



HONG KONG MONETARY AUTHORITY

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

29 May 2017



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

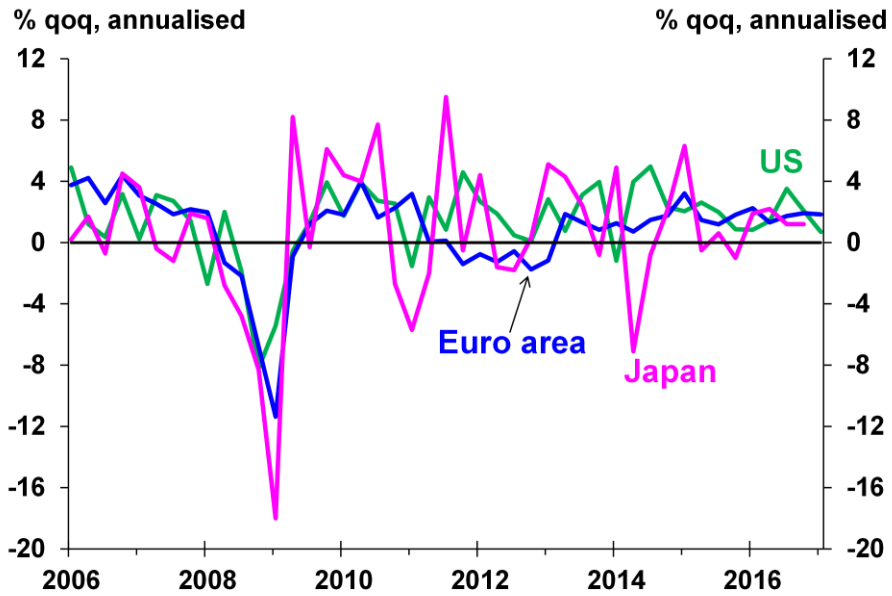
(% year-on-year)

	2016	2017 Forecasts	2018 Forecasts
US	1.6	2.1	2.4
Euro area	1.7	1.7	1.6
Japan	1.0	1.4	1.1
Asia (ex-Japan)	5.7	5.7	5.6
Mainland China	6.7	6.6	6.2
Hong Kong	1.9	2.2	2.1

