AN INTRODUCTION TO THE
HONG KONG MONETARY AUTHORITY
About the HKMA

The Hong Kong Monetary Authority (HKMA) is the government authority responsible for maintaining monetary and banking stability in Hong Kong. It was established in April 1993 by merging the Office of the Exchange Fund and the Office of the Commissioner of Banking.

THE ROLE OF THE HKMA

The HKMA has four main functions:

- maintaining currency stability within the framework of the Linked Exchange Rate system
- promoting the safety and integrity of the financial system, including the banking system
- helping to maintain Hong Kong’s status as an international financial centre, including the maintenance and development of Hong Kong’s financial infrastructure
- managing the Exchange Fund

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1 The powers, functions and responsibilities of the Monetary Authority are set out in legislation, principally in the Exchange Fund Ordinance, the Banking Ordinance, the Deposit Protection Scheme Ordinance and the Clearing and Settlement Systems Ordinance.
EXCHANGE FUND ADVISORY COMMITTEE

The HKMA’s activities are financed by the Exchange Fund to ensure a level of resource independence appropriate to a central banking institution. The HKMA reports to the Financial Secretary, who is the Controller of the Exchange Fund. In this capacity, the Financial Secretary is advised by the Exchange Fund Advisory Committee (EFAC). Five specialised sub-committees report and make recommendations to EFAC.
MONETARY STABILITY

The Hong Kong dollar is officially linked to the US dollar at the rate of HK$7.8 to US$1. The Linked Exchange Rate system underpins Hong Kong’s monetary system and plays an important role in supporting Hong Kong as a leading international trading, services and financial centre.

Currency Board mechanism

The Linked Exchange Rate system operates through a Currency Board mechanism, which requires the Monetary Base to be fully backed by foreign reserves and any change in the Monetary Base to be fully matched by a corresponding change in foreign reserves.

Under the Currency Board system, the stability of the Hong Kong dollar exchange rate is maintained through an automatic interest rate adjustment mechanism, where interest rates rather than the exchange rate adjust to the inflow or outflow of funds.

Operation of the Currency Board

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Hong Kong’s Monetary Base comprises:

- **Governments-issued notes and coins in circulation**: fully back the banknotes issued by the note-issuing banks.
- **Certificates of Indebtedness**: are Hong Kong-dollar debt securities issued by the HKMA on behalf of the Government.
- **The Aggregate Balance**: is the sum of balances in the clearing accounts maintained by commercial banks with the HKMA.
In recent years, the HKMA has strengthened and developed the Currency Board system to make it more rule-based, more transparent and less vulnerable to external shocks. The Currency Board system has ensured a high degree of exchange-rate stability. Between November 1974 and September 1983, Hong Kong adopted a floating rate regime but the experience was not satisfactory, with high volatility seen not only in the exchange rate but also on other fronts.
BANKING STABILITY

The principal function of the HKMA as banking supervisor is to promote the general stability and effective working of the banking system in Hong Kong. The HKMA seeks to ensure that authorized institutions operate in an effective, responsible, honest and business-like manner and to provide a measure of protection to depositors. Its powers to meet these objectives come from the Banking Ordinance.

The three-tier banking system

Banks in Hong Kong are divided into three tiers of authorized institutions. The main distinctions lie in the deposit business each tier is allowed to conduct under the Banking Ordinance.

Depositors in Hong Kong are protected by the Deposit Protection Scheme. The Scheme was established in accordance with the Deposit Protection Scheme Ordinance to provide protection up to HK$500,000 per depositor per bank. In addition to protecting depositors, the Scheme helps maintain the stability of Hong Kong’s banking system.
HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

A combination of factors, including a strategic location, high speed communications to the rest of the world, the free flow of information, no restrictions on capital flows, and effective and transparent regulations which meet international standards, have helped establish Hong Kong as a leading international financial centre.

Indeed, the HKMA sees regional co-operation as particularly important in improving financial stability and surveillance, and continues to maintain and strengthen contacts with the international central banking and financial community to:

- promote international understanding of, and support for, monetary and banking policies in Hong Kong
- share information with other central banks about financial developments to facilitate the proper oversight of financial markets and the prudential supervision of financial institutions
- improve understanding of international economic and financial trends to facilitate more effective policy formulation, particularly in monetary management and reserves management
- improve access to technical expertise in major central banks and multilateral institutions
- help other central banks and institutions to obtain a better understanding of monetary and general economic developments in Hong Kong and the region.

