Chapter 4

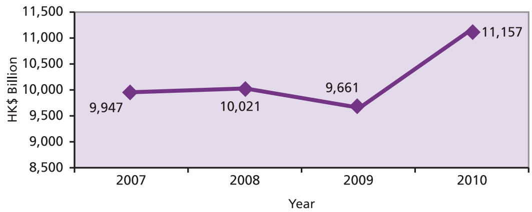
Financial and Monetary Affairs

Hong Kong ranks among the world's top financial centres, thanks to its well established and regulated banking, securities and insurance industries. Its stock market ranked seventh globally and third in Asia in terms of market capitalisation in 2010. Hong Kong also led the world in raising funds through initial public offerings (IPOs) in both 2009 and 2010. The financial sector has a 210 200-strong workforce, or 5.8 per cent of the city's total workforce, and contributes 15.2 per cent of the city's GDP.

Hong Kong is a vibrant global financial centre invigorated by a sophisticated financial infrastructure, world-class financial professionals, a regulatory regime as good as any in the world, high liquidity and efficiency. The Government's aim is to reinforce Hong Kong's position as China's Global Financial Centre in general and as a capital formation centre, an offshore Renminbi (RMB) centre and an asset management centre in particular by making continuous improvements to the regulatory system, promoting corporate governance, strengthening investor protection, fostering market development and enhancing links and co-operation with the Mainland.

Hong Kong recorded a number of major achievements in 2010. These included:

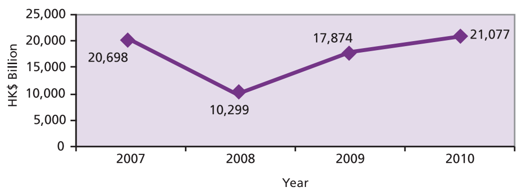
Chart 1 External Positions of Authorised Institutions (AIs)



Attaining the rank of the world's 13th and Asia's 3rd largest banking centre in terms of external positions[1] and the world's 6th largest centre for foreign exchange trading.

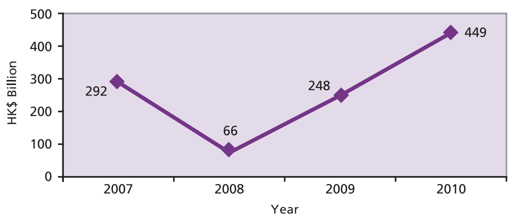
1 Sum of liabilities to banks and non-bank customers outside Hong Kong and claims on banks and non-bank customers outside Hong Kong (such as equities, securities and capital instruments).

Chart 2 Market Capitalisation of Stock Market



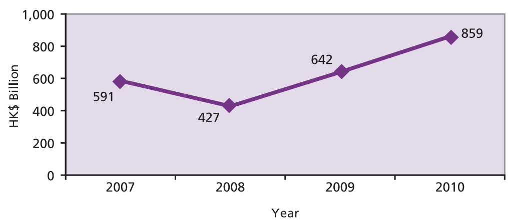
Hong Kong's stock exchange being ranked 7th in the world and 3rd in Asia in terms of market capitalisation which rose by 18 per cent over 2009 to $21,077 billion in 2010.

Chart 3 Equity Funds Raised Through IPOs



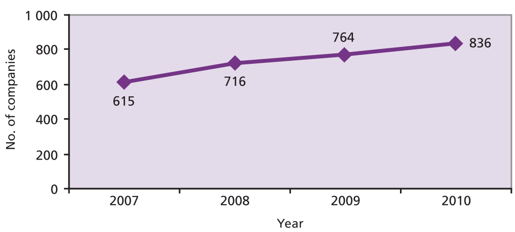
Raising $449 billion through IPOs in 2010, more than any other stock market in the world.

Chart 4 Total Equity Funds Raised in Hong Kong



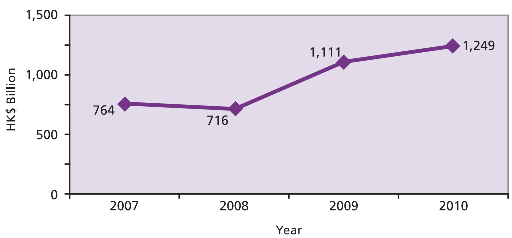
Ranking 2nd in the world and 1st in Asia as a stock exchange in terms of total equity funds raised, which amounted to $859 billion in 2010.

Chart 5 Number of Asset Management Companies in Hong Kong



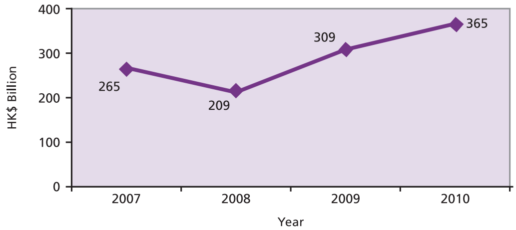
In 2010, 836 companies were licensed or registered to conduct asset management business in Hong Kong, an increase of 72, or 9 per cent over 2009.

Chart 6 Total Outstanding HKD Debt Securities



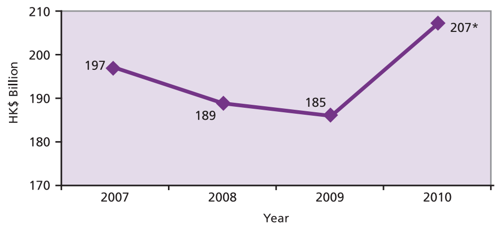
Having outstanding Hong Kong dollar debt securities, including Exchange Fund Bills and Notes (EFBNs), totalling $1,249 billion at year end, or 12.4 per cent up on the previous year's $1,111 billion.

Chart 7 **Total NAV of MPF Assets**



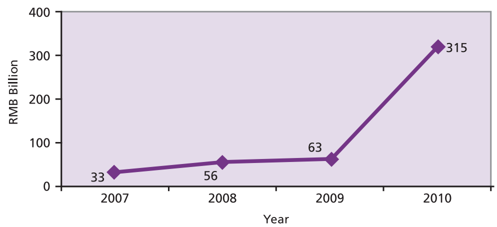
Net asset values (NAV) of Mandatory Provident Fund (MPF) schemes topped $365 billion at the end of 2010 with an annualised internal rate of return of 5.5 per cent since its inception in 2000.

Chart 8 **Annual Gross Premiums of Insurance Market**



Staying the course as one of the most open insurance markets in the world, Hong Kong's insurance market recorded a major rebound to $207* billion in total gross premiums in 2010, representing an increase of 11.6 per cent over 2009.

Chart 9 **RMB Deposits in Hong Kong**



During 2010, Hong Kong recorded significant growth in offshore RMB business. At the end of 2010, the outstanding RMB deposits in Hong Kong totalled RMB 315 billion.

