



HONG KONG MONETARY AUTHORITY

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

1 February 2016



DISCUSSION TOPICS

Updates on

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



FINANCIAL AND ECONOMIC ENVIRONMENT



GLOBAL ECONOMIC GROWTH FORECASTS

Real GDP Growth

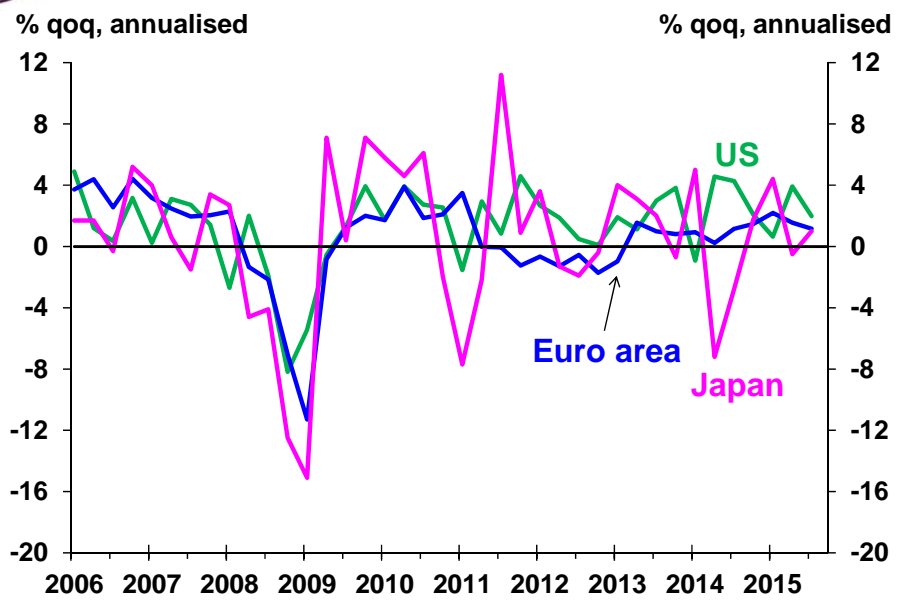
(% year-on-year)

	2014	2015 Estimates	2016 Forecasts
US	2.4	2.4	2.4
Euro area	0.9	1.5	1.7
Japan	-0.03	0.6	1.2
Asia (ex-Japan)	6.2	5.8	5.7
Mainland China	7.3	6.9	6.5
Hong Kong	2.5	2.4	2.0

Sources: January Consensus Forecasts and Official Statistics



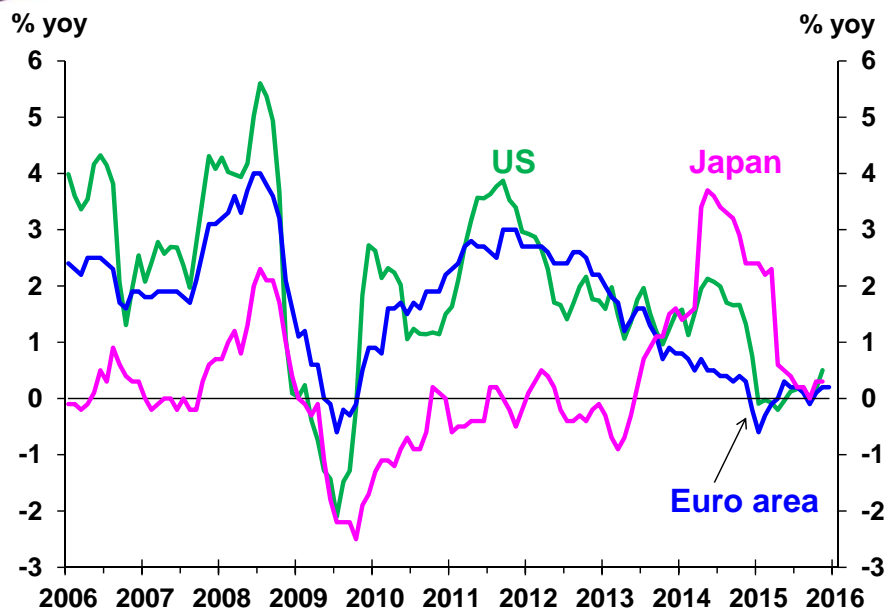
REAL GDP GROWTH IN MAJOR COUNTRIES



Source: Bloomberg



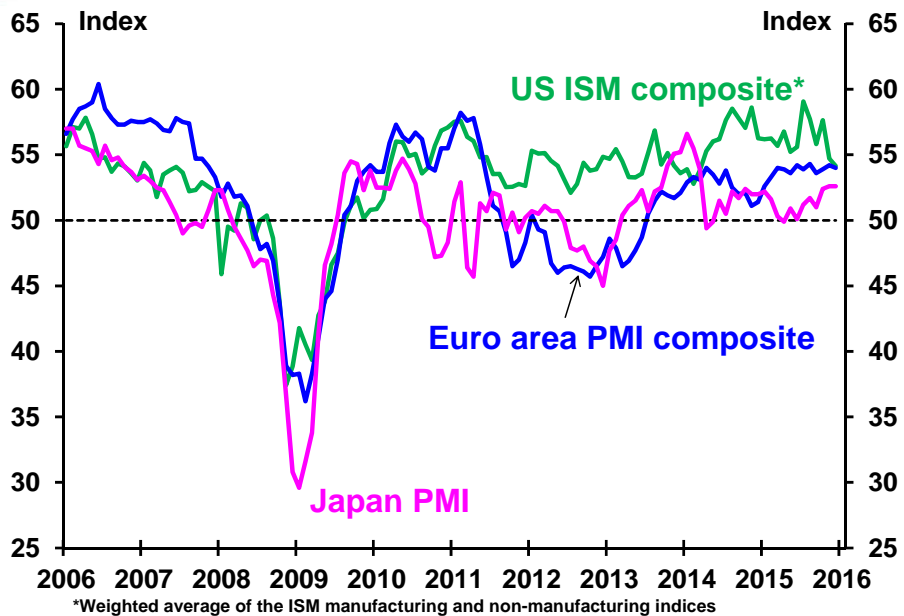
HEADLINE INFLATION IN MAJOR COUNTRIES



Sources: Bloomberg and CEIC



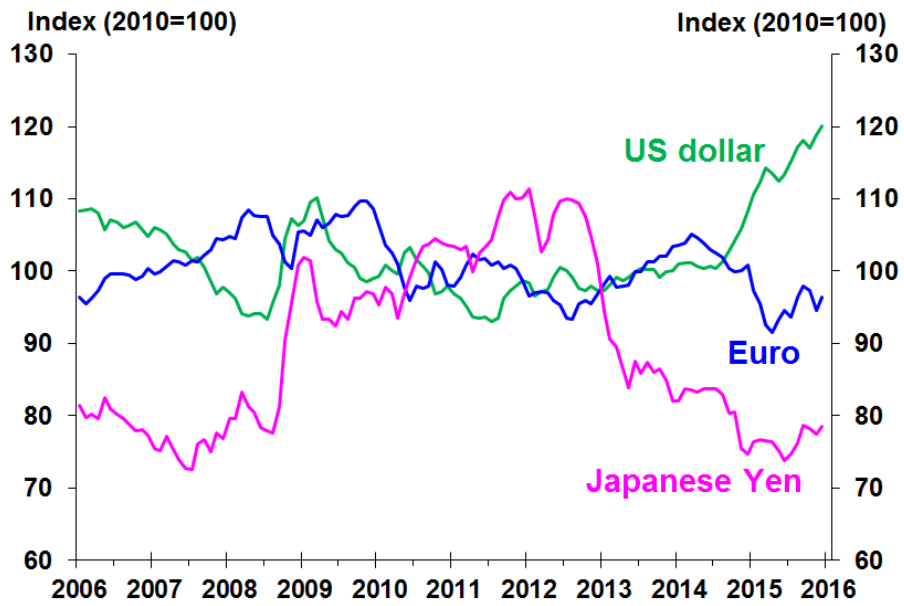
PURCHASING MANAGERS' INDEX IN MAJOR ECONOMIES



