	16	20	17	**22**
Total	208	211	211	205	**205**	133	138	142	145	**145**

(a) Top 500 banks/banking groups in the world ranked by total assets. Figures are extracted from *The Banker*, July 2009 issue.

(b) The sum of the number of licensed banks, restricted licence banks, deposit-taking companies and local representative offices exceeds the number of overseas banks with presence in Hong Kong due to the multiple presence of some of the overseas banks.

(c) Consist of branches and subsidiaries of overseas banks.

Restricted Licence Banks [c]					Deposit-taking Companies [c]					Local Representative Offices				
05	06	07	08	**09**	05	06	07	08	**09**	05	06	07	08	**09**
5	5	7	6	**8**	1	1	–	–	**–**	8	8	6	6	**5**
5	5	5	5	**4**	–	–	–	–	**1**	5	5	5	5	**4**
4	4	2	1	**1**	3	5	5	6	**5**	5	7	9	3	**14**
2	1	1	1	**0**	3	3	3	2	**3**	21	19	15	14	**15**
5	5	6	8	**8**	3	3	1	1	**1**	21	22	19	22	**18**
21	20	21	21	**21**	10	12	9	9	**10**	60	61	54	50	**56**
12	11	8	6	**5**	23	21	20	19	**18**	26	23	25	21	**15**
33	31	29	27	**26**	33	33	29	28	**28**	86	84	79	71	**71**

Table F Balance Sheet: All Authorized Institutions and Retail Banks

All Authorized Institutions	2005			2006		
(HK$ bn)	HK$	F/CY	Total	HK$	F/CY	Total
Assets						
Loans to customers	1,797	515	2,312	1,917	550	2,468
– Inside Hong Kong [a]	1,749	323	2,072	1,832	294	2,126
– Outside Hong Kong [b]	48	192	240	86	256	342
Interbank lending	433	2,457	2,890	647	2,802	3,449
– Inside Hong Kong	227	182	410	304	198	502
– Outside Hong Kong	206	2,275	2,481	343	2,604	2,947
Negotiable certificates of deposit (NCDs)	66	32	97	60	43	103
Negotiable debt instruments, other than NCDs	437	934	1,371	536	1,081	1,617
Other assets	314	263	577	347	323	670
Total Assets	3,047	4,200	7,247	3,507	4,799	8,306
Liabilities						
Deposits from customers [c]	2,132	1,936	4,068	2,568	2,189	4,757
Interbank borrowing	412	1,555	1,967	518	1,739	2,257
– Inside Hong Kong	231	184	416	309	203	511
– Outside Hong Kong	180	1,371	1,551	210	1,536	1,746
Negotiable certificates of deposit	131	132	263	129	110	240
Other liabilities	624	325	949	678	374	1,052
Total Liabilities	3,299	3,948	7,247	3,894	4,412	8,306

Retail Banks	2005			2006		
(HK$ bn)	HK$	F/CY	Total	HK$	F/CY	Total
Assets						
Loans to customers	1,510	215	1,725	1,577	218	1,794
– Inside Hong Kong [a]	1,483	160	1,643	1,528	148	1,676
– Outside Hong Kong [b]	27	56	83	48	70	118
Interbank lending	266	982	1,247	425	1,023	1,449
– Inside Hong Kong	175	101	276	245	103	348
– Outside Hong Kong	91	881	972	180	920	1,100
Negotiable certificates of deposit (NCDs)	50	20	71	44	16	59
Negotiable debt instruments, other than NCDs	316	640	955	422	755	1,177
Other assets	241	121	362	279	165	444
Total Assets	2,383	1,978	4,361	2,747	2,177	4,924
Liabilities						
Deposits from customers [c]	1,916	1,326	3,242	2,283	1,466	3,749
Interbank borrowing	102	264	366	116	228	344
– Inside Hong Kong	58	38	95	51	35	86
– Outside Hong Kong	45	226	271	65	193	258
Negotiable certificates of deposit	85	97	182	76	83	159
Other liabilities	462	109	571	537	136	673
Total Liabilities	2,565	1,796	4,361	3,011	1,913	4,924

(a) Defined as loans for use in Hong Kong plus trade finance.
(b) Includes "others" (i.e. unallocated).
(c) Hong Kong dollar customer deposits include swap deposits.
Figures may not add up to total because of rounding.

