Chapter 4

Financial and Monetary Affairs

Hong Kong stands tall as an international financial centre continually reinforced by its booming banking, securities and insurance business. Its bustling stock exchange ranks third in Asia and seventh in the world, in terms of market capitalisation. With a workforce of 191 000, or 5.5 per cent of the working population, the financial sector contributed 16 per cent of the year's Gross Domestic Product.

Hong Kong is one of the most vibrant international financial centres in the world with sophisticated financial infrastructure, world-class financial professionals, a sound regulatory regime on a par with international standards, and high liquidity and efficiency. The Government's policy is to further reinforce Hong Kong's position by making continuous improvements to the regulatory system, promoting corporate governance, strengthening investor protection, fostering market development and enhancing links and cooperation with the Mainland.

Hong Kong made a number of major achievements in 2007 including:

- continuing to be the world's 15th largest banking centre in terms of external assets and sixth largest centre for foreign exchange trading;

- its stock market being ranked seventh worldwide and third in Asia in terms of market capitalisation; fourth worldwide and second in Asia in terms of equity funds raised through initial public offerings; and fifth worldwide and second in Asia in terms of total equity funds raised;

- its asset management business topping $6,154 billion;

- total outstanding Hong Kong dollar debt securities exceeding $750 billion at year-end, up from $748 billion a year earlier;

- total assets of Mandatory Provident Fund (MPF) schemes growing to $264.79 billion by year-end. About 99.5 per cent of employers, 97.6 per cent of relevant employees and 75.1 per cent of self-employed people have enrolled in MPF schemes;

- continuing to be one of the most open insurance markets in the world and achieving an annual growth in premium of 15 per cent for the last five years; and
- the market capitalisation of Real Estate Investment Trusts (REITs) rising to $66 billion by year-end.

Hong Kong as an International Financial Centre

A favourable geographical position, bridging the time gap between North America and Europe; strong links with the Mainland and other economies in Southeast Asia and excellent communications with the rest of the world; the rule of law; a level playing field and a sound regulatory regime have all helped Hong Kong develop into both a leading international financial centre in the region and the premier capital formation centre for the Mainland. The absence of restrictions on capital flows into and out of Hong Kong is another important strength.

Hong Kong's financial markets are characterised by a high degree of liquidity. They operate under effective and transparent regulations, which are in line with international standards. A highly educated workforce and ease of entry for professionals from outside Hong Kong also contribute to the development of its financial markets.

International financial institutions maintain a strong presence in the city. Of the world's top 100 banks, 68 have operations in Hong Kong. At the end of 2007, there were 258 foreign-owned authorised institutions (including licensed banks, restricted licence banks and deposit-taking companies) and local representative offices in Hong Kong.

The interbank money market is well established. Wholesale deposits are traded actively among local authorised institutions, and between local and overseas institutions, with an average daily turnover of $432 billion in 2007.

Hong Kong also has a mature and active foreign exchange market, which forms an integral part of the global market. The link with overseas centres enables foreign exchange dealing with the rest of the world 24 hours a day. The last triennial survey coordinated by the Bank for International Settlements in 2007 showed Hong Kong recording a daily average foreign exchange turnover of US$174.6 billion. Hong Kong continues to be the world's sixth largest foreign exchange market.

With a total market capitalisation of about $20,698 billion at year-end, the Hong Kong stock market ranked seventh in the world and third in Asia. The daily turnover averaged $88.1 billion in 2007. At year-end, 1 241 public companies were listed on the Stock Exchange of Hong Kong (SEHK). The 84 newly listed companies raised $290.6 billion from initial public offerings (IPOs). Hong Kong ranked fourth worldwide in terms of IPO funds raised. Besides new share issues, $267.9 billion were raised on the secondary market. The REIT market continued to develop and the aggregate market capitalisation reached $66 billion at year-end.

The Hong Kong stock market is an important fund-raising platform for Mainland enterprises. At year-end, there were 439 Mainland enterprises listed on the SEHK. In 2007, equity funds raised by Mainland enterprises[1] amounted to $362.1 billion, which was 65 per cent of the total equity funds raised through the SEHK during the year. About $247.4 billion were raised in new listings of Mainland enterprises in Hong Kong, accounting for 85 per cent of the total equity funds raised in IPOs on the SEHK. The market capitalisation of Mainland enterprises accounted for 58 per cent of the SEHK's total market capitalisation at year-end. In 2007, the total annual trading turnover of Mainland enterprises accounted for 69 per cent of the total annual equity turnover of the Hong Kong stock market. It is expected that Mainland issuers will continue to be major growth drivers of the stock market in the future.

Overseas intermediaries were increasingly interested in setting up business operations in Hong Kong. The number of Stock Exchange Participants[2] (SEPs) has increased for the first time since 2000, rising from 425 at the end of 2006 to 439 at the end of 2007. The futures market also saw an increase in the number of Futures Exchange Participants (FEPs), from 135 at the end of 2006 to 140 at the end of 2007. Among the SEPs and FEPs, 133 and 65 respectively were owned by non-Hong Kong interests. In 2007, 24 new SEPs were admitted, including 21 from various regions around the world; seven new FEPs were admitted, of which six were from areas outside Hong Kong.

The Hong Kong asset management industry is characterised by its strong international flavour, in terms of the presence of both global fund managers and the different domiciles of authorised funds. According to the Fund Management Activities Survey 2006 conducted by the Securities and Futures Commission (SFC), which covered fund management activities of SFC licensed corporations that engage in asset management and fund advisory businesses as well as banks which engage in asset management and other private banking activities (collectively referred to as 'registered institutions'), the combined fund management business of licensed corporations and registered institutions amounted to $6,154 billion at end-2006, up 36 per cent from $4,526 billion in 2005. SFC licensed corporations accounted for 75 per cent or $4,585 billion of the combined fund management business, and the rest was reported by registered institutions.

Hong Kong operates one of the most active physical gold markets in the world. Spot gold can be traded through two closely related yet independent markets in the city — the Chinese Gold and Silver Exchange Society and the Loco-London gold market. The society, established in 1910, provides trading of both tael bars and

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1 Mainland enterprises include H share companies, red-chip companies and non-H share Mainland private enterprises.

2 Corporations with the right to trade on or through the Stock Exchange and be licensed under the Securities and Futures Ordinance to engage in such activity. Non-trading Stock Exchange Participants are not included.

kilo bars[3]. Prices closely follow those in the other major gold markets in London, Zurich and New York.

Hong Kong continues to be one of the most open insurance centres in the world. Among the 178 authorised insurers at year-end, 88 were from 22 overseas countries or the Mainland. Fifteen of the world's top 20 insurers are authorised to carry on insurance business in Hong Kong either directly or through a group company. There are 21 professional reinsurers in Hong Kong, including most of the top reinsurers in the world. Gross premium income in 2006 was $156 billion.

The Hong Kong Monetary Authority (HKMA) worked with relevant government bureaux to foster a better understanding of Hong Kong's economic and financial strengths among international credit rating agencies. The combined effort contributed to a number of rating upgrades in 2007, putting Hong Kong in the AA category accorded by all major international rating agencies. AA is the highest rating ever given to Hong Kong. The rating and outlook upgrades reflected international recognition of Hong Kong's strong economic fundamentals, as well as improved public finances and growth prospects.

Banking Sector

Main Features

Hong Kong maintains a three-tier system of deposit-taking institutions — licensed banks, restricted licence banks and deposit-taking companies. They are collectively known as authorised institutions (AIs) under the Banking Ordinance. The HKMA is the licensing authority for all three types of AIs.

Only licensed banks may conduct full banking services, including in particular the provision of current and savings accounts and acceptance of deposits of any size and maturity. Restricted licence banks may take deposits of any maturity of $500,000 or above. Deposit-taking companies may take deposits of $100,000 or above with an original maturity of at least three months. Many deposit-taking companies are owned by, or otherwise associated with, licensed banks.

Hong Kong has one of the highest concentrations of banking institutions in the world. At the end of 2007, there were 142 licensed banks, 29 restricted licence banks and 29 deposit-taking companies, which included the operations of banks from 30 countries around the world. The 200 AIs maintained an extensive network of 1 352 local branches. In addition, there were 79 representative offices of overseas banks in Hong Kong.

The total deposit liabilities of all AIs to customers and the total loans and advances extended by these institutions at the end of 2007 were $5,869 billion and $2,962 billion respectively. The total assets of all AIs amounted to $10,352 billion.

Hong Kong has a robust interbank payment system, which operates through the Real Time Gross Settlement (RTGS) system. The Hong Kong dollar RTGS system,

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3 Tael bars are of 99 per cent fineness and weighted in taels (one tael equals approximately 1.20337 troy ounces). Kilo bars are of 999.9 parts per thousand fineness and weighted in kilograms.

which was launched in 1996, has a single-tier settlement structure, with all banks maintaining settlement accounts with the HKMA. All RTGS payment transactions are settled in real time across the books of the HKMA. Intraday liquidity can be obtained by the banks through the use of their Exchange Fund Bills and Notes (EFBNs) for intraday repurchase agreements with the HKMA.

The US dollar, euro and renminbi RTGS systems which started operating in 2000, 2003 and 2007 respectively allows real-time settlement of transactions in the abovementioned currencies, thereby reducing or eliminating settlement risk caused by time gap. Thanks to the interface between the RTGS systems, Hong Kong dollar/US dollar/euro/renminbi foreign exchange transactions can be settled on a payment-versus-payment (PvP) basis.

The Central MoneyMarkets Unit (CMU) Service, established in 1990, is operated by the HKMA to provide a clearing and custodian system for EFBNs and other private debt securities. The CMU system accepts both Hong Kong dollar and foreign currency denominated debt instruments. It has been fully integrated with interbank payment systems, and is linked up with international central securities depositories to enable overseas investors to trade CMU securities. It has also established links with a number of regional central securities depositories.

