Chapter 4

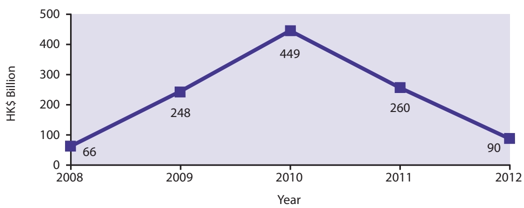
Financial and Monetary Affairs

Hong Kong ranks among the world's top financial centres, thanks to its robust regulatory framework and extensive network with other major financial centres as well as fast-growing economies in the region, particularly the mainland of China. Hong Kong was ranked first among 62 of the world's leading financial systems and capital markets for the second consecutive year in the World Economic Forum's Financial Development Report 2012. The stock market remained in the top five globally in terms of funds raised through initial public offerings in 2012. The financial sector has a 230,400-strong workforce, or 6.1 per cent of the city's total workforce, and contributes 16.1 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, high liquidity and efficiency. The Government aims to develop the financial system in line with international standards and provide an open, fair and orderly operating environment for market participants, striking a reasonable balance between market development and investor protection.

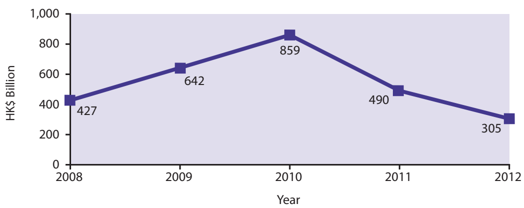
Hong Kong recorded a number of major achievements in 2012. These included:

Chart 1 **Equity Funds Raised Through IPOs**



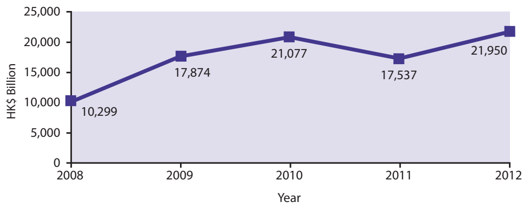
The Stock Exchange of Hong Kong Limited (SEHK) has been among the top five global initial public offering (IPO) listing markets for the past 10 years, ranking first from 2009 to 2011. In 2012, $90 billion were raised.

Chart 2 **Total Equity Funds Raised in Hong Kong**



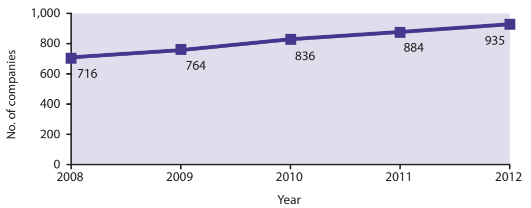
Despite the volatile external backdrop, the SEHK was ranked fifth in the world and third in Asia in terms of total equity funds raised, totalling $305.4 billion in 2012.

Chart 3 **Market Capitalisation of Stock Market**



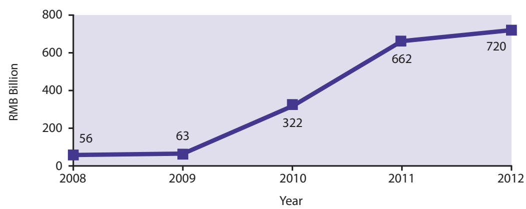
The SEHK ranked sixth in the world and second in Asia in terms of market capitalisation, amounting to $22 trillion at the end of 2012.

Chart 4 **Number of Asset Management Companies in Hong Kong**



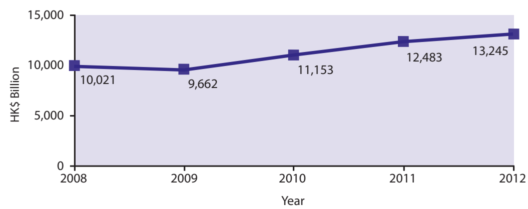
In 2012, 935 companies were licensed or registered to conduct asset management business in Hong Kong, an increase of 51, or 5.8 per cent, over 2011.

Chart 5 **RMB Deposits and RMB Certificates of Deposit in Hong Kong**



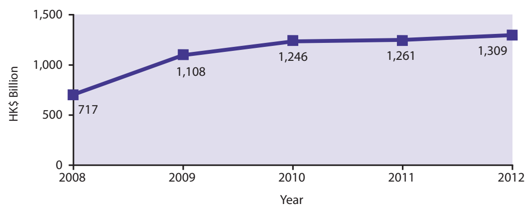
At the end of 2012, the Renminbi (RMB) customer deposits and outstanding RMB certificates of deposit issued amounted to RMB603 billion and RMB117.3 billion respectively. The combined sum of RMB720.2 billion represented an annual growth of about 9 per cent.

Chart 6 **External Positions of Authorised Institutions (AIs)**



Hong Kong was the world's eighth and Asia's second largest banking centre in terms of external positions[1] in the Bank for International Settlements (BIS) Quarterly Review for the end of 2012 position.

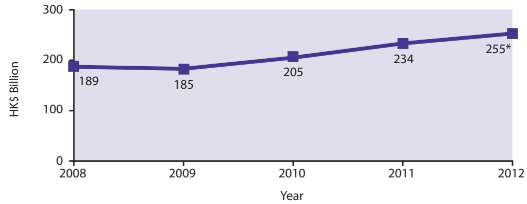
Chart 7 **Total Outstanding HKD Debt Securities**



Outstanding Hong Kong dollar debt securities, including Exchange Fund Bills and Notes, totalled $1,309 billion at the end of 2012, or 3.8 per cent higher than the previous year's $1,261 billion.

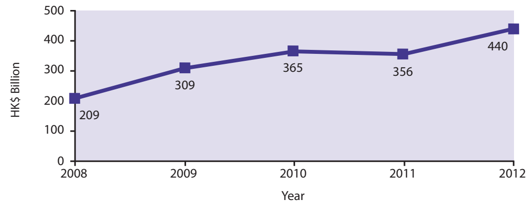
1 Sum of liabilities to banks and non-bank customers outside Hong Kong and claims on banks and non-bank customers outside Hong Kong (such as equities, securities and capital instruments).

