

Chief Executive's Statement



The year 2020 in many ways defied our wildest imaginations.

COVID-19 swept the globe at a rate that very few would have anticipated, bringing economic activities around the world to a near standstill. In Hong Kong, after having experienced a contraction in 2019, the economy suffered a further blow from COVID-19 and contracted further for the second consecutive year, registering the most severe contraction in GDP on record. The unemployment rate surged to a 16-year high, with some sectors hit particularly hard.

It is often during trying times when one's strengths become apparent. Despite these significant headwinds, Hong Kong's monetary and banking systems once again stood the test. This resilience did not happen fortuitously. Rather, it is a result of prudent policies applied over the years.

The recovery path ahead will not be plain sailing. Although central banks and governments worldwide have gone to great lengths to support the economy, the outlook remains clouded with uncertainties, ranging from the monetary policy stance of central banks globally, through to the progress of vaccination programmes as well as the potential effects of a prolonged low interest rate environment. Meanwhile, the pendulum of geopolitical tensions continues to swing, further clouding the horizon.

Amid these uncertainties, the HKMA will continue to safeguard monetary and financial stability to provide an environment conducive to economic recovery. At the same time, the HKMA will strive to capture opportunities to further strengthen Hong Kong's competitiveness as a global financial hub in the evolving banking and financial landscape.

Monetary and financial stability: resilience unshaken

In 2020, the Linked Exchange Rate System (LERS) continued to operate in a smooth and orderly manner. Since its inception in 1983, the LERS has weathered difficult times and has continued to demonstrate its resilience and robustness against shocks. Throughout 2020, the Hong Kong dollar exchange rate remained stable despite COVID-19 and the volatile macro environment. The strong-side Convertibility Undertaking was triggered a total of 85 times, leading to aggregate inflows of around HK\$383.5 billion into the Hong Kong dollar.

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Underpinning the robustness of the LERS is the solid foundation that has been built up over the years. As the International Monetary Fund summed up in its *External Sector Report 2020*, the credibility of the LERS is assured by the transparent set of rules, ample fiscal and foreign reserves, strong financial regulation and supervision, a flexible economy, and a prudent fiscal framework. The HKMA was also quick to dispel rumours and provide timely updates on facts and figures through active industry engagement, and effective public communication through both conventional and social media. Concurrently, the HKMA continued to enhance its surveillance capacity by leveraging the latest technology and data analytics, so as to stay agile in the light of the latest market conditions and emerging risks.

While the COVID-19 pandemic weighed heavily on the economy, the banking sector remained resilient with robust capital and liquidity positions. As at end-2020, the capital adequacy ratio of local banks was 20.7%, well above the international minimum requirement of 8%. The average liquidity coverage ratio of large banks was also well above the statutory minimum requirement of 100%, reaching 155.1% in the fourth quarter of 2020. Reflecting the impact of the COVID-19 pandemic, the asset quality of banks has deteriorated modestly, with the classified loan ratio increasing to 0.9% as at the end of 2020, but this level remains comparatively healthy, well below the long-run average of 1.8% since 2000.

Banking sector: lifeblood of the economy

The banking sector plays an essential financial intermediation role in the economy and society. During the year, while maintaining its focus on the supervision of the credit and liquidity risk management of banks, the HKMA also monitored closely the impact of the COVID-19 pandemic on banking operations and has taken a number of measures to ensure that the banking sector can continue to provide essential services, as well as extend credit to borrowers to support the economy. In March, the HKMA reduced the Countercyclical Capital Buffer by 100 basis points to 1%, and reduced the regulatory reserve requirement in April. These measures helped release about HK\$1 trillion of lending capacity in the banking sector.

Mindful of the cash flow problems that may be faced by small and medium-sized enterprises (SMEs), the HKMA together with the Banking Sector SME Lending Coordination Mechanism which we set up in 2019, launched several rounds of relief measures including the Pre-approved Principal Payment Holiday Scheme (PPPMS) which deferred all loan principal payments of eligible corporates by six months. By the end of 2020, over 58,000 cases for payment holiday and other relief measures totalling over HK\$740 billion had been granted by banks. The PPPMS was extended as appropriate in view of the lingering pandemic situation, and was further extended in March 2021 to end-October 2021. The Hong Kong Mortgage Corporation Limited also introduced the Special 100% Loan Guarantee under the SME Financing Guarantee Scheme to alleviate the burden of paying employee wages and rents by SMEs. More than 25,000 applications involving some HK\$40 billion had been approved by the end of 2020. In the first quarter of 2021, the scheme was enhanced and the application period was extended to 31 December 2021. During 2020, banks also approved more than 28,000 cases totalling over HK\$44 billion relating to the provision of cash flow support for individual customers. It is encouraging to see how the banking sector came together to help tide both corporates and individual borrowers over in these difficult times.

In the meantime, we have kept advancing our work with the banking industry to enhance the sector's inclusiveness and customer-centric culture. We devoted further efforts to encouraging banks to pay special attention to customers in need. Good progress was achieved in the sharing of good practices in providing banking services to persons with intellectual impairment and in the provision of more barrier-free and accessible banking services.