	2007			2008			**2009**		
	HK$	F/CY	Total	HK$	F/CY	Total	**HK$**	**F/CY**	**Total**
	2,185	777	2,962	2,355	931	3,286	**2,401**	**887**	**3,289**
	2,057	400	2,457	2,201	509	2,710	**2,249**	**425**	**2,674**
	128	377	504	154	422	575	**153**	**462**	**614**
	797	3,714	4,510	542	3,483	4,025	**475**	**3,282**	**3,757**
	346	269	615	261	287	548	**231**	**315**	**546**
	451	3,444	3,895	281	3,195	3,477	**244**	**2,967**	**3,211**
	66	28	93	39	49	88	**41**	**62**	**102**
	499	1,190	1,688	392	1,433	1,825	**816**	**1,540**	**2,356**
	529	567	1,096	605	926	1,531	**667**	**490**	**1,156**
	4,075	6,275	10,350	3,933	6,821	10,754	**4,399**	**6,261**	**10,661**

	3,075	2,794	5,869	3,034	3,026	6,060	**3,374**	**3,007**	**6,381**
	605	2,357	2,961	447	2,496	2,944	**470**	**2,409**	**2,879**
	353	277	630	262	292	555	**226**	**321**	**547**
	251	2,080	2,331	185	2,204	2,389	**244**	**2,088**	**2,332**
	122	49	172	86	22	108	**69**	**27**	**96**
	852	497	1,348	779	864	1,643	**768**	**536**	**1,304**
	4,653	5,697	10,350	4,347	6,407	10,754	**4,682**	**5,979**	**10,661**

	2007			2008			**2009**		
	HK$	F/CY	Total	HK$	F/CY	Total	**HK$**	**F/CY**	**Total**
	1,742	279	2,021	1,870	366	2,236	**1,963**	**352**	**2,316**
	1,675	190	1,865	1,787	258	2,044	**1,879**	**235**	**2,113**
	67	89	156	83	108	191	**84**	**118**	**202**
	470	1,367	1,837	368	1,205	1,574	**263**	**1,162**	**1,425**
	269	155	424	200	172	372	**168**	**185**	**352**
	201	1,211	1,413	168	1,034	1,201	**96**	**977**	**1,073**
	47	13	60	27	25	52	**28**	**30**	**58**
	378	778	1,156	293	1,074	1,367	**692**	**1,103**	**1,795**
	391	328	719	457	602	1,060	**477**	**292**	**769**
	3,029	2,764	5,793	3,014	3,273	6,288	**3,424**	**2,939**	**6,363**

	2,674	1,763	4,437	2,695	2,036	4,731	**3,012**	**1,992**	**5,004**
	138	297	435	119	356	474	**163**	**265**	**428**
	69	44	114	52	72	124	**39**	**83**	**122**
	69	253	322	66	284	350	**123**	**182**	**305**
	67	37	104	40	13	53	**25**	**11**	**36**
	641	176	817	566	464	1,029	**627**	**268**	**895**
	3,519	2,274	5,793	3,420	2,868	6,288	**3,827**	**2,536**	**6,363**

Table G Major Balance Sheet Items by Region/Economy of Beneficial Ownership of Authorized Institutions

(HK$ bn)		Mainland China	Japan	US	Europe	Others	Total
Total Assets	2008	1,856	718	789	3,019	4,372	10,754
	2009	**2,035**	**619**	**734**	**2,930**	**4,343**	**10,661**
Deposits from Customers	2008	1,318	187	395	1,152	3,006	6,060
	2009	**1,433**	**163**	**389**	**1,225**	**3,171**	**6,381**
Loans to Customers	2008	836	208	130	647	1,464	3,286
	2009	**958**	**191**	**93**	**584**	**1,463**	**3,289**
Loans to Customers	2008	672	156	120	451	1,311	2,710
Inside Hong Kong [(a)]	**2009**	**770**	**140**	**86**	**377**	**1,300**	**2,674**
Loans to Customers	2008	164	52	10	196	153	575
Outside Hong Kong [(b)]	**2009**	**187**	**50**	**7**	**207**	**163**	**614**

(a) Defined as loans for use in Hong Kong plus trade finance.

