

Chapter 4

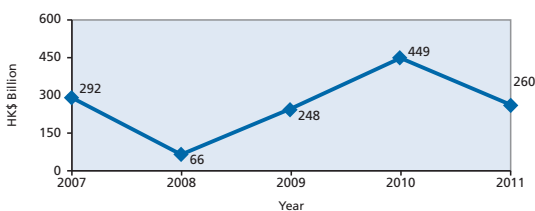
Financial and Monetary Affairs

Hong Kong ranks among the world's top financial centres, thanks to its well established and regulated banking, securities and insurance industries. It was ranked first among 60 of the world's leading financial systems and capital markets in the World Economic Forum (WEF)'s Financial Development Report 2011. Hong Kong's stock market also led the world in raising funds through initial public offerings (IPOs) for the third consecutive year. The financial sector has a 225 000-strong workforce, or 6.1 per cent of the city's total workforce, and contributes 15.4 per cent of the city's Gross Domestic Product.

Hong Kong is a vibrant global financial centre invigorated by a sophisticated financial infrastructure, world-class financial professionals, a robust regulatory regime, 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 asset management centre and an offshore Renminbi (RMB) 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.

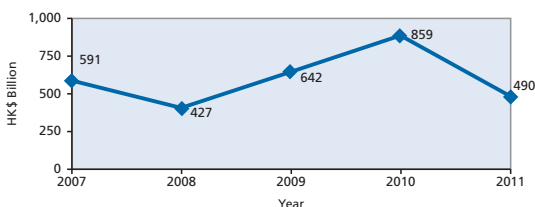
Hong Kong recorded a number of major achievements in 2011. These included:

Chart 1 Equity Funds Raised Through IPOs



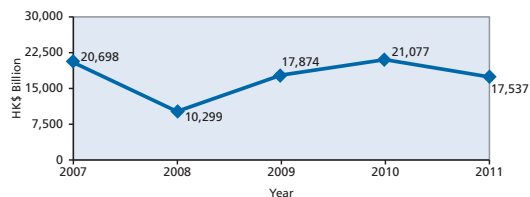
Raising \$260 billion through IPOs in 2011, the Hong Kong Exchanges and Clearing Limited (HKEx) finished 1st worldwide in IPO funds raised for the third consecutive year. Hong Kong has been among the top five global listing markets for the past 10 years.

Chart 2 Total Equity Funds Raised in Hong Kong



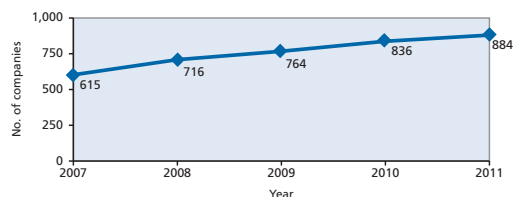
The HKEx was ranked 3rd in the world and 2nd in Asia in terms of total equity funds raised, totaling \$490 billion in 2011.

Chart 3 Market Capitalisation of Stock Market



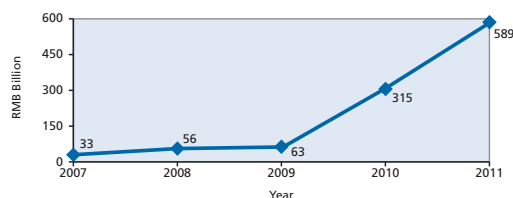
The HKEx ranked 7th in the world and 3rd in Asia in terms of market capitalisation, amounting to \$17,537 billion at the end of 2011.

Chart 4 Number of Asset Management Companies in Hong Kong



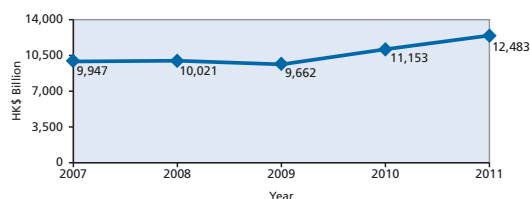
In 2011, a total of 884 companies were licensed or registered to conduct asset management business in Hong Kong, an increase of 48, or 6 per cent over 2010.

Chart 5 RMB Deposits in Hong Kong



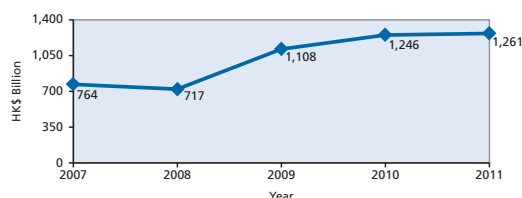
In 2011, Hong Kong recorded significant growth in offshore RMB business. At year's end, outstanding RMB deposits in Hong Kong totalled RMB589 billion, almost doubled the RMB315 billion at the end of 2010.

Chart 6 External Positions of Authorised Institutions (AIs)



Attaining the rank of the world's 10th and Asia's 3rd largest banking centre in terms of external positions¹ and the world's 6th largest centre for foreign exchange trading.

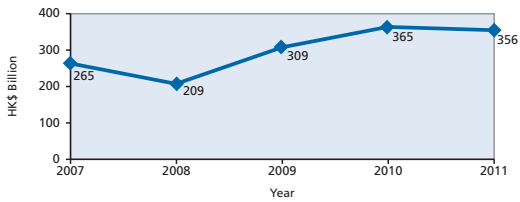
Chart 7 Total Outstanding HKD Debt Securities



Having outstanding Hong Kong dollar debt securities, including Exchange Fund Bills and Notes, totalling \$1,261 billion at the end of 2011, or 1.2 per cent higher than the previous year's \$1,246 billion.

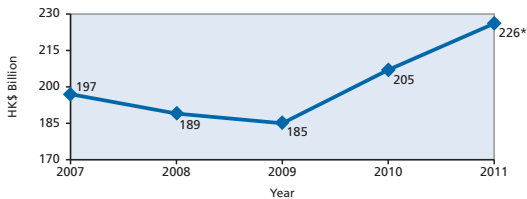
¹ Sum of liabilities to banks and non-bank customers outside Hong Kong and claims on banks and non-bank customers outside Hong Kong (such as equities, securities and capital instruments).

Chart 8 Total NAV of MPF Assets



Net asset values (NAV) of Mandatory Provident Fund (MPF) schemes stood at \$356 billion at the end of 2011 with an annualised internal rate of return of 2.5 per cent since the inception of the MPF System in 2000.