Sources: Bloomberg and CEIC



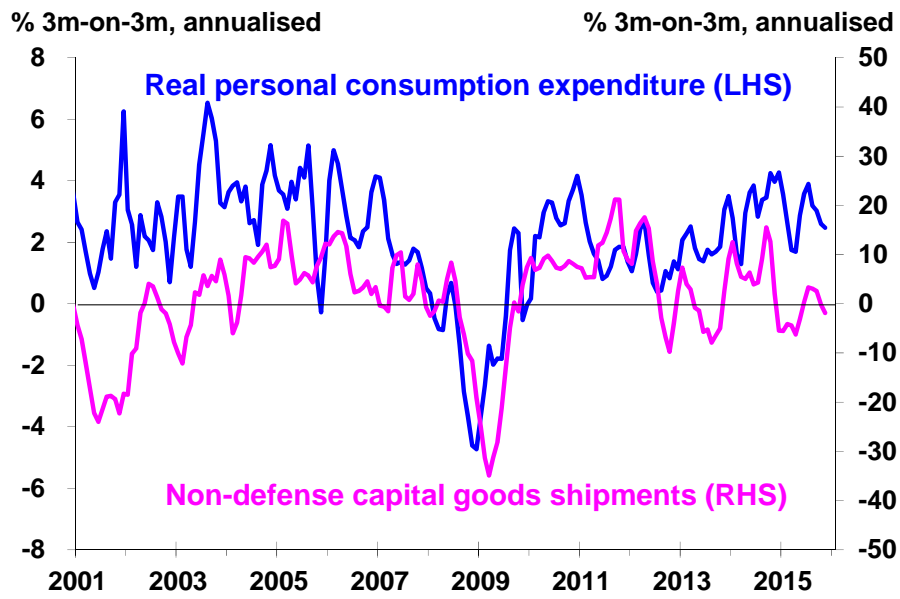
NOMINAL EFFECTIVE EXCHANGE RATE INDEX OF MAJOR CURRENCIES



Source: CEIC



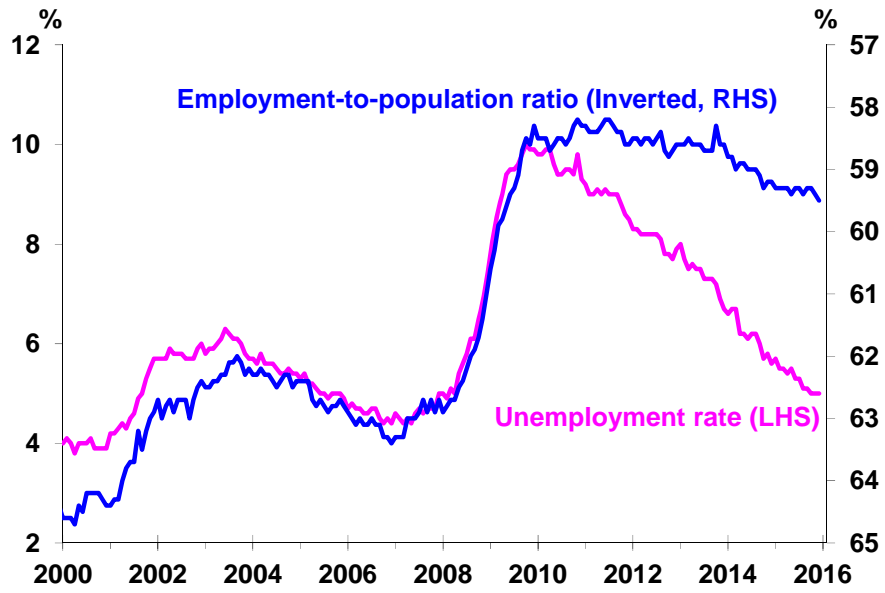
US: CONSUMPTION GROWTH & BUSINESS INVESTMENT ACTIVITY



Source: CEIC



US: LABOUR MARKET SITUATION



Source: CEIC



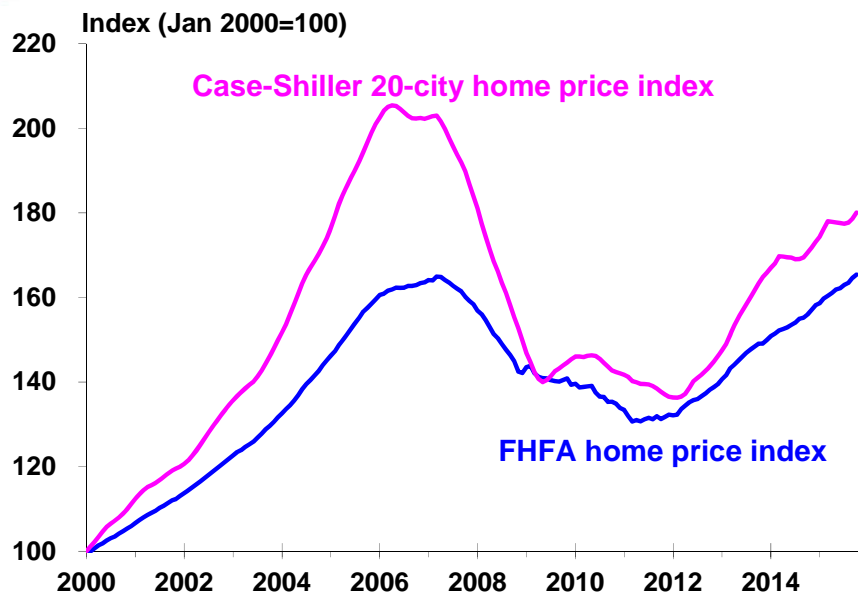
US: LABOUR FORCE PARTICIPATION



Source: CEIC



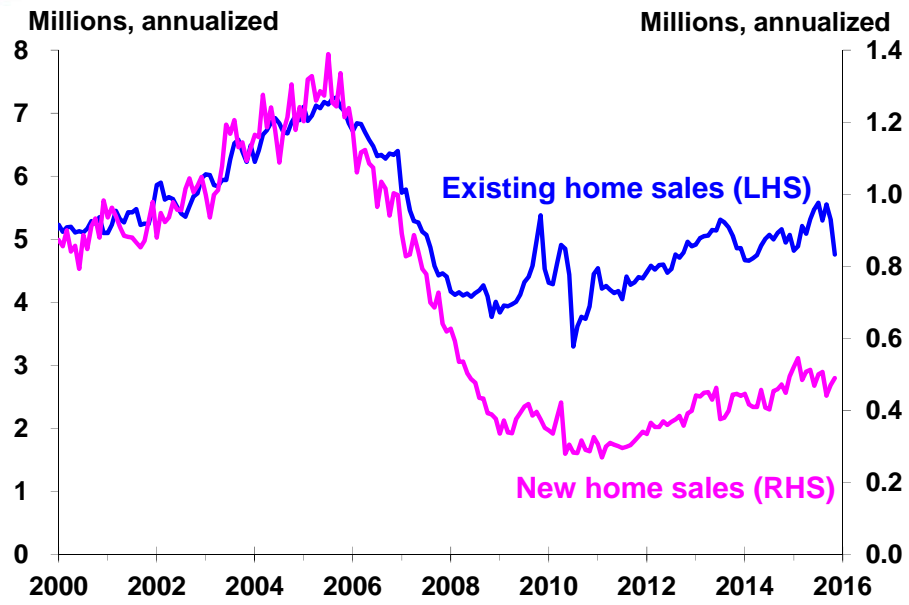
US: HOUSE PRICES



Sources: Standard & Poor's and CEIC



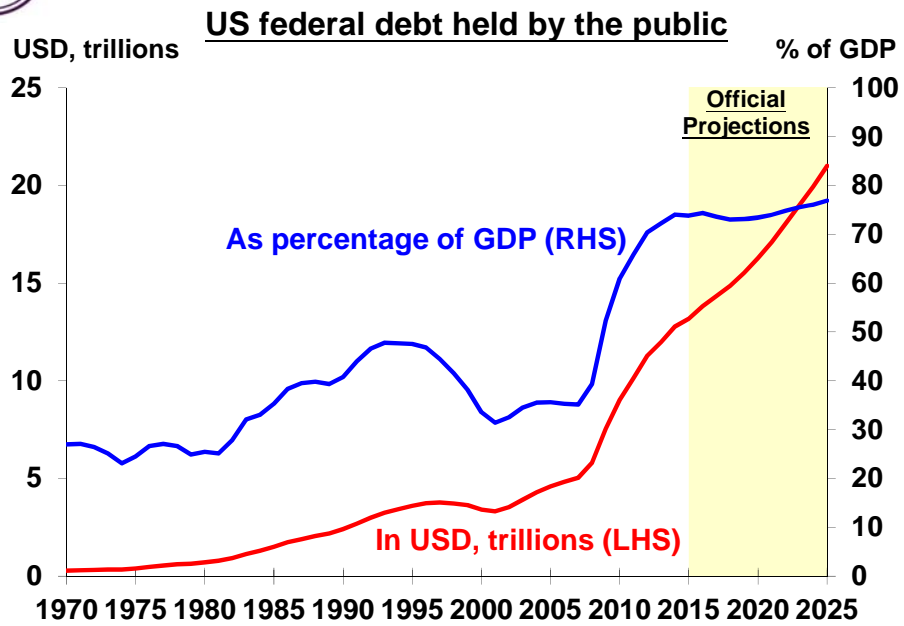
US: HOME SALES



Source: CEIC



US: FEDERAL GOVERNMENT DEBT

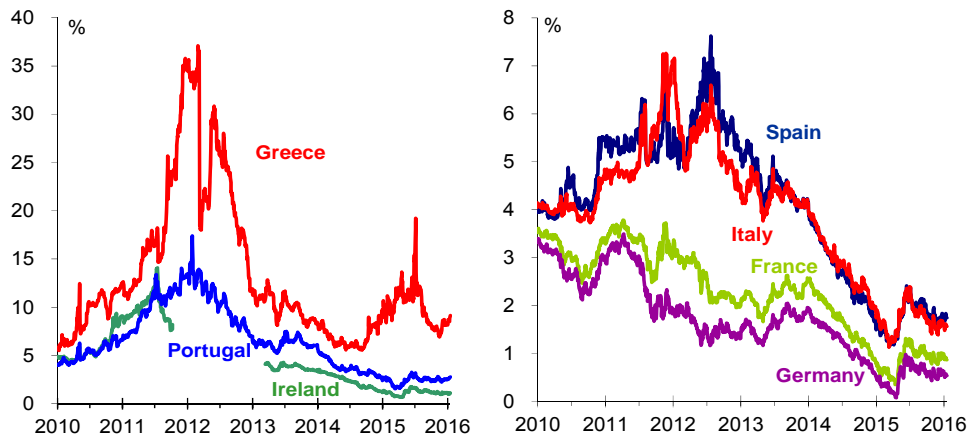


Source: Congressional Budget Office



EURO AREA: SOVEREIGN BOND YIELDS

10-year sovereign bond yield

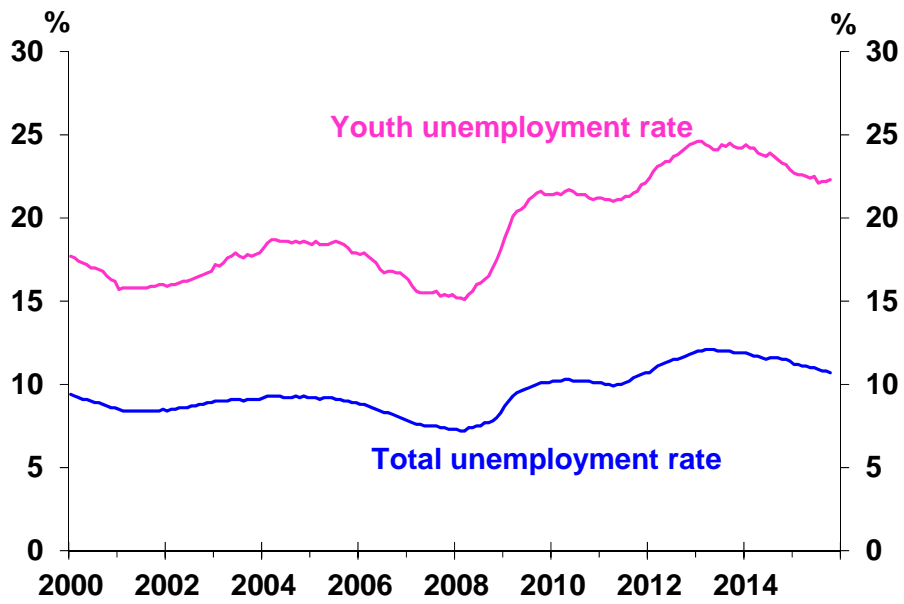


Note: 10-year Irish sovereign bond yield data is not available between 12 Oct 2011 and 14 Mar 2013

Source: Bloomberg



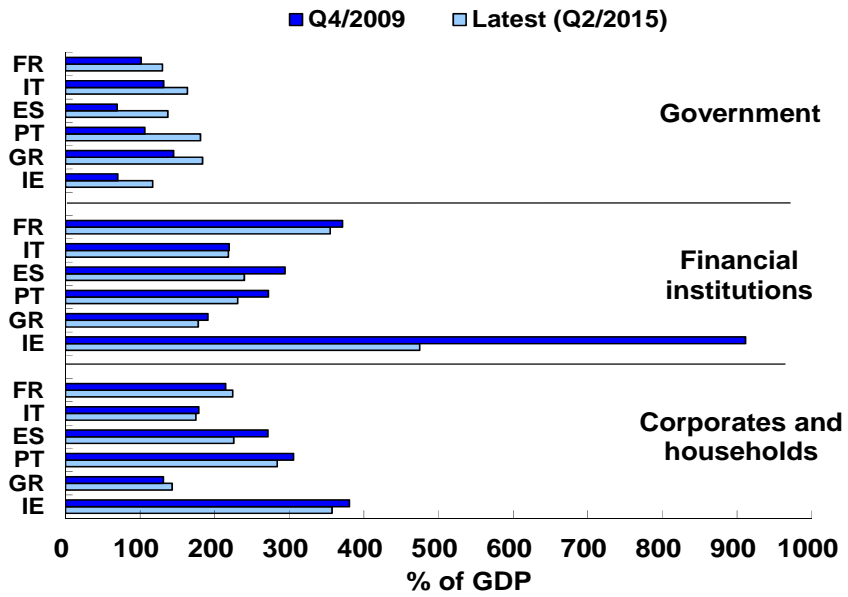
EURO AREA: UNEMPLOYMENT RATE



Source: Bloomberg



EURO AREA: OVERALL INDEBTEDNESS

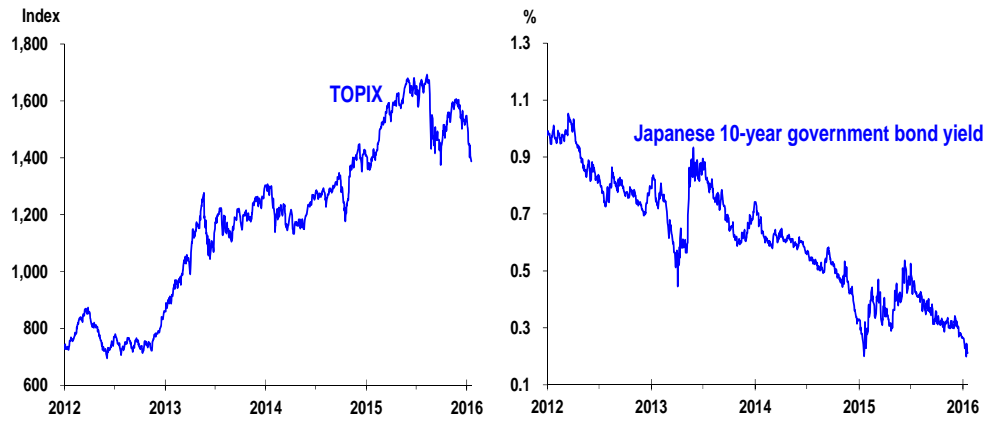


Note: FR – France, IT – Italy, ES – Spain, PT – Portugal, GR – Greece, IE – Ireland

Source: European Central Bank



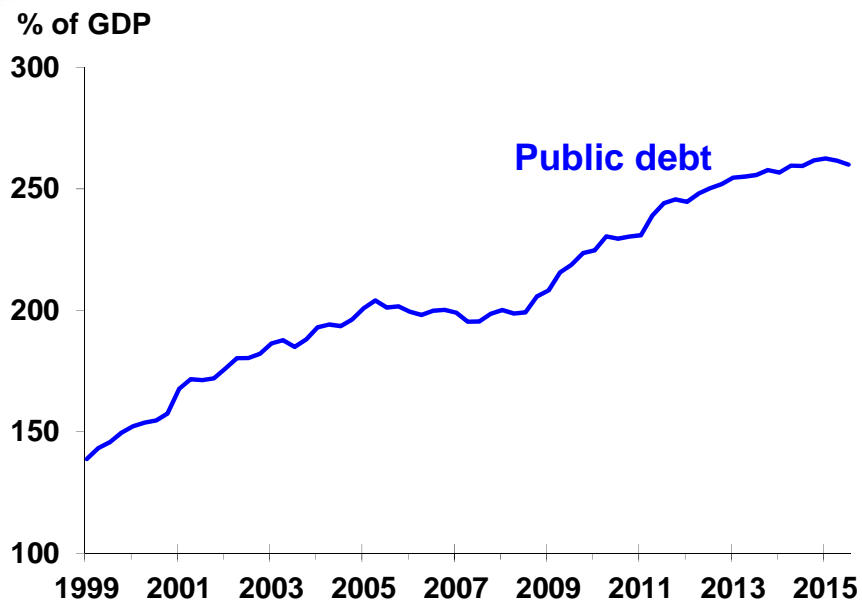
JAPAN: FINANCIAL MARKETS



Source: Bloomberg



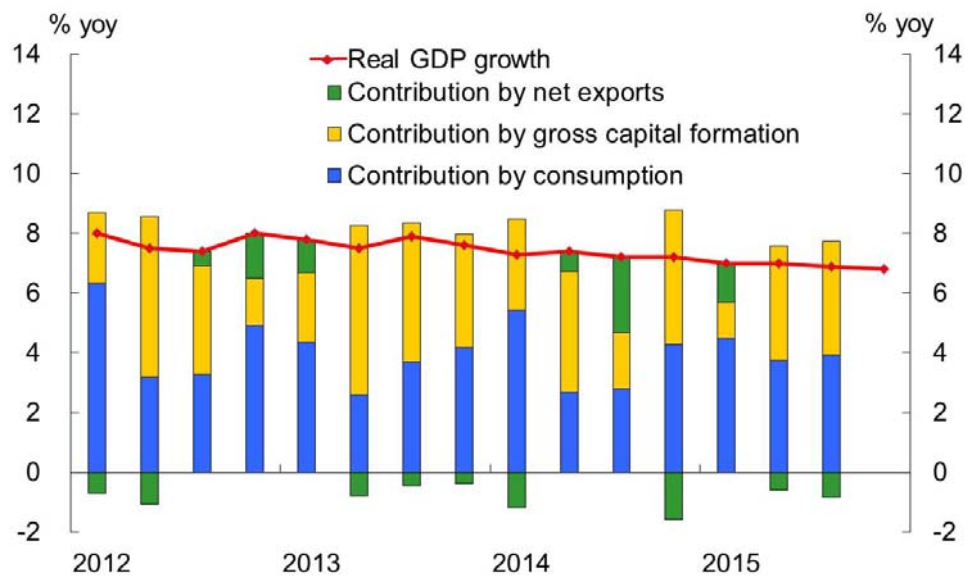
JAPAN: PUBLIC DEBT



Sources: Bank of Japan and CEIC



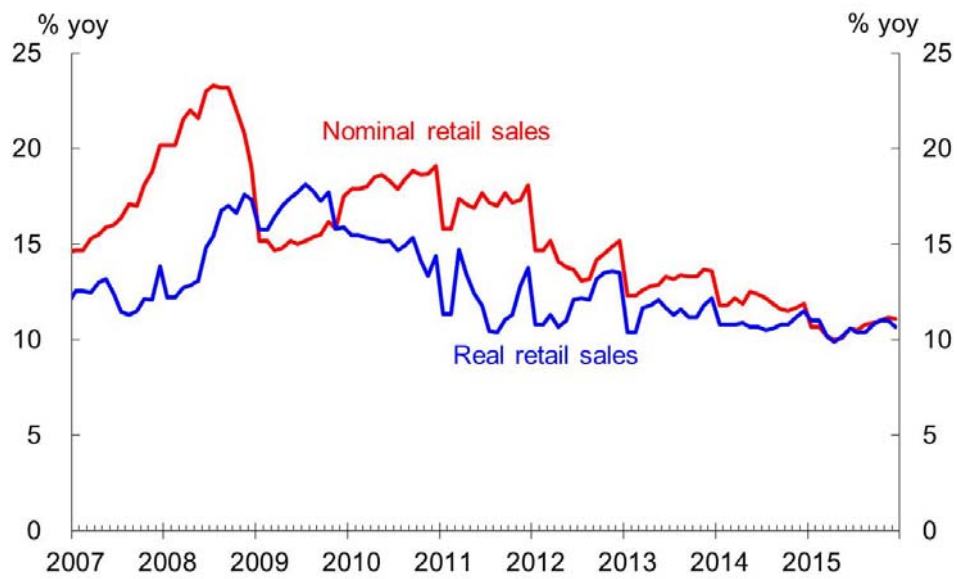
MAINLAND CHINA: REAL GDP GROWTH



Source: CEIC



MAINLAND CHINA: RETAIL SALES



Note: January and February figures are the average growth rate for the first two months of the year

Sources: WIND and HKMA staff estimates



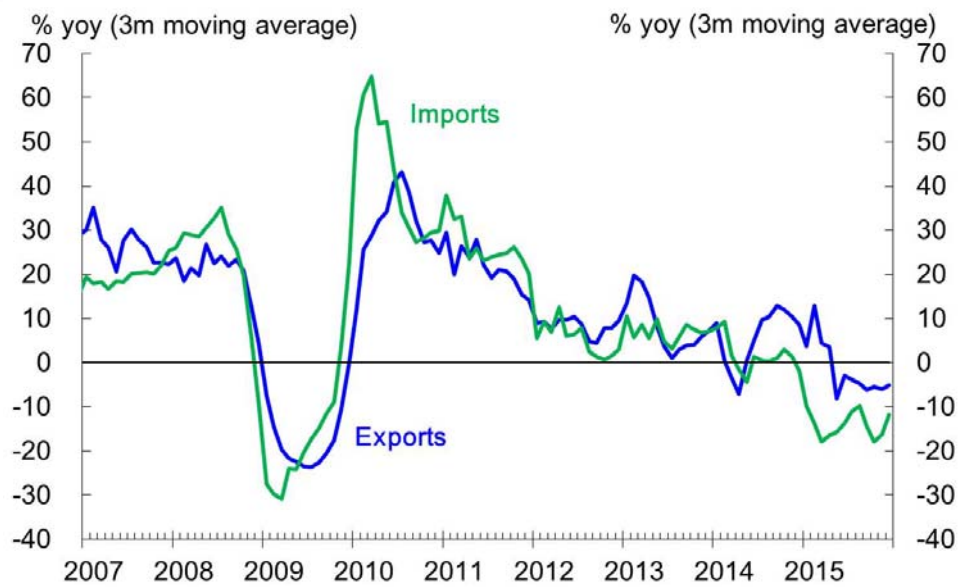
MAINLAND CHINA: FIXED ASSET INVESTMENT



Sources: CEIC and HKMA staff estimates



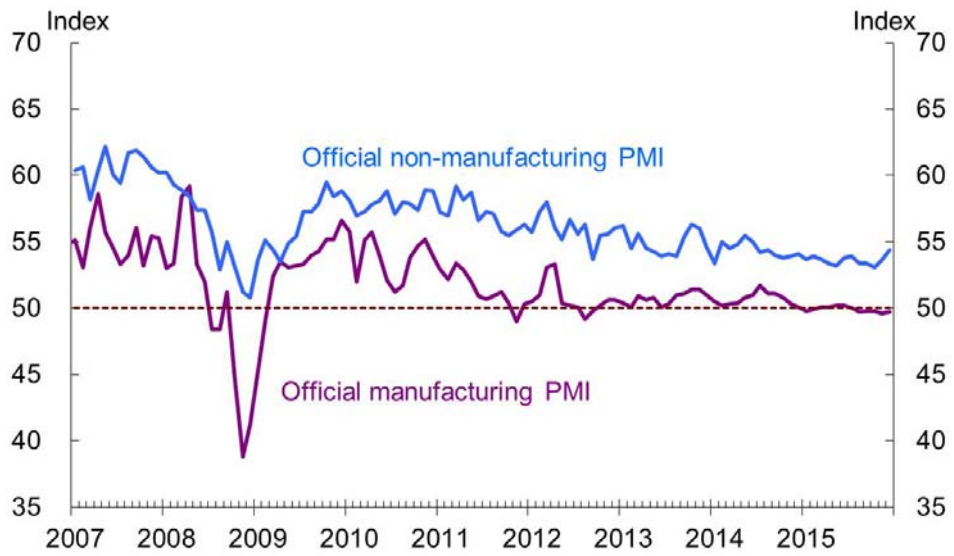
MAINLAND CHINA: IMPORT AND EXPORT GROWTH



