

HONG KONG MONETARY AUTHORITY

Briefing to the Legislative Council Panel on Financial Affairs

23 May 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

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FINANCIAL AND ECONOMIC ENVIRONMENT

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GLOBAL ECONOMIC GROWTH FORECASTS

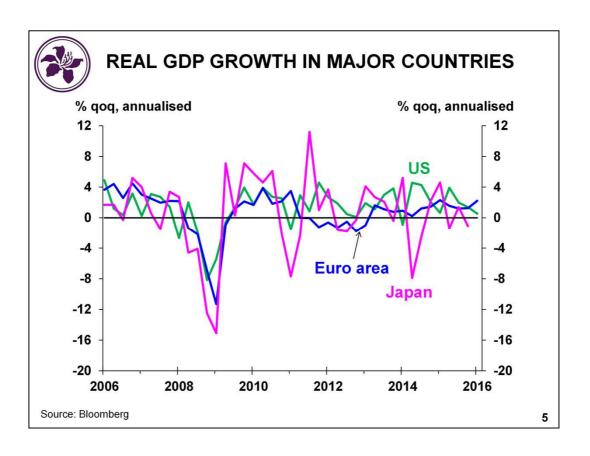
Real GDP Growth

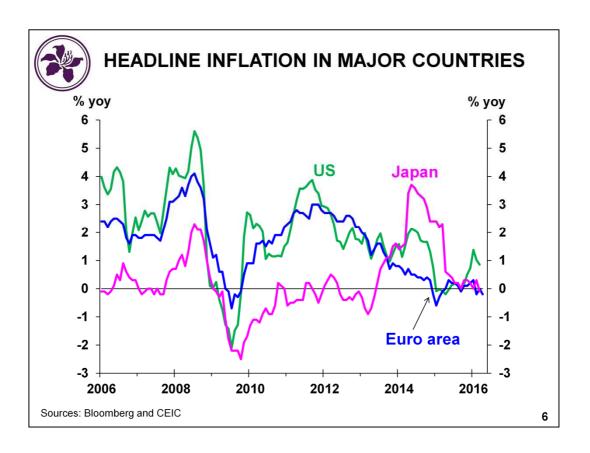
(% year-on-year)

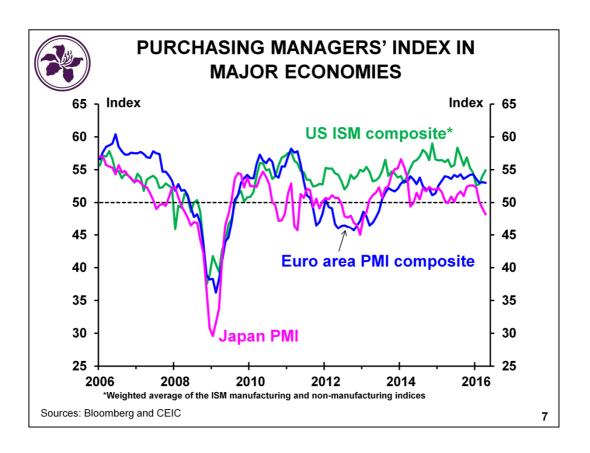
	2015	2016 Forecasts	2017 Forecasts
us	2.4	1.8	2.3
Euro area	1.6	1.6	1.6
Japan	0.5	0.5	0.5
Asia (ex-Japan)	5.8	5.6	5.6
Mainland China	6.9	6.5	6.3
Hong Kong	2.4	1.7	1.9

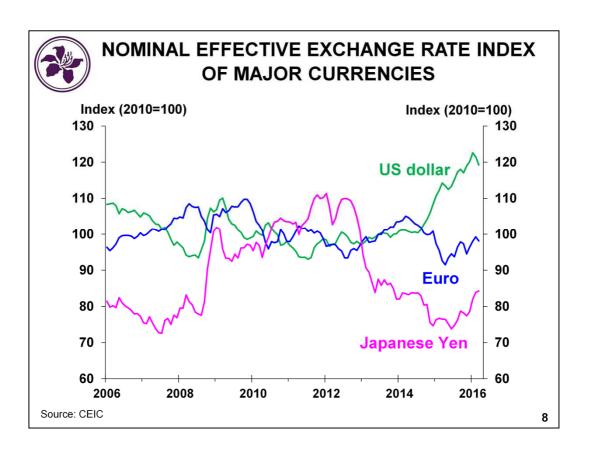
Sources: May Consensus Forecasts and Official Statistics

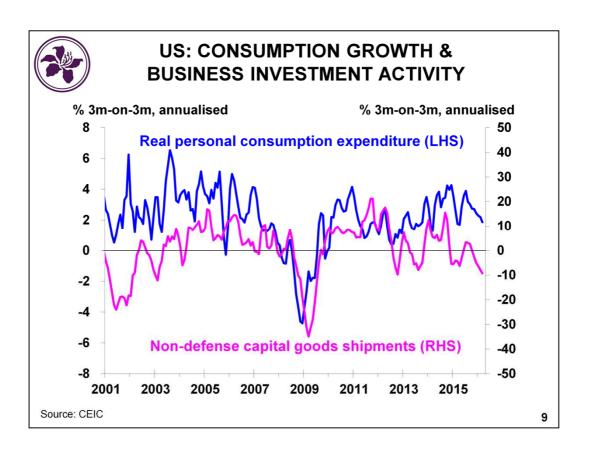
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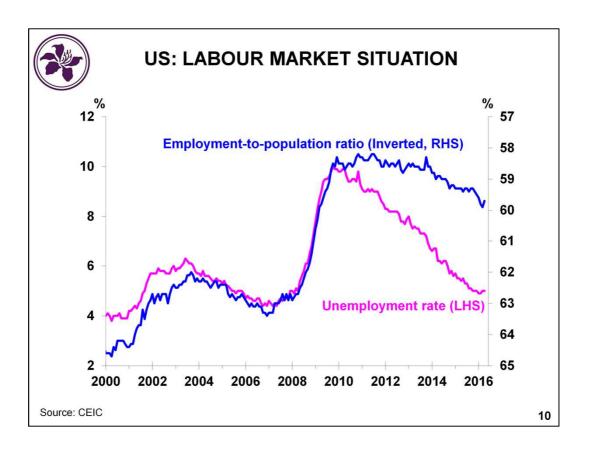