Through its integration with the RTGS systems in Hong Kong, the CMU enables members to settle securities on a delivery-versus-payment (DvP) basis, thereby enhancing settlement efficiency and eliminating settlement risk. The interface also enables automatic intraday repurchase agreements to provide intraday liquidity to participants in the RTGS systems.

The Clearing and Settlement Systems Ordinance, which became effective in November 2004, empowers the Monetary Authority to designate and oversee clearing and settlement systems that are material to the monetary or financial stability of Hong Kong or to the functioning of Hong Kong as an international financial centre. Five clearing and settlement systems — the CMU, the Hong Kong dollar Clearing House Automated Transfer System (CHATS), the Continuous Linked Settlement System, the US dollar CHATS and euro CHATS — have been designated. Each system was issued a certificate of finality, which provides statutory backing to the finality of settlement for transactions made through the system. The HKMA has found all designated systems to be continuously in compliance with the ordinance.

Hong Kong Monetary Authority

The HKMA was set up on April 1, 1993 after the Legislative Council passed amendments to the Exchange Fund Ordinance in 1992 empowering the Financial Secretary to appoint a Monetary Authority.

Its policy objectives are to maintain currency stability within the framework of the Linked Exchange Rate system through sound management of the Exchange Fund, monetary policy operations and other means deemed necessary; as well as to promote safety and stability of the banking system through the regulation of banking business, the business of taking deposits and the supervision of AIs, and to promote efficiency, integrity and development of the financial system, particularly payment and settlement arrangements.

The HKMA is an integral part of the Government, but can employ staff on terms that differ from those of the civil service to attract personnel with appropriate experience and expertise. Its staff and operating costs are charged directly to the Exchange Fund instead of the general revenue. The HKMA is accountable to the Financial Secretary, who is advised by the Exchange Fund Advisory Committee (EFAC) on matters relating to the control of the Exchange Fund.

The HKMA seeks advice on policy matters routinely from the Banking Advisory Committee and the Deposit-taking Companies Advisory Committee. Both committees are established under the Banking Ordinance. They are chaired by the Financial Secretary and comprise members from the banking industry and other relevant professions.

The Banking Ordinance provides the legal framework for banking supervision in Hong Kong. Under the ordinance, the HKMA is the licensing authority responsible for granting and revoking the authorisation of all AIs, as well as the approval and revocation of money broker licences. The HKMA seeks to maintain a regulatory framework that is fully in line with international standards. The aim is to devise a prudent supervisory system to help preserve the general stability and effective working of the banking system while at the same time provide sufficient flexibility for AIs to make commercial decisions. Hong Kong's framework of banking supervision is in line with the Core Principles for Effective Banking Supervision promulgated by the Basel Committee on Banking Supervision.

As part of the new capital adequacy framework introduced on January 1, 2007, the HKMA has, based on its risk-based supervisory approach, developed a detailed and rigorous assessment framework to help set the minimum capital adequacy ratios and supervisory priorities of individual locally incorporated AIs and, where applicable, assess the effectiveness of their internal capital assessments.

On the international front, the authority continues to promote cooperation among central banks in the region, principally through the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP)[4], whose activities cover supervisory liaison and cooperation, development of financial markets and infrastructure, and various areas of central bank operations. The HKMA continues to participate in various regional and international forums for banking supervisors.

Recent Developments

In line with its policy of adhering closely to international regulatory standards, the HKMA introduced on January 1, 2007 a capital adequacy framework for all locally incorporated AIs in accordance with the requirements and timetable recommended

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4 The EMEAP Group comprises 11 central banks and monetary authorities in the East Asia and Pacific region: Reserve Bank of Australia, People's Bank of China, Hong Kong Monetary Authority, Bank Indonesia, Bank of Japan, Bank of Korea, Bank Negara Malaysia, Reserve Bank of New Zealand, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore and Bank of Thailand.

by the Basel Committee on Banking Supervision (commonly referred to as Basel II). Banking (Capital) Rules and Banking (Disclosure) Rules have been made by the Monetary Authority under the Banking Ordinance to bring the capital adequacy and disclosure requirements in line with the recommendations of the Basel Committee.

The HKMA has taken various initiatives to further strengthen the supervisory framework for the prevention of money laundering and terrorist financing. An Industry Working Group established in 2006 published guidance papers on cases involving politically exposed persons, customer due diligence for off-shore companies and address proof for personal customers.

The HKMA continued to work closely with the SFC to ensure that both banks and non-bank financial intermediaries are subject to consistent regulatory measure under the securities regulatory framework. A reciprocal secondment programme between the HKMA and the SFC was established to promote communication and consistency in enforcement.

During the year, the HKMA continued to assist the operations of the Hong Kong Deposit Protection Board, which launched the Deposit Protection Scheme in September 2006 to provide compensation of up to $100,000 to eligible depositors in the event of a bank failure.

One of the functions of the HKMA is to promote and encourage high standards of conduct and sound and prudent business practices among AIs, primarily by way of the Code of Banking Practice. The code is issued by the industry associations and endorsed by the HKMA. It sets out the minimum standards to be followed by AIs in their dealings with personal customers. The code is reviewed from time to time by the Code of Banking Practice Committee, which is convened by the industry associations.

Securities and Futures Sector

Main Features

The securities market in Hong Kong is operated by the SEHK and futures market, the Hong Kong Futures Exchange Limited (HKFE), both being wholly owned subsidiaries of the Hong Kong Exchanges and Clearing Limited (HKEx). At year-end, there were 477 exchange participants on the SEHK and 140 exchange participants on the HKFE.

By the end of 2007, there were 1 241 companies listed on the Main Board and the Growth Enterprises Market (GEM) of the SEHK with a total market capitalisation of about $20,698 billion, raising an aggregate of $558.5 billion during the year. The total turnover of the securities market amounted to $21,666 billion.

New products continued to be launched during the year. The first retail Islamic fund and a number of UCITS III funds (funds domiciled in the European Union states which are governed by the Undertakings of Collective Investment in Transferable Securities III issued by the European Commission) adopting non-traditional investment strategies were authorised for offering to the public. Additional Exchange Traded Funds (ETFs) on world, regional and Mainland indices and commodities were launched during the year, increasing the total number of ETFs traded on the SEHK to 17. The total number of Callable Bull/Bear Contracts (CBBCs) leaped from 24 to 131 during the year. Turnover of CBBCs surged from $11.3 billion in 2006 to $71.4 billion in 2007. A total of 4 483 derivative warrants were listed on the securities market at the end of 2007, an increase of 129 per cent from 2006. Turnover of derivative warrants rose by 162 per cent to $4,694 billion, which represented nearly 22 per cent of the total market turnover. Stock options turnover also saw remarkable increase from 18 127 353 contracts in 2006 to 45 982 968 contracts in 2007.

In the futures market, a number of new records were set as a result of strong growth in trading volume and open interest. Nearly 88 million futures and options contracts were traded, representing a year-on-year increase of 105 per cent. The Hang Seng Index Futures and the H-shares Index Futures recorded a turnover of 17 160 964 contracts and 10 846 277 contracts respectively, rising 35 per cent and 122 per cent from 2006. The Hang Seng China H-Financials Index Futures were launched in April 2007 and recorded a total turnover of 3 220 contracts. It is envisaged that more new products will be introduced in 2008 to further enrich the product base of the Hong Kong market.

The SEHK operates the Third Generation Automatic Order Matching and Execution System (AMS/3) for securities trading. AMS/3 provides an electronic platform for trading equities, debt securities, exchange-traded funds, unit trusts/mutual funds, derivative warrants and equity linked instruments. It also provides facilities and investor access channels that make securities trading more accessible.

The Hong Kong Securities Clearing Company Limited (HKSCC), a wholly owned subsidiary of HKEx, operates the third generation of the Central Clearing and Settlement System (CCASS/3) for clearing and settlement of securities transactions concluded at the SEHK. The CCASS/3 is an automated book-entry system that operates on an open architecture. In addition to brokers and custodians, certain CCASS services are also available to retail investors. For example, investors may open Investor Participant Accounts with the clearing company to keep their securities in CCASS.

The HKFE operates the Hong Kong Futures Automated Trading System for the trading of futures and options contracts and the Derivatives Clearing and Settlement System (DCASS) for the clearing and settlement of such contracts. DCASS shares the same common database and system infrastructure as the trading system.

SD Net, the consolidation of the above three networks, was completed in mid-July 2007, after the successful migration of the AMS/3 circuits to the network. SD Net enables brokers and participants to use a more reliable network at lower network costs. The hardware of the trading, clearing and settlement system supporting the securities and futures markets had been upgraded with raised capacity and functionality.

New features were introduced to the Stock Segregated Account with Statement Service (SSA) in January and July. SSA users can access electronic voting and enquire about their stock balances and movements in the accounts electronically through the CCASS Internet System and CCASS Phone System. Users can also opt to receive alerts via Short Message Service and by email when there is any movement in the SSA.

The information dissemination systems of the securities and futures markets were upgraded with added functions and higher efficiency.

In June 2007, the securities market entered into a new era of electronic disclosure with the rollout of the Electronic Disclosure System which provides straight-through publication of issuer documents via the HKEx website.

At year-end, there were 13 automated trading services providers, comprising mainly foreign exchanges and regulated entities, authorised by the SFC under section 95 of the Securities and Futures Ordinance (SFO) to provide automated trading services in Hong Kong. Automated trading services are services provided through electronic facilities, not facilities provided by a recognised exchange company or a recognised clearing house, to transact or settle transactions in securities or futures contracts.