Chart 8 Annual Gross Premiums of Insurance Market



As one of the world's most open insurance markets, Hong Kong's insurance market recorded $255.2* billion in total gross premiums in 2012, representing an increase of 9 per cent over 2011.

Chart 9 Total NAV of MPF Assets



Net asset values (NAV) of Mandatory Provident Fund (MPF) schemes stood at $440 billion at the end of 2012 with an annualised internal rate of return of 4 per cent for the period from December 2000 (the inception of the MPF System) to December 2012.

Hong Kong as an International Financial Centre

Overview

Hong Kong's position as a leading international financial centre is based on its unique status as the only place in the world where a strong connection with the Mainland market coincides with a world-class financial infrastructure. On one hand, Hong Kong enjoys extensive geographical, cultural and linguistic links with the Mainland, and has long served the Mainland's financial needs 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 Asia-Pacific region and excellent communications 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 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 World Economic Forum (WEF)'s Financial Development Index for the second time in 2012; the Global Financial Centre Index published by Z/Yen Group in September 2012 ranked Hong Kong as the third global centre, behind only London and New York.

With a total market capitalisation of about $22 trillion at the end of 2012, the stock market of Hong Kong ranked sixth in the world and second in Asia. The daily turnover averaged $53.9 billion in 2012. At the end of the year, 1,547 public companies were listed on the SEHK,

* Provisional statistics.

representing a wide range of industries from banking and property to resources and telecommunications. In 2012, the stock market of Hong Kong remained in the top five worldwide in terms of IPO funds raised. In addition to new share issues, another $215 billion was raised on the secondary market.

At the end of 2012, some 721 Mainland enterprises[2] 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 international and Mainland companies represented 90 per cent of IPO equity funds raised in 2012.

Overseas intermediaries are increasingly interested in setting up companies in Hong Kong. The number of Exchange Participants (EPs)[3] trading on the SEHK and the Hong Kong Futures Exchange Limited (HKFE) increased from 498 and 182 at the end of 2011 to 511 and 185 respectively at the end of 2012.

International fund managers are strongly represented in the asset management industry. At the end of 2012, 935 companies were licensed or registered to carry out asset management business in Hong Kong, a rise of 5.8 per cent from a year earlier. International financial institutions also maintain a strong presence in Hong Kong. Of the world's top 100 banks, 70 operate in Hong Kong. At year-end, 146 of the 155 licensed banks in Hong Kong were beneficially-owned by parties outside Hong Kong.

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 $230.3 billion in 2012.

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 and overnight liquidity through 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, 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's Central Moneymarkets Unit (CMU) provides clearing, settlement 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 non-local investors to hold and settle securities lodged with the CMU and local investors to hold and settle securities lodged with overseas systems. Through its integration with the RTGS systems, the CMU enables securities to be settled on a delivery-versus-payment basis, enhancing

---

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.

settlement efficiency and eliminating settlement risk. The interface also enables users of the RTGS system to access intra-day and overnight liquidity through repurchase agreements.

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 one of the largest over-the-counter gold trading centres in Asia.

Hong Kong continues to be one of the most open insurance centres in the world, with 14 of the world's top 20 insurers authorised to conduct insurance business in Hong Kong either directly or through a group company. Of the 155 authorised insurers at the end of 2012, 72 were from 20 overseas jurisdictions or the Mainland. There were 19 professional re-insurers in Hong Kong, including most of the world's top re-insurers. Gross premium income in 2012 was $255.2* billion.

Major Initiatives in 2012

Continuous efforts were made in 2012 to enhance Hong Kong's competitiveness as an international financial centre. The Government continues to work closely with regulators and the industry to align with the international regulatory reform agenda, improve market quality and strengthen investor protection. It also continues to press ahead with various initiatives to advance financial co-operation with the Mainland and further develop offshore 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 has been working to optimise Hong Kong's regulatory framework, keep abreast of local and international developments and enhance the quality of the local financial markets and increase their depth and breadth. The sustainable development of Hong Kong's financial sector would provide good quality employment for a wide spectrum of workers within the sector and related industries, enhance the competitiveness of Hong Kong's economy, and create new opportunities for both Hong Kong and the Mainland by strengthening financial co-operation.

Fund-raising Centre

The SEHK continues to attract new listings from the Mainland and other strategically important international markets. In 2012, three overseas companies were listed on the SEHK from Canada, Japan, and Singapore. Newly listed companies are attracted by the market's liquidity, attractive valuations and access to investors across Asia. The SEHK is working to accept more overseas jurisdictions as places of incorporation.

---

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.

Asset Management and Private Wealth Management

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 and Asia. 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 $9,038 billion at the end of 2011, about 63 per cent of which came from non-Hong Kong investors, underlining the city's strong appeal to foreign investment capital[5]. At the end of 2012, there were 101 approved fund management groups managing 1,842 unit trusts and mutual funds authorised by the Securities and Futures Commission (SFC).

In 2012 the Government, together with other agencies, continued to explore ways to improve the international competitiveness of Hong Kong's financial markets and provide a more favourable operational, regulatory and tax environment. The Government led a promotion campaign in New York, Zurich, Geneva and Lugano 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. The HKMA also discussed with market participants improvements to the regulatory regime for private banking business and investor protection, introduced revised measures for the sale of investment products to private banking customers, and provided guidance and clarification to facilitate the adoption of 'portfolio-based' assessment of the suitability of investment solicitation and recommendation for private banking customers.

Enactment of the new Companies Ordinance

In July 2012, the Legislative Council enacted the new Companies Ordinance, which is expected to be implemented in early 2014. It will provide a modernised legal framework for the incorporation and operation of live companies in Hong Kong. The new regime seeks to enhance corporate governance, ensure better regulation, facilitate business and modernise the law, thereby consolidating Hong Kong's status as a major international business and financial centre.

To encourage investors to set up companies in Hong Kong to raise capital and expand their business, the capital duty levied on local companies under the Companies Ordinance was abolished with effect from 1 June 2012.