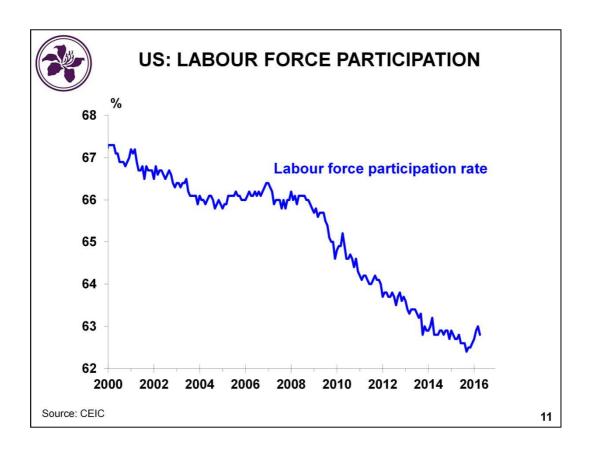


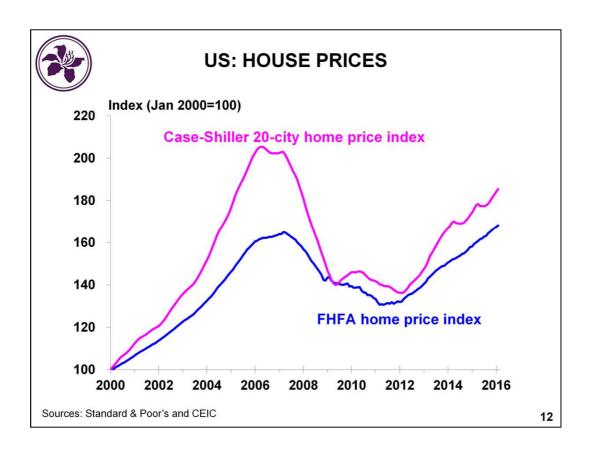


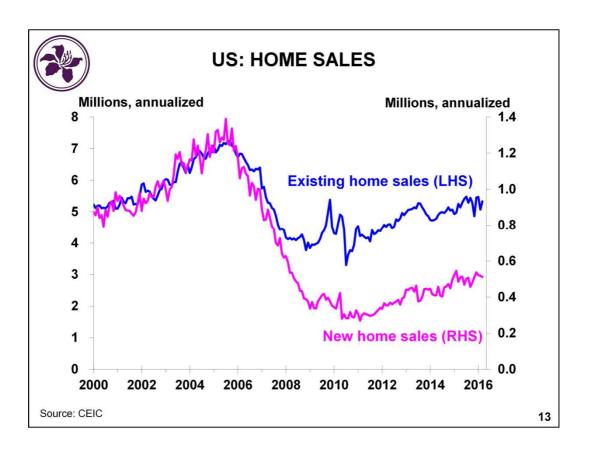


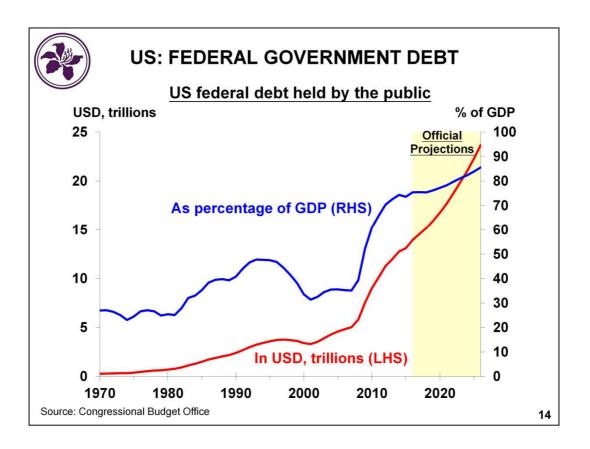


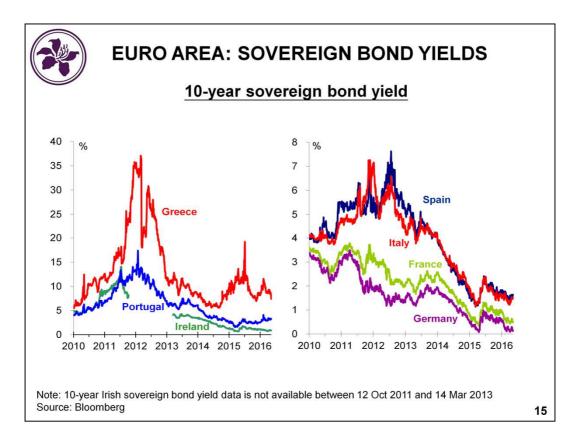


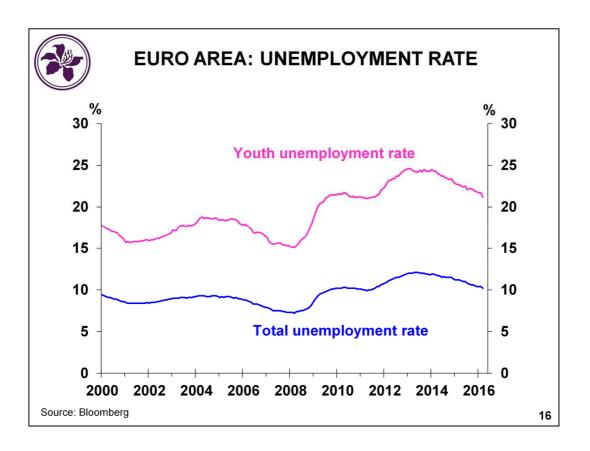


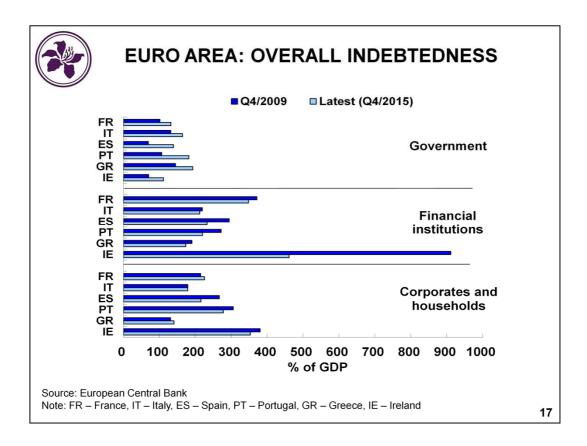


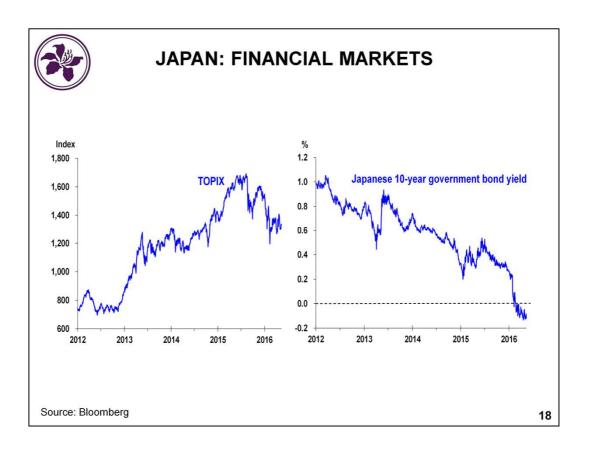


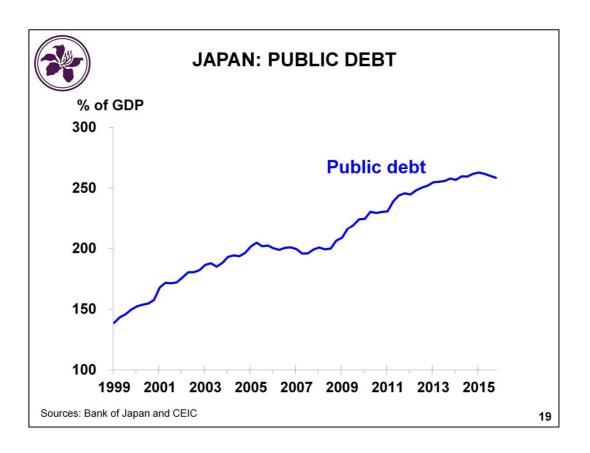


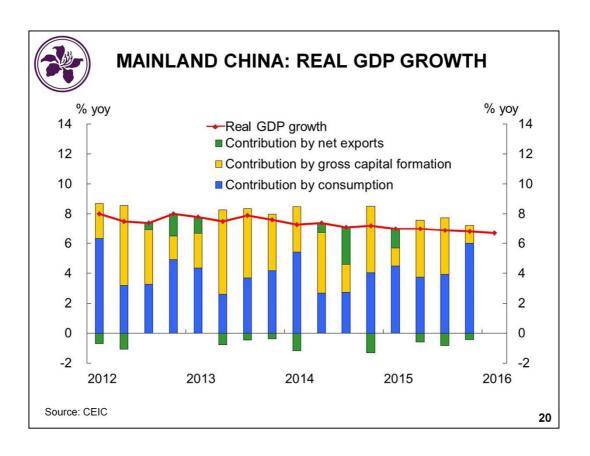


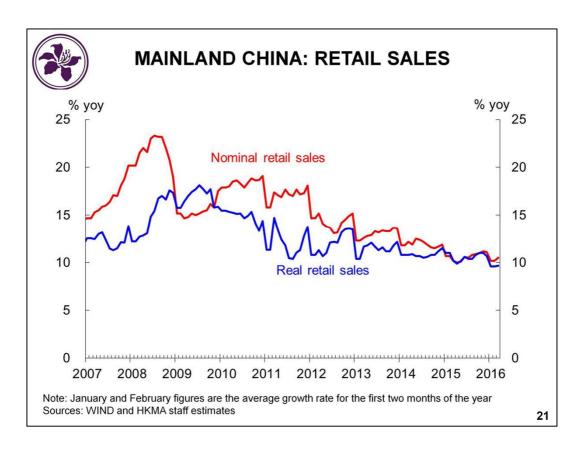






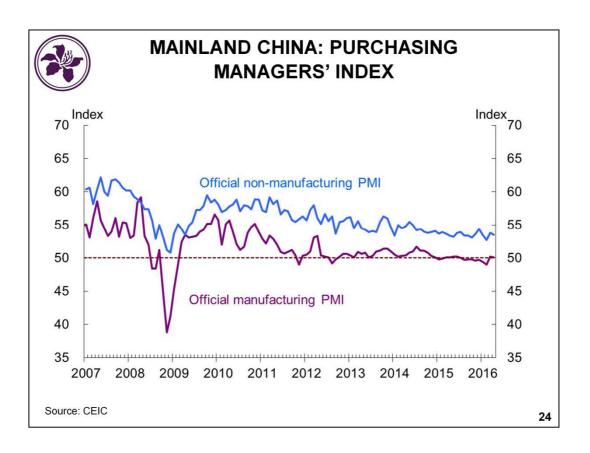


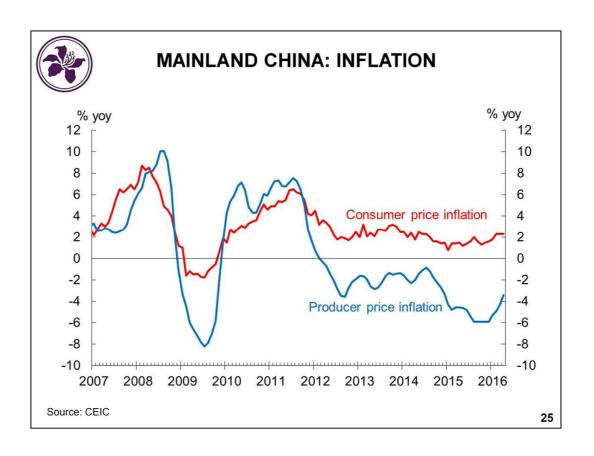


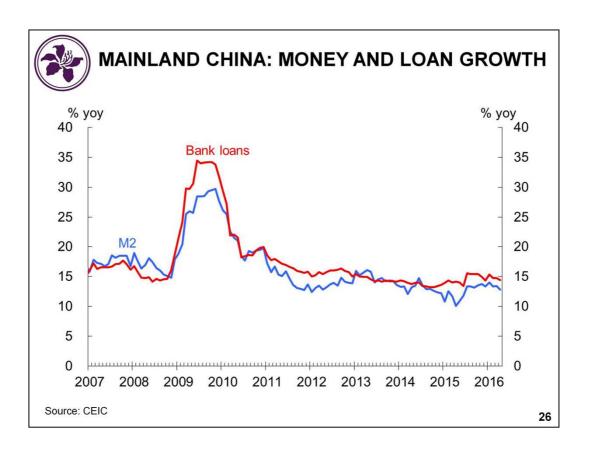


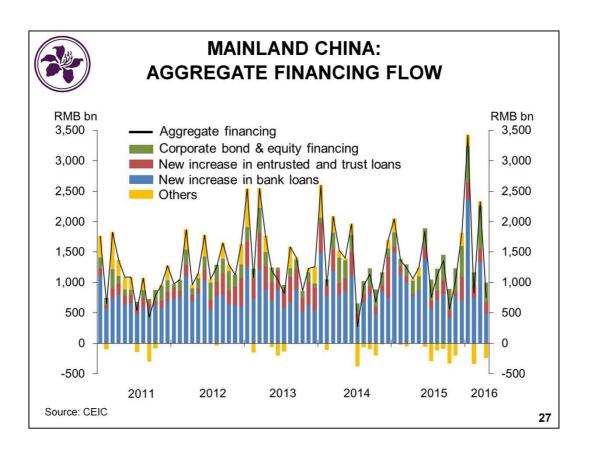


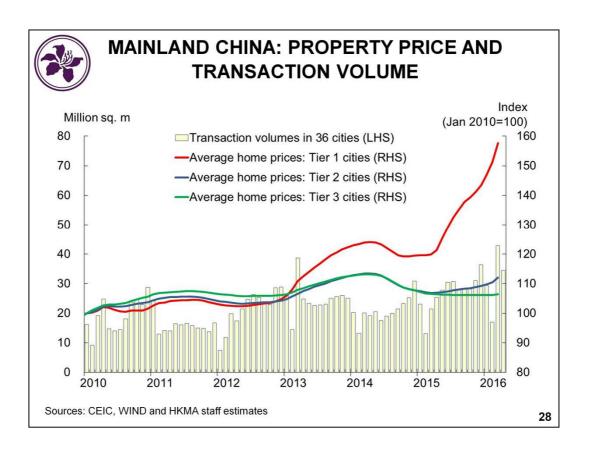


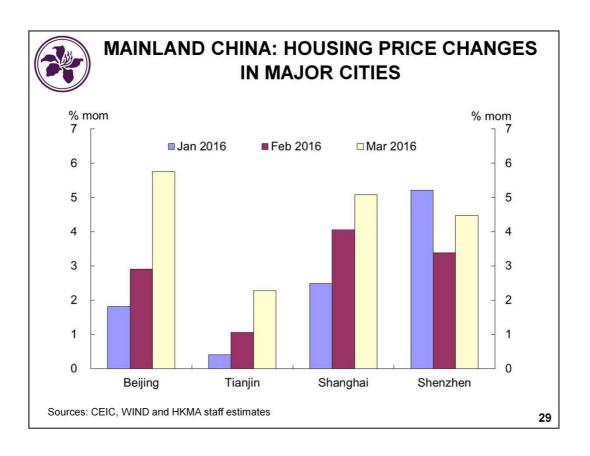


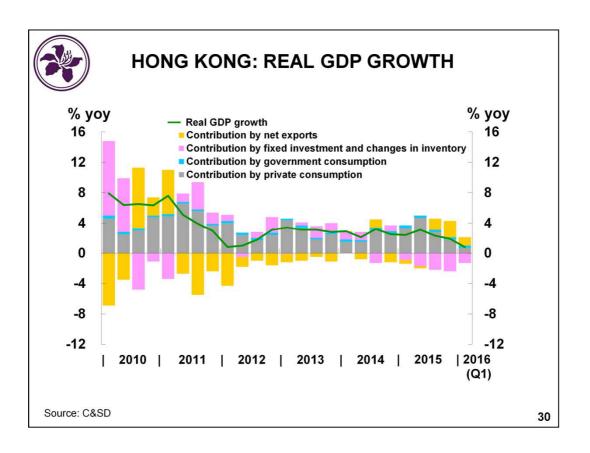


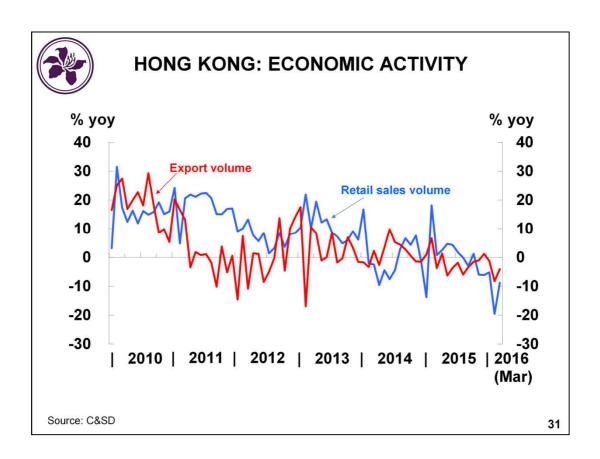


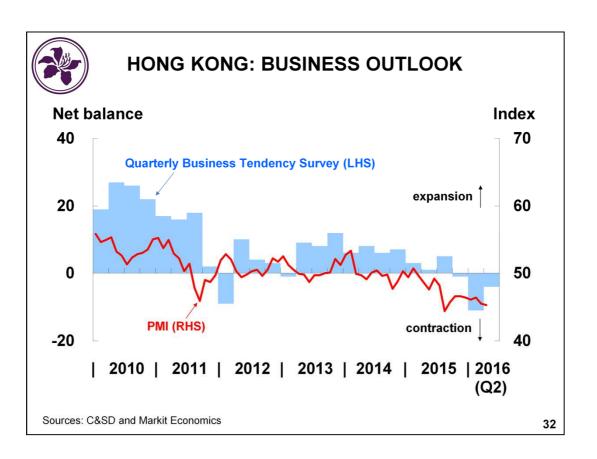


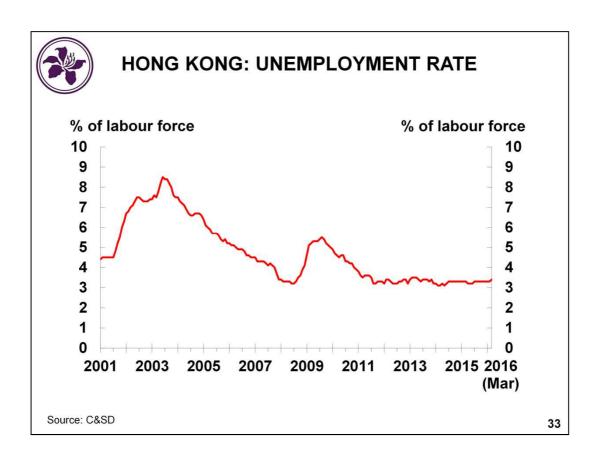


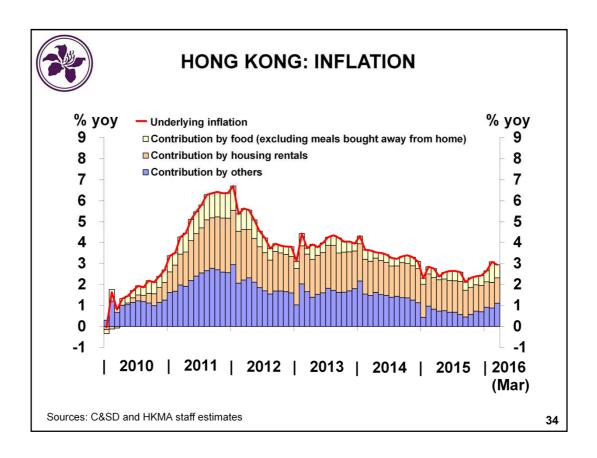


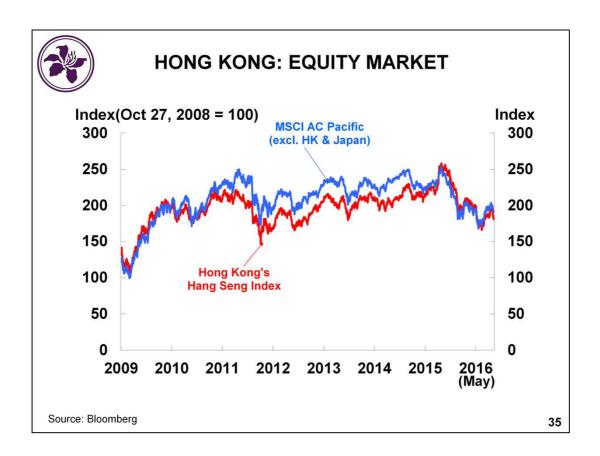


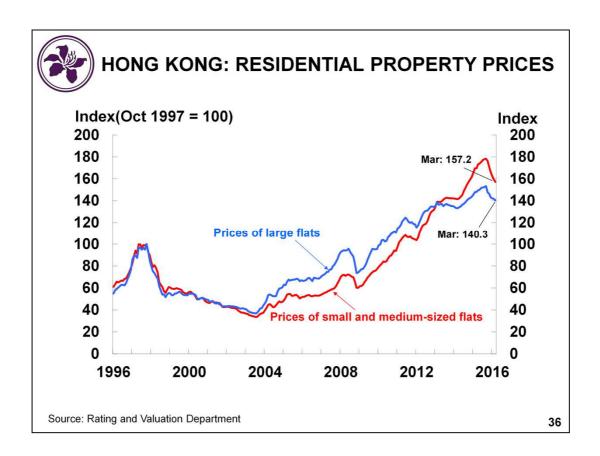


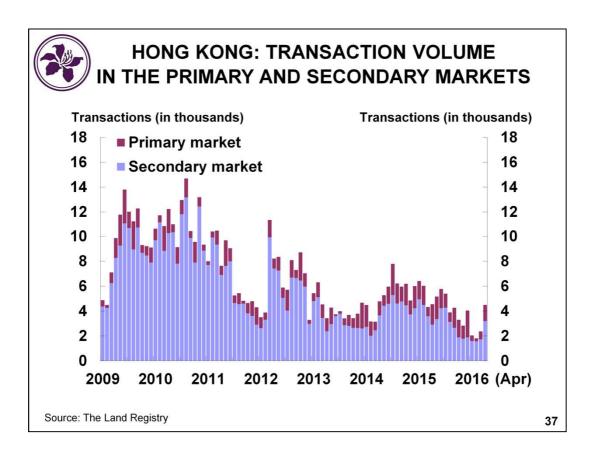


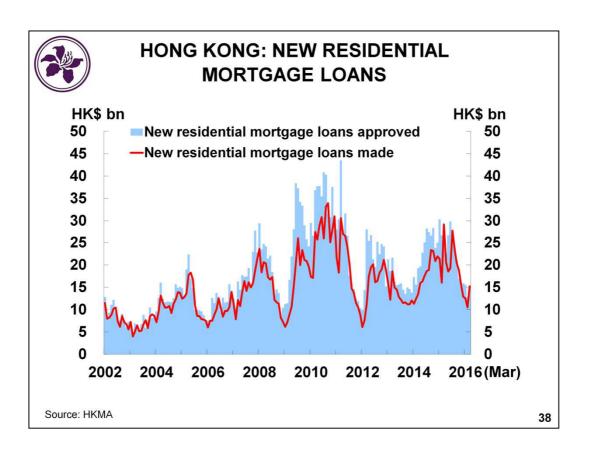