Hong Kong as China's Global Financial Centre

Overview

Hong Kong's role as China's global financial centre is based on its unique status as the only place in the world where a strong connection with the Mainland market meets a world-class business environment. On one hand, Hong Kong enjoys extensive geographical, cultural and linguistic links with the Mainland, and has long served the financial needs of the Mainland as its markets continue to open. On the other hand, Hong Kong has a favourable geographical location, bridging the time gap between New York and London; strong links with the entire Asia-Pacific region and excellent communication with the rest of the world; the rule of law; a level playing field for conducting business and a sound regulatory regime. The absence of restrictions on capital flows into and out of Hong Kong is another advantage.

Hong Kong's financial markets are highly liquid. They operate under effective and transparent regulations, which are in line with international standards. A highly

* Provisional Statistics

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, 70 have operations in Hong Kong. At the end of the year, 136 of the 146 licensed banks in Hong Kong were foreign-owned.

The interbank money market is well established. Hong Kong-dollar wholesale deposits are traded actively among local AIs, and between local and overseas AIs, with an average daily turnover of $210.3 billion in 2010.

A triennial survey co-ordinated by the Bank for International Settlements in 2010 shows the daily average foreign exchange turnover in Hong Kong at US$237.6 billion, making Hong Kong the world's sixth largest foreign exchange market.

With a total market capitalisation of about $21,077 billion at year's end, the Hong Kong stock market ranked seventh in the world and third in Asia. The daily turnover averaged $69.1 billion in 2010. At year's end, 1 413 public companies were listed on the Stock Exchange of Hong Kong Limited (SEHK). The 101 newly listed companies raised $449 billion from IPOs.

In 2010, Hong Kong ranked first worldwide in terms of IPO funds raised. Besides new share issues, $409 billion was raised on the secondary market.

The Hong Kong stock market is an important fund-raising platform for Mainland enterprises. At year's end, 592 Mainland enterprises were listed on the SEHK. In 2010, equity funds raised by Mainland enterprises[2] amounted to $473.6 billion, which was 55 per cent of the total equity funds raised through the SEHK during the year. About $224.4 billion was raised in new listings of Mainland enterprises in Hong Kong, accounting for 50 per cent of the total equity funds raised in IPOs on the SEHK.

Overseas intermediaries were increasingly interested in setting up business operations in Hong Kong. The number of Exchange Participants[3] trading on the SEHK increased from 463 at the end of 2009 to 485 at the end of 2010. The number of Exchange Participants trading on the futures market increased from 167 at the end of 2009 to 179 at the end of 2010.

The 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. At year's end, 836 companies were licensed or registered to carry out asset management business, representing an increase of 9 per cent from a year earlier. In addition to the Securities and Futures Commission (SFC)

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

3 An Exchange Participant is a corporation that may trade on or through the SEHK or the Hong Kong Futures Exchange Limited and is licensed under the Securities and Futures Ordinance to carry on securities/futures/options dealing activity.

licensed corporations, banks and insurance companies also participate in asset management business.

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 and kilo bars[4]. Prices track closely those in the major gold markets in London, Zurich and New York. In addition, Hong Kong is among the largest over-the-counter gold trading centres in Asia with strong growth in recent years.

Hong Kong continues to be one of the most open insurance centres in the world. Among the 168 authorised insurers at year's end, 80 were from 20 overseas countries or the Mainland. Twelve of the world's top 20 insurers were authorised to conduct insurance business in Hong Kong either directly or through a group company. There were 19 professional re-insurers in Hong Kong, including most of the world's top re-insurers. Gross premium income in 2010 was $207* billion.

The Government, including the Hong Kong Monetary Authority (HKMA) in particular, seeks to foster a better understanding of Hong Kong's economic and financial strengths among international credit rating agencies. In 2010, Standard & Poor's upgraded Hong Kong's long-term foreign- and local-currency ratings from 'AA+' to 'AAA', the highest ever assigned by a credit rating agency to Hong Kong, with 'Stable' outlook. Moody's, Fitch and R&I also upgraded or affirmed Hong Kong's ratings during the year.

Major Initiatives in 2010

Continued efforts were made in 2010 to enhance Hong Kong's competitiveness as an international financial centre in general and to develop Hong Kong as a capital formation centre, asset management centre and, in particular, an offshore RMB business centre. The Government continues to work closely with regulators and the industry to optimise Kong Kong's regulatory framework. It also continues to press ahead with various initiatives to develop further Hong Kong's fund-raising, wealth management and RMB business.

Enhancing Hong Kong's Competitiveness as China's Global Financial Centre

To build on Hong Kong's strength as China's global financial centre, the Government optimises its regulatory framework to keep abreast of local and international developments, to enhance the quality of its markets and to increase their depth and breadth.

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4 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.

* Provisional Statistics

Fund-raising Centre

Hong Kong is the premier capital formation centre for the Mainland whose enterprises have raised $2,975.2 billion since January 1993. The Hong Kong Exchanges and Clearing Limited (HKEx) has been stepping up its promotion of Hong Kong as a preferred listing venue.

Hong Kong is also keen to have overseas companies with China business connections to consider listing in Hong Kong through which these companies can attract international funds and practise international standards. In 2010, Russian, French and Brazilian companies listed in Hong Kong for the first time. Newly listed companies have been attracted by the market's liquidity, attractive valuations and access to investors in Asia. To attract more foreign companies to list in Hong Kong, HKEx has been streamlining its listing process for overseas companies, updating its Listing Rules on mineral and exploration companies to attract companies from the mining and resource sector, and continuing with its marketing activities.

Acceptance of Mainland Accounting and Auditing Standards and Mainland Audit Firms for Mainland Incorporated Companies Listed in Hong Kong

Based on the convergence of Mainland and Hong Kong accounting and auditing standards in December 2007 and having consulted the market in 2009, the HKEx implemented a framework to give companies from the Mainland and Hong Kong the choice of preparing financial statements under the accounting standards of the home jurisdiction and audited by auditors in the home jurisdiction for listing in the other jurisdiction with effect from mid-December 2010. This scheme, being reciprocal in nature, enables Mainland incorporated Main Board and Growth Enterprise Market issuers to choose to prepare their financial statements (including those for IPOs and periodic reports) using Mainland accounting standards and to engage Mainland audit firms endorsed by the relevant Mainland authorities to audit the financial reports, and similarly extends the allowance to Hong Kong incorporated or registered companies to use the Hong Kong Financial Reporting Standards or the International Financial Reporting Standards when they list in Mainland markets in the future. The framework serves to enhance market efficiency and help attract more Mainland company listings, benefiting Hong Kong's development as China's global financial centre and the premier capital formation platform in the region.