Sources: CEIC and HKMA staff estimates



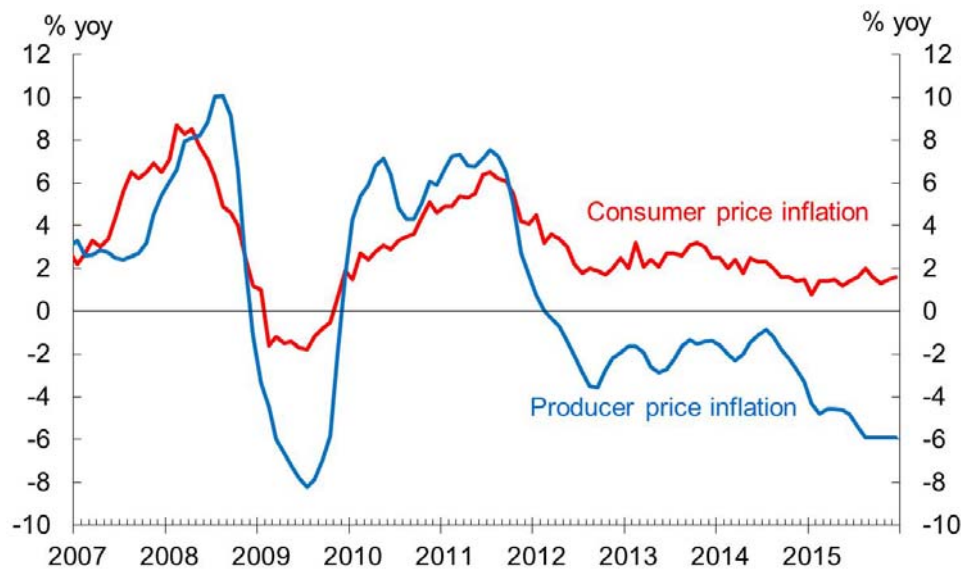
MAINLAND CHINA: PURCHASING MANAGERS' INDEX



Source: CEIC



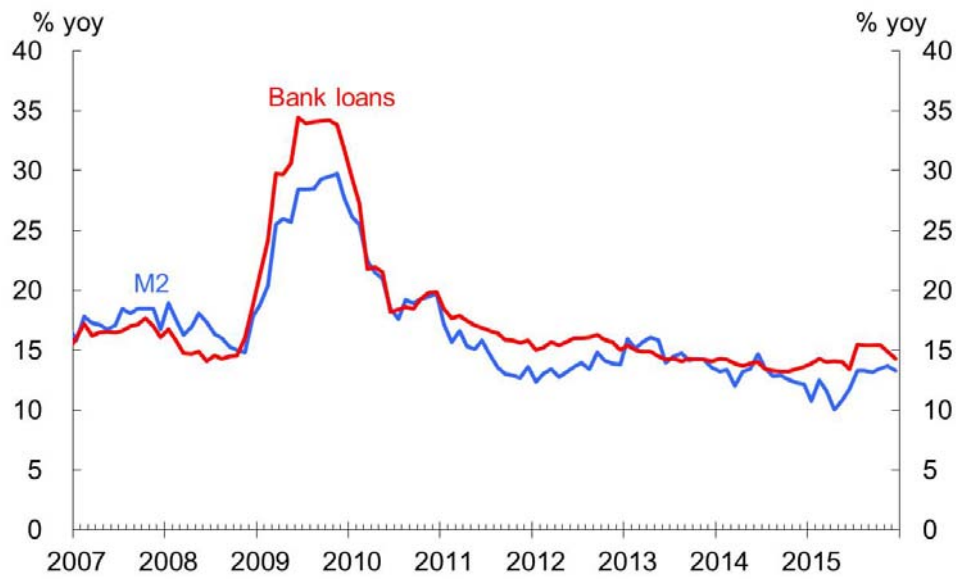
MAINLAND CHINA: INFLATION



Source: CEIC



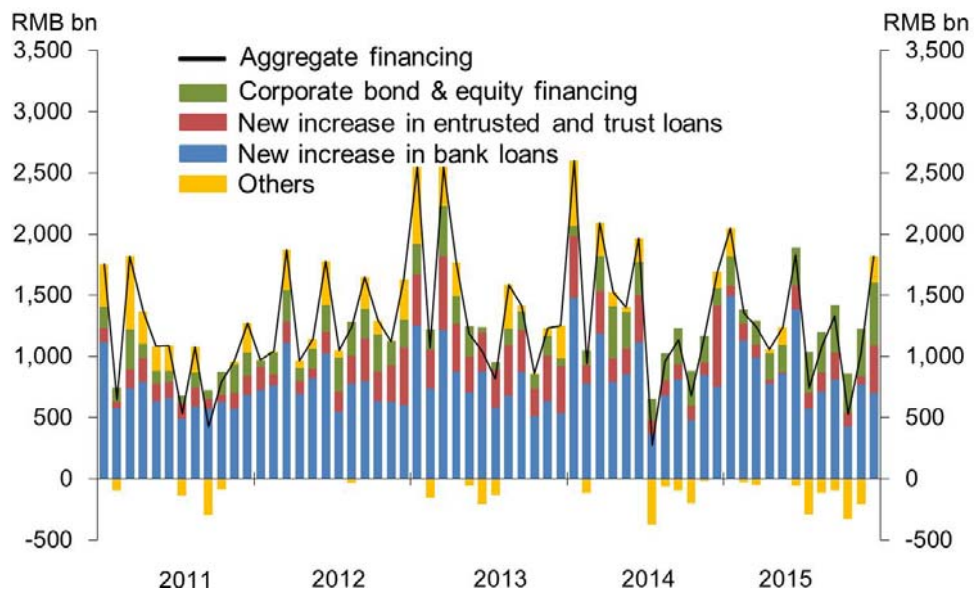
MAINLAND CHINA: MONEY AND LOAN GROWTH



Source: CEIC



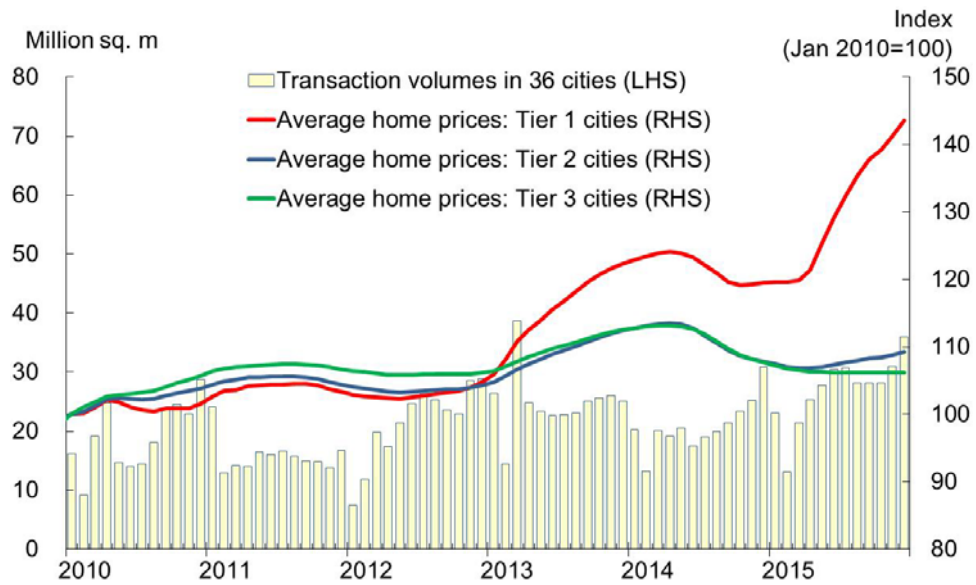
MAINLAND CHINA: AGGREGATE FINANCING FLOW