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Given the rapidly changing banking landscape as a result of evolving technologies, the HKMA's work extends beyond tackling the current challenges to expanding the talent pool to support the future growth and stable development of the banking industry. We cooperated with the Hong Kong Association of Banks and the Hong Kong Institute of Bankers in carrying out the "Capacity Building for Future Banking" exercise with an aim to identify the potential talent gaps in the industry and develop a clear road map for banks to narrow such gaps in the coming years. To nurture young talent for the banking sector, we rolled out the Banking Talent Programme with the industry to offer fresh graduates from local universities six-month work opportunities and industry-specific training. The programme is also timely in offering aspiring young talented individuals the chance to join the banking industry amid a difficult local labour market.

International financial centre: undaunted by challenges

In keeping with the HKMA's mandate to help maintain Hong Kong's status as an international financial centre, our forward-looking agenda extends beyond the banking sector to the financial system more broadly. Our work has continued during the pandemic to enhance our competitiveness as an international financial centre in the evolving financial landscape. In particular, substantial efforts have been made in opening up new opportunities to capitalise on new trends and changes.

Growing and greening Hong Kong's financial industry for a more sustainable future

The first area is promoting green and sustainable finance, where steady progress continued to be made under the HKMA's three-phase approach announced in May 2019. In 2020, we completed the assessment of the "greenness baseline" for 47 banks, and published a white paper and circular to provide guidance and share experiences on banks' management of climate risks. We have been pressing ahead with Phase II in formulating the regulatory framework for addressing climate risk in the banking industry. We will also take steps to be the first in Asia with concrete requirements for banks to align with the recommendations of the Task Force on Climate-related Financial Disclosures regarding disclosure of climate-related information by 2025.

We are also doing our part as one of the largest reserves managers globally. The HKMA has been actively incorporating environmental, social and governance (ESG) factors in the selection, appointment and monitoring of its external managers. We have also been consciously making ESG investments, including into green, social and sustainability bonds and low-carbon projects.

To further develop the green finance ecosystem in Hong Kong, the HKMA has been assisting the Government in issuing green bonds, and most recently, the second issuance of Government green bonds received an overwhelming response from international investors. Building on this momentum, the Financial Secretary announced recently in the 2021–22 Budget that the Government will double the size of the borrowing ceiling of the Government Green Bond Programme to HK\$200 billion and increase the diversity in both the types and channels of future issuances.

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As part of our overall strategy to consolidate Hong Kong's position as a regional green and sustainable finance hub, we are collaborating with other local regulators as well as the international community to advance the green agenda. Locally, the HKMA partnered with other regulators to form the Green and Sustainable Finance Cross-Agency Steering Group (CASG) to coordinate efforts across the financial sector. The CASG has set out a strategic plan for promoting green and sustainable finance in Hong Kong. Internationally, the HKMA was invited by the International Finance Corporation to serve as the founding member and first regional anchor to co-launch the Alliance for Green Commercial Banks which aims to promote green banking in the global financial market, starting with Asia with a view to expanding to other regions.

We hope these efforts will contribute to mitigating our financial sector's climate risks, as well as unleashing the capacity of our banks to satisfy the huge financing needs for green investments in the region.

Fintech: for the people, for the economy

Another key growth engine for the financial industry is fintech which has been further accelerated amid the COVID-19 pandemic.

The past year has clearly demonstrated that fintech can expand our toolkit for responding to unexpected shocks. Amid COVID-19, electronic payment channels played a more important role than ever. Since its inception in September 2018, the accounts registered with the Faster Payment System (FPS) had reached 6.9 million at the end of 2020. The average daily turnover of the FPS soared 230% during the year, facilitating the public to transfer money and make payments in a safe, convenient, and hygienic manner even if they are subject to social distancing restrictions. We have also been working with the Government on further expanding the use of the FPS for payment of Government bills and services.

Fintech could also help banks bring more diverse and convenient banking services to customers. All of the eight virtual banks which have been granted a licence by the HKMA have now commenced operation in Hong Kong. By the end of 2020, a total of 420,000 virtual bank accounts had been opened, with customer deposits totalling HK\$15 billion. Some of these virtual banks have pioneered the use of alternative data to conduct credit assessment with a view to reaching out to new types of customers and enhancing financial inclusion. As part of the Banking Made Easy initiative, the HKMA continued its work to foster a larger and more diverse regulatory technology (Regtech) ecosystem in Hong Kong. The goal is to streamline regulatory requirements so as to enhance customer experience. Besides raising industry awareness of Regtech applications through our newsletter series, we have also published a white paper which included a two-year roadmap to accelerate Regtech adoption in the banking sector. The HKMA has also embarked on a project on Commercial Data Interchange, which will enable SMEs to use their digital footprints to enhance access to credit facilities from banks.

As the fintech landscape continues to evolve and technology adoption increases, it is important for the HKMA to uphold its supervisory rigor. To this end, we have introduced an upgraded Cybersecurity Fortification Initiative 2.0 to strengthen banks' cyber resilience, stepped up on-site examinations on technological risk management, and developed supervisory frameworks to assess credit risks of new personal loan products supported by innovative credit risk assessment techniques. We have also embarked on a three-year roadmap for supervisory technology (Suptech) adoption to make our supervisory processes more effective and forward-looking. Work is underway, including on enhancing anti-money laundering and counter-financing of terrorism supervision with a better use of data and technology.