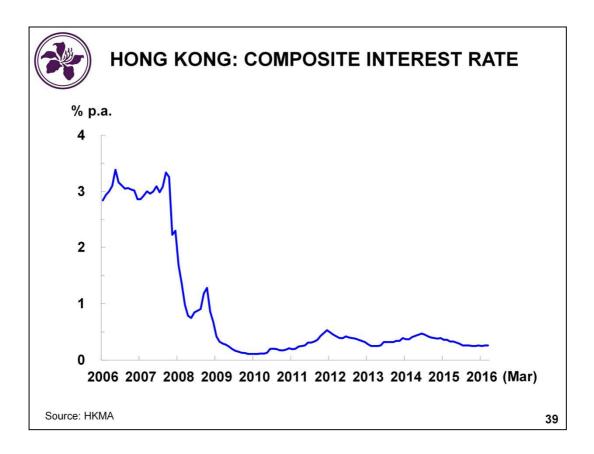


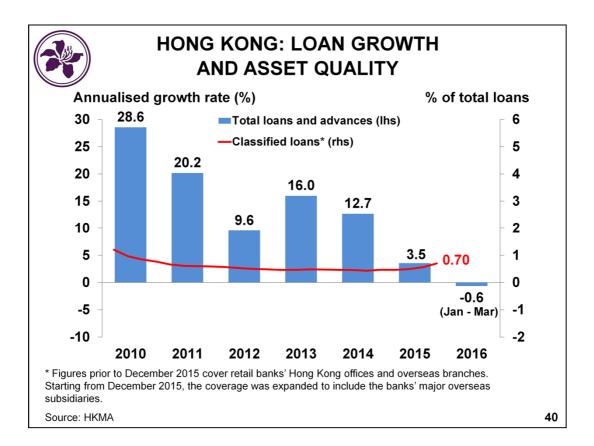


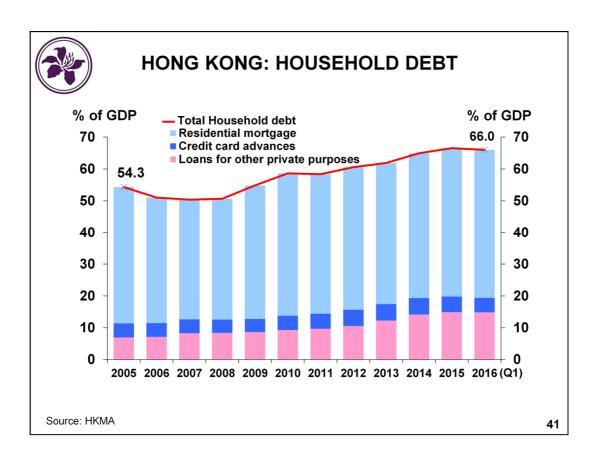






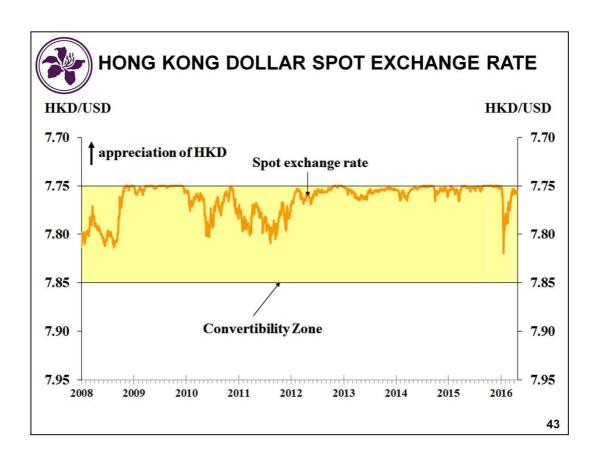




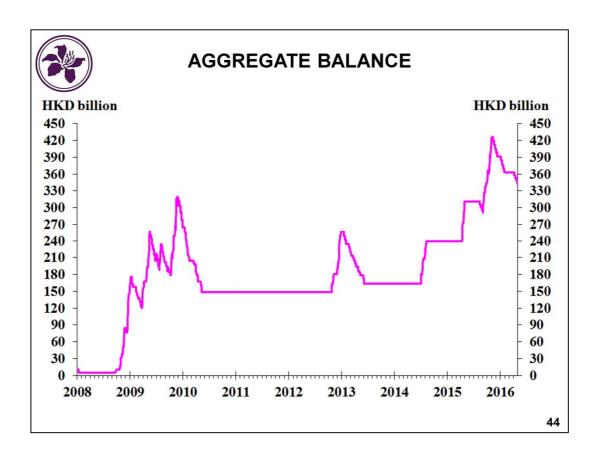




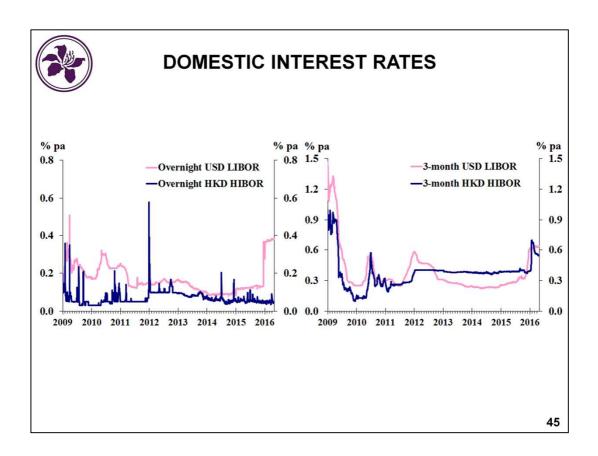
CURRENCY STABILITY



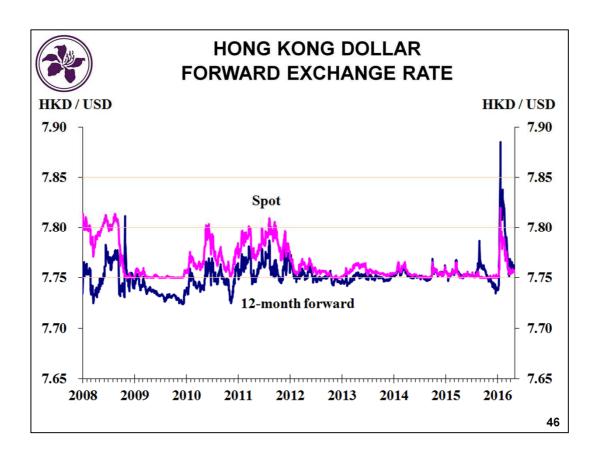
 Having eased briefly to beyond 7.8 in January, the Hong Kong dollar spot exchange rate has strengthened to 7.75-7.76 recently alongside a rebound in stocks and a rally in Asian currencies on improving global risk sentiment after European Central Bank's further monetary easing measures and expectations of a slower pace of US rate hike.



 A total of HK\$20 billion of additional Exchange Fund Bills (EFB) were issued in April to meet banks' strong demand for EFBs for liquidity management purpose. Such issuance led to a decline of the Aggregate Balance from HK\$363.4 billion at the end of March to HK\$343.4 billion by the end of April.



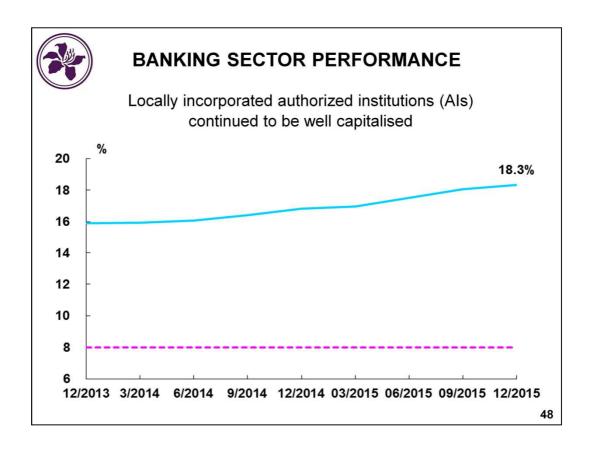
