Chapter 4

Financial and Monetary Affairs

Hong Kong is a key global financial centre. It ranked third of 80 financial centres in the latest Global Financial Centres Index and the stock market ranked second globally in terms of funds raised through initial public offerings in 2014. Hong Kong has the world's largest pool of offshore Renminbi (RMB) liquidity of over RMB1.1 trillion. The financial sector has a 237,800-strong workforce – 6.3 per cent of the city's total workforce – and contributes 16.5 per cent of the city's Gross Domestic Product. The launch of the Shanghai-Hong Kong Stock Connect marks an important milestone in the mutual market access between the Mainland and Hong Kong.

Hong Kong as an International Financial Centre

Overview

Hong Kong holds a unique position in the increasingly integrated global financial system. It enjoys extensive geographical, cultural and linguistic links with the dynamic Mainland economy, and has long offered seamless connections between the Mainland and the rest of the world. At the same time, Hong Kong's location at the heart of Asia forms a 24-hour continuous trading system together with New York and London. Hong Kong's position as the leading international financial centre in Asia is further fortified by the strong links with the whole 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 and strong protection for investors are other advantages.

Hong Kong's financial markets operate under effective and transparent regulations, which are in line with international standards. A well-educated workforce and ease of entry for professionals from outside Hong Kong ensure availability of talent, and this and the highly liquid market are also conducive to the operations of financial institutions in Hong Kong. Hong Kong's competitiveness as an international financial centre is well recognised: the Global Financial Centre Index published by Z/Yen Group in September 2014 ranked Hong Kong as the third global centre, behind only London and New York.

The International Monetary Fund's (IMF's) Financial Sector Assessment Programme, in an assessment report published in May, acknowledged that Hong Kong's financial sector was one of the largest and most developed in the world and was well regulated and resilient, with the capacity to withstand a diversity of large and global shocks. The IMF also recognised the continuing efforts made by the government and the regulators in strengthening and upgrading Hong Kong's financial infrastructure and regulatory framework.

A vibrant securities and derivatives market

With a total market capitalisation of about $25 trillion at the end of 2014, Hong Kong's stock market ranked seventh in the world and third in Asia. The daily turnover averaged $69.5 billion in 2014. At the end of the year, 1,752 public companies were listed on the Stock Exchange of Hong Kong Limited (SEHK), representing a wide range of industries from finance and property to resources and telecommunications. In 2014, the SEHK ranked second worldwide in terms of initial public offering (IPO) funds raised, at $233 billion. In addition to new share issues, another $710 billion was raised on the secondary market, also ranked second globally. Moreover, the turnover of securitised derivatives of the Hong Kong Exchanges and Clearing Limited (HKEx) ranked first in the world for the eighth consecutive year.

At the end of 2014, some 876 Mainland enterprises[1] were listed on the SEHK, raising $4.4 trillion from the Hong Kong market since 1993. Hong Kong is also a listing destination for international companies. Funds raised by international and Mainland companies represented 87 per cent of IPO equity funds raised in 2014.

With the launch of Shanghai-Hong Kong Stock Connect on 17 November, Hong Kong and overseas investors are now allowed to trade eligible stocks in Shanghai's stock market, while Mainland investors are allowed to do the same in Hong Kong's stock market.

The Hong Kong Futures Exchange Limited (HKFE) operates a futures market in Hong Kong. Total turnover of derivatives contracts in 2014 was 142 million, the highest ever and an increase of about 10 per cent from 2013, largely driven by strong trading in stock options and index futures and options. Open interest at year-end was 7.96 million contracts, up from 6.23 million at the previous year-end. In 2014, After-hours Futures Trading accounted for approximately 6 per cent of day session trading volume.

As an international and open market, Hong Kong attracts many intermediaries from other markets to set up companies here and most international brokerages have branches in the city. At the end of 2014, 28 per cent of the 500 SEHK trading participants were from the Mainland or overseas markets, and 48 per cent of the 179 HKFE trading participants were from markets outside Hong Kong.

HKEx now operates four clearing houses (Hong Kong Securities Clearing Company Limited, HKFE Clearing Corporation Limited, SEHK Options Clearing House Limited and OTC Clearing Hong Kong Limited), providing integrated clearing, settlement, depository and nominee services for its participants or members.

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

Chart 1 **Market Capitalisation of Stock Market**

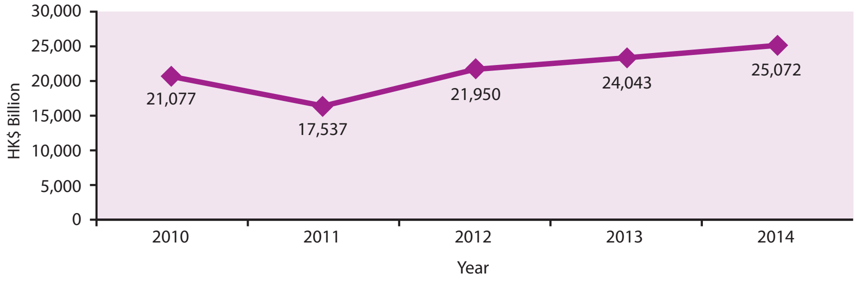


Chart 2 **Equity Funds Raised Through IPOs**

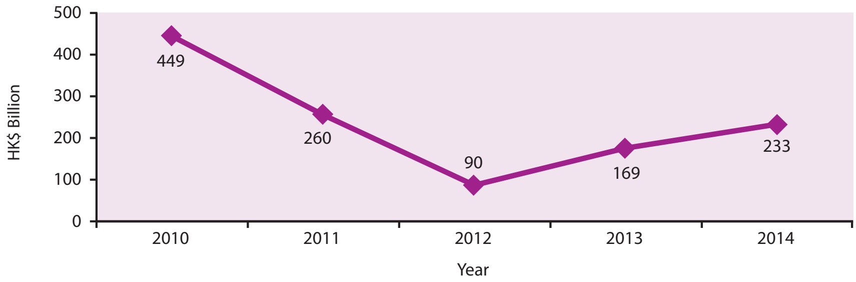
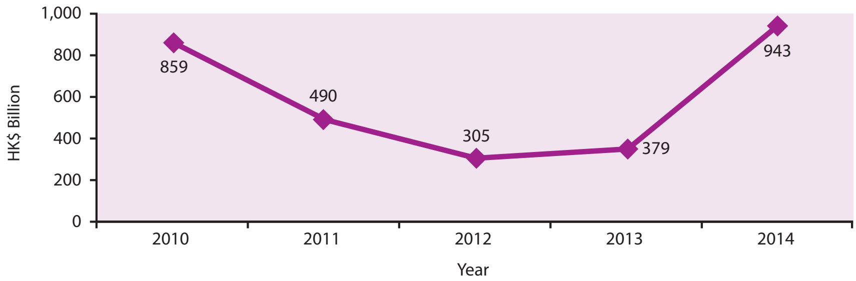


Chart 3 **Total Equity Funds Raised in Hong Kong**



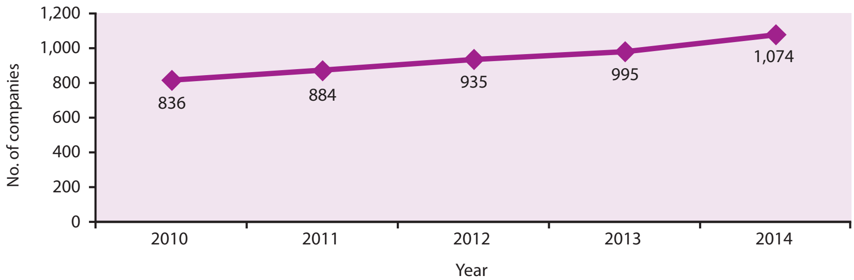
Asset Management Hub

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.