Chart 9 Annual Gross Premiums of Insurance Market



As one of the world's most open insurance markets, Hong Kong's insurance market recorded \$225.8* billion in total gross premiums in 2011, representing an increase of 10.2 per cent over 2010.

Hong Kong as China's Global Financial Centre

Overview

Hong Kong's role as China's global financial centre is based on the 'One Country, Two Systems' principle, enshrined in the Basic Law, which has been governing Hong Kong since its reunification with China in July 1997. This gives Hong Kong a 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, a sound regulatory regime, and the absence of restrictions on capital flows into and out of Hong Kong are other advantages.

Hong Kong's financial markets are highly liquid. 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.

Hong Kong's increasing competitiveness as an international financial centre is well recognised: Hong Kong topped the WEF's Financial Development Index in its 2011 issue, overtaking the United States, the United Kingdom and Singapore to become the first Asian economy to receive the honour.

With a total market capitalisation of about \$17,537 billion at the end of 2011, the Hong Kong stock market ranked seventh in the world and third in Asia. The

* Provisional Statistics

daily turnover averaged \$69.7 billion in 2011. At the end of the year, 1 496 public companies were listed on the Stock Exchange of Hong Kong Limited (SEHK).

In 2011, Hong Kong ranked first worldwide in terms of IPO funds raised. In addition to new share issues, \$230 billion was raised on the secondary market.

At the end of 2011, some 640 Mainland enterprises² were listed on the SEHK, raising \$3.2 trillion from the Hong Kong market since 1993. Hong Kong is also an increasingly attractive listing destination for international companies. Funds raised by these companies represented 52 per cent of IPO equity funds raised in 2011.

Overseas intermediaries are increasingly interested in setting up shops in Hong Kong. The number of Exchange Participants (EPs)³ trading on the SEHK and the futures market increased from 485 and 179 at the end of 2010 to 498 and 182 respectively at the end of 2011.

The asset management industry has a strong composition of international fund managers. At the end of 2011, a total of 884 companies were licensed or registered to carry out asset management business in Hong Kong, a rise of 6 per cent from a year earlier.

International financial institutions maintain a strong presence in Hong Kong. Of the world's top 100 banks, 73 operate in Hong Kong. At year's end, 142 of the 152 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 banks incorporated outside Hong Kong, with an average daily turnover of \$222.6 billion in 2011.

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.

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 bars⁴. Prices track closely those in the major gold markets in London, Zurich and New York. In addition, Hong Kong is one of the largest over-the-counter (OTC) gold trading centres in Asia.

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

³ An EP 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.

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.

Hong Kong continues to be one of the most open insurance centres in the world. Among the 163 authorised insurers at the end of 2011, a total of 78 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 2011 was \$225.8* billion.

Hong Kong continued to attain very high credit rating in 2011. Standard & Poor's affirmed Hong Kong's AAA rating, the agency's highest rating, while Moody's Investors Service and Fitch Ratings affirmed Hong Kong's rating at Aa1 and AA+ respectively, reflecting the agencies' recognition of Hong Kong's above average growth prospects, strong external position and consistently robust fiscal performance.

Major Initiatives in 2011

Relentless efforts were made in 2011 to enhance Hong Kong's competitiveness as an international financial centre and to develop Hong Kong as a capital formation centre, asset management centre and an offshore RMB business centre. The Government continues to work closely with regulators and the industry to modernise Hong Kong's regulatory framework, enhance financial infrastructure and strengthen investor protection. It also continues to press ahead with various initiatives to develop further Hong Kong's fund-raising platform, bond market, wealth management services and RMB business.

Enhancing Hong Kong's Competitiveness as an International 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.

Fund-raising Centre

The HKEx continues to attract new listings from the Mainland and other strategically important international markets. In 2011, American, Kazakh, Italian, Japanese and Swiss companies listed in Hong Kong for the first time. The HKEx also saw Hong Kong's first RMB-denominated IPO and real estate investment trust (REIT). Newly listed companies are attracted by the market's liquidity, attractive valuations and access to investors in Asia. Riding on the growing list of overseas companies listed in Hong Kong as a positive development, the HKEx continues to visit key overseas markets to share with them Hong Kong's advantages as one of the most vibrant capital raising platforms in the world. In addition, the HKEx has been streamlining its listing process for overseas companies, and accepting more overseas jurisdictions as places of incorporation.

* Provisional statistics.

Asset Management Centre

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. Thanks to the continuing inflows of investment capital into the Asia Pacific region, Hong Kong is also well placed to become Asia's premier asset management centre. The city's combined fund management business was valued at \$10,091 billion at the end of 2010, about 66 per cent of which came from non-Hong Kong investors, underlining the city's strong appeal to foreign investment capital. At the end of 2011, there were 90 approved fund management groups managing 1 836 unit trusts and mutual funds authorised by the Securities and Futures Commission (SFC).

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

Proposed Establishment of an Independent Insurance Authority

The Government is considering establishing 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.

The stakeholders and the public were consulted on the matter and the consultation's initial results were announced in June 2011. Draft legislation for the proposed IA is being prepared for another round of consultation in 2012.

Modernising the Companies Ordinance

After a series of public consultations on topical issues and the draft bill, the Government introduced the Companies Bill into the Legislative Council in January 2011. The bill seeks to rewrite and modernise the provisions relating to the operation of live companies in the Companies Ordinance (CO). Taking account of developments regarding company law in other comparable jurisdictions, the bill aims to enhance corporate governance, ensure better regulation and facilitate business by providing a modernised legal framework for the establishment and operation of companies, thereby enhancing Hong Kong's status as a major international business and financial centre.

Since the introduction of the bill into the Legislative Council, the Government has been working closely with the Legislative Council Bills Committee. Subject to the making of necessary subsidiary legislation after the enactment of the bill targeted for 2012, the Government expects the new CO to commence operation in early 2014.

Modernising Corporate Insolvency Law and Providing a Legal Framework for Corporate Rescue Procedure

The Government has launched an exercise to modernise the corporate insolvency provisions under the CO, to facilitate more efficient administration of the winding-up of companies, to better protect creditors, and to introduce a new

corporate rescue procedure. The Government plans to launch a public consultation on the legislative proposals in late 2012.

Trust Law Reform

Based on the consultation conclusions on the review of the Trustee Ordinance and related matters issued in February 2010, the Government has been preparing an Amendment Bill to introduce the reform proposals. The bill will 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. The Government plans to consult the stakeholders on the detailed legislative proposals in the first quarter of 2012.