 Short-term interbank interest rates remained at near-zero levels even though seasonal demand had pushed overnight HKD HIBOR briefly higher at end-March, and longer-term rates had increased slightly alongside their US dollar counterparts. Additional issuance of EFBs in April has no impact on interbank rates.



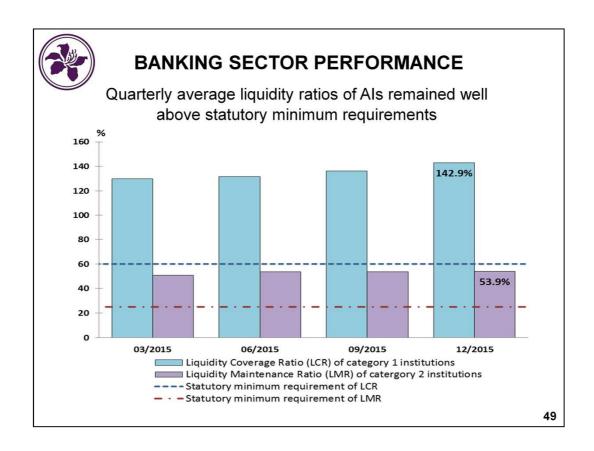
 The 1-year forward points eased from a high of +650 pips in January to about +50 pips lately amid a narrower interest rate differential between Hong Kong dollar and US dollar.



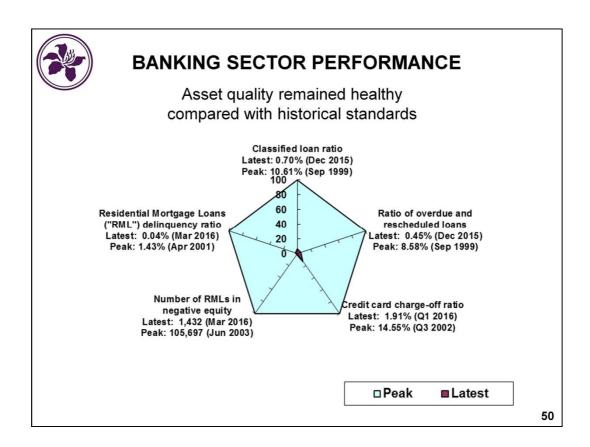
BANKING STABILITY



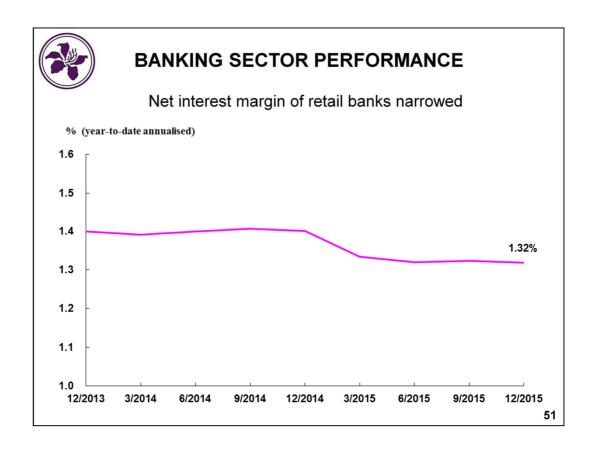
 The consolidated capital adequacy ratio (CAR) of locally incorporated Als increased to 18.3% at end-December 2015 from 18.1% a quarter ago, mainly due to an increase in capital base. The consolidated CAR remained well above the international minimum standard of 8%.



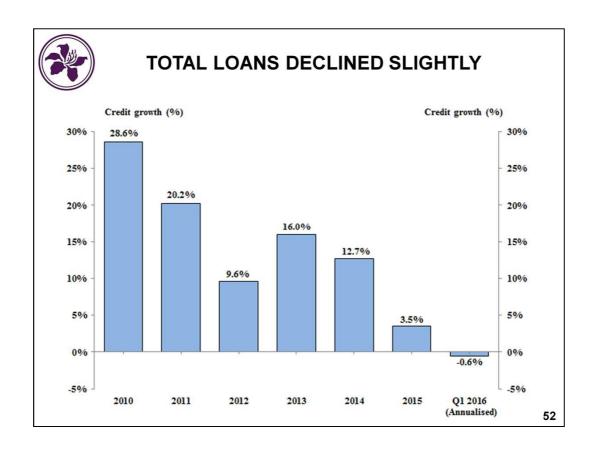
 In Q4 2015, the quarterly average Liquidity Coverage Ratio of category 1 Als was 142.9% (well above the 60% statutory minimum requirement applicable for 2015). For category 2 Als, their quarterly average Liquidity Maintenance Ratio was 53.9% (well above the 25% statutory minimum requirement).



