



HONG KONG MONETARY AUTHORITY

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

2 November 2015



DISCUSSION TOPICS

Updates on

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



FINANCIAL AND ECONOMIC ENVIRONMENT



GLOBAL ECONOMIC GROWTH FORECASTS

Real GDP Growth

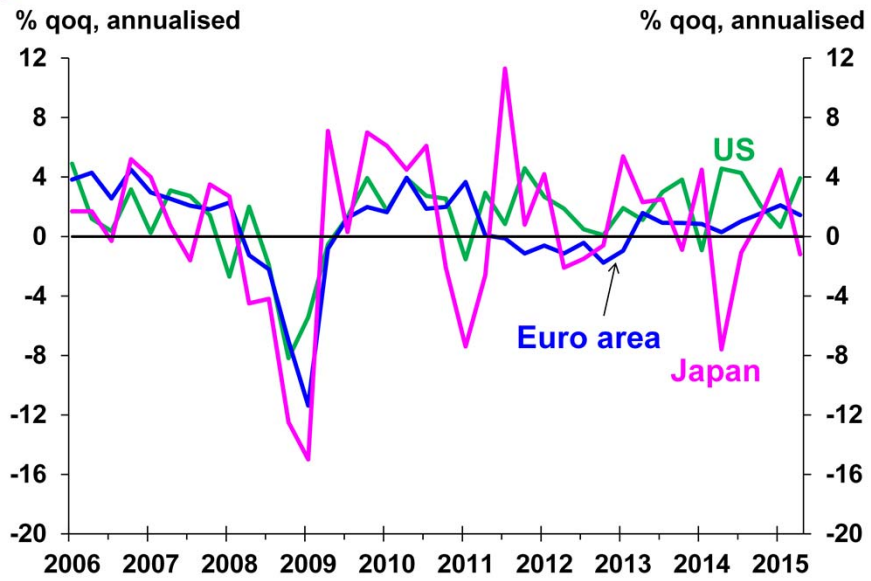
(% year-on-year)

	2014	2015 Forecasts	2016 Forecasts
US	2.4	2.5	2.6
Euro area	0.9	1.5	1.7
Japan	-0.1	0.6	1.3
Asia (ex-Japan)	6.2	5.8	5.7
Mainland China	7.3	6.8	6.5
Hong Kong	2.5	2.3	2.2

Sources: October Consensus Forecasts and Official Statistics



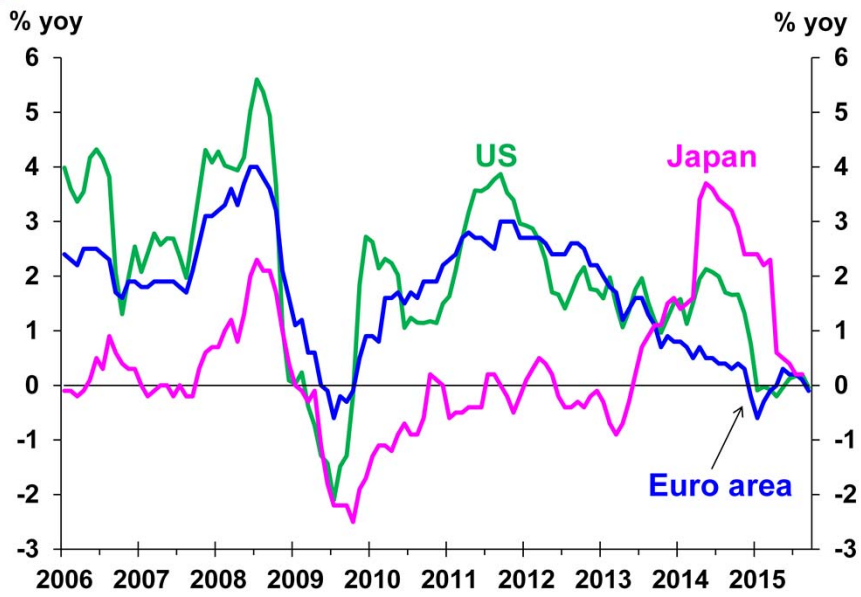
REAL GDP GROWTH IN MAJOR COUNTRIES



Source: Bloomberg



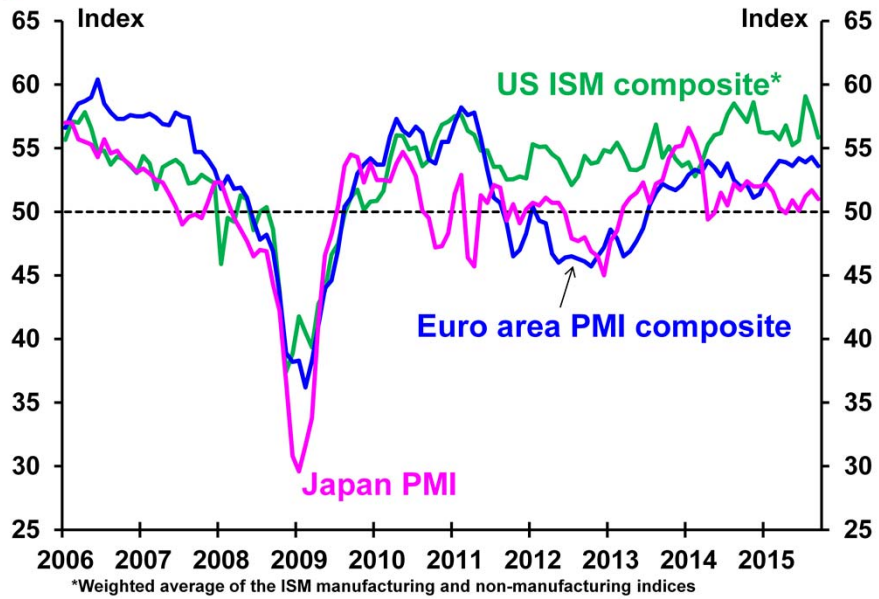
HEADLINE INFLATION IN MAJOR COUNTRIES



Sources: Bloomberg and CEIC



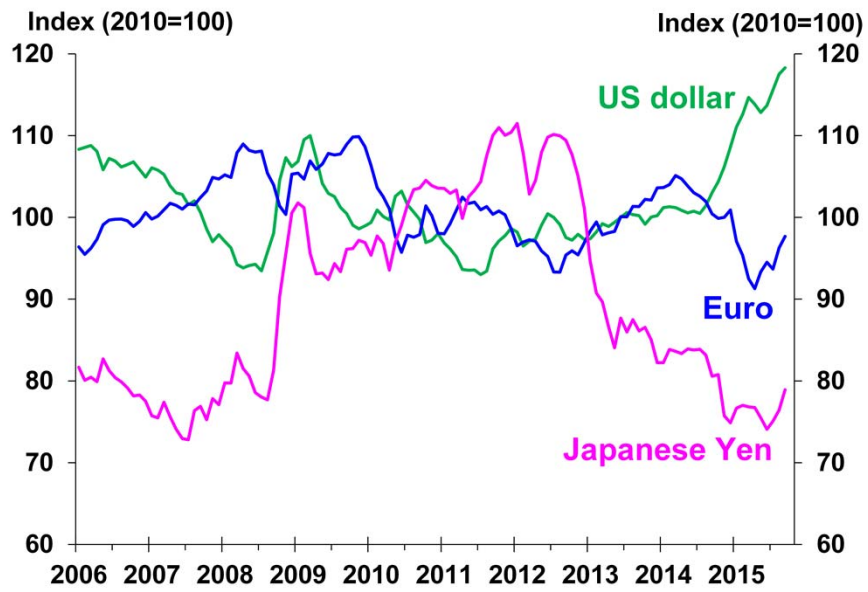
PURCHASING MANAGERS' INDEX IN MAJOR ECONOMIES