Asset Management Centre

China's strong economic growth spearheaded Asia's overall economic recovery and created investment opportunities in the region in the wake of the world financial crisis. Hong Kong with its strong asset management foundation and world-class financial infrastructure benefits greatly from the huge demand for wealth and asset management services in the Mainland. Hong Kong is also well placed to become Asia's premier asset management centre. The city's combined fund management business amounted to US$1,090 billion at the end of 2009, approximately 64 per cent of which was sourced from non-Hong Kong investors, underlining the city's strong appeal to foreign investment capital. At the end of December of 2010, there were 89 approved fund management groups managing 1 937 unit trusts and mutual funds authorised by the SFC.

During the year, the Government led a promotion campaign in London to showcase Hong Kong's status as China's global financial centre and help promote Hong Kong as a premier asset management hub in the region.

Developing Islamic Finance

In 2010, the Government continued its efforts to create an environment conducive to development of Islamic finance in Hong Kong in collaboration with the financial regulators and the private sector. Efforts focused on four broad areas: establishing necessary market infrastructure, enhancing Hong Kong's international profile and linkages, promoting market knowledge of Islamic finance, and encouraging product development.

Proposed Establishment of an Independent Insurance Authority

The Government has been looking into the establishment of an independent Insurance Authority (IA) to enable it to operate more flexibly to meet regulatory challenges and to better prepare Hong Kong for a risk-based capital regulatory regime.

A public consultation to gauge views on the proposed establishment of an Independent IA, as well as its governance structure, organisation framework, functions, powers and funding mechanism ended in the fourth quarter of 2010. The Government is examining the comments received and will continue to engage the industry and stakeholders in drawing up detailed proposals.

Proposed Establishment of a Policyholders' Protection Fund

To maintain market stability and better protect the interests of policyholders in the event of an insurer's insolvency, the Government has proposed the establishment of a Policyholders' Protection Fund (PPF) in Hong Kong and a public consultation on the detailed proposals of PPF will be conducted in early 2011.

Modernising the Companies Ordinance

The Standing Committee on Company Law Reform (SCCLR) advises the Government on reviews and reforms of Hong Kong's company law and on enhancing corporate governance.

Two phases of public consultation on the draft Companies Bill were completed in March 2010 and August 2010. The Companies Bill, which aims to enhance further Hong Kong's status as a major international business and financial centre, was being finalised in the light of the consultation feedback. The Government plans to introduce the bill into the Legislative Council in early 2011.

Trust Law Reform

The Government issued the consultation conclusions on the review of the Trustee Ordinance and related matters in February 2010. Based on the consultation conclusions, legislative amendments will be introduced to provide a better framework for the operation of trusts in Hong Kong, strengthen the competitiveness of Hong Kong's trust services industry and enhance Hong Kong's position as a major asset management centre.

Enhancement of the Financial Infrastructure

Hong Kong has a robust real time gross settlement (RTGS) interbank payment system. All banks in Hong Kong maintain settlement accounts with the HKMA through the Hong Kong dollar RTGS. All RTGS payment transactions are settled in real time. The banks may obtain intra-day liquidity through intra-day repurchase agreements with the HKMA using the EFBNs as collateral.

US dollar, Euro and RMB RTGS systems also enable transactions in these currencies to be settled in real time, reducing or eliminating settlement risk. RTGS systems in Hong Kong are linked to enable foreign-exchange transactions to be settled on a payment-versus-payment (PvP) basis.

The HKMA operates a Central Moneymarkets Unit (CMU) to provide clearing and custodian services for EFBNs and other Hong Kong dollar or foreign-currency private debt securities. It is linked to a number of international and regional central securities depositories to enable overseas investors to trade CMU securities. In November 2010, the Central People's Government's Ministry of Finance and the HKMA signed a memorandum of co-operation on using the CMU for issuance of RMB sovereign bonds.

Through its integration with the RTGS, the CMU enables securities to be settled on a delivery-versus-payment basis, enhancing settlement efficiency and eliminating settlement risk. The interface also enables users of RTGS to access intra-day liquidity through automatic intra-day repurchase agreements.

Major projects completed in 2010 included:

- Completion of SWIFTNet migration[5];
- Enhancement of the RMB RTGS system to support money settlement for the potential listing and trading of renminbi-denominated securities on the HKEx and to facilitate cross-border multi-currency payments using Hong Kong's RTGS systems;
- Launch of a PvP link between Hong Kong's US dollar RTGS system and Indonesia's local currency RTGS systems; and
- Launch of a project for developing a local trade repository for over-the-counter derivatives transactions.

Developing a Scripless Securities Market

A working group comprising representatives of the SFC, HKEx and the Federation of Share Registrars Limited, issued a set of joint consultation conclusions in September 2010 announcing plans to implement a scripless securities market in Hong Kong. The scripless regime will be implemented in phases to provide investors with the flexibility of holding securities in physical certificates or in paperless form. The new paperless option will enable investors to hold securities in their own names

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5 It replaces the closed, proprietary platform of Hong Kong's RTGS systems and the CMU with an open platform using Internet technology.

as registered holders, thus offering more opportunities for straight-through-processing to enhance market efficiency. To lay the foundation for the implementation of a scripless securities market in Hong Kong, the Government introduced the Companies (Amendment) Bill 2010 into Legislative Council. This was passed in July 2010. The Companies (Amendment) Ordinance 2010 removes the existing limitations in the Companies Ordinance that compel the issue or use of paper documents of title and transfer, and represents an important first step in the entire legislative process for implementing the scripless initiative.

Development of the Bond Market

The Government has boosted development of the bond market in recent years by providing it with the necessary financial infrastructure, simplifying the issuance process, optimising regulatory arrangements, offering tax incentives, encouraging public corporations to issue bonds and strengthening education for bond investors.

To promote further development of the local bond market, in July 2009 the Government obtained Legislative Council's approval to implement the Government Bond Programme (GBP), under which the Government is authorised to issue bonds with an aggregate outstanding principal of up to HK$100 billion and to set up the Bond Fund to manage the sums raised under the GBP. The Bond Fund is not treated as part of the fiscal reserves and is managed separately from other Government accounts. It is used to repay principal, meet the financial obligations and liabilities associated with the GBP, and make investments.

In 2010, seven issues of Government bonds for institutional investors were made, attracting a diverse group of investors.

The banks' demand for short-dated Exchange Fund paper eased in 2010. The HKMA issued HK$116 billion of additional 91- and 182-day Exchange Fund Bills. It also continued to fine-tune the maturity mix of EFBNs with increased issuance of 5-, 10- and 15-year Exchange Fund Notes.

Outstanding Hong Kong dollar debts, including EFBNs, exceeded $1,248 billion at the end of 2010.