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 Hong Kong Monetary Authority (HKMA) through the Hong Kong dollar RTGS system. 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 Exchange Fund Bills and Notes (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 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.

Through its integration with the RTGS system, 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 the RTGS system to access intra-day liquidity through automatic intra-day repurchase agreements.

Major projects in 2011 included:

- Completion of a series of enhancements of the RMB RTGS system to support further expansion of RMB business in Hong Kong;
- Continued development of a proposed local trade repository for OTC derivatives transactions;
- Continued development of the Pilot Platform and add-on services to facilitate cross-border transactions and collateral management in bonds; and
- Completion of a review of the retail payment instruments and infrastructure in Hong Kong and overseas, with recommendations to improve the efficiency of the retail payment infrastructure in Hong Kong.

Developing a Scripless Securities Market

The Scripless Securities Market Working Group comprising representatives from the SFC, the HKEx and the Federation of Share Registrars Limited announced in September 2010 plans to implement a scripless securities market in Hong Kong. The new paperless option will enable investors to hold securities in their own names as registered holders, thus enjoying the full benefits of legal ownership. In 2011, the working group worked on the details of the operational and technical processes and requirements, and examined draft enabling legislation, for the introduction of a scripless securities market.

Development of the Bond Market

The Government 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 better meet the market needs and to enhance the competitiveness of Hong Kong's debt market vis-à-vis those of other financial centres, the Government implemented some improvements to the Qualifying Debt Instrument (QDI) Scheme, under which profits tax concessions are provided to certain types of debt instruments meeting the relevant conditions in the Inland Revenue Ordinance (IRO). The improvements implemented in March 2011 include the extension of the 50 per cent profits tax concession to short-dated QDIs with a tenor of less than three years and the modifications of certain conditions/definitions governing the implementation of the QDI Scheme.

Under the Government Bond Programme (GBP) introduced in 2009, the Government is authorised to issue bonds with an aggregate outstanding principal of up to \$100 billion and to have a Bond Fund to manage the sums raised under the GBP⁵.

In 2011, six issues of Government bonds for institutional investors were made under the GBP, attracting a diverse group of investors.

Following the announcement in the 2011-12 Budget, the Government issued \$10 billion inflation-linked retail bond (iBond), with a tenor of three years, for the first time under the GBP to Hong Kong residents in July 2011 to promote further development of the retail bond market in Hong Kong. The iBond was well-received by investors, attracting some 155 000 valid applications for about \$13 billion in principal amount of the bond.

Outstanding Hong Kong dollar debts, including EFBNs, exceeded \$1,261 billion at the end of 2011.

⁵ 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.

Developing Islamic Finance

In 2011, the Government continued to create an environment conducive to development of Islamic finance in Hong Kong in collaboration with the financial regulators and the private sector. Its efforts focused on four broad areas: putting in place the necessary infrastructure, enhancing Hong Kong's linkages with other major Islamic financial markets, promoting market knowledge of Islamic finance, and encouraging product development.

On the development of infrastructure, the Government is preparing a legislative proposal to amend the IRO and the Stamp Duty Ordinance to promote the development of Islamic finance in Hong Kong. The proposal seeks to level the playing field for issuing and trading common types of Islamic bonds such as sukuk in relation to their conventional counterparts as far as the tax liabilities are concerned. In this connection, the Government will conduct a public consultation on the draft legislation in the first quarter of 2012 to ensure that the legislative amendments can meet the latest market needs.

Improving Market Quality and Investor Protection

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

The Government introduced a bill into the Legislative Council to codify the disclosure of Price Sensitive Information (PSI) in the Securities and Futures Ordinance (SFO) in June 2011. The statutory regime to require listed corporations to disclose PSI in a timely manner will enhance market transparency and quality, bring Hong Kong's regulatory regime for listed corporations more in line with those of overseas jurisdictions, and sustain Hong Kong's position as a premier capital formation centre in the region. The Government aims to enact the bill within the 2011-12 legislative session and implement the new PSI disclosure regime in the first quarter of 2013.

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

The Government announced in December 2010 its decision to establish an investor education body as a wholly-owned subsidiary of the SFC and a Financial Dispute Resolution Centre (FDRC) as a company limited by guarantee to enhance protection for investors. The new investor education body will 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. The Government introduced into the Legislative Council in June 2011 the Securities and Futures (Amendment) Bill 2011 which, among other things, enabled the new investor education body to be established under the SFC. The education body is expected to be operational about the end of 2012. The Government is also preparing for the establishment of FDRC by mid-2012.

Proposed Establishment of a Policyholders' Protection Fund

To enhance market stability and provide a safety net for policyholders in the event of an insurer becoming insolvent, the Government has proposed the

establishment of a Policyholders' Protection Fund in Hong Kong. A three-month public consultation on the proposal was conducted from March to June 2011.

Regulation of Credit Rating Agencies

Following the G-20'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 announced regulatory measures to strengthen oversight of the CRAs. Hong Kong also established such a regulatory regime to strengthen investor protection and enable credit ratings, prepared by Hong Kong-based CRAs to continue to be serviceable in other jurisdictions. With the enactment of new legislation, all Hong Kong-based CRAs and their rating analysts were required to be licensed and subject to ongoing supervision from June 1, 2011 onwards. At the end of 2011, five CRAs were licenced by the SFC.

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. The FRC stepped up its work in 2011 by reviewing financial reports based on a risk-based approach.

Statistics on FRC's work

	2009	2010	2011
Number of complaints received	13	9	7
Number of modified auditors' reports reviewed	129	142	131
Number of investigations initiated	4	4	6
Number of investigations completed	-	1	5
Number of enquiries initiated	2	2	1
Number of enquiries completed	2	1	2

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

Regulation of OTC Derivatives

The global financial crisis has revealed the risks embedded in the OTC derivatives market. The 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, and that all OTC

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

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 existing regulatory framework, the Government has been working closely with the HKMA and the SFC to develop a regulatory regime for the OTC derivatives market in Hong Kong. The proposed regulatory regime will require the reporting of certain specified OTC derivatives transactions, particularly those which are relevant to the Hong Kong market, to a designated TR to be established by the HKMA and the clearing of certain specified standardised OTC derivatives transactions through designated CCPs. In October 2011, the HKMA and the SFC issued a joint consultation paper which detailed how the regime is likely to be cast, and invited the public to provide feedback on the proposals. Valuable comments have been received and will be taken into account when finalising the proposed regulatory framework. A second joint consultation will be conducted in 2012 to consult the public on the detailed requirements. Meanwhile, the HKEx has announced its intention to establish a local CCP to provide central clearing services for certain products.