At the end of 2014, 1,074 companies were licensed or registered to carry out asset management business in Hong Kong, a rise of 7.9 per cent from the end of 2013. Hong Kong's asset management business is highly international and about 72 per cent of assets under management are from investors outside Hong Kong.

The government, together with other agencies, continues to explore ways to improve the international competitiveness of Hong Kong's financial markets and provide a more favourable operational, regulatory and tax environment.

Chart 4 Number of Asset Management Companies in Hong Kong

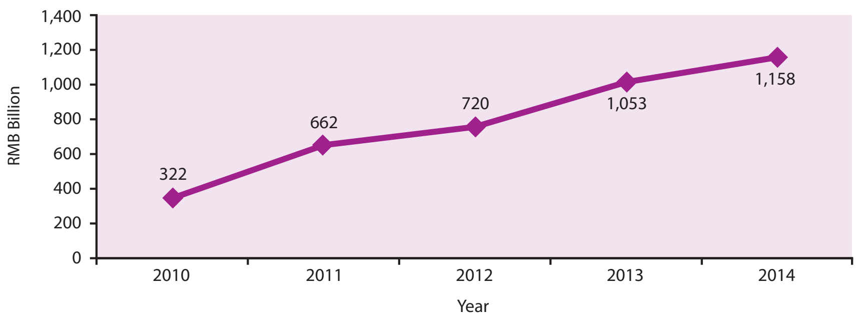


Largest Offshore RMB Centre

In tandem with the increasing use of RMB in cross-border transactions, the offshore RMB business in Hong Kong has grown rapidly in recent years. Hong Kong is now the world's largest offshore RMB business hub, with the world's largest pool of offshore RMB funds, and has also become the leading offshore RMB financing and asset management centre.

At the end of 2014, RMB customer deposits and outstanding RMB certificates of deposit issued amounted to RMB1,004 billion and RMB155 billion respectively. The combined sum of RMB1,158 billion represented an annual growth of 10 per cent. Apart from the sizable liquidity pool, Hong Kong also offers a wide range of products including investment funds (both listed and unlisted), insurance products, currency futures, real estate investment trusts, shares and derivative products.

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



International Banking and Payment Centre

International financial institutions maintain a strong presence in Hong Kong. Of the world's top 100 banks, 71 operate in Hong Kong. At year end, 152 of the 159 licensed banks in Hong Kong were beneficially-owned by parties outside Hong Kong.

Hong Kong was the world's seventh and Asia's second largest banking centre in terms of external positions[2] in the Bank for International Settlements Quarterly Review for the end of 2014 position.

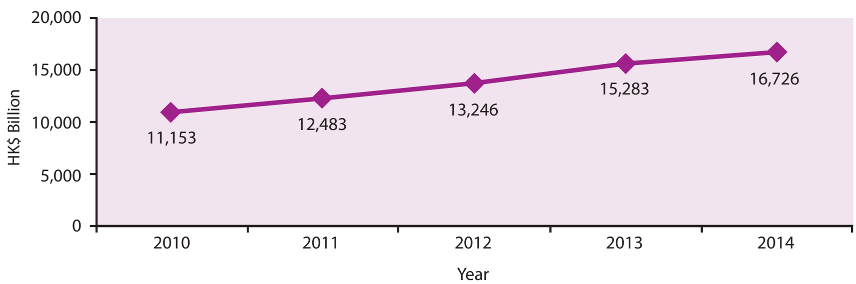
The interbank money market is well established. Hong Kong dollar (HKD) wholesale deposits are traded actively among local authorised institutions (AIs), and between local and overseas AIs, with an average daily turnover of $211.4 billion in 2014.

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 HKD RTGS system. The banks may obtain intra-day and overnight liquidity through repurchase agreements with the HKMA using Exchange Fund Bills and Notes (EFBNs) and government bonds as collateral.

US dollar (USD), euro and RMB RTGS systems also enable transactions in these currencies to be settled in real time. 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 provides clearing, settlement and custodian services for EFBNs, government bonds and other HKD 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 unit and local investors to hold and settle securities lodged with overseas systems. Through its integration with the RTGS systems, the unit enables securities to be settled on a delivery-versus-payment basis. The interface also enables users of the RTGS system to access intra-day and overnight liquidity through repurchase agreements.

Chart 6 **External Positions of AIs**

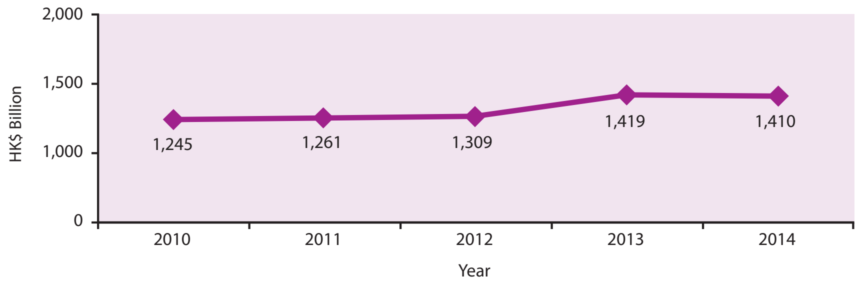


2 Sum of liabilities to banks and non-bank customers outside Hong Kong and claims on banks and non-bank customers outside Hong Kong (such as equities, securities and capital instruments).

Bond Market Development

Outstanding HKD debt securities, including EFBNs, totalled $1,410 billion at the end 2014.

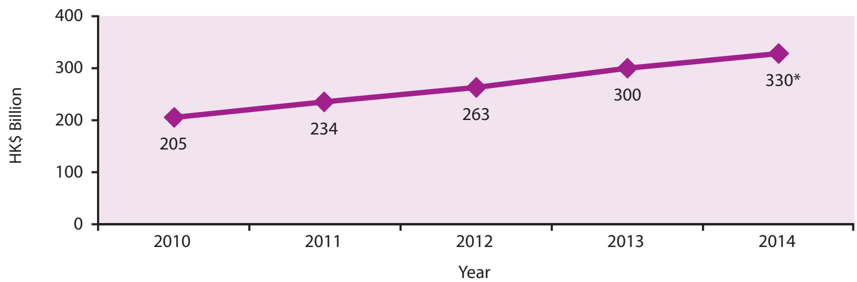
Chart 7 **Total Outstanding HKD Debt Securities**



An Open Insurance Market

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 158 authorised insurers at the end of 2014, 72 were from the Mainland or one of 21 overseas jurisdictions. There were 19 professional re-insurers in Hong Kong, including most of the world's top re-insurers. Gross premium income in 2014 was $329.7* billion, representing an increase of 10.1 per cent over 2013.