Anti-Money Laundering and Counter Financing of Terrorism

Hong Kong has put in place an effective anti-money laundering (AML) and counter financing of terrorism (CFT) regulatory regime to maintain a safe business and investment environment. A high-level Central Co-ordinating Committee on AML and CFT, chaired by the Financial Secretary, is in place to steer policy in this area. To enhance the AML/CFT regime applicable to the financial sectors to align better with international standards, an Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill was introduced into the Legislative Council on November 10, 2010. Subject to the council's approval, the new legislation is expected to commence operation in 2012.

Developing a Statutory Corporate Rescue Procedure

A three-month public consultation on the legislative proposals for a statutory corporate rescue procedure was completed in January 2010 and the consultation conclusions were issued in July 2010. The Government will continue to develop a statutory corporate rescue procedure to help companies in short-term financial difficulty, but with viable long-term business prospects, to turn around.

Improving Market Quality and Investor Protection

Proposed Statutory Codification of Certain Requirements to Disclose Price Sensitive Information (PSI) by Listed Corporations

The Administration believes that a statutory regime to require listed corporations to disclose PSI in a timely manner is necessary to enhance market transparency and quality, to bring Hong Kong's regulatory regime for listed corporations more in line with those of overseas jurisdictions, and to sustain Hong Kong's position as China's global financial centre and as a premier capital formation centre in the region. In March - June 2010, a public consultation was conducted on the proposed statutory codification of certain requirements to disclose PSI by listed corporations. The respondents generally agreed to the objective of cultivating a continuous disclosure culture among listed corporations.

The Administration plans to introduce a bill into the Legislative Council to codify the disclosure requirements in the Securities and Futures Ordinance (SFO) in the 2010-11 legislative session.

Rationalisation of the Public Offering Regime for Structured Products

The Securities and Futures and Companies Legislation (Structured Products Amendment) Bill 2010 was introduced into the Legislative Council on July 14, 2010. The bill aims to rationalise the legislative framework by putting the regulation of public offers of all structured products under the offers of investments regime of the SFO. Under the proposed regime, the SFC would authorise the issue of advertisements, invitations or documents relating to structured products; be empowered to authorise structured products; and publish codes and guidelines setting out its regulatory policy on such products. By issuing codes and guidelines under the SFO, the SFC would have more flexibility in setting out its regulatory policy on structured products.

Proposed Establishment of an Investor Education Council and a Financial Dispute Resolution Centre

Following a three-month public consultation from February to May 2010, the Government announced in December 2010 its decision to establish an Investor Education Council (IEC) and a Financial Dispute Resolution Centre (FDRC) to enhance protection for investors. IEC would holistically oversee the delivery of investor education. FDRC, on the other hand, helps consumers settle their monetary disputes with financial institutions through an impartial, simple and quick resolution mechanism.

Regulation of Credit Rating Agencies

Following the G20's consensus on the need to subject credit rating agencies (CRAs) to a regulatory oversight regime, the European Union, the United States, Japan and Australia have announced regulatory measures to strengthen oversight of CRAs. Hong Kong will also establish such a regulatory regime to enhance investor protection and enable credit ratings prepared by Hong Kong-based CRAs to continue to be serviceable in other jurisdictions. In July and August, the SFC consulted the public and obtained overwhelming support for the proposal to establish a regulatory regime for CRAs operating in Hong Kong. It is intended that by June 2011, all Hong Kong-based CRAs and their rating analysts will be required to be licensed and subject to ongoing supervision.

Upgrading of the Quality of Financial Reporting

The Government continues to press ahead with the enhancement of market quality and investor protection in collaboration with stakeholders, including the Financial Reporting Council (FRC), a statutory body established to investigate Hong Kong listed companies' audit irregularities and non-compliance with accounting standards. The FRC started reviewing in July 2008 modified auditor's reports of financial statements of entities listed in Hong Kong. From 2011 onwards, FRC will also take on additional work by reviewing financial reports based on a risk-based approach.

Statistics on FRC's work

	2008	**2009**	**2010**
No. of complaints received	12	13	9
No. of modified auditors' reports reviewed	28	129	142
No. of investigations initiated	-	4	4
No. of investigations completed	1	-	1
No. of enquiries initiated	1	2	2
No. of enquiries completed	1	2	1

A Process Review Panel reviews the FRC's handling of cases to ensure its actions and decisions comply consistently with established procedures.

Regulation of Over-the-Counter (OTC) Derivatives

The global financial crisis has revealed the risks embedded in the OTC derivatives market. G-20 has recommended that all standardised OTC derivatives contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties (CCPs)[6] by the end of 2012 at the latest, and that all OTC derivatives contracts be required to be reported to trade repositories (TRs), and non-centrally cleared contracts be subject to higher capital charges.

Building on the current regulatory framework, the Administration will take the necessary steps to implement G-20's commitments. In particular, the Administration intends to require all financial institutions in Hong Kong to clear standardised and

6 A CCP stands between two counterparties, acting as buyer for the seller and seller for the buyer. It will be able to perform multilateral netting and facilitates the reduction of counterparty risks.

eligible OTC derivatives transactions at recognised CCPs and to report all OTC derivatives transactions to authorised TRs. The HKEx has decided to develop a CCP in Hong Kong to cover OTC derivatives such as interest rate swaps and non-deliverable forwards for currencies. For market surveillance, the HKMA will develop a local TR for collecting and disseminating data on OTC derivatives trades conducted in Hong Kong. The SFO will be amended to empower the SFC to make rules to impose mandatory trading, clearing and reporting requirements.

Financial Links with the Mainland

Strengthening our financial co-operation with the Mainland is vital for our financial services, which are positioned and developed to increase our contribution in the modernisation of the Mainland's financial system.

There has been a steady flow of funds between financial institutions on both sides of the boundary. 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 in the Mainland and are subsequently channelled back to Hong Kong through the inter-bank market.

By the end of 2010, the external liabilities of authorised institutions (AIs) to banks in the Mainland amounted to $299.1 billion, while their claims on banks in the Mainland totalled $1,061 billion. These sums represent 9.2 per cent and 21.6 per cent respectively of AIs' total liabilities to and claims on banks outside Hong Kong.

The Mainland's budding fund management industry has prompted Hong Kong-based fund managers to form joint ventures with their Mainland counterparts. Hong Kong fund managers have also paved the way for investors to seize investment opportunities in the Mainland. At year end, there were 52 SFC-authorised funds with significant exposure to A-shares and 24 Exchange-traded Funds (ETFs) that track the A-share market, as well as funds that invest indirectly in A-shares via equity-linked investments issued by qualified foreign institutional investors, and guaranteed funds with their upside potential returns linked to A-share market performance.