Sources: Bloomberg and CEIC



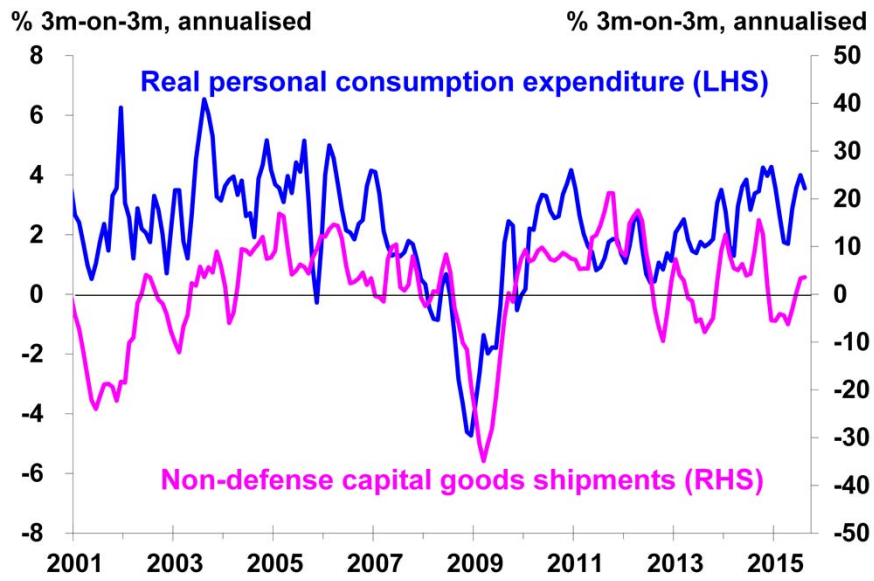
NOMINAL EFFECTIVE EXCHANGE RATE INDEX OF MAJOR CURRENCIES



Source: CEIC



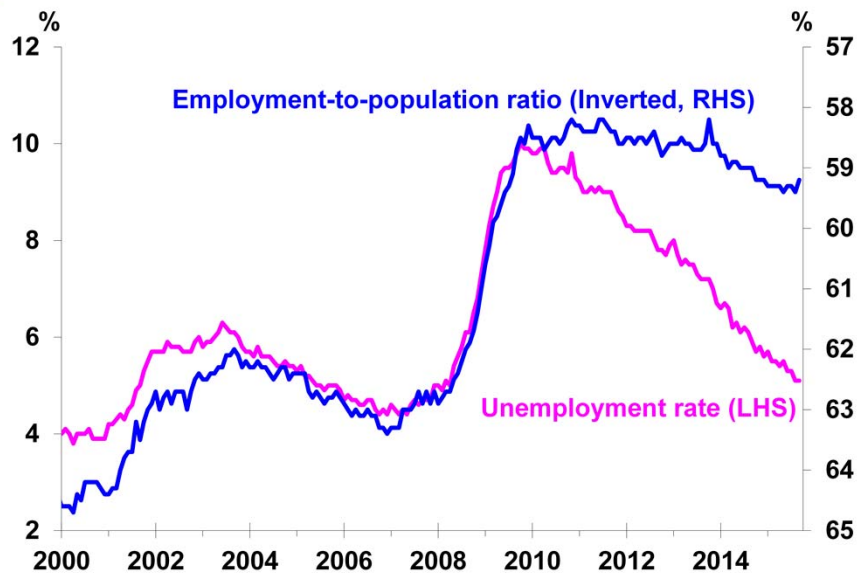
US: CONSUMPTION GROWTH & BUSINESS INVESTMENT ACTIVITY



Source: CEIC



US: LABOUR MARKET SITUATION



Source: CEIC



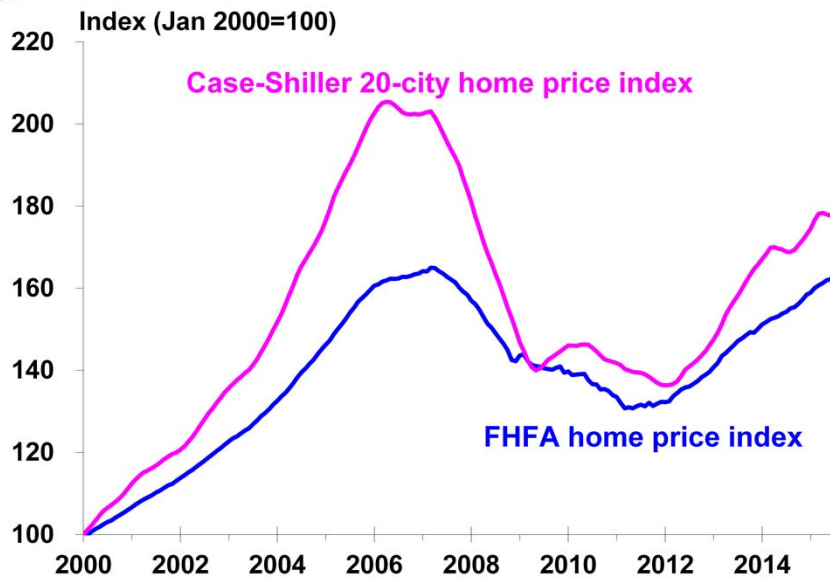
US: LABOUR FORCE PARTICIPATION



Source: CEIC



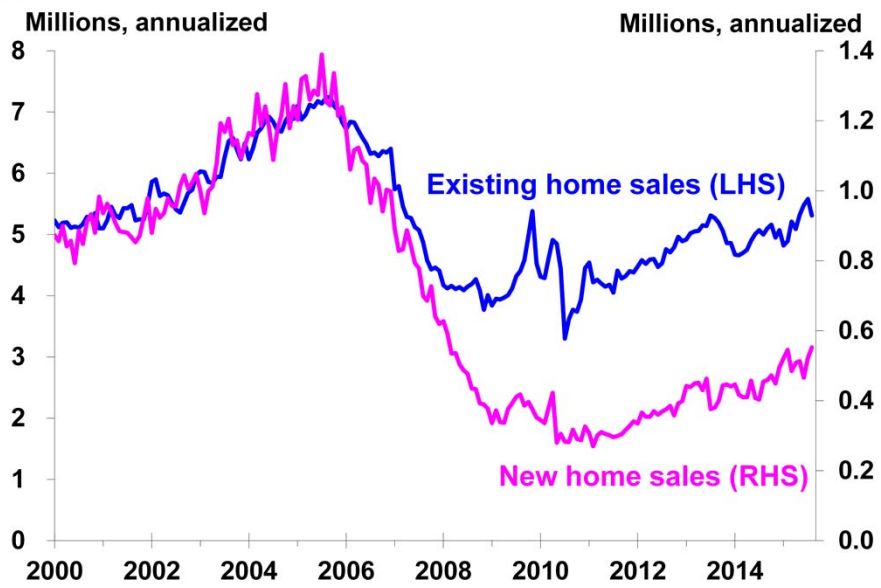
US: HOUSE PRICES



Sources: Standard & Poor's and CEIC



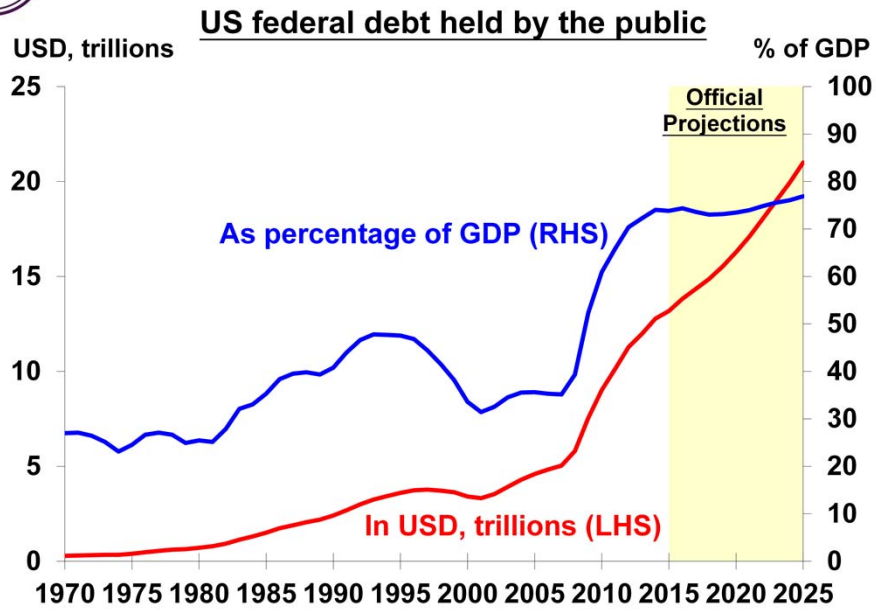
US: HOME SALES



Source: CEIC



US: FEDERAL GOVERNMENT DEBT

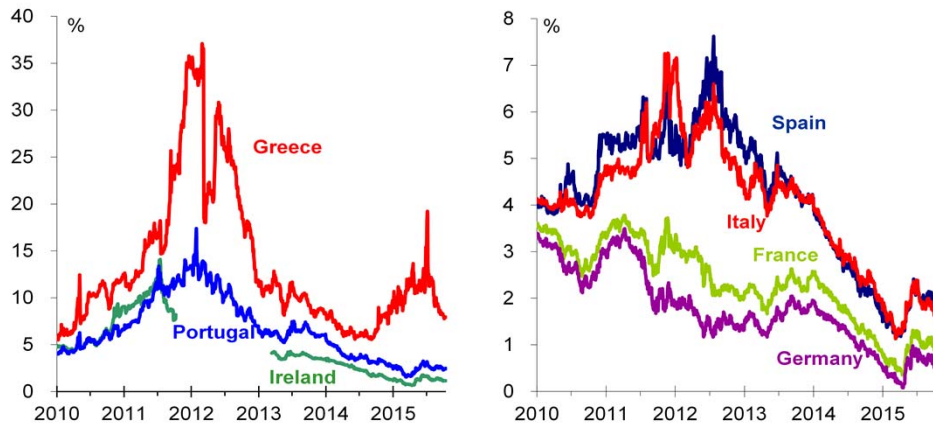


Source: Congressional Budget Office



EURO AREA: SOVEREIGN BOND YIELDS

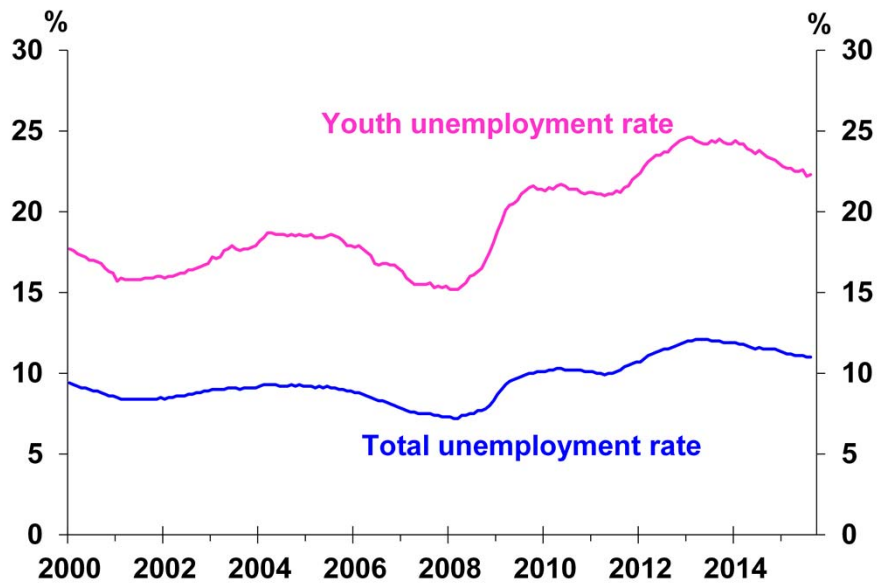
10-year sovereign bond yield



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



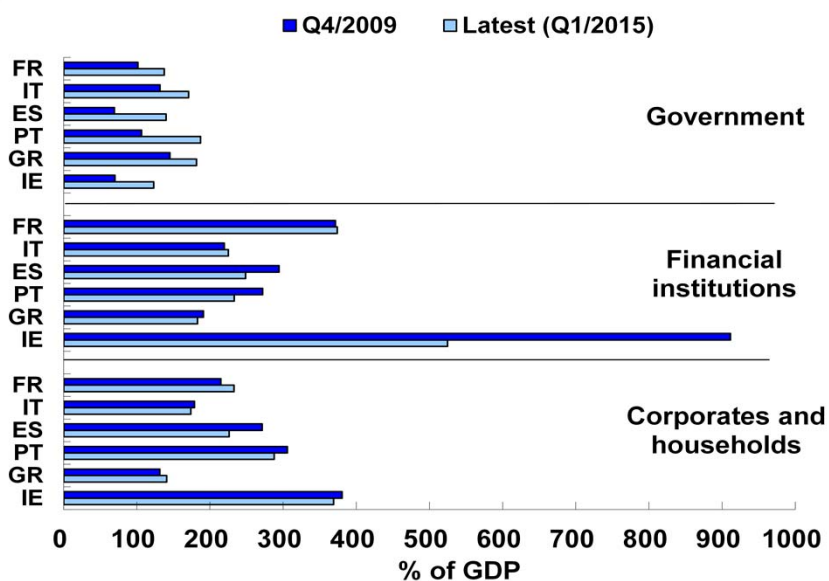
EURO AREA: UNEMPLOYMENT RATE



Source: Bloomberg



EURO AREA: OVERALL INDEBTEDNESS

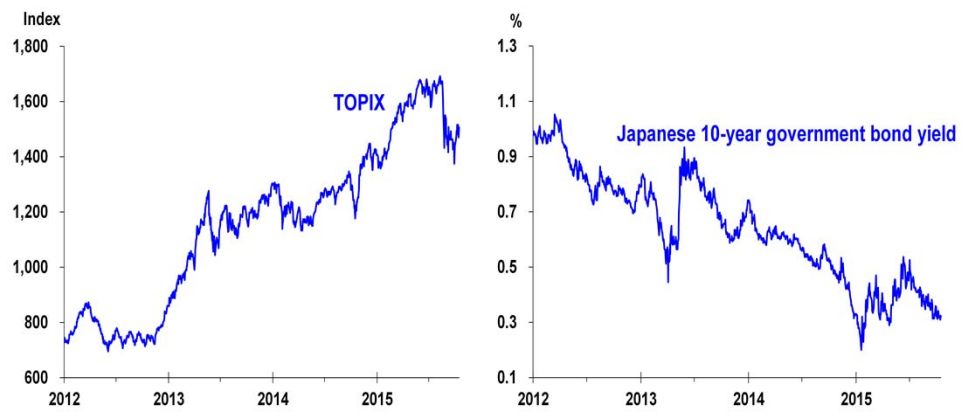


Source: European Central Bank

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



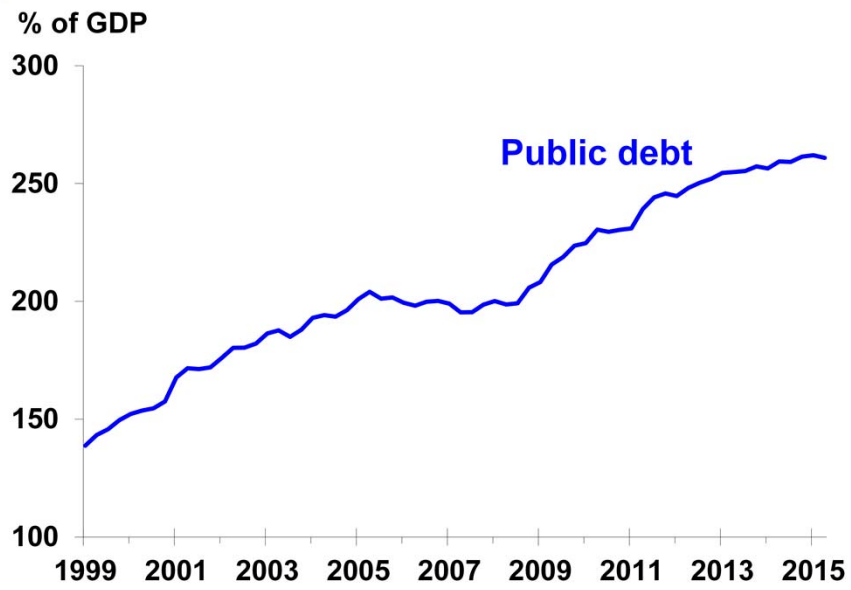
JAPAN: FINANCIAL MARKETS



Source: Bloomberg



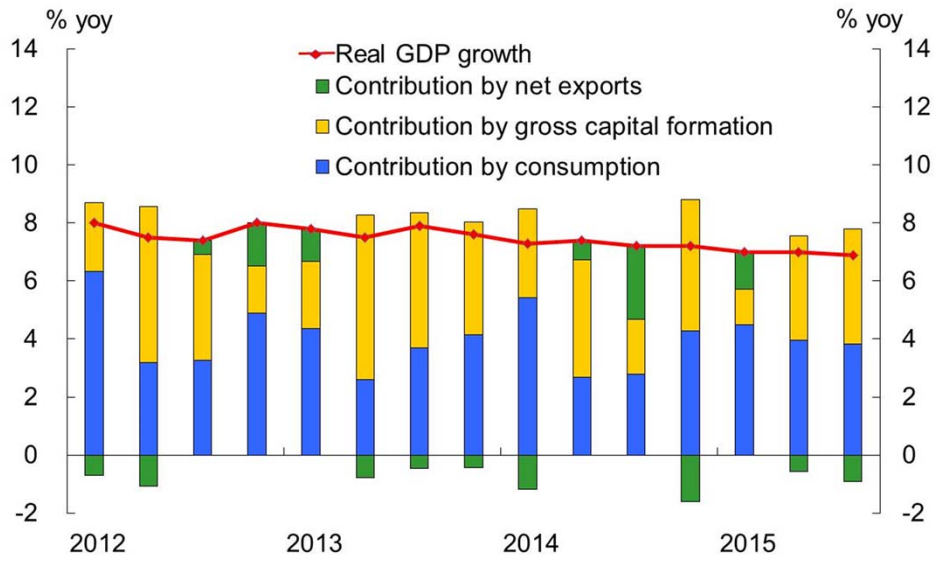
JAPAN: PUBLIC DEBT



Sources: Bank of Japan and CEIC



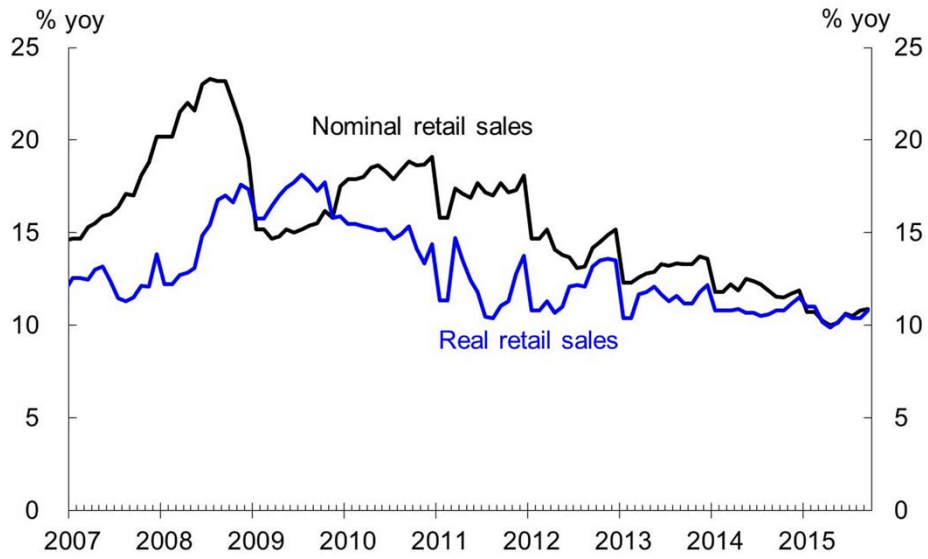
MAINLAND CHINA: REAL GDP GROWTH



Source: CEIC



MAINLAND CHINA: RETAIL SALES

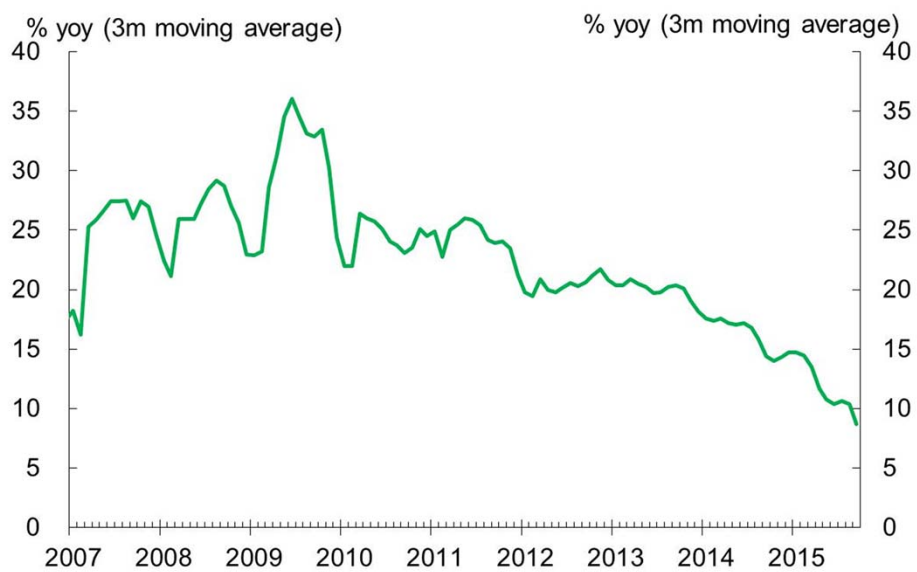


* January and February figures are the average growth rate for the first two months of the year.