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



Mandatory Provident Fund

The net asset value (NAV) of Mandatory Provident Fund (MPF) schemes stood at $565 billion at the end of 2014 with an annualised rate of return of 4 per cent for the period from December 2000 (the inception of the MPF system) to December 2014.

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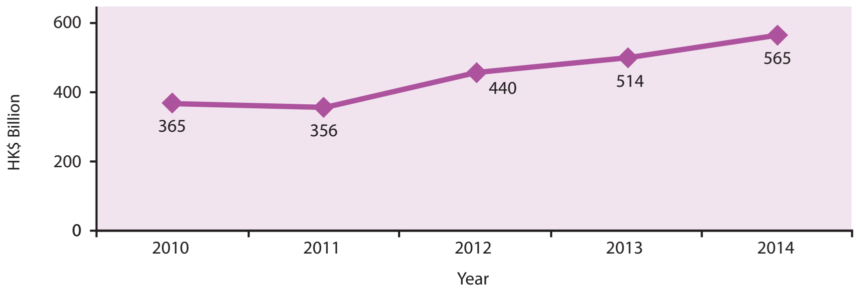
* Provisional statistics.

Chart 9 **Total NAV of MPF Schemes**



Product Offerings in Commodity Trading

Hong Kong operates one of the most active physical gold markets in the world and is one of Asia's largest over-the-counter gold trading centres. 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 provides trading of both tael and kilo bars[3]. Prices track closely those in the major gold markets in London, Zurich and New York.

In addition to operating Hong Kong's securities and derivatives markets, HKEx also owns the London Metal Exchange (LME), the world centre for industrial metals trading and price-risk management. More than 80 per cent of global non-ferrous business is conducted on the LME and its prices are used as the global benchmarks. Daily volumes on the LME hit a fresh record high in 2014, rising 3.5 per cent to 700,204 lots from the previous year's 676,238 lots. The LME launched an in-house clearing house in London in September, LME Clear, to support the LME's commodity business.

Major Initiatives in 2014

Continuous efforts were made 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 to promote stability of the financial system, improve market quality and strengthen investor protection. It also continues to press ahead with various initiatives to consolidate Hong Kong's leading role as the Asia-Pacific region's asset management centre, advance financial co-operation with the Mainland, further develop offshore RMB business and enhance the functions of its funding platform.

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 enhance the quality of the local financial markets and increase their depth and breadth, to keep abreast of local and international developments and to further optimise Hong Kong's regulatory framework. The financial services industry also provides a catalyst for the

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

growth of related sectors such as professional and commercial services. High quality financial services underpin Hong Kong's position as an international business hub, helping local enterprises to seize business opportunities and attracting Mainland and overseas companies to use Hong Kong as a platform for raising funds and developing regional business.

Fund-raising Centre

The SEHK attracted 122 new listings in 2014 (including seven transfers of listing from the Growth Enterprise Market to the Main Board). Apart from Mainland and Hong Kong companies, four overseas companies (from Japan, Malaysia, Singapore and the United States) also listed on the SEHK in 2014. Newly listed companies are attracted by the market's liquidity and access to investors across Asia. The SEHK is working to accept more overseas jurisdictions as places of incorporation.

Developing an Uncertificated Securities Regime

The Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Bill 2014 was introduced into the Legislative Council in June to enable the introduction of an uncertificated securities market regime in Hong Kong. This will enhance the securities market's overall efficiency and competitiveness, strengthen corporate governance, improve investor protection and facilitate market development.

Asset Management and Private Wealth Management

The city's combined fund management business was valued at $16,007 billion at the end of 2013. About 72 per cent came from non-Hong Kong investors, indicating that overseas investors see Hong Kong as a preferred investment platform[4]. At the end of 2014, there were 2,009 unit trusts and mutual funds authorised by the Securities and Futures Commission (SFC)[5].

To enhance the operational, regulatory and tax environment for fund managers in Hong Kong, the government has been taking forward a number of measures to further develop the business, including a proposal to allow offshore private equity funds to enjoy tax exemption, and an initiative to introduce a new open-ended investment company structure as a legal form of funds to be domiciled in Hong Kong. The government, together with the SFC, launched a three-month public consultation in March on the proposal to introduce an open-ended fund company structure in Hong Kong.

Exchange Traded Funds (ETFs)

The ETF market developed rapidly in recent years. Since the government extended the stamp duty concession to cover ETFs that track indices comprising not more than 40 per cent of Hong Kong stocks in 2010, the number of ETFs listed in Hong Kong and the average daily turnover of ETFs have increased, making Hong Kong one of the largest ETF markets in the Asia-Pacific region. The Financial Secretary announced in the 2014-15 Budget the waiver of stamp duty for

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4 Figures are quoted from the Fund Management Activities Survey for 2013, a survey conducted by the SFC annually to collect information and data on the general state of affairs in the local fund management industry.

5 This includes MPF pooled investment funds offered both as retail unit trusts and for mandatory provident fund purposes.

the transfer of all ETFs, so that the transaction cost of ETFs with more than 40 per cent of Hong Kong stocks in their portfolios can be reduced as well to help promote the development, management and trading of ETFs. The relevant Stamp Duty (Amendment) Bill 2014 was introduced into the Legislative Council in December.

Real Estate Investment Trusts

The SFC's Code on Real Estate Investment Trusts (REITs) was amended in August to give REITs the flexibility to invest in property development activities and financial instruments, subject to relevant restrictions such that a REIT will maintain its profile as primarily a recurrent rental income generating vehicle. The amendments were made following public consultation and took account of developments in comparable overseas jurisdictions, as well as the protection of investors' interests and the long-term development of the Hong Kong REIT market.

Implementation of the New Companies Ordinance

The new Companies Ordinance commenced operation on 3 March. The new ordinance aims to enhance corporate governance, ensure better regulation, facilitate business and modernise the law, thereby strengthening Hong Kong's status as a major international business and financial centre. The Companies Registry has overhauled its IT system, specified new forms and carried out a series of promotional and educational activities to enhance public awareness of the major changes introduced by the new ordinance.

Improvement of Corporate Insolvency Law

In 2013, the government conducted public consultation on legislative proposals intended 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. The consultation conclusions were published in May and on the basis of the respondents' support for the legislative exercise, the government plans to introduce an amendment bill into the Legislative Council in 2015.

Development of the Bond Market

The Government Bond Programme (GBP) was established in 2009 to promote the sustainable development of the bond market in Hong Kong. It has a borrowing ceiling of $200 billion.