Securities and Futures Commission

The SFC was established in May 1989 following the enactment of the Securities and Futures Commission Ordinance. The regulatory objectives of the SFC, as set out in the SFO that came into effect on April 1, 2003, are:

- to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
- to promote public understanding of the operation and functioning of the securities and futures industry;
- to provide protection for members of the public investing in or holding financial products;
- to minimise crime and misconduct in the securities and futures industry;
- to reduce systemic risks in the securities and futures industry; and
- to assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

Established as an autonomous statutory body, the SFC is responsible for regulating the securities and futures markets in Hong Kong. At year-end, the SFC had a governing body of 14 directors (the chairman, six executive directors and seven non-executive directors) appointed by the Chief Executive. The Government is not involved in the day-to-day regulation of the securities and futures industry.

The SFC is funded by the market. No government funding has been sought since 1993. The 2007-08 operating expenditure (including depreciation) is estimated to be $596.94 million.

The SFC seeks advice on policy matters from its advisory committee, which comprises the chairman and the chief executive officer of the SFC, two executive directors of the SFC and 12 independent members. The independent members are appointed by the Financial Secretary under the authority delegated by the Chief Executive and are broad-based and representative of market users.

The exercise of powers by the SFC is subject to a range of checks and balances. For instance, a wide range of SFC decisions are subject to appeal, and appeals are made to the independent Securities and Futures Appeals Tribunal chaired by a High Court judge. In November 2000, the Process Review Panel for the SFC (PRP) was established by the Chief Executive to review and advise the SFC on the adequacy of the internal procedures and operational guidelines governing the actions and operational decisions it takes in the performance of its regulatory functions. Members of the PRP are appointed by the Chief Executive. In September 2007, the Government published the PRP's sixth annual report, which concluded that the SFC had generally followed its internal procedures in handling cases under review.

Broadly speaking, the SFC's work involves licensing, supervision and monitoring of intermediaries; regulation of the public marketing of unit trusts, mutual funds and other collective investment products; regulation of takeovers, mergers and other corporate activities; listing regulation under the dual filing system for IPO applicants and issuers; supervision of markets including the exchanges and clearing houses; enforcement of securities laws and rules; and investor education.

As at year-end, there were 33 175 licensed persons, including securities brokerage firms, futures dealers and securities margin financiers, as well as their representatives, and 99 registered institutions, such as banks, engaging in regulated activities like dealing and advising on securities and futures.

Investor education continues to be a priority of the SFC's work. The SFC's investor education theme in 2007 was 'Know Your Risk', which aimed at encouraging investors to understand different aspects of 'risk' in their investments, including market volatility, increasing complexity of products, scams and malpractices.

The SFC launched a five-episode TV drama series, *Wising up with Experience*, which for the first time was adapted from real-life investment stories. To highlight its investor education theme, the SFC also ran the first full-length 30-minute radio programme, Investing 101, on Commercial Radio to raise the public awareness of risk relating to various investments.

Also for the first time, the SFC launched a cross-media financial knowledge quiz, Investment Triathlon, through three separate media channels, namely the Hong Kong Economic Times, Radio Television Hong Kong and Cable TV, to help investors understand financial investments and their risks.

During the year, the SFC published a new series of six investor education leaflets on wide-ranging topics, namely 'Know Your Broker', 'IPO Investing', 'Fund Investing', 'Hedge Funds', 'Index Tracking Exchange Traded Funds', and 'How to Make a Complaint'.

The SFC continued to run outreach activities targeting different audiences. It jointly organised investor education seminars for the public with The Hong Kong Society of Financial Analysts and The Open University of Hong Kong. It also collaborated with the Institute of Financial Planners of Hong Kong and the Education Bureau to offer courses for secondary school teachers to assist them in teaching the new Senior Secondary Business, Accounting and Financial Studies Curriculum starting in the 2009 academic year. Moreover, there were talks to university and secondary school students, as well as civil servants. The response to these outreach activities was positive — nearly 7 000 people attended the 59 sessions held in 2007.

In 2007, the SFC continued to enhance cross-boundary and local regulatory cooperation and the protection of investors by signing two additional Memoranda of Understanding (MOUs). The first MOU was entered into with the China Banking Regulatory Commission (CBRC) to facilitate cooperation and information sharing with respect to Hong Kong licensed intermediaries who provide services to Mainland commercial banks conducting overseas wealth management business on behalf of their clients. The second MOU was entered into with the Financial Reporting Council to facilitate the coordination of effort and exchange of information in relation to the compliance with financial reporting standards by listed entities and observance of proper standards by their auditors and reporting accountants.

Building on the existing cooperation framework, the SFC exchanged side letters concerning enforcement cooperation with the China Securities Regulatory Commission (CSRC) to enhance cooperation between the two authorities. Under the new arrangements, the SFC may request investigatory assistance from the CSRC in obtaining information in the Mainland, and the CSRC can compel persons to provide the requested information for the SFC. The SFC will also be able to exercise its investigatory powers to help the CSRC in its investigations that have a Hong Kong element.

Insider Dealing Tribunal and Market Misconduct Tribunal

The Insider Dealing Tribunal was an important feature of the regulatory framework for the securities market in Hong Kong. Established under the repealed Securities (Insider Dealing) Ordinance, the tribunal looked into cases involving suspected insider dealing referred to it by the Financial Secretary. By year-end, it had concluded a total of 25 cases since it commenced operation in 1994.

When the SFO came into force on April 1, 2003, the Insider Dealing Tribunal was replaced by the Market Misconduct Tribunal (MMT), which covers five other types of market misconduct (false trading, price rigging, disclosure of information about prohibited transactions, disclosure of false or misleading information inducing transactions, and stock market manipulation) in addition to insider dealing. The MMT decides on cases on the civil standard of proof and can impose a range of civil sanctions, such as ordering the disgorgement of profits, banning a person from trading in SFC regulated financial products and disqualifying a person from directorship or management of a company.

The MMT inquires into market misconduct that occurred on or after April 1, 2003. The Insider Dealing Tribunal continues to inquire into cases of insider dealing that occurred before April 1, 2003.

As an alternative to civil proceedings, market misconduct is subject to criminal prosecution, which, if successful, may result in more severe penalties on conviction, including up to 10 years' imprisonment or a fine of up to $10 million.

The MMT took up its first case in September 2007. By year-end, the Financial Secretary had referred three cases to the MMT.

Recent Developments

Apart from reinforcing its status as the premier capital formation centre for Mainland enterprises, Hong Kong encourages and facilitates the listing of more quality overseas companies in the HKSAR. HKEx and the SFC have published a joint policy statement to clarify requirements in the Listing Rules governing the listing of overseas companies and setting out the shareholder protection measures that overseas applicants should address in seeking a listing in Hong Kong.

The SFC and HKEx also published a joint policy statement in November 2007 on a pilot scheme for the posting, by a new listing applicant prior to its issue of a listing document, of a web proof information pack (WPIP) on the HKEx or GEM website (HKEx Website). A WPIP, in the nature of a near-final draft listing document with the omission of pricing and offer size information, should be submitted to SEHK for posting on the HKEx Website no later than the time when information about the listing applicant is first provided to institutional investors.

The rationale for the WPIP-posting requirement is to address the apparent inequality of information dissemination between institutional and retail investors in an initial public offering such that retail investors could access information about a listing applicant at an earlier stage in the listing process. It will also help ensure a more level playing field among all investors, bring the IPO regime in Hong Kong more in line with other leading international jurisdictions and assist in reducing media speculation or market rumours.

The pilot scheme will go into effect on January 1, 2008. The SFC and HKEx will commence reviewing the operation of the pilot scheme in April 2008 and assuming no major defect is identified, the WPIP-posting requirement will be codified into the Listing Rules.

To further facilitate the processing of UCITS III funds, the SFC introduced in March 2007 a series of streamlined measures for the authorisation of UCITS III funds with special features, such as index funds, guaranteed funds, fund of funds, money market funds. By year-end, there were 1 419 SFC-authorised UCITS III funds, representing 70 per cent of all unit trusts and mutual funds authorised by the SFC.

The SFC approved HKEx's proposal to increase the position limits on stock options contracts in October 2005. The increased limit took effect on February 10, 2006 after completion of legislative amendments.

To meet market needs and promote growth in the futures and options market, the SFC adjusted in March 2007 the position limits of Hang Seng China Enterprises Index (H-shares Index) futures and options contracts from 6 000 contracts per futures contract month/options series to an aggregate delta limit of 12 000 applicable to all futures months and options series.

In May 2007, the SFC consulted the public on the proposal to amend the Securities and Futures (Contracts Limits and Reportable Positions) Rules to empower the SFC to authorise Exchange Participants or their affiliates to exceed the position limits (by up to 50 per cent) for Hang Seng Index futures and options contracts as well as H-shares Index futures and options contracts where the limits are not enough to enable them to serve their clients' needs. The amended rules became effective on December 21, 2007.

In November 2007, the SFC approved HKEx's rule amendments to facilitate the introduction of Third Party Clearing (TPC) to the cash market which allows a Stock Exchange Participant to give up its clearing and settlement obligations with HKEx to another clearing participant. This provides an option to Exchange Participants to minimise its back office operations and concentrate on its core business.

The SFC also approved HKEx's proposal for the issuance of new trading rights in the stock and derivatives markets. Under the new arrangement, the exchanges may issue a new trading right at $500,000 if a new exchange participant cannot purchase a trading right from existing holders during a tender process. The new procedures became effective on March 7, 2007.

Pursuant to a review of the derivative warrants market by the SFC, a six-point plan to improve market operations was proposed in March 2006. As at end-2007, most of the proposals under the six-point plan, which include issuing new marketing guidelines, requiring the use of plain language for listing documents, facilitating further and identical issues, banning commission rebates and other incentive schemes offered by issuers, and enhancing investor education and information dissemination, have been implemented. The SFC is working with HKEx on the remaining proposal to tighten liquidity-providing provisions.