Sources: May Consensus Forecasts and Official Statistics



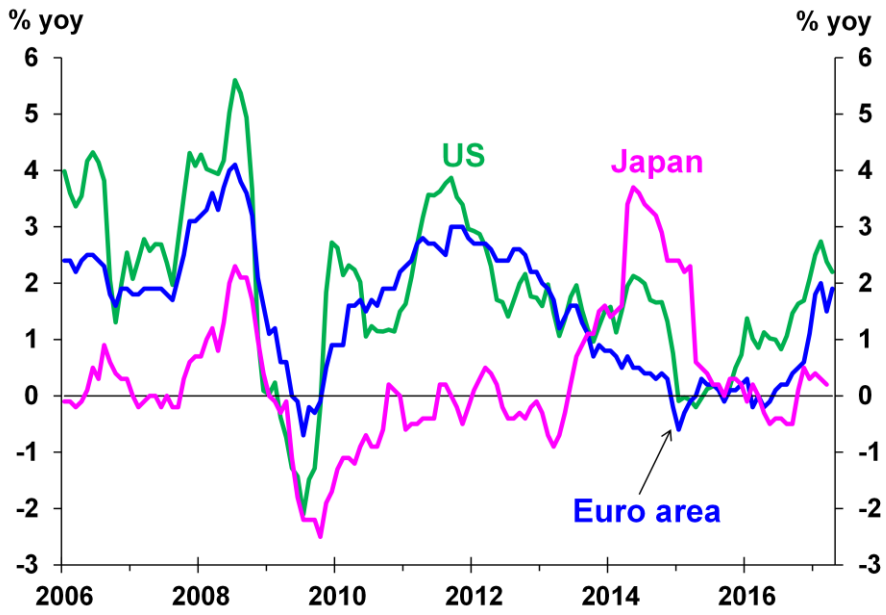
REAL GDP GROWTH IN MAJOR COUNTRIES



Source: Bloomberg



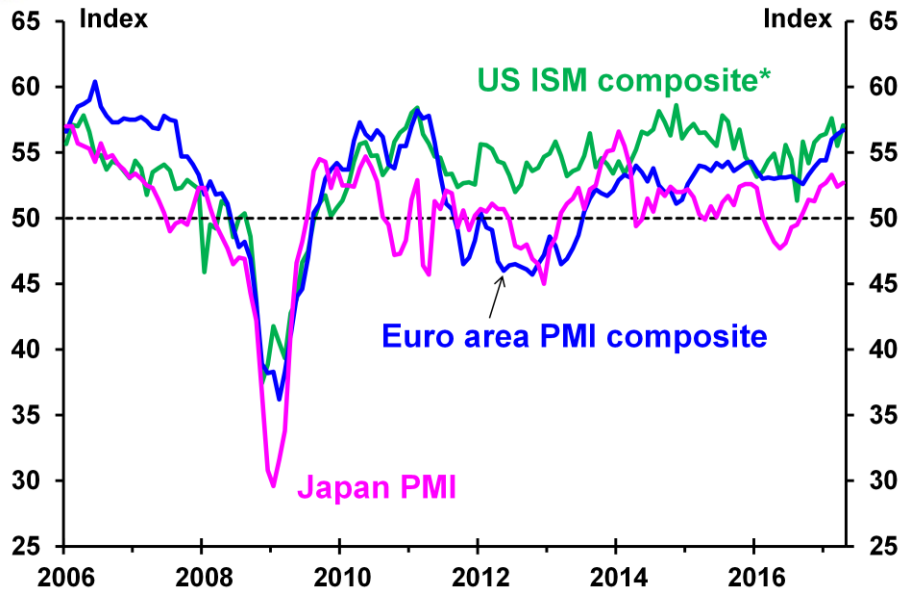
HEADLINE INFLATION IN MAJOR COUNTRIES



Sources: Bloomberg and CEIC



PURCHASING MANAGERS' INDEX IN MAJOR ECONOMIES

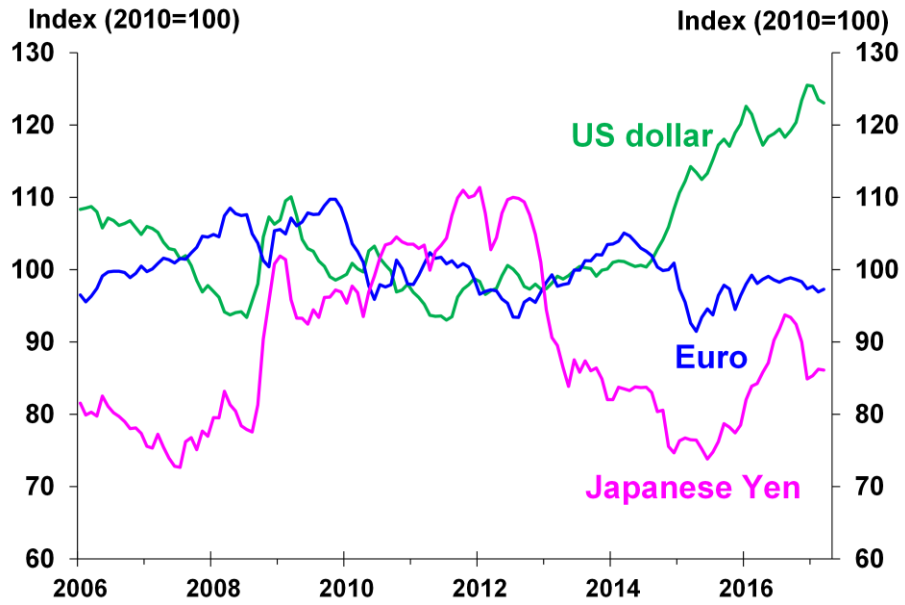


*Weighted average of the ISM manufacturing and non-manufacturing indices

Sources: Bloomberg and CEIC



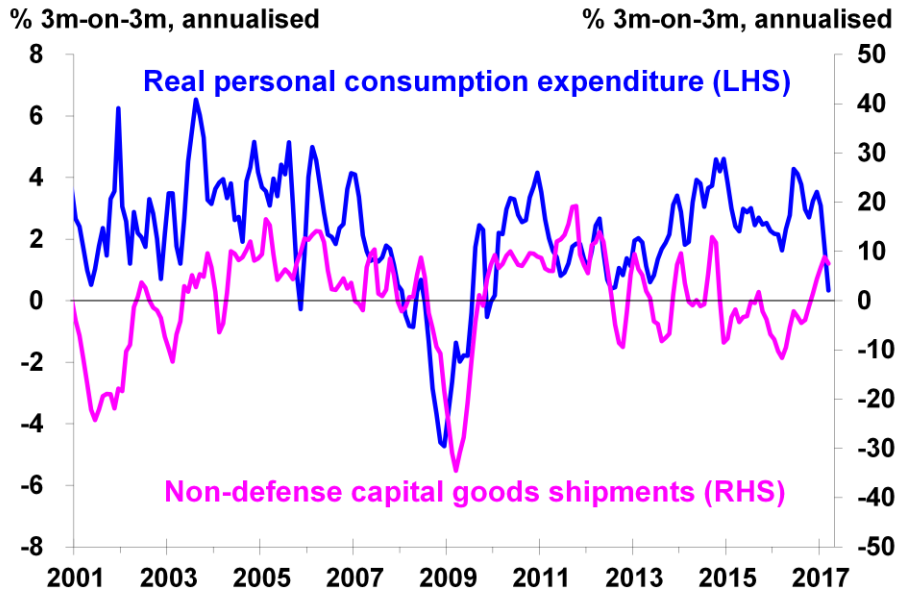
NOMINAL EFFECTIVE EXCHANGE RATE INDEX OF MAJOR CURRENCIES



Source: CEIC



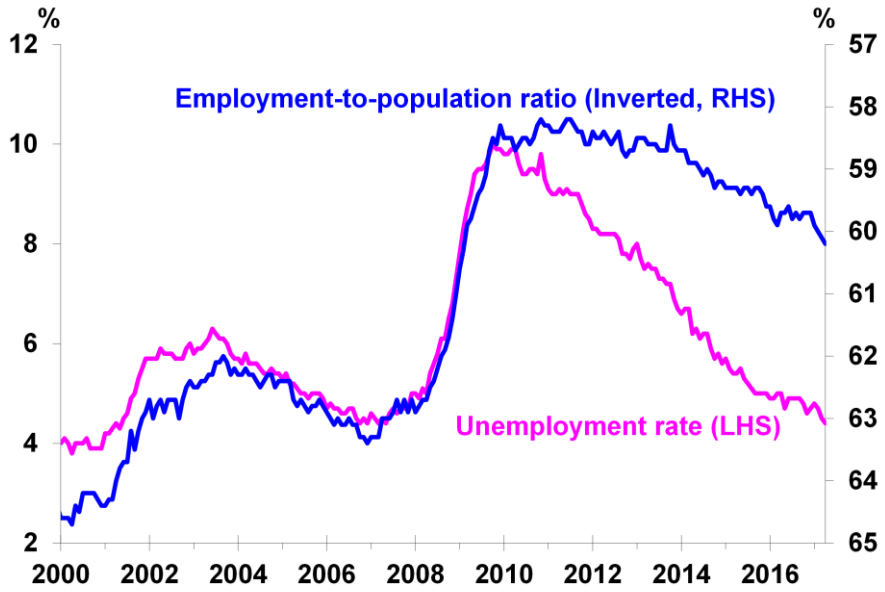
US: CONSUMPTION GROWTH & BUSINESS INVESTMENT ACTIVITY



Source: CEIC



US: LABOUR MARKET SITUATION



Source: CEIC



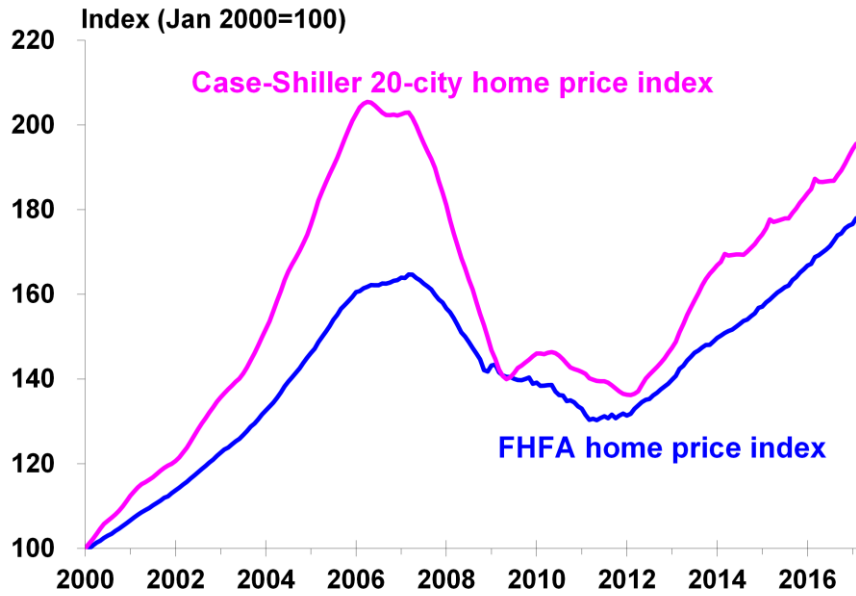
US: LABOUR FORCE PARTICIPATION



Source: CEIC



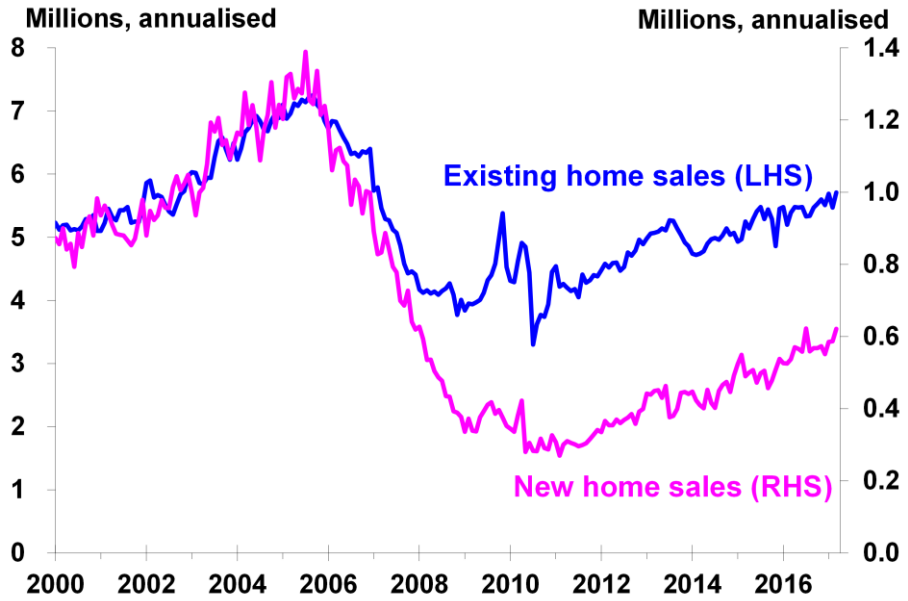
US: HOUSE PRICES



Sources: Standard & Poor's and CEIC



US: HOME SALES

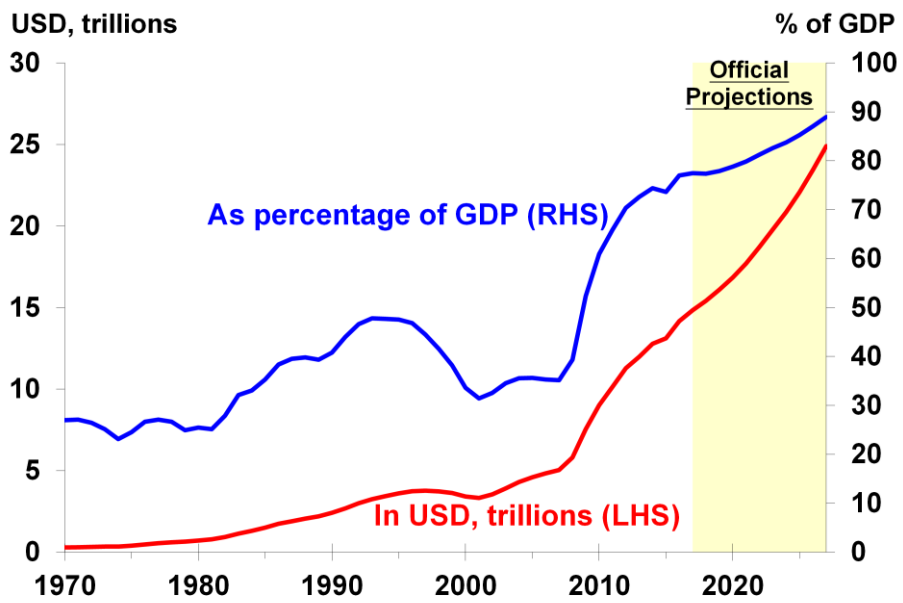


Source: CEIC



US: FEDERAL GOVERNMENT DEBT

US federal debt held by the public

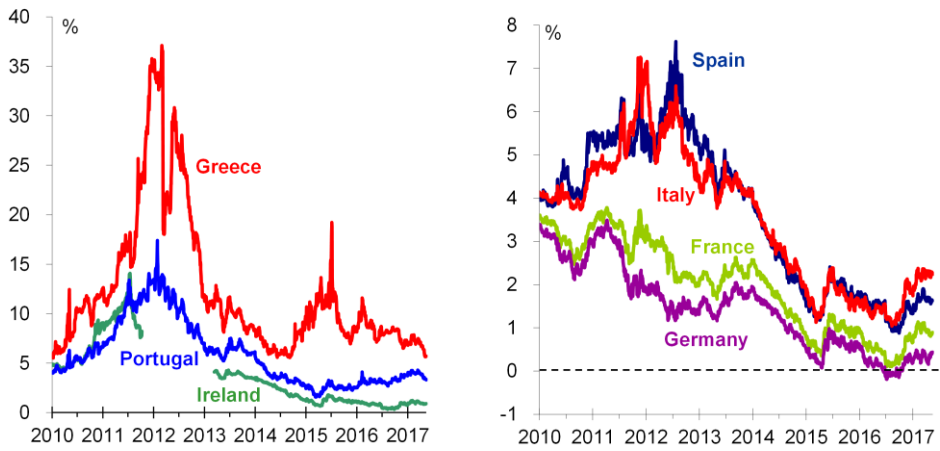


Source: Congressional Budget Office



EURO AREA: SOVEREIGN BOND YIELDS

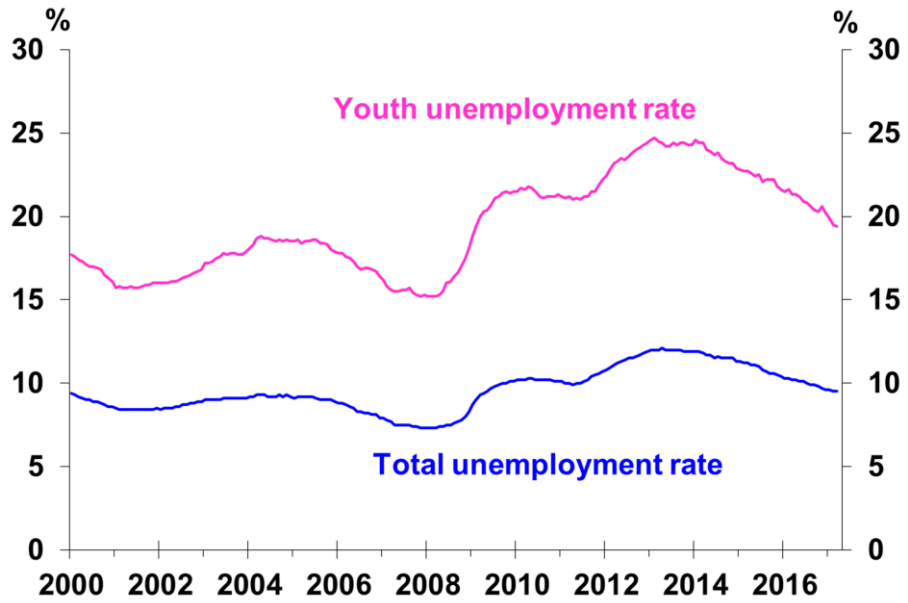
10-year sovereign bond yield



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



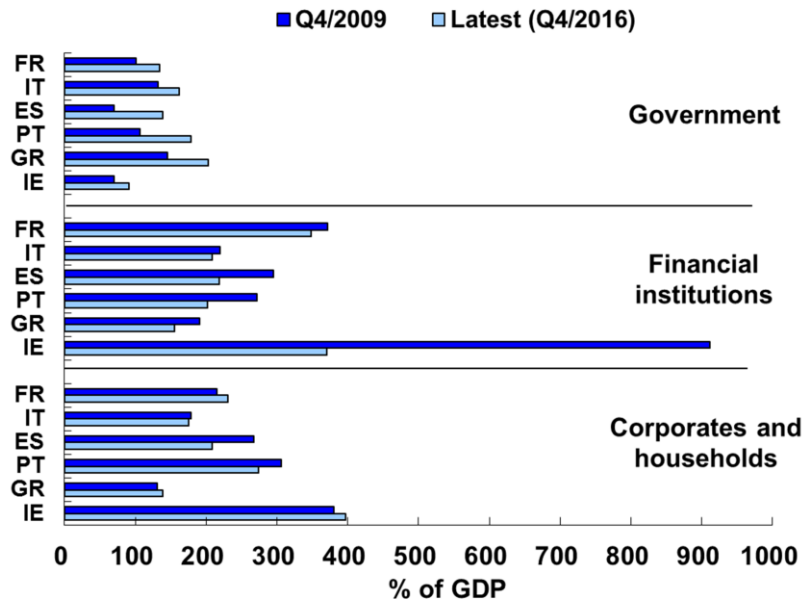
EURO AREA: UNEMPLOYMENT RATE



Source: Bloomberg



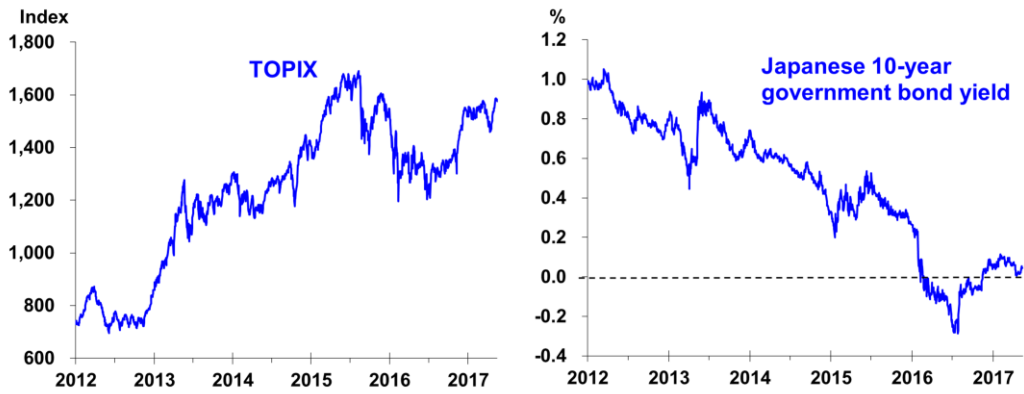
EURO AREA: OVERALL INDEBTEDNESS



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



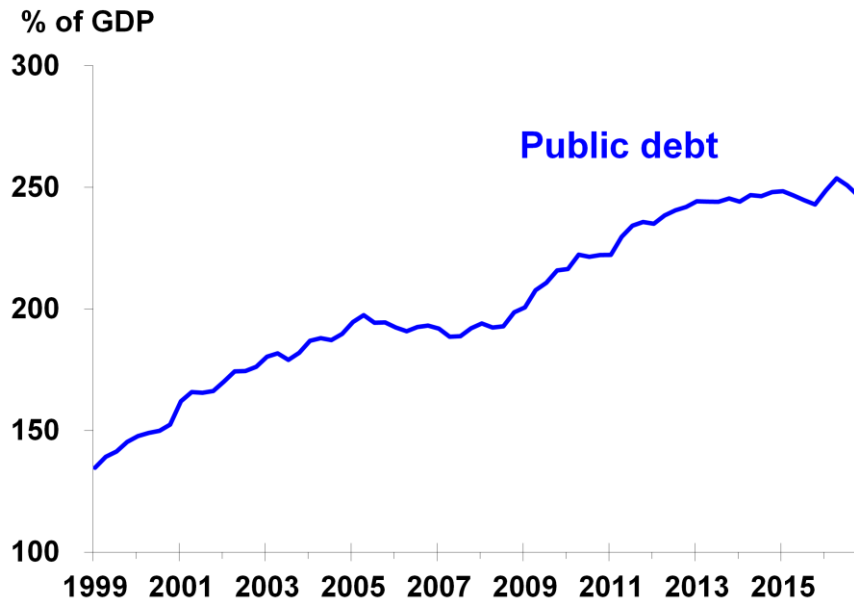
JAPAN: FINANCIAL MARKETS



Source: Bloomberg



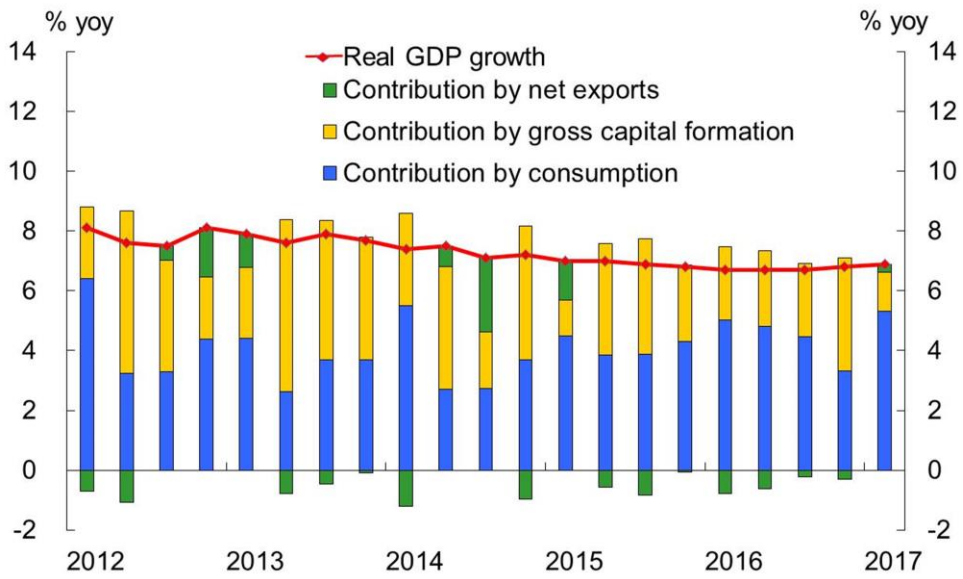
JAPAN: PUBLIC DEBT



Sources: Bank of Japan and CEIC



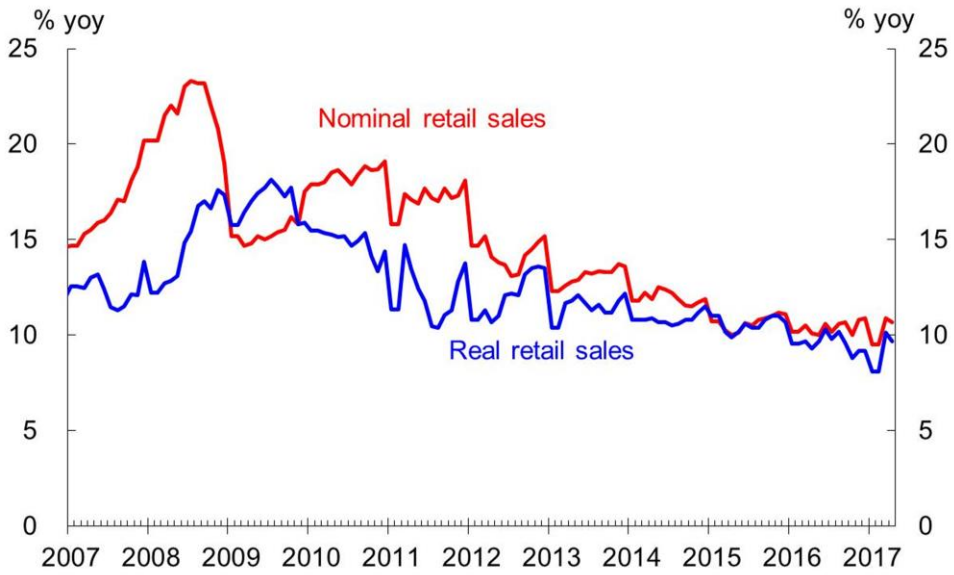
MAINLAND CHINA: REAL GDP GROWTH



Source: CEIC



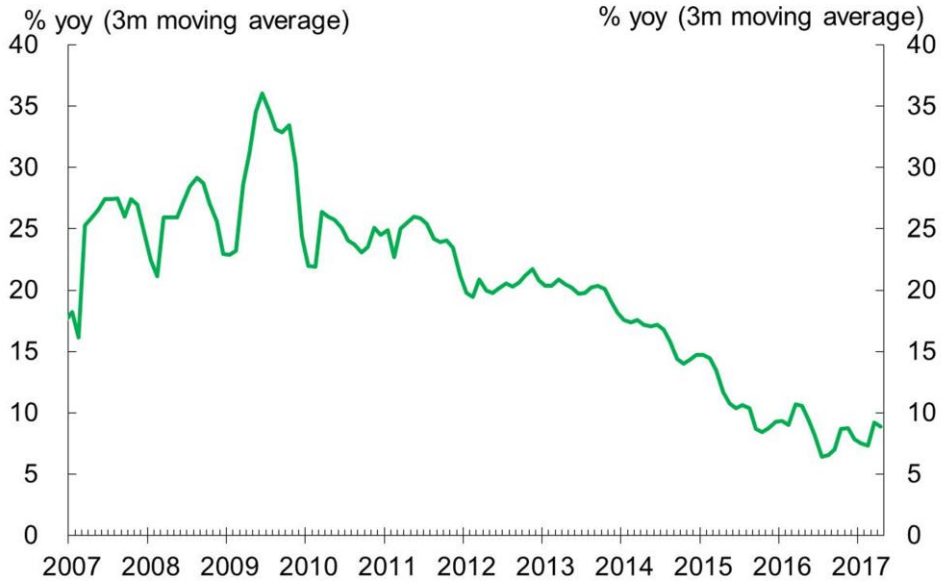
MAINLAND CHINA: RETAIL SALES



Note: January and February figures are the average growth rate for the first two months of the year
Sources: WIND and HKMA staff estimates