Improvement of Corporate Insolvency Law

The Government has launched an exercise to improve the corporate insolvency provisions under the Companies Ordinance. Its objectives are to facilitate more efficient administration of the winding-up process and increase protection of creditors through streamlining and rationalising the company winding-up procedures and enhancing regulation of the winding-up process having regard to international experience. An Advisory Group comprising representatives from the business and financial sectors, relevant professions, the academic sector and members of the Standing Committee on Company Law Reform was established in early 2012 to provide technical input and expert advice to the Government on the legislative

5 Figures are quoted from the Fund Management Activities Survey for 2011, a survey conducted by the SFC annually to collect information and data on the general state of affairs in the local fund management industry.

proposals. The Government plans to launch a public consultation on the legislative proposals in April 2013.

Trust Law Reform

The trust law reform seeks to enhance trustees' default powers, whilst providing appropriate checks and balances to ensure trustees exercise the new default powers properly. This will bolster the competitiveness of Hong Kong's trust services industry and attract settlors to set up trusts in Hong Kong, in turn enhancing Hong Kong's status as an international asset management centre. The response to the public consultation on the detailed legislative proposals in March 2012 was generally supportive and the consultation conclusions were published in November 2012. The relevant Amendment Bill will be introduced into the Legislative Council in early 2013.

Developing a Scripless Securities Market

A bill is being prepared to provide the legal framework for a scripless securities market in Hong Kong, allowing investors to hold securities electronically in their own names, with legal title rather than just the beneficial interest of the securities. The proposal will provide better investor choice and protection and help enhance the overall competitiveness of our securities market.

Development of the Bond Market

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 GBP[6].

In 2012, six tenders of Government bonds for institutional investors were made under the GBP, attracting a diverse group of investors. In June 2012, the Government issued $10 billion inflation-linked retail bond (iBond), with a tenor of three years, for the second time under the GBP to Hong Kong residents to promote further development of a retail bond market in Hong Kong. Over 330,000 valid applications for nearly $50 billion in principal amount of the bond were received, both setting records in the local retail bond market. At the end of 2012, outstanding Hong Kong dollar debts, including Exchange Fund Bills and Notes, totalled $1,309 billion.

Developing Islamic Finance

The Government continued to create an environment conducive to the development of Islamic finance in Hong Kong in collaboration with the financial regulators and the private sector. In March 2012, the Government consulted the public on a legislative proposal to provide a taxation framework for some common types of Islamic bonds comparable to that for their conventional counterparts. In view of the positive responses, the Government will introduce the related Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Bill 2012 into the Legislative Council in January 2013.

---

6 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.

Establishment of the Financial Services Development Council

On 1 July 2012, a preparatory task force came into operation to assist the Government in studying the establishment of a financial services development council to facilitate and enhance the long-term development of Hong Kong's financial services industry. In a report submitted to the Chief Executive in December 2012, the task force recommended that the new council be a high-level and cross-sector advisor to the Government and its main functions should include giving advice to the Government to facilitate the formulation and implementation of appropriate policies, providing a platform for the financial services industry to express and exchange their views, conducting policy research, promoting Hong Kong's financial services on the Mainland and overseas, and upgrading the skills and expertise of financial industry practitioners.

Alignment with International Agenda, Improving Market Quality and Investor Protection

Basel III Implementation in Hong Kong

As an international financial centre, Hong Kong intends to follow the international timeline of the Basel Committee on Banking Supervision (BCBS) for implementation of Basel III standards in Hong Kong. To this end, the Banking (Amendment) Ordinance 2012 was enacted by the Legislative Council in February 2012 to empower the Monetary Authority to make rules prescribing capital, liquidity and disclosure requirements for AIs. The Banking (Capital) (Amendment) Rules 2012, made in October 2012, introduce the first phase of Basel III standards from January 2013 covering principally minimum capital requirements, in accordance with the BCBS' recommendation.

Regulation of Over-the-Counter Derivatives

Working closely with the SFC and the HKMA following two rounds of public consultation in October 2011 and July 2012, the Government expects to introduce legislative proposals into the Legislative Council in mid-2013 to implement the Group of Twenty (G-20) commitments on over-the-counter (OTC) derivative regulatory reform. Under the proposed regulatory regime, certain specified OTC derivative transactions will have to be reported to a local Trade Repository under the HKMA and certain specified standardised OTC derivatives transactions will have to be cleared through a designated central counterparty.

Regulation of Sponsors

After consulting the public between May and July, in December 2012 the SFC announced proposals to improve the overall quality of IPO sponsors and to strengthen market confidence through amendment to the SFC's Corporate Finance Adviser Code of Conduct and Sponsor Guidelines. The Government is also following up with the SFC on proposed legislative amendments in relation to prospectus liability.

Regulation of Electronic Trading

In July 2012, the SFC launched a two-month public consultation on proposals to provide a more coherent and comprehensive regulatory framework for electronic trading (including internet trading, direct market access (DMA) and algorithmic trading) in view of the increased use of electronic trading by intermediaries. The proposals also aimed to bring the regulation of DMA activities in line with the standards set by the International Organisation of Securities Commissions.

Anti-Money Laundering and Counter Financing of Terrorism

Hong Kong's anti-money laundering (AML) and counter financing of terrorism (CFT) regulatory regime maintains a safe business and investment environment. In April 2012, the Anti-Money Laundering and Counter Terrorist Financing (Financial Institutions) Ordinance introduced customer due diligence and record-keeping requirements to financial institutions, with sanctions for non-compliance and enforcement powers for competent authorities. In July, the United Nations (Anti-Terrorism Measures) (Amendment) Ordinance 2012 expanded the scope of the terrorist financing offences to cover assets of all kinds, broadened the definition of terrorist acts, and expanded the prohibition on assistance for terrorists and terrorist organisations to cover the collection of their property. In view of these upgrades to Hong Kong's regulatory framework, the Financial Action Task Force unanimously agreed to remove Hong Kong from its regular follow-up process in October 2012.