Proposed Statutory Regulatory Regime for Mandatory Provident Fund Intermediaries

Preparation for the implementation of the Employee Choice Arrangement (ECA) is in full swing. Under the ECA, MPF scheme members will be allowed to transfer the accrued benefits derived from their own (i.e. employees') portion of mandatory contributions made during their current employment to an MPF scheme of their own choice, and hence will be conducive to greater market competition.

Before implementing the ECA, the Government introduced into the Legislative Council a bill on December 14, 2011 to put in place a statutory regulatory regime for MPF intermediaries to enhance the protection of scheme members' interests. The statutory regime is modelled on the existing administrative regulatory regime adopted since the inception of the MPF system in 2000. It will introduce criminal sanctions against the sales and marketing of MPF products by unregistered MPF intermediaries and a range of sanctions against registered MPF intermediaries for breaches of the statutory conduct requirements.

The bill is being scrutinised by the Legislative Council. Subject to the bill being approved by the Legislative Council by July 2012, the ECA will be implemented on November 1, 2012.

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. Following enactment of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill by the Legislative Council in June 2011 to enhance the AML/CFT regime applicable to the financial sectors, preparations for implementation are being finalised and the new legislation will commence operation on April 1, 2012 as scheduled.

Financial Links with the Mainland

Strengthening Hong Kong's financial co-operation with the Mainland is vital for the city's financial services sector, which is best placed to contribute to the modernisation of the Mainland's financial system.

There has been a steady flow of funds between financial institutions on both sides of the border over the years. At the end of 2011, the external liabilities of Als to banks in the Mainland amounted to \$343.4 billion, while their claims on banks in the Mainland totalled \$1,514.9 billion. These sums represent 9.5 per cent and 28.7 per cent respectively of Als' total liabilities to and claims on banks outside Hong Kong.

Hong Kong continued to be the springboard to the Mainland market for gaining investment exposure there. At the end of 2011, there were 40 unlisted SFC-authorized funds with significant exposure to A-shares either by direct investment in A-shares via the investment quota granted to qualified foreign institutional investors (QFII) or investment in market access products issued by QFII or their affiliates that are linked to A-shares. There were 24 Exchange-traded Funds (ETFs) that track the A-share market, and one listed close-ended fund that invests directly in A-shares via QFII quota at the end of the year.

Capital Formation Centre and Global Investment Platform for the Mainland

Hong Kong's fundamental strengths make it an ideal provider of top class services to Mainland enterprises seeking listing in the city. The growing presence of Mainland issuers in turn has increased the breadth and depth of Hong Kong's securities and futures markets through a great diversity of constituent stocks in the equity market and a wider 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.

To further enhance financial co-operation with the Mainland, the HKEx will, in conjunction with the Shanghai Stock Exchange and the Shenzhen Stock Exchange, establish a joint venture company. Possible areas of business operation of the joint venture company include, but are not limited to, development of index and other equity derivative products and compilation of new indices.

National 12th Five-Year Plan and Vice-Premier Li Keqiang's Announcement of Central People Government Measures to Support the Financial Development in Hong Kong

The Outline of the 12th Five-Year Plan for the National Economic and Social Development promulgated in March 2011 includes a dedicated chapter on Hong Kong and Macao, which emphasises the Central Authorities' support for Hong Kong to develop into an offshore RMB centre and an international asset management centre.

The Vice-Premier of the State Council, Mr Li Keqiang, announced on August 17, 2011 a series of measures to reinforce the Central Authorities' support for the development of Hong Kong as an offshore RMB business centre. The measures cover a number of aspects, including further expansion of the RMB trade settlement scheme to cover the whole country, support for the use of RMB for foreign direct investment in the Mainland, introduction of the RMB Qualified Foreign Institutional Investors (RQFII) Pilot Scheme for investing in Mainland's securities markets, pilot arrangement for foreign banks to increase the capital of their Mainland subsidiaries using RMB, and expansion of the issuance of RMB bonds in Hong Kong by Mainland entities (including financial institutions and corporations).

Development of Offshore RMB Business

Benefiting from China's policy to promote greater use of the RMB in external trade and investment, Hong Kong made tremendous progress in offshore RMB business in 2011.

The RMB trade settlement pilot scheme, launched in July 2009, was expanded to cover the whole of China on August 24, 2011. At the end of 2011, there were a total of 187 banks participating in the RMB clearing platform in Hong Kong, of which 165 were branches and subsidiaries of foreign banks and overseas presence of banks in the Mainland. In 2011, the total remittance of RMB for cross-border trade settlement amounted to RMB1,915 billion, more than five times the amount in 2010.

Hong Kong is also the first place outside the Mainland to have developed an RMB bond market. By the end of 2011, there had been 120 RMB bond issues (with a total issuance size of RMB181.7 billion). In 2011, 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, were able to 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, opening up a channel for RMB funds in Hong Kong to invest in the Mainland. So far, the HKMA and 32 Hong Kong banks have been permitted to invest in the Mainland's interbank bond market.

Hong Kong is a major destination and source of the Mainland's outward and foreign direct investment. The Mainland authorities put in place administrative arrangements for the use of RMB in outward direct investment from the Mainland and foreign direct investment into the Mainland in January and October 2011 respectively.

RQFII Pilot Scheme rules were promulgated on December 16, 2011, further enhancing the circulation of onshore and offshore RMB funds. A total of 21 Hong Kong subsidiaries of qualified Mainland fund managers and securities companies were granted RQFII quotas worth RMB 20 billion by the Mainland authorities to channel RMB proceeds raised in Hong Kong to invest in the Mainland securities markets. The SFC authorised the first batch of four RQFII retail investment funds managed by Hong Kong licensed subsidiaries of three Mainland asset management firms and one securities company at the end of 2011.