Sources: WIND and HKMA staff estimates



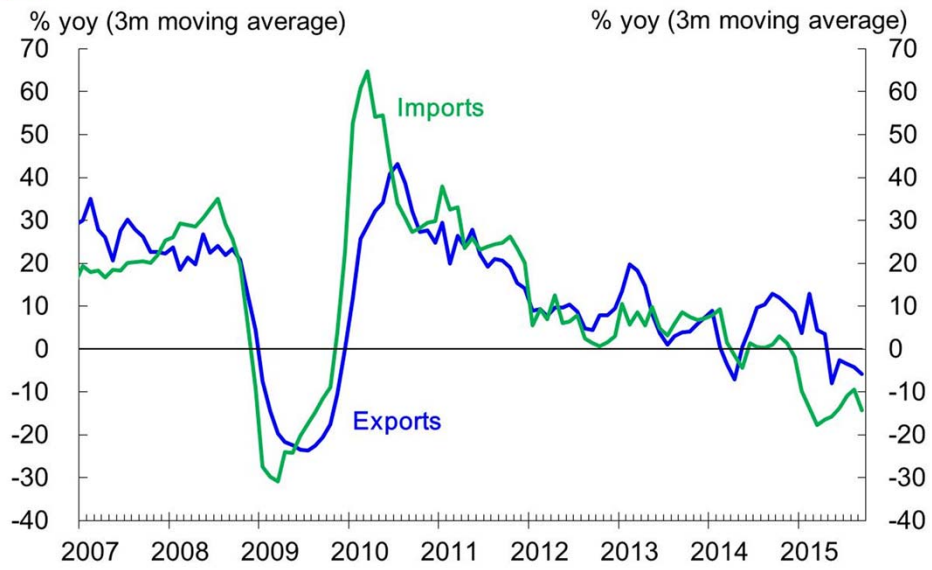
MAINLAND CHINA: FIXED ASSET INVESTMENT



Sources: CEIC and HKMA staff estimates



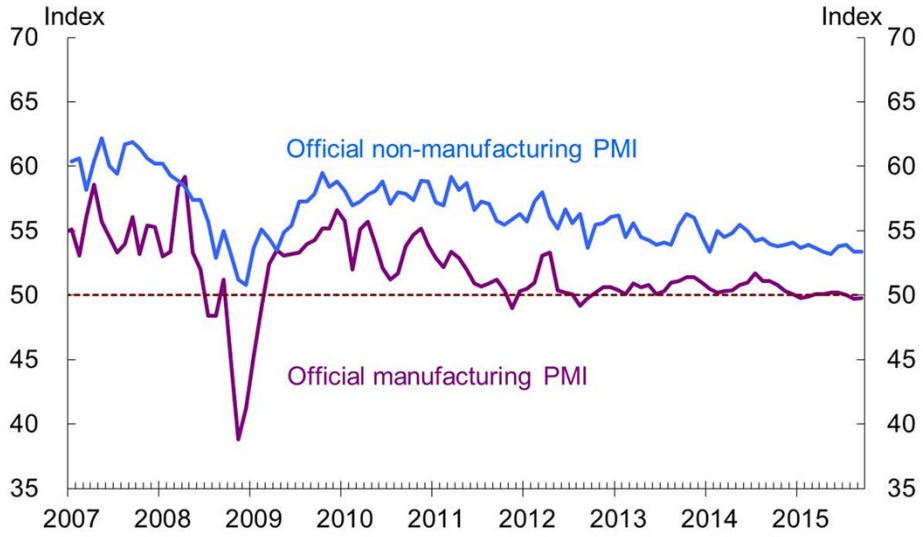
MAINLAND CHINA: IMPORT AND EXPORT GROWTH



Sources: CEIC and HKMA staff estimates



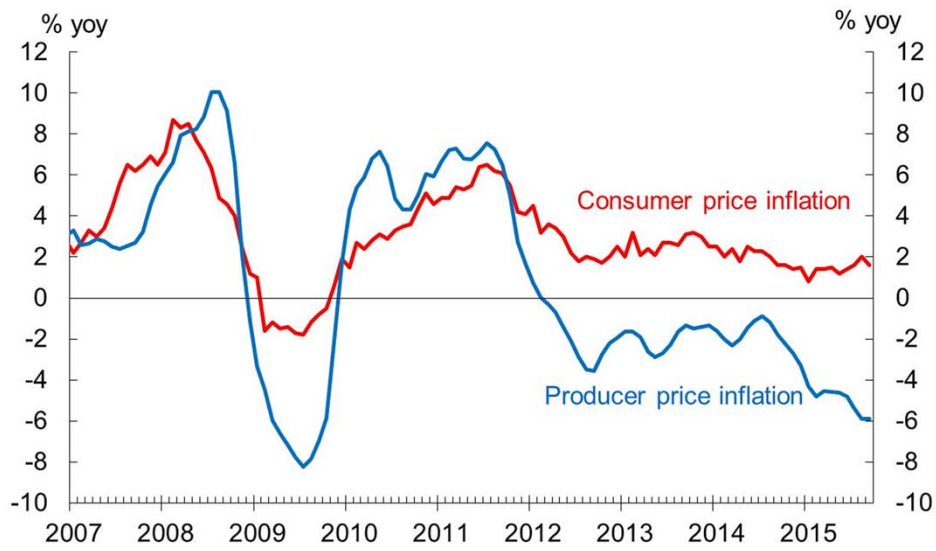
MAINLAND CHINA: PURCHASING MANAGERS' INDEX



Source: CEIC



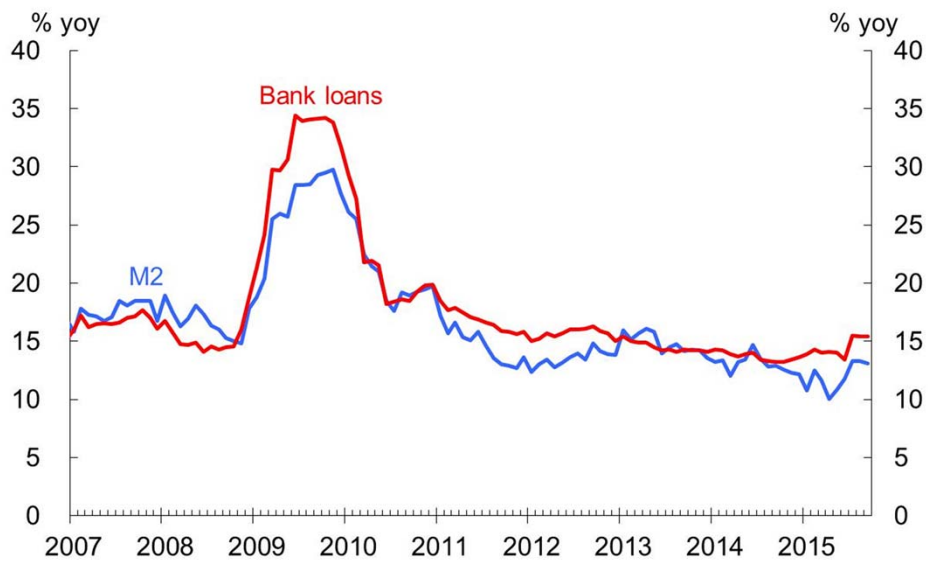
MAINLAND CHINA: INFLATION



Source: CEIC



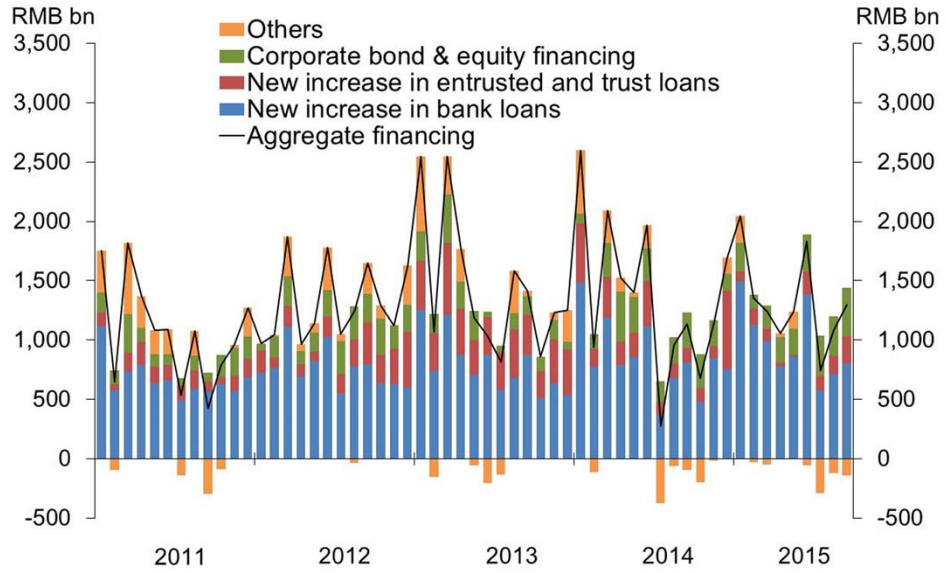
MAINLAND CHINA: MONEY AND LOAN GROWTH



Source: CEIC



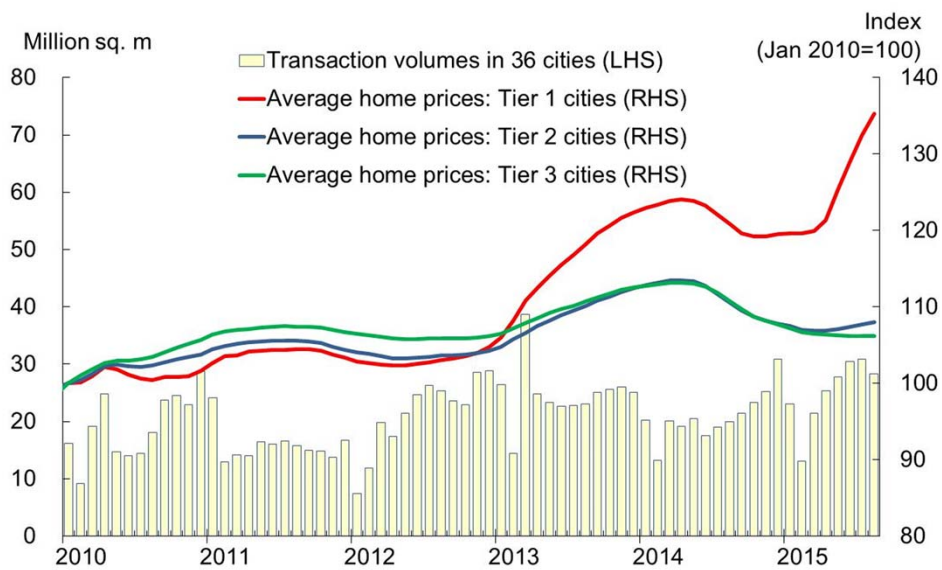
MAINLAND CHINA: AGGREGATE FINANCING FLOW