Source: CEIC



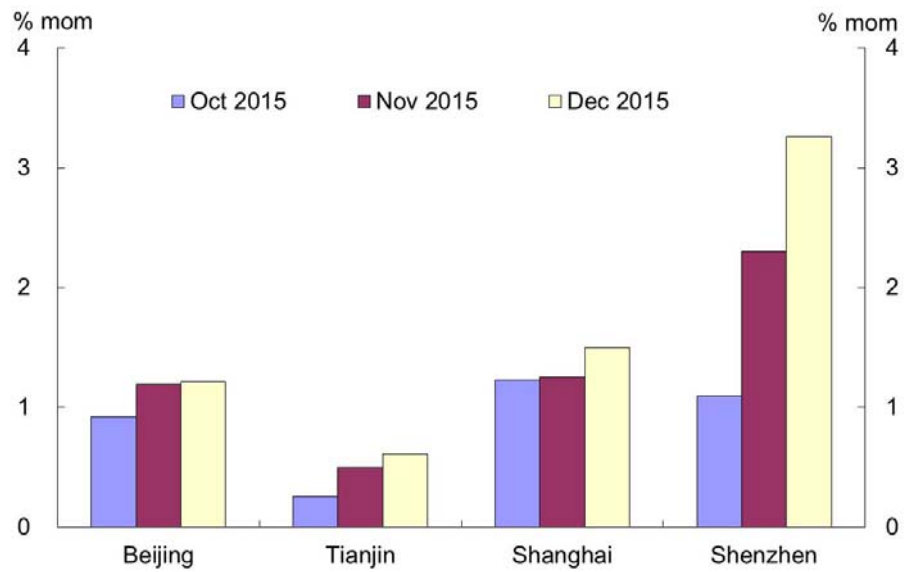
MAINLAND CHINA: PROPERTY PRICE AND TRANSACTION VOLUME



Sources: CEIC, WIND and HKMA staff estimates



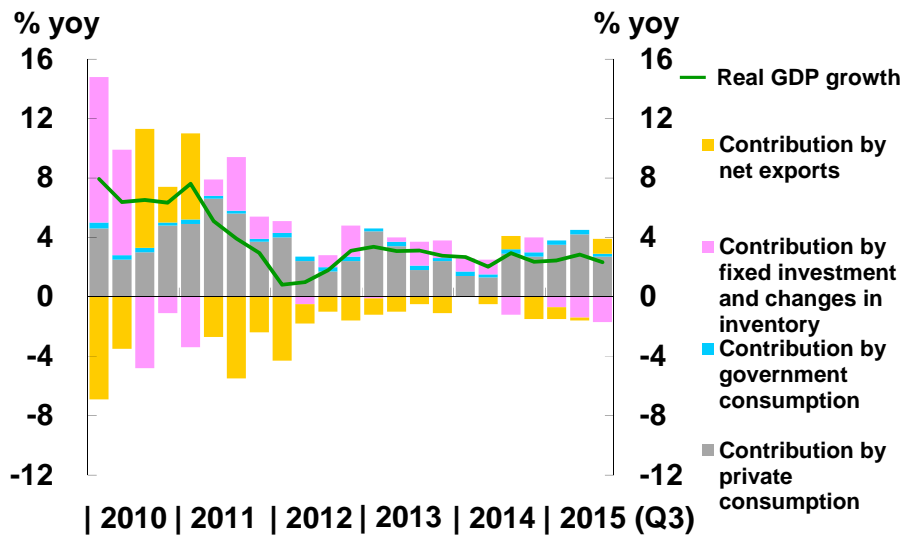
MAINLAND CHINA: HOUSING PRICE CHANGES IN MAJOR CITIES



Sources: CEIC, WIND and HKMA staff estimates



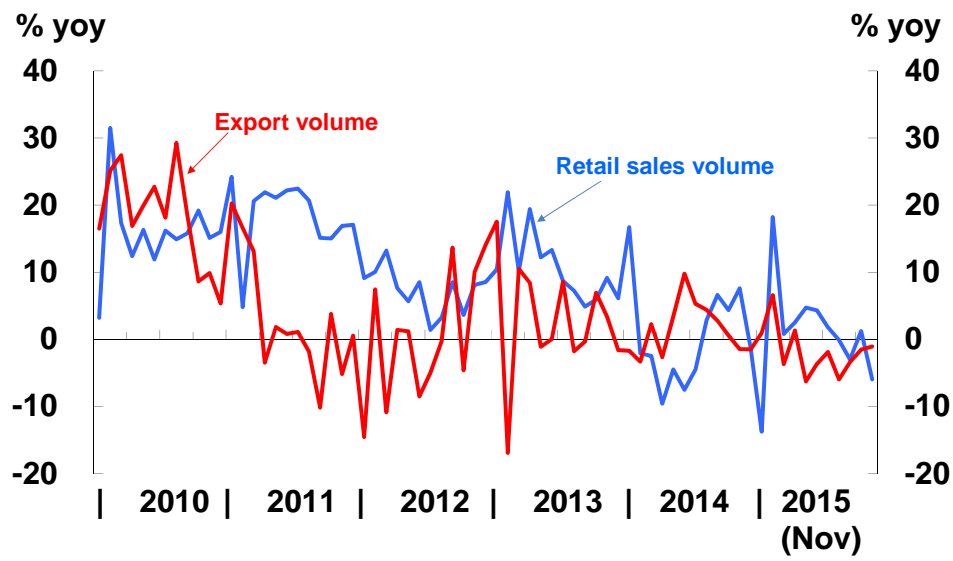
HONG KONG: REAL GDP GROWTH



Source: C&SD



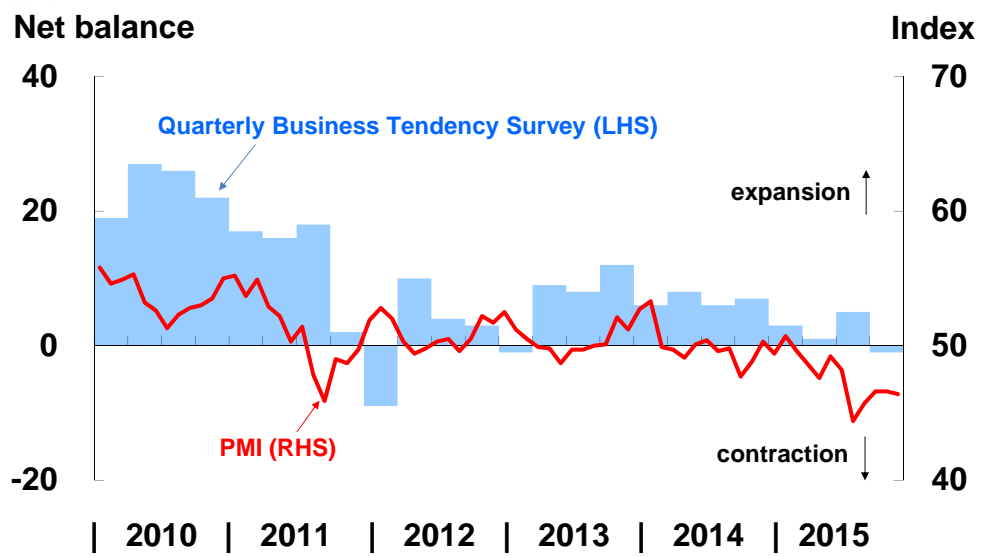
HONG KONG: ECONOMIC ACTIVITY



Source: C&SD



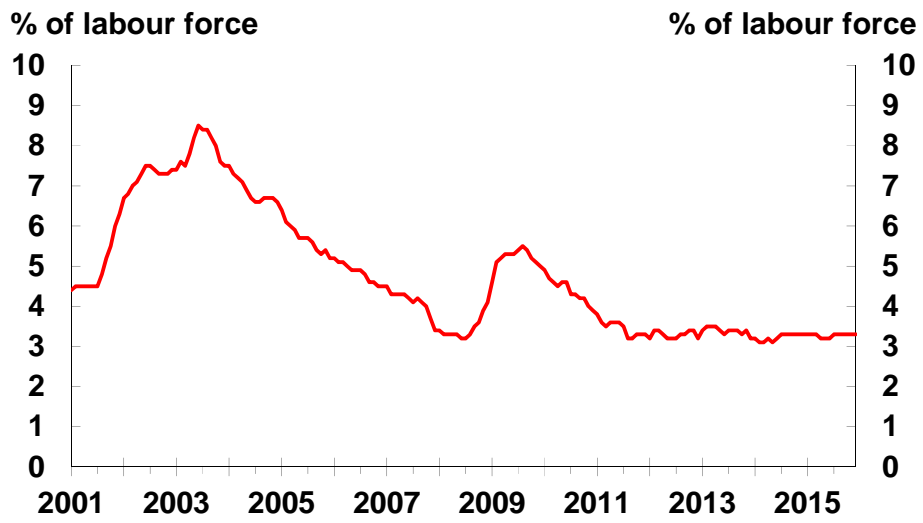
HONG KONG: BUSINESS OUTLOOK



Sources: C&SD and Markit Economics



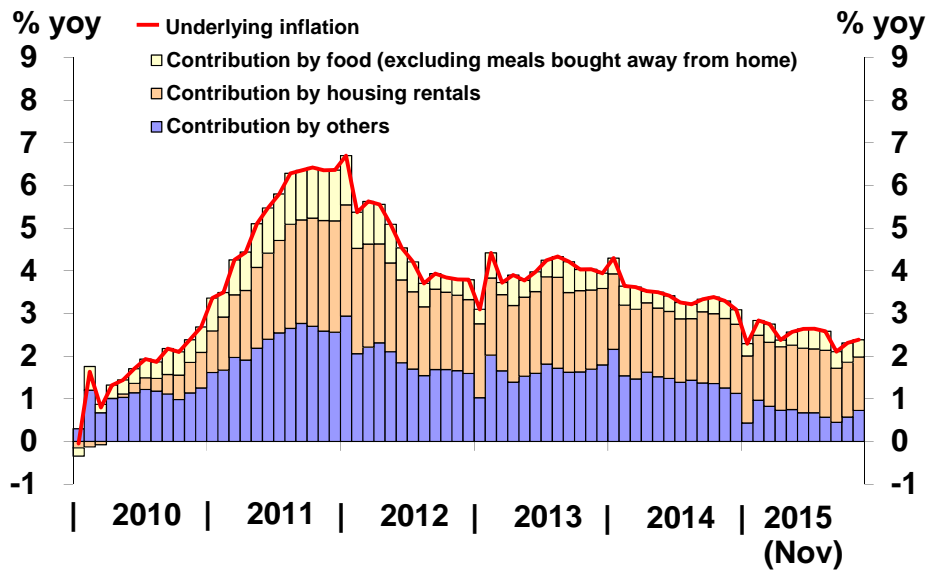
HONG KONG: UNEMPLOYMENT RATE



Source: C&SD



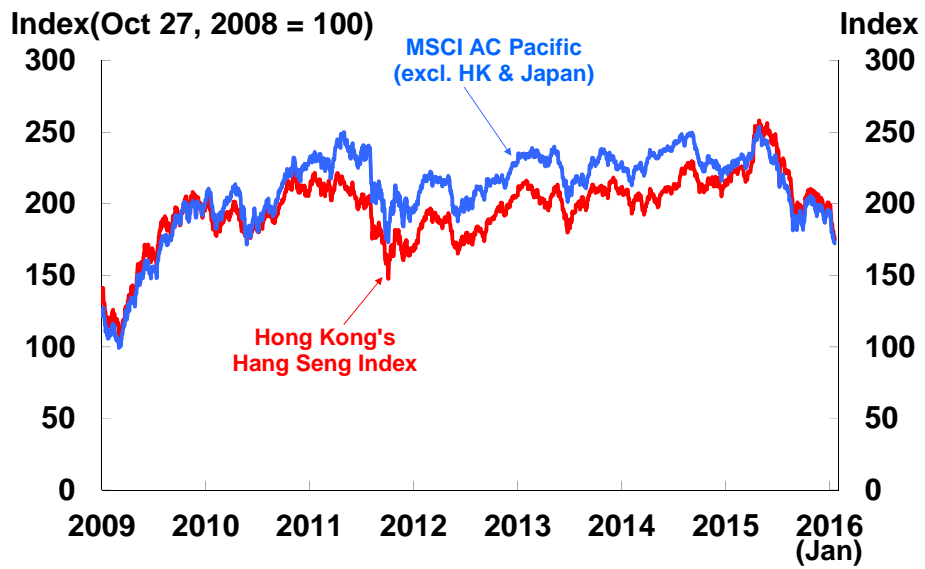
HONG KONG: INFLATION



Sources: C&SD and HKMA staff estimates



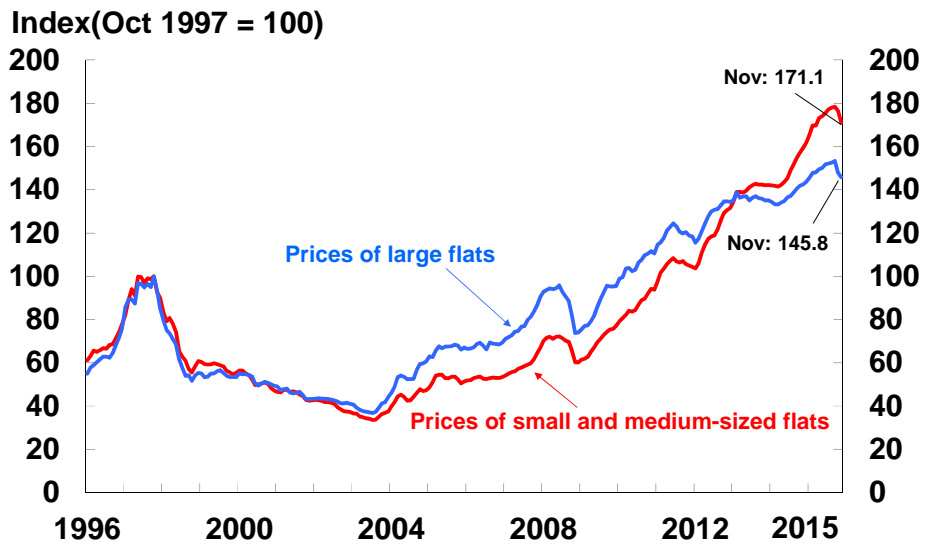
HONG KONG: EQUITY MARKET



Source: Bloomberg



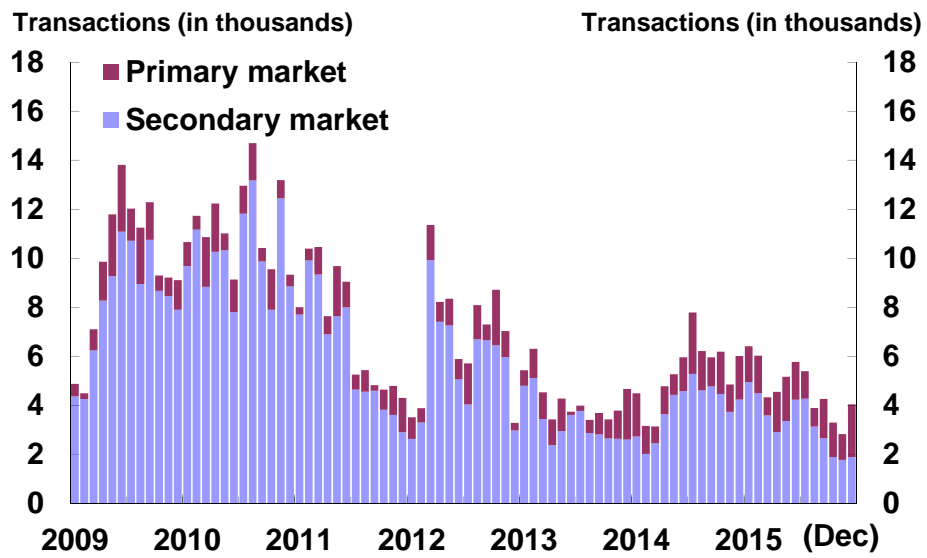
HONG KONG: RESIDENTIAL PROPERTY PRICES



Source: Rating and Valuation Department



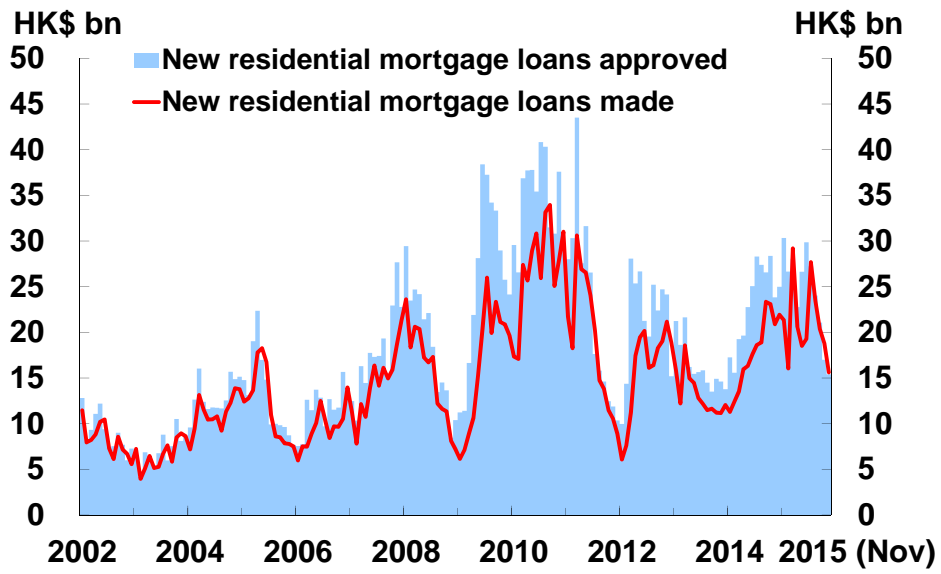
HONG KONG: TRANSACTION VOLUME IN THE PRIMARY AND SECONDARY MARKETS



Source: The Land Registry



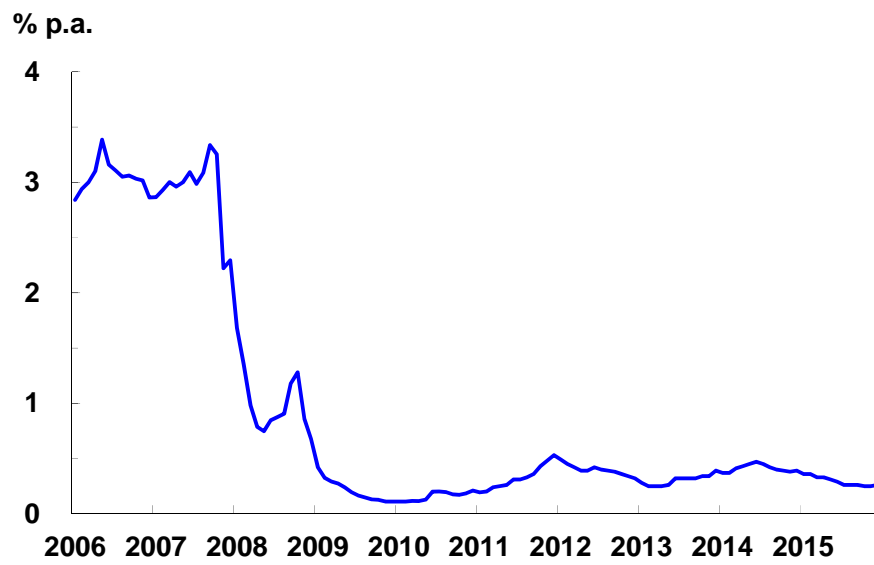
HONG KONG: NEW RESIDENTIAL MORTGAGE LOANS