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 December 13, 2011, the Central People's Government and the Government of the Hong Kong Special Administrative Region signed Supplement VIII to CEPA, which, among other things, further strengthened co-operation in the following financial services:

- (a) Banking: Mainland-incorporated banking institutions established by a Hong Kong bank may engage in the sale and distribution of mutual funds;
- (b) Securities: the Mainland and Hong Kong will continue to support qualified Mainland financial institutions engaged in securities activities to set up subsidiaries in Hong Kong and to operate businesses in accordance with law; deepen co-operation in financial services and products development, and allow investments in the Mainland securities market through the RQFII scheme; and
- (c) Insurance: Hong Kong insurance brokerage companies will be allowed to set up wholly-owned insurance agency companies in the Guangdong Province (including Shenzhen) on a pilot basis. In addition, Hong Kong insurance companies will be allowed to enter the market through setting up business institutions or capital participation.

Banking Sector

Main Features

Hong Kong maintains three tiers of deposit-taking institutions, comprising licensed banks (LBs), restricted licence banks (RLBs) and deposit-taking companies

(DTCs)⁷. They are known collectively as AIs under the Banking Ordinance (BO)⁸. The HKMA is the licensing authority for AIs.

Hong Kong has one of the highest concentrations of banking institutions in the world. At the end of 2011, there were 152 LBs, 20 RLBs and 26 DTCs. These 198 AIs maintained a network of 1 422 local branches. There were also 61 representative offices of banks incorporated outside Hong Kong at the end of the year.

The total deposit liabilities of all AIs to customers and the total loans and advances extended by these institutions at the end of 2011 were \$7,591.3 billion and \$5,080.4 billion respectively. The total assets of all AIs amounted to \$13,741.3 billion.

Statistics on AIs

	2009	2010	2011
AIs	199	193	198
<i>Of which:</i> LBs	145	146	152
RLBs	26	21	20
DTCs	28	26	26
Local branches of AIs	1 379	1 413	1 422
Total customer deposits (\$ billion)	6,381	6,862.3	7,591.3
Total loans and advances (\$ billion)	3,288.5	4,227.7	5,080.4
Total assets (\$ billion)	10,635.4	12,290.8	13,741.3

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 administrative expenditure of the HKMA is funded by the Exchange Fund established under the Exchange Fund Ordinance. The administrative expenditure of the HKMA in 2011 was \$1,033 million.

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

⁷ Only LBs may conduct full banking services, including in particular the provision of current and savings accounts and acceptance of deposits of any size and maturity. RLBs may take deposits of any maturity of \$500,000 or above. DTCs may take deposits of \$100,000 or above with an original maturity of at least three months.

⁸ The BO 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.

promote efficiency, integrity and development of the financial system, particularly the 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 BO 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 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 robust in 2011 despite a worsening of the European sovereign debt crisis. Bank lending continued to grow significantly, resulting in tightened liquidity conditions, but the liquidity ratio of banks remained well above the statutory minimum. Asset quality improved further and locally incorporated AIs remained well capitalised.

The HKMA has been closely monitoring the credit growth of AIs because of potential stress on credit quality and liquidity risk management. Early in the year, AIs were required to submit their business plans and funding strategies to the HKMA for review. Where considered appropriate, the HKMA requested AIs to revise their business plans having regard to the sustainability of stable funding to support their lending activities. To build a stronger buffer against possible deterioration in asset quality, the HKMA also discussed with the retail banks the raising of their regulatory reserves to individually agreed levels by the end of 2011. Industry consultation on the primary legislation for implementing the Basel III requirements in Hong Kong had also been conducted.

Having regard to the continued increase in risk of a property price bubble which might potentially undermine the stability of the banking system, the HKMA introduced on June 10, 2011 the fourth round of countercyclical macro-prudential measures since October 2009. These macro-prudential measures have strengthened the risk management standards and practices of AIs in their mortgage lending business. This also enables AIs to build up a larger safety cushion to absorb potential losses arising from a property market downturn.

In the light of the volatile market conditions due to the European sovereign debt crisis in the second half of 2011 and as part of the ongoing strategies, the HKMA has been closely monitoring the funding and liquidity positions of foreign AIs, particularly those from Europe, including their access to the interbank market and deposit movements. These AIs have also been asked to step up their contingent funding plans and to maintain sufficient high-quality liquefiable assets to meet any unexpected developments. In addition, the HKMA has stepped up its communication with the home supervisors of some European AIs on matters concerning the latest financial conditions of their head offices and market developments.

The enhanced Deposit Protection Scheme providing a higher protection limit of \$500,000 per depositor per bank came into operation on January 1, 2011. In addition to the increase in the protection limit, coverage of the scheme expanded to include deposits pledged as security for banking services. Measures to enhance the efficiency of the determination of compensation payments also became effective at the beginning of the year.

At the end of 2011, over 99.6 per cent of the 21 835 complaints on Lehman-related products had been dealt with. Investigation into the remaining 72 Lehman-related complaints was under way at the end of the year, with a majority of them received in 2011.

Securities and Futures Sector

Main Features

The securities market in Hong Kong is operated by the SEHK and the futures market by the Hong Kong Futures Exchange Limited (HKFE), both being wholly owned subsidiaries of the HKEx.

At the end of 2011, there were 1 496 companies listed on the Main Board and the Growth Enterprises Market (GEM) of the SEHK with a total market capitalisation of about \$17,537 billion and total equity funds raised of \$490 billion during the year. The total turnover of the securities market amounted to \$17,154 billion. The total number of shares traded reached 39 907.3 billion, a record high.

The ETF market continued to expand in 2011. During the year, 20 new ETFs were authorised and the total number of ETFs listed on the SEHK increased to 77, offering a wide range of investment exposures to world, regional and Mainland indices and commodities for investors. According to the HKEx, turnover of ETFs reached \$545.3 billion. To help investors better distinguish between synthetic ETFs and traditional ETFs, the SFC and the HKEx introduced measures to enhance disclosure related to synthetic ETFs listed on the SEHK during 2011. Managers of synthetic ETFs were required to put an asterisk and an annotation explaining the product is a synthetic ETF right after the name of a synthetic ETF in all public documents, marketing materials and websites. In addition, the alphabet 'X' must appear as a marker on the English and Chinese stock short names of synthetic ETFs. Furthermore, to strengthen protection for investors, additional measures were

implemented by the SFC in October 2011 to enhance the level of the collateral and transparency of domestic synthetic ETFs.

Relevant ETF managers were required to top up the collateral levels for all of their synthetic ETFs primarily regulated by the SFC to achieve and maintain at least 100 per cent collateralisation. This enhancement serves to minimise uncollateralised counterparty risk exposure that could arise from the use of financial derivatives by synthetic ETFs in replicating index performance.