Source: CEIC



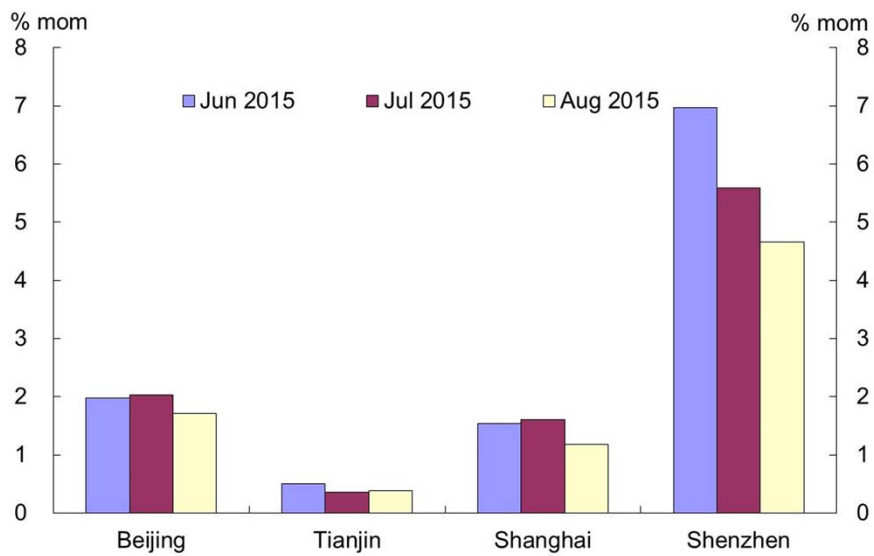
MAINLAND CHINA: PROPERTY PRICE AND TRANSACTION VOLUME



Sources: CEIC, WIND and HKMA staff estimates



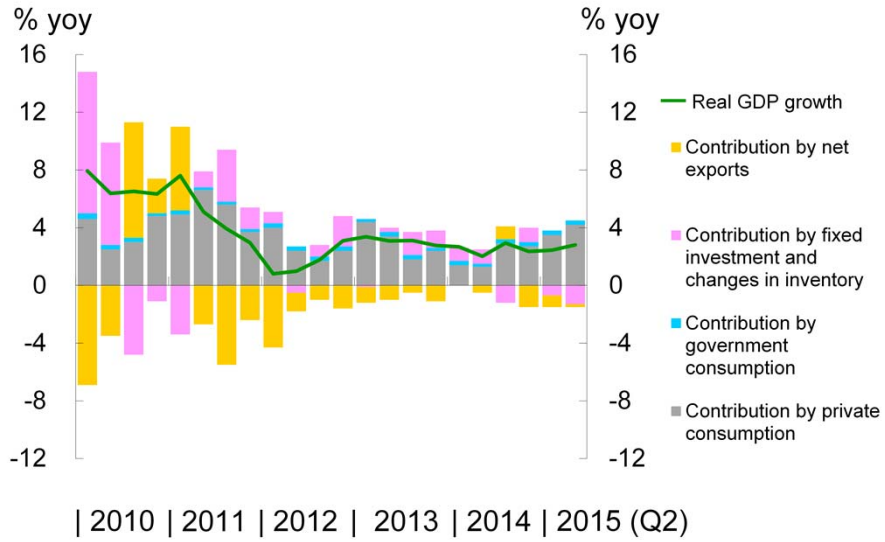
MAINLAND CHINA: HOUSING PRICE CHANGES IN MAJOR CITIES



Sources: CEIC, WIND and HKMA staff estimates



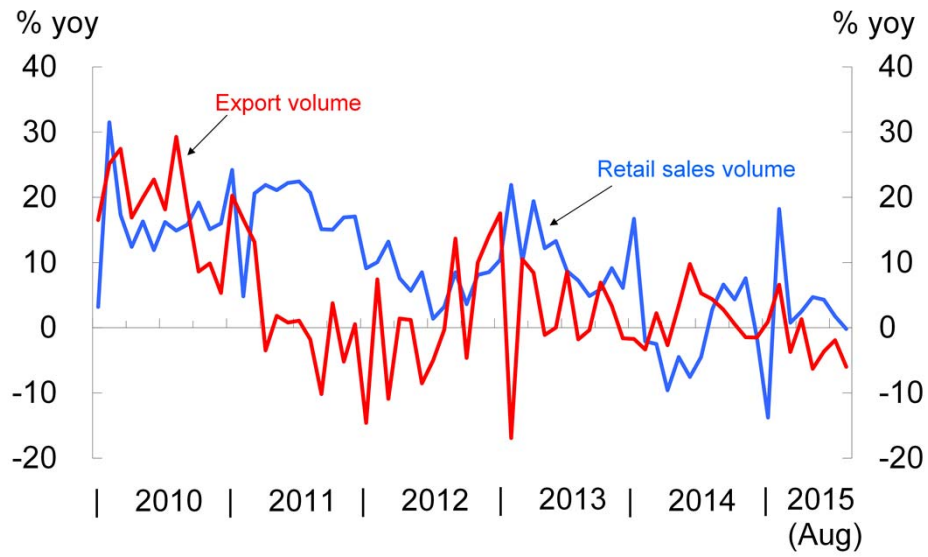
HONG KONG: REAL GDP GROWTH



Source: C&SD



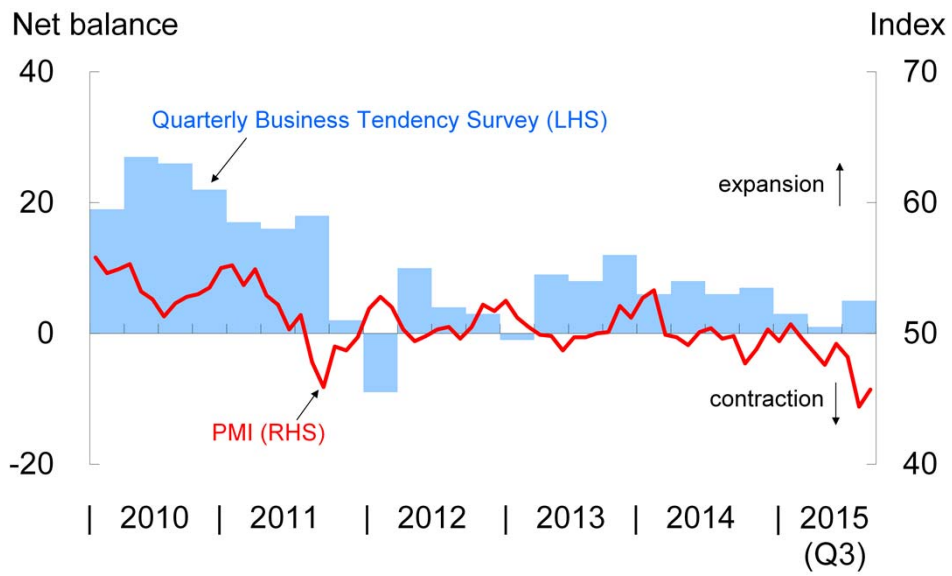
HONG KONG: ECONOMIC ACTIVITY



Source: C&SD



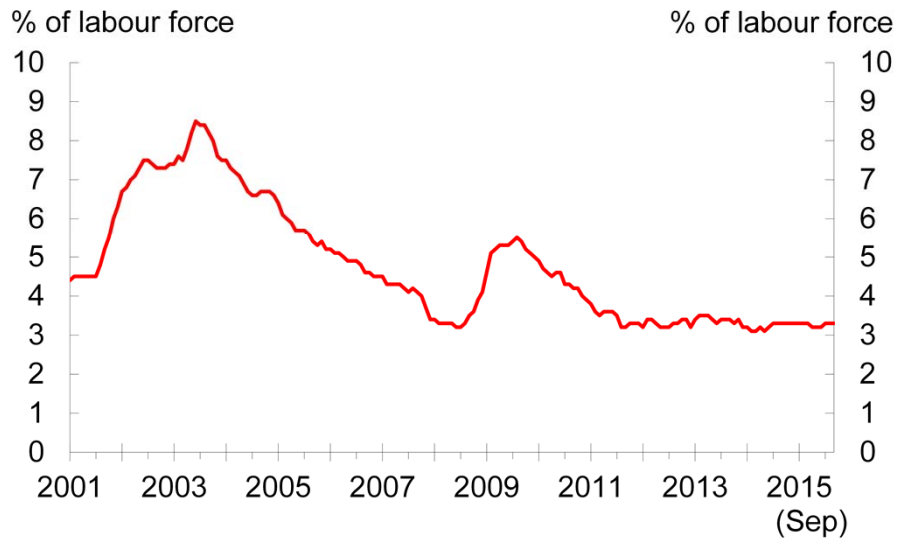
HONG KONG: BUSINESS OUTLOOK



Sources: C&SD and Markit Economics



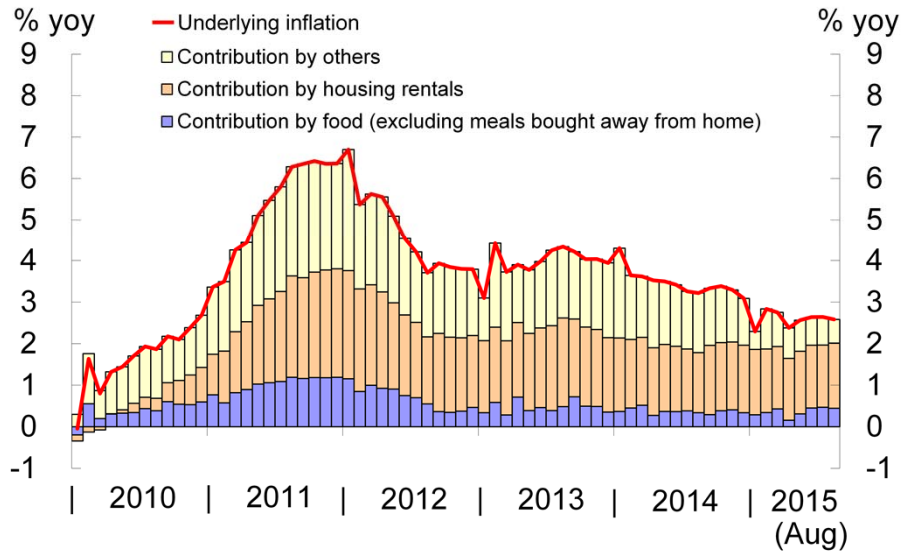
HONG KONG: UNEMPLOYMENT RATE



Source: C&SD



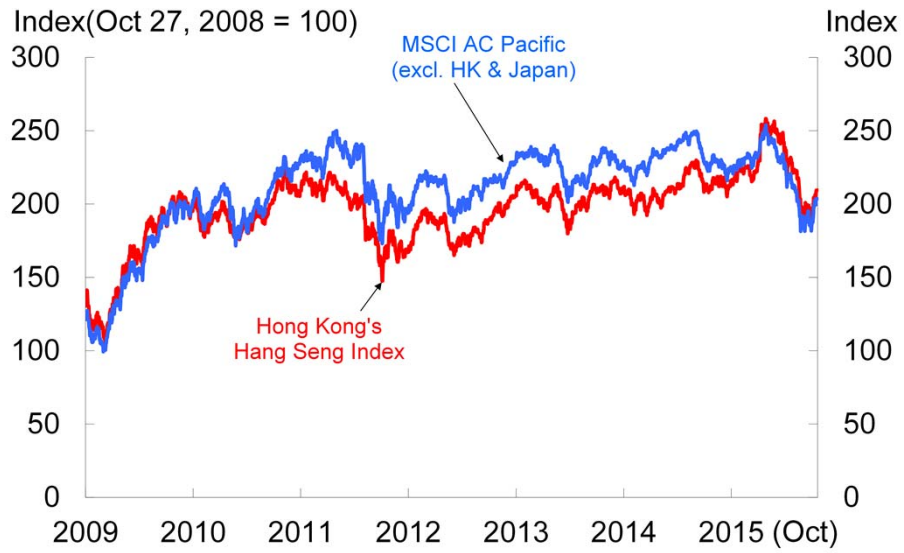
HONG KONG: INFLATION



Sources: C&SD and HKMA staff estimates



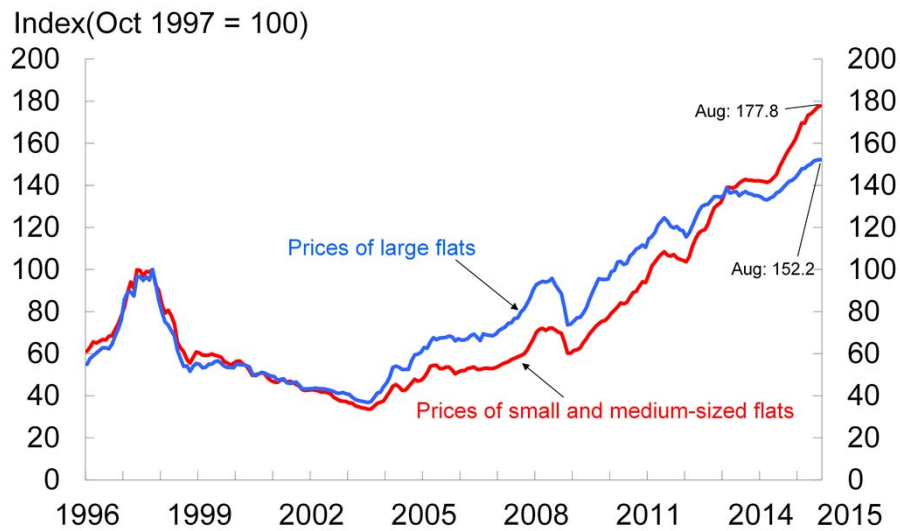
HONG KONG: EQUITY MARKET



Source: Bloomberg



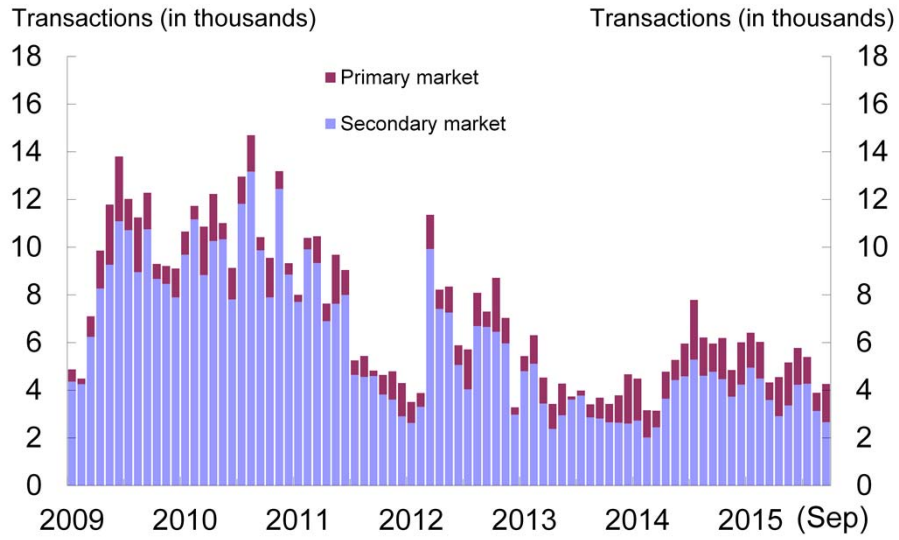
HONG KONG: RESIDENTIAL PROPERTY PRICES



Source: Rating and Valuation Department



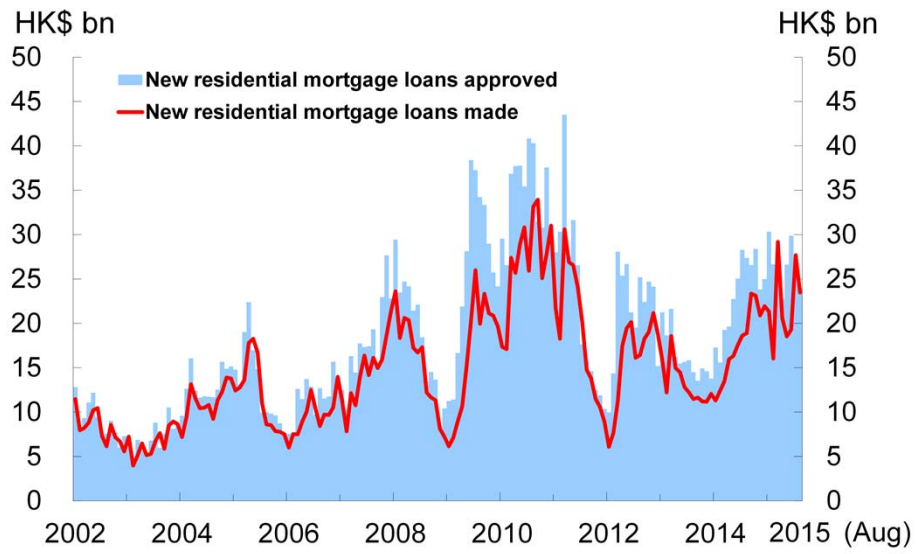
HONG KONG: TRANSACTION VOLUME IN THE PRIMARY AND SECONDARY MARKETS



•Source: The Land Registry



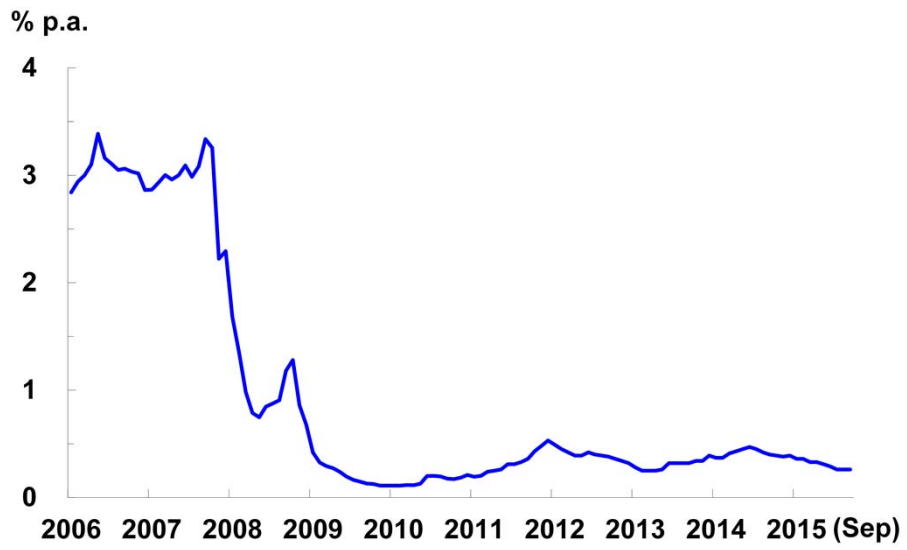
HONG KONG: NEW RESIDENTIAL MORTGAGE LOANS