The new sponsor regime and the Guidelines on Sponsors and Compliance Advisers came into effect on January 1, 2007. Only those intermediaries that had met the stringent eligibility requirements were allowed to continue their sponsor or compliance adviser work. As at year-end, 189 of the 267 intermediaries licensed or registered for Type 6 regulated activity had been subjected to licensing conditions restricting them from acting as sponsors or compliance advisers.

In November 2007, the SFC issued a consultation paper proposing to require all licensed corporations to submit their financial returns electronically. Electronic submission is beneficial to both the industry and the SFC as it facilitates efficient handling by minimising manual errors in the current data collection process and allowing straight through processing. This move to e-submission is in line with the practice adopted by other financial services both locally and overseas. The consultation period ended on December 10, 2007 and the SFC is reviewing the responses received.

In 2007, the SFC continued its rigorous supervision of licensed intermediaries. The SFC had identified two cases of broker frauds involving misappropriation of clients' assets. In each of those cases, the SFC took swift and decisive action to protect the interests of investors, such as imposing appropriate prohibition on the broker and applying to the court for appointment of an independent administrator to take over the broker's operations. These arrangements safeguarded and protected clients' interests.

In addition, the SFC continued to focus its enforcement resources on fighting market misconduct and intermediaries who are dishonest or put clients at risk. By year-end, there were 14 outstanding investigations of listed companies. In relation to listed company investigations, the SFC obtained the first disqualification order against a former listed company director who will not be allowed to become a director or be involved in the management of any listed company, subsidiary or affiliate for four years. The SFC also commenced similar proceedings against five former directors of a listed company.

In two ongoing insider dealing cases, the SFC made two separate applications seeking urgent interim freezing orders over money and other property. These orders prevent assets and property held by or on behalf of persons suspected of being involved in insider dealing from being dissipated during the SFC's ongoing investigations.

During the year, the SFC successfully prosecuted nine entities for market manipulation and false or misleading disclosure, and summonses were issued to an additional nine entities but those cases were not concluded by year-end. In one of the market manipulation cases, the court for the first time, imposed an immediate prison sentence on the market manipulator. In the previous year, there were 10 successful prosecutions and two outstanding cases. There were 20 referrals to the Police.

Insurance Sector

Main Features

At year-end, there were 178 authorised insurers, 90 of which were incorporated in Hong Kong while the remaining 88 were incorporated on the Mainland and in 22 overseas countries, with the United States taking the lead.

The total gross premiums of the insurance industry reached $156 billion in 2006, representing 13.7 per cent growth over that in 2005. Gross premiums of the general insurance sector increased slightly by 1.8 per cent to $23 billion in 2006. The increase was mainly driven by the strong momentum registered in accident and health insurance business. Overall underwriting profit of general insurance business decreased from $2.5 billion in 2005 to $2.1 billion in 2006 due to higher claims and management expenses.

The long-term insurance business continued to attain double-digit annual growth from 1991 to 2006, with office premiums increased by 16 per cent to $133.1 billion in 2006. The individual life business remained dominant with the office premiums in force of $114.9 billion, accounting for 86.3 per cent of the total office premiums. The number of individual life policies in force grew by 7.6 per cent to 7.1 million in 2006.

At year-end, there were 31 550 insurance intermediaries, including 31 042 agents (of whom 2 150 were agency firms) and 508 brokers.

Insurance Authority

The Commissioner of Insurance, appointed by the Chief Executive as the Insurance Authority (IA), has the principal function, under the Insurance Companies Ordinance (ICO), to regulate and supervise the insurance industry to promote its general stability and protect existing and potential policy holders.

The ICO, which prescribes a comprehensive regulatory framework for all classes of insurance business, has two main objectives of ensuring the financial stability of all insurers authorised in Hong Kong and the fitness and propriety of their management. These objectives are achieved through the prescription of, among other things, minimum share capital and solvency margin requirements, as well as the requirement for directors and controllers of insurers to be fit and proper persons.

A general business insurer is also required to maintain assets locally to meet the claims of Hong Kong policyholders. For life insurance business, an appointed actuary system is in place to ensure that the insurer would be able to meet its obligations.

Prudent supervision of insurers is carried out mainly through examination of the financial statements, actuarial reports and other returns submitted by insurers and regular on-site visits. The IA may take appropriate action under the ICO against an insurer to safeguard the interests of policyholders. These measures include limiting premium income, placing of assets in the IA's custody, assumption of control by a manager appointed by the IA or petitioning for winding-up of the insurer.

Insurance intermediaries have been subject to regulation under the ICO since 1995. An insurance agent must be properly appointed by an insurer, who is required to comply with the Code of Practice for the Administration of Insurance Agents in appointing and controlling its agents. Moreover, an insurance broker must meet certain minimum requirements to become eligible for authorisation.

Self-regulatory measures are in place to strengthen market discipline in the insurance industry. These measures, formulated by the insurance industry in consultation with the IA, include the adoption of a Code of Conduct for Insurers governing the writing of insurance contracts and insurance benefit illustration standards for life insurance policies.

As a member of the International Association of Insurance Supervisors, Hong Kong endeavours to ensure that its supervisory regime is in line with prevailing principles and standards. It has also established an Insurance Advisory Committee, as provided for in the ICO, comprising representatives drawn from the industry.

Recent Developments

The IA oversees the well being of the insurance market and the insurance needs of the insuring public. To address public concerns over the lack of coverage for certain high-risk trades and emerging calls for a central employees' compensation scheme, the Employees' Compensation Insurance Residual Scheme was successfully launched in May 2007. The scheme is operating on a co-insurance arrangement entered into by all employees' compensation insurers. Under the scheme, any employer who has been declined by no less than three insurers or has received three successive quotations in excess of the benchmark premium rate are eligible to apply for coverage.

The IA, on behalf of the Government, entered into a market agreement with insurers in June 2007 to extend, at no extra premiums, the territorial scope of all existing motor and employees' compensation insurance policies to cover Shenzhen Bay Port Hong Kong Port Area (HKPA) after it began operation on July 1, 2007. The market agreement serves as a cost-effective and convenient means to resolve the problem that insurance policies issued prior to July 1, 2007 would not automatically cover the HKPA, which would pose potential problems to motor and employees' compensation policyholders.

In line with international supervisory principles and to keep pace with rapid development of the insurance market, the Government is looking into the proposal of turning IA into an independent regulatory authority. In this regard, a consultancy study was commissioned in November 2007 to look into the various aspects of an independent IA. Taking into account the consultant's recommendations, the Government will prepare proposals on the setting up of an independent IA for consultation with stakeholders.

The IA had commissioned a consultancy study on the need and feasibility of establishing Policyholders' Protection Funds (PPFs) in Hong Kong, and the final consultancy report was issued in March 2007. In light of the findings in the final report which revealed that while a form of PPF scheme might work in Hong Kong, its success would depend heavily on the scope and nature as well as availability of industry and public support, the Government is focusing attention on developing together with the insurance industry a post-funded contingency plan that does not require legislative backing to cope with potential insurer insolvencies in future.

The IA had commissioned another consultancy study in September 2003 to examine the supervisory regime of the assets of long-term business insurers. This study focused on an appropriate asset valuation framework and the need for a more robust mechanism to safeguard the interest of Hong Kong policyholders upon failures of long-term insurers. The study was completed, and the IA will pursue administrative measures to strengthen its monitoring regime on long-term business insurers.

To facilitate mutual assistance and exchange of information, the IA concluded a Memorandum of Understanding respectively with the Australian Prudential Regulation Authority and the Isle of Man Insurance and Pensions Authority in February 2007.

Mandatory Provident Fund Schemes and Occupational Retirement Schemes

Main Features

On December 1, 2000, the MPF System was implemented to help encourage the workforce to save and invest for their retirement. It is a privately managed, employment-related mandatory system of provident fund schemes. Unless exempted, employees and self-employed people aged between 18 and 65 are required to join MPF schemes.

The employer and employee are each required to contribute 5 per cent of the employee's relevant income to a registered MPF scheme, subject to the maximum and minimum levels of income for contribution purposes. The accrued benefits are fully vested in the scheme members and can be transferred from scheme to scheme when employees change employment or cease to be employed. A self-employed person has to contribute five per cent of his or her relevant income. In normal circumstances, benefits must be preserved until the scheme member attains the retirement age of 65.

By year-end, 99.5 per cent of employers (about 238 700), 97.6 per cent of relevant employees (2 130 300) and 75.1 per cent of self-employed persons (271 100) had enrolled in MPF schemes. Total MPF assets amounted to about $264.79 billion, with monthly MPF contributions amounting to around $2.6 billion.

Unlike the compulsory MPF schemes, occupational retirement schemes registered under the Occupational Retirement Schemes Ordinance are voluntary schemes established by employers. To tie in with the implementation of the MPF system, schemes registered under the ordinance that fulfilled certain conditions were exempted from MPF requirements. Members of such schemes may choose to remain in the existing scheme or join an MPF scheme. At year-end, there were 4 804 MPF-exempted occupational retirement schemes covering over 430 000 employees.

Mandatory Provident Fund Schemes Authority

Established in September 1998 under the Mandatory Provident Fund Schemes Ordinance, the Mandatory Provident Fund Schemes Authority (MPFA) is responsible for regulating and supervising the MPF System and ensuring compliance with the ordinance. It is also the Registrar of Occupational Retirement Schemes. To ensure that the interests of MPF scheme members are protected, the MPFA closely monitors the operation of MPF trustees and other service providers, investigates cases of non-compliance identified through reports, complaints or inspections, and takes enforcement actions accordingly. The MPFA also conducts MPF investment education to strengthen public awareness of the need to take care of their MPF investment and disseminates in-depth messages that will facilitate scheme members in choosing the appropriate funds.