Enhancing Disclosure of Price Sensitive Information by Listed Corporations

The Securities and Futures (Amendment) Ordinance 2012, enacted in May 2012, brings into operation on 1 January 2013 a statutory regime for listed corporations to disclose price sensitive information. Listed corporations will be required to disclose price sensitive information to the public in a timely manner. This will bring Hong Kong's regulatory regime for listed corporations in line with other international financial centres and enhance Hong Kong's position as a premier capital formation platform. In December 2012, the SFC launched a consultation service to help listed corporations understand and comply with the statutory disclosure provisions.

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

The Investor Education Centre (IEC), a new SFC subsidiary, was launched in November 2012 to improve financial consumers' financial literacy.

The Financial Dispute Resolution Centre (FDRC) was established in June 2012 to provide an independent, accessible and efficient avenue for resolving monetary disputes between individual clients and financial institutions. Since its establishment, the FDRC has endeavoured to promote mediation as a means to resolve disputes among financial institutions and investors.

Hong Kong as China's Global Financial Centre — Financial Links with the Mainland

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 a 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 greater 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 Hong Kong Exchanges and Clearing Limited (HKEx) set up a joint venture, China Exchanges Services Company (CESC), in October 2012 with the Shanghai Stock Exchange and the Shenzhen Stock Exchange. On 10 December 2012, CESC launched CES120, the first index in the new CESC Cross Border Index Series. CESC will develop sub-indices, including a pure A-shares index and a Hong Kong Mainland index based on CES120 constituents, and plans to introduce other cross-border indices as well as index-related products in early 2013.

Development of Offshore RMB Business

In June 2012, the Central People's Government announced a series of measures to boost Hong Kong's role as an offshore RMB centre and global financial centre. These include developing the offshore RMB lending market, increasing the choice of offshore RMB products in Hong Kong, increasing the investment quotas, enlarging the range of participating entities and relaxing the investment restrictions in relation to the RMB Qualified Foreign Institutional Investors (RQFII)[7] Pilot Scheme. The measures have not only broadened the scope of the offshore RMB market in Hong Kong, but also expanded the channels for the flow and circulation of RMB funds between Hong Kong and the Mainland.

There was significant progress in the development of offshore RMB business in Hong Kong in 2012, with rapid growth notably in RMB trade settlement, deposits, bond issuance and financing, making Hong Kong a global hub for RMB trade settlement, financing and asset management. Banks in Hong Kong handled RMB trade settlements of RMB2,633 billion in 2012, representing a 37 per cent growth as compared to 2011. At the end of 2012, the RMB customer deposits and outstanding RMB certificates of deposit issued amounted to RMB603 billion and RMB117.3 billion respectively, totalling RMB720.2 billion, up 9 per cent compared with RMB661.6 billion at the end of 2011. Since 1 August 2012, AIs in Hong Kong are offering RMB services to personal customers who are non-Hong Kong residents, and over 29,000 such accounts had been opened by the end of 2012, with deposits exceeding RMB4 billion.

At the end of 2012, there were 204 banks participating in Hong Kong's RMB clearing platform, of which 181 were branches and subsidiaries of foreign banks and overseas presence of banks from the Mainland.

Meanwhile, the scale of RMB financing activities expanded markedly. There was a significant growth in RMB bank lending, with the outstanding amount of RMB loans increasing to RMB79 billion at the end of 2012, from RMB31 billion at the end of 2011. RMB bond issuance was active, and totalled RMB112.2 billion during the year. The outstanding RMB bonds amounted to RMB237.2 billion at the end of 2012, up more than 60 per cent from 2011.

Since the launch of the RQFII Pilot Scheme in December 2011, the SFC has authorised 19 RQFII funds with an aggregate quota size of RMB20.6 billion. The quota for RQFII Pilot Scheme funds was increased by RMB50 billion in April 2012, allowing eligible institutions to invest in A-share index shares and launch RMB-denominated A-share exchange-traded funds (ETFs) in Hong Kong. In June, the SFC authorised the first RQFII A-share ETF for listing on the SEHK. Four RQFII

7 The scheme channels offshore RMB funds raised in Hong Kong to invest in the Mainland's equity and bond markets.

A-share ETFs with a total investment quota of RMB43 billion had been authorised as at the end of 2012, all trading under the Dual Counter model (ie Hong Kong dollar and RMB counters). In November, the China Securities Regulatory Commission further increased the RQFII investment quota by RMB200 billion, bringing the total RQFII investment quota to some RMB270 billion. The RQFII A-share ETF offers local and international investors alternatives to invest in the A-share market, expanding Hong Kong's RMB investment offering and reinforcing the city's role as the leading offshore RMB centre.

Apart from RQFII products, there were a number of other RMB product developments in 2012. In October, Hopewell Highway Infrastructure Limited's RMB-traded shares were listed on the SEHK (in addition to its Hong Kong dollar-traded shares), becoming the first RMB-traded share outside the Mainland. In December, the first derivative warrant traded in RMB was also listed on the SEHK. The RMB Currency Futures contract introduced for trading by the HKFE in September is based on the US dollar and CNH currency pair (ie offshore RMB exchange rate in Hong Kong), and was the world's first deliverable RMB currency futures to be quoted, margined and settled in RMB. The new futures contract helps RMB users manage their RMB exchange rate risk exposure.

In 2012, the pilot scheme for eligible institutions (including the Clearing Bank and Participating Banks of Hong Kong RMB clearing platform) to invest in the Mainland's interbank bond market was extended to insurance companies in Hong Kong. So far, the HKMA, 39 Hong Kong banks and seven Hong Kong insurance companies have been permitted to invest in the Mainland's interbank bond market.