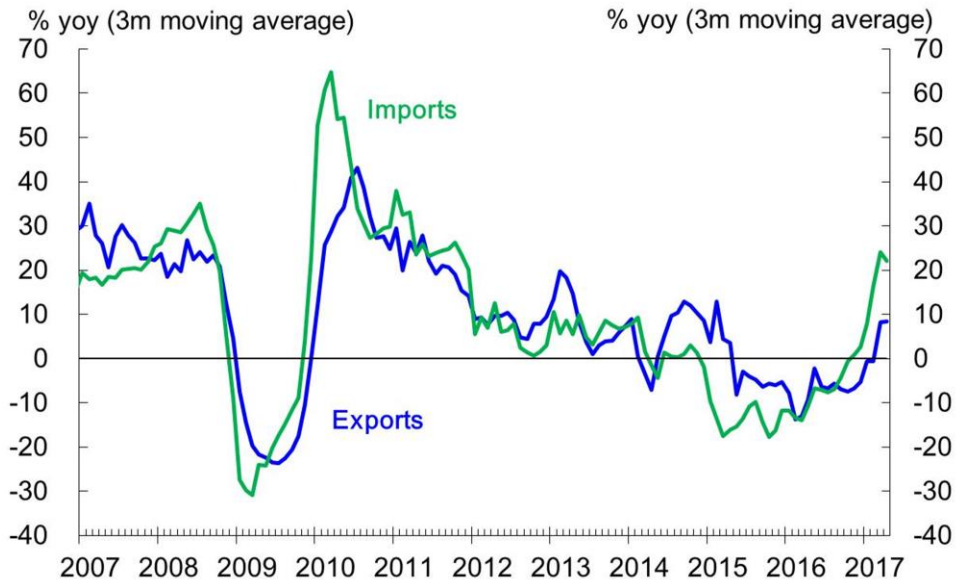
MAINLAND CHINA: FIXED ASSET INVESTMENT



Sources: CEIC and HKMA staff estimates



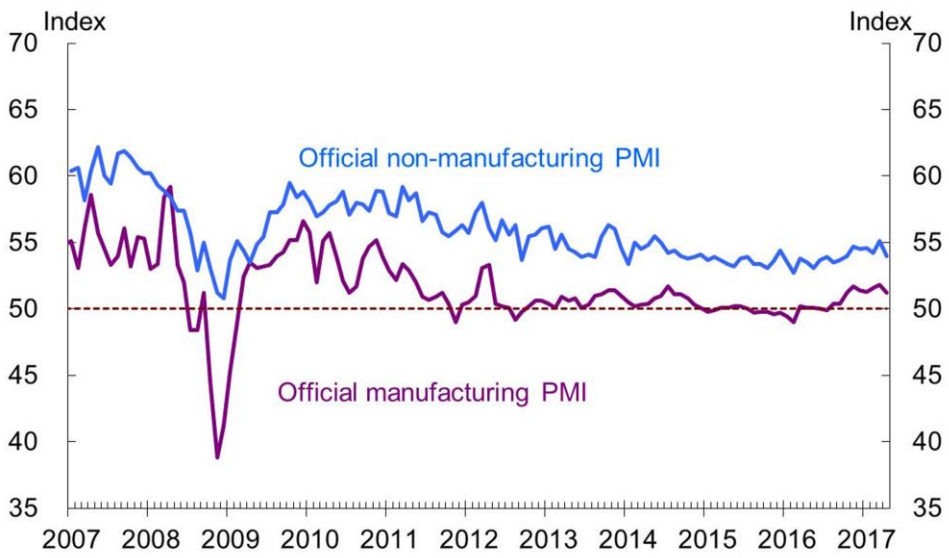
MAINLAND CHINA: IMPORT AND EXPORT GROWTH



Sources: CEIC and HKMA staff estimates



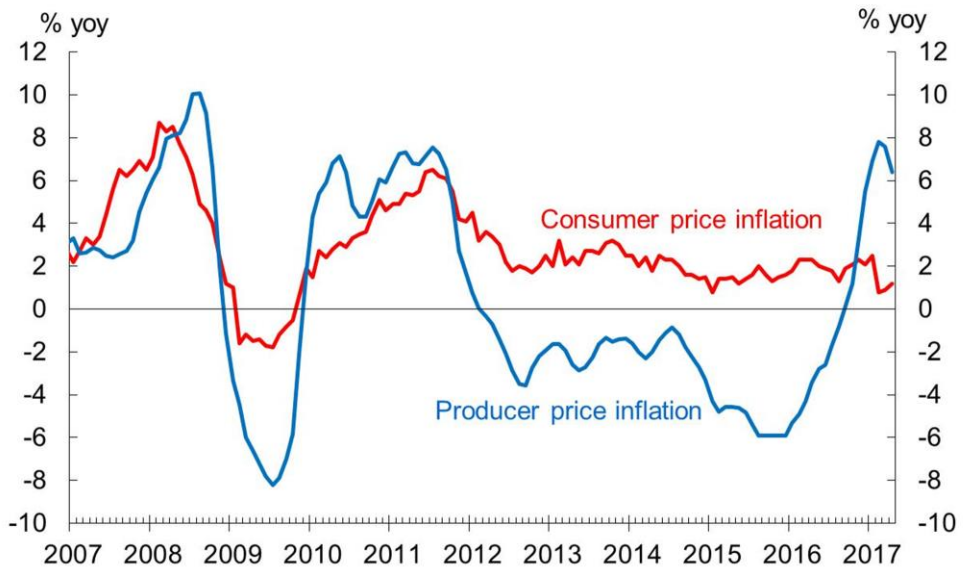
MAINLAND CHINA: PURCHASING MANAGERS' INDEX



Source: CEIC



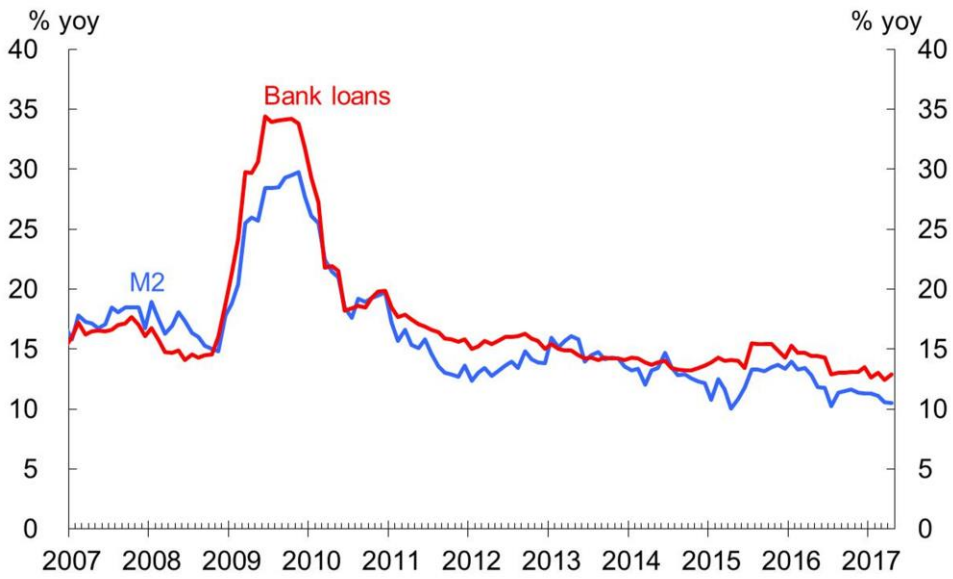
MAINLAND CHINA: INFLATION



Source: CEIC



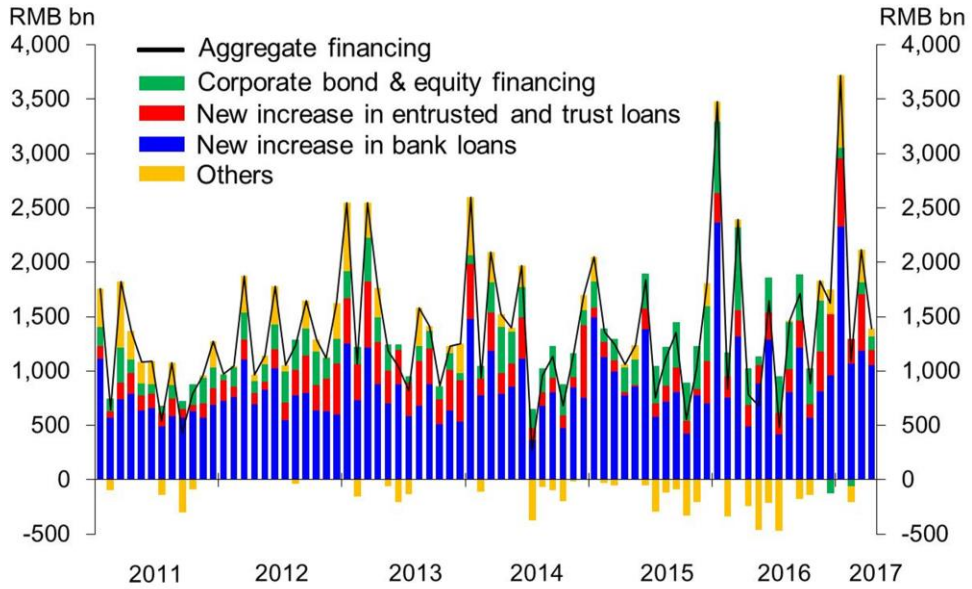
MAINLAND CHINA: MONEY AND LOAN GROWTH



Source: CEIC



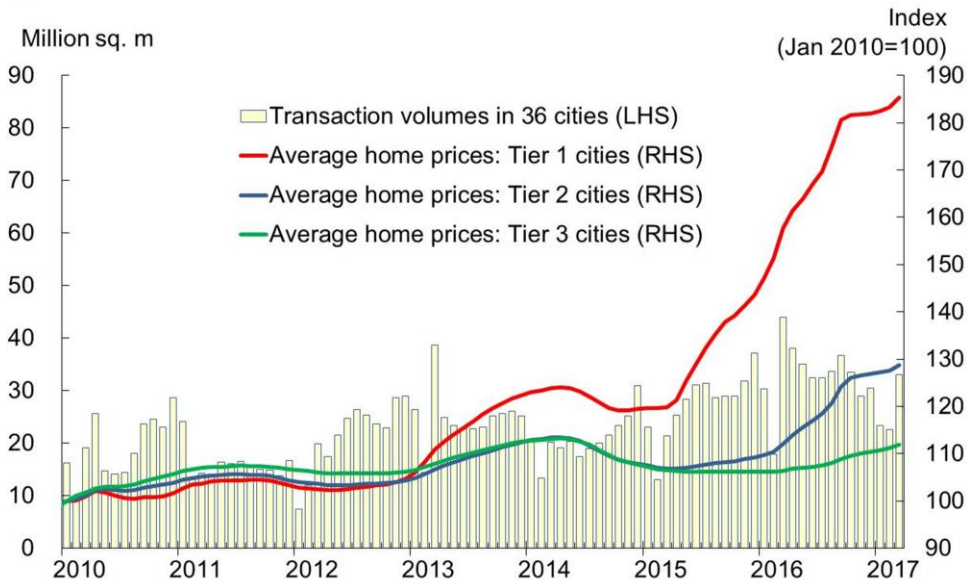
MAINLAND CHINA: AGGREGATE FINANCING FLOW