(b) Includes "others" (i.e. unallocated).

Figures may not add up to total because of rounding.

Table H Flow of Funds for All Authorized Institutions and Retail Banks

All Authorized Institutions (HK$ bn) Increase/(Decrease) in	2008 HK$	2008 F/CY	2008 Total	**2009 HK$**	**2009 F/CY**	**2009 Total**
Assets						
Loans to customers	170	154	324	**47**	**(44)**	**3**
– Inside Hong Kong [a]	144	109	253	**48**	**(84)**	**(36)**
– Outside Hong Kong [b]	26	45	71	**(1)**	**40**	**39**
Interbank lending	(254)	(231)	(485)	**(68)**	**(200)**	**(268)**
– Inside Hong Kong	(85)	18	(67)	**(30)**	**28**	**(2)**
– Outside Hong Kong	(170)	(249)	(419)	**(37)**	**(229)**	**(266)**
All other assets	(58)	623	566	**487**	**(316)**	**172**
Total Assets	(142)	546	404	**466**	**(560)**	**(93)**
Liabilities						
Deposits from customers [c]	(41)	232	191	**340**	**(18)**	**322**
Interbank borrowing	(157)	140	(18)	**23**	**(87)**	**(64)**
– Inside Hong Kong	(91)	16	(75)	**(36)**	**29**	**(8)**
– Outside Hong Kong	(66)	124	58	**60**	**(116)**	**(57)**
All other liabilities	(108)	339	231	**(28)**	**(323)**	**(351)**
Total Liabilities	(307)	711	404	**335**	**(428)**	**(93)**
Net Interbank Borrowing/(Lending)	97	371	468	**91**	**113**	**204**
Net Customer Lending/(Borrowing)	211	(78)	133	**(293)**	**(26)**	**(319)**

Retail Banks (HK$ bn) Increase/(Decrease) in	2008 HK$	2008 F/CY	2008 Total	**2009 HK$**	**2009 F/CY**	**2009 Total**
Assets						
Loans to customers	128	87	215	**93**	**(14)**	**80**
– Inside Hong Kong [a]	112	68	179	**92**	**(23)**	**69**
– Outside Hong Kong [b]	16	19	36	**1**	**9**	**11**
Interbank lending	(102)	(161)	(264)	**(105)**	**(43)**	**(148)**
– Inside Hong Kong	(69)	16	(52)	**(33)**	**13**	**(20)**
– Outside Hong Kong	(34)	(178)	(211)	**(72)**	**(56)**	**(128)**
All other assets	(40)	583	543	**421**	**(277)**	**144**
Total Assets	(14)	509	495	**409**	**(334)**	**75**
Liabilities						
Deposits from customers [c]	21	273	294	**317**	**(44)**	**273**
Interbank borrowing	(20)	59	39	**44**	**(91)**	**(47)**
– Inside Hong Kong	(17)	27	11	**(13)**	**11**	**(2)**
– Outside Hong Kong	(3)	31	28	**57**	**(102)**	**(45)**
All other liabilities	(102)	263	162	**46**	**(197)**	**(151)**
Total Liabilities	(100)	595	495	**407**	**(332)**	**75**
Net Interbank Borrowing/(Lending)	83	220	303	**149**	**(47)**	**101**
Net Customer Lending/(Borrowing)	106	(185)	(79)	**(224)**	**31**	**(193)**

(a) Defined as loans for use in Hong Kong plus trade finance.

(b) Includes "others" (i.e. unallocated).

(c) Hong Kong dollar customer deposits include swap deposits.