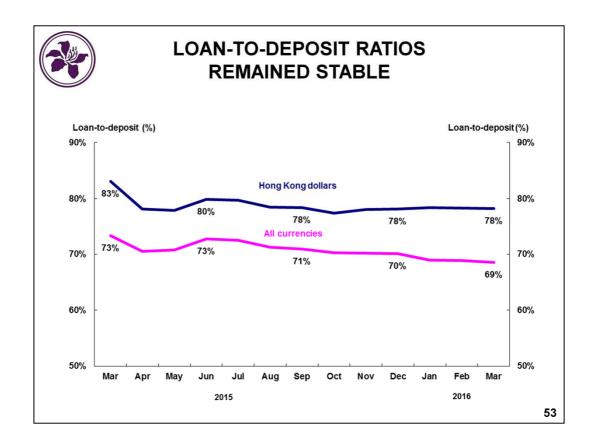
 Asset quality of retail banks' loan portfolio deteriorated slightly but remained healthy by historical standards.



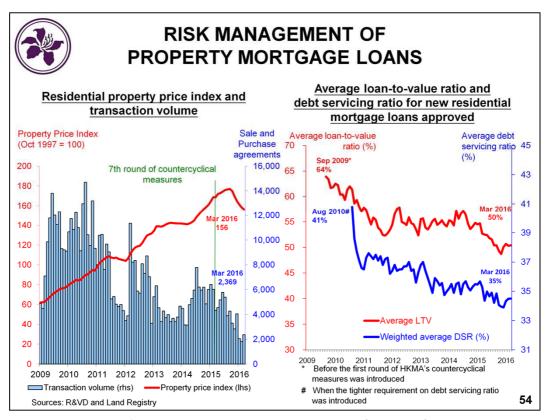
 The net interest margin (NIM) of retail banks' Hong Kong offices narrowed to 1.32% in 2015 from 1.40% in 2014, due to a number of factors including lower returns on RMB-denominated assets and investment of excess funds by retail banks in lower-yielding assets.



• Hong Kong banking sector's total loans declined slightly in the first quarter of 2016 as demand for new loans weakened.



- The Hong Kong dollar loan-to-deposit ratio stayed at 78% at end-March 2016, the same as that at end-December 2015.
- The all currencies loan-to-deposit ratio edged down to 69% at end-March 2016 from 70% at end-December 2015.



Latest statistics for residential mortgage loans ("RMLs")

	Monthly average in 2014	Monthly average in 2015	Nov 2015	Dec 2015	Jan 2016	Feb 2016	Mar 2016
Number of sale and purchase agreements	5,317	4,665	2,826	4,043	2,045	1,807	2,369
Number of new RML applications	10,481	9,626	6,571	6,593	6,440	4,869	7,446
Number of new RMLs approved	7,337	7,059	4,649	4,829	4,668	3,926	4,704

Latest statistics for residential property prices

Property	price index	Period	Property price index	
Rating and Valuation Department	Latest position	03/2016	156.3	
	Recent Peak	09/2015	177.0	
(10/1997=100)	Peak in 1997	10/1997	100.0	
Centaline	Latest position	01/05/2016	128.5	
(6/7/1997=100)	Recent Peak	13/09/2015	146.9	
	Peak in 1997	19/10/1997	102.9	



Banking (Capital) (Amendment) Rules 2016 (BCAR 2016)

- Amendments to implement three Basel Committee capital standards:
 - New Standardised Approach to counterparty credit risk (SA-CCR)
 - Final risk-weighting framework for exposures to central counterparties (CCPs)
 - New risk-weighting framework for equity investment in funds
- Amendments to be submitted to the LegCo in the last quarter of this year
- Target implementation: 1 January 2017

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BCAR 2016

• The BCAR 2016 introduces 3 capital standards of the Basel Committee which, according to the international implementation timetable, are all scheduled to take effect on 1 January 2017.



BCAR 2016 (SA-CCR)

- A new approach for risk-weighting banks' counterparty credit risk (CCR) exposures in:
 - Derivatives
 - Securities financing transactions
- It increases risk-sensitivity of CCR exposure measure through:
 - Better recognition of credit risk mitigation through collateral and netting
 - Supervisory calibration to reflect stressed price volatility

- A new Standardised Approach for banks to measure their credit risk exposure to their counterparty in derivatives and securities financing transactions.
- The new approach is designed to enhance the risk-sensitivity of the CCR exposure measure through:
 - (i) better recognising the risk-reducing effects of collateral and netting; and
 - (ii) adjusting the supervisory calibration to reflect price volatility during stress periods.



BCAR 2016 (CCPs)

- A "final" risk-weighting framework for exposures to CCPs which:
 - replaces existing "interim" standard on treatment of banks' contributions to CCP default funds; and
 - accommodates treatment for multi-level client structures in central clearing

- A final risk-weighting framework for banks' exposures to CCPs which:
 - replaces the treatment of banks' contributions to CCP default funds in the existing "interim" standard; and
 - accommodates capital calculation in relation to multi-level client structures where clearing services are provided by clients of a CCP clearing member.



BCAR 2016 (equity investments in funds)

- A new risk-weighting framework with higher risksensitivity
- It includes 3 approaches to risk-weighting banks equity investments in funds:
 - Look-through to determine (i) credit risk of underlying assets held by the fund; and (ii) degree of leverage of the fund
 - Reference to fund's investment mandate
 - Fixed risk weight at 1250%

- A new risk-weighting framework to better align the risk-weights for bank's equity investments in funds with the risks of these funds.
- Under the new framework, banks are required to look-through a fund to determine (i) the credit risk of the underlying assets held by the fund; and (ii) the degree of leverage of the fund.
- If the look-through method is not possible, then risk-weights will be determined by reference to the fund's investment mandate or fixed at the relatively high level of 1250%.



Banking (Disclosure) (Amendment) Rules 2016 (BDAR 2016)

- Amendments to implement Basel Committee disclosure standards:
 - Standalone report for regulatory disclosures
 - Standard templates and tables
 - Quarterly disclosures
- Amendments to be submitted to the LegCo in the last quarter of this year
- Target implementation: financial year ending 31 December 2016

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BDAR 2016

- The BDAR 2016 will implement revised disclosure standards from the Basel Committee designed to enhance relevance for users and comparability among banks and across jurisdictions. The standards cover:
 - a requirement for regulatory disclosures to be housed in a standalone report to facilitate review by users;
 - greater use of standard templates and tables to achieve more consistent and comparable disclosure; and
 - greater emphasis on quarterly disclosures we will take this opportunity to introduce quarterly disclosure of key regulatory ratios (i.e. capital ratios and leverage ratio) which will address a finding in the Regulatory Consistency Assessment Programme (RCAP) report released by the Basel Committee in March 2015 on Hong Kong's compliance with the Basel capital and disclosure standards.

Work schedule

- We have consulted the industry on our policy proposals for implementing these capital and disclosure standards.
- The amendment rules are being prepared in conjunction with the Financial Services and the Treasury Bureau (FSTB) and the Department of Justice (DoJ).
- We will conduct a further round of statutory consultation as required under the Banking Ordinance with relevant parties (FS, BAC, DTCAC, HKAB, DTCA) in the third quarter, with a view to tabling the rules before the LegCo for negative vetting in October.

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"
- Imperative to achieve compliance with international standards as soon as possible to deter overseas financial institutions from seeking to reduce operations in Hong Kong to improve resolvability
- Financial Institutions (Resolution) Bill (FIRB) introduced into the LegCo in December 2015 - Bills Committee scrutiny underway

- Absent an effective resolution regime in Hong Kong meeting the international standards in the Financial Stability Board's "Key Attributes of Effective Resolution Regimes for Financial Institutions", cross-border financial institutions may, on their own initiative or at the behest of the authorities in their "home" jurisdictions, take action to reduce their exposures to, and dependencies upon, their Hong Kong operations in order to improve the resolvability of the wider group.
- 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 is currently in progress.
- Internationally, guidance and standards on various aspects of resolution continue to be developed to facilitate the practical operation of resolution regimes (e.g. work is underway on the mechanics of implementing a bail-in). It is therefore expected that measures will in turn be developed in the light of these international initiatives to make the local regime fully operable complementing the legislative framework in the FIRB. In this regard, the FIRB provides for the issuance of a series of rules and regulations as well as a Code of Practice.



BANK CONSUMER PROTECTION

- Issued circulars in April to share with banking industry key observations and practices on selling of investment products
- Continued supervisory collaboration with fellow regulators on selling of investment and insurance products
- Enhancing customer communication regarding US Foreign Account Tax Compliance Act (FATCA) and upcoming Automatic Exchange of Information (AEoI)

- Our recent supervisory experience revealed that whilst authorized institutions (Als) in general had put in place policies and procedures to govern business conduct in the selling of investment products, some issues and good practices identified warrant further attention by Als. HKMA issued two circulars in April to Als to share some key observations and practices on the selling of investment products as well as key controls and procedures in the distribution of certain bonds that contain complex features and/or inherent risks including a lack of secondary market which results in them being highly illiquid. Als were reminded to refer to these practical examples, and implement enhancement measures and strengthen staff training where necessary in order to ensure compliance with the prevailing regulatory standards and sufficient understanding from board level to middle management to frontline staff on their respective roles. The HKMA will continue to monitor Als' selling practices in respect of investment products and provide feedback to the industry as appropriate.
- The HKMA has co-operated closely with other financial regulators in Hong Kong in providing guidance and supervising Als' selling of investment products and insurance products. We worked with fellow regulators especially on various issues involving financial groups or regulated entities with close business relationships across different sectors in the financial services industry to ensure more co-ordinated and effective supervisory work. The HKMA has also collaborated with the Office of the Commissioner of Insurance (OCI) on developing, and reviewing after implementation, supplementary guidance to the industry for implementation of the new regulatory standards in respect of non-investment-linked long term insurance products.
- In support of the government's participation in global efforts in combatting tax evasion, the banking industry is facilitating the implementation of requirements under US FATCA and actively preparing for the introduction of AEoI in Hong Kong. In view of these new developments which also affect bank customers, the HKMA had issued guidance to the industry on improving customer communication, and after a recent survey of retail banks' actual practices, we are now working with the Hong Kong Association of Banks (HKAB) in enhancing the FATCA Fact Sheet previously developed by the HKAB so as to better address the commonly asked questions by bank customers on what are required on them under FATCA. While appreciating that banks are not professional tax advisors, we encourage banks to work with customers and prospective customers to seek to minimise the reporting burden and especially for those customers who confirm themselves as non-US persons and non-US taxpayers. Meanwhile, the HKMA is also providing guidance to the banking industry to follow customer-centric principles when developing an industry guideline for implementation of the upcoming AEoI.