Capital Formation Centre and Global Investment Platform for the Mainland

Hong Kong's fundamental strengths, enhanced by its high market liquidity, a robust regulatory system, efficient information flow, a rich pool of financial professionals and proximity to the Mainland market, make it an ideal provider of top class services to Mainland enterprises seeking listing in the city.

The growing presence of Mainland issuers in Hong Kong has increased 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 financial businesses to one with a great diversity of constituent stocks and a wide range of products.

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

HKEx and the Shanghai Stock Exchange (SSE) agreed in January 2010 on new co-operation initiatives, including strengthening exchanges and co-operation on information technology, product development, listing compliance and monitoring, etc. The HKEx and the SSE signed a Closer Co-operation Agreement in January 2009. The two parties have since started a market data collaboration programme, shared information on ETF and conducted mutual training programmes. The HKEx also maintained close relationship with the Shenzhen Stock Exchange via exchanges of executives and mutual training programmes.

Development of Offshore RMB Business

Benefiting from China's policy to promote greater use of the RMB in external trade and investment, Hong Kong demonstrated tremendous growth in offshore RMB business in 2010.

The RMB trade settlement pilot scheme was launched on July 6, 2009 and expanded on June 22, 2010. The expanded pilot scheme covers 20 provinces and cities in the Mainland, and their trade transactions with any part of the world can be settled in RMB. Any enterprises in the relevant Mainland provinces and cities can settle their merchandise imports, service trades and other current account transactions in RMB, while an expanded list of eligible enterprises are able to settle their merchandise exports in RMB. On December 6, 2010, the Mainland authorities expanded further the list of Mainland enterprises eligible under the scheme. The number of Mainland enterprises that can settle merchandise exports in RMB increased from 365 to 67 359. At the end of 2010, 153 banks, including 43 overseas banks, had become Participating Banks of Hong Kong's RMB clearing platform. In 2010, the amount of RMB trade settlement conducted through Hong Kong amounted to RMB 369 billion.

Also, Hong Kong is the first place outside the Mainland that has developed an RMB bond market. By the end of 2010, there had been 29 RMB bond issues (with a total issuance size of RMB 73.8 billion). In 2010, there was a significant expansion in the range of issuers, from Mainland banks to Hong Kong and international corporations.

Following the revision of the Clearing Agreement signed between the People's Bank of China (PBoC) and the Clearing Bank for RMB Business in Hong Kong (Bank of China (Hong Kong) Limited) in July 2010, all companies and organisations, including all types of financial institutions, can open RMB accounts at banks. Restrictions on RMB interbank transfers between personal accounts and corporate accounts have been removed, enabling the financial industry to launch different RMB financial and wealth management products including insurance, equities, and investment funds.

Separately, in August 2010, the PBoC promulgated a notice on a pilot scheme for eligible institutions, including the Clearing Bank and Participating Banks of Hong Kong's RMB clearing platform to invest in the Mainland's interbank bond market.

This has opened up a channel for RMB funds in Hong Kong to invest in the Mainland.

Mainland and Hong Kong Closer Economic Partnership Arrangement

The Closer Economic Partnership Arrangement (CEPA) between the Mainland and Hong Kong, which went into force in 2004, gives Hong Kong's financial service providers and professionals greater market access and flexibility for their operations in the Mainland. It has also enhanced Hong Kong's attractiveness to market users and strengthened the city's competitiveness as an international financial centre and the premier capital formation centre for Mainland enterprises.

On May 27, 2010 the Central People's Government and the Government of the Hong Kong Special Administrative Region (HKSAR) signed Supplement VII to CEPA, which, among other things, further strengthened co-operation in financial services.

With regard to banking, a Hong Kong bank that has maintained a representative office in the Mainland for more than one year can apply to set up a wholly foreign-funded bank or a foreign bank branch. A Hong Kong bank's operating institution in the Mainland can apply to conduct renminbi business, if it has been operating for more than two years and profitable for one year prior to the application. Foreign banking institutions established in the Mainland by Hong Kong banks can establish specialised institutions to provide financial services to small enterprises.

Following the approval of the State Council, the Mainland and the Government of the HKSAR agreed to add a new liberalisation measure into the banking sector of CEPA Supplement VII, which stipulates that for a Hong Kong bank's operating institution in the Mainland to apply to conduct RMB business to serve Hong Kong enterprises operating in the Mainland, it should have been operating in the Mainland for more than one year and had been profitable for one year prior to the application.

The timing for implementation of the above commitment will be agreed by the relevant authorities of both sides.

On securities, the Mainland and Hong Kong will deepen co-operation in financial services and product development, and ETFs constituted by Hong Kong listed stocks will be launched in the Mainland at an appropriate time.

Banking Sector

Main Features

Hong Kong maintains three tiers of deposit-taking institutions, comprising licensed banks, restricted licence banks and deposit-taking companies. They are known collectively as AIs under the Banking Ordinance. The HKMA is the licensing authority for 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.

Hong Kong has one of the highest concentrations of banking institutions in the world. At the end of 2010, there were 146 licensed banks, 21 restricted licence banks and 26 deposit-taking companies. These 193 AIs maintained a network of more than 1 400 local branches. There were also 67 representative offices of overseas banks in Hong Kong at year's end.

The total deposit liabilities of all AIs to customers and the total loans and advances extended by these institutions at the end of 2010 were $6,862.2 billion and $4,227.3 billion respectively. The total assets of all AIs amounted to $12,296.5 billion.

Hong Kong Monetary Authority

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

The HKMA's 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; 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 of the 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 investment policies and strategies for the Exchange Fund and on projects that are charged to the Exchange Fund, such as the development of financial infrastructure.

The Banking Advisory Committee and the Deposit-taking Companies Advisory Committee are established under the Banking Ordinance to give advice on relevant policy matters. They are chaired by the Financial Secretary and comprise members from the banking industry and other 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, and 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 prudential supervisory system to help preserve the general stability and effective operation of the banking system, while at the same time providing sufficient flexibility for AIs to make commercial decisions.

Recent Developments

The Hong Kong banking sector remained resilient in 2010. The strength in loan growth and improved asset quality reflected the favourable global economic and financial conditions. The capital position of locally incorporated AIs also remained sound.

Before the end of March 2010, investigations had been completed in over 99 per cent of Lehman Brothers-related complaints. And, by the end of 2010, over 77 per cent of the complaints had been resolved.

With the approval of the Legislative Council, amendments to the Deposit Protection Scheme Ordinance and its subsidiary legislation were made in 2010 to effect the enhancement measures as recommended by the Hong Kong Deposit Protection Board. The enhanced Deposit Protection Scheme increased the protection limit from HK$100,000 to HK$500,000 per depositor per bank. This and other relevant enhancements will come into operation on January 1, 2011, following the expiry of the Government's Full Deposit Guarantee on December 31, 2010.