Figures may not add up to total because of rounding.

Table I Loans to and Deposits from Customers by Category of Authorized Institutions

(HK$ bn)	Loans to Customers				Deposits from Customers [a]			
	HK$	F/CY	Total	%	HK$	F/CY	Total	%
2005								
Licensed banks	1,750	500	2,250	97	2,116	1,927	4,043	99
Restricted licence banks	26	13	39	2	12	7	19	–
Deposit-taking companies	22	1	23	1	3	2	5	–
Total	1,797	515	2,312	100	2,132	1,936	4,068	100
2006								
Licensed banks	1,870	532	2,402	97	2,551	2,174	4,725	99
Restricted licence banks	24	17	41	2	14	13	26	1
Deposit-taking companies	23	1	24	1	3	2	5	–
Total	1,917	550	2,468	100	2,568	2,189	4,757	100
2007								
Licensed banks	2,127	749	2,876	97	3,056	2,782	5,839	99
Restricted licence banks	32	26	59	2	15	9	25	–
Deposit-taking companies	25	2	27	1	3	2	5	–
Total	2,185	777	2,962	100	3,075	2,794	5,869	100
2008								
Licensed banks	2,293	904	3,197	97	3,013	3,015	6,028	99
Restricted licence banks	35	24	59	2	15	9	24	–
Deposit-taking companies	27	3	29	1	6	2	8	–
Total	2,355	931	3,286	100	3,034	3,026	6,060	100
2009								
Licensed banks	**2,352**	**859**	**3,211**	**98**	**3,358**	**3,000**	**6,358**	**100**
Restricted licence banks	**27**	**26**	**53**	**2**	**11**	**6**	**16**	**–**
Deposit-taking companies	**22**	**3**	**25**	**1**	**5**	**2**	**7**	**–**
Total	**2,401**	**887**	**3,289**	**100**	**3,374**	**3,007**	**6,381**	**100**

(a) Hong Kong dollar customer deposits include swap deposits.

A "-" sign denotes a figure of less than 0.5.

Figures may not add up to total because of rounding.

Table J Loans to Customers Inside Hong Kong by Economic Sector

All Authorized Institutions										
(HK$ bn)	2005		2006		2007		2008		**2009**	
Sector	HK$	%	HK$	%	HK$	%	HK$	%	**HK$**	**%**
Hong Kong's visible trade	142	7	152	7	183	7	186	7	**175**	**7**
Manufacturing	119	6	103	5	121	5	147	5	**135**	**5**
Transport & transport equipment	123	6	123	6	145	6	155	6	**150**	**6**
Building, construction and property development, and investment	451	22	492	23	578	24	687	25	**683**	**26**
Wholesale and retail trade	101	5	105	5	116	5	152	6	**155**	**6**
Financial concerns (other than authorized institutions)	179	9	185	9	251	10	283	10	**194**	**7**
Individuals										
– to purchase flats in the Home Ownership Scheme, the Private Sector Participation Scheme and the Tenants Purchase Scheme	68	3	60	3	58	2	57	2	**52**	**2**
– to purchase other residential properties	539	26	535	25	564	23	593	22	**647**	**24**
– other purposes	169	8	182	9	221	9	226	8	**219**	**8**
Others	183	9	188	9	220	9	223	8	**265**	**10**
Total [(a)]	2,072	100	2,126	100	2,457	100	2,710	100	**2,674**	**100**

Retail Banks										
(HK$ bn)	2005		2006		2007		2008		**2009**	
Sector	HK$	%	HK$	%	HK$	%	HK$	%	**HK$**	**%**
Hong Kong's visible trade	115	7	124	7	147	8	147	7	**131**	**6**
Manufacturing	75	5	68	4	79	4	97	5	**95**	**5**
Transport & transport equipment	81	5	82	5	87	5	92	4	**94**	**4**
Building, construction and property development, and investment	378	23	397	24	460	25	536	26	**554**	**26**
Wholesale and retail trade	69	4	73	4	78	4	99	5	**106**	**5**
Financial concerns (other than authorized institutions)	70	4	76	5	88	5	106	5	**90**	**4**
Individuals										
– to purchase flats in the Home Ownership Scheme, the Private Sector Participation Scheme and the Tenants Purchase Scheme	68	4	60	4	58	3	57	3	**52**	**2**
– to purchase other residential properties	526	32	522	31	551	30	579	28	**634**	**30**
– other purposes	140	9	152	9	178	10	188	9	**183**	**9**
Others	120	7	123	7	139	7	144	7	**174**	**8**
Total [(a)]	1,643	100	1,676	100	1,865	100	2,044	100	**2,113**	**100**