Source: HKMA



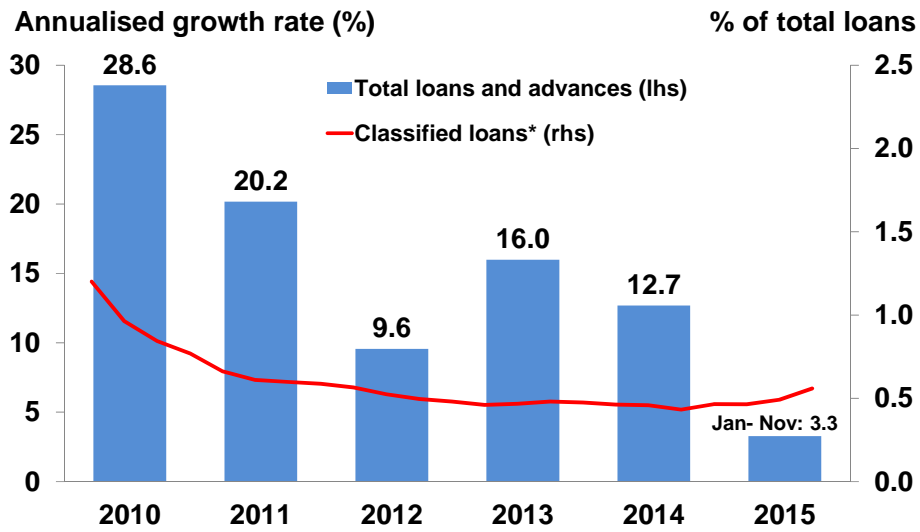
HONG KONG: COMPOSITE INTEREST RATE



Source: HKMA



HONG KONG: LOAN GROWTH AND ASSET QUALITY

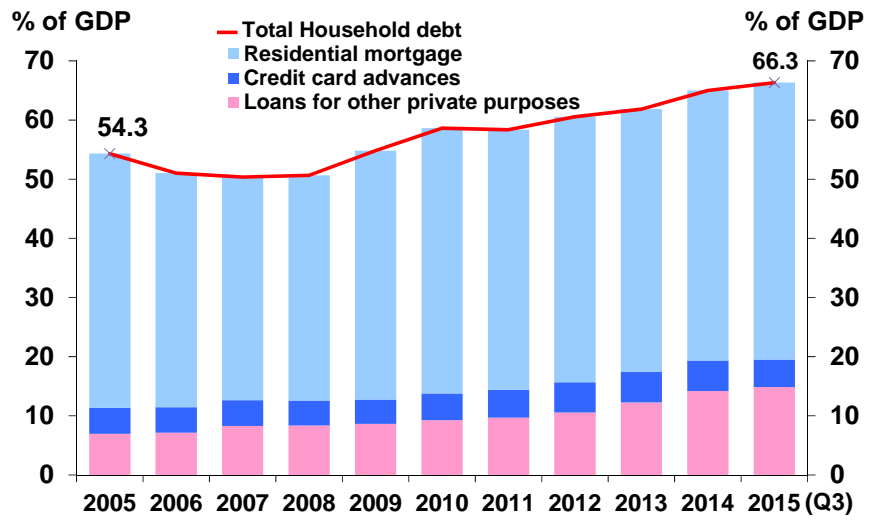


Note: * Q3 figure is used for 2015's classified loan ratio

Source: HKMA



HONG KONG: HOUSEHOLD DEBT



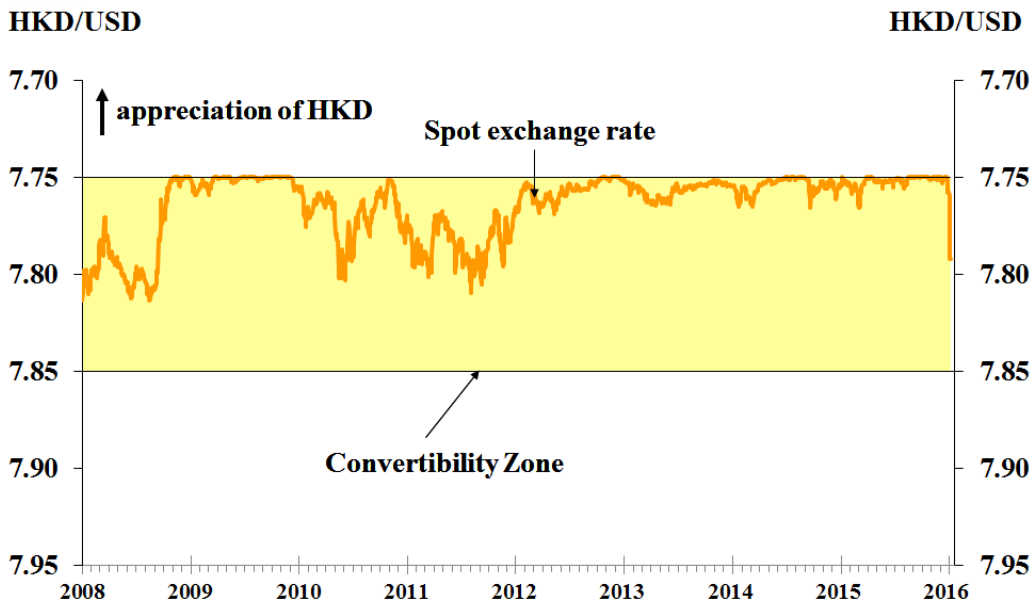
Source: HKMA



CURRENCY STABILITY



HONG KONG DOLLAR SPOT EXCHANGE RATE

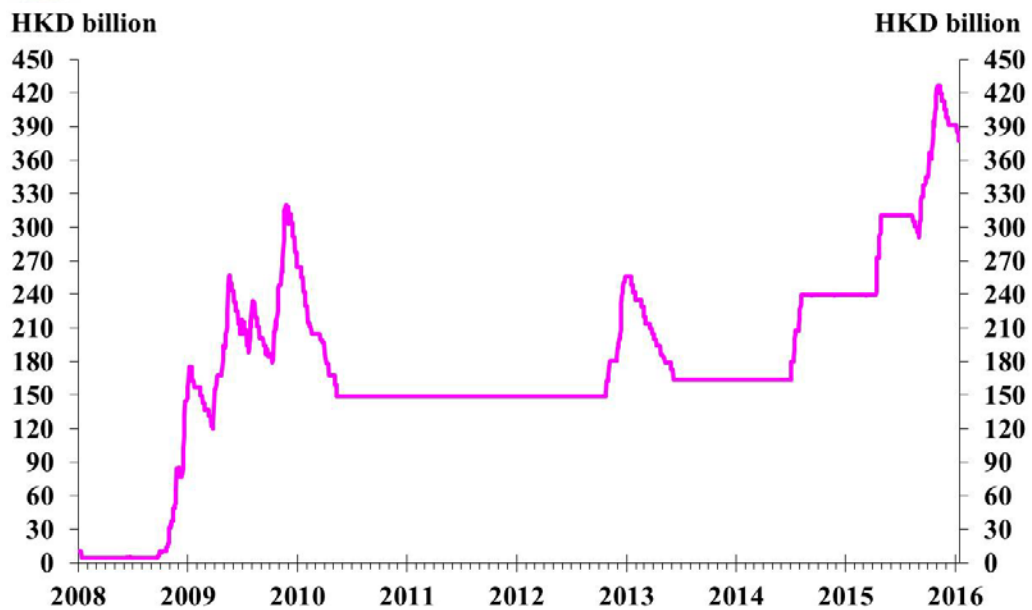


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- The Hong Kong dollar (HKD) spot exchange rate remained steady and continued to stay in levels near 7.7500 during November to December 2015. There has been no triggering of the strong-side Convertibility Undertaking since 1 November 2015.
- Since early January this year, the HKD eased notably against the US dollar, trading near 7.8000 at mid-month. Selling pressure on HKD increased, reflecting the widened interest differential with the US dollar, the correction in the local stock market and general weakness in Asian currencies.



AGGREGATE BALANCE

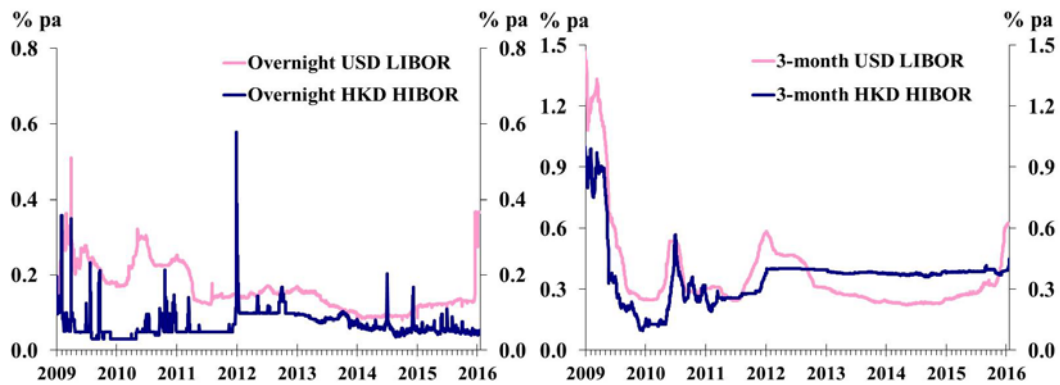


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- On 3 November 2015, the HKMA announced the issuance of a total of HK\$35 billion of additional Exchange Fund Bills (EFB) during November to December 2015 to meet increased demand for the papers by banks amid the abundance of liquidity in the banking system. Since the strong-side Convertibility Undertaking had not been triggered since November 2015, the Aggregate Balance decreased from HK\$424.4 billion at the beginning of November 2015 to HK\$391.3 billion at the end of 2015 as a result.
- The HKMA announced on 29 December 2015 the issuance of another HK\$ 28 billion of additional EFB in January 2016, in view of the continued strong demand for the paper, as evidenced by the still-low level of yields at the end of 2015. The decline in the Aggregate Balance during early January 2016 reflected the additional issuance of EFB.

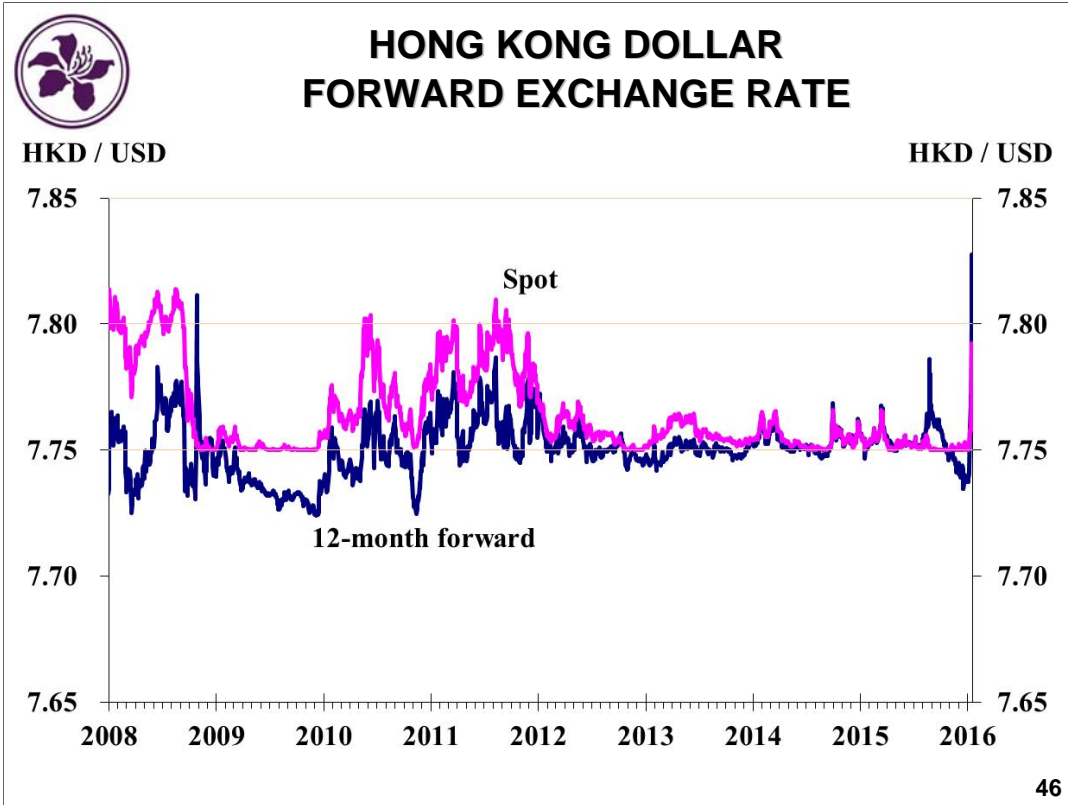


DOMESTIC INTEREST RATES



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- Despite the increase in US Fed Funds target rate in December 2015, overnight HKD HIBOR stayed at relatively low levels amid ample liquidity in the local banking system. Nevertheless, the 3-month HIBOR has risen, narrowing its spread with US interest rates.



- In early January 2016, the HKD forward exchange rate eased alongside the spot rate, reflecting in part currency hedging demand amid general weakness in Asian currencies.

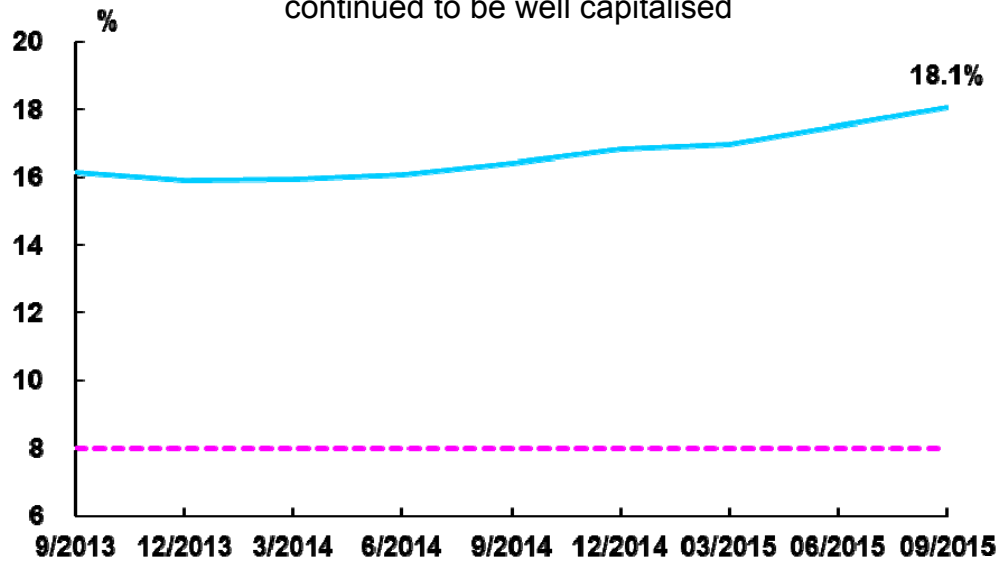


BANKING STABILITY



BANKING SECTOR PERFORMANCE

Locally incorporated authorized institutions (AIs)
continued to be well capitalised



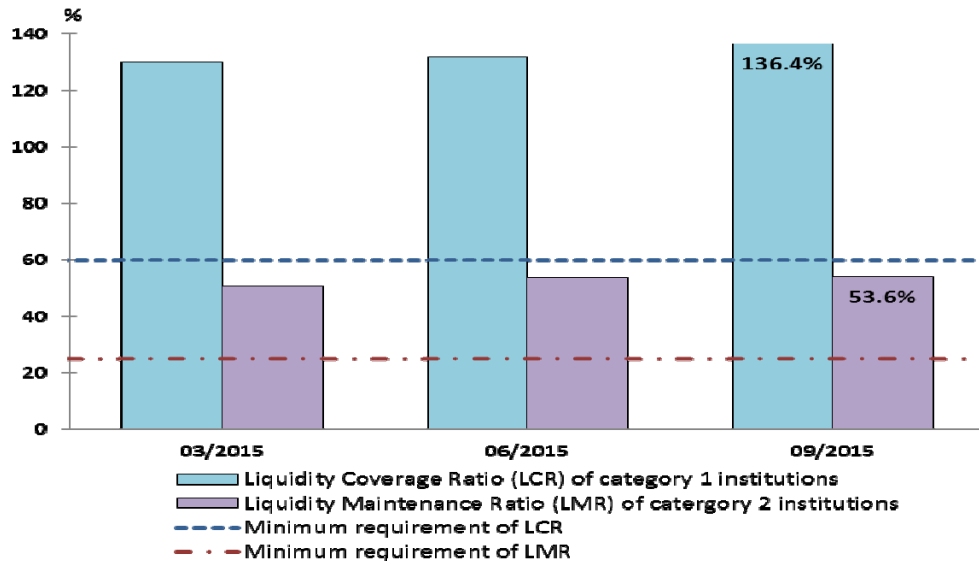
48

- The consolidated capital adequacy ratio (CAR) of locally incorporated AIs increased to 18.1% at end-September 2015 from 17.5% a quarter ago, mainly due to a 2.9% reduction in risk-weighted amount. The consolidated CAR remained well above the international minimum standard of 8%.



BANKING SECTOR PERFORMANCE

Quarterly average liquidity ratios of AIs remained well above statutory minimum requirements



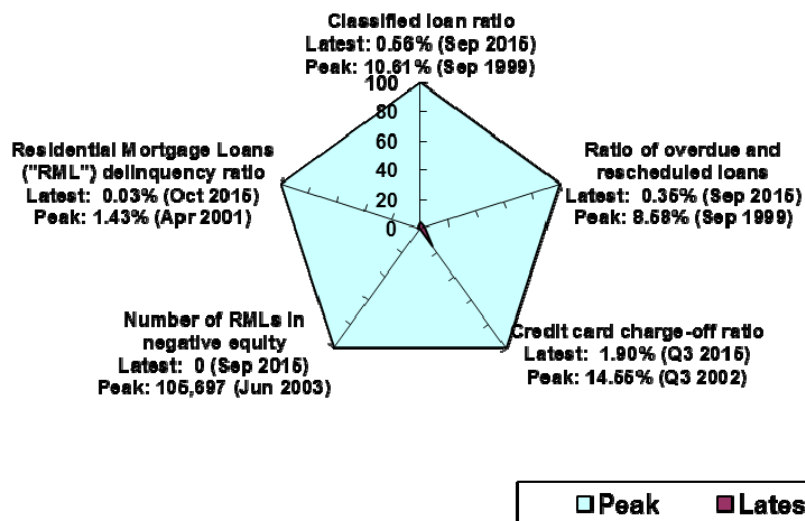
49

- In Q3 2015, the quarterly average Liquidity Coverage Ratio of category 1 AIs was 136.4% (well above the 60% minimum requirement for 2015). For category 2 AIs, their quarterly average Liquidity Maintenance Ratio was 53.6% (well above the 25% minimum requirement).