Source: CEIC



MAINLAND CHINA: PROPERTY PRICE AND TRANSACTION VOLUME



Sources: CEIC, WIND and HKMA staff estimates



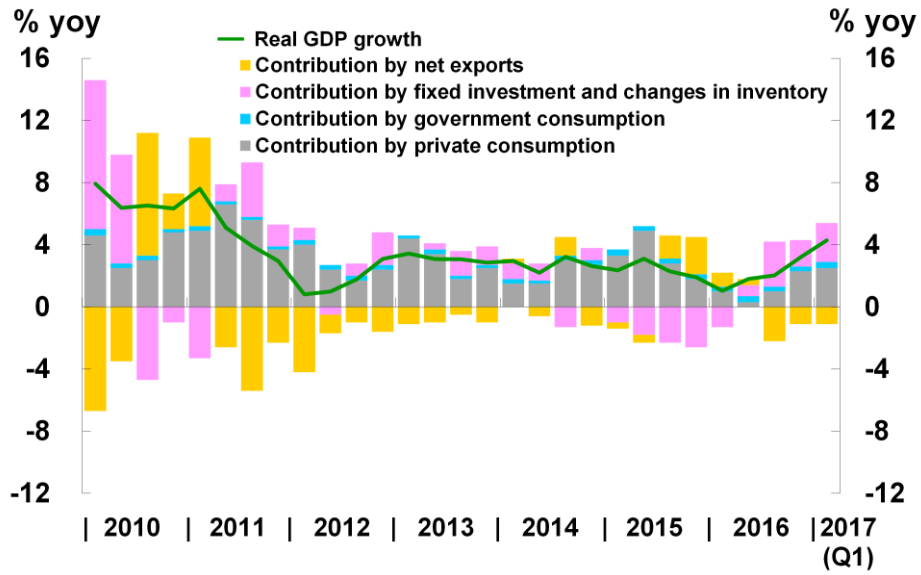
MAINLAND CHINA: HOUSING PRICE CHANGES IN MAJOR CITIES



Sources: CEIC, WIND and HKMA staff estimates



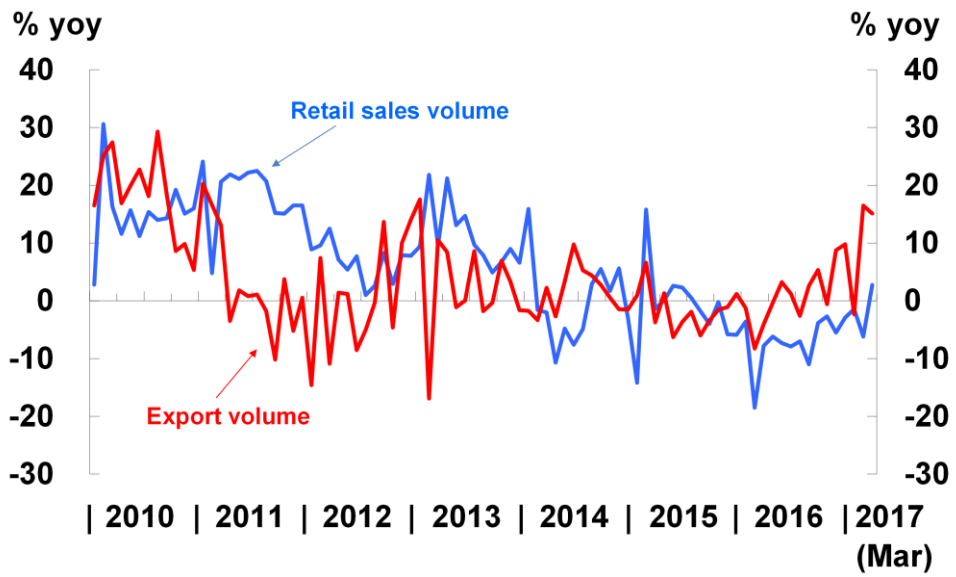
HONG KONG: REAL GDP GROWTH



Source: C&SD



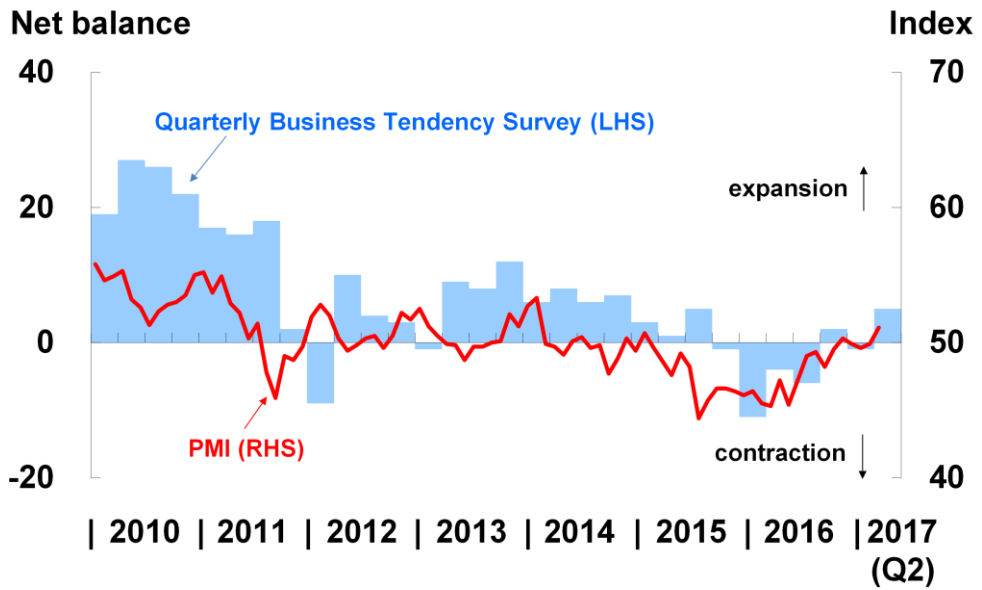
HONG KONG: ECONOMIC ACTIVITY



Source: C&SD



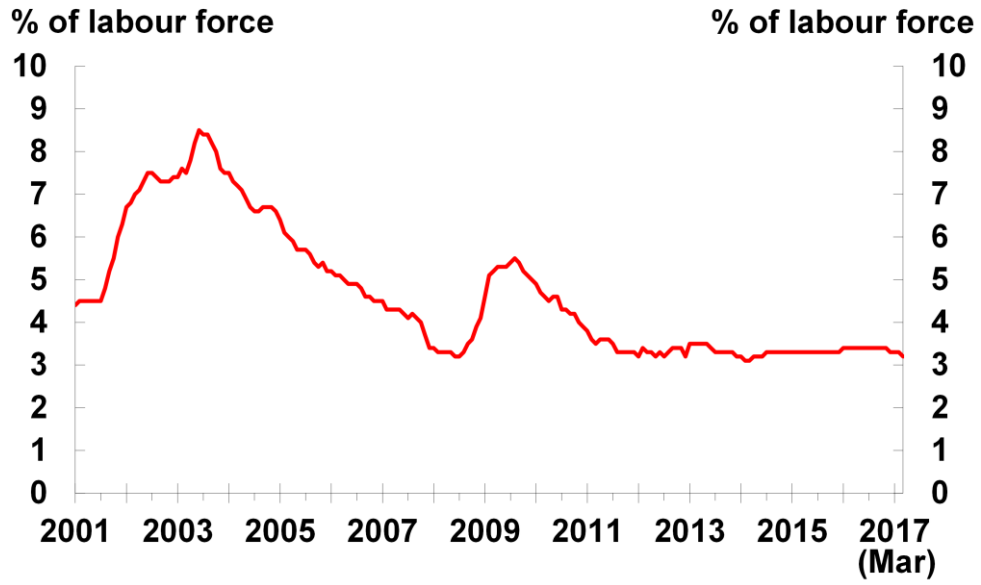
HONG KONG: BUSINESS OUTLOOK



Sources: C&SD and Markit Economics



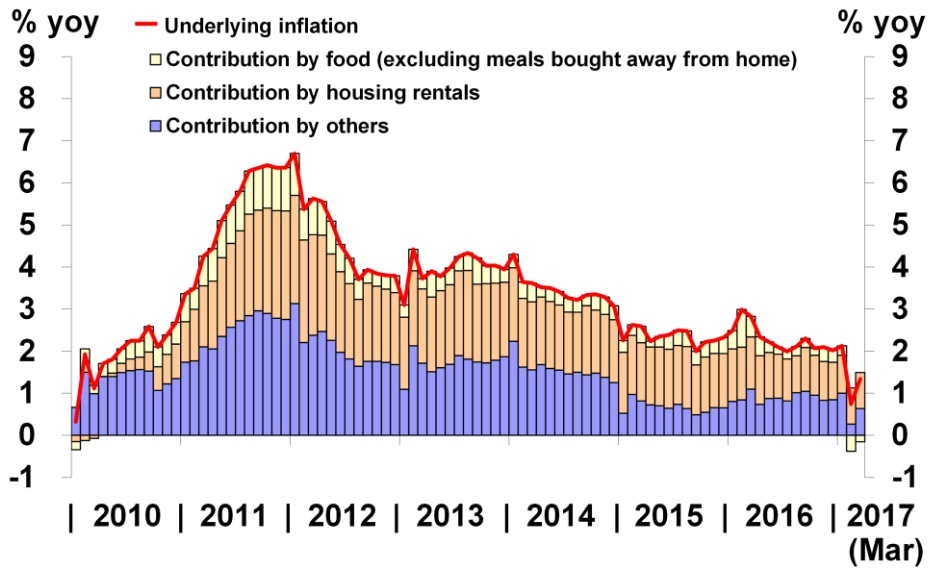
HONG KONG: UNEMPLOYMENT RATE



Source: C&SD



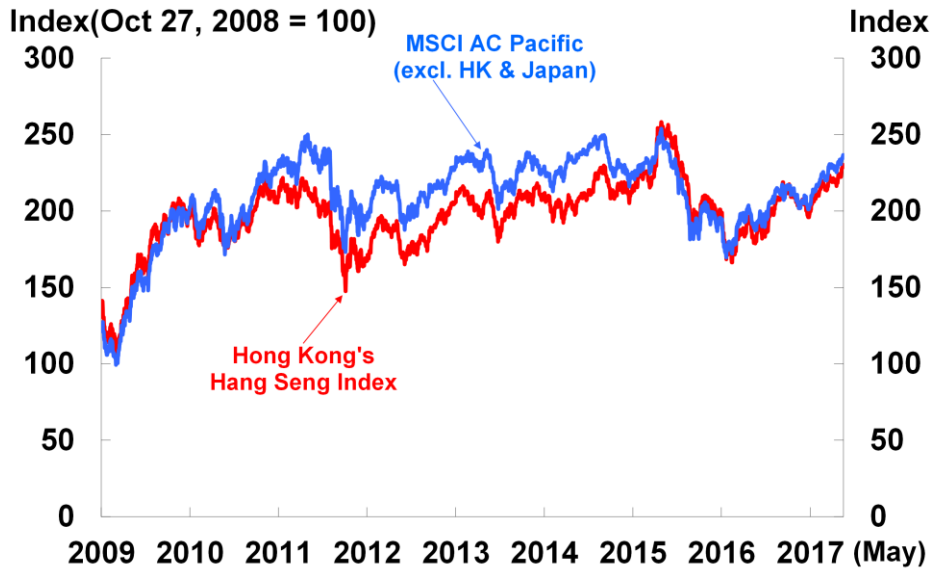
HONG KONG: INFLATION



Sources: C&SD and HKMA staff estimates



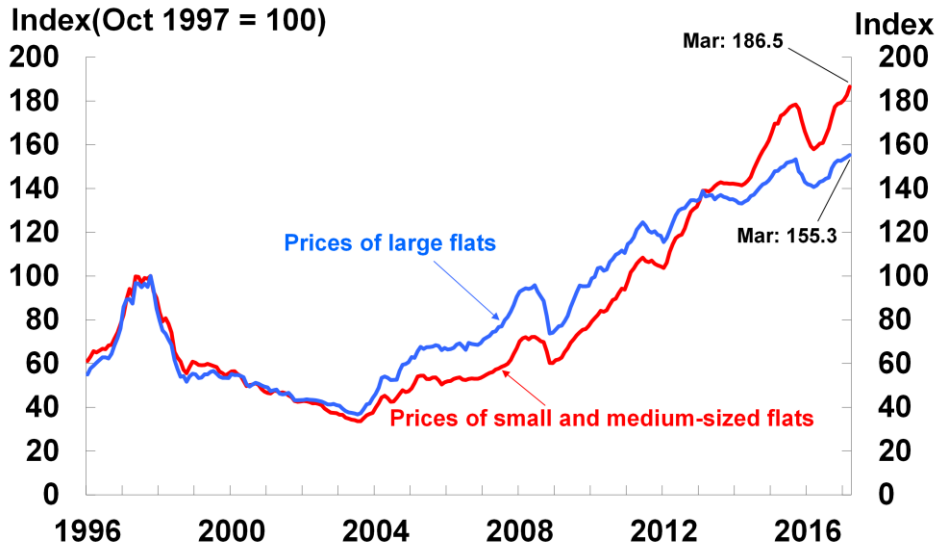
HONG KONG: EQUITY MARKET



Source: Bloomberg



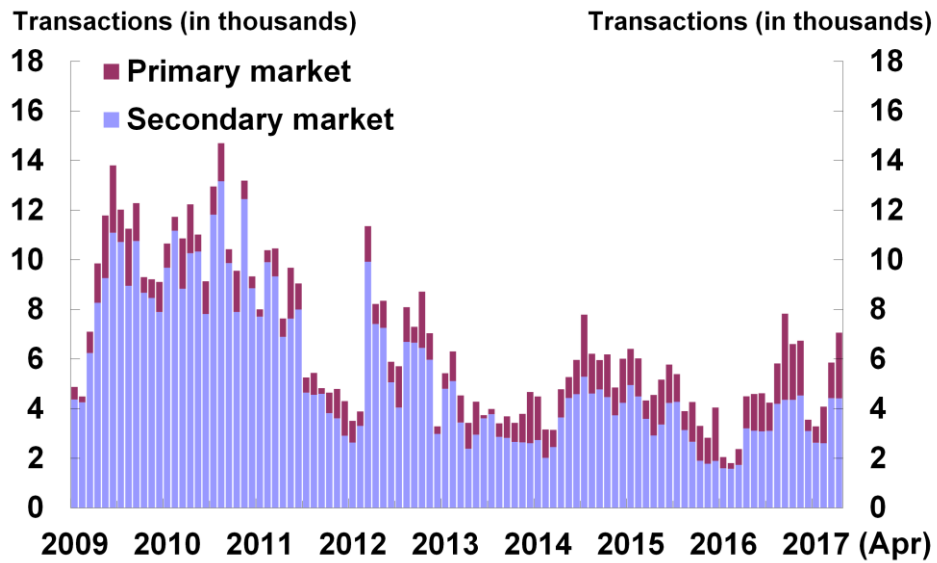
HONG KONG: RESIDENTIAL PROPERTY PRICES



Source: Rating and Valuation Department



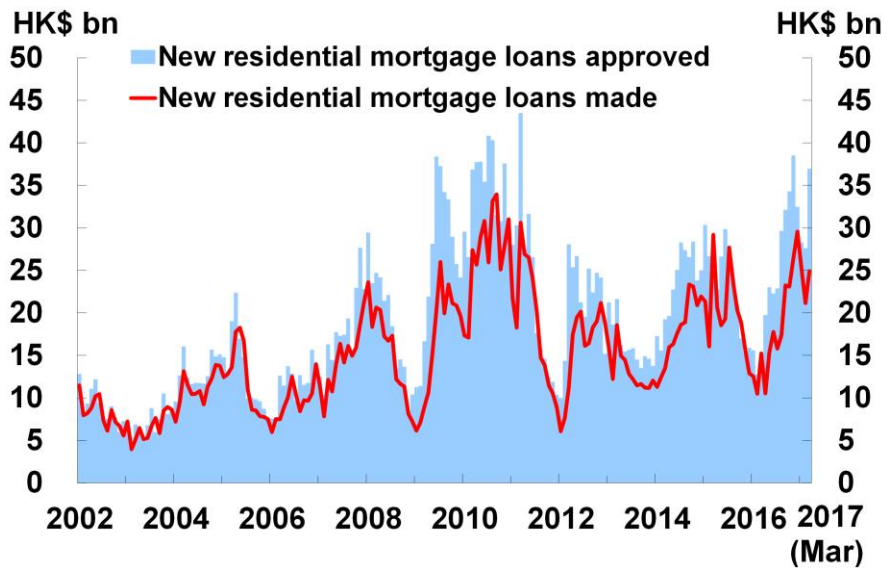
HONG KONG: TRANSACTION VOLUME IN THE PRIMARY AND SECONDARY MARKETS



Source: The Land Registry



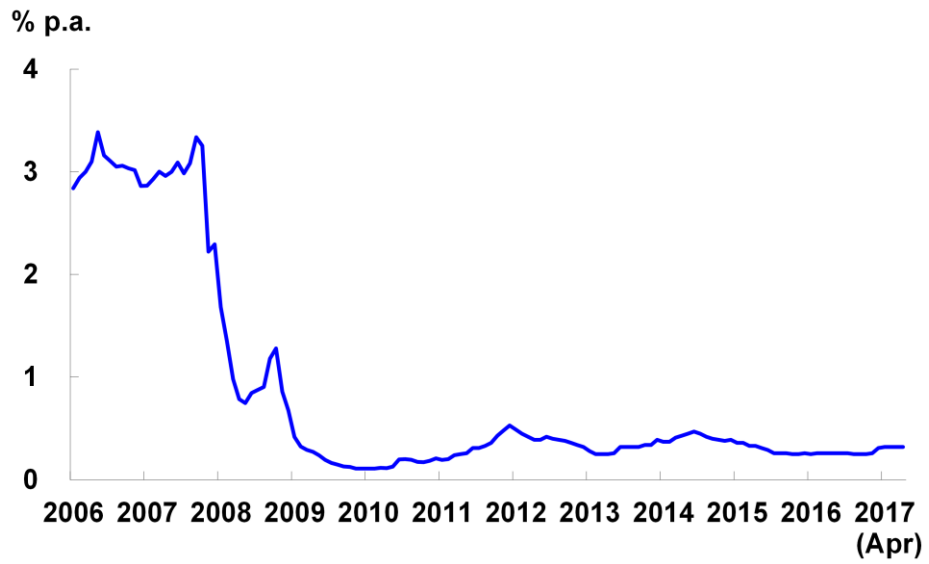
HONG KONG: NEW RESIDENTIAL MORTGAGE LOANS



Source: HKMA



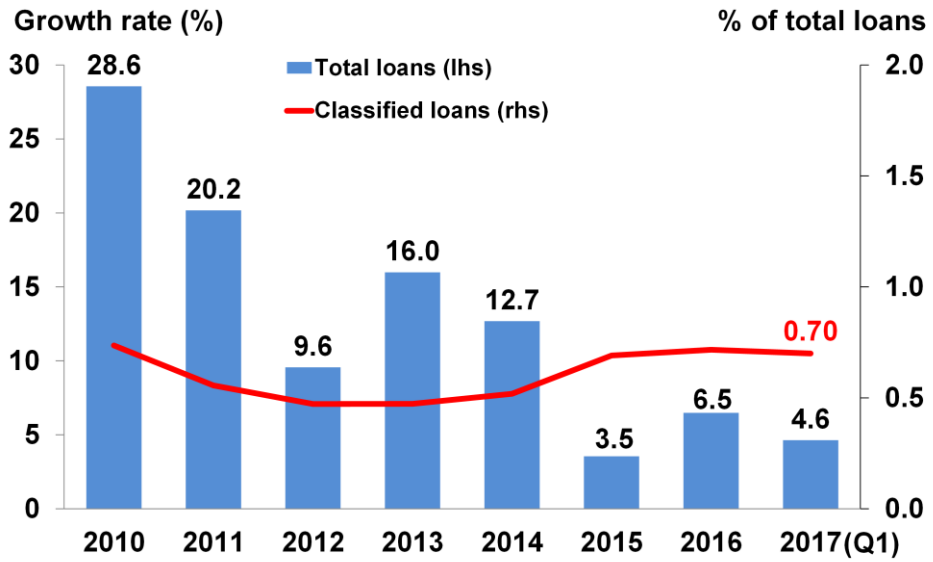
HONG KONG: COMPOSITE INTEREST RATE



Source: HKMA



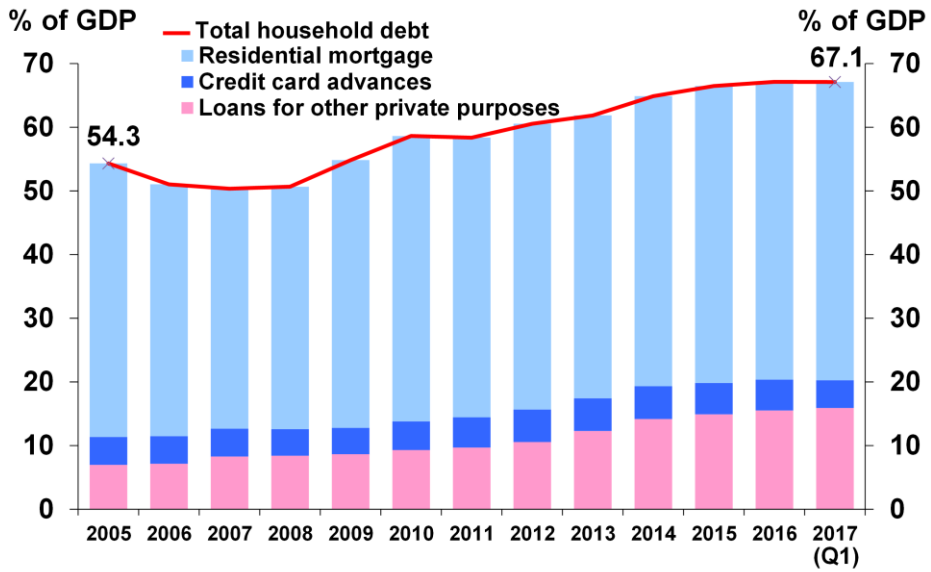
HONG KONG: LOAN GROWTH AND ASSET QUALITY