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Fintech also has great potential to facilitate transactions across geographic boundaries, addressing the long-standing pain points in cross-border payments. The HKMA has been undertaking a number of initiatives. Key progress has been made, including the successful linkage between eTradeConnect and the People's Bank of China (PBoC) Trade Finance Platform, which could streamline cross-border trade finance transactions. We are also cooperating with three other central banks in studying the application of central bank digital currency (CBDC) in cross-border payments through the m-CBDC Bridge project, which has been included into the ambit of the Bank for International Settlements Innovation Hub. Furthermore, the HKMA also supported the Digital Currency Institute of the PBoC on technical pilot testing of the use of e-CNY, the digital renminbi issued by the PBoC, for making cross-boundary payments in Hong Kong. This will bring greater convenience and enhance user experience in cross-boundary consumption.

Looking ahead, the HKMA will continue to refine our strategy to facilitate the healthy growth of Hong Kong's fintech eco-system and capitalise on fintech's transformative power to improve people's daily lives as well as spur further economic development in Hong Kong.

Gateway to the Mainland, connecting the world

Finally, connectivity has always been a defining feature of Hong Kong as an international financial centre and continues to be highly placed on our agenda. During the year, we continued to consolidate our core strengths as the dominant gateway to Mainland China and our competitiveness as a global financial hub.

The vibrancy of the connect schemes with the Mainland can speak for their importance. The average daily turnover of Stock Connect more than doubled during the year, with significant increases in both northbound and southbound traffic. Daily turnover under Bond Connect increased by 82% in 2020, accounting for 52% of overall trading turnover by foreign investors in the China Interbank Bond Market. A number of enhancements to Bond Connect were introduced, offering more convenience and flexibility to investors. Building on the success of the Northbound Bond Connect, we have also started a study on the framework for the Southbound Bond Connect with the PBoC.

We have every confidence that the opportunities presented by our connection with the Mainland will keep expanding, particularly in view of the recent developments in the Guangdong-Hong Kong-Macao Greater Bay Area (GBA). Following the promulgation of a high-level blueprint for financial market development in the GBA by Mainland authorities, we have been in close dialogue with Mainland authorities to promote cross-boundary financial collaboration. In June, the HKMA and its counterparts in the Mainland and Macao jointly announced the decision to implement a Wealth Management Connect scheme in the GBA. The HKMA has been working with the Mainland and local authorities as well as the industry to formulate the implementation details. The HKMA also closely engaged with the Mainland authorities on other initiatives to expand room for banks in Hong Kong to broaden the scope of their cross-boundary business.

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In other financial services areas, we continued to make rigorous efforts to maintain our competitive position. Hong Kong is well positioned as a hub for private equity (PE) and family office businesses. A major milestone during the year was the establishment of the Limited Partnership Fund (LPF) regime which came into effect in August. To date, it has attracted more than 170 LPFs to register in Hong Kong. The HKMA has also been working with the Government to introduce legislative amendments to provide a tax concession for carried interest, thereby providing a more competitive tax environment for PE funds. The HKMA will continue to promote the setting up of PE funds in Hong Kong, and refine the LPF regime to meet market needs.

Exchange Fund: investing for the people of Hong Kong

Despite the difficult and complex investment environment, in 2020 the Exchange Fund recorded an investment income of HK\$235.8 billion, representing an investment return of 5.3%. We also continued to diversify our investments through the Long-Term Growth Portfolio (LTGP). The annualised internal rate of return of the LTGP from 2009 to the end of 2020 was 13.7%.

In late-March 2021, we are still facing significant uncertainties surrounding the disconnect between the financial market and the real economy, the ultra-low interest rate environment, as well as the road to global economic recovery. We will adhere to the principle of "Capital Preservation First, Long-Term Growth Next" in managing the Exchange Fund, and continue to invest prudently for the people of Hong Kong.

Navigating uncertainties with dedication and professionalism

Notwithstanding the challenges in 2020, the HKMA has maintained its operational resilience and continued to carry out its work in a smooth and efficient manner. I want to thank my HKMA colleagues for their swift and robust responses to unexpected challenges and their dedication in fulfilling their duties, which ensured that the HKMA's commitment to serving the people of Hong Kong was uncompromised.

As always, the HKMA will endeavour to identify any forthcoming risks and opportunities ahead of the curve and ensure that Hong Kong will continue to thrive in the new banking and financial landscape. We will continue to care and to dare — to care for the economy, and to dare to undertake new endeavours for future development. On the one hand, we will spare no effort to facilitate economic recovery and maintain financial stability. On the other, we stand ready to grasp the opportunities presented by green finance, fintech, and connectivity with the Mainland. Despite the potential headwinds and challenges ahead, we will continue to serve the people of Hong Kong with dedication and professionalism.



Eddie Yue
Chief Executive