Bonds totalling $20 billion were issued to institutional investors under the GBP in 2014, attracting a diverse group of investors. In August, the government issued a $10 billion inflation-linked retail bond (iBond), with a tenor of three years, for the fourth time under the GBP to Hong Kong residents to promote further development of the retail bond market in Hong Kong. At the end of 2014, outstanding HKD debts, including EFBNs, totalled $1.41 trillion.

Developing Islamic Finance

In March, the Loans (Amendment) Ordinance 2014 was enacted by the Legislative Council to enable the issuance of Islamic bonds (*sukuk*) under the GBP. In September, the government successfully offered its inaugural US$1 billion five-year *sukuk*, the world's first USD-denominated *sukuk* originated by an AAA-rated government. The *sukuk* saw strong demand from global investors, attracting orders exceeding US$4.7 billion. The transaction demonstrated that issuance of *sukuk* using Hong Kong's platform is a viable fund-raising option.

Financial Services Development Council

The Financial Services Development Council (FSDC), established by the government in 2013, published six reports in 2014, providing proposals on subjects including RMB and Mainland-related opportunities, fund-raising platforms, promotion and human capital. The government will continue to provide support for the work of the FSDC as a high-level cross-sectoral government advisory body in collecting views from the industry to formulate strategic proposals for the development of our financial services industry and advise the government on industry development.

Alignment with International Agenda, Improving Market Quality and Financial Consumer Education and Protection

Over the past few years, international financial centres have pursued a series of regulatory reform initiatives under the G20 agenda to enhance the resilience and stability of the global financial system. These include Basel III implementation, regulation of the over-the-counter (OTC) derivative market and establishment of effective resolution regimes. The government will continue to drive, facilitate and co-ordinate initiatives to ensure that the overarching framework would enhance protection for investors and promote market development in the face of both global needs and local circumstances.

Basel III Implementation in Hong Kong

Hong Kong follows the international timeline of the Basel Committee on Banking Supervision (BCBS) for implementing the Basel III reform package. For the purpose of implementing the second phase of the reform package (covering a series of capital buffers and a new liquidity framework), amendments to the Banking (Capital) Rules, as well as the Banking (Liquidity) Rules, will take effect from 1 January 2015.

Regulation of OTC Derivatives

To introduce the OTC derivative regulatory regime, the Securities and Futures (Amendment) Ordinance 2014 was enacted by the Legislative Council in March. The SFC and the HKMA are preparing the related subsidiary legislation.

Development of an Effective Resolution Regime for Financial Institutions in Hong Kong

According to the Key Attributes of Effective Resolution Regimes for Financial Institutions published by the Financial Stability Board in November 2011, relevant authorities are to be vested with the resolution powers in resolving financial institutions in an orderly manner and without exposing taxpayers to the risk of loss from solvency support, while maintaining continuity of their vital economic functions.

In order to meet the standards, it will be necessary for Hong Kong to vest in its relevant authorities the resolution powers set out in the Key Attributes for resolving financial institutions which are deemed systemically significant or critical if they fail. The first stage of public consultation was completed in April. The government will launch the second stage of public consultation in January 2015 to seek views on specific aspects of the resolution regime in Hong Kong (including further details on the resolution options and powers proposed in the first consultation paper, the governance arrangements and safeguards). As work is still continuing at the international level to provide guidance on the implementation of certain aspects of the new standards, including ensuring that resolution regimes are effective in the context of cross-border resolution, there may be a need to carry out a third, shorter consultation later in 2015. Subject to the outcome of these public consultations, the government aims to introduce legislative proposals into the Legislative Council by the end of 2015.

Anti-Money Laundering and Counter Financing of Terrorism

Anti-money laundering and counter financing of terrorism (AML/CFT) continues to be a key focus area for financial regulators who have strengthened specialist resources and increased their supervision of financial institutions' AML/CFT programmes. The government and financial regulators play an active role in relevant international standard setting bodies, such as the Financial Action Task Force, to ensure that Hong Kong's AML/CFT regime is in line with those standards and practices.

Auditor Regulatory Reform

The international trend is for the oversight of the regulation of auditors to be independent of the profession itself. In 2014 the government conducted a three-month public consultation, ending in September, on proposals to enhance the independence of our audit regulatory regime from the audit profession. The government plans to issue the consultation conclusions in 2015.

Establishment of an Independent Insurance Authority

The policy objectives of setting up an independent Insurance Authority are to modernise the insurance industry regulatory infrastructure to facilitate the industry's stable development, provide better protection for policyholders, and align with international practice that financial regulators should be financially and operationally independent of the government. The necessary legislation to establish an independent Insurance Authority, the Insurance Companies (Amendment) Bill 2014, was introduced into the Legislative Council on 30 April 2014.

Risk-based Capital Framework for the Insurance Industry

In September, the Insurance Authority (IA) launched a three-month consultation on the proposed Risk-based Capital framework for the Hong Kong insurance industry. The framework seeks to align Hong Kong's insurance regime with international standards and make capital requirements more sensitive to the level of risk that insurance companies are bearing. The IA will conduct another round of consultation on the detailed proposals after carrying out quantitative impact studies.

Enhanced Regulation of SFC-authorised Investment Products and Policyholders Protection Measures

In April, the SFC published a circular containing guidance on the internal product approval process applicable to providers of SFC-authorised unit trusts and mutual funds, investment-linked assurance schemes (ILAS) and unlisted structured investment products. The guidance, which came into effect on 1 May, covers the entire chain from inception of the product to post-sale, explains the requirements for a robust internal product approval process and reminds product providers about their duty to consider investors' interests as part of the product design process.

To enhance the proper standards of conduct and promote sound and prudent business practices amongst insurers, the IA issued a guidance note on underwriting ILAS business on 30 July. The note made reference to the 'fair treatment of customers' principle promulgated by the International Association of Insurance Supervisors, and sets out comprehensive requirements, including the design of ILAS products, sales processes, remuneration of intermediaries and post-sale control requirements. The note will take effect from 1 January 2015.

The IA continues to work closely with the Hong Kong Federation of Insurers, the HKMA and the SFC to enhance the regulation of ILAS. The Investor Education Centre was engaged to prepare campaigns to enhance the public's understanding of ILAS products.

Regulatory Regime for Stored-value Facilities and Retail Payment Systems

The government released the consultation conclusions in October. Following the positive response from the market and the public, the government is preparing legislation to establish a regulatory regime for stored value facilities and retail payment systems.

Investor Education Centre

Supported by Hong Kong's four financial regulators[6] and the Education Bureau, the Investor Education Centre was established in 2012 to raise financial literacy in Hong Kong. It seeks to provide comprehensive, credible and impartial financial information to better equip the general public with skills and knowledge to make informed financial decisions and to manage their money wisely.

In 2014, the centre held its inaugural financial literacy forum, with over 150 participants from the government and the finance, education and community sectors and the media. During the year, the centre held 144 community outreach events reaching more than 18,000 people, and there were over 280,000 visitors to its website.