Source: HKMA



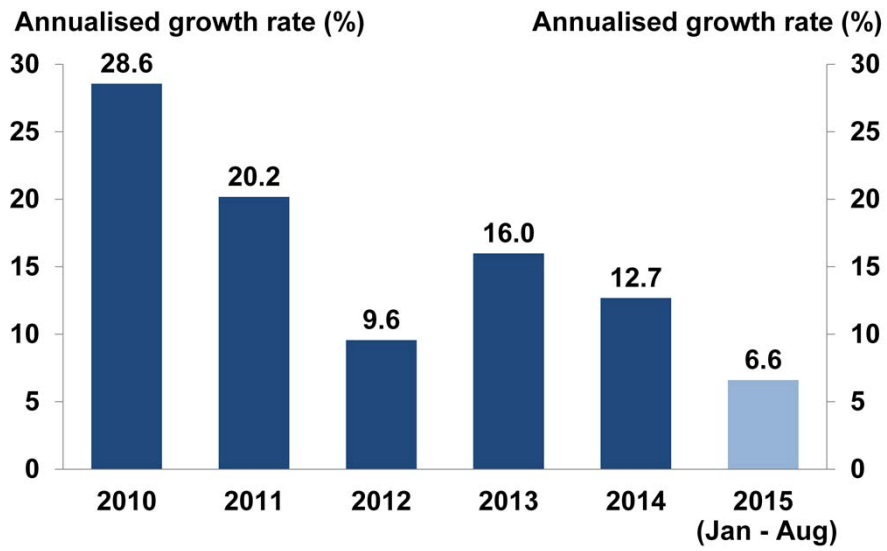
HONG KONG: COMPOSITE INTEREST RATE



Source: HKMA



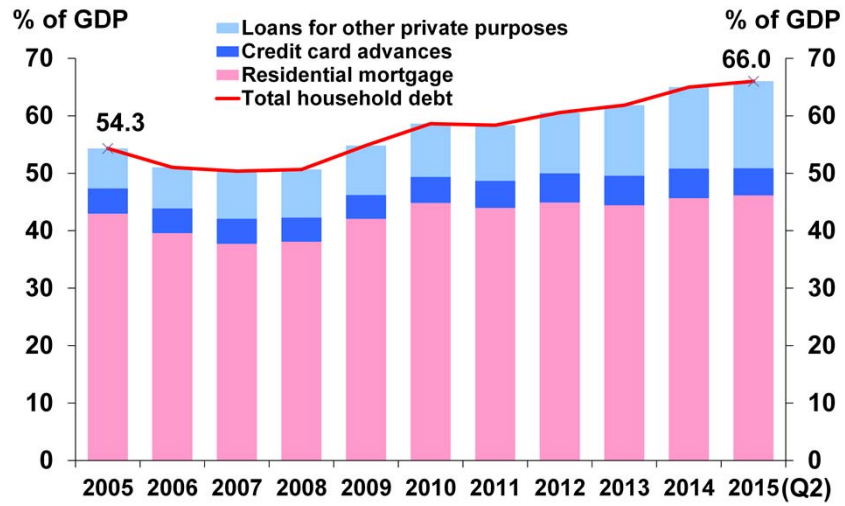
HONG KONG: LOAN GROWTH



Source: HKMA



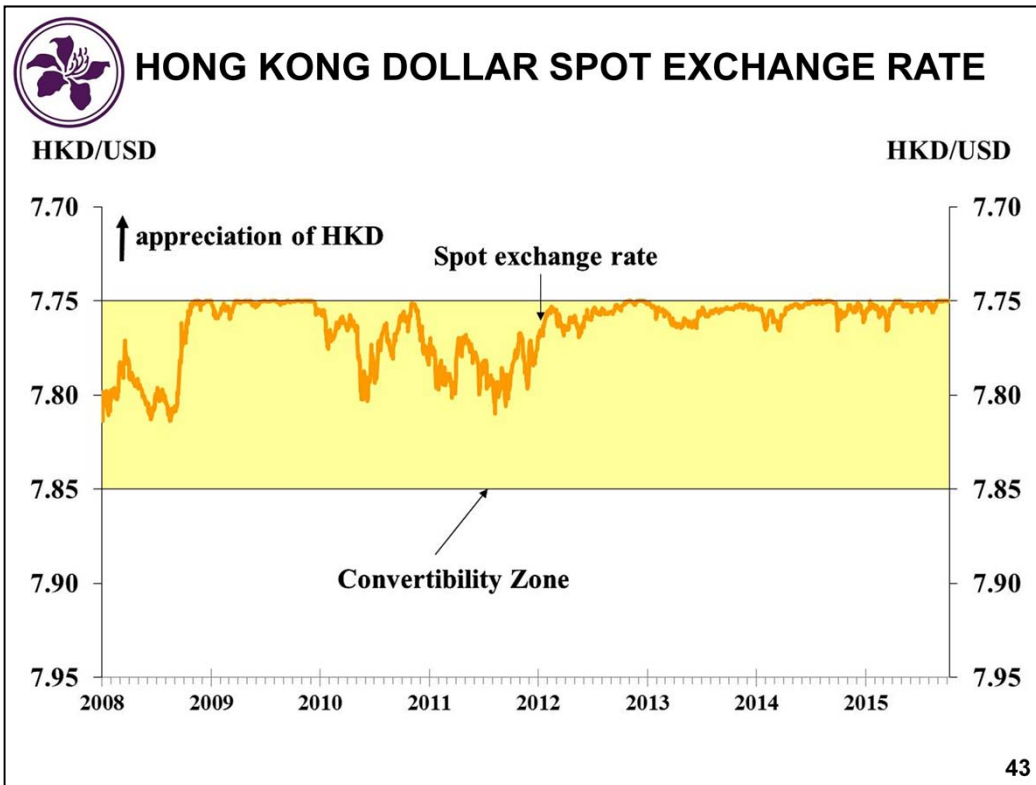
HONG KONG: HOUSEHOLD DEBT



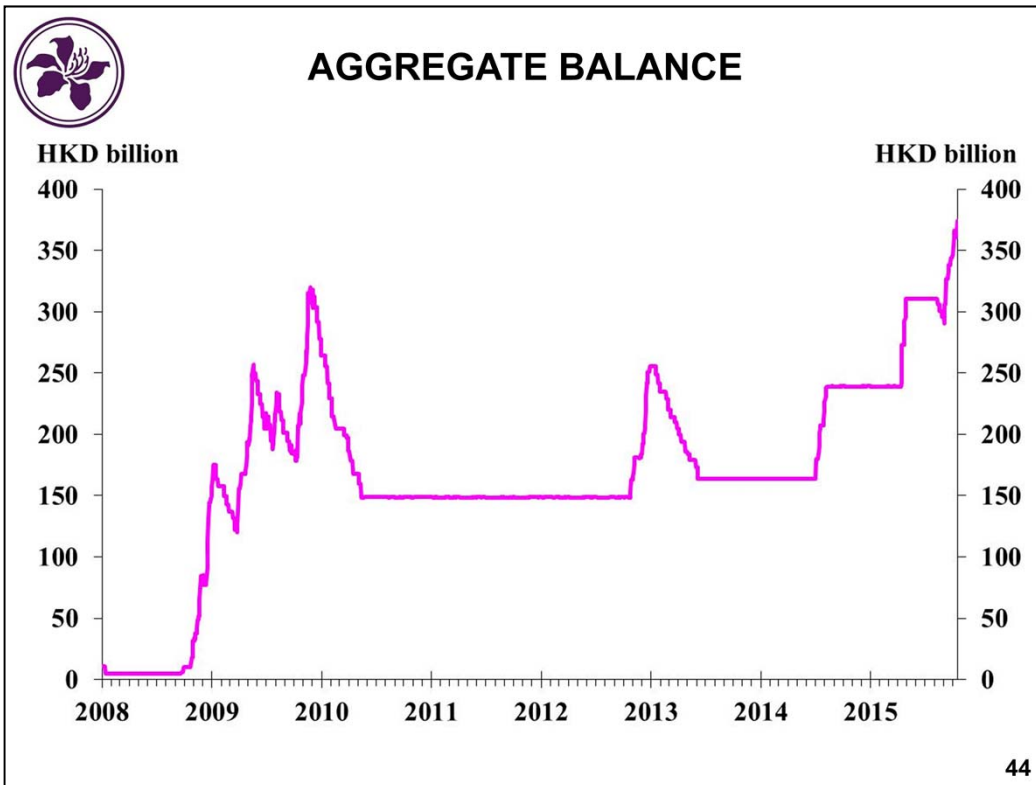
Sources: HKMA



CURRENCY STABILITY



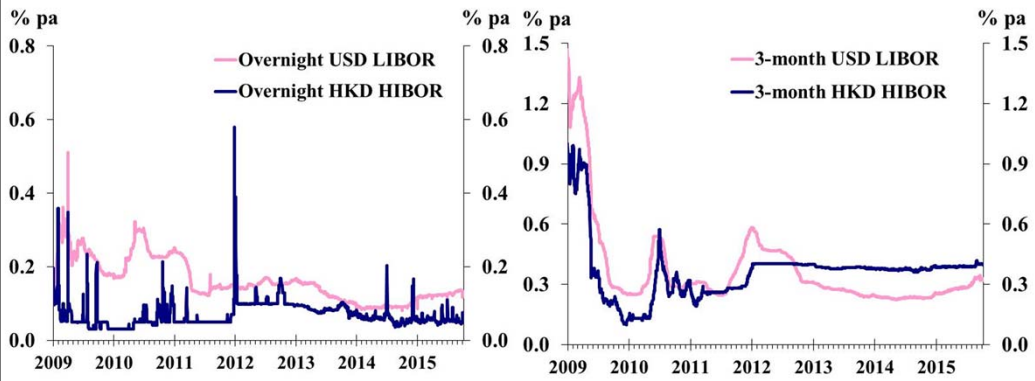
- Despite heightened volatility in global financial markets, the Hong Kong dollar spot exchange rate remained broadly stable in the range of 7.751 to 7.754 most of the time in May to August.
- In September, the Hong Kong dollar strengthened to 7.75 against the US dollar, and the strong-side Convertibility Undertaking was triggered multiple times. The net inflows were possibly driven by increased conversions of CNH into Hong Kong dollar after the recent volatility of the renminbi exchange rate.



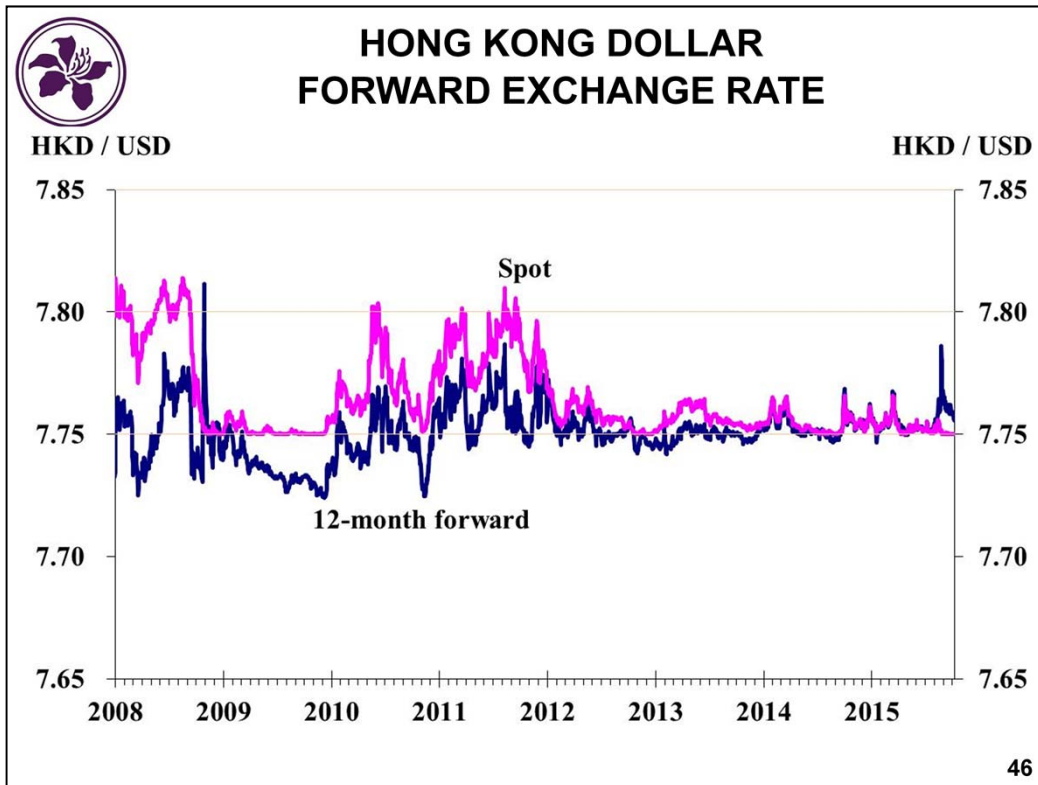
- A total of HK\$20 billion of additional Exchange Fund Bills (EFB) were issued in August to September to meet banks' strong demand. Such issuance led to a decline of the Aggregate Balance in August. The HKMA announced on 29 September the issuance of another HK\$20 billion worth of additional EFB in October.
- But since the beginning of September, the strong-side Convertibility Undertaking has been triggered multiple times. In the period of 1 September to 16 October, total net inflows into the Hong Kong dollar amounted to HK\$93.5 billion, thus offsetting the impact of additional EFB issuance and sending the Aggregate Balance to the level of HK\$374.1 billion.



DOMESTIC INTEREST RATES



- Short-term interbank interest rates were broadly steady at low levels.



- The Hong Kong dollar forward exchange rate tracked closely the Hong Kong dollar spot rate most of the time over the past few months.
- The forward rate eased briefly in late August, alongside the increased volatility in RMB exchange rate and market expectations of a potential US interest rate liftoff, which led to depreciation in other emerging market currencies.

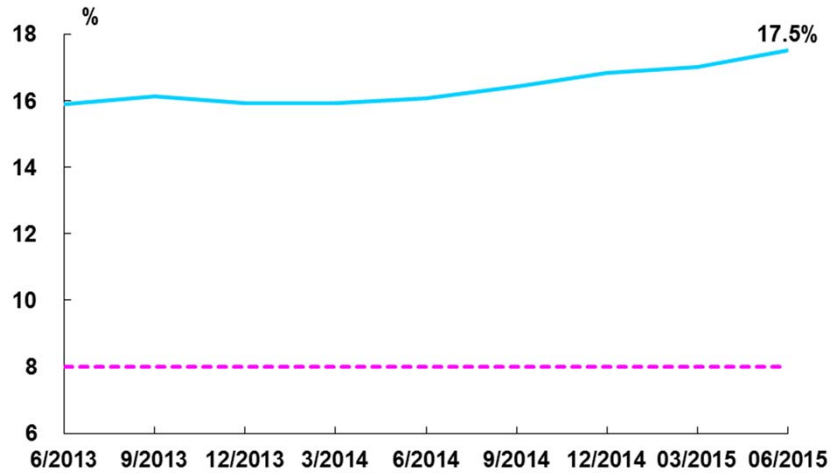


BANKING STABILITY



BANKING SECTOR PERFORMANCE

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



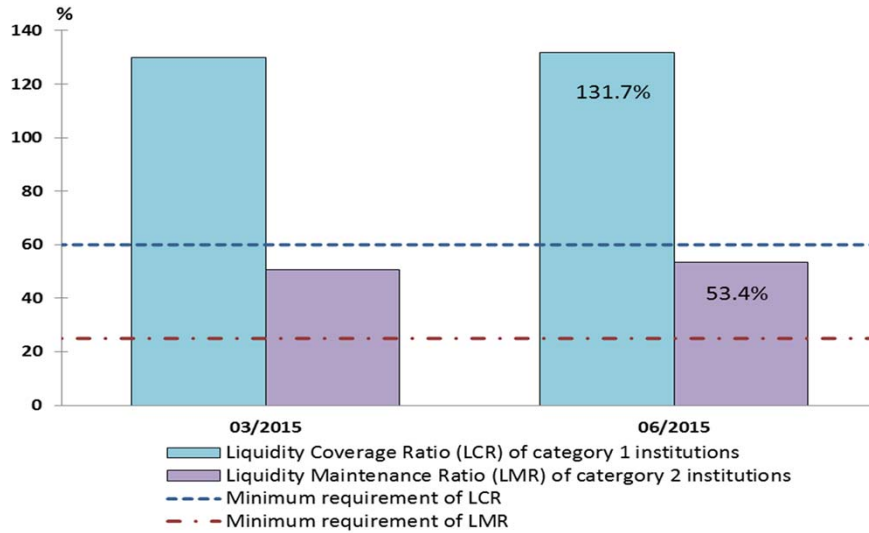
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- The consolidated capital adequacy ratio (CAR) of locally incorporated AIs increased to 17.5% at end-June 2015 from 17.0% a quarter ago, mainly due to a 2.6% rise in capital base in Q2 2015. The consolidated CAR remained well above the international minimum standard of 8%.