Mainland and Hong Kong Closer Economic Partnership Arrangement

The Closer Economic Partnership Arrangement (CEPA) between the Mainland and Hong Kong, which came into force in 2004, gives Hong Kong's financial service providers and professionals greater market access and flexibility for their Mainland operations. 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 29 June 2012, the Central People's Government and the HKSAR Government signed Supplement IX to CEPA, which further strengthened co-operation in the following financial services:

(a) Banking: allowing eligible Hong Kong banks to offer custodian services for settlement funds of customers of securities companies and margin deposits on futures transactions; allowing Hong Kong financial institutions to set up consumer finance companies in Guangdong Province on a pilot basis;

(b) Securities: allowing Hong Kong securities companies which satisfy the qualification requirements as foreign shareholders of foreign-invested securities companies, and Mainland securities companies which satisfy the requirements for establishing subsidiaries, to set up equity joint venture securities investment advisory companies in the Mainland. The equity joint venture securities investment advisory company shall be a subsidiary of the Mainland securities company, the scope of business of which shall focus specifically on carrying on securities investment advisory business. The Hong Kong securities company's shareholding could be no more than 49 per cent of the total shareholding of such a joint venture securities investment advisory company; and

(c) Accounting: Hong Kong professionals who have obtained the Chinese Certified Public Accountants qualification are allowed to become partners of partnership firms in Qianhai on a pilot basis; and the documentation requirements will be simplified for applications by Hong Kong accounting firms to conduct business on a temporary basis in the Mainland.

Banking Sector

Main Features

Hong Kong maintains three tiers of deposit-taking institutions: licensed banks (LBs), restricted licence banks (RLBs) and deposit-taking companies (DTCs)[8]. They are known collectively as 'authorised institutions' (AIs) under the Banking Ordinance[9] and are licensed by the HKMA.

Hong Kong has one of the highest concentrations of banking institutions in the world. At the end of 2012, there were 155 LBs, 21 RLBs and 24 DTCs. These 200 AIs maintained a network of more than 1,400 local branches. There were also 60 representative offices of banks incorporated outside Hong Kong.

Hong Kong Monetary Authority

The HKMA was established in 1993 and its policy objectives are to maintain currency stability within the framework of the linked exchange rate system through sound management of the Exchange Fund, monetary policy operations and other means deemed necessary; 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 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. The HKMA is accountable to the Financial Secretary, who is advised by the Exchange Fund Advisory Committee 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

---

8 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.

9 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.

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 2012, despite the heightened uncertainties in the global economy and external environment. Credit growth moderated during the year and liquidity conditions improved. Asset quality remained sound and locally incorporated AIs continued to be well capitalised.

At the end of 2012, AIs' deposit liabilities to customers and the loans and advances extended by AIs totalled $8,296.4 billion and $5,567.6 billion respectively, 9.3 per cent and 9.6 per cent higher than a year earlier. AIs' total assets also rose 8.1 per cent, to $14,858.1 billion.

Statistics on AIs

		2010	**2011**	**2012**
AIs		193	198	200
Of which:	LBs	146	152	155
	RLBs	21	20	21
	DTCs	26	26	24
Local branches of AIs		1,413	1,422	1,404
Total customer deposits ($ billion)		6,862.3	7,591.3	8,296.4
Total loans and advances ($ billion)		4,227.7	5,080.7	5,567.6
Total assets ($ billion)		12,290.8	13,741.8	14,858.1

The risk of an overheating property market in Hong Kong increased further in 2012. The HKMA remained vigilant towards AIs' mortgage lending and in September introduced the fifth round of countercyclical macroprudential measures to further lower the loan-to-value and debt-servicing ratios for borrowers with multiple outstanding mortgage loans. The measures introduced since 2009 have enhanced banks resilience to a property market downturn. The HKMA also reviewed the major AIs' underwriting policies for car park mortgages and asked AIs to ensure their underwriting policies were in line with the good practices identified in the review. To increase the local banking system's resilience, the first phase of the Basel III standards will be implemented in accordance with the Basel Committee's international timeline.

Securities and Futures Sector

Main Features

The securities market in Hong Kong is operated by the SEHK and the futures market by the HKFE, both being wholly owned subsidiaries of the HKEx. At the end of 2012, there were 1,547 companies listed on the Main Board and the Growth Enterprises Market (GEM) of the SEHK with a total market capitalisation of about $22 trillion. Due to continued turmoil in the external environment, total equity funds raised fell 37.7 per cent to $305.4 billion during the year, while total turnover of the securities market declined by 22.5 per cent, to $13,301 billion, with 33,967.6 billion shares traded.

In 2012, 35 new Exchange Traded Funds (ETFs) were authorised and the total number of ETFs listed on the SEHK increased to 100, 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 $522.1 billion.

Managers of synthetic ETFs primarily regulated by the SFC were required to achieve and maintain at least 100 per cent collateralisation to minimise the risk 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)

	2010	**2011**	**2012**
Number of listed companies (year-end)	1,413	1,496	1,547
Total market capitalisation (year-end)	21,077	17,537	21,950
Total equity funds raised	859	490	305
Total securities market turnover	17,210	17,154	13,301
Total number of shares traded (billion)	34,991	39,907	33,968
Number of derivative warrants (DWs) listed (year-end)	5,148	4,027	3,747
Turnover of DWs	2,692	2,630	1,646
Number of Callable Bull/Bear Contracts (CBBCs) listed (year-end)	1,064	901	1,214
Turnover of CBBCs	1,455	1,852	1,533
Number of ETFs listed (year-end)	69	77	100
Turnover of ETFs	604	545	522

In the derivatives market, around 120 million futures and options contracts were traded in 2012, or 17 per cent fewer than in 2011. Trading of major derivatives products included Hang Seng

Index (HSI) Futures with total turnover of 20.4 million contracts; H-shares Index Futures with total turnover of 15.9 million contracts; HSI Options with total turnover of 9.2 million contracts; H-shares Index Options with total turnover of 6.3 million contracts; and Stock Options with total turnover of 56.1 million contracts.

Statistics on derivatives market turnover (million contracts)

		2010	2011	2012
All options and futures contracts		116	140	120
Of which:	HSI Futures	21	23	20
	H-shares Index Futures	12	15	16
	HSI Options	9	11	9
	H-shares Index Options	3	4	6
	Stock Options	61	74	56

At the end of 2012, there were 23 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 1989 as an autonomous body that is responsible for regulating the securities and futures markets in Hong Kong. The SFC is funded by the market, with total expenditure in 2012-13 estimated to be $1,292 million.