•Source: HKMA



HONG KONG: HOUSEHOLD DEBT



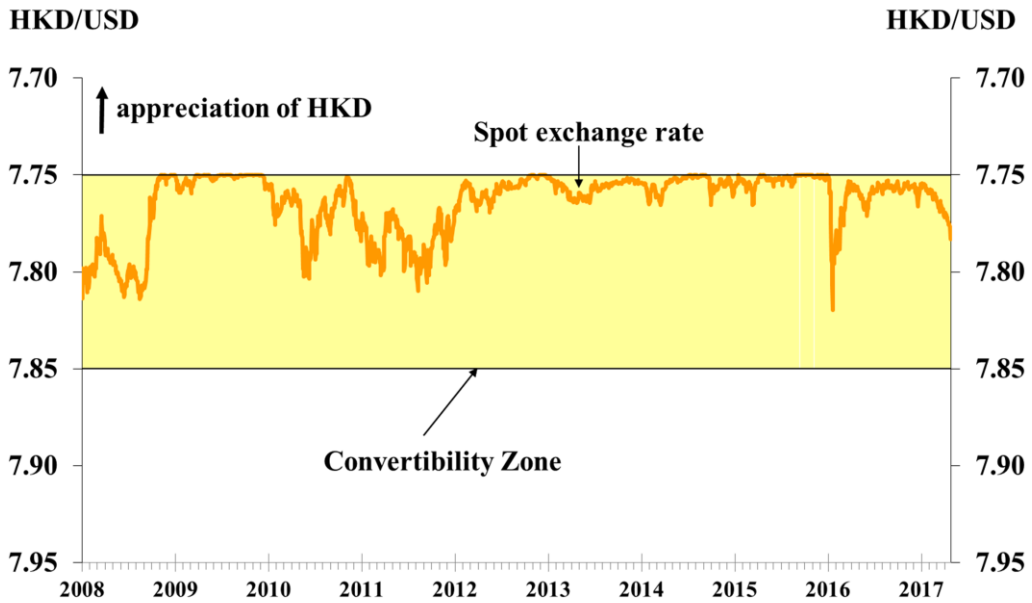
Source: HKMA



CURRENCY STABILITY



HONG KONG DOLLAR SPOT EXCHANGE RATE

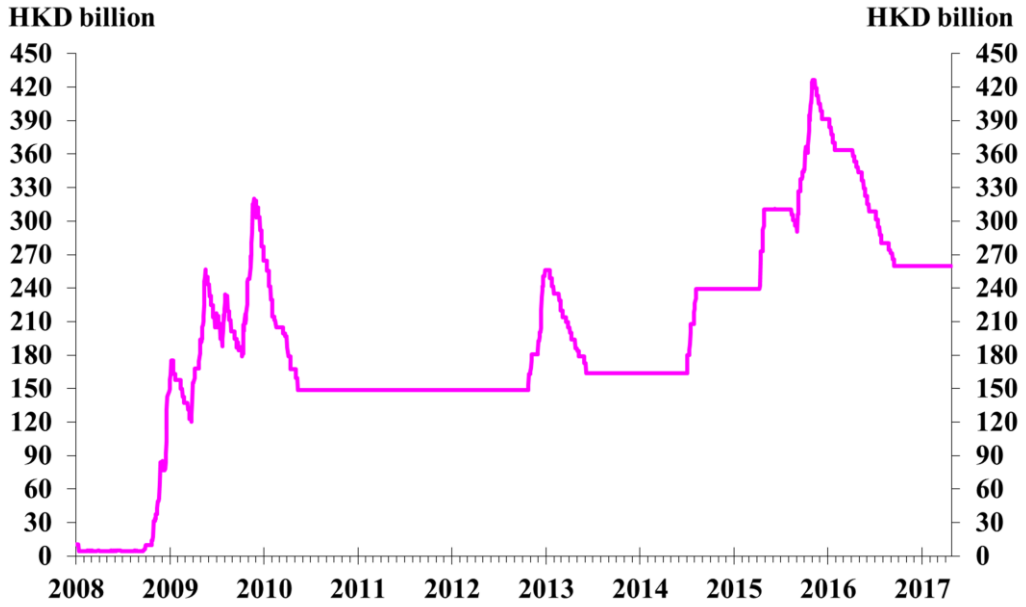


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- The Hong Kong dollar spot exchange rate traded in a softer tone in the past two months amid increased carry trades on the back of widening interest rate differentials between the US dollar and Hong Kong dollar. The Hong Kong dollar eased gradually from about 7.76 per US dollar at end-February to around 7.78 at end-April.



AGGREGATE BALANCE

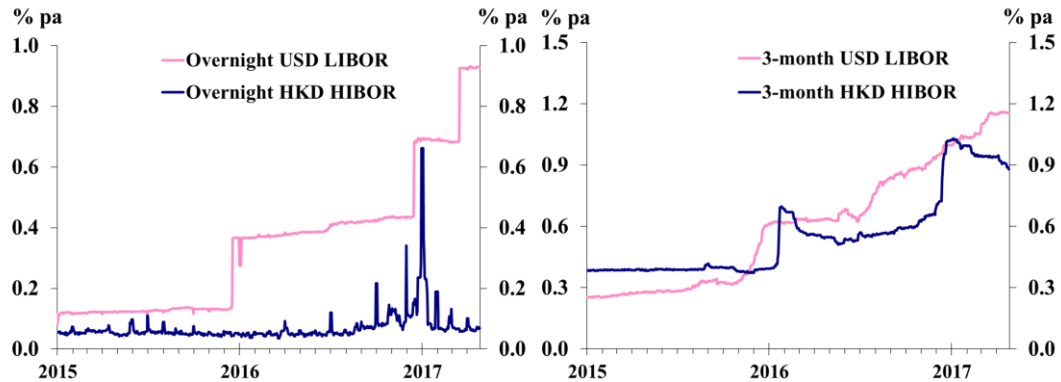


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- The Aggregate Balance remained stable at levels close to HK\$260 billion in the past two months.



DOMESTIC INTEREST RATES



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- The Hong Kong dollar interbank interest rates (HIBORs) remained lower than their US dollar counterparts (LIBORs). Owing to the US interest rate hike in March, the spread between overnight HIBOR and LIBOR widened from -55 basis points at end-February to about -85 basis points at end-April. During the same period, the three-month spread also widened from -12 basis points to nearly -30 basis points.



- Reflecting widened interest rate differentials between the Hong Kong dollar and US dollar, the 12-month Hong Kong dollar forward points moved into deeper discounts, from -170 pips at end-February to around -340 pips in mid-April. It remained steady at such level towards the end of April.

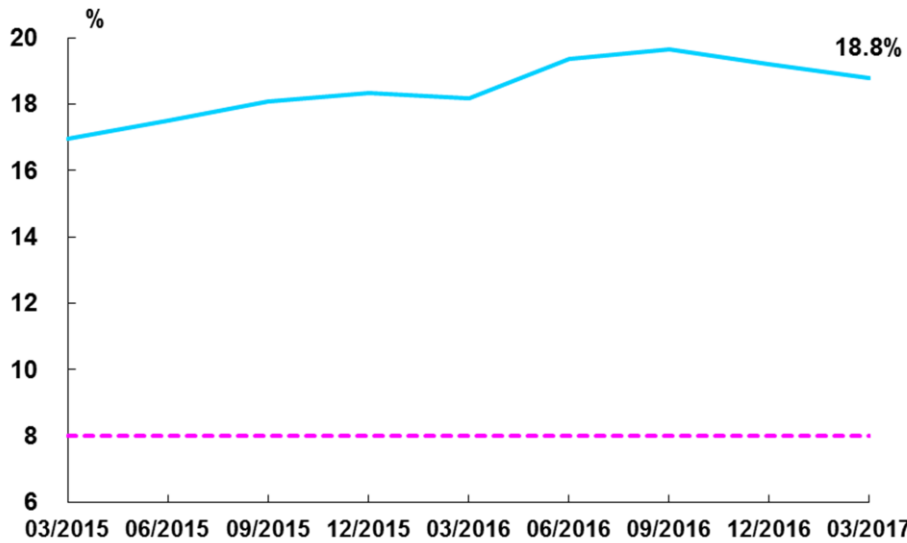


BANKING STABILITY



BANKING SECTOR PERFORMANCE

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



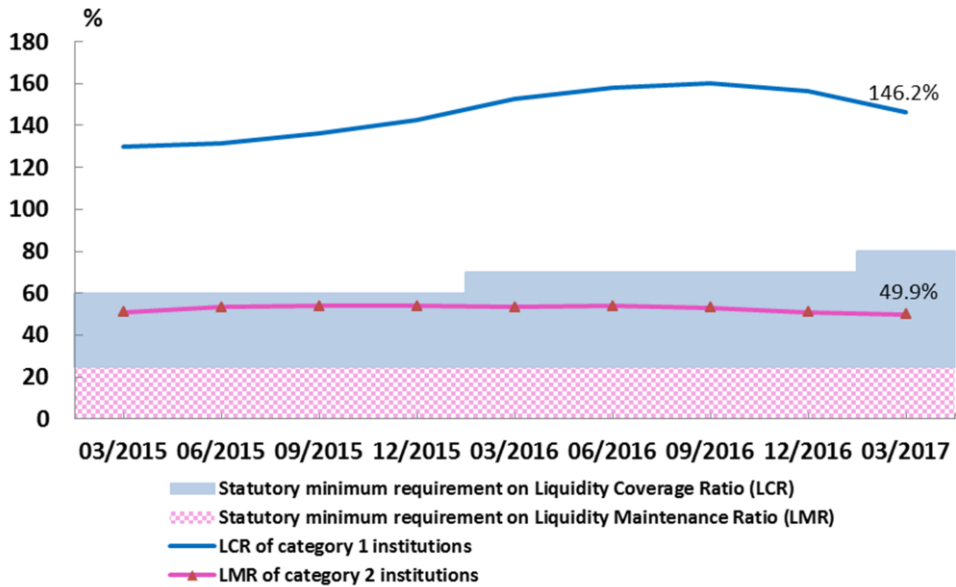
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- The banking sector continued to be well capitalised. The consolidated capital adequacy ratio of locally incorporated AIs declined slightly to 18.8% at end-March 2017 from 19.2% a quarter earlier, but still well above the international minimum requirement of 8%.



BANKING SECTOR PERFORMANCE

Liquidity position remained sound



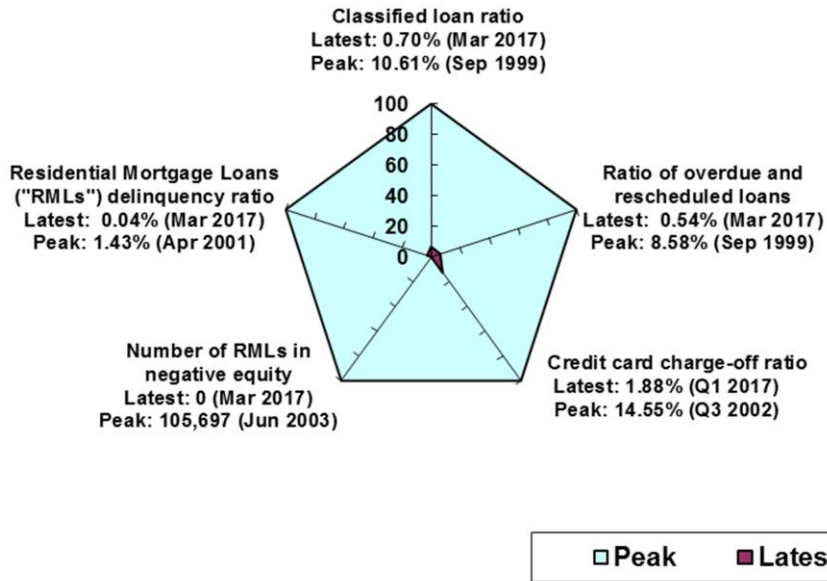
49

- In Q1 2017, the quarterly average Liquidity Coverage Ratio of category 1 institutions was 146.2%, well above the 80% statutory minimum requirement applicable for 2017. For category 2 institutions, their quarterly average Liquidity Maintenance Ratio was 49.9%, also well above the 25% statutory minimum requirement.



BANKING SECTOR PERFORMANCE

Asset quality remained healthy



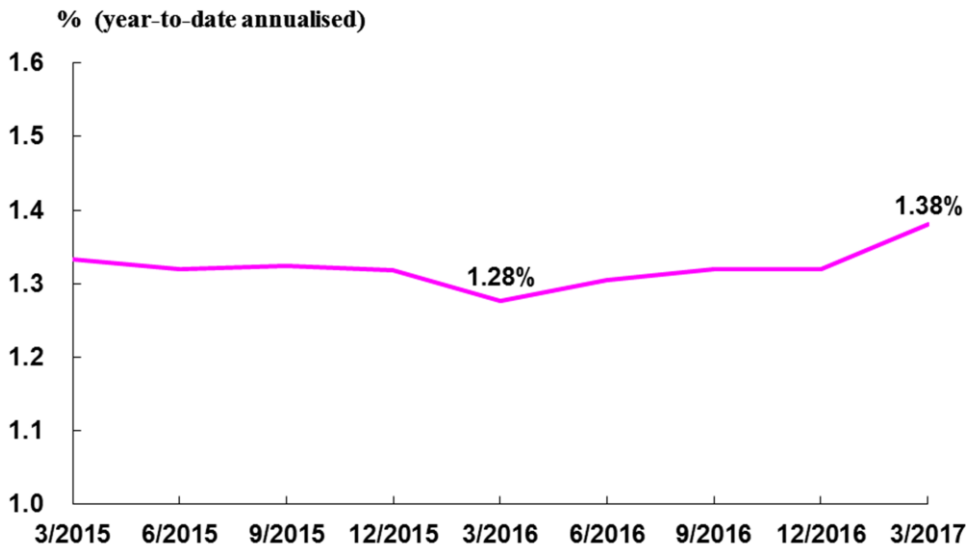
50

- The asset quality of retail banks continued to hold up well. Their classified loan ratio edged down to 0.70% at end-March 2017 from 0.72% a quarter earlier. Similarly, the classified loan ratio of the whole banking sector fell to 0.83% from 0.85%.



BANKING SECTOR PERFORMANCE

Net interest margin improved



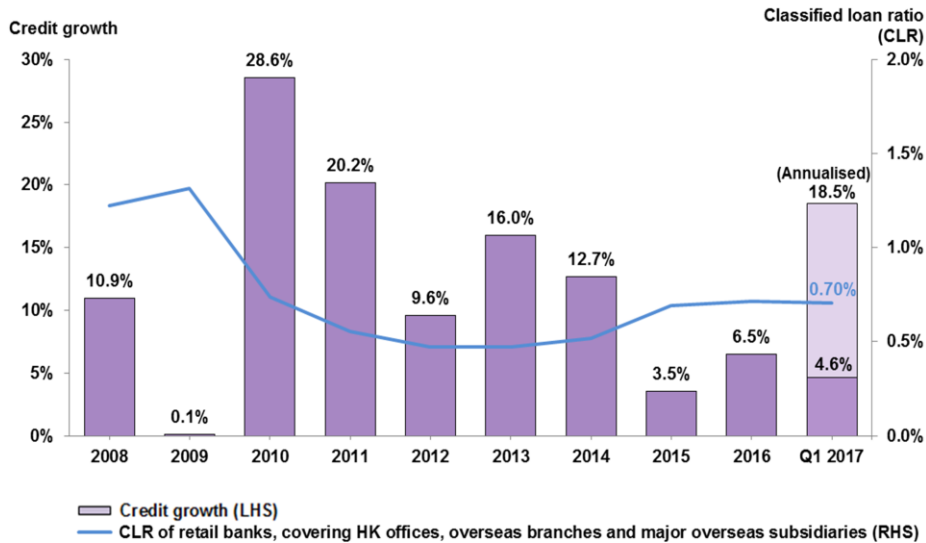
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- The net interest margin of retail banks' Hong Kong offices rose to 1.38% in the first quarter of 2017 from 1.28% in the same period last year.



