Chief Executive's Statement

The year 2021 was a year of concurrent consolidation and development.

In 2021, the pandemic entered its second year unabated: global supply chains were disrupted, inflation pressures were on the rise, risk of premature tightening of global financial conditions increased. Adding to the unpredictability were the emergence of mutant variants of COVID-19 and the intensification of geopolitical tensions. Despite such a macro environment filled with uncertainties, we continued to safeguard monetary and financial stability and maintain operational resilience.

2021 also brought hope for recovery with the successful rollout of COVID-19 vaccines together with the accommodative monetary and fiscal policies introduced in multiple economies. The global economy began to recover from the severe contraction in 2020. Locally, after having endured economic contraction in 2019 and 2020, the Hong Kong economy grew by 6.3% in 2021, thanks to the rollout of the vaccination programme and the Government's pandemic relief measures which have lent crucial support to our economic recovery.

With financial and monetary stability maintained, as well as a steadying macro environment, 2021 gave us some room to pursue more development work. We seized the opportunity and pressed ahead with developmental initiatives that will help our financial sector remain highly competitive. Significant progress has been made across our three strategic priorities, namely fintech, green finance and Mainland market opportunities arising from Hong Kong's gateway role.

As we entered 2022, the global environment took a turn for the worse. But as the saying goes, when the going gets tough, the tough get going. We will continue to be proactive and pursue our developmental goals and priorities to be better prepared for the next challenge and to cement our status as an international financial centre. We will also remain steadfast in our commitment to ensure the soundness of Hong Kong monetary and financial systems, as we have risen to the many challenges time and again as in the past.

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Monetary and financial stability: foundation of an international financial centre

Since its establishment in 1983, the Linked Exchange Rate System (LERS) has been a strong anchor of Hong Kong's financial system and has helped Hong Kong withstand numerous shocks and challenges. Despite the lingering uncertainties surrounding the COVID-19 pandemic and market concerns about the pace of US monetary tightening, the Hong Kong dollar exchange and money markets continued to function in an orderly manner throughout the year, reflecting the robustness of the LERS.

This confidence in our systems did not happen overnight, but is based on the solid foundation which has been built up over the years. In its *2021 External Sector Report*, the International Monetary Fund once again reiterated that the credibility of the LERS has been assured by a transparent set of rules, ample fiscal and foreign reserves, strong financial regulation and supervision, a flexible economy, and a prudent fiscal framework.

The confidence is also a result of our efforts in public and market engagement, as well as effective surveillance. On the latter, we have leveraged technology and data analytics to strengthen our capability for more timely and comprehensive analysis on financial stability and macroprudential surveillance.

The robustness of the banking system is of paramount importance to financial stability in Hong Kong. Two years into the COVID-19 pandemic, our banks remained resilient with liquidity positions and capitalisation faring very well by international standards. As at end-2021, the capital adequacy ratio of local banks stood at 20.2%, well above the minimum requirement of 8%, while the average Liquidity Coverage Ratio of large banks was 151.9% in the fourth quarter of 2021, also well above the statutory minimum requirement of 100%. Despite a challenging credit landscape amid the pandemic, the asset quality of the banking sector remained largely stable during the year. The classified loan ratio of the industry was 0.88% at the end of 2021, down from 0.90% at the end of 2020, well below the long-run historical average of 1.8% since 2000.

Banking sector: a pillar of support to the economy

As always, the banking sector is an important pillar of support to economic activity. This is ever more crucial in the face of economic fallout from the COVID-19 outbreak. In the past year, a main challenge was to strike a balance between managing credit risk in the banking sector and maintaining the sector's support for the real economy. With our supervisory work over the years, banks continued to manage credit risks effectively. At the same time, we worked closely with banks to provide the much needed relief to corporate and personal customers through the Pre-approved Principal Payment Holiday Scheme (PPPHS) and other relief measures. The PPPHS, launched together with the Banking Sector Small and Medium-sized Enterprise (SME) Lending Coordination Mechanism in 2020 allowing eligible corporate customers to defer loan principal payments by six months on a pre-approval basis, was again further extended twice during 2021 until April 2022 recognising that some economic sectors were still hard-pressed by the lingering pandemic and were in need of continued credit relief. Subsequently, in light of a resurgence of local coronavirus infections, in February 2022, the PPPHS was further extended until the end of October 2022. It is encouraging to see that the banking sector has joined forces with the HKMA to help relieve cash-flow pressures on corporate and individual borrowers, even whilst the sector itself is experiencing its own difficult operating conditions due to the outbreak of the pandemic.