The SFC's powers are subject to a range of checks and balances. For instance, a wide range of SFC decisions is subject to appeal to the independent Securities and Futures Appeals Tribunal. The Process Review Panel for the SFC reviews and advises the SFC on the adequacy of the internal procedures and operational guidelines governing its actions and operational decisions in performing 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, and regulating offering documents and promotional materials for retail investment products. Together with the SEHK, the SFC ensures the quality of disclosure of listing applicants and securities issuers. It oversees 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, the Mainland 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. With the establishment of the Investor Education Centre in November 2012, the SFC will continue its investor education role through this subsidiary that also includes other regulators' members.

At the end of 2012, there were 39,119 licensed entities, including securities brokers, futures dealers, investment advisors and fund managers, as well as their representatives, and 117 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)

		2010	2011	2012
Licensed entities		38,022	39,296	39,119
Of which:	Licensed corporations	1,731	1,804	1,897
	Licensed individuals	36,291	37,492	37,222
Registered institutions		109	110	117

Market Misconduct

In 2012, 15 individuals and two corporations were successfully prosecuted for various criminal offences, including insider dealing, illegal short-selling and market manipulation. In addition, the SFC completed civil proceedings against a formerly-listed company over false or misleading statements inducing trading in the company's shares and revoked the licence of the sole sponsor which managed that company's listing application. Court orders saw the return of over $1 billion to investors who were affected by the misconduct.

Additionally the SFC obtained compensation orders in two cases involving listed companies, including a case against a former CEO of a listed company. One intermediary was disciplined for internal control failings regarding the disclosure of certain fees and charges in secondary-market transactions of OTC bonds, options and structured notes, leading to substantial compensation being paid in relation to over 3,000 transactions.

The Market Misconduct Tribunal (MMT), established in 2003, conducts civil proceedings and hears cases referred to it following investigation by the SFC. In 2012, the MMT heard four cases and concluded two cases in which three persons 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.

Recent Developments

In June 2012, a requirement took effect for weekly reports of the net short positions that reach or exceed the specified reporting threshold on a stock-by-stock basis. To provide further information to the market, the SFC started publishing the aggregate short positions of each eligible stock on an anonymous basis on its website from September 2012.

During the year, the SFC also put forward measures to reform the IPO sponsors regime, intended to encourage sponsors to take a responsible, proactive and constructive role when leading IPOs and to maintain investor confidence in Hong Kong's IPO market. The new requirements will apply to listing applications submitted on or after 1 October 2013.

Insurance Sector

Main Features

At the end of 2012, there were 155 authorised insurers, 83 of which were incorporated in Hong Kong while the remaining 72 were incorporated in the Mainland and overseas jurisdictions.

During the past five years, the Hong Kong insurance industry achieved an average annual growth of 5.3 per cent. In 2012, the total gross premiums of the Hong Kong insurance industry amounted to $255.2* billion, representing an increase of 9 per cent over 2011. The total revenue premiums[10] of in-force long term business rose by 8.6 per cent to $215.9* billion in 2012. Individual life insurance remained the leading business, accounting for $196.4* billion or 90.9* per cent of total revenue premiums, while the corresponding number of policies stood at 10.1* million.

General insurance business rose in money terms from $34.8 billion in 2011 to $39.3* billion in 2012, representing a 12.9 per cent increase in gross premiums. The growth was largely led by insurance policies relating to general liability business (comprising employees' compensation business) and accident and health business (comprising medical business). However, the overall underwriting performance of general insurance business decreased from $2.6 billion in 2011 to $2.2* billion in 2012, due to the fall in the underwriting profit of pecuniary losses business and general liability business.

At the end of December 2012, there were 74,236 individual insurance intermediaries, including 8,798 Chief Executives or Technical Representatives of 604 broker firms, 27,830 Responsible Officers or Technical Representatives of 2,419 agency firms, and 37,608 individual agents.

Statistics on insurance business

		2010	2011	2012
Number of authorised insurers		168	163	155
Of which:	Incorporated in Hong Kong	88	85	83
	Incorporated in the Mainland and overseas	80	78	72
Premium income ($billion)				

* Provisional statistics.

10 The premiums actually received during the financial year.

Total gross premiums		205	233.7	255.2*
Of which:	Long-term in-force business (Office / Revenue premiums)	173.9^	198.9^	215.9*#
	General insurance (Gross premiums)	31.1	34.8	39.3*

* Provisional statistics

^ Office premiums

Revenue premiums

Insurance Authority

Appointed by the Chief Executive as the Insurance Authority (IA) under the Insurance Companies Ordinance, the Commissioner of Insurance's principal function is to regulate and supervise the insurance industry to promote its general stability and protect policyholders[11].

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 international principles and standards. The Government's Insurance Advisory Committee advises the Chief Executive on matters relating to the administration of the Insurance Companies Ordinance and the carrying on of insurance business in Hong Kong.

Recent Developments

The IA continues to collaborate with the Hong Kong Federation of Insurers in improving the regulation of the sale of Investment Linked Assurance Scheme (ILAS) products to strengthen investor protection. In addition to the enhanced measures launched previously, the IA plans, among other measures to introduce new disclosure requirements to increase the transparency of ILAS products and extend post-sale telephone confirmation calls (audio-recorded) to cover all ILAS customers.

As a member of the IAIS, the IA participates in the development of international standards in insurance supervision. In response to the financial crisis and its impact on the global insurance industry, in 2011 the IAIS revamped 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.

---

11 The Insurance Companies Ordinance 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 ordinance against an insurer to safeguard the interests of policyholders.
The ordinance 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.
With effect from 1 November 2012, the IA has the statutory role of monitoring the compliance of registered Mandatory Provident Fund intermediaries with the conduct requirements stipulated in the Mandatory Provident Fund Schemes Ordinance.

In addition, the IA works closely with regulators in other jurisdictions in regulating major insurance groups. In April 2012, the IA chaired for the first time a supervisory college[12] in Hong Kong for an insurance group based in Hong Kong with operations in a number of jurisdictions.