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 HKEx.

By the end of 2010, there were 1 413 companies listed on the Main Board and the Growth Enterprises Market (GEM) of the SEHK with a total market capitalisation of about $21,077 billion, raising an aggregate of $859 billion within the year. The total turnover of the securities market amounted to $17,210 billion.

The ETFs market continued to expand in 2010. During the year, 27 new ETFs were authorised, increasing the total number of ETFs listed on the SEHK to 69, offering a wide range of investment exposures to world, regional and Mainland indices and commodities for investors. Turnover of ETFs reached a record high of $604.5 billion. In 2010, the fourth Hong Kong ETF was cross-listed on the Taiwan Stock Exchange. The mix of ETF managers was also expanded, with the authorisation of the first ETF that is managed by a Hong Kong subsidiary of a Mainland financial institution and the first ETF that is managed by a Hong Kong asset management subsidiary of a Korean investment and securities group.

The number of newly listed derivative warrants was 7 826 in 2010. A total of 5 148 derivative warrants were listed on the securities market at the end of 2010. Turnover of derivative warrants was $2,692 billion during the year. At the end of 2010, there were 1 064 Callable Bull/Bear Contracts (CBBCs) listed in Hong Kong. Turnover of CBBCs decreased from $1,676.1 billion in 2009 to $1,455.4 billion in 2010. Stock options turnover increased from 47 439 896 contracts in 2009 to 61 125 647 contracts in 2010, which was the highest ever.

In the derivatives market, there were some new records. Turnovers of Hang Seng Index options and H-shares Index options were 8 515 049 and 2 910 713 contracts respectively, the highest ever. Turnover of Mini H-shares Index futures and Mini-Hang Seng Index options also set record highs in 2010. There was also record high open interest for H-shares Index futures, Mini H-shares Index futures, Hang Seng Index options and Mini Hang Seng Index options.

In the futures market, around 116 million futures and options contracts were traded in 2010, 18 per cent higher than in 2009. The Hang Seng Index futures and the H-shares Index futures recorded a turnover of 21 031 085 contracts and 12 429 800 contracts respectively, rising 1.5 per cent and 0.3 per cent from 2009. At year-end 2010, there were 16 automated trading services providers, comprising mainly foreign exchanges and regulated entities, authorised by the SFC to provide automated trading services in Hong Kong. Automated trading services are services provided by means of electronic facilities, not being 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, which was replaced by the SFO that came into effect on April 1, 2003. Established as an autonomous statutory body, the SFC is responsible for regulating the securities and futures markets in Hong Kong.

The SFC is funded by the market. No government funding has been sought since 1993. Its total expenditure in 2010-11 is estimated to be $881 million.

The exercise of powers by the SFC is subject to a range of checks and balances. For instance, a wide range of SFC decisions is subject to appeal at the independent Securities and Futures Appeals Tribunal. The Process Review Panel for the SFC (PRP) was established in 2000 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. The PRP’s ninth annual report, which was published in September 2010, concluded that the SFC had generally followed its internal procedures in handling cases under review.

The SFC’s work is wide in scope. It starts with setting standards for industry participants using a licensing system and extends to the supervision and monitoring of intermediaries, enforcement of securities laws and rules, the regulation of the public marketing of collective investment schemes (such as mutual funds), maintaining the quality of disclosure of listing applicants and securities issuers jointly with SEHK, oversight of takeovers, mergers and privatisations of listed companies and supervision of markets including the exchanges and clearing houses. In addition, the SFC also assumes the statutory role of educating investors of the risk of investing and the importance of making informed investment decisions.

At the end of 2010, there were 38 022 licensed persons, including securities brokerage firms, futures dealers and securities margin financiers, as well as their representatives, and 109 registered institutions, such as banks, engaging in regulated activities such as dealing and advising on securities and futures.

Market Misconduct

In 2010, the SFC continued to prosecute insider dealing and market manipulation in the criminal courts. Two individuals were prosecuted for market manipulation in derivative warrants under the SFO and were sentenced to 33 and 36 months imprisonment by the District Court in the first indictable prosecution for market manipulation in derivative warrants in Hong Kong. The individuals appealed to the Court of Appeal which dismissed the appeals but reduced the jail sentences to 20 and 21 months respectively. Actions were also brought against company directors who failed to perform their duties as directors. 2010 saw the first case of its kind in which the High Court disqualified company directors over failure in timely disclosure of information, and ordered a listed company to commence proceedings against its former directors. The SFC also continued to seek court orders to freeze suspected proceeds of market misconduct.

The Market Misconduct Tribunal (MMT), established in 2003, carries out civil proceedings and hears cases referred to it by the Financial Secretary following investigation by the SFC. So far, the MMT has concluded five cases, and 17 persons or companies were found to have engaged in market misconduct. They were ordered by the MMT to disgorge profits arising from the misconduct and to pay the costs of investigation and proceedings, and were disqualified from being company directors, where appropriate.

Recent Developments

The SFC also announced a package of investor protection measures, including a consolidated product handbook with revised codes on unit trusts and mutual funds and on investment-linked assurance schemes as well as a new code on unlisted structured investment products. The codes became effective on June 25, 2010 and introduced a series of measures to enhance disclosure and product transparency, including product key facts statements and for unlisted structured investment products offered to the public a post-sale cooling-off period. As part of the package of investor protection measures, the SFC also strengthened requirements for intermediaries to enhance selling practices relating to the sale of investment products.

Investor protection and education continued to be the highlight following the global financial crisis. Further to the settlement agreement among SFC, HKMA and 16 distributing banks related to Lehman Brothers Minibonds as announced in July 2009, the SFC and HKMA reached an agreement in July 2010 with a bank in relation to the bank's distribution of the Lehman Brothers-related credit-linked notes. Under the agreement the bank offered to pay its customers classified as low to medium risk a sum equal to the amount of their investment in the notes plus interest. Approximately 2 160 accounts of low to medium risk customers benefited, involving a total sum of approximately $651 million. In addition, the bank was required to review complaints of high risk customers who bought the notes and complaints in relation to distribution of other unlisted structured products under the enhanced complaint procedures[7].

In 2010, the SFC ran extensive investor education campaigns in co-ordination with the development of new products in the market, such as RMB funds and bonds, and synthetic ETFs. The SFC also launched a year-long campaign to give details of the package of investor protection measures surrounding the sale of investment products. While explaining the regulatory measures, the SFC also aims to promulgate a responsible approach to investment decisions.