Recent Developments

The MPFA has been pressing ahead with enhancing the transparency of MPF schemes, including information on fees and charges of MPF funds, to facilitate market competition and to enable scheme members to make more informed and effective investment decisions. In July 2007, a web-based MPF Fee Comparative Platform was launched to facilitate comparison of fees and charges of MPF funds. New requirements to improve the content of annual benefit statements were introduced in November 2007 for implementation after the enactment of the Mandatory Provident Fund Schemes (Amendment) Bill 2007.

As regards the recent developments in the MPF legislation, please see the section 'Improvement of the Mandatory Provident Fund Schemes Ordinance' below.

Financial Links between Hong Kong and the Mainland

Hong Kong has long served as an international financial centre for the Mainland, helping Mainland enterprises to access international capital through its banking, equity and debt markets. Hong Kong's banks have also maintained a strong presence on the Mainland. The financial links between Hong Kong and the Mainland have been further strengthened with China's accession to the World Trade Organisation, which will, over time, generate increasing demand for a wide range of financial support services for the increasing trade and investment flows between the Mainland and the rest of the world.

The smooth and orderly development of renminbi business facilitates cross-boundary tourist spending in Hong Kong and helps promote economic integration between Hong Kong and the Mainland. Further development of renminbi business is expected to enhance the capability of Hong Kong's financial system to handle renminbi transactions, which is an important step in strengthening the status of Hong Kong as an international financial centre.

There has been a steady flow of cross-boundary funds among financial institutions in both places. Over the years, the Mainland has accumulated a substantial amount of funds in Hong Kong dollars from trading activities and inward investment. These funds are placed with financial institutions on the Mainland and are subsequently channelled back to Hong Kong through the inter-bank market.

By the end of 2007, AIs' external liabilities to banks on the Mainland amounted to $508.7 billion, while their claims on banks on the Mainland totalled $305.8 billion. The amounts represented 20.7 per cent and 6.1 per cent respectively of AIs' total liabilities to and claims on banks outside Hong Kong.

The use of cross-boundary links with Guangdong Province and Shenzhen continued to rise in 2007, reflecting increasing economic integration between the Mainland and Hong Kong. The daily average turnover of cross-boundary links (such as RTGS in Hong Kong dollars and US dollars; cheques in Hong Kong dollars, US dollars and renminbi) increased by 50 per cent to the equivalent of over $1.5 billion in 2007.

In light of the potential of the fund management industry on the Mainland, Hong Kong-based fund managers, who are recognised for their knowledge and experience in asset management, have successfully established joint ventures with Mainland fund managers. Hong Kong managers have also embarked on ways to enable investors to seize investment opportunities on the Mainland. At year-end, there were 14 SFC authorised funds with significant exposure to the A-share market on the Mainland. These included the first equity fund that directly invests in A-shares via the fund manager's own Qualified Foreign Institutional Investors (QFII) quota and an ETF that tracks the A-share market, funds that invest indirectly in A-shares via equity-linked investments issued by QFII, and guaranteed funds with their upside potential returns linked to the A-share market performance.

Renminbi Business in Hong Kong

Since its launch in early 2004, renminbi business in Hong Kong had developed in a steady and orderly manner and had expanded further in 2005 and 2007. By year-end, outstanding renminbi deposits in Hong Kong had exceeded RMB 33 billion.

On January 10, 2007, the State Council announced its agreement to a further expansion of renminbi business in Hong Kong. Financial institutions on the Mainland, upon obtaining approval, can issue renminbi financial bonds in Hong Kong. On July 12, 2007, the first renminbi bond was successfully launched in Hong Kong by the China Development Bank. The Export-Import Bank of China and the Bank of China later issued the second and third RMB bonds in Hong Kong on August 24, 2007 and September 28, 2007 respectively. The three renminbi bonds had a total issuance size of RMB10 billion. Responses from investors were encouraging.

Capital Formation Centre and Global Investment Platform for the Mainland

Hong Kong's fundamental strengths, including high market liquidity, a robust regulatory system, efficient information flow, a rich pool of financial professionals and proximity to the Mainland market, mean that it is well placed to provide excellent services to Mainland enterprises seeking listing in an international financial centre.

The rapidly expanding Mainland market provides abundant opportunities. The presence of Mainland issuers has increased both the breadth and depth of Hong Kong's securities and futures markets. Hong Kong's equity market has evolved from one with a high concentration of property and finance businesses into a market with a great diversity of constituent stocks and a wide range of products.

Hong Kong has become the premier international fund-raising centre for Mainland enterprises. At year-end, 439 Mainland enterprises were listed in Hong Kong, raising a total of $1,849.5 billion since 1993. The 10 largest IPOs of all enterprises listed on the SEHK were all from the Mainland.

Apart from the equity market, Mainland enterprises raise capital in Hong Kong through the issuance of bonds, project financing and loan syndication. Mainland enterprises also have easy access in Hong Kong to investment banking services for mergers and acquisitions, and consultancy on restructuring.

Hong Kong, with its financial facilities, experts and first-rate regulatory regime, already has all the right ingredients to develop its asset management business even further. In April 2006, the Mainland authorities announced measures to allow investment in overseas financial markets by Mainland companies and individuals through qualified institutional investors covering commercial banks, securities firms and insurance institutions. The measures, commonly referred to as the Qualified

Domestic Institutional Investors (QDII) Scheme, strengthen Hong Kong's role as an international financial centre as it serves as a platform for Mainland funds to invest in international markets. Hong Kong's financial market provides many quality products and liquidity, which enable Mainland investors to use Hong Kong as their base for undertaking global investment to enhance investment returns and to deal with diversified risks. In May 2007, CBRC issued a notice which promulgated the widening of the scope of investment allowed under the overseas wealth management business provided by the Mainland commercial banks on behalf of their clients.

Hong Kong professionals are well qualified to provide professional advice and services to Mainland investors on asset management, including risk management and diversification of investment. In June 2007, CSRC announced the Provisional Rules for QDII Investing in Overseas Securities and a related notice, which widened the scope of investment of QDII fund management companies and securities firms. In July 2007, the China Insurance Regulatory Commission promulgated the Provisional Measures for the Administration of Overseas Investment of Insurance Fund. It relaxes the limit of insurance funds that can be invested outside the Mainland to 15 per cent. Furthermore, the State Administration of Foreign Exchange announced in August 2007 a pilot scheme for Mainland individuals to invest directly in securities in Hong Kong. The details are being worked out.

The Government and concerned regulatory authorities will continue to actively promote the links and cooperation between Hong Kong and the Mainland on financial services. The SFC has regular meetings with the China Securities Regulatory Commission, the stock exchanges in Shanghai and Shenzhen, and HKEx to discuss issues of mutual interest.

Mainland and Hong Kong Closer Economic Partnership Arrangement

Under the Closer Economic Partnership Arrangement (CEPA), Hong Kong's financial services suppliers and professionals can enjoy greater market access and flexibility for their operations on the Mainland. Implementation of CEPA has not only enhanced Hong Kong's attractiveness to market users, but also strengthened its competitiveness as an international financial centre and the premier capital formation centre for Mainland enterprises. Further progress was made with the signing of the Supplement IV to CEPA in June 2007 in Hong Kong.

Pursuant to the Mainland's further liberalisation measures in the financial services sector under the Supplement IV to CEPA, Mainland fund management companies can, starting from January 1, 2008 and upon approval by CSRC, set up subsidiaries in Hong Kong and apply for licence to carry out regulated activities in Hong Kong.

Hong Kong-incorporated banks have gained greater access to the Mainland market since the implementation of CEPA in January 2004. By the end of 2007, five local banks that had benefited under CEPA had established nine branches or sub-branches on the Mainland. The latest improvements to CEPA, which became effective from January 2008, relax the criteria for Hong Kong-incorporated banks to gain the status of Hong Kong Service Supplier (a prerequisite for an entity to enjoy the benefits under CEPA) and to acquire shareholdings in Mainland banks. The Mainland authorities will also expedite the processing of Hong Kong banks' applications to establish branches in specific regions on the Mainland, including Guangdong Province.

Hong Kong insurers also took advantage of CEPA during 2007. A Hong Kong insurer was approved by the China Insurance Regulatory Commission under CEPA in September 2007 to form a joint venture insurance company in the Mainland. There have been further liberalisation measures in the insurance sector since the signing of the Supplement IV to CEPA. They include the setting up of an examination centre in Hong Kong for the Mainland qualifying examinations for insurance intermediaries and the permission for Hong Kong insurance agency companies to set up wholly-owned enterprises in the Mainland to provide insurance agency services to the Mainland insurance companies.

In the accounting sector, liberalisation measures include, among others, the mutual exemption of certain professional examination papers, extension of the validity period of Hong Kong accounting firms' Mainland 'Provisional Licence for the Performance of Audit-related Services' to two years.

Economic Summit on 'China's 11th Five-Year Plan and the Development of Hong Kong'

In January 2007, the Focus Group on Financial Services formed under the Economic Summit on 'China's 11th Five-Year Plan and the Development of Hong Kong' proposed an action agenda with 80 recommendations and an overall direction for developing Hong Kong as China's international financial centre of global significance, and establishing a cooperative, complementary and interactive relationship with the financial systems in the Mainland.

By end-2007, progress had been made in over one-third of the 80 recommendations, which included the issuance of RMB bonds and the expansion of the QDII scheme. Looking ahead, the Government and Hong Kong's financial regulators will continue to foster the links between the Mainland and Hong Kong markets to enhance their efficiency. Hong Kong will also seek to expand its financial institutions' business on the Mainland, and to better enable Mainland capital, investors and financial institutions to use Hong Kong to go international.