Apart from the challenging credit landscape, the pandemic also brought about a more difficult operating environment and a digital landscape with escalating cyber threat. We have stepped up our efforts to enhance operational and cyber resilience of the banking sector, as well as consumer and investor protection amid increasing digitalisation and a surge in phishing scams. In particular, the Code of Banking Practice was revised to enhance consumer protection in digital financial services.

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Besides supervisory work, we are dedicated to promoting financial inclusion and customer-centric culture in the banking sector. Enhancing accessibility to banking services by customers in need has been one of our priority areas and we have been working closely with the industry to develop industry guidelines. Further to the guidance on barrier-free banking services and provision of banking services for persons with intellectual disabilities, the industry, with the support of the HKMA, published in December 2021 a guideline to set out the principles and good practices for the banking industry in providing banking services to persons with dementia and customers in need.

To support the continued development of the banking sector in the future where the new growth opportunities and challenges require a new set of skills from the workforce, the HKMA has formulated a holistic talent development strategy — "Connecting Talent to the Future" — to groom future talent and upskill existing practitioners in a more systematic and targeted manner. Our new strategy is built on three "connect" directions: connecting students to the banking industry, connecting practitioners to the future of banking, and connecting the key stakeholders together to enhance collaboration in implementing the strategy. We have launched a series of outreach and promotional campaigns to attract more students to enter the banking industry. To better prepare university students to be "future ready", we have launched the Future Banking Bridging Programme jointly with the Hong Kong Institute of Bankers, which comprises a series of courses that cover practical banking knowledge and useful soft skills that are highly in demand in the banking industry. For the existing banking practitioners, we have been working closely with the industry on developing opportunities for upskilling through providing more in-demand training programmes. In December 2021, the new Fintech module under the Enhanced Competency Framework for banking practitioners was launched.

Financial talent is crucial to the future development of Hong Kong as an international financial centre. We will work hand in hand with all stakeholders with a view to strengthening the talent pool for the further development of the industry.

International financial centre: strong position underpinned by an unparalleled access to opportunities

The competitiveness of Hong Kong as an international financial centre is underpinned by the unparalleled access to opportunities it offers. There is general consensus that global fintech adoption, opening-up of Mainland's financial markets, and the mainstreaming of green and sustainable finance present huge opportunities for the future development of Hong Kong's financial sector. At the HKMA, we have dedicated substantial efforts in leveraging Hong Kong's unique edge to capture these opportunities. Let me talk about the fintech and Mainland opportunities first.

Comprehensive adoption of fintech

The pandemic has clearly demonstrated the power of fintech and permanently changed customers' behaviour towards financial services. To make sure we continue to stay at the forefront of the global fintech scene and are ready to tap all of the potential of fintech, we must build an ecosystem where the value of fintech is experienced across all levels and by all groups of people.

This vision has driven us to formulate a new strategy, "Fintech 2025", which was unveiled in June 2021. As its name suggests, it aspires to help the financial sector adopt technology comprehensively by 2025. The strategy comprises five focus areas which cover the required elements to achieve a successful ecosystem, and also the right factors for the ecosystem to grow further in a virtuous cycle. The first two parts of the strategy, namely "all banks go fintech" and "future-proofing Hong Kong for Central Bank Digital Currencies (CBDCs)" mainly sought to create more demand for fintech adoption. The other parts of the strategy relate to data, infrastructure, talent and funding, which are vital to the growth of the ecosystem.

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Under this strategy, a number of new initiatives were introduced, such as the Guangdong-Hong Kong-Macao Greater Bay Area (GBA) fintech pilot trial facility which allows financial institutions and technology firms to conduct pilot trials and obtain early feedback from regulators and users on their cross-boundary fintech initiatives, and the pilot launch of the Commercial Data Interchange which leverages the use of alternative data to facilitate SME financing. We have also stepped up research on the application of wholesale CBDC to cross-border payments, and explored the prospect of e-HKD, which will increase Hong Kong's readiness in terms of adopting CBDCs and in turn future-proof our city's financial infrastructure in the decades ahead.