BANKING SECTOR PERFORMANCE

Asset quality remained healthy compared with historical standards



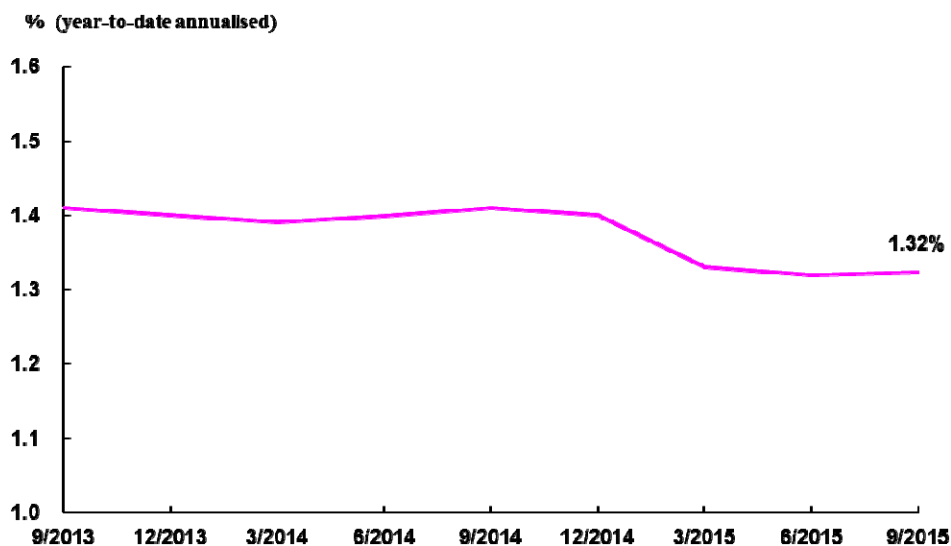
50

- Asset quality of retail banks' loan portfolio deteriorated slightly but remained healthy by historical standards.



BANKING SECTOR PERFORMANCE

Net interest margin of retail banks narrowed

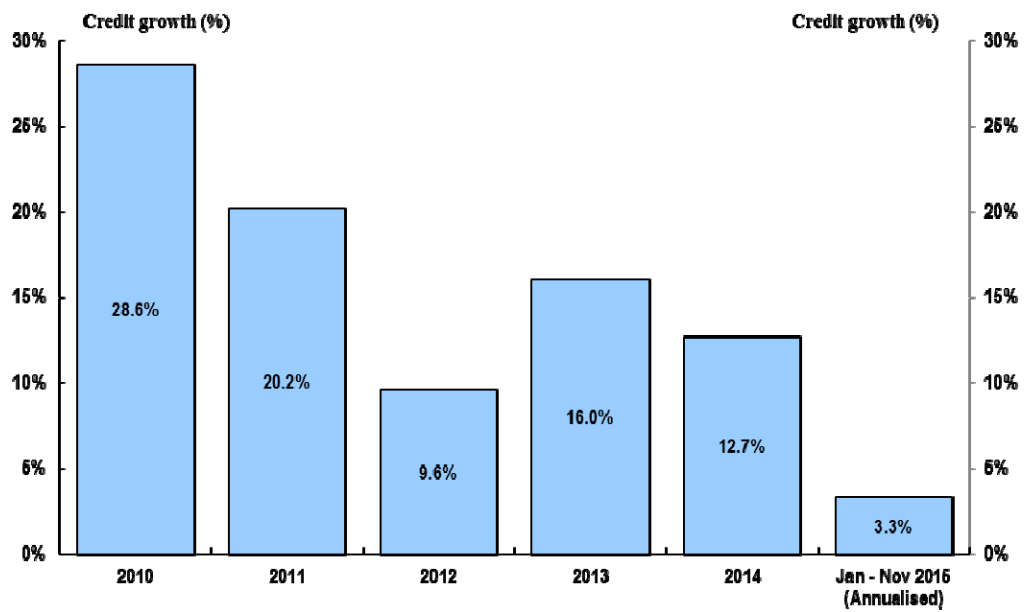


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- The year-to-date annualised net interest margin (NIM) of retail banks' Hong Kong offices narrowed to 1.32% in the first three quarters of 2015 from 1.41% in the same period last year, due to a number of factors such as the decrease in average interest spread of RMB assets as well as investment of excess funds by retail banks in lower-yielding assets (e.g. interbank placement as well as Exchange Fund Bills and Notes).
- The aggregate pre-tax operating profit of retail banks' Hong Kong offices edged down by 0.9% in the first three quarters of 2015 compared with the same period last year. In spite of growth in fee and commission income (+10.7%) and net interest income (+2.6%), the rising operating expenses (+9.1%) and loan impairment charges (+67%) weighed on retail banks' profitability.



CREDIT GROWTH CONTINUED TO MODERATE



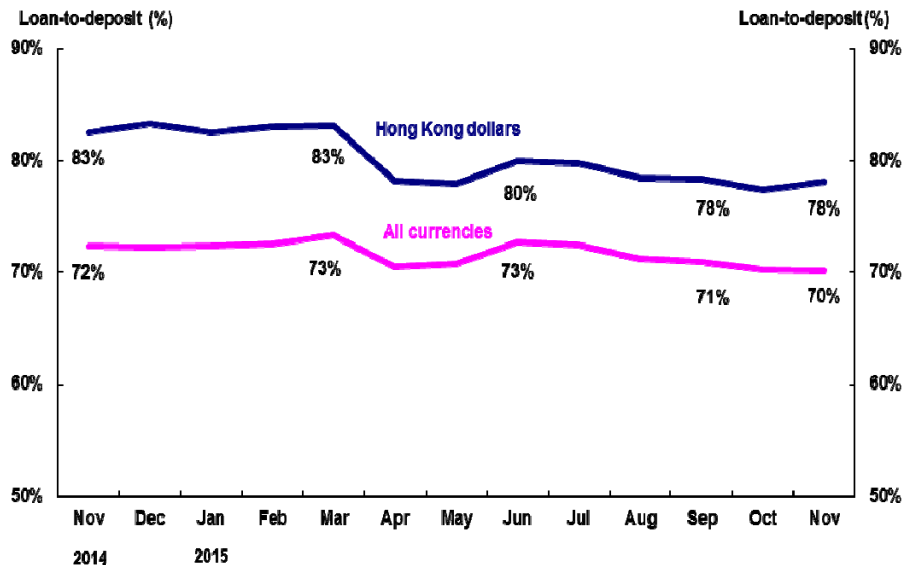
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- Credit growth continued to moderate in the first 11 months of 2015 as corporations are generally conservative in borrowing amid the uncertain macro-economic outlook.



CREDIT GROWTH

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



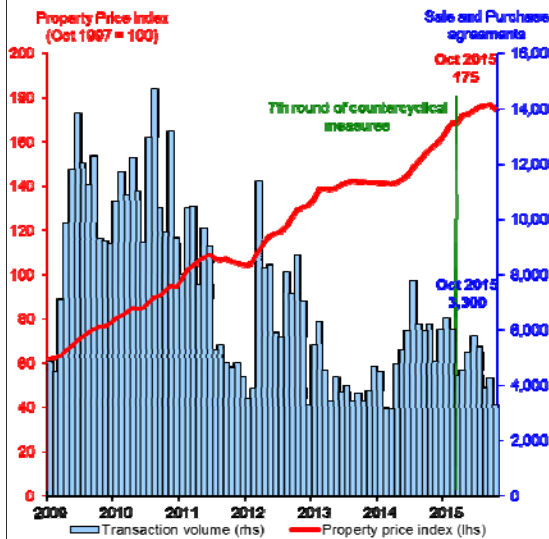
53

- The Hong Kong dollar loan-to-deposit ratio maintained at 78% at end-November 2015, the same as that at end-September 2015.
- The all currencies loan-to-deposit ratio edged down to 70% at end-November 2015 from 71% at end-September 2015. The decrease was due to a decline in total loans coupled with a slight increase in total deposits.



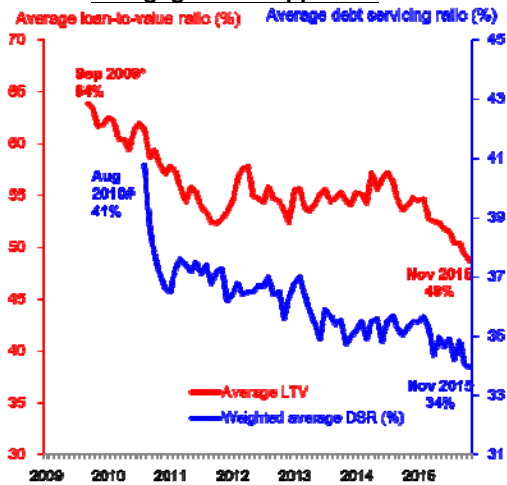
RISK MANAGEMENT OF PROPERTY MORTGAGE LOANS

**Residential property price index and
transaction volume**



Sources: R&VD and Land Registry

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



* Before the first round of HKMA's countercyclical measures was introduced
When the tighter requirement on debt servicing ratio was introduced

Latest statistics for residential mortgage loans (“RMLs”)

	Monthly average in 2013	Monthly average in 2014	Jul 2015	Aug 2015	Sep 2015	Oct 2015	Nov 2015
Number of sale and purchase agreements	4,223	5,317	5,393	3,896	4,263	3,300	2,826
Number of new RML applications	8,694	10,481	10,139	9,630	7,881	6,533	6,571
Number of new RMLs approved	5,952	7,337	8,112	6,981	6,154	5,125	4,649

Latest statistics for residential property prices

Property price index		Period	Property price index
Rating and Valuation Department (10/1997=100)	Latest position	10/2015	175.0
	Recent Peak	09/2015	177.0
	Peak in 1997	10/1997	100.0
Centaline (6/7/1997=100)	Latest position	27/12/2015	135.9
	Recent Peak	13/09/2015	146.9
	Peak in 1997	19/10/1997	102.9



BASEL STANDARDS IMPLEMENTATION

- Amendments to Banking (Capital) Rules (BCR) to introduce revised capital treatment for counterparty credit risk exposures and equity investment in funds
- Amendments to Banking (Disclosure) Rules (BDR) to implement revised Pillar 3 disclosure package
- Amendments to Banking Ordinance to update rules on exposure limits

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BCR and BDR amendments

•We are aiming to introduce amendments to the BCR and the BDR this year to implement a number of revised Basel standards relating to capital and disclosure which are scheduled to take effect internationally from 2017:

- the revised capital standards are to enhance the risk-sensitivity of the risk-weighting of counterparty credit risk exposures and equity investments in funds in the light of lessons learned from the global financial crisis. We have already consulted the industry on our policy proposals for implementing these standards.
- the revised disclosure standards are the outcome of the first phase of a Basel Committee review of the existing regulatory disclosure requirements which aims to enhance banks' regulatory disclosures in terms of clarity, comprehensiveness, user-relevance, and comparability. Our proposals for implementing these standards have also been issued to the industry for consultation.

•Preparatory work for drafting of the two sets of amendment rules is currently in progress. We intend to brief members in greater detail towards the middle of this year.

Revised regulatory framework for exposure limits

•We plan to revise our current exposure limit rules by (i) implementing locally the 2014 Basel Committee on Banking Supervision (BCBS) standards on large exposures and (ii) updating other current rules on exposure limits not directly related to the revised BCBS standards.

•Given the volume and level of detail in the revised BCBS standards, we are proposing to introduce a rule-making power into Part XV of the Banking Ordinance to enable the technical calculation mechanics for determining large exposures to be set out in rules.



ESTABLISHING A CROSS-SECTOR RESOLUTION REGIME FOR FINANCIAL INSTITUTIONS IN HONG KONG

- To meet international standards: Financial Stability Board’s “Key Attributes of Effective Resolution Regimes for Financial Institutions”
- Financial Institutions (Resolution) Bill (FIRB) introduced into the LegCo in December 2015
- Bills Committee scrutiny of the FIRB began in January 2016

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- Following two rounds of public consultation, the FIRB was introduced into the LegCo in December 2015. A Bills Committee was formed and its scrutiny of the FIRB began in January 2016.
- Internationally, guidance and standards on various aspects of resolution continue to be developed to facilitate the full implementation of the Key Attributes (e.g. work is underway on the mechanics of implementing a bail-in of liabilities, on internal loss absorbing capacity and on the resolution of central counterparties). It is therefore expected that future practical measures to make the local regime fully operable will be developed in the context of ongoing international and resolution planning work to complement the legislative framework in the FIRB. In this regard, the FIRB provides for the issuance of a range of rules, regulations and a Code of Practice.



INVESTOR AND CONSUMER PROTECTION

- Good progress in implementing the Enhanced Competency Framework for private wealth management practitioners
- Collaborated with fellow regulators on developing appropriate guidance to banks on selling of life insurance products and MPF products

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- The HKMA has been encouraging and monitoring private banks' implementation of the Enhanced Competency Framework (ECF) to enhance on-going competence and proper conduct of private wealth management (PWM) practitioners. About 90% out of a total of around 3,000 relevant private banking practitioners will meet the PWM ECF benchmark by the end of 2016, and around 1,300 relevant practitioners have been granted the professional designation of Certified Private Wealth Professional (CPWP) as of end-December 2015.
- The HKMA has collaborated with fellow regulators on developing appropriate guidance to banks for implementing the new requirements on financial needs analysis for selling of life insurance products as well as conduct requirements for implementation in February 2016 of phased withdrawals of accrual benefits by MPF scheme members upon retirement or early retirement. The HKMA will continue to collaborate with the Office of the Commissioner of Insurance on the latter's initiative of providing supplementary guidance to the industry for implementation of the newly issued regulatory standards in respect of non-investment-linked long term insurance products.



CONSUMER EDUCATION PROGRAMME

- Launched new TV and radio APIs to further remind the public to stay vigilant against fraudulent phone calls purportedly from banks
- Debuted an eight-episode five-minute TV drama series produced jointly with RTHK to disseminate smart tips on using banking services



A new API to raise public awareness against bogus phone calls



A new TV drama series entitled "All about Banking" to disseminate smart tips on using various banking services

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- The HKMA launched new TV and radio APIs, which further remind the public that as banks no longer accept intermediary referrals for personal loans or credit card applications, any calls that claim to be offering such referrals are potentially fraudulent. The public is also reminded not to divulge their personal information without verifying the callers' identity via banks' hotlines.
- To reach out to the mass public through television broadcasting, we jointly developed a new TV drama series entitled "All about Banking" with the RTHK for broadcasting from December 2015 to February 2016 on TV, website (including YouTube) and smartphone application. This eight-episode five-minute drama series covered smart tips on using various banking services. To reinforce the education messages conveyed in the drama, various publicity activities through print, web, mobile and out-of-home media, plus a promotion game, were conducted.
- Conducted education initiatives including an inSight article on 10 December 2015 and radio broadcasting to remind the public to always ask the overseas merchants about the exchange rates and handling fees before deciding whether to settle in foreign currencies or Hong Kong dollars at overseas point-of-sale (i.e. Dynamic Currency Conversion).



ENHANCEMENTS TO DEPOSIT PROTECTION SCHEME

- Introduced the Deposit Protection Scheme (Amendment) Bill 2015 into the LegCo on 25 November 2015 to adopt gross payout approach
- Wide support received during public consultation
- Benefits:
 - Depositors: quicker access to compensation
 - Banks: lower contagion risk and simpler IT systems
 - Financial system in Hong Kong: more robust financial safety net in line with global reform trends

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- The legislative amendments seek to adopt the “gross payout” approach to determine deposit compensation as opposed to the existing “net payout” approach so as to achieve faster payouts, in 7 days under most circumstances.
- The Bill includes the following key provisions:
 - determining the compensation payment of a depositor on a gross basis, without deducting any liabilities owed by him/her to the failed bank;
 - revising the definition of “Quantification Date” to refer to Deposit Protection Scheme trigger date, which can provide a higher certainty, essential to fast compensation determination; and
 - enabling the use of the electronic communication in addition to the existing written notice for notifying depositors about the payout details.
- It is expected that both depositors and banks can benefit from a simpler, faster and streamlined payout process. A more effective Deposit Protection Scheme will contribute to a more robust financial safety net in line with global reform trends.



FINANCIAL INFRASTRUCTURE



FINANCIAL INFRASTRUCTURE

- Continue to maintain safety and efficiency of financial infrastructure.
- Daily average turnover in RMB Real Time Gross Settlement (RTGS) system in Q4 2015 was at a high level of RMB982.2 billion.
- Reporting to the over-the-counter (OTC) derivatives trade repository (TR) of the HKMA has been smooth. The TR will be further developed to meet local reporting requirements and international standards.

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Operation of financial infrastructure

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

OTC derivatives Trade Repository

- Since the reporting function of the TR was launched in July 2013, reporting by banks to the TR has been smooth.
- Preparations including technical training workshops, system testing sessions and regulation briefings have been made to support the implementation of the mandatory reporting requirement introduced under the Securities and Futures (OTC Derivatives Transactions-Reporting and Record Keeping Obligations) Rules in Hong Kong on 10 July 2015.