The Focus Group on Professional Services, Information & Technology and Tourism conducted an in-depth study of the specific issues raised at the Economic Summit, including how Hong Kong should strive to attain a leading position globally in professional services. The Sub-group on Professional Services recommended a number of strategic proposals for the accountancy profession to sustain Hong Kong's influence in the international professional arena and to enhance cooperation and exchange between the accountancy professions on the Mainland and Hong Kong. The Government and the Hong Kong Institute of Certified Public Accountants (HKICPA) will follow up the recommendations.

Pan-Pearl River Delta Cooperation

In June 2007, the Chief Executive led a delegation to Hunan to take part in the 'Fourth Pan-Pearl River Delta Regional Cooperation and Development Forum', and the Financial Services and the Treasury Bureau (FSTB) led 35 delegates from Hong Kong's financial services sector to the 'Pan-Pearl River Delta Regional Financial Cooperation Forum'. The HKEx also led a delegation of intermediaries to the Mainland to promote Hong Kong as the premier capital raising centre for Mainland enterprises.

To keep up the momentum, the FSTB will organise another such visit to Guangdong in 2008.

Enhancing Hong Kong's Competitiveness as an International Financial Centre

The Government is committed to strengthening Hong Kong's competitiveness as an international financial centre and the premier capital formation centre for the Mainland through enhancing its regulatory regime, promoting corporate governance, upgrading financial infrastructure and fostering the development of the bond market.

In 2007, enhancement of Hong Kong's regulatory framework continued in the light of international experience and standards to ensure sound business standards and confidence of the market without unnecessary impediments. Major initiatives were pursued to enhance Hong Kong's competitiveness as an international financial centre.

Upgrading the Quality of Financial Reporting

Quality financial reporting is of paramount importance for upholding Hong Kong's corporate governance regime. The Hong Kong Financial Reporting Standards (HKFRS), which are issued by the HKICPA, have been fully convergent with the International Financial Reporting Standards (IFRS) since January 2005. This uniform accounting platform, well understood by global investors and financial analysts, enables the comparison of corporations and their results in different jurisdictions, and leads to greater confidence in the transparency and quality of Hong Kong's financial markets.

In addition, the Government is acutely aware of the need to maintain an effective, transparent and accountable regulatory regime for the accountancy profession that is on a par with international standards. With the enactment of the Financial Reporting Council Ordinance in July 2006, the Financial Reporting Council (FRC) was established on December 1, 2006 and became fully operational on July 16, 2007. The FRC is a new statutory body tasked to investigate audit irregularities and accounting non-compliances of listed companies in Hong Kong. It is one of the key initiatives of the Government to upgrade the quality of financial reporting, promote the integrity of the accountancy profession, enhance corporate governance, and protect investors' interest.

Expanding the Sources of Listed Enterprises on the Exchange

Hong Kong has established itself as the premier capital formation centre for the Mainland. Mainland enterprises raised a total of $1,849.50 billion in the past years.

At year-end, 439 Mainland enterprises were listed on Hong Kong's stock exchange, accounting for 35 per cent of the total number of listed companies; the market capitalisation of Mainland enterprises accounted for about 58 per cent of total market capitalisation; and the turnover of Mainland enterprises accounted for about 69 per cent of the daily turnover on the exchange.

To further facilitate the listing of overseas companies in Hong Kong, the SFC and HKEx published a joint policy statement regarding the listing of overseas companies in March 2007. The statement sought to clarify the listing rules requirements governing the listing of companies incorporated outside the expressly recognised jurisdictions and provide guidance for overseas companies seeking a primary listing in Hong Kong.

HKEx has been stepping up efforts in promoting Hong Kong as a preferred listing venue, and establishing cooperation framework with other jurisdictions. These include signing of memoranda of understanding (MOUs) with the Abu Dhabi Securities Market and the Moscow Interbank Currency Exchange in March 2007 and July 2007 respectively to establish cooperation in areas such as information exchange. In December 2007, HKEx signed MOUs with the Ho Chi Minh Stock Exchange and the Mongolian Stock Exchange.

There are also ongoing marketing initiatives and visits to the Mainland and other jurisdictions, including Vietnam, Thailand, Malaysia, Kazakhstan, Russia and Taiwan, to promote Hong Kong's status as a premier capital formation centre.

Promoting Asset Management Business

The saving rates in Asia are high compared to other regions. Located at the heart of Asia, Hong Kong is well positioned to further develop as an international asset management centre. According to the Fund Management Activities Survey 2006 released by the SFC in July 2007, which covered licensed corporations and registered institutions, the combined fund management business had grown by 36 per cent from $4,526 billion in 2005 to $6,154 billion in 2006. Since the establishment of the SFC in 1989, the number of retail funds in Hong Kong had more than doubled from 781 to 1 973 in 2006, with the value jumping 25-fold from $283 billion to $7,100 billion. Following the introduction of the QDII Scheme by the Mainland authorities in 2006, detailed implementation rules were rolled out and the scope of investments under the QDII Scheme had also been expanded in 2007 to allow investments in overseas equities and funds. All these measures are expected to provide further impetus to the development of the asset management industry in Hong Kong (see also 'Capital Formation Centre and Global Investment Platform for the Mainland' under Financial Links between Hong Kong and the Mainland).

To provide a conducive environment for the further development of Hong Kong as Asia's asset management centre, the Government continued to lead financial services delegations to a number of cities on the Mainland and various countries to promote Hong Kong's financial services and Hong Kong's strengths as a major asset management centre in Asia. The SFC continued to review relevant codes and guidelines and facilitate the launch of new investment products and international funds' access to the local market. In June 2007, the SFC announced a set of initiatives to streamline the licensing procedures for overseas fund managers.

Improvement of the Mandatory Provident Fund Schemes Ordinance

Since the enactment of the Mandatory Provident Fund Schemes Ordinance in August 1995, the MPFA has been reviewing and making proposals to improve the MPF legislation in the light of operational experience. Amendments to the legislation since the implementation of the MPF System have sought to simplify MPF scheme administration, enhance protection for scheme members and improve the regulation of MPF schemes and investments.

On June 27, 2007, the Mandatory Provident Fund Schemes (Amendment) Bill 2007 was introduced into the Legislative Council. The Bill covers around 30 proposals to amend the MPF legislation in respect of scheme administration and enforcement and is expected to be enacted in January 2008. Further legislative amendments which aim to enhance protection of scheme members' interests under the MPF System by strengthening the supervision and enforcement of the MPF regime will be introduced into the legislature in 2008.

Rewrite of the Companies Ordinance and other legislative amendment exercise

The Standing Committee on Company Law Reform (SCCLR), established in 1984, meets regularly to consider amendments to the Companies Ordinance (CO) to ensure that the CO meets the evolving needs of the business community. The Companies Registry provides secretariat support for the SCCLR.

The Overall Review of the CO and the Corporate Governance Review by the SCCLR in recent years resulted in a number of recommendations for reform. Some of the recommendations such as improving the registration regime for non-Hong Kong companies have been implemented through amendments to the CO. The remaining recommendations such as reform of the capital maintenance provisions and modernisation of the statutory language are taken forward through a comprehensive rewrite of the CO. The rewrite exercise will also provide Hong Kong with an up-to-date legal infrastructure attuned to its needs as a major international business and financial centre. It also leverages on recent company law developments in other common law jurisdictions such as the United Kingdom, Australia, and Singapore.

Spearheaded by the Financial Services and the Treasury Bureau, the rewrite exercise has been progressing at full steam since mid-2006. Four advisory groups, comprising relevant professionals, business and market practitioners, and academics, were established in late 2006 to advise on various specific areas of the CO. Their work is expected to be completed by mid-2008. A public consultation on the accounting and auditing provisions in the CO was conducted in the second quarter of 2007.

Other complex subjects, such as company names, directors' duties, corporate directorship, registration of charges, share capital, capital maintenance rules, and statutory amalgamation procedures, will be put forward for public consultation in

2008. The Companies Bill will be issued for public consultation in the form of a white bill in mid-2009.

On the other hand, the Government attaches great importance to enhancing the quality of the equity market. In this regard, the Government has proposed giving statutory backing to major listing requirements to improve the regulation of listing. The Government will continue to work closely with stakeholders, including the SFC and the HKEx, to ensure that the legislative proposal to give statutory backing to major listing requirements can effectively enhance market quality and increase investor protection without stifling market development or imposing an undue compliance burden.

Review of the Trustee Ordinance

The Government commenced a review of the Trustee Ordinance in late 2007 to strengthen the competitiveness of Hong Kong's trust services industry and enhance its position as an international financial centre. Relevant professional bodies and stakeholders will be consulted during the review process.

Enhancement of the Financial Infrastructure

The HKMA continues to pursue the goal of building a safe and efficient financial infrastructure based on a multi-currency, multi-dimensional platform, and developing Hong Kong into a payment and settlement centre in the region.

Major projects completed in 2007 include:

- a Renminbi RTGS System;
- a link between the securities settlement system in Malaysia and the US dollar RTGS system in Hong Kong; and
- an electronic trading platform for the Exchange Fund Bills and Notes.

The HKMA has established a comprehensive marketing programme to explore opportunities to link the various RTGS systems and the CMU with similar systems in the region, and to promote the use of the clearing and settlement systems in Hong Kong.

Development of the Bond Market

The Government has boosted the development of the bond market in recent years by providing the necessary financial infrastructure, simplifying the issuance process, removing regulatory impediments, offering tax incentives and encouraging public corporations to issue bonds. Investor education on bond investment has also been strengthened.

The HKMA continues to implement the recommendations of the review of the Exchange Fund Bills and Notes (EFBN) Programme conducted in 2006. Following the refinements to the market-making arrangements and the publication of the league table related to the EFBN Programme, the benchmark yield curve has been extended to 15 years after the inaugural issue of 15-year Exchange Fund Notes in August 2007.