Insurance Sector

Main Features

At year's end, there were 168 authorised insurers, 88 of which were incorporated in Hong Kong while the remaining 80 were incorporated in the Mainland and in 20 overseas countries, with Bermuda taking the lead.

During the past five years, the Hong Kong insurance industry achieved an average annual growth of 8.6 per cent. In 2009, similar to other jurisdictions in the aftermath of the global financial crisis, total gross premiums of the Hong Kong insurance industry decreased by 2.1 per cent to HK$185 billion, while a major rebound has been recorded at $207* billion for 2010.

General insurance business recorded an increase of gross premiums by 9.8 per cent from $28.6 billion in 2009 to $31.4* billion in 2010. The business growth was largely led by accident and health business (comprising medical business). On the other hand, the overall underwriting performance of general insurance business showed an increase in profit from $2.2 billion in 2009 to $2.6* billion in 2010, mainly attributable to premium growth and favourable claims experience. Total revenue premiums of long term in-force business rose by 11.9 per cent to $175.8* billion in 2010. Individual life remained the dominant line of business, taking up $150.5* billion or 85.6* per cent of the total business and the corresponding number of policies stood at 9.1* million.

At the end of December 2010, there were 67 189 individual insurance intermediaries, including 7 722 Chief Executives or Technical Representatives of 582 broker firms, 26 267 Responsible Officers or Technical Representatives of 2 381 agency firms, and 33 200 individual agents.

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7 The collapse of Lehman Brothers in September 2008 triggered complaints about sales of structured investment products by financial intermediaries to retail investors. To resolve the complaints efficiently and effectively, the SFC adopted a 'top-down' approach, examining, among other aspects, systemic problems with product marketing, including the selling practices and internal controls of intermediaries. In July 2009, the HKMA and SFC reached an agreement with 16 distributing banks to repurchase from about 25 000 eligible clients the Lehman Brothers Minibonds at 60 per cent or 70 per cent of their original investment value, with the higher percentage going to those aged 65 and above.

* Provisional Statistics

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) of regulating and supervising the insurance industry to promote its general stability and protect policy holders.

The ICO prescribes a regulatory framework for all classes of insurance business to ensure the financial stability of all insurers authorised in Hong Kong and the fitness and propriety of their management. The IA may take appropriate actions under the ICO against an insurer to safeguard the interests of policyholders.

The ICO also sets out the self-regulatory framework for insurance intermediaries. The self-regulatory organisations include the Insurance Agents Registration Board under The Hong Kong Federation of Insurers (HKFI), the Hong Kong Confederation of Insurance Brokers and the Professional Insurance Brokers Association.

As a member of the International Association of Insurance Supervisors (IAIS), Hong Kong makes its best efforts to ensure that its supervisory regime is in line with prevailing principles and standards. It has also established an Insurance Advisory Committee to advise the Chief Executive on matters relating to the administration of the ICO and the carrying on of insurance business in Hong Kong.

Recent Developments

In view of the global financial crisis, the IA strengthened investor protection and adopted a multi-pronged approach to enhancing the regulation of Investment Linked Assurance Scheme (ILAS) products. To strengthen suitability assessment, a suitability test comprising a Financial Needs Analysis Form, Risk Profile Questionnaire and post-sale telephone confirmation (with audio recording) for vulnerable groups has been rolled out in phases since the last quarter of 2009. In addition, with effect from March 1, 2010, all new insurance intermediaries wishing to sell ILAS products are required to pass the revised Investment-Linked Long Term Insurance Examination paper. In addition, consumer education on ILAS products has been stepped up. The IA and the HKFI have jointly prepared a pamphlet setting out key issues that potential policyholders should consider before they procure ILAS products. Starting from February 1, 2011, the pamphlet will be distributed to potential policyholders at the point of sale.

To further strengthen investor protection, the cooling-off period arrangement has been revised since February 1, 2010. The new cooling-off period will be 21 days after the delivery of the policy to the policyholder or the policyholder's representative, whichever is the earlier. Policyholders have the right to cancel new policies within the cooling-off period and request a refund of the premiums paid.

Since July 6, 2010, ILAS products satisfying the requirements of the Capital Investment Entrant Scheme (CIES) have been recognised as eligible collective investment schemes under the CIES. Insurers authorised to carry on Class C business[8] under the ICO have also been permitted to act as financial intermediaries for the purpose of the CIES with effect from October 14, 2010. To enhance investor protection, the post-sales calls (audio-recorded) requirement will be applied to all applicants of ILAS products for CIES purpose. ILAS products sold for CIES purpose requires prior approval of the SFC and the Immigration Department.

As a member of the IAIS, the IA contributes to the development of international standards in insurance supervision. The IAIS has been analysing the financial crisis and its impact on the global insurance industry in order to identify areas for reform, with particular emphasis on enhancing group and cross sectoral supervision. The IA will keep in view any new standards promulgated by the IAIS and will consider adopting them in Hong Kong, taking local circumstances into account.

In addition, the IA will continue to participate in supervisory colleges so as to work closely with regulators in other jurisdictions in regulating major insurance groups.

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 five 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 when employees change employment or cease to be employed. A self-employed person has to contribute 5 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 the end of 2010, 99 per cent of employers (about 244 000), 99 per cent of relevant employees (2 261 600) and 80 per cent of self-employed persons (260 500) had participated in MPF schemes. Total MPF assets amounted to about $365.4 billion.

Unlike the compulsory MPF schemes, occupational retirement schemes registered under the Occupational Retirement Schemes Ordinance (ORSO) are

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8 The description of Class C is linked long term and its nature of business is effecting and carrying out contracts of insurance on human life or contracts to pay annuities on human life where the benefits are wholly or parly to be determined by reference to the value of, or the income from, property of any description (whether or not specified in the contracts) or by reference to fluctuations in, or in an index of, the value of property of any description (whether or not so specified).

voluntary schemes established by employers. To tie in with the implementation of the MPF system in 2000, schemes registered under the ORSO 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's end, there were 4 247 MPF-exempted occupational retirement schemes covering over 380 161 employees.

Mandatory Provident Fund Schemes Authority (MPFA)

Established in September 1998 under the Mandatory Provident Fund Schemes Ordinance (MPFSO), the 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 protect the interests of MPF scheme members, the MPFA closely monitors the operation of MPF trustees and other service providers, investigates cases of non-compliance identified through reports, complaints or proactive 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 messages that will assist scheme members in choosing appropriate funds.

Recent Developments

Since its inception in December 2000, the MPF System has been under continual review to enhance its effectiveness and efficiency. The Mandatory Provident Fund Schemes (Amendment) Bill 2009 was passed on July 8, 2009 to allow employees to transfer in a lump-sum the accrued benefits derived from their mandatory contributions made during their current employment from a contribution account to another MPF scheme of their choice at least once per year (Employee Choice Arrangement). By reducing the portability restrictions on employees' mandatory contributions, it is expected that the new law will create greater competition among MPF service providers and encourage more active management of MPF investment by employees. Preparations for implementing the Employee Choice Arrangement are underway.