Financial Dispute Resolution Centre

The Financial Dispute Resolution Centre administers independently and impartially a financial dispute resolution scheme to facilitate the resolution of monetary disputes between individual customers and financial institutions in Hong Kong by 'mediation first, arbitration next'. To raise the public awareness of its services, the centre launched a series of advertising campaigns and other promotional programmes in 2014, including investor education seminars and an Open

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6 The SFC, the HKMA, the Mandatory Provident Fund Schemes Authority, and the Office of the Commissioner of Insurance.

Day attended by over 200 participants from professional bodies and interested individuals. The centre also promoted its alternative dispute resolution services at a large-scale exhibition for investors.

Hong Kong as China's Global Financial Centre — Financial Co-operation with the Mainland

Capital Formation Centre and Global Investment Platform for the Mainland

Hong Kong's fundamental strengths make it an ideal provider to Mainland enterprises of top class investment banking services for mergers and acquisitions as well as consultancy on restructuring. The growing presence of Mainland companies listed on the SEHK 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.

Development of Offshore RMB Business

The offshore RMB business in Hong Kong registered robust growth in 2014. Hong Kong's RMB liquidity pool has expanded steadily. At the end of 2014, the RMB customer deposits and outstanding RMB certificates of deposit issued amounted to RMB1,004 billion and RMB155 billion respectively, totalling RMB1,158 billion, up 10 per cent compared with RMB1,053 billion at the end of 2013. Banks in Hong Kong handled RMB trade settlement of RMB6,258 billion in 2014, representing a 63 per cent growth as compared to 2013.

Hong Kong's role as a platform to support global RMB payments has been deepening. The RMB Clearing Bank in Hong Kong extended its service hours from 15 hours (HKT 8.30am - 11.30pm) to 20.5 hours (HKT 8.30am - 5.00am of the next day), giving financial institutions in the European and American time zones an extended window to settle offshore RMB payments through the Hong Kong infrastructure. In 2014, the average daily turnover of Hong Kong's RMB RTGS system amounted to RMB733 billion. At the end of 2014, there were 225 banks participating in the RMB clearing platform in Hong Kong, of which 200 were branches and subsidiaries of foreign banks and overseas presence of Mainland banks, forming a global RMB payment network covering over 40 countries and regions. According to the Society for Worldwide Interbank Financial Telecommunication (SWIFT), Hong Kong handled around 70 per cent of global RMB payments.

Hong Kong is also the world's largest offshore RMB investment product market. A wide range of RMB products (including investment funds (both listed and unlisted), insurance products, currency futures, real estate investment trusts, shares and derivative products) are available in the market. Qualified institutions continued to show interest in developing Renminbi Qualified Foreign Institutional Investor (RQFII) products in Hong Kong. The number of RQFII fund management companies managing SFC-authorised RQFII funds increased from 24 at the end of 2013 to 38 at the end of 2014. In January 2014, the SFC authorised the world's first physical RQFII bond ETF tracking an onshore Mainland government bond index, and in February 2014, it authorised the first RQFII money market fund. The first RQFII A-share ETF managed by a subsidiary of a Mainland securities company was also authorised in February. At the end of 2014, there were 65 SFC-authorised RQFII unlisted funds with an aggregate net asset value of

RMB30 billion, and 18 SFC-authorised RQFII ETFs adopted dual counter trading arrangements (ie RMB and HKD trading counters) with an aggregate net asset value of RMB53 billion. The RQFII scheme continues to promote the development of a broader range of RMB investment offerings in Hong Kong and to strengthen the city's position as the leading offshore RMB centre.

The RMB conversion limit for Hong Kong residents of RMB20,000 per day was removed on 17 November 2014, making it more convenient for Hong Kong residents to participate in Shanghai-Hong Kong Stock Connect and other RMB financial transactions and facilitating the launch of RMB investment products by financial institutions in Hong Kong.

Meanwhile, RMB financing activities gained further momentum. There was a significant growth in RMB bank lending, with the outstanding amount of RMB loans increasing to RMB188 billion at the end of 2014, from RMB116 billion at the end of 2013. RMB bond issuance in Hong Kong (or so-called 'dim sum bonds') totalled RMB197 billion in 2014, up 69 per cent from 2013. Outstanding RMB bonds amounted to RMB381 billion at the end of 2014. In 2014, the Central People's Government issued sovereign bonds twice, with a total size of RMB28 billion, up from RMB 23 billion in 2013.

Since the pilot scheme for eligible institutions to invest in the Mainland's interbank bond market was extended to insurance companies in Hong Kong in 2012, 13 Hong Kong insurance companies have been permitted to invest in the Mainland's interbank bond market.

Shanghai-Hong Kong Stock Connect

Stock Connect, launched on 17 November 2014, enables mutual stock market access between the Shanghai Stock Exchange (SSE) and the SEHK. It allows eligible Mainland investors to trade directly for the first time in eligible stocks listed on the SEHK through the SSE, and allows Hong Kong and overseas investors to trade directly for the first time in eligible stocks listed on the SSE through the SEHK.

Stock Connect marks an important step in the opening up of Mainland China's capital markets and the internationalisation of RMB. It also reinforces Hong Kong's position as a premier international financial centre and strengthens Hong Kong's role as an offshore RMB business centre.

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 18 December, the Central People's Government and the Hong Kong Special Administrative Region Government signed the Agreement between the Mainland and Hong Kong on Achieving Basic Liberalisation of Trade in Services in Guangdong, to be implemented on 1 March 2015. The agreement adopts a hybrid approach of negative and positive listings in further liberalisation[7]. The key liberalisation measures agreed on financial services cover the areas of accounting, insurance, securities and banking.

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 2014, there were 159 LBs, 21 RLBs and 23 DTCs. These 203 AIs maintained a network of more than 1,370 local branches. There were also 63 representative offices of banks incorporated outside Hong Kong.

Hong Kong Monetary Authority

The HKMA's main functions 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 stability and integrity of the financial system, including the banking system; to help maintain Hong Kong's status as an international financial centre, including the maintenance and development of Hong Kong's financial infrastructure, and to manage the Exchange Fund.

The HKMA is an integral part of the government, but operates with a high degree of autonomy, complemented by a high degree of accountability and transparency, and 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 in control of the Exchange Fund.

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

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7 Positive and negative listings are two approaches to trade liberalisation. Positive listing sets out the Mainland's liberalisation measures for Hong Kong, while measures in the negative list are reserved restrictive measures. Except for those reserved restrictive measures and the measures on standards management, the Mainland will not impose any particular restrictions on eligible Hong Kong service suppliers in the Guangdong Province in terms of market access requirement. In other words, it is 'permitted if not forbidden'.

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.

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 provide sufficient flexibility for AIs to make commercial decisions.

Recent Developments

The Hong Kong banking sector remained sound in 2014 despite the uncertainties surrounding the global financial market. Retail banks' asset quality remained good. The liquidity ratio was also maintained at a comfortable level. Locally incorporated AIs continued to be well capitalised.