Following a three-month public consultation in 2011, the Government is preparing the enabling legislation to establish a Policyholders' Protection Fund (PPF) to enhance market stability and provide a safety net for policyholders in the event of an insurer becoming insolvent. It aims to introduce the bill in the 2013-14 legislative session.

In addition, in October 2012 the Government launched a three-month consultation on the key legislative proposals to establish an independent Insurance Authority, in line with international practice that financial regulators should be financially and operationally independent of the Government, and to modernise the insurance industry regulatory infrastructure to facilitate the stable development of the industry and provide better protection for policyholders. The Government plans to introduce the legislation into the Legislative Council by the end of 2013.

Mandatory Provident Fund Schemes and Occupational Retirement Schemes

Main Features

The Mandatory Provident Fund (MPF) System, implemented on 1 December 2000 to assist the workforce to start saving for their retirement early, is a privately managed, employment-related mandatory system of provident fund schemes. Unless exempted, employees and self-employed persons who are 18 years of age or above, and below the age of 65, are required to join an MPF scheme.

The employer and employee are each required to contribute five per cent of the employee's relevant income (RI) to a registered MPF scheme as mandatory contributions, subject to the maximum and minimum levels of RI for MPF contribution purposes. The accrued benefits can be transferred to another MPF scheme when employees change employment or cease to be employed. Since 1 November 2012, the accrued benefits derived from the employees' portion of mandatory contributions made during their current employment can also be transferred on a lump sum basis once every calendar year. A self-employed person must contribute 5 per cent of his or her RI. Accrued benefits derived from mandatory contributions must be preserved until a 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 2012, close to 100 per cent of employers (about 259,800), 99 per cent of relevant employees (about 2,375,100) and 65 per cent of self-employed persons (about 220,400) participated in MPF schemes. Total NAV of MPF assets amounted to about $440 billion.

Unlike the MPF schemes which are mandatory in nature, 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, operators of ORSO schemes that fulfil certain conditions may apply for exemption from

[12] A forum for co-operation and communication between supervisors in different jurisdictions, established for the effective supervision of cross-border insurance groups.

the 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 2012, there were 3,705 MPF-exempted ORSO registered schemes covering over 361,000 employees.

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

	2010	2011	2012
MPF Enrolment			
Number of participating employers	244,000	252,500	259,800
Number of participating relevant employees	2,261,600	2,341,200	2,375,100
Number of participating self-employed persons	260,500	229,400	220,400
MPF Enrolment Rate (per cent)			
Employers	99	98	100
Relevant employees	99	99	99
Self-employed persons	80	70	65
MPF Schemes			
Number of registered schemes	41	41	41
Number of approved constituent funds	421	445	464
Aggregate NAV of all MPF schemes ($ billion)	365	356	440
MPF-exempted ORSO Registered Schemes			
Number of MPF-exempted ORSO registered schemes	3,948	3,804	3,705
Number of participating employees in MPF-exempted ORSO registered schemes	380,200	369,900	361,000
Aggregate NAV of all ORSO Registered schemes ($ billion)	231	251	250

Mandatory Provident Fund Schemes Authority

Established in September 1998 under the Mandatory Provident Fund Schemes Ordinance, the Mandatory Provident Fund Schemes Authority (MPFA) is responsible for regulating and supervising the MPF System. The MPFA's prime objectives are to ensure compliance with the ordinance and protect the interests of scheme members. It is also the Registrar of Occupational Retirement Schemes. To protect the interests of MPF scheme members, the MPFA monitors MPF trustees and other service providers, investigates cases of non-compliance, conducts proactive inspections, and takes enforcement action where necessary. The MPFA also offers MPF investment education to strengthen public awareness of the need to take care of their MPF investment and provides information to assist scheme members in choosing appropriate MPF funds. The MPFA's operations are mainly financed by the investment returns generated from a one-off Capital Grant of $5 billion from the Government.

Recent Developments

The Employee Choice Arrangement (ECA) came into operation on 1 November 2012, with a view to increasing market competition, allowing employees once every calendar year to transfer as a lump sum the accrued benefits derived from the employees' mandatory contributions made during their current employment to an MPF trustee and scheme of their choice. MPF trustees have made noticeable competitive moves since it was decided to introduce the ECA. At the end of 2012, the average fund expense ratio of MPF funds with financial year-end dates in 2011 was 1.75 per cent, about 15 per cent lower than the 2.06 per cent level reported in 2007.

To enhance the protection for MPF scheme members following the ECA's implementation, the MPF Schemes (Amendment) Ordinance 2012 was enacted in June and came into operation on 1 November 2012 requiring MPF intermediaries to register with the MPFA before they can carry out sales and marketing activities or give advice in relation to MPF schemes. Non-compliance with the statutory conduct requirements will be subject to disciplinary sanctions imposed by the MPFA, ranging from reprimand or fines to suspension or revocation of registration[13].

To encourage saving for basic retirement needs, the maximum RI level was increased from $20,000 to $25,000 per month from 1 June 2012. The MPFA is reviewing the statutory mechanism for adjustment of the RI levels and aims to submit its proposal to the Government in 2013.

The MPF Schemes (General) (Amendment) Regulation 2012, enacted in July 2012, suspends the levy for the MPF Compensation Fund when the fund's reserve level exceeds $1.4 billion, and resumes the levy when the reserve level falls below $1 billion. As at 31 March 2012, the fund's NAV exceeded $1.4 billion and payment of the levy by MPF schemes will be suspended in their financial years beginning on or after 1 September 2012.

Following public consultation in March 2012, the MPFA proposes to introduce legislative amendments by July 2014 explicitly allowing an option to withdraw MPF benefits in stages when scheme members reach 65, and to allow early withdrawal by scheme members certified as suffering from a terminal illness.