CREDIT GROWTH AND ASSET QUALITY

Credit growth accelerated with asset quality staying at healthy level



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Credit Growth

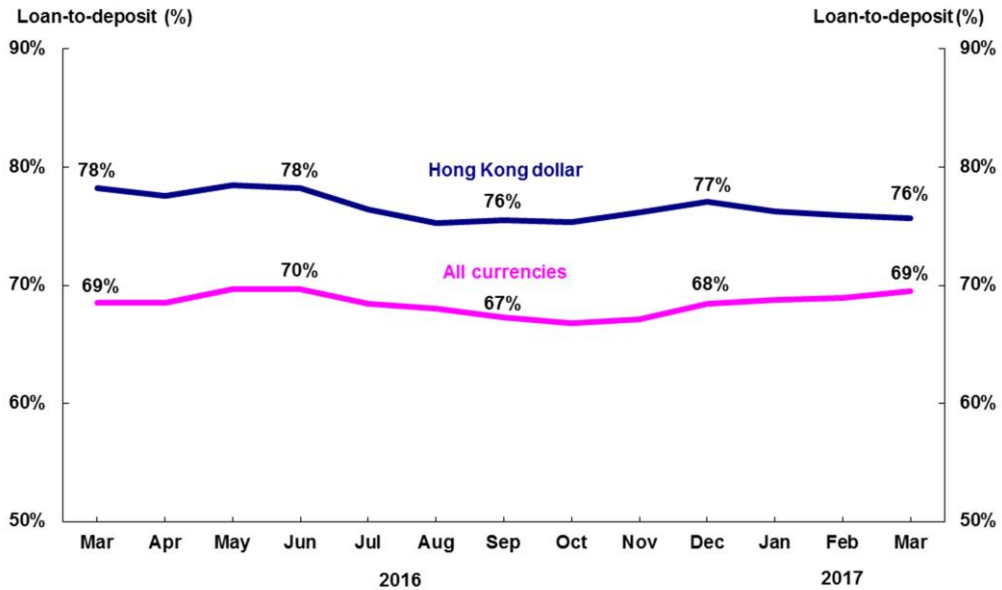
- Hong Kong banking sector's total loans increased by 4.6% in the first quarter of 2017, or 18.5% on an annualized basis, higher than the 6.5% increase in 2016. The growth in the first quarter was broad-based. Both loans for use in Hong Kong (+4.1% on quarter-on-quarter basis or +16.4% on an annualized basis) and loans for use outside Hong Kong (+6.2% on quarter-on-quarter basis or +24.7% on an annualized basis) recorded significant growth, mainly due to increase in demand for new loans by Hong Kong corporates and overseas entities. Trade finance also grew at a faster pace in March, reflecting the significant improvement of import and export trades in recent months.

Asset Quality

- The asset quality of the banking sector remained healthy. At end-March 2017, retail banks' classified loan ratio stood at 0.70%, still well below the long-run historical average of 2.3% since 2000.



LOAN-TO-DEPOSIT RATIOS WERE BROADLY STABLE



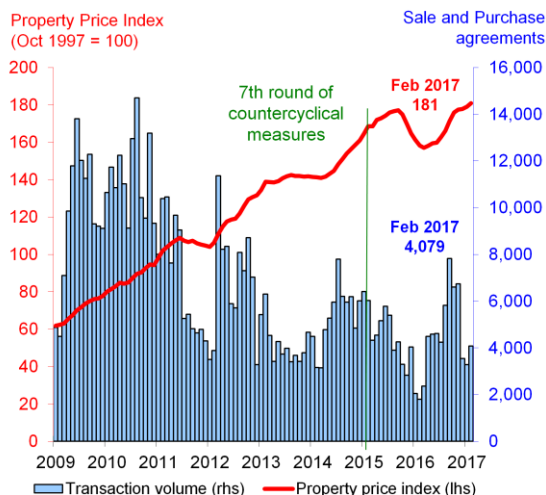
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- Hong Kong-dollar loan-to-deposit ratio stood at 76% at end-March 2017, slightly down from 77% a quarter earlier.
- All currencies loan-to-deposit ratio edged up to 69% from 68%.



RISK MANAGEMENT OF PROPERTY MORTGAGE LOANS

Residential property price index and transaction volume



Sources: R&VD and Land Registry

Average loan-to-value ratio and debt servicing ratio for new residential mortgage loans approved



* Before the first round of HKMA's countercyclical measures was introduced

When the tighter requirement on debt servicing ratio was introduced by the HKMA

Latest statistics for residential mortgage loans (RMLs)

	Monthly average in 2015	Monthly average in 2016	Oct 2016	Nov 2016	Dec 2016	Jan 2017	Feb 2017	Mar 2017
Number of sale and purchase agreements	4,665	4,558	6,601	6,739	3,550	3,286	4,079	5,856
Number of new RML applications	9,626	10,294	14,323	14,204	10,505	9,914	9,904	15,603
Number of new RMLs approved	7,059	7,290	9,830	10,664	8,961	7,678	7,404	9,940

Latest statistics for residential property prices

Property price index		Period	Property price index
Rating and Valuation Department (10/1997=100)	Latest position	02/2017	180.9
	Recent Peak	02/2017	180.9
	Peak in 1997	10/1997	100.0
Centaline (6/7/1997=100)	Latest position	16/04/2017	152.8
	Recent Peak	16/04/2017	152.8
	Peak in 1997	19/10/1997	102.9



PROPERTY MARKET

Introduced measures on 12 May to strengthen the risk management of banks for lending to property developers:

1. Tightening the caps on ratios for construction financing
2. Introducing a new mechanism requiring banks to set aside an adequate amount of capital with reference to the level of mortgage exposures of property developers



PROPERTY MARKET

Introduced the 8th round of counter-cyclical macroprudential measures on 19 May :

1. Raising the risk-weight floor for new residential mortgage loans granted by banks using Internal Ratings-Based Approach from 15% to 25%
2. For borrowers with one or more pre-existing mortgages: lowering the applicable loan-to-value ratio cap by 10 percentage points
3. For borrowers with income mainly derived from outside Hong Kong: lowering the applicable debt servicing ratio limit by 10 percentage points



INTERNATIONAL STANDARDS IMPLEMENTATION

- Amendment of Banking (Capital) Rules to implement:
 - Revised securitisation framework
 - Basel III leverage ratio
 - Capital treatment of expected loss provisioning

- Amendment of Banking (Liquidity) Rules to implement Basel III Net Stable Funding Ratio (NSFR)

- Amendment of Banking Ordinance to implement Basel Committee's new large exposure framework and Financial Stability Board's standards relating to recovery planning

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- We plan to submit the above legislative proposals to the LegCo in the fourth quarter of 2017 for implementing the relevant international regulatory standards.



AMENDMENT OF BANKING (CAPITAL) RULES – SECURITISATION

- A revised framework for risk-weighting banks' exposures to securitisation transactions
- Key enhancements:
 - less mechanistic reliance on external ratings
 - more prudent calibration of risk-weights
 - enhancing risk-weighting formulas

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- A revised framework for banks to risk-weight their credit risk exposures to securitisation transactions.
- The revised securitisation framework is designed to:
 - reduce mechanistic reliance on external credit ratings, for instance, by improving the existing ratings-based approach by requiring (apart from external ratings) other risk drivers (e.g. seniority and thickness of a securitisation tranche) that should be taken into account in determining the risk-weight for an exposure;
 - calibrate risk-weights in a more prudent manner, in particular for certain types of exposures. For example, the risk-weights for highly-rated exposures (such as AAA-rated exposures) have been increased so that their risk-weights will not be excessively low; and
 - enhance risk-weighting formulas (e.g. by taking into account the maturity of a securitisation exposure in determining the risk-weight of the exposure).
- According to the Basel timeline, the revised framework should take effect from 1 January 2018.



AMENDMENT OF BANKING (CAPITAL) RULES (BASEL III LEVERAGE RATIO)

- Basel III introduced the “leverage ratio” as a “back-stop” measure to prevent excessive leverage in banking sector
- A ratio of a bank’s “Tier 1 capital” to “leverage exposure measure”
- Under the Basel transitional timeline, banks must:
 - (from 2013) report leverage ratio for supervisory monitoring based on 3% “testing minimum”
 - (from 2015) disclose leverage ratio and components (based on prescribed format)
 - (from 2018) comply with minimum leverage ratio as a binding requirement from 2018

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- The leverage ratio was introduced under Basel III as a “back-stop” measure to contain the build-up of excessive leverage in the banking system. It is essentially a “gross measure” intended to provide additional safeguards against model risk and measurement errors inherent in the risk-based capital ratio.
- According to the transitional Basel III implementation timetable, the leverage ratio is scheduled to become a binding minimum standard starting from 1 January 2018, preceded by:
 - a “parallel run” period starting from 2013 when banks are required to report their leverage ratio to regulators for supervisory monitoring based on a 3% “testing minimum”, and
 - a requirement since 2015 to disclose their leverage ratio and components (based on a prescribed format).
- Numerically, leverage ratio is expressed as a percentage of a bank’s “Tier 1 capital” (an existing defined term in the Banking (Capital) Rules (BCR)) to its “exposure measure” (generally derived from a prescribed calculation methodology using accounting values as a starting position).
- We intend to amend the BCR to implement the minimum leverage ratio of 3% (same as testing minimum) and do not expect authorized institutions in Hong Kong to have any difficulty in complying with the requirement based on data reported to us so far.



AMENDMENT OF BANKING (CAPITAL) RULES (CAPITAL TREATMENT OF EXPECTED LOSS PROVISIONING)

- Implementation of “expected loss” provisioning approach (under International Financial Reporting Standards 9 (IFRS 9)) from 2018
- A response to address “too little, too late” loan loss provisions under the existing “incurred loss” approach
- Basel capital framework in relation to “general provisions” and “specific provisions” categorisation and treatment of provisions remains unchanged for the time being
- Only minor definitional changes to Banking (Capital) Rules (BCR) required

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- This relates to the implementation of the “expected loss” provisioning model under the new accounting standard IFRS 9 that is scheduled to come into effect on 1 January 2018.
- The move is a response to the lessons learned from the global financial crisis where the “incurred loss” provisioning model under the existing accounting standard (International Accounting Standard (IAS) 39) was considered to have resulted in loan loss provisions that were “too little, too late”.
- The Basel capital framework requires provisions to be categorised into “general provisions” and “specific provisions” which (under the standardised approach) are subject to different treatments. Such categorisation and treatment will remain unchanged for the time being pending the design and development of a longer-term solution by the Basel Committee.
- There is little impact on the BCR apart from minor changes to align current definitions for “collective provisions” (i.e. general provisions) and “specific provisions” in the BCR (current definition tracks IAS 39 and hence to be adjusted).



AMENDMENT OF BANKING (LIQUIDITY) RULES

- Net Stable Funding Ratio (NSFR): a new international standard seeking to reduce banks' funding risk by requiring banks to fund their activities with sufficiently stable sources of funding
 - To be applied to category 1 institutions currently defined under Banking (Liquidity) Rules (BLR)
- A modified or simplified NSFR, known as Core Funding Ratio (CFR), will be applied to another category of institutions to be specified by the Monetary Authority

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- Following the implementation of the Basel III Liquidity Coverage Ratio (LCR) in 2015, we are preparing to implement the other Basel III liquidity standard – NSFR. The NSFR seeks to reduce banks' funding risk by requiring banks to fund their activities with sufficiently stable source of funding.
- We propose that authorized institutions (AIs) designated as “category 1 institutions” under the BLR, i.e. those institutions that are required to observe the LCR, should also observe the NSFR requirements.
- It is also proposed that the Monetary Authority will specify another category of AIs based on their size and liquidity profile and require them to observe a modified or simplified version of the NSFR, known as the CFR.
- The NSFR and the CFR will come into effect from 1 January 2018, in line with the Basel Committee's timetable.



AMENDMENT OF BANKING ORDINANCE

- **Exposure Limits** - To implement Basel Committee's new large exposures framework by 1 January 2019 and modernise some local rules on exposure limits
 - Propose amendments to repeal relevant provisions in Part XV of the Banking Ordinance (BO) and replace them with a rule-making power enabling Monetary Authority (MA) to prescribe exposure limits given the highly technical nature of some parts of the new framework
- **Recovery planning** - Propose amendments to incorporate explicit provisions into the BO with respect to authorized institutions' (AIs) recovery planning to fully reflect the Financial Stability Board's (FSB) standards

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Exposure Limits

- The first part of the amendment is to implement the Basel Committee's new large exposures framework locally. The opportunity is also taken to modernise our local rules on exposure limits to align them with the Basel Committee's new large exposures framework and the latest market developments.
- It is proposed that relevant provisions in Part XV of the BO be repealed and replaced with a rule-making power enabling the MA to prescribe exposure limits in rules (issued as subsidiary legislation) after consultation with the Financial Secretary. This is because some parts of the new framework are highly technical in nature and setting them out in rules can avoid the need of including a significant volume of technical calculation mechanics within the primary legislation. This is in line with the approach previously adopted for implementing the Basel Committee's capital and liquidity standards.

Recovery planning

- The second part of the amendment aims to incorporate explicit provisions into the BO to fully reflect the standards set by the FSB in its "Key Attributes of Effective Resolution Regimes for Financial Institutions". Incorporating such provisions in the BO serves to provide greater transparency and certainty on the actions that should be taken by the banks and the MA's powers to require AIs to maintain and implement recovery plans.

Target implementation

- The HKMA briefed the LegCo Panel on Financial Affairs on the proposed amendments on 16 March 2017 and intends to introduce the bill into the LegCo in the fourth quarter of this year. This will allow time for the HKMA to develop the necessary rules, and for the AIs to prepare for the implementation of Basel Committee's new large exposures framework in accordance with the Basel timetable.



HONG KONG RESOLUTION REGIME

- Protected arrangements regulation (PAR): tabled before the Legislative Council on 17 May
- Publication of relevant policy papers: institutional arrangements for the discharge of statutory functions, core information requirements for resolution planning
- Loss-absorbing capacity requirements: consultation expected by year end

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- Following a two-month consultation on the PAR which closed on 21 January 2017, a consultation conclusion was published on 6 April 2017. The PAR and the commencement notice of the Financial Institutions (Resolution) Ordinance (FIRO) were tabled before the Legislative Council on 17 May, with a view to bringing the PAR and the FIRO into operation shortly after the completion of the negative vetting procedure within 2017.
- To increase market understanding on how the Monetary Authority (MA) as a resolution authority will carry out its core functions, a number of policy papers are expected to be issued by the HKMA around the time the FIRO comes into effect. These policy papers, amongst others, will describe how the MA plans to carry out its statutory functions as a resolution authority for banks in Hong Kong, and the resolution planning core information requirements on authorized institutions (AIs), which is expected to be published as a chapter of the Code of Practice under the FIRO once FIRO comes into effect.
- A key priority for 2017 is to begin the development of rules to be made by the MA as a resolution authority under FIRO relating to loss-absorbing capacity requirements (including the local implementation of the Financial Stability Board's standard on Total Loss-Absorbing Capacity) to set local loss-absorbing requirements for AIs, with a view to beginning consultation on its proposals around end-2017.



BANK CONSUMER PROTECTION

- Further enhance supervisory collaboration with fellow financial regulators on selling of investment and insurance products

- The HKMA has co-operated closely with other financial regulators in Hong Kong in providing guidance and supervising authorized institutions' selling of investment and insurance products. Our enhanced cooperation covered various aspects 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. Besides, the HKMA will continue to collaborate with the Office of the Commissioner of Insurance on implementing the new regulatory standards in respect of non-investment-linked long term insurance products, and reviewing the implementation of those standards.