Offshore renminbi business in Hong Kong

The HKMA works closely with the Mainland authorities and the financial industry in Hong Kong to promote the development of Hong Kong as the offshore renminbi business centre. With the expansion of offshore renminbi business since 2004, Hong Kong has developed a reliable and highly efficient renminbi financial platform providing one-stop services, including banking and settlement, financing and wealth management, to corporates and financial institutions. Hong Kong now hosts the largest offshore renminbi liquidity pool, and is a global hub for renminbi trade settlement and bond issuance.

International and regional co-operation

Hong Kong is a member of a number of international and regional bodies, including the Asian Development Bank, the Asia-Pacific Economic Co-operation forum, the Bank for International Settlements, the Basel Committee on Banking Supervision, the Executives’ Meeting of East Asia and Pacific Central Banks, the Financial Stability Board and SEANZA (South East Asia, New Zealand and Australia). It also participates in the activities of ASEAN + 3 (Association of Southeast Asian Nations and China, Japan and South Korea), the Group of Twenty (G20), the International Monetary Fund, SEACEN (South East Asian Central Banks), the World Bank, and other international and regional bodies.
FINANCIAL INFRASTRUCTURE

A prerequisite of a stable financial market and an international financial centre is a safe, reliable and efficient financial infrastructure. The HKMA is committed to ensuring that Hong Kong continues to meet current and future best international standards. The infrastructure components fall into three broad types:

(a) **Payment systems** for the settlement of interbank payments:

- Hong Kong dollar Real-Time Gross Settlement (RTGS) system launched in 1996
- US dollar RTGS system launched in 2000
- Euro RTGS system launched in 2003
- Renminbi RTGS system launched in 2007 (upgraded from Renminbi Settlement System launched in 2006)

(b) The **debt securities settlement system**, called the Central Money markets Unit, established in 1990, for the settlement and custody of debt securities

(c) **Domestic and external system links** to provide payment-versus-payment and delivery-versus-payment services, locally and across the border.

**Payment versus payment (PvP)**

A mechanism for settling a foreign-exchange transaction to ensure that a final transfer of one currency occurs only if the transfer of the other currency or currencies also takes place at the same time.

**Delivery versus payment (DvP)**

A securities-delivery arrangement in which the delivery of securities takes place as soon as payment is made and is confirmed to be final and irrevocable.
Hong Kong’s financial infrastructure allows financial institutions to:

- provide efficient payment and settlement services to their customers
- make real-time payments in Hong Kong during local hours, in Hong Kong dollars, US dollars, euros and renminbi
- trade and hold multi-currency-denominated debt securities
- execute PvP foreign-exchange transactions, covering eight currency pairs, through domestic links among Hong Kong RTGS systems and external links with overseas RTGS systems:

* Through the linkage between Hong Kong’s USD RTGS system and Malaysia’s ringgit RTGS system
** Through the linkage between Hong Kong’s USD RTGS system and Indonesia’s rupiah RTGS system
THE EXCHANGE FUND

The Exchange Fund, established in 1935, comprises Hong Kong’s official reserves and provides the backing to safeguard the exchange value of the Hong Kong dollar. The Fund also helps preserve the stability and integrity of Hong Kong’s monetary and financial systems to enhance the city’s status as an international financial centre.

Investment Management

The Exchange Fund is not primarily an investment fund, and it is predominantly invested in a wide range of fixed-income, equity and other assets in major international markets.

The Exchange Fund is divided into portfolios:

- the Backing Portfolio, which provides backing for the Monetary Base
- the Investment Portfolio, which preserves the long-term purchasing power of the Fund
- the Strategic Portfolio, which contains assets purchased by the Hong Kong Government for the account of the Exchange Fund for strategic purposes.

In addition to managing assets of the Fund itself, the HKMA employs external fund managers operating in various international financial centres to tap the best investment expertise available and diversify investment styles.
ACCOUNTABILITY AND TRANSPARENCY

The HKMA is accountable to the people of Hong Kong through the Financial Secretary and the laws passed by the Legislative Council. There is a formal commitment from the Chief Executive of the HKMA to appear before the Legislative Council’s Panel on Financial Affairs three times a year to brief Members and to answer questions on the HKMA’s work. Representatives from the HKMA also attend Legislative Council meetings from time to time to explain and discuss particular issues, and to assist Members in their scrutiny of draft legislation.

The HKMA seeks to follow international best practices in its transparency arrangements through:

- maintaining extensive relations with the media
- a range of regular and special publications
- a comprehensive website (www.hkma.gov.hk)
- an Information Centre
- public education programmes
- public enquiry service.
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