(a) Defined as loans for use in Hong Kong plus trade finance.

Figures may not add up to total because of rounding.

Table K Deposits from Customers

(HK$ bn)	All Authorized Institutions				Retail Banks			
	Demand	Savings	Time	Total	Demand	Savings	Time	Total
Hong Kong Dollar [a]								
2005	206	742	1,183	2,132	190	734	992	1,916
2006	238	933	1,397	2,568	219	924	1,140	2,283
2007	296	1,110	1,669	3,075	273	1,096	1,305	2,674
2008	321	1,254	1,459	3,034	295	1,239	1,161	2,695
2009	**477**	**1,767**	**1,130**	**3,374**	**434**	**1,744**	**835**	**3,012**
Foreign Currency								
2005	86	402	1,448	1,936	56	353	917	1,326
2006	104	426	1,659	2,189	70	373	1,024	1,466
2007	162	520	2,112	2,794	112	451	1,200	1,763
2008	155	691	2,180	3,026	102	610	1,324	2,036
2009	**231**	**932**	**1,845**	**3,007**	**143**	**828**	**1,021**	**1,992**
Total								
2005	292	1,144	2,631	4,068	246	1,087	1,909	3,242
2006	341	1,359	3,057	4,757	289	1,297	2,163	3,749
2007	459	1,629	3,781	5,869	385	1,547	2,506	4,437
2008	475	1,945	3,639	6,060	397	1,849	2,485	4,731
2009	**707**	**2,699**	**2,975**	**6,381**	**576**	**2,572**	**1,856**	**5,004**

(a) Hong Kong dollar customer deposits include swap deposits.

Figures may not add up to total because of rounding.

Table L Geographical Breakdown of Net External Claims/ (Liabilities) of All Authorized Institutions