FINANCIAL INFRASTRUCTURE DEVELOPMENT: PROGRESS UPDATE

- Regulatory framework for Stored Value Facilities (SVF) and Retail Payment Systems (RPS)
 - The Payment Systems and Stored Value Facilities Ordinance (PSSVFO) was enacted on 4 November 2015 and commenced operation on 13 November 2015
 - A one-year period is allowed for existing and new SVF issuers to apply for SVF licences from the HKMA. The HKMA has issued an explanatory note and met with prospective applicants to explain the licensing requirements to facilitate the application process
 - The HKMA will commence its work to determine whether any existing RPS should be designated. An explanatory note setting out the HKMA's policies and procedures with respect to the designation of RPS will be issued in H1 2016
 - To launch public education programme to enhance awareness of payment products or services, and the new SVF and RPS regulatory regime

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Regulatory regime for SVF and RPS:

- Implement a licensing regime for SVF covering both device-based and non-device based SVF issued in Hong Kong. Licensing requirements include physical presence in Hong Kong; SVF issuing being the principal business; meeting with capital requirements; effective float safeguarding and management measures; fit and proper controllers and officers; anti-money laundering and counter terrorist financing requirements; secure and reliable system, and viable business model, etc.
- Implement a RPS designation regime under which RPS that are important to the public and the financial stability of Hong Kong will be so designated by the HKMA and subject to the HKMA's regulation
- Empower the HKMA to exercise necessary supervisory functions on SVF and designated RPS including powers to conduct on-site and off-site examination; gather information; make regulations; issue guidelines; impose operating rules; and give directions, etc.
- Empower the HKMA to exercise necessary enforcement actions on SVF and RPS, including investigation and taking disciplinary actions

Implementation of the regulatory regime for SVF:

- Issued an "Explanatory Note on Licensing for Stored Value Facilities" in November 2015 to provide guidance about the licensing regime, and the policies and approach of the HKMA in implementing it
- Held industry briefing sessions and one-on-one meetings with prospective applicants to explain the licensing requirements and application procedures
- Developing supervisory guidelines to provide guidance to licensees on compliance with the regulatory requirements

Implementation of the regulatory regime for RPS:

- A draft "Explanatory Note on Designation of Retail Payment System" was provided to industry participants for comments in November 2015 and expected to be published in H1 2016
- Intend to collect information from RPS operators for determining designation of RPS during 2016

Public education program:

The HKMA will continue to launch public education programme (through press releases, TV and radio announcements, posters, brochures, etc.) to enhance public awareness of the use of payment products or services, and their understanding of the new regulatory regime implemented by the HKMA.



E-CHEQUE: PROGRESS UPDATE

- The e-Cheque service was launched on 7 December 2015. The operations of the e-Cheque infrastructure have been smooth and robust.
- At the beginning, 9 banks, which account for around 80% of cheques issued in Hong Kong, have offered e-Cheque issuance service to their customers through the Internet banking platform. Besides, all banks are able to accept the deposit of e-Cheques by their customers through the Internet banking platform, mobile banking platform or the e-Cheque Drop Box service provided by the Hong Kong Interbank Clearing Limited.
- The HKSAR Government also launched the “Pay e-Cheque” Portal on the same date to facilitate the public to pay the Government bills by e-Cheques. The public can pay the tax bills issued by the Inland Revenue Department and the General Demand Notes in the initial phase.
- The HKMA continues to conduct consumer education campaigns to enhance the public awareness of e-Cheque and to educate the public how to use e-Cheques.

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- The objective of e-Cheque is to provide an additional safe and efficient option of payment instrument for the public. The e-Cheque is an “end-to-end” electronic payment instrument without the use of paper or the need of physical delivery or presentment throughout the process. It will be issued through the Internet banking platform of the paying bank, and presented either through the Internet banking platform of the collecting bank or the e-Cheque Drop Box service provided by the Hong Kong Interbank Clearing Limited (the clearing house in Hong Kong).
- The e-Cheque service was launched on 7 December 2015. All banks are required to accept e-Cheque deposits starting from 7 December 2015. Nonetheless, it is up to banks’ commercial decision to provide the e-Cheque issuance service.
- The 9 banks which offer e-Cheque issuance service in December 2015 include HSBC, Hang Seng, BoC(HK), Bank of East Asia, Wing Lung, Fubon, Chiyu, Nanyang Commercial Bank and Agricultural Bank of China.
- Government bills and fees which can now be settled at the Pay e-Cheque Portal include general demand notes, tax demand notes, business registration fees, tax reserve certificates, stamp duties, etc. This portal will be extended to more Government bills in the future.
- To help members of the public better understand the e-Cheque service, the HKMA and the Hong Kong Association of Banks have jointly developed a series of educational materials such as API on television and radio, posters and electronic brochures.



REGULATORY DEVELOPMENT OF THE OTC DERIVATIVES MARKET

- Following the enactment of the Securities and Futures (Amendment) Ordinance 2014, which provides for the regulatory regime for the over-the-counter (OTC) derivatives market, the first phase of rules on reporting obligation under the regime took effect in July 2015
- Detailed rules are now being prepared for implementing other aspects of the regulatory regime for the OTC derivatives market in Hong Kong. Consultation on the first phase of mandatory clearing and related record keeping obligations as well as the product expansion for the mandatory reporting obligation was conducted in the second half of 2015. The target is to table the relevant subsidiary legislation before LegCo for negative vetting in Q1 2016



FINANCIAL BENCHMARK REFORM IN HONG KONG

- International bodies including the International Organization of Securities Commissions (IOSCO) and the Financial Stability Board (FSB) have made recommendations to enhance the transparency and robustness of the major interest rate and foreign exchange (FX) benchmarks that are widely used in the global financial markets
- Hong Kong has been reviewing the need and feasibility in reforming our financial benchmarks along the international recommendations having regard to local market conditions
- For FX benchmarks, following a public consultation, HKMA will announce in due course a specific plan to reform the determination arrangements
- For interest rate benchmarks, HKMA is analysing relevant transactions data to study the feasibility of reform, and will work with the industry to consult stakeholders on the proposed way forward

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

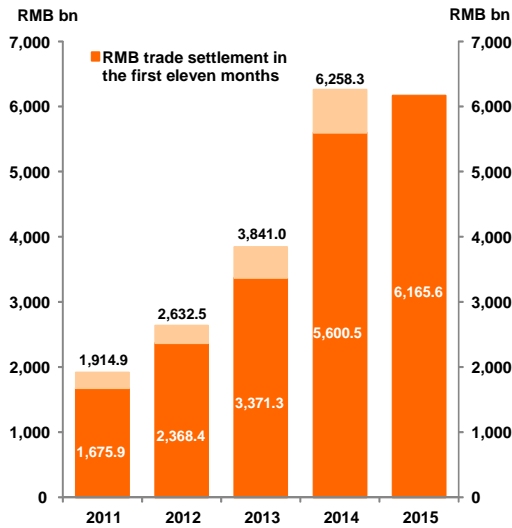


HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

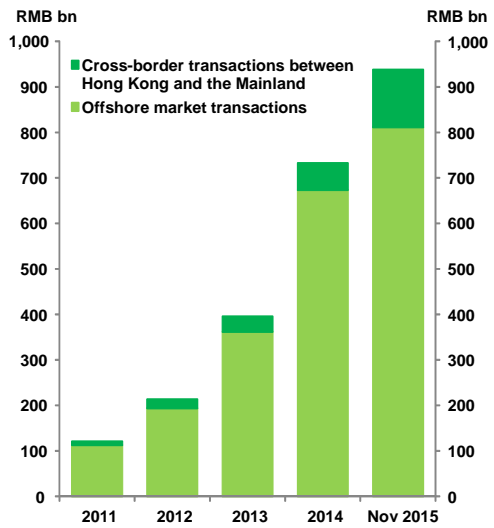


STEADY GROWTH IN RMB TRADE SETTLEMENT AND PAYMENTS

RMB trade settlement handled by banks in Hong Kong



Average daily turnover of Hong Kong RMB RTGS System



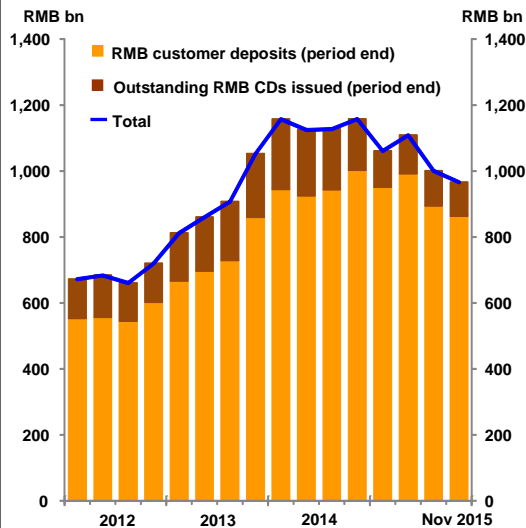
67

- In the first eleven months of 2015, RMB trade settlement handled by banks in Hong Kong amounted to RMB6,165.6 billion, up 10% compared with the same period in 2014.
- In Q4 2015, the daily average turnover of Hong Kong's RMB Real Time Gross Settlement (RTGS) system amounted to RMB9,822 billion.

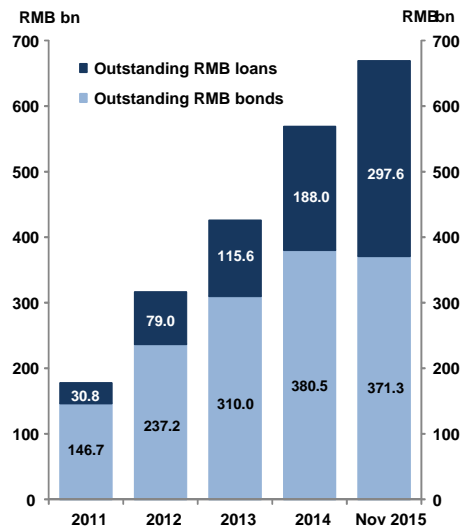


SOME CONTRACTION OF LIQUIDITY POOL BUT NOTABLE GROWTH IN LENDING BUSINESS

RMB customer deposits and certificates of deposit (CDs)



RMB financing activities



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- At end-November 2015, RMB customer deposits and outstanding RMB CDs amounted to RMB864.2 billion and RMB102.3 billion respectively, totalling RMB966.5 billion. The contraction of liquidity pool in the second half of 2015 partly reflected changes in market expectation on RMB exchange rate movements. Notwithstanding this, the offshore RMB market in Hong Kong continued to function in an orderly manner, and the liquidity pool remained adequate to support huge amounts of RMB financial transactions and payments. The size of RMB customer deposits has begun to stabilise towards year end.
- RMB dim sum bond issuance moderated, with issuance in the first eleven months of 2015 totalling RMB68.7 billion. Outstanding dim sum bonds amounted to RMB371.3 billion at end-November 2015. On the other hand, RMB bank lending grew significantly, with outstanding amount of RMB loans increasing to RMB297.6 billion at end-November 2015, a growth of 58% from the end of 2014.



MAINTAINING RMB BUSINESS LINKS WITH OTHER JURISDICTIONS

	Nov 2015	2014	2013	2012
No. of participating banks of Hong Kong's RMB clearing platform	217	225	216	204
Of which:	192	200	191	181
Branches and subsidiaries of overseas banks and overseas presence of Mainland banks				
Amount due to overseas banks (RMB billion)	98.9	145.2	166.0	99.1
Amount due from overseas banks (RMB billion)	128.9	193.3	164.5	117.1

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- At end-November 2015, the International Monetary Fund decided to include the RMB in its Special Drawing Rights currency basket. This affirmed the RMB's status as a freely usable currency, marking a key milestone in RMB internationalisation. Being the largest offshore RMB business centre, Hong Kong can continue to play a pivotal role of financial hub in the process of the Mainland's further opening up its financial markets and RMB internationalisation.
- The HKMA continued to enhance RMB business collaboration and exchanges between Hong Kong and other markets and promote Hong Kong's RMB business platform to overseas corporations and financial institutions. The HKMA facilitated the second Hong Kong - Thailand RMB Business Forum together with the Bank of Thailand in November 2015, and co-hosted the fifth Hong Kong - London RMB Business Forum with the HM Treasury in December 2015. Steps were also taken to broaden our marketing efforts through active participation in industry events in overseas markets like Japan and Africa.



DEVELOPING HONG KONG AS A CTC HUB

- Corporate treasury centres (CTCs) set up by multinational and Mainland enterprises will bring more banking, financing and risk management activities in Hong Kong, deepen our capital markets and provide impetus to the development of headquarters economy in Hong Kong.
- The Inland Revenue (Amendment) (No. 4) Bill 2015 was introduced into LegCo on 16 December 2015 to (i) allow, under specified conditions, interest deductions under profits tax for CTCs and (ii) reduce profits tax for specified treasury activities by 50%.
- A Bills Committee has been set up to scrutinise the Bill. The HKMA will continue to work closely with the Government with a view to having the Bill passed within this legislative session.
- To continue to engage the industry and step up marketing effort to promote Hong Kong as a preferred regional location for CTCs.

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- Developing Hong Kong into a regional hub for corporate treasury centres has been one of the important areas of work of the HKMA in recent years. With their vast, global business networks, some multinational corporations (MNCs) process numerous large-value payments on a daily basis. Under their treasury management systems, it is common for cash management, receipt/payment processing, financing and risk management, etc. to be centralised to facilitate management of these corporate treasury functions. The development of Hong Kong as a CTC hub would complement many of Hong Kong's existing strengths, such as the offshore RMB market, capital formation, banking capabilities, etc., thereby reinforcing Hong Kong's status as an international financial centre and enhancing the development of headquarters economy in Hong Kong.
- The HKMA has been working closely with the private sector and other Government agencies in organising various marketing activities to promote Hong Kong as a preferred regional destination for CTCs. To that end, we have met with over 170 corporations and financial institutions as of end-2015.



CONTINUED DEVELOPMENT AS AN INTERNATIONAL ASSET MANAGEMENT CENTRE

- The HKMA continued to promote Hong Kong's platform as an asset management centre
- The combined fund management business in Hong Kong hit a record high of US\$2.3 trillion at the end of 2014, a 10.5% increase over 2013
- Continued increase in the number of licensed corporations and licensed individuals for asset management
- Over 60 of the 100 largest global money managers have offices in Hong Kong
- 22 private banks have opened for business in Hong Kong since 2009, bringing the total to 47 banks offering private wealth management services in Hong Kong as of January 2016

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- According to the Securities and Futures Commission (SFC)'s survey, 71% of the combined fund management business in Hong Kong was sourced from non-Hong Kong investors in 2014, attesting to the fact that Hong Kong is a preferred location for asset management business in the region.
- The number of licensed corporations for asset management has increased from 680 in 2008 to 1,107 in September 2015.
- Over 60 of the 100 largest global money managers (ranked by assets under management as of end 2014) have offices in Hong Kong, and about 60 of them are licensed by the SFC.
- Achieved leading positions as an asset management centre in Asia Pacific:
 1. Hong Kong is the second largest private equity hub in Asia. The total capital under management in private equity funds in Hong Kong reached US\$117.1 billion as of 3Q 2015.
 2. About 50% of RMB Qualified Foreign Institutional Investor managers and 60% of Qualified Foreign Institutional Investor managers, as well as over 70% Mainland fund management and securities firms with Qualified Domestic Institutional Investor license have a presence in Hong Kong as of November 2015.
 3. Hong Kong is also the largest hub for Asian hedge funds, with the number of funds increased from 676 in 2012 to 778 as of 30 September 2014.



DEVELOPMENT OF ISLAMIC FINANCE

- Following the two successful sukuk issuances in 2014 and 2015, the HKMA has been sharing its sukuk issuance experience with enterprises which have funding needs.
- Will continue to maintain close dialogue with market players, encouraging other public and private sector entities to issue sukuk through Hong Kong's platform, in an effort to promote the further development of sukuk market in Hong Kong.