Statistics on securities market (Main Board and GEM) (\$ billion)

	2009	2010	2011
Number of listed companies (year-end)	1 319	1 413	1 496
Total market capitalisation (year-end)	17 874	21 077	17 537
Total equity funds raised	642	859	490
Total securities market turnover	15 515	17 210	17 154
Total number of shares traded (billion)	24 794	34 991	39 907
Number of derivative warrants (DWs) listed (year-end)	3 367	5 148	4 027
Turnover of DWs	1 655	2 692	2 630
Number of Callable Bull/Bear Contracts (CBBCs) listed (year-end)	1 692	1 064	901
Turnover of CBBCs	1 676	1 455	1 852
Number of ETFs listed (year-end)	43	69	77
Turnover of ETFs	500	604	545

In the derivatives market, around 140 million futures and options contracts were traded in 2011, or 21 per cent higher than in 2010. Trading of major derivatives products was active and set record highs in 2011. They included Hang Seng Index (HSI) Futures with total turnover of 23 085 833 contracts; H-shares Index Futures with total turnover of 15 003 870 contracts; HSI Options with total turnover of 10 667 426 contracts; H-shares Index Options with total turnover of 3 771 799 contracts; and Stock Options with total turnover of 74 325 068 contracts. In addition, most derivatives contracts' open interests set record highs on particular days during 2011.

Statistics on derivatives market turnover (million contracts)

	2009	2010	2011
All options and futures contracts	99	116	140
<i>Of which:</i> HSI Futures	21	21	23
H-shares Index Futures	12	12	15
HSI Options	5	9	11
H-shares Index Options	2	3	4
Stock Options	47	61	74

At the end of 2011, there were 21 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 2011-12 is estimated to be \$1,012 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 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 SFC's work is wide in scope. It starts with setting standards for industry participants through a licensing system and extends to the supervision and monitoring of intermediaries, enforcing of securities laws and rules, regulating offering documents and promotional materials of retail investment products. Together with SEHK, the SFC ensures the quality of disclosure of listing applicants and securities issuers. It has oversight of takeovers, mergers and privatisations of listed companies, the markets, the exchanges, the clearing houses and alternative trading platforms. In addition, the SFC works with counterparts in Hong Kong, in the mainland of China and overseas on issues that require regulatory collaboration and assumes the statutory role of educating investors on investment risks and the importance of making informed investment decisions.

At the end of 2011, there were 39 296 licensed persons, including securities brokerage firms, futures dealers and securities margin financiers, as well as their representatives, and 110 registered institutions, such as banks, engaging in regulated activities such as dealing and advising on securities and futures.

Statistics on licensing for SFC-regulated activities (year-end)

	2009	2010	2011
Licensed persons	35 953	38 022	39 296
<i>Of which: Licensed corporations</i>	1 608	1 731	1 804
<i>Licensed individuals</i>	34 345	36 291	37 492
Registered institutions	107	109	110

Market Misconduct

In 2011, the SFC continued to prosecute market misconduct offences in criminal courts. Four individuals were prosecuted for market manipulation in derivative warrants under the SFO and one of the manipulators was sentenced to five months' imprisonment. The SFC also obtained orders in the High Court to disqualify five directors, of whom three were directors of a listed company who were involved in misusing about 25 per cent of the company's total assets. An alternate non-executive director found guilty of misconduct was also disqualified in the first case of its kind tried in the High Court. The SFC also continued seeking court orders to freeze proceeds obtained through suspected market misconduct.

The Market Misconduct Tribunal (MMT), established in 2003, conducts civil proceedings and hears cases referred to it by the Financial Secretary following investigation by the SFC. So far, the MMT has concluded six cases, and 18 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 authorised the first RMB-denominated REIT in April 2011. The REIT was also the first RMB-denominated equity product traded outside the Mainland, marking a significant milestone in Hong Kong's development as an offshore RMB centre.

The investor protection measures introduced in June 2010 to enhance disclosure and the selling practices of investment products were implemented during the year. Since June 2011, all SFC-authorized funds and investment-linked assurance schemes marketed to the public were required to provide product key fact statements (KFS) as part of their offering documents. The KFS, in the form of a summary of key features and risks of an investment product, are spelled out in plain language, to enable investors to better understanding the product.

Effective in September 2011, licensed and registered persons under the Code of Conduct for Persons Licensed by or Registered with the SFC are required to ascertain

the full and true identity of their clients before offering them a product containing a derivative element. Likewise, they are obliged to make sure their clients know clearly what they are investing in.

Other new developments include the regulation of the public offers of structured products in the form of shares of debentures being transferred from the prospectus regime of the Companies Ordinance to the regime for public offers of investments under the SFO. The legislation was enacted in May 2011. Under the new regime, advertisements and offer documents for all structured products that are publicly offered must be authorised by the SFC, unless otherwise exempted by the SFO. The SFC also approved in 2011 the Hong Kong Mercantile Exchange to operate a commodity futures market in Hong Kong where trading began in May 2011 with a physically-settled gold futures contract.

The SFC continued to educate investors in tandem with market developments and regulatory enhancements. The SFC ran a series of campaigns to boost public awareness of new classes of product such as RMB REITs, Hong Kong Depositary Receipts as well as synthetic ETFs, IPO investing and margin trading. Leveraging retail interest in RMB products, the SFC launched a dedicated campaign on bond investing that drew the public's attention to the key features and risks of RMB bonds and funds. A TV campaign, entitled 'Invest prudently/Signing means responsibility' was launched in the fourth quarter of 2011, advising investors to consider carefully before signing any documents and to acknowledge responsibility for their investment decisions.

Insurance Sector

Main Features

At the end of 2011, there were 163 authorised insurers, 85 of which were incorporated in Hong Kong while the remaining 78 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 7.7 per cent. In 2011, the total gross premiums of the Hong Kong insurance industry amounted to \$225.8* billion, representing an increase of 10.2 per cent over 2010.

General insurance business rose in money terms from \$31.1 billion in 2010 to \$34.7* billion in 2011, representing a 11.6 per cent increase in gross premiums. The growth was largely led by insurance policies relating to property damage and accident and health businesses (comprising medical business). At the same time, the overall underwriting performance of general insurance business showed a rise in profit from \$2.5 billion in 2010 to \$3* billion in 2011, mainly attributable to the underwriting of pecuniary losses business which surged in 2011 due to release of claims reserve.

* Provisional statistics.