OPENING OF BANK ACCOUNTS

- Statutory guideline and regulatory requirements
 - Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance
 - Risk based approach
- Foreign Account Tax Compliance Act of the United States
 - Global efforts on tax transparency
 - Role of banks
 - Possible enhancement to the interface with customers
- Opening of bank accounts for trustees in bankruptcies
 - Section 91 of the Bankruptcy Ordinance
 - Facilitation of bankruptcy process by banks

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Statutory guideline and regulatory requirements

- Before opening an account with a customer, banks are required to comply with the
 relevant legal and regulatory requirements, which include the statutory customer due
 diligence (CDD) requirements stipulated in the Anti-Money Laundering and CounterTerrorist Financing (Financial Institutions) Ordinance (AMLO). To ensure
 compliance, each bank develops its own account opening procedures and
 requirements, taking into account its own risk appetite and the requirements of its
 headquarters or Group where applicable.
- The CDD requirements stipulated in the AMLO are risk-based, which is an internationally recognised concept that different customers, transactions or services will each present different risks, and CDD measures applied by banks should be commensurate with the risk identified, i.e. on a risk-sensitive basis.
- The HKMA has issued statutory guideline under the AMLO to provide practical guidance to assist banks in designing and implementing their own policies, procedures and controls in the relevant operational areas. The guideline covers different criteria/guidance which cater for different circumstances, for instance, there are detailed provisions on what information/documents are required for different types of customers, namely natural persons, corporations, partnerships, trusts, nominees, etc. Moreover, in the case of address verification, the guideline provides a non-exhaustive list of 14 methods for verifying residential address and further emphasises that banks may, on a risk-sensitive basis, adopt a common sense approach by adopting alternative methods.
- The HKMA requires that the account opening process of banks should be transparent. In this respect, the industry has enhanced the access to basic information about account opening procedures and documentation requirement by putting the information in banks' websites. Banks are also required to provide sufficient training to frontline staff to ensure enhanced communication with customers throughout the account opening process.

Foreign Account Tax Compliance Act (FATCA)

- As part of the HKSARG's commitment in joining global efforts on enhancing tax transparency and combatting tax evasion, the banking industry in Hong Kong is facilitating the implementation of requirements under the FATCA. This is in line with efforts adopted in other jurisdictions.
- FATCA is a United States (US) legislation that aims at combatting tax evasion by US persons holding accounts and other financial assets outside the US. In brief, under FATCA, foreign financial institutions including banks are required to sign agreements with the US Internal Revenue Service (IRS) to identify and disclose detail regarding their US account holders; otherwise they will be subject to a 30% withholding tax on relevant US-sourced payments to them.
- In order to ascertain customers' non-US or US tax status, FATCA requires banks to collect additional information or documentation from customers. For instance, when individuals (regardless of whether they are US citizens/residents or not) open new bank accounts, banks may request customers to complete specific US tax forms (e.g. IRS Forms W-8BEN / W-9) or bespoke self-certification forms, and other supporting documentation as required (collectively, "FATCA documentation") to support the customers' claim of their US or non-US tax status.
- In view of such new developments which also affect bank customers, in October 2015, the HKMA issued guidance to the industry on improving customer communication. Specifically, banks are reminded to (i) ensure that when asking customers to complete the FATCA forms or customer declaration forms, their communication must be clear enough for customers to adequately understand the purpose and that doing so is necessary; (ii) ensure that proper procedures and staff training are put in place for responding to customer enquiries in a prompt and user-friendly manner; (iii) add or insert explanatory notes that would help proactively address likely questions or concerns of customers when sending the FATCA documentation requests to customers. The industry associations are also asked to assist in explaining to the general public that the implementation of FATCA requirements is necessary and unavoidable for Hong Kong as an international finance centre which should support the global efforts in combatting tax evasion.
- To understand retail banks' implementation progress after receiving the HKMA's guidance of October 2015, the HKMA has conducted a survey of retail banks' actual practices. We see room for improvement in the FATCA Fact Sheet which was developed by HKAB for its member banks' reference in tailoring their customer communications on FATCA. The HKMA is now working with HKAB in enhancing the FATCA Fact Sheet so as to better address the commonly asked questions by bank customers on what are required on them under FATCA in light of the recent experience. While appreciating that banks are not professional tax advisors, the HKMA encourages banks to work with customers and prospective customers to seek to minimise the reporting burden and especially for those customers who confirm themselves as non-US persons and non-US taxpayers.

Opening of bank accounts for trustees in bankruptcies

 We understand from the Official Receiver's Office that under section 91 of the Bankruptcy Ordinance, every trustee in a bankruptcy shall open an account in the name of the bankrupt's estate at the same bank where the Official Receiver maintains an account ("OR banks") and shall pay to the credit of such account all sums which may from time to time be received by him as trustee. Currently, the Official Receiver maintains bankruptcy accounts with five banks, namely, Bank of China (Hong Kong) Limited, The Bank of East Asia Limited, The Hongkong and Shanghai Banking Corporation Limited, Industrial and Commercial Bank of China (Asia) Limited and Standard Chartered Bank (Hong Kong) Limited.

- Where a trustee is not able to open such a bank account, this would make it impossible for the administration of the bankruptcy estate concerned. It is thus the expectation of the HKMA that OR banks are supportive of bona fide activities of such trustees and accommodate their legitimate applications for opening of accounts for the bankrupts'estates. We have recently reminded the OR banks concerned about our expectation. Trustees may open accounts at any of the OR banks in accordance with section 91 of the Bankruptcy Ordinance.
- If there is any case whereby a trustee is not able to open an account at any of the OR banks in accordance with the Bankruptcy Ordinance, it would be helpful if the trustee concerned could provide detailed information to the HKMA for possible follow-up.



UNAUTHORISED ONLINE SHARE TRADING TRANSACTIONS (1)

- In early April, banks identified 8 cases of unauthorised share trading transactions involving a total amount of HK\$6.86 million (compared with 1 case in 2015 involving HK\$0.74 million)
- The HKMA forthwith alerted banks to this type of frauds and asked them to step up security surveillance
- On 20 April, the HKMA issued an "E-banking Alert" to alert the public to guard against unauthorised online share trading transactions
- Code of Banking Practice provides that unless a customer acts fraudulently or with gross negligence such as failing to safeguard properly his device(s) or secret code(s) for accessing the e-banking service, he should not be responsible for any direct loss suffered by him as a result of unauthorised transactions conducted through his account

- In early April, banks identified 8 cases of unauthorised online share trading transactions involving a total amount of HK\$6.86 million (compared with 1 case in 2015 involving HK\$0.74 million).
- HKMA forthwith issued another email to banks to alert them to this type of frauds and asked them to step up security surveillance. Besides, the banks concerned have promptly informed their affected customers and adopted measures to protect the Internet banking accounts of their customers so as to reduce the risk of similar fraud cases.
- On 20 April, an "E-banking Alert" was issued to draw public attention to unauthorised online share trading transactions and adoption of suitable precautionary measures.
- Code of Banking Practice provides that unless a customer acts fraudulently or with gross negligence such as failing to safeguard properly his device(s) or secret code(s) for accessing the e-banking service, he should not be responsible for any direct loss suffered by him as a result of unauthorised transactions conducted through his account.



UNAUTHORISED ONLINE SHARE TRADING TRANSACTIONS (2)

- The HKMA has been calling upon the public to take suitable precautionary measures to avoid such cases, including:
 - Setting e-banking passwords that are difficult to guess and different from the ones for other internet services
 - Installing and promptly updating security software to protect their computers and mobile phones
 - Refraining from using public computers or public Wi-Fi to access e-banking accounts
 - Checking their e-banking accounts from time to time and reviewing alert messages and statements issued by banks in a timely manner
- The HKMA is discussing with the banking industry on possible ways to further strengthen cyber security measures to prevent such unauthorised transactions

- Suitable precautionary measures adopted by the public can help avoid such cases, including:
 - Setting e-banking passwords that are difficult to guess and different from the ones for other internet services. This can lower the chance of guessing correctly the customers' passwords by fraudsters using brute-force attack.
 - Installing and promptly updating security software to enhance the security of customers' computers and mobile phones. This can reduce the risk of planting malwares on customers' computers and mobile phones by fraudsters for stealing the customers' passwords.
 - Refraining from using public computers or public Wi-Fi to access e-banking accounts. This can prevent fraudsters from capturing the customers' password by using malwares through these channels.
 - Checking their e-banking accounts from time to time and reviewing alert messages and statements issued by banks in a timely manner. If customers are aware of unauthorised transactions conducted over their accounts, they should contact their bank as soon as practicable and report to the Police.
- The HKMA is discussing with the banking industry on possible ways to further strengthen cyber security measures to prevent such unauthorised transactions.



FINANCIAL INFRASTRUCTURE



FINANCIAL INFRASTRUCTURE

- Continue to maintain safety and efficiency of financial infrastructure
- <u>Daily average</u> turnover in RMB Real Time Gross Settlement (RTGS) system in Q1 2016 remained at a high level, standing at RMB944.5 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.

REGULATORY FRAMEWORK FOR STORED VALUE FACILITIES AND RETAIL PAYMENT SYSTEMS - PROGRESS UPDATE

- Following the enactment of the Payment Systems and Stored Value Facilities Ordinance in November 2015, the HKMA issued two sets of guidance documents on the Stored Value Facilities (SVF) licensing regime and related key regulatory requirements
- The HKMA has been engaging in close dialogues with more than 20 prospective SVF applicants to facilitate the application process. It is expected that the first batch of SVF licences will be issued in Q3 2016
- The HKMA will commence work to determine if any existing Retail Payment Systems (RPS) should be designated. It is expected that an explanatory note on the HKMA's policies and procedures on RPS designation will be issued in H1 2016
- A media briefing on the SVF regime was held on 5 April 2016. The HKMA will continue on public education programme to enhance public awareness of the new SVF and RPS regulatory regime and the use of retail payment products and services

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; 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; 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 "Explanatory Note on Licensing for Stored Value Facilities" and "Preliminary Regulatory Expectations of SVF Licencees" in November 2015 and January 2016 respectively to provide guidance about the licensing regime as well as key regulatory requirements on SVF.
- Held industry briefing sessions and one-on-one meetings with more than 20 prospective applicants to explain the licensing requirements and application procedures.
- Developing supervisory guidelines to provide guidance to licencees 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 is expected to be published in H1 2016.

Public education program:

- A media briefing was held on 5 April 2016 to explain the new SVF regulatory regime and remind the public to stay vigilant in choosing retail payment products and services especially during the transitional period.
- The HKMA will continue to conduct 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 e-Cheque infrastructure have been smooth and robust, and the usage of e-Cheque has been steadily increasing
- The HKSAR Government also launched the "Pay e-Cheque" portal to facilitate the public to pay respective Government bills by e-Cheques
- Joint e-Cheque clearing between Hong Kong and Guangdong province is tentatively planned for launching in June 2016, which is the first step to expand the usage of e-Cheque in cross-boundary payments
- The HKMA continues to conduct consumer education campaigns to enhance the public awareness of e-Cheque

- The e-Cheque is an "end-to-end" electronic payment instrument. It is 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).
- 9 banks which offer e-Cheque issuance service include HSBC, Hang Seng, BoC(HK), Bank of East Asia, Wing Lung, Fubon, Chiyu, Nanyang Commercial Bank and Agricultural Bank of China. On the other hand, all banks are required to accept e-Cheque deposits.
- Government bills such as general demand notes, tax demand notes, business registration fees, tax reserve certificates, e-stamping payment notices, court fees, etc, can be paid by e-Cheque via the "Pay e-Cheque" portal. This portal will be extended to more Government bills in the future.
- Under the joint e-Cheque clearing between Hong Kong and Guangdong province, e-Cheques issued by banks in Hong Kong and deposited with banks in Guangdong province will be settled on T+1 basis.
- 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, video demos, posters and electronic brochures.