FINANCIAL INCLUSION

Bank Branch Network

- Implementing the plan for setting up more physical branches
- Working with the banking industry to further enhance barrier-free banking services

Difficulties in Opening Bank Account

- Feedback from Chambers of Commerce shows improvement in customer experience
- Set up dedicated team and dedicated HKMA webpage to provide assistance to applicants for bank accounts

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- Positive responses were received from banks to further enhance the coverage of banking networks in remote areas and public housing estates (PHEs), with 8 banks planning to set up a total of 10 branches and 3 mobile branches for the next year or so. As of mid-May, 2 branches have already been opened in Tin Shui Wai North and Sha Tin respectively, and 1 additional mobile branch providing services to 6 PHEs. One more branch will be opened in Tin Shui Wai North in the third quarter, while more details will be announced in due course depending on the availability of suitable sites.
- The HKMA, together with the banking industry, have reached out to the disabled groups to gather feedback for further enhancing barrier-free basic banking services (e.g. provide adjusted height counters at branches for people with physical disabilities, more voice-navigation ATMs for people with visual impairment). The HKMA is working with the industry on issuing practical guidance to promote accessibility of basic banking services by the disabled.
- The HKMA has been working closely with the banking industry and business community on the important issue of account opening and maintenance. Various measures have been taken by banks to enhance transparency and improve customer experiences, e.g. putting in place review mechanisms to re-examine unsuccessful applications. Recent feedback suggests customer experience is improving while the work on this front is ongoing. In April, over 100 representatives of 21 Chambers of Commerce, Hong Kong Association of Banks and 28 banks also participated in a briefing cum networking session jointly organised by the HKMA and InvestHK to share about the changing international regulatory requirements and the improvement measures introduced by banks on account opening and maintenance.
- In March, the HKMA set up a dedicated team to follow up on feedbacks received about bank account opening and maintenance, and launched a dedicated webpage on its website to provide useful information and latest updates.



FINANCIAL INFRASTRUCTURE



FINANCIAL INFRASTRUCTURE

- Continue to maintain safety and efficiency of financial market infrastructure
- Continue the enhancements of the over-the-counter (OTC) derivatives trade repository (TR) having regard to the relevant requirements of local and international regulatory authorities

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Operation of financial infrastructure

- The Hong Kong Dollar, US dollar, Euro and Renminbi Real Time Gross Settlement systems, the Central Moneymarkets Unit 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.
- A series of system operation training, system testing sessions and regulation briefings have been organised to support the Securities and Futures (OTC Derivatives Transactions-Reporting and Record Keeping Obligations) Rules which came into force on 10 July 2015. Similar events have been organised continuously to support the Securities and Futures (OTC Derivatives Transactions-Reporting and Record Keeping Obligations) (Amendment) Rules, which will come into force on 1 July 2017.



REGULATORY REGIME FOR STORED VALUE FACILITIES (SVF) AND RETAIL PAYMENT SYSTEMS (RPS)

- 13 SVF licences have been granted so far. The licensees are developing new products and/or enhancing their services, providing the public with more choices
- In addition to the implementation of principle-and-risk-based supervision on SVF licensees, the HKMA started to publish statistics on SVF issued by the licensees from March 2017
- In relation to regulation of RPS, the HKMA has collected information from operators of important RPS in Hong Kong to determine whether the relevant systems should be designated. An oversight framework for designated RPS is also being developed

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Supervision of SVF licensees

- In implementing continuous supervision on SVF licensees, the HKMA adopts a principle-and-risk-based approach focusing on areas of significant risk to the SVF industry and individual SVF licensees. Ongoing supervisory work on SVF licensees includes offsite review, onsite examination and supervisory dialogues.
- In March 2017, the HKMA started to publish statistics on SVF issued by the SVF licensees on a quarterly basis to enhance market transparency.

Public education programme:

- The HKMA will continue to conduct public education programmes via various channels to raise public awareness on issues in relation to online payment and mobile payment.

Implementation of the regulatory regime for RPS:

- The HKMA has formally commenced the designation process pursuant to the Payment Systems and Stored Value Facilities Ordinance (PSSVFO) by collecting information from operators of important RPS (e.g. payment card schemes) in Hong Kong to determine whether the relevant RPS are eligible for designation under the PSSVFO. Active dialogues are being held with these operators on a number of policy and implementation issues in relation to designation.
- An oversight framework is being developed to regulate designated RPS.



LATEST FINTECH DEVELOPMENTS

Research on Central Bank Digital Currency

- In collaboration with 3 notes-issuing banks, Hong Kong Interbank Clearing Limited and R3 consortium, first stage of the research is expected to be completed in the fourth quarter

Distributed Ledger Technology

- Second-stage research is in progress. Results are scheduled to be published by the end of the year

Fintech Supervisory Sandbox (FSS)

- 6 banks have used FSS for 15 pilot trials, 9 of which have been completed. The results have been encouraging

Haccelerator

- Launched the platform in March 2017 and 2 banks will use it for fintech competitions in May

Fintech Career Accelerator Scheme

- Interviews completed by end of April with more than 400 applicants. Offers are being made to successful students



ENHANCED COMPETENCY FRAMEWORK (ECF) FOR BANKING PRACTITIONERS

- Continue the development of the ECF professional level module on anti-money laundering and counter-financing of terrorism
- Commenced the design of two other ECF modules on retail wealth management and treasury management
- To consult the industry on these two ECF modules in the first half of 2017

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- Following the launch of the ECF core-level module on anti-money laundering and counter-financing of terrorism (AML/CFT) (targeting practitioners with less than three years of experience) in December 2016, the HKMA continues to work with the banking industry to develop the professional level module of ECF on AML/CFT for more experienced practitioners. This can help promote professional development, raise the level of competency and enlarge the pool of qualified AML/CFT professionals.
- Concurrently, efforts are being made to develop the ECF modules on retail wealth management and treasury management. Discussion on the proposed design of these two new ECF modules with the banking industry and relevant professional bodies are being held. After taking into account their initial comments, the HKMA will prepare the consultation papers. It is expected that formal industry consultation will be conducted in the first half of 2017. Depending on the consultation results, the proposals on the ECF modules on retail wealth management and treasury management will be implemented progressively.



CONSUMER EDUCATION PROGRAMME

- Arranged the Hong Kong Liberal Studies Financial Literacy Championship to enhance the financial literacy and knowledge on financial management of secondary school students



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- For the third consecutive year, the HKMA organised the Hong Kong Liberal Studies Financial Literacy Championship with different entities. The campaign, consisting of an online quiz, a school based financial experimental game and a live competition, aims at enhancing the financial literacy and knowledge on financial management of secondary school students.



DEPOSIT PROTECTION SCHEME (DPS)

- Requested selected banks to submit audit report to certify the correctness of relevant deposit calculations for contribution assessment
- Reviewed self assessment reports and on-site examination findings on compliance with the Representation Rules
- Maintain high public awareness through publicity initiatives and community education activities

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- The amount of contribution payable by DPS member banks is calculated on the basis of the amount of relevant deposits reported in the returns of relevant deposits and the supervisory ratings assigned by the Monetary Authority to each DPS member bank. Collection of 2017 contribution (HK\$475 million) from DPS member banks has been completed. To ensure that the amount of relevant deposits reported in the returns are accurate, 21 member banks have been selected and required to conduct an audit review by April 2017.
- The self-assessment review of member banks' compliance with the DPS Representation Rules for 2015-16 was completed. From April 2016 to March 2017, the HKMA has completed 12 on-site examinations for monitoring member banks' compliance with the Representation Rules in greater detail. The results show that the overall compliance level is satisfactory in general.
- Publicity initiatives and community education activities are sustained to promote the public understanding of the DPS coverage and appreciation of the value of DPS protection, including promotional videos through TV, out-of-home and digital publicity channels, educational talks as well as school workshops.



COIN COLLECTION PROGRAMME

- Maintain the Coin Collection Programme until September 2018
- Two Coin Carts collect coins from members of the public in 18 districts on a rotational basis
- 300,000 people were served and 253 million coins with a total face value of HK\$317 million were collected between October 2014 and April 2017



GOVERNMENT BOND PROGRAMME

Institutional part – outstanding as at end April 2017

- Twelve Government bonds totalling HK\$71.1 billion
- Three Islamic bonds totalling US\$3 billion

Retail part

- Three iBonds and one Silver Bond totalling HK\$33 billion were outstanding as at end April 2017
- Will issue the second batch of Silver Bond targeting Hong Kong residents aged 65 or above



REGULATORY DEVELOPMENT OF THE OVER-THE-COUNTER (OTC) DERIVATIVES MARKET

- Following the amendment of the Securities and Futures Ordinance in 2014 providing for the regulatory regime for the OTC derivatives market, we continue to develop concrete regulatory requirements covering its different aspects
- The phase one rules for the reporting and related record keeping obligations took effect on 10 July 2015, while the clearing and record keeping obligations and designation of central counterparties under the regime became effective on 1 September 2016
- The second phase rules for the reporting obligations will commence operations on 1 July 2017



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 markets
- Major reforms for FX benchmarks have been completed
- For interest rate benchmarks, the HKMA has completed an analysis on reform feasibility, and is working with the industry to consult stakeholders on the proposed way forward

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- 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 and the Foreign Exchange Benchmark Group to review, and make recommendations for enhancement on, interest rate benchmarks (the three major Interbank Offered Rates, i.e. London Interbank Offered Rate, Euro Interbank Offered Rate and Tokyo Interbank Offered Rate) 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. On how to implement the relevant recommendations, both IOSCO and FSB take the view that there is no one-size-fits-all approach. 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, namely the Treasury Markets Association, to reform the Hong Kong Interbank Offered Rate and Hong Kong Dollar Overnight Index Average as appropriate. The HKMA will take into account international progress and developments as reference for our local review.

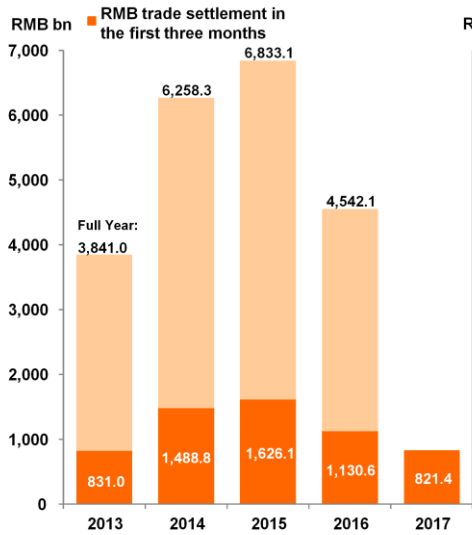


HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

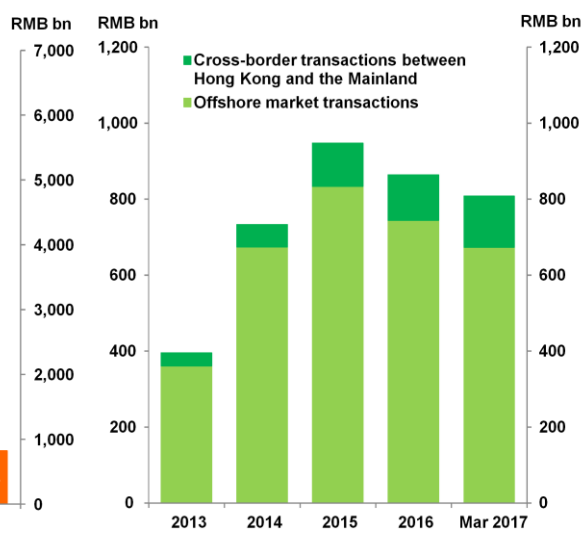


RMB TRADE SETTLEMENT AND PAYMENT

RMB trade settlement handled by banks in Hong Kong



Average daily turnover of Hong Kong RMB RTGS System



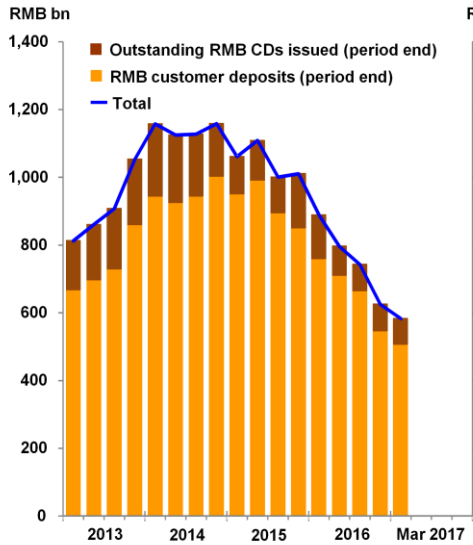
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- In the first three months of 2017, RMB trade settlement handled by banks in Hong Kong amounted to RMB821.4 billion.
- In March 2017, the average daily turnover of Hong Kong RMB Real Time Gross Settlement (RTGS) system stood at RMB808.0 billion.

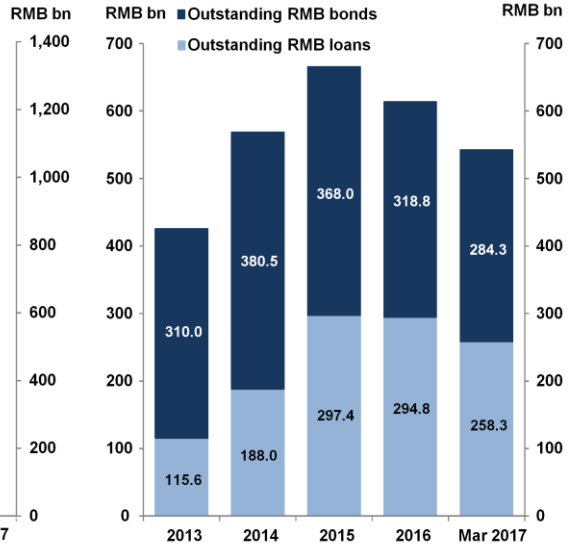


RMB LIQUIDITY POOL AND FINANCING ACTIVITIES

RMB customer deposits and certificates of deposit (CDs)



RMB financing activities



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- At end March 2017, RMB customer deposits and outstanding RMB certificates of deposit amounted to RMB507.3 billion and RMB75.8 billion respectively, totaling RMB583.1 billion.
- At end March 2017, outstanding RMB loans amounted to RMB258.3 billion. Outstanding dim sum bonds amounted to RMB284.3 billion. The dim sum bond issuance totalled RMB1 billion for the first three months of 2017.



MAINTAINING RMB BUSINESS LINKS WITH OTHER JURISDICTIONS

	Mar 2017	2016	2015	2014	2013
1 No. of participating banks of Hong Kong's RMB clearing platform	207	210	217	225	216
Of which:					
Branches and subsidiaries of overseas banks and overseas presence of Mainland banks	181	184	192	200	191
2 Amount due to overseas banks (RMB billion)	81.4	69.0	105.7	145.2	166.0
3 Amount due from overseas banks (RMB billion)	94.6	91.6	132.1	193.3	164.5

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- The HKMA maintained ongoing dialogues with other offshore renminbi centres and continued our marketing efforts through active participation in industry events to promote Hong Kong's renminbi business platform and our unique role as a springboard between Mainland China and the rest of the world.
- The 4th Hong Kong and Australia Renminbi Trade and Investment Dialogue, led by the HKMA, Reserve Bank of Australia and the Australian Treasury, was held at the Renminbi Global Cities Dialogue organised by the New South Wales Government of Australia on 27 April 2017, promoting the opportunities arising from the internationalisation of the renminbi and Chinese capital going out.



DEVELOPING HONG KONG AS A CTC HUB

- Attracting multinational and Mainland enterprises to set up their corporate treasury centres (CTCs) in Hong Kong will bring more banking, financing and risk management activities to Hong Kong, deepen our capital markets and provide impetus to the development of headquarters economy in Hong Kong
- We will continue to engage the industry and step up marketing efforts to promote Hong Kong as a preferred regional location for CTCs

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- Developing Hong Kong into a regional hub for CTCs has been one of the important areas of work of the HKMA in recent years. With their vast global business networks, some multinational corporations process numerous large-value payments on a daily basis. Under their treasury management systems, it is common for cash management, receipt/payment processing, financing, 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 networks, etc., thereby reinforcing Hong Kong's status as an international financial centre and promoting 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 reached out to over 450 corporations, financial institutions and industry associations by end-March 2017. Based on the engagement between the HKMA and its marketing partners, industry feedback has been positive after the amendment of legislation and there were already corporates planning to set up or expand their treasury operations in Hong Kong.