While we capitalise on the new opportunities presented by technological advancement, we also continue to build on our existing achievements as well as watch out for new risks that may arise. For example, the Faster Payment System (FPS) introduced in 2018 has grown rapidly over the years, with the number of registrations reaching 9.6 million at the end of 2021, up 40% year on year. The average daily turnover also increased 90% from 2020, reaching about 673,000 real-time transactions in 2021. Meanwhile, in view of the rapid development of crypto-assets particularly payment-related stablecoins, we have issued a discussion paper earlier this year to invite market feedback on the development of an appropriate regulatory framework.

Our new, forward-thinking strategy will set the scene for a healthy growth of the fintech ecosystem. As the banking sector increasingly adopts fintech to capture the opportunities it offers, this will ultimately benefit both financial institutions and Hong Kong people, while strengthening Hong Kong's competitiveness as an international financial centre.

Hong Kong as the dominant gateway to the Mainland

Hong Kong has always played a strategic role in linking the Mainland market with international financial markets, providing international investors with a familiar regime and platform to conduct various kinds of financial, investment and wealth management activities. The National 14th Five-Year Plan strengthens Hong Kong's position as an international financial centre, a global offshore renminbi business hub, as well as asset management and risk management centres. This together with global economic trends has reinforced our conviction that Hong Kong should continue to enhance its unique value as a bridge connecting the Mainland and international markets.

In 2021, we reached a milestone in enhancing connectivity, adding two new members to our family of Connect schemes, namely the Cross-boundary Wealth Management Connect (Cross-boundary WMC) Scheme in the GBA, and Southbound Trading under Bond Connect, essentially completing the two-way loop of mutual access in a wide spectrum of financial markets including equities, debts and wealth management. The launch of the two schemes will bring new opportunities for Hong Kong in various aspects. By meeting the increasing diversification needs of Mainland investors, the two schemes will enlarge the customer base of our bond market and wealth management industry. I am pleased to see that these two schemes have been operating smoothly. The HKMA will continue to engage the Mainland authorities to further enhance these schemes over time.

As a global offshore renminbi business hub, 2021 was also a year of stellar performance with offshore renminbi businesses registering solid growth across bank deposits, trade settlement, payments and bond issuance. Just to quote a few examples. At the end of 2021, renminbi deposits grew by 25% to RMB944.7 billion compared to 2020, partly benefitting from the strong growth in the turnover of the Stock and Bond Connect schemes. As for the amount of offshore renminbi bonds issued in Hong Kong, it recorded an impressive year-on-year growth of 87%, reaching RMB109.6 billion. In particular, the Shenzhen Municipal People's Government issued RMB5 billion offshore renminbi bonds in Hong Kong in October. This marks the first time a Mainland municipal government has issued renminbi bonds outside the Mainland, and sets a precedent for other Mainland local governments to use Hong Kong as a fundraising platform. The Northbound Bond Connect, which

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began trading in July 2017, is getting increasingly popular among foreign investors seeking to participate in the Mainland onshore bond market. Since then, daily turnover saw a 17-fold increase to RMB26 billion and currently, more than half of international investors' turnover in onshore bonds is traded through this Connect scheme. I could go on further but suffice it to say, all these figures point to the fact that Hong Kong continues to maintain a firm foothold as the global hub for offshore renminbi business.

Exchange Fund: investing prudently for long-term return

In 2021, the global financial markets embarked on the track to recovery while market volatility heightened. The Exchange Fund recorded an investment income of HK$191.9 billion, representing an investment return of 4.1%. Bearing in mind our duty to preserve the long-term purchasing power of the Exchange Fund, we have also been diversifying our investments to strive for higher returns in the long run. In 2021, our Long-term Growth Portfolio, which invests in private equity and real estate, has continued to do well, achieving an annualised internal rate of return of 15.4% since inception.

Looking ahead, the global investment environment will continue to be volatile. Risks on the radar include rising inflation pressure, the path of monetary normalisation, lingering concerns over new virus variants and geopolitical tensions. We will remain flexible, implement defensive measures as appropriate, and maintain a high degree of liquidity to buffer against any adverse economic scenarios. As always, we will adhere to the principle of "capital preservation first while maintaining long-term growth" in managing the Exchange Fund, and continue to invest prudently for the people of Hong Kong.