BANKING SECTOR PERFORMANCE

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



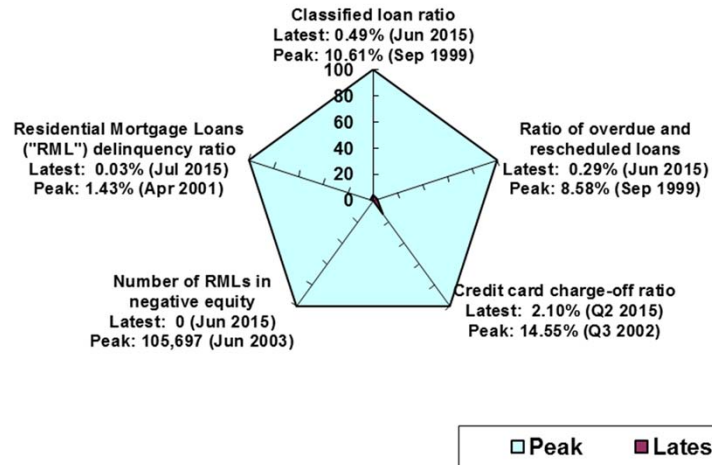
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- Hong Kong implemented the new Basel III liquidity requirements on 1 January 2015. Under the regime, AIs' liquidity level is measured by either the Liquidity Coverage Ratio (LCR) for category 1 AIs or the Liquidity Maintenance Ratio (LMR) for category 2 AIs.
- In Q2 2015, the quarterly average LCR of category 1 AIs was 131.7% (well above the 60% minimum requirement for 2015). For category 2 AIs, their quarterly average LMR was 53.4% (well above the 25% minimum requirement).



BANKING SECTOR PERFORMANCE

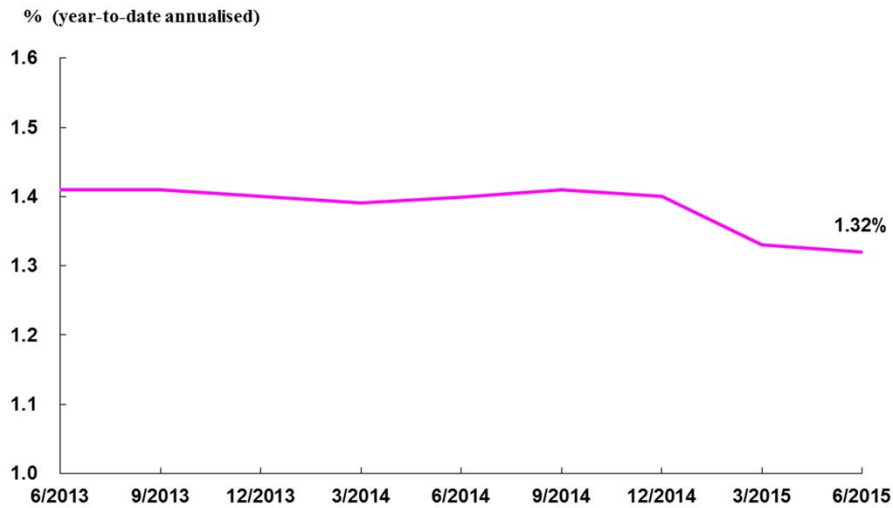
Asset quality remained good compared with historical standards





BANKING SECTOR PERFORMANCE

Net interest margin of retail banks narrowed

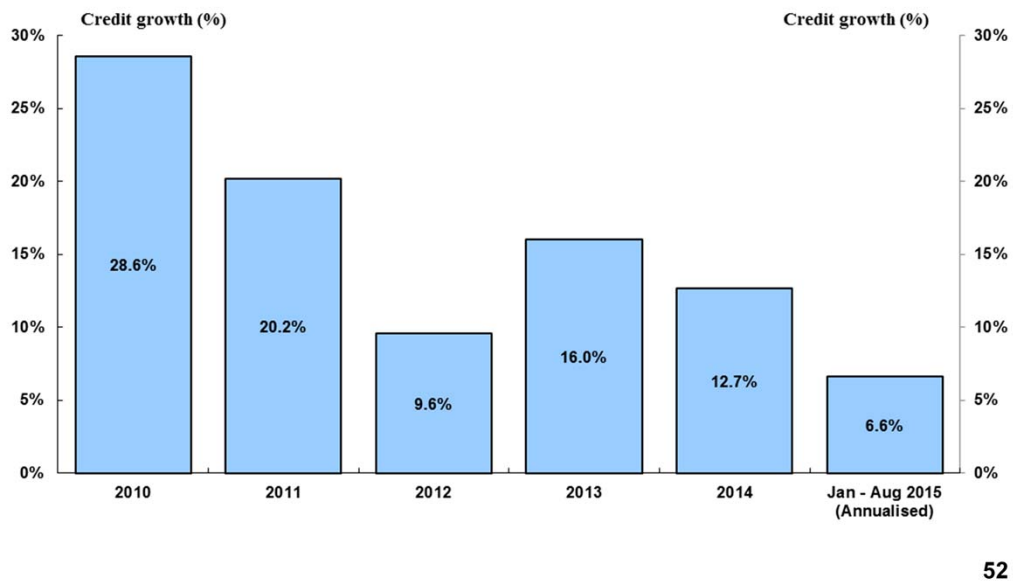


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- The year-to-date annualised net interest margin (NIM) of retail banks' Hong Kong offices narrowed to 1.32% in first half of 2015 from 1.40% in first half of 2014, as subdued loan demand has caused some banks to allocate excess funding to lower-yielding assets (e.g. interbank placement).
- The aggregate pre-tax operating profit of retail banks' Hong Kong offices grew by 4.9% in first half of 2015 as compared with the same period last year. The improvement was mainly driven by the increases in fees and commission income (+14.4%) and net interest income (+3.6%), but was partly offset by growth in operating expenses (+10.7%).



CREDIT GROWTH CONTINUED TO MODERATE

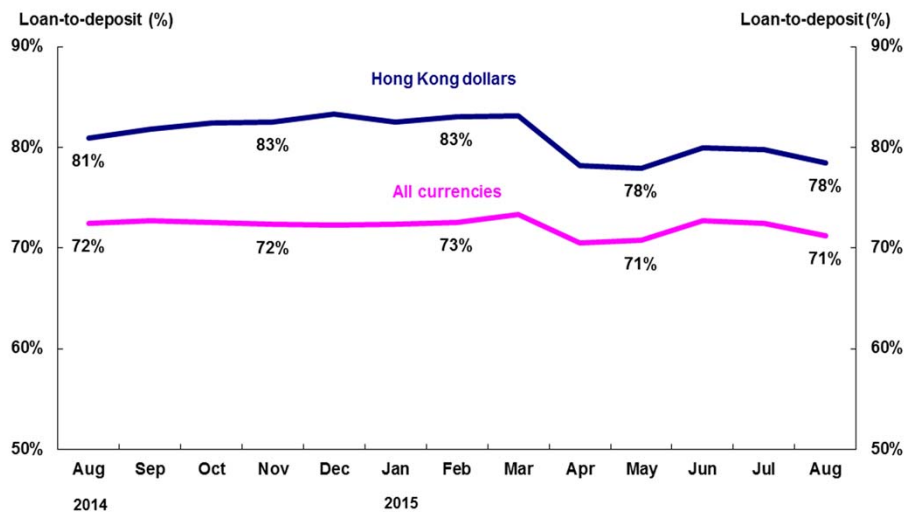


- Credit growth moderated in the first 8 months of 2015 as corporations generally have become more conservative in borrowing in view of the uncertain macro-economic outlook.



CREDIT GROWTH

Loan-to-deposit ratios of banks in Hong Kong trended lower

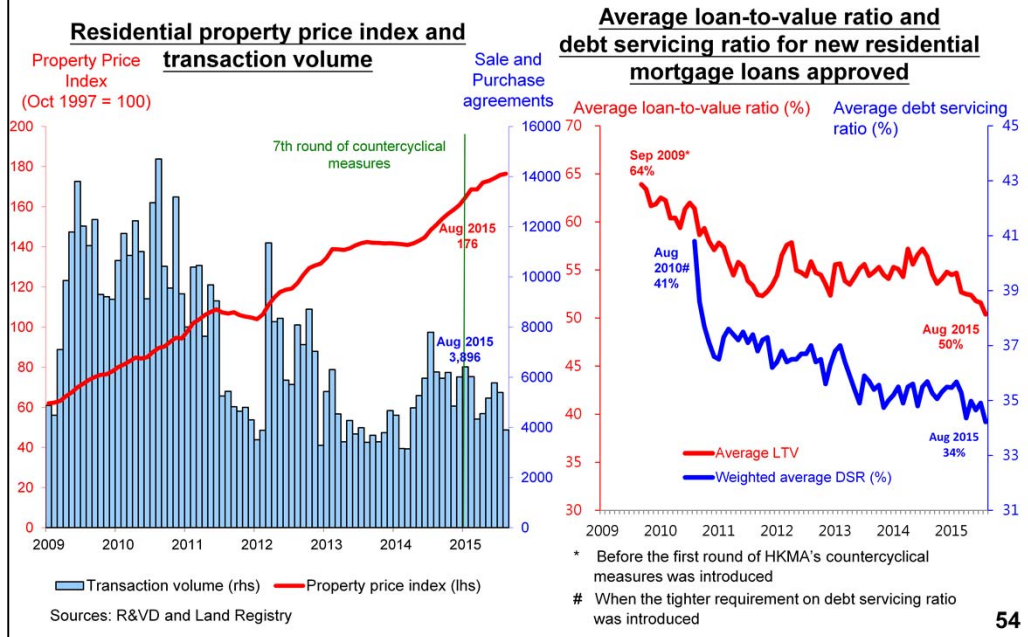


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- The Hong Kong dollar loan-to-deposit ratio decreased to 78% at end-August 2015 from 80% at end-June 2015. The decrease was due to a faster pace of decline in Hong Kong dollar loans than the decline in Hong Kong dollar deposits.
- The all currencies loan-to-deposit ratio decreased to 71% at end-August 2015 from 73% at end-June 2015. The decrease was due to a rise in total deposits coupled with a decline in total loans.



RISK MANAGEMENT OF PROPERTY MORTGAGE LOANS



Latest statistics for residential mortgage loans ("RMLs")

	Monthly average in 2013	Monthly average in 2014	Apr 2015	May 2015	Jun 2015	Jul 2015	Aug 2015
Number of sale and purchase agreements	4,223	5,317	4,549	5,168	5,776	5,393	3,896
Number of new RML applications	8,694	10,481	10,007	11,990	11,726	10,139	9,630
Number of new RMLs approved	5,952	7,337	6,690	7,952	8,785	8,112	6,981

Latest statistics for residential property prices

Property price index		Period	Property price index
Rating and Valuation Department (10/1997=100)	Latest position	08/2015	176.4
	Recent Peak	08/2015	176.4
	Peak in 1997	10/1997	100.0
Centaline (6/7/1997=100)	Latest position	11/10/2015	144.6
	Recent Peak	13/09/2015	146.9
	Peak in 1997	19/10/1997	102.9



BASEL STANDARDS IMPLEMENTATION

Legislative amendments 2015

- Banking (Capital) (Amendment) Rules 2015 (BCAR 2015) to address Basel Committee's Regulatory Consistency Assessment Programme (RCAP) findings

Legislative amendments 2016

- Amendments to Banking (Capital) Rules (BCR) to reflect revised capital treatment of counterparty credit risk exposures and equity investments in funds
- Amendments to Banking (Disclosure) Rules (BDR) to implement Pillar 3 revised disclosure package

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Our plan for legislative amendments for the rest of this year and next year relating to Basel standards implementation:

BCAR 2015

- A draft set of BCAR 2015 have been prepared to address a few technical differences between the text of the Banking (Capital) Rules and the underlying Basel standards that were identified in the 2014 RCAP assessment on Hong Kong conducted by the Basel Committee. All of the differences were assessed as having no or immaterial impact on the capital ratios of Als but it is a good practice to make the proposed amendments to closely align with the Basel standards.
- The amendment Rules were gazetted on 23 October and will be tabled at LegCo on 28 October for negative vetting, with a target commencement from next year.

2016 amendments to BCR and BDR

- Policy development is underway in relation to the implementation of a number of Basel revised standards scheduled to take effect internationally from 2017. These include:
 - Capital treatment of counterparty credit risk exposures and equity investments in funds (to be implemented through BCR amendments), and
 - Pillar 3 disclosure requirements (to be implemented through BDR amendments)
- Consultation with the industry on detailed policy proposals is expected to commence in the next couple of months.



CROSS-SECTOR RESOLUTION REGIME FOR FINANCIAL INSTITUTIONS IN HONG KONG

- To meet international standards: Financial Stability Board (FSB)'s "Key Attributes of Effective Resolution Regimes for Financial Institutions"
- Cross-sectoral approach including entities from banking, insurance as well as securities and futures sectors
- Response to comments on second consultation (January – April 2015) was issued on 9 October 2015
- Aim to introduce a Bill into the LegCo by end of 2015

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- The second consultation on the regime (issued on 21 January) closed on 20 April 2015. 28 responses were received.
- A consultation response was issued on 9 October 2015. The response also included discussion on a few further issues (e.g. on the Total-Loss Absorbing Capacity (TLAC) requirement for the global systemically important banks where international policy framework is close to being finalised). TLAC is designed as a financial resource to absorb losses and recapitalise a financial institution should it become non-viable.



INVESTOR AND CONSUMER PROTECTION

- Issued guidance in August 2015 to banks on suitability assessment and product disclosure in the selling of life insurance products
- Introduced further measures since July to further enhance the protection of the interests of bank customers. They include:
 - All retail banks to provide customer hotlines to facilitate the public in verifying the identity of callers
 - All banks to cease the use of intermediaries for the purpose of sourcing retail consumer financial products
 - Organised publicity campaign jointly with the industry to raise public awareness of phone scams

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- In August 2015, the HKMA issued guidance to banks on suitability assessment and product information disclosure in the selling of life insurance products to customers. The guidance assists banks to comply with regulatory standards, including relevant requirements issued by the Office of the Commissioner of Insurance and the Hong Kong Federation of Insurers respectively in July 2015.
- The HKMA notes that, since July this year, members of the public have been receiving calls purportedly from banks which may ask them for sensitive personal information for other unrelated purposes or may even cheat them for their money. In addition, some so-called “credit intermediaries” have also claimed to be offering lower interest rates to the customers, but which turned out to impose high interest rates or handling fees. In order to further enhance the protection of the interests of customers, the HKMA has since July this year introduced further measures to help the general public in identifying possible scams, including:
 - Required banks to step up efforts in drawing their customers’ attention to bogus phone calls via various channels, and to take appropriate follow up actions to protect customers who have disclosed their personal information;
 - Required all retail banks to provide customer hotlines to facilitate the public in verifying the identity of callers, and to post the hotline numbers and relevant information on the websites of individual retail banks and the dedicated page newly set up on the websites of the HKMA and the Hong Kong Association of Banks for easy access by the public;
 - Issued a circular to all banks on 7 August requiring them to cease the use of intermediaries for the purpose of sourcing retail consumer financial products so that if going forward there are intermediaries claiming to be able to provide referral services to banks in respect of personal loans, tax loans and credit cards, the public should be aware that such arrangements are not authorised by banks and may involve fraudulent acts; and
 - Jointly organised with the industry the “Beware of Fraudulent Calls, Verify the Caller’s Identity” publicity campaign on 31 August, and will continue to work with the industry in raising public awareness of phone scams and reminding the public not to easily divulge personal information in order to protect their own interests.