When the new law comes into effect, employees are likely to become the major sales targets of MPF intermediaries. Enhancing the regulation of MPF intermediaries will be of critical importance. The Government, the MPFA and the front-line regulators (i.e. SFC, HKMA and IA) are working together to reinforce the existing regulatory regime of MPF intermediaries through legislation to pave the way for the implementation of the Employee Choice Arrangement.

The introduction and impending implementation of the Employee Choice Arrangement will lead to a significant and fundamental change to the MPF System from being employer-based to a system that is more member-based. Raising the financial literacy of scheme members is pivotal to the successful implementation of the Employee Choice Arrangement. To equip scheme members with the knowledge to make informed decisions in managing their MPF investments, the MPFA has intensified its on-going investment education efforts to educate scheme members on decision making at various stages of their MPF investment journey.

Companies Registry

The Companies Registry (the Registry) administers and enforces most parts of the Companies Ordinance (CO). The Registry registers local and non-Hong Kong companies and documents required to be filed under the CO and related ordinances, de-registers defunct solvent private companies and provides the public with services and facilities for inspecting and obtaining company information kept by the Registry. It 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 processing applications related to money lenders licences as well as maintaining a register of money lenders for inspection by members of the public.

The Registry has been operating as a trading fund department since 1993. Consequently, it can deploy its resources more flexibly to meet customers' demands and expectations. The department achieved a surplus of $141.3 million in 2009-10.

The Registry has continued to implement the Integrated Companies Registry Information System in phases to computerise its operations fully and enable electronic delivery of services in filing, processing, storing and providing company information. The electronic search services have been well received by customers and about 99 per cent of company searches are conducted online nowadays. Electronic services for company incorporation and a one-stop service for company incorporation and business registration are expected to be launched in the first quarter of 2011.

In 2010, a total of 139 530 local companies were incorporated. By the end of 2010, 863 762 local companies were on the register, compared with 772 253 in 2009.

Companies incorporated outside Hong Kong must register with the Registry within one month of establishing a place of business in Hong Kong. During the year, 737 non-Hong Kong companies were registered and, by year's end, there were 8 165 registered non-Hong Kong companies from 78 countries.

Bankruptcies, Individual Voluntary Arrangement and Compulsory Winding-up

The Official Receiver (OR)'s Office ensures that service in personal and corporate insolvencies is of high quality on a par with international standards.

When acting as the trustee or liquidator, the OR or a private sector insolvency practitioner investigates the affairs of the bankrupt or the wound-up company, realises assets and distributes dividends to creditors. The OR also prosecutes insolvency related offences under the Bankruptcy Ordinance and the CO, applies for disqualification orders against unfit company directors of wound-up companies, and monitors the conduct of outside liquidators and trustees, and the liquidation monies.

Professional Accountancy

The Hong Kong Institute of Certified Public Accountants (HKICPA) is established under the Professional Accountants Ordinance to perform a wide range of functions, such as registering certified public accountants (CPA); setting and maintaining financial reporting, auditing and ethical standards for the profession; and conducting training programmes and qualifying examinations.

Numbers of CPAs, CPA firms and corporate practices in Hong Kong:

	2008	2009	2010
No. of CPA, including CPA (Practising)	27 884	29 107	30 817
No. of CPA (Practising)	3 679	3 749	3 784
No. of firms of CPA (Practising)	1 176	1 198	1 217
No. of corporate practices	254	291	336

The Hong Kong Financial Reporting Standards, issued by the HKICPA, have converged with the International Financial Reporting Standards (IFRS). This convergence is beneficial to Hong Kong because international investors and financial analysts are well acquainted with IFRS.

Monetary Policy

The monetary policy objective of Hong Kong is currency stability, 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 clear policy aim is achieved through the linked exchange rate system introduced in 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 EFBNs.

Banks have unrestricted access to a Discount Window for day-end liquidity through repurchase agreements using EFBNs as collateral. Under the currency board system, Hong Kong dollar exchange rate stability is maintained through an interest rate adjustment mechanism.

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.

A Currency Board Sub-Committee under the EFAC was established in August 1998 to oversee the operation of the currency board system in Hong Kong and recommend to the Financial Secretary through 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 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

Notwithstanding the European sovereign debt crisis, volatile international capital flows and buoyant fund raising activities in the local equity market, currency stability was well maintained during the year. As concerns over European sovereign debt problems intensified in May, the Hong Kong dollar market exchange rate weakened to around 7.80. Between June and October, the exchange rate strengthened towards 7.75, supported by equity-related demand associated with IPOs and a buoyant stock market. Partly reflecting the repatriation of funds raised in the equity market, the exchange rate weakened in November and December. Overall, the exchange rate moved within a narrow range between 7.7511 and 7.8034 during the year.

The money market was stable in a low interest rate environment. Underpinned by low US dollar interest rates and ample interbank liquidity locally, HIBORs[9] generally stayed below 1 per cent during the year. Term HIBORs increased slightly in May and June following upward movements in their US dollar counterparts. The temporary rise in US dollar interbank rates partly reflected the concerns about the exposure of European banks to the debt-ridden countries in the Euro area. HIBORs rose occasionally in the second half of the year due to increased demand for equity funds.

The markets did not have any unusual reaction when the temporary Full Deposit Guarantee and Contingent Bank Capital Facility provided by the Exchange Fund expired at the end of the year as scheduled.

Exchange Fund

According to the Exchange Fund Ordinance, the Exchange Fund's primary statutory role is to affect the exchange value of the Hong Kong dollar. It can also be used to maintain the stability and integrity of the monetary and financial systems, with a view to maintaining Hong Kong as an international financial centre.

The HKMA is responsible to the Financial Secretary for the use and the investment management of the Exchange Fund. 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 approved by the Financial Secretary on the

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9 Hong Kong Interbank Offered Rate is the rate of interest offered on Hong Kong dollar loans by banks in the interbank market for a specified period ranging from overnight to one year.

advice of the EFAC. 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 HKEx acquired for strategic purposes by the Financial Secretary using the Exchange Fund.

On December 31, 2010, the Exchange Fund's total assets stood at $2,345.0 billion. The accumulated surplus of the Exchange Fund amounted to $591.5 billion. Foreign currency asset figures have been published monthly since January 1997 to demonstrate 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: Bank of China (Hong Kong) Limited, the Hongkong and Shanghai Banking Corporation Limited and the Standard Chartered Bank (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.

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 value of all notes and coins in circulation at year's end was $235.4 billion.

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