ROLE OF THE FINTECH FACILITATION OFFICE (FFO)

1. Clustering and outreaching platform

 The FFO will organise industry liaison events for fintech industry players and interested parties to exchange ideas and share information and insights about market development

2. Interface between the industry and the HKMA

 The FFO will help fintech stakeholders better understand the regulatory landscape for the banking and payment services in Hong Kong and respond to industry enquiries

3. Research and application (R&A) initiator

- "Cybersecurity Fortification Initiative": cyber risk and preparedness assessment, training programme and information sharing platform
- Other projects (e.g. research on blockchain technology)



ENHANCED COMPETENCY FRAMEWORK

- To develop the Enhanced Competency Framework (ECF) for attracting more talents to the banking industry and enhancing the professional competence of banking practitioners in Hong Kong
- Priority be given to the following areas:
 - (i) Anti-money laundering and counter-terrorist financing (AML/CFT)
 - (ii) Credit risk management
 - (iii) Cybersecurity
 - (iv) Risk management, compliance and internal controls
 - (v) Retail wealth management
 - (vi) Treasury management

- In order to support talent development and enhance the professional competence of banking practitioners, the HKMA is developing the Enhanced Competency Framework (ECF) for major functional areas which are central to the safety and soundness of banks, and where manpower and skill shortages are more apparent. This initiative can in turn contribute to the continuous growth of the industry and banking stability.
- Six ECF areas will be developed over the next few years. Taking into account views
 from the industry and demand for talents in the respective areas, the first ECF to be
 developed will be AML/CFT, which will be followed by cybersecurity. The remaining ECF
 areas will be developed in the coming years with priority subject to further discussion
 with the industry.
- The consultation of ECF on AML/CFT was completed in Jan 2016 and the relevant programme is being developed. The development of the ECF on cybersecurity has also been embarked and industry consultation on the detailed arrangements will be held soon.



CONSUMER EDUCATION PROGRAMME

- Promoted security tips on conducting P2P small-value funds transfer via smartphone apps and other internet banking services
- Co-organised the Hong Kong Liberal Studies Financial Literacy Championship to enhance the financial literacy of secondary school students for the second consecutive year
- Broadcast smart tips on using various banking services on radio



- The HKMA launched a thematic campaign on Security Tips on Using Internet Banking Services. A comic was deployed to explain the security tips on making P2P small-value funds transfer via smartphone apps. It was published in newspapers and further promoted on the internet through an animated version.
- Collaborated with various stakeholders, the HKMA co-organised the Hong Kong Liberal Studies Financial Literacy Championship for the second consecutive year. The campaign is an online quiz which aims at enhancing the financial literacy of secondary school students.
- Educational promotions were broadcast on radio to remind the public about smart and responsible use of credit cards, personal loans, internet and mobile banking services, as well as the need to stay vigilant against bogus calls purportedly from banks.



ENHANCEMENTS TO DEPOSIT PROTECTION SCHEME

- Deposit Protection Scheme (Amendment) Bill 2015 enacted on 17 March 2016
- Enhanced the Deposit Protection Scheme with capability to complete payout arrangements to affected depositors within 7 days under most circumstances
- Continue to work with the banking industry to streamline the information submission requirements

- The Deposit Protection Scheme (Amendment) Bill 2015 seeks to adopt the "gross payout" approach to determine deposit compensation as opposed to the "net payout" approach so as to achieve faster payouts. The Bill was enacted on 17 March 2016 and the Deposit Protection Scheme (Amendment) Ordinance 2016 was gazetted on 24 March 2016 and came into effect.
- With the implementation of the enhancements, the Deposit Protection Scheme (DPS) is ready to enable a speedier payout in case the DPS is triggered, which would allow affected depositors to get access to their deposits within 7 days under most circumstances.
- A more effective DPS contributes to a more robust financial safety net in line with global reform trends.
- The Hong Kong Deposit Protection Board will continue to work with the banking industry to streamline the information submission requirements and refine the related compliance review programme as a result of adoption of the gross payout approach.



COIN COLLECTION PROGRAMME

 The Coin Collection Programme is a two year pilot scheme until September 2016. Since its launch in October 2014 until end of April 2016, 180,000 people had used the service. The HKMA had collected 154 million coins with total face value of HK\$174 million



GOVERNMENT BOND PROGRAMME

Institutional part

- 14 issues totalling HK\$74.5 billion were outstanding as at end April 2016
- Two Islamic bonds totalling US\$2 billion were outstanding as at end April 2016

Retail part

- The Government will later launch an iBond issue of up to HK\$10 billion with a maturity of three years following the existing practice
- The Government will launch a pilot scheme to issue Silver Bond targeting at Hong Kong residents aged 65 or above, with a maturity of three years for the first issue. The HKMA has commenced preparatory work. The Government will announce the details when the relevant works are completed 74



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
- The subsidiary legislation covering the rules for the first phase of mandatory clearing and related record keeping obligations as well as the product expansion for the mandatory reporting obligation was enacted by LegCo in February 2016. The rules for the first phase clearing and second phase reporting will commence on 1 September 2016 and 1 July 2017 respectively



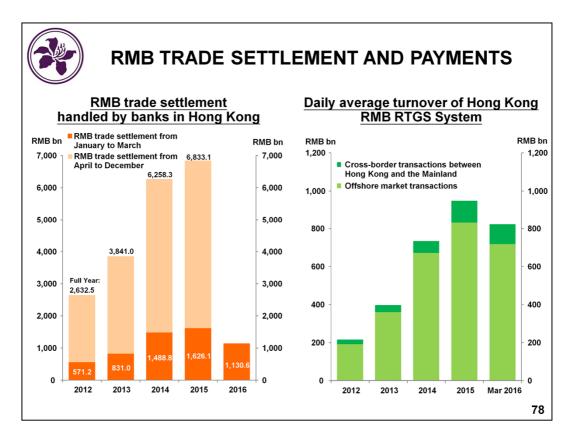
FINANCIAL BENCHMARK REFORM IN HONG KONG

- Having regard to local market conditions, Hong Kong has been reviewing the need and feasibility in reforming major interest rate and foreign exchange (FX) benchmarks along international recommendations promulgated to enhance the transparency and robustness of benchmarks that are widely used in the global financial market
- For FX benchmarks, the Treasury Markets Association (TMA)
 has announced that USD/HKD and USD/CNY(HK) Spot
 Rates will adopt a transaction-based determination
 mechanism with effect from 1 August 2016. The HKMA will
 continue to facilitate the reform
- For interest rate benchmarks, the HKMA is analysing relevant transaction data to study reform feasibility, and will work with the industry to consult stakeholders on the proposed way forward

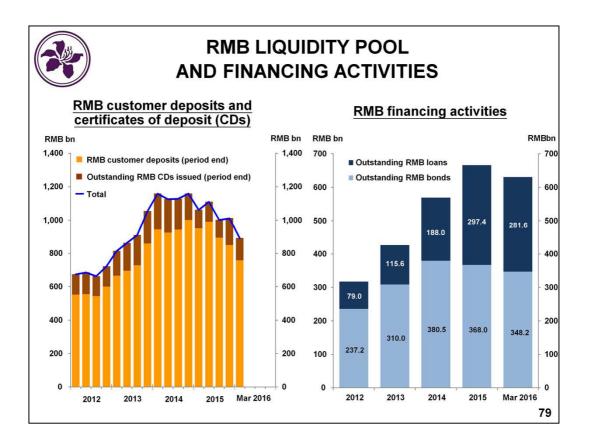
- Financial benchmarks, especially the interest rate (commonly referred to as the "Interbank Offered Rates (IBORs)") and FX benchmarks, are referred to in many financial contracts. Their robustness is crucial to the proper functioning of the financial market. In view of the London Interbank Offered Rate (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 International Organization of Securities Commissions (IOSCO) promulgated a set of principles, containing an overarching framework of recommended practices for financial benchmarks in general. The Financial Stability Board (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.
- The HKMA has been working with the administrator of Hong Kong's financial benchmarks, the TMA, to reform the Hong Kong Interbank Offered Rates (HIBOR), as well as the USD/HKD and USD/CNY(HK) Spot 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



- In the first three months of 2016, RMB trade settlement handled by banks in Hong Kong amounted to RMB1,130.6 billion, down 30% compared with the same period in 2015.
- In March 2016, the daily average turnover of the RMB Real Time Gross Settlement (RTGS) system in Hong Kong came down to RMB820.9 billion.



- At end March 2016, RMB customer deposits and outstanding RMB CDs amounted to RMB759.4 billion and RMB129.0 billion respectively, totalling RMB888.4 billion, down about 12% since the end of 2015. Nevertheless, liquidity management of Hong Kong banks remains robust and the offshore RMB market in Hong Kong continues to function in an orderly manner. The current liquidity pool is sizeable enough to support a large amount of RMB financial intermediation activities and payments.
- At end March 2016, outstanding dim sum bonds amounted to RMB348.2 billion and outstanding amount of RMB loans was RMB281.6 billion, both down around 5% compared with their end-2015 positions. In the first three months of 2016, dim sum bond issuance totalled RMB4.3 billion.



MAINTAINING RMB BUSINESS LINKS WITH OTHER JURISDICTIONS

	Mar 2016	2015	2014	2013
No. of participating banks of Hong Kong's RMB clearing platform	211	217	225	216
Of which: Branches and subsidiaries of overseas banks and overseas presence of Mainland banks	186	192	200	191
Amount due to overseas banks (RMB billion)	102.3	105.7	145.2	166.0
Amount due from overseas banks (RMB billion)	137.7	132.1	193.3	164.5

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• To promote Hong Kong's competitive edge as the global offshore RMB business hub and the hub for corporate treasury centres, the HKMA hosted a thematic session on RMB Internationalisation and Corporate Treasury at the Asian Financial Forum in January 2016, which attracted some 600 attendees from local and overseas corporations and financial institutions. Meanwhile, the HKMA maintained ongoing dialogues with other offshore RMB centres and continued to strengthen our marketing efforts through active participation in industry events to promote Hong Kong's RMB business platform.