In addition, the HKMA launched an electronic trading platform for EFBNs in December 2007.

At the end of 2007, the total amount of Hong Kong dollar debts outstanding exceeded $750 billion. Issuers included the Exchange Fund, statutory bodies or government-owned corporations, AIs, multilateral development banks (MDBs), non-MDB overseas borrowers and local corporations. New issues of EFBNs amounted to $223.5 billion and accounted for around 50 per cent of total new debt issuance in 2007.

Excluding the Exchange Fund papers, new issuance of Hong Kong dollar debt totalled $221.3 billion in 2007, comparable to the previous year. Of this total, non-MDB overseas borrowers remained the most active, accounting for nearly 56 per cent of the new issues. Issuance by statutory bodies and government-owned corporations, local corporations and authorised institutions remained stable in 2007 as compared with 2006.

Excluding EFBNs[5], fixed rate debt constituted about 75 per cent of total new issues in 2007, comparable to 2006.

During the year, the HKMA offered three issues of retail Exchange Fund Notes, worth $587 million.[6] The Hong Kong Mortgage Corporation (HKMC) also issued four series of retail bonds to the public, worth a total of $925 million.

In 2007, the HKMA conducted a study to assess the market potential and identify hurdles to the development of an Islamic bond market in Hong Kong, and made recommendations on changes in the taxation, legal and regulatory framework.

The long-term development of the bond market is promising. Hong Kong's free and open financial markets, with free flow of capital, help create a large international investor base and will continue to fuel the growth of Hong Kong's bond market. Other positive factors contributing to higher demand for bond investments include the vast amount of Hong Kong dollar time deposits, the growing retirement funds in Hong Kong for the aging population, and capital from the Mainland as a result of gradual liberalisation of its capital account.

Debt issuance

Through its debt-issuing activities, the Hong Kong Mortgage Corporation plays its part in promoting the development of the Hong Kong dollar debt market. By the end of 2007, the HKMC had $33.3 billion of debt securities outstanding with tenor up to 15 years.

The HKMC has pioneered the development of retail bond market in Hong Kong since 2001. At the end of 2007, the amount of retail bonds outstanding issued by the HKMC was $4.7 billion.

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5 All EFBNs were fixed rate debt instruments.

6 These issues followed the introduction of the refined Retail Exchange Fund Programme under which investors could purchase Exchange Fund Notes through a larger distribution network and at lower prices.

In June 2007, the HKMC established the multi-currency US$3 billion Medium Term Note Programme to raise funds in the international market. The programme will help to set a quasi-sovereign benchmark for Hong Kong to further promote the development of the regional bond market. It is a flexible, efficient and cost-effective platform to broaden the investor base and funding sources for the HKMC.

HKMC's local currency issues continued to be rated triple-A by Moody's, enhancing its ability to promote the development of the debt and securitisation markets in Hong Kong.

Development of Secondary Mortgage Market

A well-developed secondary mortgage market plays a useful role in channelling long-term funds, such as insurance and pension funds, to meet demand for long-term home financing. To develop this market, the Government established the HKMC in March 1997:

- to promote the development of the secondary mortgage market in Hong Kong;
- to improve banking and monetary stability;
- to facilitate the development of the local debt market; and
- to promote wider home ownership.

Asset Purchase Programme

Under the Asset Purchase Programme, the HKMC purchases assets from banks to facilitate their risk and balance sheet management. The HKMC is a key player in the secondary mortgage market. The total outstanding principal balance of the HKMC's asset portfolio at the end of 2007 amounted to $34.5 billion.

Mortgage Insurance Programme

The Mortgage Insurance Programme (MIP) was launched in 1999 to provide mortgage insurance cover to banks so that they may extend residential mortgage loans to homebuyers above the 70 per cent loan-to-value ceiling set by the HKMA. The maximum insurance cover is 25 per cent of the value of the mortgaged property.

The MIP has gained wide acceptance and has promoted home ownership through product diversification and improvements to servicing standards. As at the end of 2007, over 96 000 applications had been received involving an aggregate mortgage loan of $188 billion.

Mortgage-backed Securities Market

The HKMC set up a back-to-back mortgage-backed securities (MBS) programme in October 1999, which provides a platform for banks to effectively repackage their mortgage portfolios into more liquid MBS. The HKMC guarantees the timely payment of interest and repayment of principal for the securitised mortgage loans.

In December 2001, to further develop the range of products available in Hong Kong's MBS market, the HKMC established the multi-currency Bauhinia MBS

Programme with MBS collateralised by mortgage loans from HKMC's retained mortgage portfolio. A total of $4.1 billion of MBS were outstanding under the Bauhinia MBS Programme at the end of the year.

Companies Registry

The Companies Registry administers and enforces the major part of the CO. It registers local and non-Hong Kong companies, deregisters defunct solvent private companies, registers documents required to be submitted by registered companies and provides the public with services and facilities to inspect and obtain company information kept by the registry. It also administers and enforces several other ordinances including the Trustee Ordinance (insofar as it relates to trust companies), the Registered Trustees Incorporation Ordinance and the Limited Partnerships Ordinance. The registry is also responsible for a wide range of legal, policy and regulatory matters related to the relevant ordinances as well as corporate governance.

The registry has operated as a trading fund department since 1993. Consequently, it can deploy its resources more flexibly when needed to meet business turnover and customers' demands and expectations. The department achieved a surplus of $118.6 million in the 2006-07 financial year. The surplus generated over the past years had enabled the registry to build up a healthy reserve to finance the department's development projects and had removed the need to raise fees since December 1997.

The registry has continued to implement the Strategic Change Plan to fully computerise the department's operations and enable delivery of services in filing, processing, storing and obtaining documents or information electronically. Implementation of the plan will lead to a significant reduction in the time taken to process documents, enable timely updating and disclosure of company information, enhance data security and integrity, and increase productivity. The two-phase development of an Integrated Companies Registry Information System is an integral part of the plan. The electronic search services developed under Phase I have been well received by customers and over 98 per cent of company searches are now conducted online. Phase II, which includes the provision of electronic filing services for incorporation and document registration, is expected to be implemented by 2010.

During the year, 100 761 local companies were incorporated. By year-end, 655 038 local companies were on the register, compared with 591 944 in 2006.

Companies incorporated outside Hong Kong must enrol with the registry within one month of setting up business in Hong Kong. During 2007, 748 non-Hong Kong companies were registered and, by year-end, there were 8 081 non-local companies from 81 countries registered in Hong Kong.

Money Lenders

Under the Money Lenders Ordinance, anyone wishing to carry on business as a money lender must apply to a licensing court for a licence. The ordinance does not apply to AIs within the meaning of the Banking Ordinance.

Applications are submitted to the Registrar of Companies as Registrar of Money Lenders. During the year, 756 applications were received. In all, a total of 716 licences were granted or renewed, involving both new applications and outstanding applications brought forward from the previous year. At the end of 2007, there were 741 licensed money lenders.

Bankruptcies, Individual Voluntary Arrangement and Compulsory Winding-up

The Official Receiver's Office ensures that service in personal and corporate insolvencies is of a high quality on a par with international standards, and that the legislation is commensurate with the aim of maintaining Hong Kong's leading position as a major international financial centre.

When acting as the trustee or liquidator, the Official Receiver or a private sector insolvency practitioner investigates the affairs of the bankrupt or the wound-up company, realises its assets and distributes dividends to creditors. The Official Receiver also prosecutes certain offences set out in the Bankruptcy Ordinance and the Companies Ordinances, applies for disqualification orders against unfit company directors of wound-up companies, monitors the conduct of outside liquidators and trustees, and monitors the funds held by liquidators in both compulsory and voluntary liquidations.

During the year, the court issued 11 063 bankruptcy orders, 1 883 interim orders in individual voluntary arrangements and 455 winding-up orders, compared with last year's figures of 10 324, 1 239 and 552. The assets realised by the Official Receiver during 2007 amounted to $159.8 million, while $190.1 million in dividends was paid to creditors in 3 140 insolvency cases.

Professional Accountancy

Hong Kong had 26 848 certified public accountants at year-end. Of these, 3 624 were certified public accountants (practising), who were in public practice and may perform statutory audits. There were 1 172 certified public accountancy firms (practising) and 229 corporate practices registered at year-end.

The HKICPA operates a largely self-regulatory arrangement under the Professional Accountants Ordinance. The institute is vested under the ordinance with a wide range of responsibilities, such as registering certified public accountants; maintaining financial reporting, auditing and ethical standards for the profession; and conducting training programmes and qualifying examinations.

Since becoming fully operational in July 2007, the FRC had taken over from the HKICPA the investigation of cases concerning audit irregularities and accounting non-compliances relating to listed companies. Following an investigation, the FRC may, in accordance with the Financial Reporting Council Ordinance, pass the results of the probe to the HKICPA or to law enforcement agencies such as the Independent Commission Against Corruption (ICAC), the Police, Department of Justice, or the SFC for follow-up action. This arrangement is provided with proper checks and balances in respect of the different roles of 'investigator', 'prosecutor' and 'disciplinary committee'. The HKICPA continues to handle cases involving unlisted companies.

Monetary Policy

The main aim of Hong Kong's monetary policy is to maintain currency stability, which is defined as a stable external exchange value of the currency of Hong Kong, in terms of its exchange rate in the foreign exchange market against the US dollar, at around HK$7.80 to US$1. This objective is achieved through a linked exchange rate system introduced in October 1983.

The linked exchange rate system is characterised by currency board arrangements requiring the Hong Kong dollar monetary base to be at least 100 per cent backed by — and changes in it to be 100 per cent matched by — corresponding changes in US dollar reserves held in the Exchange Fund at the fixed exchange rate of $7.80 to US$1. In Hong Kong, the monetary base includes the amount of currency notes and coins issued, the Aggregate Balance (the sum of the clearing balances of banks held with the HKMA for the purpose of effecting the clearing and settlement of transactions between banks themselves and also between the HKMA and banks), and the outstanding amount of Exchange Fund Bills and Notes.