Regarding long-term insurance business, the total revenue premiums of in-force long-term business rose by 9.9 per cent to \$191.1* billion in 2011. Individual life insurance remained the leading business, accounting for \$174.7* billion or 91.4* per cent of total revenue premiums, while the corresponding number of policies stood at 9.6* million.

At the end of 2011, there were 70 905 individual insurance intermediaries, including 8 571 Chief Executives or Technical Representatives of 591 broker firms, 27 498 Responsible Officers or Technical Representatives of 2 368 agency firms, and 34 836 individual agents.

Statistics on insurance business

	2009	2010	2011
Number of authorised insurers	171	168	163
<i>Of which: Incorporated in Hong Kong</i>	89	88	85
<i>Incorporated in the Mainland and overseas</i>	82	80	78
<u>Premium Income (\$billion)</u>			
Total gross premiums	184.6	205	225.8*
<i>Of which: General insurance (Gross premiums)</i>	28.6	31.1	34.7*
<i>Long-term in-force business (Office / Revenue premiums)</i>	156.1 [^]	173.9 [^]	191.1* [#]

* Provisional statistics

[^] Office premiums

[#] Revenue premiums

Insurance Authority

The Commissioner of Insurance, appointed by the Chief Executive as the 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 policyholders⁹.

* Provisional statistics.

⁹ 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, 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 endeavours to ensure that its supervisory regime is in line with prevailing principles and standards. The Government has 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

To strengthen investor protection, the IA, in collaboration with the Hong Kong Federation of Insurers, has adopted a multi-pronged approach to enhancing the regulation of sale of Investment Linked Assurance Scheme (ILAS) products, including requiring intermediaries to conduct improved suitability assessment, extending the cooling-off period from 14 days to 21 days, enhancing the syllabus of the Investment-Linked Long-Term Insurance Examination and requiring intermediaries to provide to potential policyholders with a pamphlet setting out key issues that they should consider before they procure ILAS products at the point of sale. Since May 2011, insurers were prohibited from offering gifts to promote the sale of ILAS products. Separately, with effect from June 2011, insurers were required to provide a copy of the Product Key Facts Statement for the relevant ILAS product to the customer together with the policy.

As a member of the IAIS, the IA continues to participate in the development of international standards in insurance supervision. In response to the financial crisis and its impact on the global insurance industry, the IAIS has revamped relevant international standards to strengthen insurance supervision, with particular emphasis on improving group and cross sectoral supervision. The IA is examining the new standards and their application 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

The MPF System was implemented on December 1, 2000 to assist 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 persons of 18 years of age or above, and below the age of 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 as mandatory contributions, subject to the maximum and minimum levels of relevant income (Max RI and Min RI respectively) for contribution purposes. The accrued benefits 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. Accrued benefits derived from mandatory contributions must be preserved until the scheme member

attains the retirement age of 65 unless the member meets any of the statutory conditions for early withdrawal of benefits. At the end of 2011, 98 per cent of employers (about 252 500), 99 per cent of relevant employees (about 2 344 300) and 70 per cent of self-employed persons (about 229 400) participated in MPF schemes. Total MPF assets amounted to about \$356 billion.

Unlike the mandatory MPF schemes, occupational retirement schemes registered under the Occupational Retirement Schemes Ordinance (ORSO) are voluntary schemes established by employers. To tie in with the implementation of the MPF system in 2000, ORSO schemes that can fulfil certain conditions can apply for exemptions from MPF requirements. Members of ORSO schemes that have been granted exemption may choose to remain in the existing ORSO scheme or join an MPF scheme. At the end of 2011, there were 3 804 MPF-exempted ORSO registered schemes covering over 369 900 employees.

Statistics on MPF schemes and MPF-exempted ORSO registered schemes (year-end)

	2009	2010	2011
<u>MPF Enrolment</u>			
Number of participating employers	238 400	244 000	252 500
Number of participating relevant employees	2 209 000	2 261 600	2 344 300
Number of participating self-employed persons	263 200	260 500	229 400
<u>MPF Enrolment Rate (per cent)</u>			
Employers	100	99	98
Relevant employees	100	99	99
Self-employed persons	76	80	70
<u>MPF Schemes</u>			
Number of registered schemes	38	41	41
Number of approved constituent funds	369	421	445
<u>MPF-exempted ORSO Registered Schemes</u>			
Number of MPF-exempted ORSO registered schemes	4 127	3 948	3 804
Number of participating employees in MPF-exempted ORSO registered schemes	403 500	380 200	369 900

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. The prime objectives of the MPFA are to ensure compliance with the MPFSO and protect the interests of scheme members. It is also the Registrar of ORSO

Schemes. To protect the interests of MPF scheme members, the MPFA monitors closely the operation of MPF trustees and other service providers, investigates cases of non-compliance, complaints or proactive inspections, and takes enforcement actions where necessary. 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 assist scheme members in choosing appropriate MPF funds. The operations of MPFA are mainly financed by the investment returns generated from a one-off Capital Grant of \$5 billion from the Government.

Recent Developments

The Government and the MPFA have been working closely reviewing the various aspects of the operation of the MPF System to strengthen its effectiveness and efficiency. The major initiatives in 2011 are set out in the ensuing paragraphs.

Having regard to the findings of the review of the Min RI and Max RI for MPF contribution in 2010, conducted by MPFA as required under the MPFSO, the Government put forward legislative proposals to increase the Min RI and Max RI to Legislative Council, which subsequently approved in June and November 2011 respectively the proposals to increase the Min RI from \$5,000 to \$6,500 per month with effect from November 1, 2011, thus lessening the financial burden on lower-paid employees and self-employed persons making MPF contributions and to increase the Max RI from \$20,000 to \$25,000 per month with effect from June 1, 2012 in line with the policy objective of encouraging the workforce to save for basic retirement needs.

The Government introduced a bill to provide a statutory regime for better regulation of MPF intermediaries in December 2011 to pave the way for early implementation of the ECA which would be conducive to greater market competition. In anticipation of the implementation of the ECA, individual MPF trustees introduced new MPF schemes with lower fees or reduced the fee level of their existing schemes. At the end of 2011, the average fund expense ratio was 1.77 per cent, or more than 15 per cent lower than the 2.1 per cent level in December 2007.