- 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 the 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%
- The relevant Bills Committee has completed the scrutiny of the Bill. The HKMA will continue to work closely with the Government with a view to securing passage of the Bill 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 81
- 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 global offshore renminbi business hub, 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 200 corporations, financial institutions and industry associations as of March 2016.

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 April 2016

- 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 1,135 at end-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\$121 billion as of Q1 2016.
 - 2. About 50% of RMB Qualified Foreign Institutional Investor managers and 60% of Qualified Foreign Institutional Investor managers, as well as close to 80% of Mainland fund management and securities firms with Qualified Domestic Institutional Investor licence have a presence in Hong Kong as of March 2016.
 - 3. Hong Kong is also the largest hub for hedge funds in Asia, with the number of funds increased from 676 in 2012 to 778 as of 30 September 2014.



DEVELOPMENT OF ISLAMIC FINANCE

- Following the success of the two sukuk issuances in the past two years, the Government will look for opportunities to launch the third sukuk when market conditions are conducive
- The HKMA is developing a detailed issuance plan having regard to market conditions
- The HKMA will also continue to share its previous sukuk issuance experience with enterprises which have funding needs

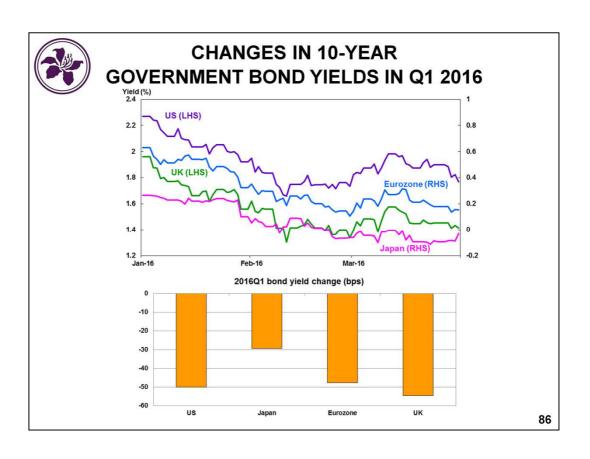


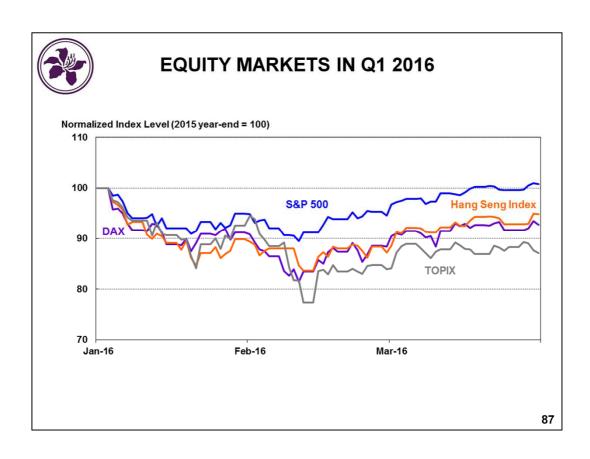
INVESTMENT ENVIRONMENT AND PERFORMANCE OF THE EXCHANGE FUND

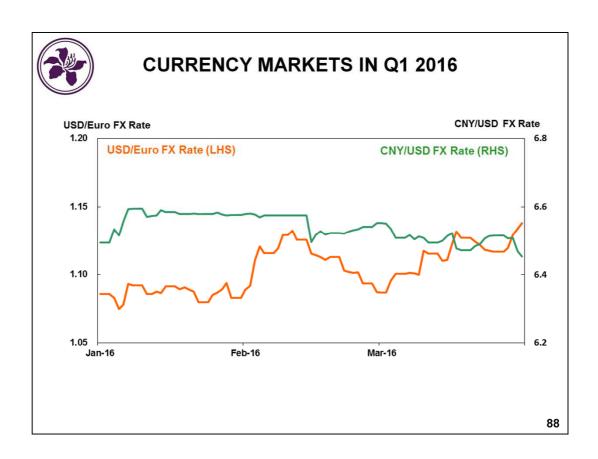


INVESTMENT ENVIRONMENT IN Q1 2016

- Interest rates: Major 10-Year government bond yields fell in Q1 2016, a result of major central banks' negative interest rate policies and safe haven demand arising from concerns about global growth slowdown and disinflation exacerbated by a further drop in commodity prices
- Equity markets: Major equity markets rebounded with recovering investors' risk appetite, after sharp dips in early 2016, supported by accommodative central bank policies, stabilising commodity prices and a steadier renminbi exchange rates
- Exchange rates: The US dollar softened in Q1 2016, as the Federal Reserve's accommodative policy stance pushed back market expectations of widening interest rate gaps between the US and other developed market economies









INVESTMENT INCOME

	2016	2015	2014
	(unaudited)		
(HK\$ billion)	Q1	Full Year	Full Year
Hong Kong equities*		(5.0)	6.5
Other equities		7.1	33.7
Bonds		15.9	47.3
Other investments@		11.1	9.9
Foreign exchange#		(44.9)	(52.7)
Investment income/(loss)		(15.8)	44.7

^{*} Excluding valuation change of the Strategic Portfolio

Including valuation changes of private equity and real estate investments held under the Long-Term Growth Portfolio (LTGP).

[#] 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

	2016 (unaudited)	2015	2014	
(HK\$ billion)	Q1	Full Year	Full Year	
Investment income/(loss)		(15.8)	44.7	
Other income		0.2	0.2	
Interest and other expenses		(4.8)	_(5.2)	
Net income/(loss)		(20.4)	39.7	
Fee payment to Fiscal Reserves*		(46.7)	(27.5)	
Fee payment to HKSAR government funds and statutory bodies*		(14.7)	(8.6)	

 $^{^{\}ast}~$ The annual fixed rate is 5.5% for 2015 and 3.6% for 2014.



EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)	31 Mar 2016 (Unaudited)	31 Dec 2015	31 Dec 2014
ASSETS	• • • • • • • • • • • • • • • • • • • •		
Deposits		290.5	315.6
Debt securities		2,462.0	2,146.3
Hong Kong equities*		148.2	156.8
Other equities		392.4	416.3
Other assets#		129.8	114.0
Total assets		3,422.9 =====	3,149.0 =====
LIABILITIES AND FUND EQUITY			
Certificates of Indebtedness		357.9	340.2
Government-issued currency notes & coins in circulation		11.3	11.0
Balance of the banking system		391.3	239.2
Exchange Fund Bills and Notes issued		827.8	752.4
Placements by banks and other financial institutions		66.9	64.0
Placements by Fiscal Reserves		833.5	788.7
Placements by HKSAR government funds and statutory bodies		280.9	261.1
Other liabilities		108.4	56.9
Total liabilities		2,878.0	2,513.5
Accumulated Surplus		544.9	635.5
Total liabilities and fund equity		3,422.9 =====	3,149.0 =====

^{*} Including shares of the Hong Kong Exchanges and Clearing Limited in the Strategic Portfolio.

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



HISTORICAL INVESTMENT INCOME

′ (HK\$ billion)					
Year	Full Year	Q4	Q3	Q2	Q1
2001	7.4	13.6	10.4	(2.0)	(14.6)
2002	47.0	26.3	(2.1)	26.5	(3.7)
2003	89.7	33.5	8.4	41.1	6.7
2004	56.7	33.0	14.1	(7.2)	16.8
2005	37.8	7.3	19.0	13.6	(2.1)
2006	103.8	36.0	37.1	12.5	18.2
2007*	142.2	33.4	61.8	26.3	20.7
2008*	(75.0)	8.3	(48.3)	(20.4)	(14.6)
2009*#	107.7	10.6	71.9	58.7	(33.5)
2010*#	79.4	5.9	74.5	(12.1)	11.1
2011*#	27.1	22.1	(41.4)	21.6	24.8
2012*#	111.6	30.3	42.4	(5.6)	44.5
2013*#	81.2	30.7	54.7	(23.3)	19.1
2014*#	44.7	6.1	(17.8)	43.3	13.1
2015*#	(15.8)	21.0	(63.8)	18.7	8.3
2016* (unaudited)	N/A	N/A	N/A	N/A	

Excluding valuation change of the Strategic Portfolio Including valuation changes of private equity and real estate investments held under the LTGP



HONG KONG MORTGAGE CORPORATION



MORTGAGE INSURANCE PROGRAMME (MIP)

- Since the launch in March 1999, the MIP has helped over 118,200 families attain home ownership
- In the first three months of 2016, the total drawdown amount under the MIP was HK\$3.5 billion and the average loan size was HK\$3.44 million
- About 69% of drawn down loans were for secondary market properties



REVERSE MORTGAGE PROGRAMME

- As at end of March 2016, 1,211 applications have been received:
 - Average age of borrowers: 69 years old
 - Average monthly payout: HK\$15,100
 - Payment terms: 10-year (29%), 15-year (16%), 20-year (13%), life (42%)
 - Average property value: HK\$5.2 million
 - Average property age: 30 years



SME FINANCING GUARANTEE SCHEME (SFGS)

- To take timely and appropriate measures to stimulate the economy, support local enterprises and safeguard employment, the Financial Secretary announced in the 2016-17 Budget Speech the extension of application period for the 80% loan guarantee product until 28 February 2017
- The 80% loan guarantee product has been well received by the market. As at end of March 2016, 10,838 applications were approved, involving a total loan amount of around HK\$43.7 billion. Key data of the approved applications are as follows:

Average guarantee period	4.7 years
Proportion of application from manufacturing and non-manufacturing industries	24% and 76% (in terms of no. of applications approved)
Enterprises with less than 50 employees	91%

Average loan size	HK\$4.03 million
Average loan interest rate and average guarantee fee rate	4.83% p.a. 0.54% p.a.
Benefitted enterprises and the related no. of employees	6,810 enterprises and 175,131 employees

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

Manufactu	ıring sector –	24.1%
_	Textiles and clothing	4.7%
_	Electronics	2.2%
_	Plastics	1.9%
_	Printing and publishing	1.7%
Non-manu	ıfacturing sector –	75.9%
_	Trading	46.1%
_	Wholesales and retail	8.7%
_	Engineering	2.9%
_	Construction	2.8%



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 March 2016, the Scheme received 366 formal loan applications. Out of the vetted applications, 168 have been approved with the total loan amount of HK\$42 million. The approval rate is around 49%
- For the approved applications, the average loan size was about HK\$250,000 and the average loan tenor was 4.6 years

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Industry types for the approved start-up loans and self-employment loans (excluding 2 self-enhancement loans):

Retailing 68 cases (41%)
 Servicing 61 cases (37%)
 Wholesales 20 cases (12%)
 IT related 9 cases (5%)
 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
- As at end of March 2016, over 1,700 enquiries and 4 applications have been received