Sustainability: shaping a greener financial system and a more sustainable future

Climate change is one of the most pressing challenges facing the world today. To the financial sector, climate change is both a source of risk and opportunity. Hong Kong can leverage on, and in turn strengthen, its role as an international financial centre in supporting Hong Kong's 2050 carbon neutrality goal and mobilising capital towards sustainable activities.

For some time now, the HKMA has been prioritising its efforts in strengthening Hong Kong's financial system to support a greener and more sustainable future. Hong Kong is the first Asian jurisdiction that has committed to specifically aligning disclosure requirements with recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) by 2025 across relevant sectors. In 2021, we have also issued a statement to support the Central Banks and Supervisors Network for Greening the Financial System (NGFS) Glasgow Declaration, reaffirming our commitment to delivering on the NGFS recommendations in taking the necessary measures to foster a greener financial system.

This year, we have opened a new chapter in our sustainability journey. And I also mean it literally — we are adding a new chapter in our *Annual Report 2021*, as our inaugural sustainability report which sets out our strategy on sustainability and how the HKMA embeds sustainability considerations across its key roles and functions, whether as a banking supervisor, a market facilitator, a responsible investor, or as an organisation. In this new chapter, you will read about the notable advancements and enhanced disclosures we have made in these key areas.

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First, as a banking supervisor, to strengthen resilience of the banking system against climate risks, we have formulated a regulatory framework setting out supervisory requirements for banks to manage and disclose climate risks. The pilot exercise on climate risk stress test with 27 participating banks, which concluded in 2021, has confirmed the resilience of Hong Kong's banking sector even in the face of extreme climate-related shocks, and helped banks enhance their capabilities for measuring and assessing climate risks.

Secondly, on the market development front, we are focusing our efforts in enhancing Hong Kong's role as a green and sustainable finance hub in the region, including the GBA. Significant progress was achieved in 2021, with the establishment of the world's first government Global Medium Term Note Programme dedicated to green bond issuances, which issued close to US$6.5 billion equivalent of institutional green bonds in multiple currencies and tenors, as well as the launch of the Centre for Green and Sustainable Finance which co-ordinates cross-sectoral efforts in capacity building and data. In 2021, Hong Kong witnessed a fourfold increase in green and sustainable debt instruments issuance, totalling US$57 billion.

Thirdly, as a responsible investor, the HKMA makes its inaugural disclosures on climate scenario analysis and carbon footprint metrics of the Exchange Fund's portfolios, aligning with recommendations of the TCFD. The weighted average carbon intensity of the public equities portfolios as at the end of 2020 was 128 tCO_2e/US$ million revenue, representing an overall 42% reduction compared to the 2017 level. This sharp reduction is testament to our determination in seeking climate friendlier investments.

Finally, we at the HKMA also aim to be a responsible and sustainable organisation. We have established the Corporate Social Responsibility & Sustainability Committee, which I chair, to steer our sustainability strategies covering the environment, our people and social responsibility. I am pleased to share with you that, in terms of reducing carbon footprint of our daily operations, the HKMA has as a start established its carbon profile and made corresponding disclosures. In 2021, we have achieved double-digit reduction across our greenhouse gas emissions, total paper consumption, and non-hazardous waste generated, compared with the 2017 level. We also strive to promote greener solutions in the broader community. For example, our online platform for banks' submission of regular reports, the use of FPS as an alternative to cash and to give out electronic lai sees, and Coin Carts, are all successful in helping to minimise resource consumption while enhancing operational efficiency.

Serving Hong Kong with professionalism and dedication

The year 2021 provided a window for us to refocus priorities and capture opportunities to strengthen the resilience and further the development of the financial system. Although the global environment has deteriorated quite dramatically in the first few months of 2022, our financial system is traversing this rougher terrain on a stronger footing. We will continue to stay alert to emerging risks and respond nimbly. We have the capability, resources and commitment to safeguard monetary and financial stability. We will also continue to seize opportunities to bolster Hong Kong's status as an international financial centre.

The HKMA is committed to delivering the above objectives and to serving Hong Kong and its people with integrity, professionalism and collaboration. There may be obstacles and challenges ahead but my colleagues and I, as a team, will be ready to tackle them. Some say the best view comes after the hardest climb. I agree and am confident that Hong Kong's financial system will continue to grow in strength and vibrancy.

Eddie Yue
Chief Executive