CONTINUED DEVELOPMENT AS AN INTERNATIONAL ASSET MANAGEMENT CENTRE

- The HKMA continues to promote Hong Kong's platform as an asset management centre
- The combined fund management business in Hong Kong reached US\$2.2 trillion at the end of 2015
- Continued increase in the number of licensed corporations and licensed individuals for asset management
- Close to 70 of the 100 largest global money managers have offices in Hong Kong, and more and more asset owners establish a presence in Hong Kong
- 23 private banks have opened for business in Hong Kong since 2009, bringing the total number of private banks offering private wealth management services in Hong Kong to 46 as of March 2017

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- According to the Securities and Futures Commission (SFC)'s survey, 68.5% of the combined fund management business in Hong Kong was sourced from non-Hong Kong investors in 2015, 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 increased from 680 in 2008 to 1,238 as of the third quarter of 2016.
- Close to 70 of the 100 largest global money managers (ranked by assets under management as of the end of 2015) have offices in Hong Kong, and over 60 of them are licensed by the SFC. Hong Kong is also a hub for global asset owners.
- Achieved leading positions as an asset management centre in Asia Pacific:
 - 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\$124 billion as of the first quarter of 2017.
 - About 40% of RMB Qualified Foreign Institutional Investor managers, 60% of Qualified Foreign Institutional Investor managers, and 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 2017.
 - Hong Kong is the largest hub for hedge funds in Asia, with the number of funds increasing from 676 in 2012 to 778 as of end-September 2014.



INFRASTRUCTURE FINANCING FACILITATION OFFICE (IFFO)

- IFFO was launched in July 2016 with the mission to facilitate infrastructure investments and their financing by working with a cluster of key stakeholders
- To date, over 60 organisations from Mainland China, Hong Kong and overseas have joined as partners. They include multilateral financial agencies and development banks, investors, asset managers, banks, insurance companies, infrastructure project developers and operators, professional service firms, etc.
- Since its launch till March 2017, IFFO has organised and participated in 13 large-scale conferences, seminars and workshops on infrastructure investment and financing, including the Debt Financing and Investors' Roundtables in March 2017

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- IFFO has been proactively working on different aspects since its launch on 4 July 2016. As of March 2017, IFFO has organised 13 large-scale conferences, seminars and workshops on infrastructure investment and financing, and the number of IFFO partners has grown from 41 at inception to over 60 now.
- In particular, IFFO organised the Debt Financing and Investors' Roundtables on 23-24 March 2017 to promote information exchange and discuss opportunities in infrastructure investment and financing. The Roundtables were well attended by financiers and investors including the leading sovereign wealth funds and pension investors from around the world with total assets under management exceeding US\$4 trillion.
- A key objective of the Roundtables was to develop a reference term sheet for infrastructure investment, which provides a set of common language that can be understood and accepted by the investing/financing and operating sides, thereby narrowing the gap in their expectations and bringing them closer for doing deals.



DEVELOPMENT OF ISLAMIC FINANCE

- The HKMA assisted the Government to successfully launch the third US\$1 billion sukuk under the Government Bond Programme in February 2017
 - the world's first 10-year sukuk originated by an AAA-rated government
 - the 10-year sukuk has extended the yield curve, setting an important new benchmark for potential issuers in Hong Kong and globally
 - strong demand from global investors, with a US\$1.7 billion order book, despite uncertain global economic environment and longer tenor
- The HKMA will continue to share its sukuk issuance experiences with enterprises which have funding needs



INVESTMENT ENVIRONMENT AND PERFORMANCE OF THE EXCHANGE FUND

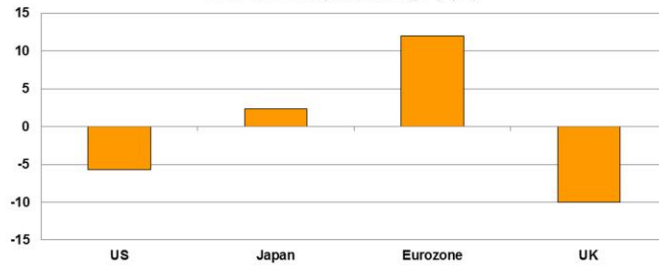
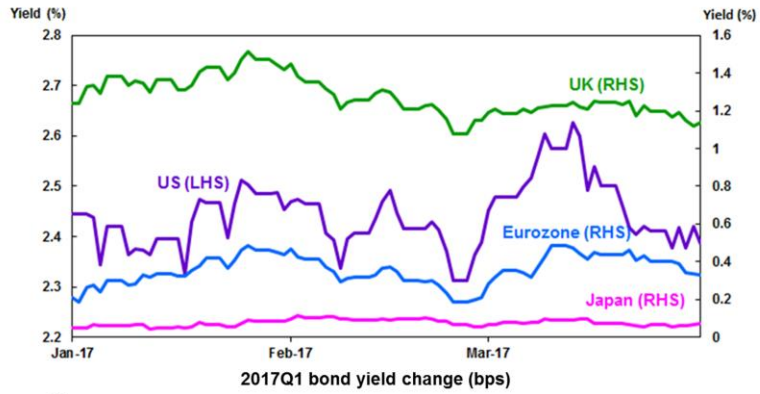


INVESTMENT ENVIRONMENT IN Q1 2017

- **Interest rates:** Major developed economies' government bond yields traded largely in narrow ranges in the first quarter of 2017
- **Equities:** Major equity markets rallied in the first quarter of 2017, with positive sentiments supported by the improving global macroeconomic outlook. Hang Seng Index outperformed other major equity indices, as the worry about Mainland's hard landing abated
- **Exchange rates:** The US dollar weakened slightly against major currencies in the first quarter of 2017. The Euro stabilised on receding fears of populism in Europe while the renminbi also stabilised on easing concerns of capital outflows



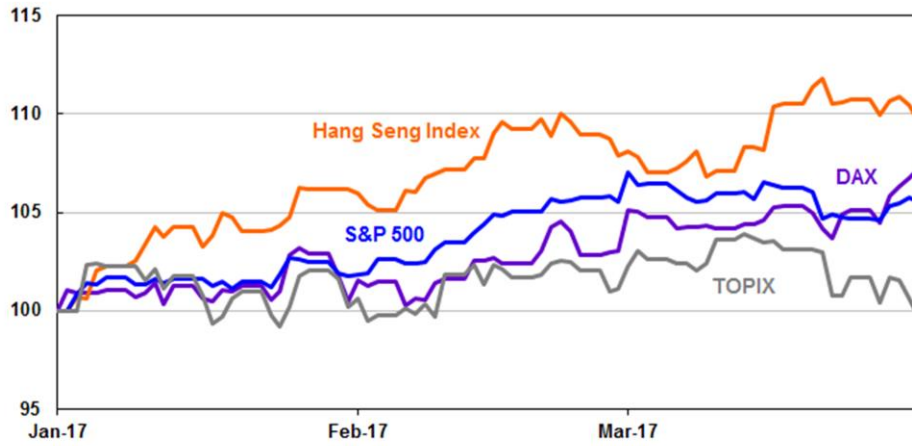
CHANGES IN 10-YEAR GOVERNMENT BOND YIELDS IN Q1 2017





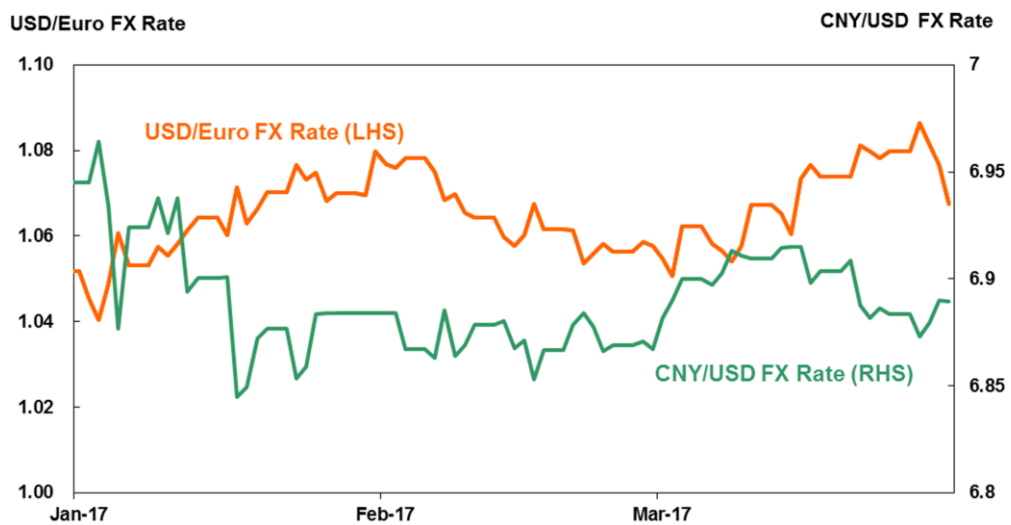
EQUITY MARKETS IN Q1 2017

Normalised Index Level (2016 year-end = 100)





CURRENCY MARKETS IN Q1 2017





INVESTMENT INCOME

(HK\$ billion)	2017		2016	2015
	(unaudited)			
	Q1	Full Year	Full Year	Full Year
Hong Kong equities*		5.3		(5.0)
Other equities		28.6		7.1
Bonds		33.1		15.9
Other investments@		16.9		11.1
Foreign exchange#		<u>(15.8)</u>		<u>(44.9)</u>
Investment income/(loss)		68.1		(15.8)

* Excluding valuation changes of the Strategic Portfolio

@ Including valuation changes of private equity and real estate investments held under the Long-Term Growth Portfolio. The valuation figures for the first quarter of 2017 are not yet available

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



INCOME AND EXPENDITURE

	2017	2016	2015
	(unaudited)		
(HK\$ billion)	Q1	Full Year	Full Year
Investment income/(loss)		68.1	(15.8)
Other income		0.2	0.2
Interest and other expenses		<u>(6.4)</u>	<u>(4.8)</u>
Net income/(loss)		61.9	(20.4)
Fee payable to Fiscal Reserves*		(33.1)	(46.7)
Fee payable to HKSAR government funds and statutory bodies*		(9.6)	(14.7)

* The rate of fee payment is 3.3% for 2016 and 5.5% for 2015



EXCHANGE FUND ABRIDGED BALANCE SHEET

(HK\$ billion)	At 31 Mar 2017 (Unaudited)	At 31 Dec 2016	At 31 Dec 2015
ASSETS			
Deposits		386.7	290.5
Debt securities		2,466.1	2,462.0
Hong Kong equities*		147.3	148.2
Other equities		429.3	392.4
Other assets#		<u>189.3</u>	<u>129.8</u>
Total assets		<u>3,618.7</u>	<u>3,422.9</u>
LIABILITIES AND FUND EQUITY			
Certificates of Indebtedness		405.4	357.9
Government-issued currency notes & coins in circulation		11.9	11.3
Balance of the banking system		259.6	391.3
Exchange Fund Bills and Notes issued		961.0	827.8
Placements by banks and other financial institutions		56.1	66.9
Placements by Fiscal Reserves®		914.6	833.5
Placements by HKSAR government funds and statutory bodies		302.5	280.9
Other liabilities		<u>161.1</u>	<u>108.4</u>
Total liabilities		3,072.2	2,878.0
Accumulated Surplus		<u>546.5</u>	<u>544.9</u>
Total liabilities and fund equity		<u>3,618.7</u>	<u>3,422.9</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\$118.8 billion at 31 Dec 2016 and HK\$96.0 billion at 31 Dec 2015

® Including placements by the Future Fund of HK\$224.5 billion



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*#	68.1	(23.3)	47.1	18.9	25.4
2017* (unaudited)	N/A	N/A	N/A	N/A	

* Excluding valuation changes of the Strategic Portfolio

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



HONG KONG MORTGAGE CORPORATION



MORTGAGE INSURANCE PROGRAMME (MIP)

- Since its launch in March 1999, the MIP has helped over 126,900 families attain home ownership
- In the first four months of 2017, the total drawdown amount under the MIP was HK\$9.2 billion and the average loan size was HK\$3.6 million
- About 83% of drawn down loans were for secondary market properties



REVERSE MORTGAGE PROGRAMME (RMP)

- As at end-April 2017, 1,769 applications had been received:
 - Average age of borrowers: 69 years old
 - Average monthly payout: HK\$15,000
 - Payment terms: 10-year (28%), 15-year (16%), 20-year (13%), life (43%)
 - Average property value: HK\$5 million
 - Average property age: 30 years
- The extension of the RMP to cover subsidised sale flats in October 2016 has been well received by the market

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- Since inception in mid-October 2016, the extension of the RMP to cover subsidised sale flats has been well received by the market. Up to end-April 2017, over 210 applications had been received.



SME FINANCING GUARANTEE SCHEME (SFGS)

- SMEs and banks responded positively to the promotion and communication effort of the HKMC on the SFGS
- Continuous effort will be made by the HKMC to further optimise the operation of the SFGS and raise the awareness of the scheme among SMEs and banks
- As at end-April 2017, 11,764 applications had been approved, involving a total loan amount of around HK\$46.8 billion. Key data of the approved applications are as follows:

Average guarantee period	4.6 years	Average loan size	HK\$3.98 million
Proportion of application from manufacturing and non-manufacturing industries	23% and 77% (in terms of no. of applications approved)	Average loan interest rate and average guarantee fee rate	4.83% p.a. 0.49% p.a.
Enterprises with less than 50 employees	91%	Benefitted enterprises and the related no. of employees	7,209 enterprises and 185,453 employees

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

Manufacturing sector –	23.2%
– Textiles and clothing	4.4%
– Electronics	2.1%
– Plastics	1.8%
– Printing and publishing	1.7%
Non-manufacturing sector –	76.8%
– Trading	45.8%
– Wholesale and retail	9.1%
– Construction	3.0%
– Engineering	3.0%



MICROFINANCE SCHEME

- Launched in June 2012, trial period up to 2018 and maximum aggregate loan amount up to HK\$200 million
- As at end-April 2017, the Scheme had received 409 formal loan applications. Out of the vetted applications, 190 had been approved with the total loan amount close to HK\$47.5 million. The approval rate was 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):

Some approved applications are classified as more than one of these industry types.

– Services	119 cases (47%)
– Retail	70 cases (28%)
– Wholesale	37 cases (15%)
– Manufacturing	19 cases (8%)
– IT related	8 cases (3%)

- * Component percentages in the table above may not add up to 100% due to rounding.



PREMIUM LOAN INSURANCE SCHEME (PLIS)

- PLIS was launched in September 2015 to provide subsidised housing property owners 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-April 2017, over 2,500 enquiries and 11 applications had been received



HKMC LIFE ANNUITY SCHEME

- The HKMC's Board approved in principle in April to introduce the Life Annuity Scheme
- The Life Annuity Scheme aims at providing an additional financial planning option to the elderly citizens. The design of the Scheme is based on three important principles:
 1. Simple and easy to understand and attractive to the annuitants
 2. Relevant risks can be prudently managed by the insurer
 3. Conform with commercial principles and financially viable and sustainable



TENTATIVE KEY DESIGN FEATURES OF LIFE ANNUITY SCHEME*

- The Scheme will provide immediate lifetime guaranteed fixed monthly payouts to annuitants aged 65 or above
- The cap and floor of the premium amount are tentatively set at \$1 million and \$50,000 respectively
- Based on the tentative estimate of the highest internal rate of return of 4%, the expected monthly payout for a male annuitant at the entry age of 65 and for \$1 million premium would be about \$5,800
- Each annuitant is guaranteed to receive instalments of monthly annuity payment of total amount equal to 105% of the premium paid, and early surrender is allowed
- The amount offered for subscription will be subject to a quota, tentatively up to \$10 billion for the first batch, with actual amount subject to market conditions and prudent risk management considerations

* subject to validation by independent consultant and approval by insurance industry regulatory authority