(HK$ bn) Region/Economy	2008 Net Claims on/ (Liabilities to) Banks Outside Hong Kong	2008 Net Claims on/ (Liabilities to) Non-bank Customers Outside Hong Kong	2008 Total Net Claims/ (Liabilities)	**2009** **Net Claims on/ (Liabilities to) Banks Outside Hong Kong**	**2009** **Net Claims on/ (Liabilities to) Non-bank Customers Outside Hong Kong**	**2009** **Total Net Claims/ (Liabilities)**
Asia & Pacific	692	(169)	523	**819**	**(314)**	**505**
South Korea	248	41	289	**295**	**47**	**342**
Australia	286	19	305	**279**	**46**	**325**
Japan	(77)	177	99	**45**	**63**	**108**
Singapore	316	(92)	224	**189**	**(99)**	**89**
India	21	36	57	**38**	**38**	**76**
New Zealand	4	0	4	**3**	**5**	**8**
Sri Lanka	2	1	3	**2**	**1**	**3**
Maldives	2	0	2	**2**	**0**	**2**
Bangladesh	2	0	2	**1**	**0**	**1**
Malaysia	16	2	18	**2**	**(1)**	**1**
Republic of Kazakhstan	1	0	1	**1**	**0**	**1**
Laos	0	1	1	**0**	**0**	**0**
Cambodia	0	0	0	**(1)**	**0**	**(1)**
Myanmar	(1)	0	(1)	**(1)**	**0**	**(1)**
Vietnam	1	0	1	**0**	**(1)**	**(1)**
Nepal	(1)	0	(1)	**(3)**	**0**	**(3)**
Western Samoa	0	(8)	(8)	**0**	**(9)**	**(9)**
Thailand	(15)	(7)	(22)	**(2)**	**(11)**	**(12)**
Indonesia	(1)	(4)	(5)	**(8)**	**(4)**	**(12)**
Brunei	(9)	(2)	(11)	**(7)**	**(8)**	**(15)**
Philippines	(5)	(11)	(16)	**(22)**	**(14)**	**(36)**
Macau SAR	(78)	0	(77)	**(55)**	**(2)**	**(57)**
Taiwan	48	(148)	(100)	**3**	**(152)**	**(149)**
Mainland China	(67)	(168)	(235)	**60**	**(209)**	**(149)**
Others	(1)	(6)	(7)	**(3)**	**(5)**	**(8)**
North America	168	175	343	**79**	**214**	**293**
United States	138	184	322	**55**	**211**	**266**
Canada	30	(9)	21	**25**	**3**	**27**
Caribbean	22	(41)	(19)	**71**	**(79)**	**(8)**
Bahamas	(13)	(9)	(22)	**55**	**(11)**	**45**
Cayman Islands	35	15	49	**15**	**1**	**16**
Netherlands Antilles	0	2	2	**0**	**3**	**3**
Panama	0	1	1	**0**	**1**	**1**
Bermuda	0	6	6	**0**	**1**	**1**
Others	0	(56)	(56)	**0**	**(74)**	**(74)**
Africa	3	(5)	(2)	**(2)**	**(6)**	**(8)**
Nigeria	0	0	1	**0**	**0**	**1**
South Africa	4	0	4	**0**	**0**	**0**
Mauritius	(1)	2	1	**(2)**	**0**	**(2)**
Liberia	0	(1)	(1)	**0**	**(4)**	**(4)**
Others	0	(6)	(6)	**0**	**(3)**	**(4)**

Table L Geographical Breakdown of Net External Claims/ (Liabilities) of All Authorized Institutions (cont.)

(HK$ bn) Region/Economy	2008 Net Claims on/ (Liabilities to) Banks Outside Hong Kong	2008 Net Claims on/ (Liabilities to) Non-bank Customers Outside Hong Kong	2008 Total Net Claims/ (Liabilities)	2009 Net Claims on/ (Liabilities to) Banks Outside Hong Kong	2009 Net Claims on/ (Liabilities to) Non-bank Customers Outside Hong Kong	2009 Total Net Claims/ (Liabilities)
Latin America	5	(3)	2	9	(3)	6
Chile	2	0	2	7	0	7
Brazil	3	(1)	2	2	(1)	1
Mexico	0	0	1	0	0	1
Venezuela	0	(1)	(1)	0	(1)	(1)
Others	0	(2)	(1)	0	(2)	(2)
Eastern Europe	10	1	10	5	0	5
Western Europe	1,236	40	1,276	945	55	1,000
United Kingdom	793	(25)	768	512	(35)	477
France	202	10	212	178	43	221
Switzerland	92	(2)	90	117	(2)	115
Netherlands	87	(2)	85	68	6	74
Germany	(5)	0	(5)	38	31	68
Luxembourg	24	4	28	20	2	22
Belgium	(8)	0	(8)	19	1	20
Denmark	10	8	18	7	8	15
Sweden	20	2	21	9	2	12
Norway	14	3	17	10	0	10
Jersey	4	31	35	5	2	6
Republic of Ireland	17	2	19	9	(3)	6
Finland	2	1	3	1	1	2
Cyprus	0	2	2	0	2	2
Turkey	1	1	2	1	0	1
Iceland	1	0	1	1	0	1
Greece	0	1	1	0	0	0
Portugal	1	0	1	0	0	0
Gibraltar	0	0	0	0	(1)	(1)
Austria	5	0	5	(3)	0	(3)
Malta	0	4	4	(2)	(6)	(8)
Spain	(13)	(1)	(15)	(12)	3	(8)
Italy	(12)	3	(9)	(33)	2	(32)
Others	0	0	0	1	(1)	0
Middle East	18	29	48	26	31	57
United Arab Emirates	15	24	39	29	26	55
Qatar	1	2	3	1	4	5
Saudi Arabia	3	1	4	2	1	3
Egypt	0	1	0	0	1	1
Kuwait	1	1	1	0	0	0
Oman	0	0	0	(1)	0	(1)
Bahrain	0	0	0	(6)	0	(6)
Others	0	0	0	0	0	(1)
Others [a]	20	1	21	83	4	87
Overall Total	2,175	27	2,202	2,036	(99)	1,937