GOVERNMENT BOND PROGRAMME

Institutional part

- 13 issues totalling HK\$68.9 billion were outstanding as at end December 2015
- In addition, two Islamic bonds totalling US\$2 billion were outstanding as at end December 2015

Retail part

- Three iBonds totalling HK\$30 billion were outstanding as at end December 2015



INVESTMENT ENVIRONMENT AND PERFORMANCE OF THE EXCHANGE FUND

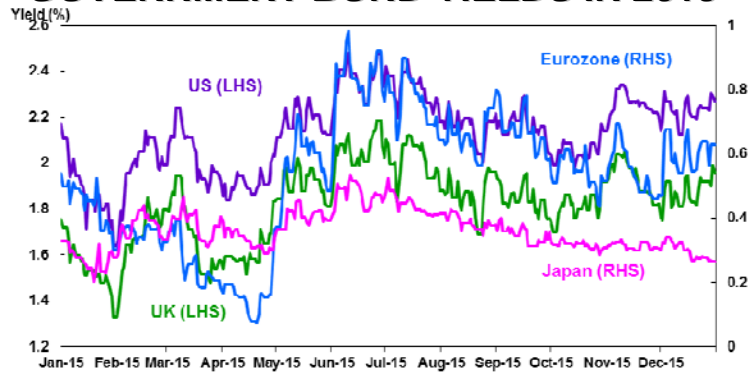


INVESTMENT ENVIRONMENT IN 2015

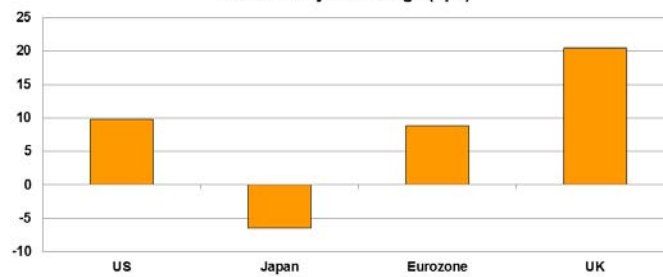
- **Interest rates:** 10-Year US Treasury yields rose moderately in 2015 despite increasing market expectations on US interest rate normalisation. Short-term Euro-zone bond yields declined on the back of quantitative easing programme introduced by the European Central Bank (ECB)
- **Equity markets:** The equity markets were exceptionally volatile in 2015. Major equity markets registered losses to varying degrees in Q3 amid negative market sentiments arising from China growth concerns. Global equity markets recovered in Q4 along with improving market sentiments. With its close linkage with Mainland China's economy, Hang Seng Index underperformed other major equity markets in 2015
- **Exchange rates:** The US dollar remained strong in 2015 on the back of market expectations on interest rate hikes by the Federal Reserve. The Euro depreciated by about 10% against the US dollar in 2015, as the ECB introduced quantitative easing measures in January and decided to extend them in December. The Yen stayed largely flat against the US dollar in 2015



CHANGES IN 10-YEAR GOVERNMENT BOND YIELDS IN 2015



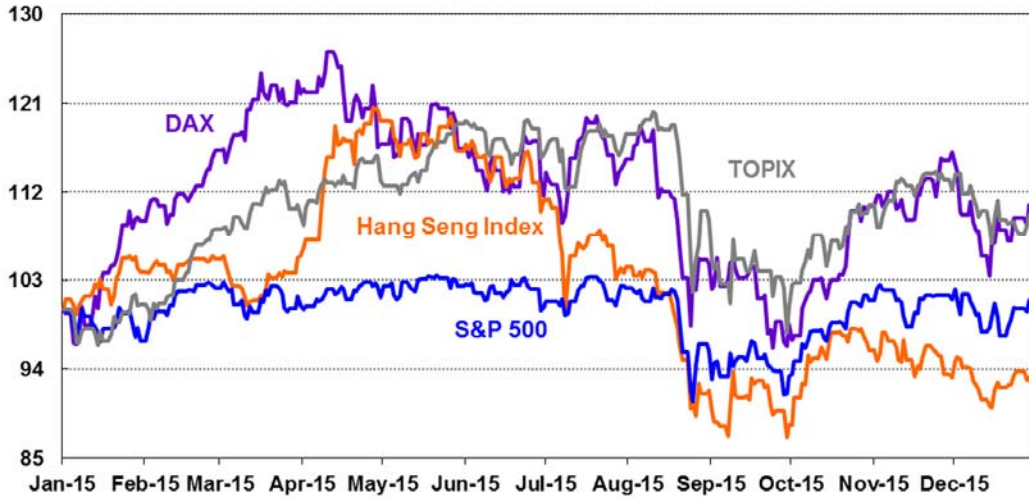
2015 bond yield change (bps)





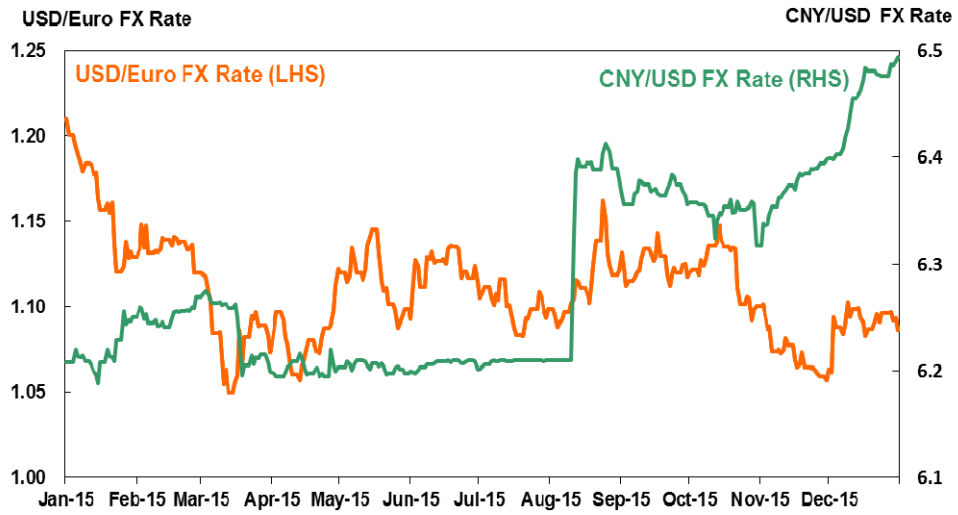
EQUITY MARKETS IN 2015

Normalized Index Level (2014 year-end = 100)





CURRENCY MARKETS IN 2015





INVESTMENT INCOME

	← 2015 →					2014	2013	2012	2011
	(unaudited)								
(HK\$ billion)	Full year	Q4	Q3	Q2	Q1	Full year	Full year	Full year	Full year
Hong Kong equities*	(5.0)	6.9	(30.7)	9.7	9.1	6.5	10.1	30.7	(24.2)
Other equities	7.4	21.0	(34.1)	2.0	18.5	33.7	71.8	42.8	(12.2)
Bonds	15.9	(0.4)	11.8	(7.7)	12.2	47.3	(19.1)	33.1	71.9
Other investments[@]	8.3	-	0	6.6	1.7	9.9	16.8	6.4	0.7
Foreign exchange[#]	<u>(44.9)</u>	<u>(9.0)</u>	<u>(10.8)</u>	<u>8.1</u>	<u>(33.2)</u>	<u>(52.7)</u>	<u>1.6</u>	<u>(1.4)</u>	<u>(9.1)</u>
Investment income/(loss)	(18.3)	18.5	(63.8)	18.7	8.3	44.7	81.2	111.6	27.1

* Excluding valuation change of Strategic Portfolio

[@] Including valuation changes of private equity and real estate investments held by Exchange Fund's investment holding subsidiaries. (The above figures for 2015 represent valuation changes of these investments up to end-September. The valuation figures for the fourth quarter are not yet available.)

[#] This is primarily the effect of translating non-US dollar foreign currency assets into Hong Kong dollar after deducting the portion for currency hedging



INCOME AND EXPENDITURE

(HK\$ billion)	← 2015 →					2014
	(unaudited)					
	Full year	Q4	Q3	Q2	Q1	Full year
Investment income/(loss)	(18.3)	18.5	(63.8)	18.7	8.3	44.7
Other income	0.2	0.1	0.0	0.1	0.0	0.2
Interest and other expenses	<u>(4.8)</u>	<u>(1.1)</u>	<u>(1.0)</u>	<u>(1.7)</u>	<u>(1.0)</u>	<u>(5.2)</u>
Net income/(loss)	(22.9)	17.5	(64.8)	17.1	7.3	39.7
Fee payment to Fiscal Reserves #	(46.7)	(11.6)	(11.5)	(11.8)	(11.8)	(27.5)
Fee payment to HKSAR government funds and statutory bodies #	(14.7)	(3.8)	(3.7)	(3.7)	(3.5)	(8.6)

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



EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)

At 31 Dec 2015
(unaudited)

At 31 Dec 2014

Change

ASSETS

Deposits	290.9	315.6	(24.7)
Debt securities	2,464.1	2,146.3	317.8
Hong Kong equities*	148.2	156.8	(8.6)
Other equities	397.7	416.3	(18.6)
Other assets*	<u>128.0</u>	<u>114.0</u>	<u>14.0</u>
Total assets	<u>3,428.9</u>	<u>3,149.0</u>	<u>279.9</u>

LIABILITIES AND FUND EQUITY

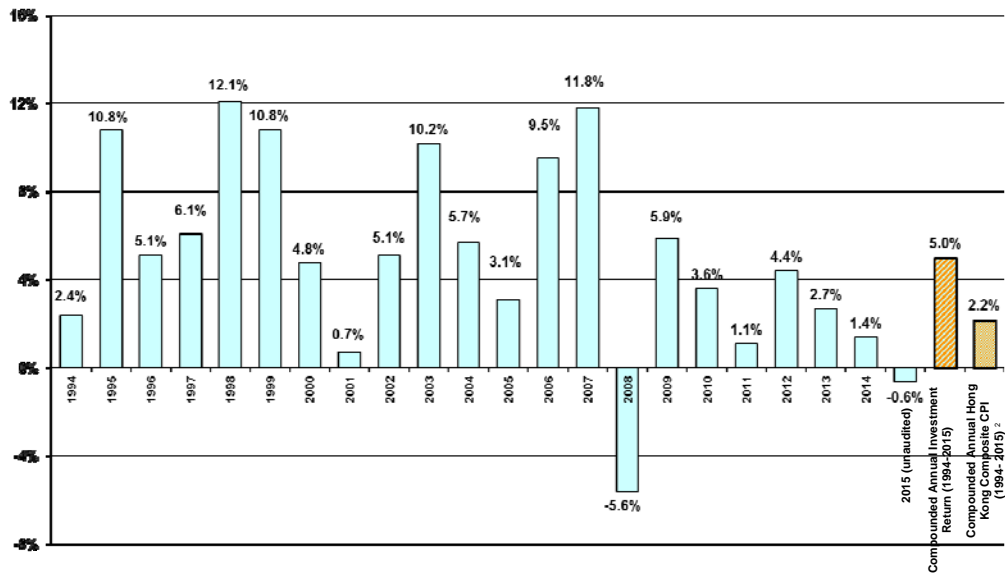
Certificates of Indebtedness	357.9	340.2	17.7
Government-issued currency notes & coins in circulation	11.3	11.0	0.3
Balance of the banking system	391.3	239.2	152.1
Exchange Fund Bills and Notes issued	827.8	752.4	75.4
Placements by banks and other financial institutions	66.9	64.0	2.9
Placements by Fiscal Reserves	833.6	788.7	44.9
Placements by HKSAR government funds and statutory bodies	280.8	261.1	19.7
Other liabilities	<u>114.1</u>	<u>56.9</u>	<u>57.2</u>
Total liabilities	2,883.7	2,513.5	370.2
Accumulated Surplus	<u>545.2</u>	<u>635.5</u>	<u>(90.3)</u>
Total liabilities and fund equity	<u>3,428.9</u>	<u>3,149.0</u>	<u>279.9</u>

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

Including fund injection to Exchange Fund's investment holding subsidiaries at a carrying amount of HK\$96.0 billion at 31 Dec 2015 (HK\$82.6 billion at 31 Dec 2014)



INVESTMENT RETURN OF THE EXCHANGE FUND (1994-2015) ¹



¹ Investment return calculation excludes the holdings in the Strategic Portfolio.

² Composite CPI is calculated based on the 2009/2010 base series.



INVESTMENT DIVERSIFICATION

- To enhance the return of the Exchange Fund in the medium and long term, the HKMA has, since 2008, been diversifying part of the Fund's investment into more asset classes and set up the Long-Term Growth Portfolio (LTGP).
- The progress of the LTGP in 2015 has been good. Positions at end-2015 and performance since inception are as follows:

As of end-2015

New Asset Classes	Market Value HK\$ billion	Annualised return since inception till end-2015
Private Equity	90.0	12.0% (IRR)
Real Estate	49.3	
Total	139.3	

Note: Outstanding investment commitments at the end of 2015 amounted to HK\$122.4 billion



HONG KONG MORTGAGE CORPORATION



MORTGAGE INSURANCE PROGRAMME (MIP)

- Since the launch in March 1999, the MIP has helped over 117,000 families attain home ownership
- In the first eleven months of 2015, the total drawdown amount under the MIP was HK\$16.3 billion and the average loan size was HK\$3.49 million
- About 88% of drawn down loans were for secondary market properties



REVERSE MORTGAGE PROGRAMME

- By end of November 2015, 1,072 applications have been received:
 - Average age of borrowers: 69 years old
 - Average monthly payout: HK\$14,800
 - Payment terms: 10-year (30%), 15-year (16%), 20-year (13%), life (41%)
 - Average property value: HK\$5 million
 - Average property age: 30 years



SME FINANCING GUARANTEE SCHEME (SFGS)

- To support small and medium enterprises and hence drive domestic demand with a view to maintaining economic vibrancy and preserving employment, the Financial Secretary announced last year in the 2015-16 Budget Speech the extension of application period for the 80% loan guarantee product until 29 February 2016.
- The 80% loan guarantee product has been well received by the market. As at end of November 2015, 10,630 applications were approved, involving a total loan amount of HK\$43.0 billion. Key data of the approved applications are as follows:

Average guarantee period	4.7 years	Average loan size	HK\$4.05 million
Proportion of application from manufacturing and non-manufacturing industries	24% and 76% (in terms of no. of applications approved)	Average loan interest rate and average guarantee fee rate	4.82% p.a. 0.54% p.a.
Enterprises with less than 50 employees	91%	Benefitted enterprises and the related no. of employees	6,727 enterprises and 171,029 employees

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

Manufacturing sector –	24.3%	
– Textiles and clothing	4.7%	
– Electronics	2.2%	
– Plastics	1.9%	
– Printing and publishing	1.7%	
Non-manufacturing sector –	75.7%	
– Trading	46.0%	
– Wholesales and retail	8.7%	
– Construction		2.9%
– Engineering	2.7%	



MICROFINANCE SCHEME

- Launched in June 2012 for a trial period extended to 6 years with an expanded maximum aggregate loan amount of HK\$200 million
- As at end of November 2015, the Scheme received 347 formal loan applications. Out of the vetted applications, 163 have been approved with the total loan amount of HK\$41.1 million. The approval rate is around 51%
- For the approved applications, the average loan size was about HK\$252,000 and the average loan tenor was 4.5 years

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- Industry types for the approved start-up loans and self-employment loans (excluding 2 self-enhancement loans):
 - Retailing 65 cases (40%)
 - Servicing 59 cases (37%)
 - Wholesales 20 cases (12%)
 - IT related 9 cases (6%)
 - Manufacturing 7 cases (4%)
 - Others 1 case (1%)
- * Component percentages in the table above may not add up to 100% due to rounding.



PREMIUM LOAN INSURANCE SCHEME (PLIS)

- PLIS was officially launched in September 2015 to provide owners of subsidised housing properties who are aged 50 or above with an additional financing option to settle land premium payment
- After settling premium payment, borrowers will have greater flexibility in letting or selling their properties in the open market
- The scheme can help release some under-utilised flats and promote the market circulation of subsidised housing properties
- A lot of enquiries and several applications have been received since the launch of the scheme