At the end of 2014, AIs' total deposits and loans and advances increased to $10,073.9 billion and $7,276 billion respectively, up 9.7 per cent and 12.7 per cent from a year earlier. AIs' total assets also rose 8.8 per cent to $18,435.9 billion.

Statistics on AIs

		2012	2013	2014
AIs		200	201	203
Of which:	LBs	155	156	159
	RLBs	21	21	21
	DTCs	24	24	23
Local branches of AIs		1,404	1,384	1,370
Total deposits ($ billion)		8,296.4	9,178	10,073.9
Total loans and advances ($ billion)		5,566.8	6,457.4	7,276
Total assets ($ billion)		14,858.7	16,943.5	18,435.9

The HKMA has always been vigilant towards AIs' property mortgage business, which constitutes a significant portion of their lending portfolios. The HKMA introduced six rounds of macroprudential measures between October 2009 and February 2013 to strengthen the resilience of banks, including tightening the maximum loan-to-value ratios for higher risk property mortgages; applying more prudent criteria to assess the repayment ability of mortgage loan applicants; and limiting the maximum loan tenor for all new property and standalone car park space mortgage loans.

Securities and Futures Sector

Main Features

Hong Kong's securities market is operated by the SEHK and its futures market by the Hong Kong Futures Exchange Limited, both being wholly owned subsidiaries of the HKEx. At the end of 2014, there were 1,752 companies listed on the Main Board and the Growth Enterprises Market (GEM) of the SEHK with a total market capitalisation of about $25 trillion. With improved financial market conditions, total equity funds raised increased 149 per cent in 2014 to $943 billion, while the securities market's total turnover increased by 12.4 per cent, to $17.2 trillion, with 34.3 trillion shares traded.

In 2014, 12 new ETFs were authorised and the total number of ETFs listed on the SEHK increased to 122, offering a wide range of investment exposures to world, regional and Mainland indices and commodities for investors. Issuance of ETFs with dual HKD and RMB trading counters also increased significantly, tracking a variety of onshore equity and bond indices as well as commodities. According to the HKEx, turnover of ETFs reached $1.2 trillion.

Statistics on Securities Market (Main Board and GEM)

	2012	2013	2014
Number of listed companies (year-end)	1,547	1,643	1,752
Total market capitalisation (year-end) ($ billion)	21,950	24,043	25,072
Total equity funds raised ($ billion)	305	379	943
Total securities market turnover ($ billion)	13,301	15,265	17,156
Total number of shares traded (billion)	33,968	34,440	34,287
Number of Derivative Warrants (DWs) listed (year-end)	3,747	4,715	4,938
Turnover of DWs ($ billion)	1,646	1,783	2,045
Number of Callable Bull/Bear Contracts (CBBCs) listed (year-end)	1,214	1,620	1,579
Turnover of CBBCs ($ billion)	1,533	1,269	1,230
Number of ETFs listed (year-end)	100	116	122
Turnover of ETFs ($ billion)	522	903	1,168

In the derivatives market, around 142 million futures and options contracts were traded in 2014, 9.5 per cent more than in 2013. Trading of major derivatives products included Hang Seng Index (HSI) Futures with total turnover of 17.07 million contracts; H-shares Index Futures with total turnover of 21.98 million contracts; HSI Options with total turnover of 7.52 million contracts; H-shares Index Options with total turnover of 9 million contracts; and Stock Options with total turnover of 74.54 million contracts.

Statistics on Derivatives Market Turnover (million contracts)

		2012	2013	2014
All options and futures contracts		120	130	142
Of which:	HSI Futures	20	20	17
	H-shares Index Futures	16	21	22
	HSI Options	9	9	8
	H-shares Index Options	6	8	9
	Stock Options	56	61	75

At the end of 2014, there were 32 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

As the statutory securities and futures regulator in Hong Kong, the SFC derives its statutory powers from the Securities and Futures Ordinance (SFO). The SFC's work can be divided into five areas: intermediaries, investment products, listing and takeovers, market infrastructure and trading, and enforcement.

Intermediaries – The SFC's licensing regime sets standards for industry practitioners seeking to be, and to remain, licensed. It supervises licensed corporations, including stock brokers, investment banks, futures and leveraged forex dealers, fund managers, investment advisers and credit rating agencies in Hong Kong, with a particular focus on their business conduct and financial soundness.

Investment products – The SFC supports the development of Hong Kong both as an asset management hub and a premier offshore RMB centre. While facilitating market growth and product innovation, the SFC continues to perform its gate-keeping functions in authorising investment products offered to the public and monitoring their compliance with disclosure and other requirements.

Listing and takeovers – The SFC oversees the listing-related functions of the SEHK, mergers, takeovers and share repurchases of public companies. It monitors corporate disclosures under the statutory inside information disclosure regime and vets listing applications alongside the SEHK under the dual filing regime, in addition to granting approval for the creation of new listed products and enhancing listing rules. It also performs risk-based reviews of particular companies and broader thematic reviews of activities which may signal corporate misconduct.

Market infrastructure and trading – The SFC supervises the HKEx's exchanges and clearing houses, share registrars, the Investor Compensation Company Limited and automated trading services, including overseas exchanges and clearing houses operating in Hong Kong.

Enforcement – The SFC takes firm and prompt action in combating misconduct and malpractice in the securities and futures markets in order to protect the investing public. It can discipline licensed intermediaries through reprimands, suspension or revocation of licences and imposition of fines. It can also deal with market misconduct cases, such as insider dealing and market manipulation, by criminal prosecution or bringing them directly to the Market Misconduct Tribunal[10]. In addition, the SFC can apply to the court for injunctive and remedial orders against wrongdoers in favour of victims. Through criminal, administrative, compensatory and disciplinary actions, the SFC strives to protect the collective interests of the investing public and send strong deterrent messages to the markets.

The SFC's powers are subject to both internal controls and external scrutiny, designed to ensure fairness in its decision-making, observance of due process and proper use of its regulatory powers. Specified SFC decisions are subject to review by the Securities and Futures Appeals

10 The MMT is an independent body established under the SFO, and is chaired by a judge or a former judge of the High Court who sits with two members.

Tribunal. The SFC's procedures, actions and decisions are also subject to other checks and balances including the Process Review Panel for the SFC, the Ombudsman, and the courts.

Recent Developments

At the end of 2014, there were 39,621 licensed entities, including securities brokers, futures dealers, investment advisors and fund managers as well as their representatives, and 118 registered institutions, such as banks, engaging in regulated activities such as dealing in and advising on securities and futures.

Statistics on Licensing for SFC-regulated Activities (year-end)

		2012	2013	2014
Licensed entities		39,119	38,985	39,621
Of which:	Licensed corporations	1,897	1,956	2,034
	Licensed individuals	37,222	37,029	37,587
Registered institutions		117	121	118

In February, the SFC published a consultation paper on the regulation of alternative liquidity pools[11] (ALPs) operating in Hong Kong, proposing a uniform set of requirements with which all ALP operators and licensed or registered persons who route orders to ALPs will be obliged to comply. The SFC further published supplemental consultation conclusions in August reaffirming that IPO sponsors are subject to existing statutory civil and criminal liability for defective prospectuses. In September, the SFC concluded a consultation on proposed amendments to the professional investor regime. Under this regime, intermediaries are not allowed to be exempt from various fundamental Code of Conduct[12] requirements when serving individual professional investors; and intermediaries are to adopt principles-based criteria to assess whether exemptions to these fundamental requirements apply when they serve corporate professional investors.