CONSUMER EDUCATION PROGRAMME

- Launched thematic campaign to remind the public of e-banking security tips, smart use of credit cards, and to check if a financial institution is an authorized institution under the HKMA's supervision before placing a deposit with it
- Conducted a “Meet the HKMA Chief Executive” activity and under the “Hong Kong Liberal Studies Financial Literacy Championship” co-organised by the HKMA to further promote financial literacy of senior secondary school students. A school-based version was also launched.



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- Educational messages on e-banking security and smart use of credit cards are disseminated through video and radio broadcasting, publicity on the internet, smartphone apps and out-of-home media. Comic strip was published and radio clips were broadcast to remind the public to check if a financial institution is an authorized institution under the HKMA's supervision before placing a deposit with it.
- The HKMA co-organised the “Hong Kong Liberal Studies Financial Literacy Championship”, an online quiz targeting senior secondary school students. Under the event, a “Meet the HKMA Chief Executive” activity and a school-based version of the quiz (i.e. an educational kit sent to all secondary schools for use as a post-examination activity for students) were also launched this summer to further promote financial literacy of senior secondary school students and help them understand the importance of responsible financial management.



ENHANCEMENTS TO DEPOSIT PROTECTION SCHEME

- Objective: shift to gross payout approach for prompt payouts
- Wide support received during public consultation
- Benefits:
 - Depositors: quicker access to compensation
 - Banks: lower contagion risk and simpler IT systems
 - Financial system in Hong Kong: more robust financial safety net in line with global reform trends
- Preparation of the Deposit Protection Scheme (Amendment) Bill is in final stage, target to introduce the Bill into the LegCo by end of 2015

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- The key objective is to adopt the “gross payout” approach to determine deposit compensation as opposed to the existing “net payout” approach so as to achieve faster payouts, in 7 days under most circumstances.
- The draft Bill includes the following key provisions:
 - determining the compensation payment of a depositor on a gross basis, without deducting any liabilities owed by him/her to the failed bank;
 - revising the definition of “Quantification Date” to refer to Deposit Protection Scheme trigger date, which can provide a higher certainty, essential to fast compensation determination; and
 - enabling the use of the electronic communication in addition to the existing written notice for notifying depositors about the payout details.



FINANCIAL INFRASTRUCTURE



REGULATORY DEVELOPMENT OF THE OTC DERIVATIVES MARKET

- The Securities and Futures (Amendment) Ordinance 2014 was enacted by the LegCo in Q1 2014. The regulatory regime for the over-the-counter (OTC) derivatives market in Hong Kong has been implemented in phases, with the detailed rules for the first phase of mandatory reporting and related record keeping obligations taking effect in July 2015
- Detailed rules are now being prepared for implementing other aspects of the regulatory regime for the OTC derivatives market in Hong Kong. Consultation on the first phase of mandatory clearing and related record keeping obligations as well as the product expansion for the mandatory reporting obligation was launched in September 2015



CONTINUED DEVELOPMENT AS AN INTERNATIONAL ASSET MANAGEMENT CENTRE

- The HKMA continued to promote HK'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
- 20 private banks have opened for business in Hong Kong since 2009, bringing the total to 46 banks offering private wealth management services in Hong Kong as of August 2015

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- According to the Securities and Futures Commission (SFC)'s survey, 71% of the combined fund management business in Hong Kong was sourced from non-Hong Kong investors in 2014, attesting to the fact that Hong Kong is a preferred location for asset management business in the region.
- The number of licensed corporations for asset management has increased from 680 in 2008 to 1,082 in June 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\$113.7 billion as of mid-2015.
 2. About 60% of Qualified Foreign Institutional Investor managers and Renminbi Qualified Foreign Institutional Investor managers, as well as over 70% Mainland fund management and securities firms with Qualified Domestic Institutional Investor license have a presence in Hong Kong as of August 2015.
 3. Hong Kong is also the largest hub for Asian hedge funds, with the number of funds increased from 676 in 2012 to 778 as of 30 September 2014.



DEVELOPING HONG KONG AS A CTC HUB

- Corporate treasury centres (CTCs) set up by multinational and Mainland enterprises will bring more banking, financing and risk management activities in Hong Kong, deepen our capital markets and provide impetus to the development of headquarters economy in Hong Kong.
- The Financial Secretary announced in the 2015-16 Budget that the Government will amend the Inland Revenue Ordinance to (i) allow, under specified conditions, interest deductions under profits tax for CTCs and (ii) reduce profits tax for specified treasury activities by 50%.
- Working closely with the Financial Services and the Treasury Bureau, Inland Revenue Department, and Department of Justice on drafting the relevant Bill, which will be introduced in the 2015-16 legislative session. An industry consultation on the detailed legislative proposal has commenced in September.
- To continue to engage the industry and step up marketing effort to promote Hong Kong as a preferred regional location for CTCs.

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- Developing Hong Kong into a regional hub for corporate treasury centres (CTC) has been one of the important areas of work of the HKMA in recent years. With their vast, global business networks, some multinational corporations (MNCs) process numerous large-value payments on a daily basis. Under their treasury management systems, it is common for cash management, receipt/payment processing, financing and risk management, etc. to be centralised to facilitate management of these corporate treasury functions. The development of Hong Kong as a CTC hub would complement many of Hong Kong's existing strengths, such as the offshore RMB market, capital formation, banking capabilities, etc., thereby reinforcing Hong Kong's status as an international financial centre and enhancing the development of headquarters economy in Hong Kong.
- The HKMA is 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 100 corporations and financial institutions as of end August 2015.



GOVERNMENT BOND PROGRAMME

Institutional part

- 13 issues totalling HK\$77.4 billion were outstanding as at end October.
- Successfully issued a 15-year bond for the first time in July to extend the yield curve.

Retail part

- Three iBonds totalling HK\$30 billion were outstanding as at end October.
- The fifth issue of iBond was successfully launched in August. Total subscription amount was HK\$35.7 billion. The number of subscribers was at a record high of 597,895 persons.



DEVELOPMENT OF ISLAMIC FINANCE

- Following the success of the inaugural sukuk in 2014, the HKMA assisted the Government to issue the second sukuk in June 2015.
- The issuance size was US\$1 billion with tenor of five years, and attracted orders of US\$2 billion from a diverse group of 49 international investors. The sukuk was priced at 1.894%, which gave the Government a cheaper funding cost than that for the inaugural sukuk issue in 2014 (2.005%).
- The sukuk uses asset-light Wakalah structure, making Hong Kong as the first AAA-government sukuk issuer to adopt this structure and demonstrating the flexibility of Hong Kong's issuance platform.
- Will continue to maintain close dialogue with market players, hoping that the sukuk issuance will catalyse further growth of the sukuk market in Hong Kong and attract more issuers and investors to participate in our Islamic finance platform.



FINANCIAL BENCHMARK REFORM IN HONG KONG

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

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



FINANCIAL INFRASTRUCTURE

- Continue to maintain safety and efficiency of financial infrastructure.
- Daily average turnover in RMB Real Time Gross Settlement (RTGS) system in August 2015 was at record high of RMB1,036.4 billion.
- Reporting to the over-the-counter (OTC) derivatives trade repository (TR) of the HKMA has been smooth. The TR will be further developed to meet local reporting requirements and international standards.

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Operation of financial infrastructure

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

OTC derivatives Trade Repository

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



FINANCIAL INFRASTRUCTURE DEVELOPMENT: PROGRESS UPDATE

- Legislative framework for Stored Value Facilities (SVF) and Retail Payment Systems (RPS)
 - The clause-by-clause scrutiny process by the Bills Committee was completed in June. The LegCo will resume Second Reading of the Bill on 4 November 2015.
 - For SVF, a number of companies have approached the HKMA to learn about the new regulatory regime and some of them have sent in letters of intent to apply for an SVF licence.
 - There will be a transitional period of 12 months after the enactment of the new legislation for SVF issuers to apply for licences. Industry players have been kept informed about the requirements under the new regulatory regime through industry briefing sessions organised by the HKMA.

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The Bill includes provisions to:

- implement a licensing regime for SVF covering both device-based and non-device based SVF with a series of licensing criteria including physical presence in Hong Kong; principal business has to be SVF issuing; financial strength; float safeguarding and management; fitness and propriety of ownership and management; anti-money laundering and counter terrorist financing requirements; security and soundness of system and business scheme, etc.;
- implement a designation regime for RPS under which RPS that are important to the public and 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 supervision; gather information; make regulations; issue guidelines; impose operating rules; and give directions, etc.;
- empower the HKMA to exercise necessary enforcement actions on SVF and RPS including the conduct of investigation;
- with reference to other legislation including the Banking Ordinance, Securities and Futures Ordinance and the Anti-Money Laundering and Counter Terrorists Financing (Financial Institutions) Ordinance, introduce relevant offenses and sanctions for contravention of the the Clearing and Settlement Systems Ordinance (CSSO) including minor sanctions such as caution, warning and reprimand; and
- enhance the existing appeal mechanism under the CSSO to enable persons aggrieved by a reviewable decision of the HKMA made under the CSSO to refer the decision to an Appeal Tribunal for review.



RETAIL PAYMENT DEVELOPMENT: PROGRESS UPDATE

- **Electronic Bill Presentment and Payment (EBPP) service**
 - The Water Supplies Department and the Rating and Valuation Department have joined the platform in September 2015, adding the total number of EBPP participating merchants to 140.
- **e-Cheque**
 - A three-month pilot run of the service will commence on 7 December 2015.
 - 18 banks have expressed interest to offer e-Cheque issuance service, among which 9 of them have planned to roll out the service in December.
 - The public can issue and present e-Cheque through their Internet and mobile banking accounts using the desktop computers, tablet or smartphone.
 - The HKSAR Government will also launch an online platform to facilitate the public to pay the Government bills by e-Cheque. The public can pay some tax bills issued by the Inland Revenue Department and the General Demand Notes in the initial phase.
 - The HKMA has commenced consumer education campaigns to enhance the public awareness of e-Cheque and to educate the public on how to use e-Cheque.

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Electronic Bill Presentment and Payment (EBPP) service

- The Water Supplies Department and the Rating and Valuation Department are among the largest public sector bill issuers and account for around 70% of total bill payments received by the HKSAR Government.
- Members of the public are now able to receive, view, manage and schedule payments for Water Bill and Demand for Rates and/or Government Rent through their Internet banking accounts.
- Currently, 19 banks, which operate over 9 million Internet banking accounts, are providing the EBPP service to their customers through the Internet banking system. In addition, 140 merchants and charity organisations have joined the EBPP service.
- To help members of the public better understand and use the EBPP service for receiving e-bill summaries from and making e-payments to the merchants and HKSAR Government, the HKMA and the HKAB have jointly developed a wide range of educational materials including a television API, radio API, video demo, poster and electronic brochure.

e-Cheque

- The objective of e-cheque is to provide an additional safe and efficient option of payment instrument for the public. E-cheque is an “end-to-end” electronic payment instrument without the use of paper or the need of physical delivery or presentment throughout the process. It will be issued through the internet banking platform of the paying bank, and presented either through the internet banking platform of the collecting bank or the centralised presentment portal operated by Hong Kong Interbank Clearing Limited (the clearing house in Hong Kong).
- Banks will launch a three-month pilot run of the service on 7 December 2015, and a large scale roll out in March 2016.
- All banks are required to accept e-Cheque deposit starting from 7 December 2015. Nonetheless, it is up to banks’ commercial decision to provide the e-Cheque issuance service.
- The HKMA has commenced consumer education campaigns to enhance the public awareness of e-Cheque and to educate the public on how to use e-Cheque. The first batch of the publicity materials have been launched and the rest will also be rolled out by phases soon.

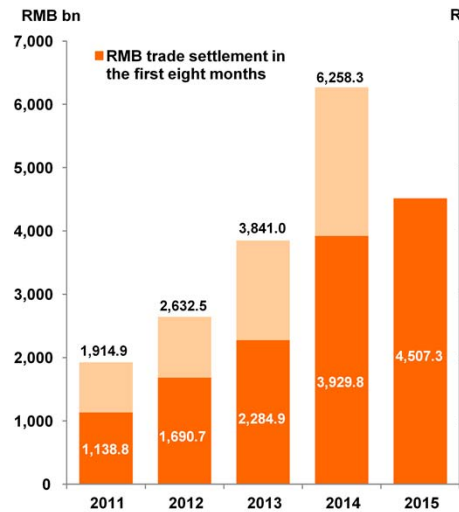


HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

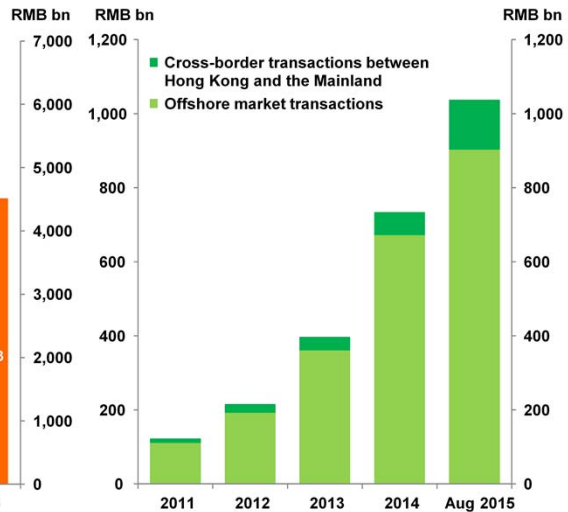


CONTINUED GROWTH IN RMB TRADE SETTLEMENT AND PAYMENTS

**RMB trade settlement
handled by banks in Hong Kong**



**Average daily turnover of Hong Kong
RMB RTGS System**



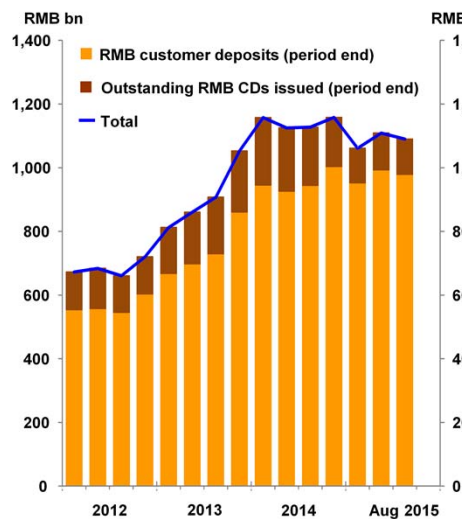
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- In the first eight months of 2015, RMB trade settlement handled by banks in Hong Kong amounted to RMB4,507.3 billion, up 15% compared with the same period in 2014.
- Transactions handled by Hong Kong RMB Real Time Gross Settlement (RTGS) system increased further, with daily average turnover reaching RMB1,036.4 billion in August 2015.