Since the inception of the linked exchange rate system in October 1983, note-issuing banks have been required to hold Certificates of Indebtedness (CIs) issued by the Exchange Fund to provide backing for bank note issuance. The issuance and redemption of CIs are made against US dollars at the convertibility rate of $7.80 to US$1 for the account of the Exchange Fund. Similarly, the issue and withdrawal of government-issued currency notes and coins in circulation are conducted against US dollars at the fixed exchange rate of $7.80.

A Liquidity Adjustment Facility was set up in 1992 to enable the HKMA to provide lending to any bank with day-to-day shortages of liquidity. This was replaced in September 1998 by the Discount Window arrangement under which banks have unrestricted access to day-end liquidity through repurchase agreements using EFBNs as collateral. A two-tier structure of Discount Rates has been adopted to ensure that interest rates are adequately responsive to capital flows, while avoiding excessive interest rate volatility if liquidity shortages are only modest.

Under the currency board system, Hong Kong dollar exchange rate stability is maintained through an interest rate adjustment mechanism. The monetary base increases when the foreign currency (in Hong Kong's case, US dollars) to which the domestic currency is linked, is sold to the currency board for the domestic currency (inflow into the Hong Kong dollar). It contracts when the foreign currency is bought from the currency board (outflow from the Hong Kong dollar). The expansion or contraction in the monetary base leads interest rates for the domestic currency to fall or rise, respectively, creating the monetary conditions that automatically counteract the original capital movements, ensuring stability of the exchange rate.

In May 2005, the HKMA introduced three refinements to the operation of the linked exchange rate system: (a) the introduction with immediate effect of a strong-side Convertibility Undertaking by the HKMA to buy US dollars from licensed banks at $7.75; (b) the shifting of the existing weak-side Convertibility Undertaking by the HKMA to sell US dollars to licensed banks from $7.80 to $7.85; and (c) within the zone defined by the levels of the Convertibility Undertakings, the HKMA may choose to conduct market operations consistent with currency board principles.

To strengthen the institutional framework for the operation of the currency board system in Hong Kong, the Subcommittee on Currency Board Operations was established under the Exchange Fund Advisory Committee in August 1998. The subcommittee has been entrusted with the responsibility of overseeing the operation of the currency board system in Hong Kong and may, where appropriate, recommend to the Financial Secretary through the EFAC measures to enhance the robustness and effectiveness of Hong Kong's currency board arrangements.

The HKMA pursues a policy of transparency to ensure that the financial industry and the wider public are fully informed of the currency board operations. The Aggregate Balance and forecast changes to the Aggregate Balance attributable to the currency board's foreign exchange transactions are disclosed on a real-time basis. The size of the monetary base and its components are published on a daily basis, while the Currency Board Account is published on a monthly basis. The records of the meetings of the Subcommittee on Currency Board Operations are also published regularly.

The Government is fully committed to the maintenance of the linked exchange rate system, which is a cornerstone of Hong Kong's monetary and financial stability, and to the strict discipline of the currency board arrangement under that system.

Monetary Situation

Monetary conditions remained stable in 2007 despite domestic and external shocks, demonstrating the resilience of the Linked Exchange Rate system. Activities in Hong Kong's foreign exchange and money markets were generally orderly and smooth, although there were increased volatility in exchange rates and interest rates in the latter half of 2007. Under the present monetary arrangements, the Convertibility Undertakings effectively limited the fluctuations of the Hong Kong dollar exchange rate within a narrow band, while the Discount Window borrowing mechanism dampened volatility of domestic interest rates in the face of different shocks.

Following the strengthening of the Hong Kong dollar to near the strong-side Convertibility Undertaking (CU), the HKMA conducted a monetary operation within the Convertibility Zone on October 23. Thereafter, licensed banks triggered the strong-side CU of 7.75 once on October 26 and five times on October 31, prompting the HKMA to passively sell Hong Kong dollars against US dollars at HK$7.75 to US$1.

After staying close to the strong side of the Convertibility Zone in 2006, the Hong Kong dollar market exchange rate depreciated in the first seven months of 2007, reaching a peak of 7.8295 on August 2 and 3. This partly reflected interest rate arbitrage activities taking advantage of the lower domestic interest rates relative to those of the US and the conversion of proceeds from IPOs into US dollars by Mainland companies newly listed in Hong Kong. From August to October, the Hong Kong dollar exchange rate quickly strengthened towards the strong-side CU of 7.75. This was caused by several factors: the US sub-prime mortgage problems and the resultant increase in global risk aversion induced the unwinding of Hong Kong dollar-funded carry trade positions; equity-related demand for Hong Kong dollars increased substantially under the influence of a series of highly-subscribed IPOs between September and November; and a buoyant stock market, which helped sustain large equity-related demand for Hong Kong dollars. In the last two months of 2007, the Hong Kong dollar exchange rate depreciated towards the centre of the Convertibility Zone due to carry trades amid a low interbank interest rate environment.

Movements in the Hong Kong dollar interbank interest rates largely tracked the US dollar interest rates in 2007, with occasional deviations due to sharp rises in funding demand arising from heavily-subscribed IPOs. They generally increased between January and mid-September, first as a result of interest rate arbitrage activities, and then increased liquidity demand arising from concerns about the contagion effect of the US sub-prime mortgage problem. Interest rates began to ease in mid-October, gaining momentum when supply of liquid funds in the interbank market increased because of the expansion in the Aggregate Balance after the triggering of the strong-side CU.

Monetary conditions eased in 2007, with monetary aggregates and domestic loans growing at a brisk pace. For the year as a whole, broad money and domestic credit picked up by 18.1 per cent and 15.7 per cent respectively. The loan-to-deposit ratio, on the other hand, fell to a record low towards the end of the year, suggesting a prudent approach to credit quality by individual banks and the relatively abundant liquidity in the banking system.

Exchange Fund

The Exchange Fund was established by the Currency Ordinance of 1935 (later renamed the Exchange Fund Ordinance). Since its establishment, the fund has been responsible for backing Hong Kong dollar note issues. The role of the fund was expanded in 1976 to include the backing for coins issues. The Coinage Security Fund was merged with the Exchange Fund on December 31, 1978.

The Government transferred the fiscal reserves of its General Revenue Account (apart from the working balances) to the fund to centralise the investment management of its financial assets. Through this transfer, the bulk of the Government's financial assets were placed with the fund.

When the Hong Kong Special Administrative Region (HKSAR) was established on July 1, 1997, the Chief Executive appointed the Financial Secretary as the public officer to receive, hold and manage the Land Fund, as part of the HKSAR

Government reserves, which were merged into the Exchange Fund and has been managed as part of the Investment Portfolio of the Exchange Fund since November 1, 1998.

A resolution was passed by the Legislative Council under the Public Finance Ordinance to authorise the transfer of $120 billion from the Land Fund to the General Revenue Account to meet the Government's expenditure requirement. A further transfer of $40 billion was made under a similar resolution passed by the Legislative Council in June 2004.

The Exchange Fund's primary statutory role, as defined in the Exchange Fund Ordinance, is to affect the exchange value of the Hong Kong dollar. Its functions were extended to maintaining the stability and integrity of the monetary and financial systems to keep Hong Kong as an international financial centre, when the Exchange Fund (Amendment) Ordinance 1992 went into force.

The HKMA manages the Exchange Fund. Apart from ensuring that the fund meets its statutory responsibilities, the HKMA's principal activity is the day-to-day management of the fund's assets.

To meet the objectives of preserving capital, providing liquidity to maintain financial and currency stability and generating an adequate long-term return, the Exchange Fund is managed as distinct portfolios. The Backing Portfolio holds highly liquid US-dollar-denominated debt securities to fully back the monetary base. The Investment Portfolio aims to preserve the fund's long-term purchasing power. The asset allocation strategy of the Exchange Fund is guided by the investment benchmark, which defines the bonds and equities mix as well as the overall currency composition of the fund. The details of the management of the fund and the investment style adopted are set out and explained in the HKMA's annual report. A Strategic Portfolio was set up in 2007 to hold all the shares of Hong Kong Exchanges and Clearing Limited acquired for strategic purposes by the Financial Secretary using the Exchange Fund.

On December 31, 2007, the Exchange Fund's total assets stood at $1,414.4 billion, of which foreign currency assets amounted to $1,198.9 billion. The accumulated surplus of the Exchange Fund amounted to $617.0 billion. Foreign currency asset figures have been published monthly since January 1997 demonstrating the Government's continued commitment to greater openness and transparency. In addition, an abridged balance sheet of the Exchange Fund and a set of Currency Board accounts are published monthly.

Another function related to the Exchange Fund is currency issuance. Bank notes in denominations of $20, $50, $100, $500 and $1,000 are issued by the three note-issuing banks: Standard Chartered Bank (Hong Kong) Limited, the Hongkong and Shanghai Banking Corporation Limited and Bank of China (Hong Kong) Limited. The note-issuing banks may issue currency notes only by surrendering non-interest-bearing US dollar backing at a fixed exchange rate of $7.80. Thus the fund enjoys the seigniorage from the notes.

Through the HKMA, the Government issues $10 currency notes and coins of $10, $5, $2, $1, 50 cents, 20 cents and 10 cents denominations. The Hong Kong $10 polymer note was put into circulation in July 2007. The HKMA, which has been examining alternative technologies for the production of currency notes, issued the note to assess the performance and acceptability of polymer notes in Hong Kong. The value of all notes and coins in circulation at year-end was $170.8 billion.

Websites

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