Following the announcement of the results of the consultancy study on MPF trustees' administration costs in November 2012, the MPFA has been following up on the measures suggested by the consultant which can be implemented within the existing legislative framework to increase the scope for fee reduction by MPF trustees. The MPFA is also working

13 Each registered intermediary has also been assigned a frontline regulator entrusted with clear statutory responsibility and power to monitor its compliance with the statutory conduct requirements.

with the Government on other reform proposals, including preparing proposals on the rationalisation of fund choices and the introduction of a cap on MPF fees in case of market failure, with a view to conducting public consultation in 2013. The MPFA is mapping out the implementation of full portability in parallel.

Companies Registry

The Companies Registry administers and enforces most parts of the Companies Ordinance. The registry records local and non-Hong Kong companies and documents required to be filed under the Companies Ordinance 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 and maintaining a register of money lenders for inspection by the public.

The registry has been operating as a trading fund department since 1993, allowing it to deploy its resources more flexibly to meet customers' demands and expectations.

The electronic search services provided by the Integrated Companies Registry Information System have been well received by customers and about 99 per cent of company searches are now conducted online. With the introduction of the new electronic services at the registry's e-Registry portal (www.eregistry.gov.hk) in March 2011, electronic Certificates of Incorporation and Business Registration Certificates can normally be issued together in less than one hour after receipt of the applications.

In 2012, the electronic services at the e-Registry portal were expanded in phases to cover submission of annual returns for private companies and 15 commonly filed specified forms for reporting changes of company information. A new Company Search Mobile Service (www.mobile-cr.gov.hk) was also launched in June 2012 to enable users to conduct company searches through mobile devices.

Companies Registry statistics (year-end)

	2010	2011	2012
Local companies incorporated	139,530	148,329	150,165
Local companies on the register	863,762	956,392	1,044,644
Non-Hong Kong companies registered	737	798	686
Non-Hong Kong companies on the register	8,165	8,554	8,848

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-in-bankruptcy 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 Companies Ordinance, 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

	2010	2011	2012
Bankruptcy Orders	9,163	7,981	8,178
Interim Orders in IVAs	1,017	840	778
Winding-up Orders	438	333	312

Professional Accountancy

The Hong Kong Institute of Certified Public Accountants (HKICPA), established under the Professional Accountants Ordinance, performs 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

	2010	2011	2012
Number of CPA	30,817	32,636	34,423
Of which : CPA (Practising)	3,784	3,851	4,012
Number of firms of CPA (Practising)	1,217	1,214	1,228
Number of corporate practices	336	365	392

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

The Government works with stakeholders (including the Financial Reporting Council (FRC), a statutory body established to investigate Hong Kong listed companies' auditing and financial reporting irregularities and non-compliance with accounting standards) to improve market quality and investor protection. The FRC reviews financial reports based on a risk-based approach and screens modified auditor's reports of financial statements of entities listed in Hong Kong.

Statistics on FRC's work

	2010	2011	2012
Number of complaints received	9	7	19
Number of modified auditors' reports screened	142	131	138
Number of financial reports reviewed under risk-based approach	-	70	75
Number of investigations initiated	4	6	9
Number of investigations completed	1	5	9
Number of enquiries initiated	2	1	3
Number 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.

Monetary Policy

Hong Kong's monetary policy objective 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 objective is achieved through the linked exchange rate system introduced in 1983.

The linked exchange rate system consists of 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[14], and the outstanding amount of Exchange Fund Bills and Notes (EFBNs). Banks have unrestricted access to a Discount Window for overnight 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.

14 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.

A Currency Board Sub-Committee under the Exchange Fund Advisory Committee (EFAC) oversees the operation of the currency board system in Hong Kong and recommends to the Financial Secretary through EFAC measures to enhance the robustness and effectiveness of Hong Kong's currency board arrangements.

The HKMA ensures 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 arrangements under that system.

Monetary Situation

In the first half of the year, the Hong Kong dollar exchange rate strengthened gradually from around 7.770 to 7.755 against the US dollar, although with occasional fluctuations amid the uncertainties surrounding the global economic and financial environment, particularly the on-going euro debt crisis. In July and August, the Hong Kong dollar exchange rate was broadly stable. However, strengthening pressure again gathered pace, moving the Hong Kong dollar exchange rate closer towards the strong-side Convertibility Undertaking (CU) of 7.75 for the rest of the year.

Between 19 October and 21 December, the strong-side CU was repeatedly triggered and the HKMA passively purchased a total of US$13.8 billion in response to banks' offers, creating HK$107.2 billion consistent with the currency board system. As a result, the Aggregate Balance increased to $255.9 billion at the end of 2012 from $148.7 billion a year ago. The inflows partly reflected the increased allocation to Hong Kong dollar assets by investors outside Hong Kong, as well as the proceeds from the issuance of foreign currency bonds by Hong Kong firms in exchange for Hong Kong dollars. The stronger equity initial public offerings activities in late November and December to some extent also supported the inflows.

Interbank liquidity improved steadily during the year. After temporary rises towards the end of 2011, the Hong Kong dollar interbank interest rates eased back in early 2012, tracking the downward movements in the US dollar interbank interest rates and partly due to a respite in the euro debt crisis. The interbank interest rates then held broadly stable, before easing again in the fourth quarter with the triggering of the strong-side CU and the corresponding rise in the Aggregate Balance. For the whole of 2012, short-dated interbank rates continued to stay much below the Base Rate of 0.5 per cent. Discount Window borrowing was not active and amounted to only $3 billion, compared with $6.7 billion in 2011. Overall, the money market and the forward market continued to operate in an orderly and smooth manner.

Exchange Fund

The Exchange Fund's primary statutory role under the Exchange Fund Ordinance 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 Exchange Fund's asset allocation strategy is guided by the investment benchmark approved by the Financial Secretary on the advice of the EFAC[15]. 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 2012, the Exchange Fund's total assets stood at $2,781.1 billion. The accumulated surplus of the Exchange Fund amounted to $623.9 billion[16].

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, have been in circulation since 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 value of all notes and coins in circulation at the end of 2012 was $301.4 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

Investor Education Centre: www.hkiec.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

Financial Dispute Resolution Centre: www.fdrc.org.hk

---

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

16 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.