On the enforcement front, the SFC disciplined licensees in 2014 involving 40 individuals and 12 corporations with fines totalling $66.47 million; separately, 17 individuals and two corporations were successfully prosecuted for various criminal offences, including unlicensed activities, insider dealing and market manipulation.

During the year, the SFC successfully obtained a number of compensation orders in favour of investors: a futures trader was ordered to pay compensation of over $13 million to around 500 investors as a result of his manipulation of the futures market; and the former chairman and a director of a listed company were ordered to compensate the company $420 million for breaching their directors' duties to the company. The SFC also obtained a freezing injunction order against the former chairman of another listed company up to a sum of $1.2 billion pending a compensation order in favour of more than 1,300 minority shareholders. Civil proceedings and Market Misconduct Tribunal proceedings were also commenced against a listed company and five of its former executive directors for disclosure of possible false or misleading information concerning the financial status of the company. The SFC also obtained

[11] Also known as alternative trading systems or dark pools.

[12] The Code of Conduct for Persons Licensed by or Registered with the SFC.

a landmark judgment from the court affirming its power to obtain documents possessed by accounting firms in Hong Kong.

Insurance Sector

Main Features

At the end of 2014, there were 158 authorised insurers, 86 of which were incorporated in Hong Kong while the remaining 72 were incorporated in the Mainland or overseas jurisdictions.

During the past five years, the Hong Kong insurance industry achieved an average annual growth of 12.3 per cent. In 2014, the total gross premiums of the Hong Kong insurance industry amounted to $329.7* billion, representing an increase of 10.1 per cent over 2013. The total revenue premiums[13] of in-force long term business rose by 10.9 per cent to $285.8* billion in 2014. Individual life insurance remained the leading business, accounting for $262.7* billion or 91.9* per cent of total revenue premiums, while the corresponding number of policies stood at 10.9* million.

General insurance business rose in money terms from $41.8 billion in 2013 to $43.9* billion in 2014, representing a 5 per cent increase in gross premiums. The growth was largely led by insurance policies relating to Accident and Health business (comprising Medical business) and Ships business. The overall underwriting performance of general insurance business remained at $3 billion in 2014, on par with that of 2013.

At the end of 2014, there were 86,420 individual insurance intermediaries, comprising 9,736 Chief Executives or Technical Representatives (TRs) of 657 broker firms, 27,442 Responsible Officers or TRs of 2,480 agency firms, and 46,079 individual agents and their 26 TRs.

Statistics on Insurance Business

		2012	2013	2014
Number of authorised insurers		155	155	158
Of which:	Incorporated in Hong Kong	83	85	86
	Incorporated in the Mainland or overseas	72	70	72
Premium income ($ billion) Total gross premiums		263.3	299.5	329.7*
Of which:	Long-term in-force business (Office / Revenue premiums)	224.1^	257.7^	285.8*#
	General insurance (Gross premiums)	39.2	41.8	43.9*

^ Office premiums
# Revenue premiums

13 The premiums actually received during the financial year.

* Provisional statistics.

Insurance Authority

Appointed by the Chief Executive as the 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[14]. The 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.

As a member of the International Association of Insurance Supervisors (IAIS), Hong Kong is also required to observe international principles and standards in its insurance supervisory regime.

Recent Developments

In response to the financial crisis and its impact on the global insurance industry, IAIS revamped international standards to strengthen insurance supervision. The IA is examining the standards and their application in Hong Kong, taking local circumstances into account. Hong Kong participated in the Financial Sector Assessment Programme Update in 2014. Assessors from the IMF considered that Hong Kong had a high degree of observance of the Insurance Core Principles, and expressed full support for Hong Kong's current regulatory reforms.

The IA works closely with regulators in other jurisdictions in regulating major insurance groups and continues to participate in supervisory colleges organised by the home regulators of such groups. In particular, in 2014, the IA led two supervisory colleges, one for an insurance group headquartered in Hong Kong and another for an insurance group with regional headquarters in Hong Kong.

Mandatory Provident Fund Schemes and Occupational Retirement Schemes

Main Features

The Mandatory Provident Fund (MPF) System is a privately managed, employment-related mandatory system of provident fund schemes to assist the Hong Kong working population to save for retirement. Unless exempted, employees and self-employed persons aged 18 to 64 are required to join an MPF scheme.

An employer is required to contribute five per cent of an employee's relevant income (RI) as mandatory contributions for the employee, subject to a maximum RI level for MPF contribution purposes. Employees are required to make the same contributions for themselves unless their income is below the minimum RI level. Self-employed persons must also contribute five per cent of their RI, subject to the minimum and maximum RI levels.

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14 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 assumed the statutory role of ensuring compliance by MPF intermediaries from the insurance sector with the conduct requirements stipulated in the Mandatory Provident Fund Schemes Ordinance.

MPF accrued benefits (ie accumulated mandatory contributions and investment returns) must be preserved until a scheme member reaches the age of 65 or meets a statutory condition for early withdrawal of benefits.

Occupational retirement schemes operated under the Occupational Retirement Schemes Ordinance (ORSO) are voluntary schemes set up by employers. Before the launch of the MPF System, operators of ORSO schemes had the option to apply for exemption from MPF requirements.

Statistics on MPF Schemes and MPF-exempted ORSO Registered Schemes (year-end)

	2012	2013	2014
MPF Enrolment			
Number of participating employers	259,800	264,400	271,500
Number of participating relevant employees	2,375,100	2,485,300	2,506,600
Number of participating SEPs	220,400	212,400	208,000
Estimated MPF Enrolment Rate (per cent)			
Employers	100	99	99
Relevant employees	99	100	99
SEPs	65	62	66
MPF Schemes			
Number of registered schemes	41	41	38
Number of approved constituent funds	464	477	458
Aggregate NAV ($ billion)	440	514	565
MPF-exempted ORSO Registered Schemes			
Number of schemes	3,705	3,601	3,500
Number of participating employees	361,083	351,497	341,894
Aggregate NAV ($ billion)	250	273	278

Mandatory Provident Fund Schemes Authority

The Mandatory Provident Fund Schemes Authority (MPFA) was established under the Mandatory Provident Fund Schemes Ordinance to regulate, supervise and monitor the operation of the MPF system. It is also the Registrar of Occupational Retirement Schemes. Its objectives are to ensure compliance with MPF legislative requirements and protect the interests of scheme members. The MPFA monitors MPF trustees and their service providers, investigates cases of non-compliance, conducts inspections, and takes enforcement actions where necessary. It also arranges programmes to strengthen the public's understanding of the MPF system, publicise new developments of the system and educate scheme members on MPF investment.