(a) "Others" include economies not listed above and positions in relation to international organisations.

Figures may not add up to total because of rounding.

Abbreviations used in this Report

AI – Authorized institution
AML – Anti-money-laundering
APEC – Asia-Pacific Economic Co-operation
ASEAN – Association of Southeast Asian Nations
BLR – Best lending rate
CAAP – Capital adequacy assessment process
CAMEL – Capital adequacy, Asset quality, Management, Earnings and Liquidity
CAR – Capital adequacy ratio
CBRC – China Banking Regulatory Commission
CCASS – Central Clearing and Settlement System
CCPI – Composite Consumer Price Index
CCR – Counterparty credit risk
CCRA – Commercial Credit Reference Agency
CEPA – Closer Economic Partnership Arrangement
CFT – Counter-terrorist-financing
CHATS – Clearing House Automated Transfer System
CLS – Continuous Linked Settlement
CMIM – Chiang Mai Initiative Multilateralisation
CMU – Central Moneymarkets Unit
CRAs – Credit rating agencies
CRCC – Credit Review and Compliance Committee
CSSO – Clearing and Settlement Systems Ordinance
CU – Convertibility Undertaking
DCA – Debt collection agent
DPS – Deposit Protection Scheme
DvP – Delivery-versus-Payment
EFAC – Exchange Fund Advisory Committee
EFBN – Exchange Fund Bills and Notes
EMEAP – Executives' Meeting of East Asia-Pacific Central Banks
FATF – Financial Action Task Force on Money Laundering
F/CY – Foreign currency
FSB – Financial Stability Board
G20 – Group of Twenty
GDP – Gross Domestic Product
GSC – Governance Sub-Committee
HIBOR – Hong Kong Interbank Offered Rate
HKASs – Hong Kong Accounting Standards
HKDPB – Hong Kong Deposit Protection Board
HKFRSs – Hong Kong Financial Reporting Standards
HKICL – Hong Kong Interbank Clearing Limited
HKICPA – Hong Kong Institute of Certified Public Accountants
HKIMR – Hong Kong Institute for Monetary Research
HKMA – Hong Kong Monetary Authority
HKMC – Hong Kong Mortgage Corporation Limited
HKSAR – Hong Kong Special Administrative Region
IASB – International Accounting Standards Board
IFSB – Islamic Financial Services Board
IMF – International Monetary Fund
IPO – Initial Public Offering
IRB approach – Internal ratings-based approach
IMM approach – Internal models approach
ISC – Investment Sub-Committee
MA – Monetary Authority
MFSC – Monetary and Financial Stability Committee
MPF – Mandatory Provident Fund
NAB – New Arrangements to Borrow
NDIs – Negotiable debt instruments
OCL – Octopus Cards Limited
PBoC – People's Bank of China
PvP – Payment-versus-Payment
RIs – Registered institutions
RM – Ringgit Malaysia
RMB – Renminbi
RMC – Risk Management and Compliance Division
RTGS – Real Time Gross Settlement
SFC – Securities and Futures Commission
SRP – Supervisory review process
TMA – Treasury Markets Association
VaR – Value-at-Risk
yoy – Year-on-year

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CONTAINS
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HONG KONG MONETARY AUTHORITY

55/F, Two International Finance Centre,
8 Finance Street, Central, Hong Kong
Telephone : (852) 2878 8196
Facsimile : (852) 2878 8197
E-mail : hkma@hkma.gov.hk

www.hkma.gov.hk