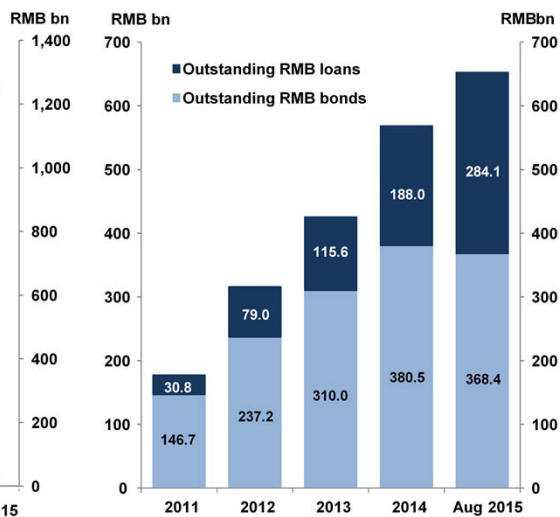


MODERATION IN GROWTH MOMENTUM OF LIQUIDITY POOL AND BOND ISSUANCE

RMB customer deposits and certificates of deposit (CDs)



RMB financing activities



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- At end August 2015, RMB customer deposits and outstanding RMB certificates of deposit amounted to RMB979.0 billion and RMB111.4 billion respectively, totaling RMB1,090.3 billion, a 6% decline from the end of 2014. The drop in customer deposits partly reflects a net outflow from Hong Kong to Mainland China under trade settlement. Recent fluctuation in RMB exchange rate and change in market expectation on RMB exchange rate movement may continue to affect the size of RMB liquidity pool in Hong Kong.
- RMB dim sum bond issuance slowed down, with issuance in the first eight months of 2015 totalling RMB50.5 billion. Outstanding dim sum bonds amounted to RMB368.4 billion at end August 2015. On the other hand, RMB bank lending grew significantly, with outstanding amount of RMB loans increasing to RMB284.1 billion at end August 2015, a growth of 51% from the end of 2014.



MAINTAINING RMB BUSINESS LINKS WITH OTHER JURISDICTIONS

	<u>Aug 2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
No. of participating banks of Hong Kong's RMB clearing platform	219	225	216	204
Of which:	194	200	191	181
Branches and subsidiaries of overseas banks and overseas presence of Mainland banks				
Amount due to overseas banks (RMB billion)	163.7	145.2	166.0	99.1
Amount due from overseas banks (RMB billion)	148.0	193.3	164.5	117.1

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- The HKMA continued to enhance RMB business collaboration and exchanges between Hong Kong and other markets and promote Hong Kong's RMB business platform to overseas corporations and financial institutions. The HKMA held a seminar on "RMB Internationalisation : A New Era for Global Trade and Finance" in Toronto on 8 June 2015. In addition, together with the Reserve Bank of Australia and the Australian Treasury, the HKMA facilitated the Third Hong Kong-Australia RMB Trade and Investment Dialogue on 9 July 2015 in Sydney.



INVESTMENT ENVIRONMENT AND PERFORMANCE OF THE EXCHANGE FUND

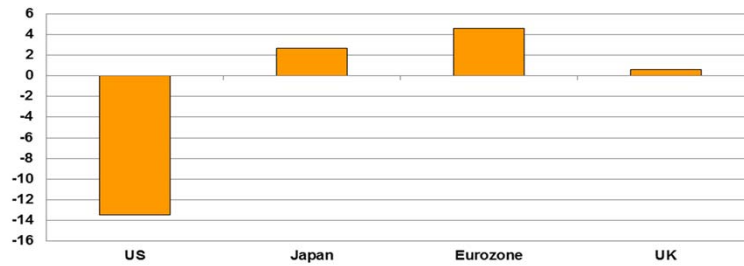
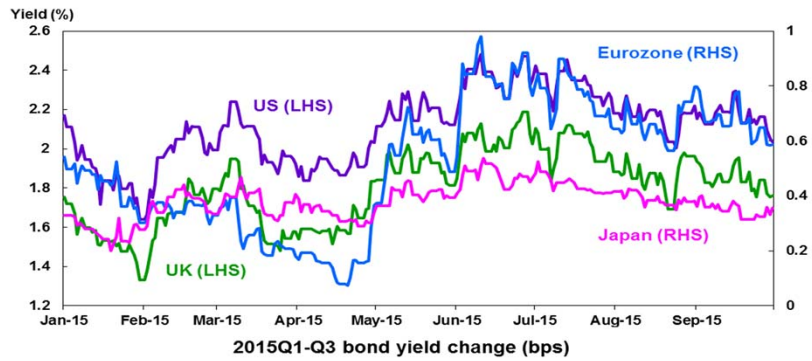


INVESTMENT ENVIRONMENT IN Q3 2015

- **Interest rates:** Longer term US Treasury and European government bond yields fell in Q3 2015 amid worries over global slowdown, renewed disinflationary pressure and economic slowdown in Mainland China. Longer term Japanese government and UK Gilt bond yields also fell in tandem
- **Equity markets:** Major equity indices reversed year-to-date gains and registered the worst quarterly performance in 4 years in Q3 2015 amid negative market sentiments arising from global growth concerns and uncertainty around Fed's lift-off. With its close linkage with Mainland China's economy, Hang Seng Index underperformed other major markets during the period
- **Exchange rates:** Euro traded in range against the US dollar in Q3, mainly supported by modest pick-up in growth momentum in the Euro-area brought by the ECB's QE. Yen strengthened slightly against the US dollar on safe haven flows during the period



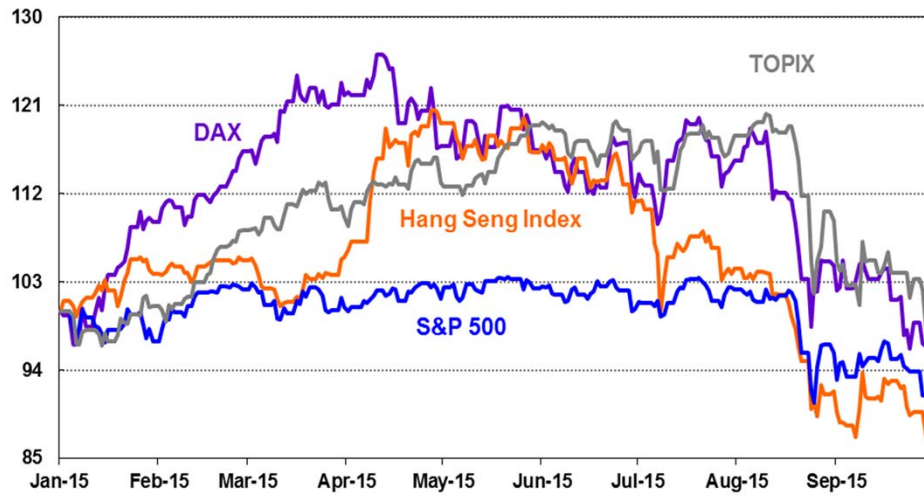
CHANGES IN 10-YEAR GOVERNMENT BOND YIELDS IN Q1-Q3 2015





EQUITY MARKETS IN Q1-Q3 2015

Normalized Index Level (2014 year-end = 100)

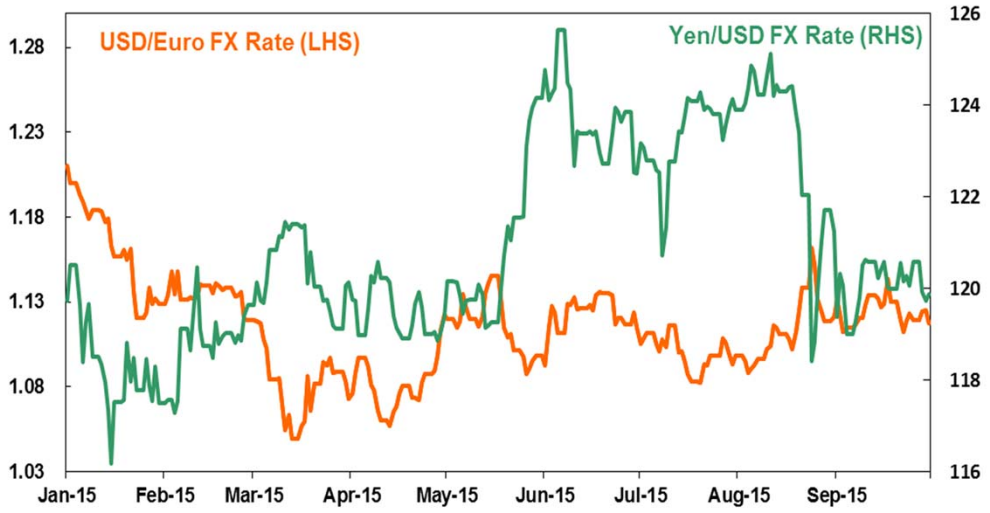




CURRENCY MARKETS IN Q1-Q3 2015

USD/Euro FX Rate

Yen/USD FX Rate





INVESTMENT INCOME

← 2015 → 2014 2013 2012
(unaudited)

(HK\$ billion)	Jan - Sep	Q3	Full Year	Full Year	Full Year
Hong Kong equities*			6.5	10.1	30.7
Other equities			33.7	71.8	42.8
Bonds			47.3	(19.1)	33.1
Other investments@			9.9	16.8	6.4
Foreign exchange#			<u>(52.7)</u>	<u>1.6</u>	<u>(1.4)</u>
Investment income/(loss)			44.7	81.2	111.6

* Excluding valuation change of the Strategic Portfolio

@ Including valuation changes of private equity and real estate investments held by Exchange Fund's investment holding subsidiaries

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



INCOME AND EXPENDITURE

(HK\$ billion)	2015 (unaudited)				2014
	Jan – Sep	Q3	Q2	Q1	Full year
Investment income/(loss)		18.7	8.3	44.7	
Other income		0.1	0.0	0.2	
Interest and other expenses		<u>(1.7)</u>	<u>(1.0)</u>	<u>(5.2)</u>	
Net income/(loss)		17.1	7.3	39.7	
Fee payable to Fiscal Reserves*		11.4	11.4	27.5	
Fee payable to HKSAR Government funds and statutory bodies*		3.7	3.5	8.6	

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



EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)	30 Sep 2015	31 Dec 2014	31 Dec 2013
ASSETS			
Deposits		315.6	292.8
Debt securities		2,146.3	2,080.0
Hong Kong equities *		156.8	152.9
Other equities		416.3	370.6
Other assets #		<u>114.0</u>	<u>136.5</u>
Total assets		<u>3,149.0</u>	<u>3,032.8</u>
		=====	=====
LIABILITIES AND FUND EQUITY			
Certificates of Indebtedness		340.2	327.4
Government-issued currency notes & coins in circulation		11.0	10.6
Balance of the banking system		239.2	164.1
Exchange Fund Bills and Notes issued		752.4	782.6
Placements by banks and other financial institutions		64.0	50.7
Placements by Fiscal Reserves		788.7	773.9
Placements by HKSAR Government funds and statutory bodies		261.1	214.9
Other liabilities		<u>56.9</u>	<u>71.1</u>
Total liabilities		<u>2,513.5</u>	<u>2,395.3</u>
Accumulated Surplus		<u>635.5</u>	<u>637.5</u>
Total liabilities and fund equity		<u>3,149.0</u>	<u>3,032.8</u>
		=====	=====

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

Including fund injection to Exchange Fund's investment holding subsidiaries at a carrying amount of HK\$82.6 billion at 31 Dec 2014 and HK\$66.4 billion at 31 Dec 2013



HONG KONG MORTGAGE CORPORATION



MORTGAGE INSURANCE PROGRAMME (MIP)

- Since the launch in March 1999, the MIP has helped over 115,800 families attain home ownership
- In the first eight months of 2015, the total drawdown amount under the MIP was HK\$12 billion and the average loan size was HK\$3.48 million
- About 89% of drawn down loans were for secondary market properties



REVERSE MORTGAGE PROGRAMME

- By end of August 2015, 956 applications have been received:
 - Average age of borrowers: 69 years old
 - Average monthly payout: HK\$14,500
 - Payment terms: 10-year (30%), 15-year (16%), 20-year (14%), life (40%)
 - Average property value: HK\$4.9 million
 - Average property age: 30 years

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The Hong Kong Mortgage Corporation introduced the following new enhancements to the Reverse Mortgage Programme (RMP), with effect from 12 March 2015:

1. Properties provided as security under the RMP are no longer required to be the borrower's principal residence;
2. More than one property can be used as security for application of a reverse mortgage loan;
3. The maximum number of joint borrowers is increased from two to three; and
4. Assignment of life insurance policy to the bank as additional collateral under the RMP is allowed.



SME FINANCING GUARANTEE SCHEME (SFGS)

- Hong Kong's external trade performance is affected by a host of uncertainties this year. To support small and medium enterprises and hence drive domestic demand with a view to maintaining economic vibrancy and preserving employment, the Financial Secretary announced in the 2015-16 Budget Speech the extension of application period for the 80% loan guarantee product until 29 February 2016.
- The 80% loan guarantee product has been well received by the market. As at end-August 2015, 10,441 applications were approved, involving a total loan amount of HK\$42.3 billion. Key data of the approved applications are as follows:

Average guarantee period	4.7 years	Average loan size	HK\$4.06 million
Proportion of application from manufacturing and non-manufacturing industries	25% and 75% (in terms of applications approved)	Average loan interest rate and average guarantee fee rate	4.82% p.a. 0.54% p.a.
Enterprises with less than 50 employees	91%	Benefitted enterprises and the related no. of employees	6,651 enterprises and 169,766 employees

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

Manufacturing sector – **24.5%**

- Textiles and clothing 4.8%
- Electronics 2.3%
- Plastics 2.0%
- Printing and publishing 1.7%

Non-manufacturing sector – **75.5%**

- Trading 45.9%
- Wholesales and retail 8.6%
- Engineering 2.9%
- Construction 2.7%



MICROFINANCE SCHEME

- Launched in June 2012, the Scheme has been extended this June for further 3 years to 28 June 2018 with a number of enhancements
- As at end of August 2015, the Scheme received 331 formal loan applications. Out of the vetted applications, 159 have been approved with the total loan amount of HK\$41.0 million. The approval rate is around 51%
- For the approved applications, the average loan size was about HK\$252,000 and the average loan tenor was 4.5 years

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- Industry types for the approved start-up loans and self-employment loans (excluding 2 self-enhancement loans):
 - Retailing 65 cases (41%)
 - Servicing 55 cases (35%)
 - Wholesales 20 cases (13%)
 - IT related 9 cases (6%)
 - Manufacturing 7 cases (4%)
 - Others 1 case (1%)
- * Component percentages in the table above may not add up to 100% due to rounding.
- The enhancements introduced in June 2015 includes:
 1. The aggregate lending amount cap of the Scheme will be expanded by HK\$100 million to HK\$200 million;
 2. The maximum loan amount of a Self-employment Loan will be increased from HK\$200,000 to HK\$300,000, which is consistent with that of the Micro Business Start-up Loan under the Scheme;
 3. The maximum number of co-borrowers is increased from 2 to 3; and
 4. Existing or former borrowers of Micro Business Start-up Loan or Self-employment Loan who have/had maintained their existing or former loans for at least two years and a satisfactory repayment record under the Scheme can apply for a new loan with a maximum loan amount of HK\$600,000 (including the existing outstanding loan under the Scheme, if any) at a lower interest rate ceiling of 8% per annum.