The MPFA embarked on a study on the supporting measures to facilitate the implementation of an arrangement for full portability by scheme members of all of their accrued benefits in future. The MPFA also launched a consultancy study on the administrative costs of MPF trustees to identify measures to further simplify administrative processes and achieve greater economies of scale to reduce costs and allow room for further fee reduction by the trustees. Furthermore, the Government and the MPFA are now working on legislative proposals to implement a mechanism for automatic suspension and re-imposition of levy for the MPF Compensation Fund, currently set at 0.03 per cent per year¹⁰. The suspension would reduce scheme expenses and members' fees and charges by 0.03 per cent per year.

¹⁰ As a result of the more than \$1.5 billion accumulated by the fund at the end of 2011, the levy can be suspended, because the fund's reserves have exceeded the \$1.4 billion mark at which suspension is allowed.

In addition to the above initiatives, the MPFA launched a public consultation in December 2011 on proposals to allow early withdrawal from the scheme by members with terminal illness and to allow members reaching the age of 65 to get their money in instalments instead of in a lump sum. The consultation period ends in March 2012, and the MPFA aims to submit its recommendations to the Government in the third quarter of 2012.

Companies Registry

The Companies Registry administers and enforces most parts of the CO. The registry records 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 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 \$226.8 million in 2010-11.

The registry has continued to implement the Integrated Companies Registry Information System in phases to computerise its operations fully and provide electronic 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. With the introduction of the new electronic services in March 2011, electronic Certificates of Incorporation and Business Registration Certificates can be issued in one go in less than 24 hours after receipt of the applications. The new services facilitate the setting up of business in Hong Kong and boosted Hong Kong's world ranking as a place to start business from sixth to fifth place in the *Doing Business Report* published by the World Bank.

Companies Registry statistics (year-end)

	2009	2010	2011
Local companies incorporated	109 424	139 530	148 329
Local companies on the register	772 253	863 762	956 392
Non-Hong Kong companies registered	683	737	798
Non-Hong Kong companies on the register	7 912	8 165	8 554

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.

Statistics on Bankruptcy Orders, Interim Orders in Individual Voluntary Arrangements (IVAs) and Winding-up Orders

	2009	2010	2011
Bankruptcy Orders	16 157	9 163	7 981
Interim Orders in IVAs	3 017	1 017	840
Winding-up Orders	573	438	333

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 (CPAs); setting and maintaining financial reporting, auditing and ethical standards for the profession; and conducting training programmes and qualifying examinations.

Statistics on CPAs, CPA firms and corporate practices in Hong Kong (year-end)

	2009	2010	2011
Number of CPA, including CPA (Practising)	29 107	30 817	32 636
Number of CPA (Practising)	3 749	3 784	3 851
Number of firms of CPA (Practising)	1 198	1 217	1 214
Number of corporate practices	291	336	365

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 the 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 \$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 Balance¹¹, 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 market volatilities arising from the European sovereign debt crisis and the historic downgrading of the United States' sovereign credit rating by the Standard & Poor's, currency stability in Hong Kong was well maintained during the year. Between January and March, the market exchange rate softened slightly from around 7.77 to 7.80, partly reflecting some repatriation of funds raised in the equity market. With the US dollar depreciating against other major currencies, the Hong Kong dollar exchange rate strengthened somewhat against the US dollar in April. From May to July the bilateral exchange rate weakened again as growing worries about the European sovereign debt problems weighed on market sentiment. In the five months to December, the exchange rate largely mirrored the swings in the US dollar against other major currencies, either strengthening amid a weaker US dollar or weakening alongside a stronger US dollar. Overall, the market exchange rate traded within a narrow range of between 7.7671 and 7.8097 during the year.

¹¹ Aggregate Balance is 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.

After being largely stable at low levels in the first half of 2011, Hong Kong dollar interbank interest rates increased slightly in the second half, tracking the upward movements in their US dollar counterparts. The upticks in Hong Kong Interbank Offered Rates (HIBORs¹²) also reflected increased demand for year-end Hong Kong dollar liquidity and occasional funding needs arising from IPOs in the equity market. Despite the modest rises, the short-term interbank rates stayed well below the Base Rate of the Discount Window.

From January to July the forward discounts were generally stable, consistent with the roughly stable HIBOR-LIBOR¹³ spreads. However, tighter Hong Kong dollar liquidity towards the end of 2011 was evident in the forward market. Following some widening in August, the Hong Kong dollar forward discounts broadly narrowed during the period between September and December and the three-month forward point even momentarily turned from discounts to small premiums in December. Some market participants might have tapped into collateralised term funding by swapping US dollars for Hong Kong dollars, leading to the contraction in forward discounts, especially during the last two months of the year.

To strengthen its oversight of global financial issues, the HKMA established the Financial Stability Surveillance Division under the Monetary Management Department in December 2011. The new division brings together staff of the Banking Policy Department and the Monetary Operations Division previously engaged in macro-prudential surveillance work. Their analyses will form the basis for deliberations by the HKMA Macro Surveillance Committee, which was set up in the second quarter of the year to facilitate regular monitoring of risks and vulnerabilities to Hong Kong's monetary and financial system. In 2011, the committee examined a number of major risks, including the rapid pace of credit growth among AIs and the development of the sovereign debt crisis in Europe.

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

¹² HIBORs are 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.

¹³ London Interbank Offered Rate.

advice of the EFAC¹⁴. A Strategic Portfolio was set up in 2007 to hold all the shares of the HKEx acquired for strategic purposes by the Financial Secretary using the Exchange Fund. At the end of 2011, the Exchange Fund's total assets stood at \$2,488 billion. The accumulated surplus of the Exchange Fund amounted to \$567.9 billion¹⁵.

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. All five denominations of the 2010 series of banknotes, which incorporate state-of-the-art security features, will be put into circulation starting January 2012.

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 the end of 2011 was \$269.5 billion.

Websites

Financial Services and the Treasury Bureau: www.fstb.gov.hk

Office of the Commissioner of Insurance: www.oci.gov.hk

Official Receiver's Office: www.oro.gov.hk

Companies Registry: www.cr.gov.hk

Hong Kong Monetary Authority: www.hkma.gov.hk

Securities and Futures Commission: www.sfc.hk

SFC Investor Education Portal: www.invested.hk

Mandatory Provident Fund Schemes Authority: www.mpfa.org.hk

Hong Kong Exchanges and Clearing Limited: www.hkex.com.hk

Financial Reporting Council: www.frc.org.hk

¹⁴ The details of the management of the fund and the investment style adopted are set out and explained in the HKMA's annual report.

¹⁵ 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.