Recent Developments

The Mandatory Provident Fund Schemes (Amendment) Bill 2014 was introduced into the Legislative Council for scrutiny in June. It includes proposals for increasing flexibility for withdrawing MPF accrued benefits, streamlining the MPF schemes' operational procedures to provide greater scope for MPF fee reduction and enabling more effective enforcement to protect scheme members' interests.

During 2014, the government and the MPFA consulted the public on a proposal for a 'core fund'. The 'core fund' will become the default investment strategy of each MPF scheme. It is subject to fee control and adopts an investment strategy which decreases the level of risk according to a scheme member's age. The government and the MPFA are finalising the proposal and plan to launch the 'core fund' in 2016.

Companies Registry

The Companies Registry administers and enforces most parts of the Companies Ordinance. The registry registers local and non-Hong Kong companies and statutorily required documents, de-registers defunct solvent companies and provides the public with services and facilities for inspecting and obtaining company information kept by the registry. The registry is also responsible for processing applications relating to money lenders licences and maintaining a register of money lenders for inspection by the public.

The registry operates as a trading fund department, allowing it to deploy its resources more flexibly to meet public demands and expectations.

The Integrated Companies Registry Information System provides electronic search services and over 99 per cent of company searches are now conducted online. The public may also retrieve company information through the Company Search Mobile Service. Electronic Certificates of Incorporation and Business Registration Certificates can normally be issued together in less than one hour after receipt of the applications through the e-Registry portal. The electronic filing service at the e-Registry portal also covers submission of annual returns for private companies as well as the more commonly filed specified forms for reporting changes of company information.

Companies Registry Statistics

	2012	**2013**	**2014**
Local companies incorporated	150,165	174,031	167,280
Local companies on the register	1,044,644	1,162,931	1,272,693
Non-Hong Kong companies registered	686	780	811
Non-Hong Kong companies on the register	8,848	9,258	9,624

Bankruptcies, Individual Voluntary Arrangement and Compulsory Winding-up

The Official Receiver's (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 (Winding Up and Miscellaneous Provisions)

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

	2012	2013	2014
Bankruptcy Orders	8,178	9,371	9,674
Interim Orders in IVAs	778	817	798
Winding-up Orders	312	274	271

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

	2012	2013	2014
Total number of CPAs	34,423	36,094	38,426
Number of practising CPAs	4,012	4,166	4,353
Number of practising CPA firms	1,228	1,246	1,275
Number of corporate practices	392	427	467

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

The Financial Reporting Council (FRC), a statutory body established under the Financial Reporting Council Ordinance, is responsible for investigating Hong Kong listed companies' non-compliance with accounting standards as well as their auditors' auditing and reporting irregularities. 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

	2012	2013	2014
Number of complaints received	19	20	33
Number of modified auditors' reports screened	138	168	171
Number of financial reports reviewed under risk-based approach	69	53	34
Number of investigations initiated	9	7	22
Number of investigations completed	9	5	4
Number of enquiries initiated	3	—	1
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 USD, at around $7.80 to US$1. This objective is achieved through the Linked Exchange Rate System introduced in 1983. The government is fully committed to maintaining this system, which is a cornerstone of Hong Kong's monetary and financial stability, and to the strict discipline of the system's currency board arrangements.

The Linked Exchange Rate System is characterised by currency board arrangements requiring the HKD 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 USD 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[15] , 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, HKD exchange rate stability is maintained through an interest rate adjustment mechanism and the HKMA's commitment to honour the Convertibility Undertaking. In particular, the HKMA undertakes to buy USD from licensed banks at HK$7.75 to US$1 (strong-side Convertibility Undertaking) and sell USD at HK$7.85 to US$1 (weak-side Convertibility Undertaking). The expansion or contraction in the monetary base arising from these currency board operations leads interest rates for the domestic currency to fall or rise respectively, creating the monetary conditions that automatically counteract the original capital movements and ensuring exchange rate stability.

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.

Monetary Situation

The HKD exchange rate traded within a tight range of 7.750 to 7.766 in 2014. The strong-side Convertibility Undertaking was repeatedly triggered between 1 July and 5 August 2014. Net inflows of HK$75.3 billion were recorded on the back of strong commercial and equity-related demand for HKD. As a result, the Aggregate Balance increased from HK$163.9 billion at the beginning of July to HK$239.2 billion at the end of August and stayed at this level until the end of 2014.

Interbank liquidity remained abundant during the year. The HKD interbank interest rates were little changed compared to last year, with some fluctuations due to equity fund-raising activities

[15] 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.

and seasonal and quarter-end liquidity demand. Overall, the HKD money market and foreign exchange market continued to operate in an orderly and smooth manner in 2014.

Exchange Fund

The Exchange Fund's primary statutory role under the Exchange Fund Ordinance is to affect the exchange value of the HKD. 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 USD-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[16]. 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. To better manage risks and enhance returns in the medium and long term, the HKMA has been diversifying part of the Exchange Fund's investment in a prudent and incremental manner into a greater variety of asset classes, including private equity and real estate investments housed under the Long-Term Growth Portfolio (LTGP). The cap for the net asset value of the LTGP is maintained at one-third of the Accumulated Surplus of the Exchange Fund. At the end of 2014, the Exchange Fund's total assets stood at $3,149 billion. The Exchange Fund's accumulated surplus amounted to $635.5 billion[17].

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 Standard Chartered Bank (Hong Kong) Limited. The note-issuing banks may issue currency notes only by surrendering non-interest bearing USD backing at a fixed exchange rate of $7.80 to US$1.

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 2014 was $353.5 billion.

In October 2014 the HKMA launched a Coin Collection Programme to provide a channel for the public to get value for their coins in addition to the existing banking system. The coins collected are re-circulated to meet public demand, making circulation more efficient and reducing the

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

17 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.

need for minting new coins. Two coin collection vehicles (the 'Coin Carts') collect coins from members of the public in the 18 districts of Hong Kong on a rotating basis. By the end of 2014, the two Coin Carts had collected 46 million coins from 50,000 people with a total face value of $41 million.

Websites

Companies Registry: www.cr.gov.hk
Companies Registry e-Registry: www.eregistry.gov.hk
Company Search Mobile Service: www.mobile-cr.gov.hk
Financial Dispute Resolution Centre: www.fdrc.org.hk
Financial Reporting Council: www.frc.org.hk
Financial Services and the Treasury Bureau: www.fstb.gov.hk
Financial Services Development Council: www.fsdc.org.hk
Hong Kong Exchanges and Clearing Limited: www.hkex.com.hk
Hong Kong Monetary Authority: www.hkma.gov.hk
Investor Education Centre: www.hkiec.hk
Mandatory Provident Fund Schemes Authority: www.mpfa.org.hk
Office of the Commissioner of Insurance: www.oci.gov.hk
Official Receiver's Office: www.oro.gov.hk
Securities and Futures Commission: www.sfc.hk