

Chapter 4

Financial and Monetary Affairs

Hong Kong's status as the world's premier international financial centre is well recognised. The city is ranked third in the Global Financial Centres Index and is also commended by the International Monetary Fund. The financial sector had a workforce of over 250,000 and contributed to 17.7 per cent of the local economy.

Hong Kong as International Financial Centre

Located at the heart of Asia, Hong Kong as a leading international financial centre forms a 24-hour continuous trading system with other global financial centres, including New York and London. At the southern part of China, the city's extensive geographical, cultural and linguistic links with the Mainland, and the distinctive advantage of 'one country, two systems', bestow on Hong Kong a unique position in the increasingly integrated global financial system.

The city's financial markets operate under effective and transparent regulations that are in line with international standards. It also thrives on excellent communications with the rest of the world, the rule of law, a level playing field for conducting business, free capital inflows and outflows, an emphasis on investor protection, and a well-educated workforce and ease of entry for non-local professionals.

Hong Kong's competitiveness as an international financial centre is also well recognised: the Global Financial Centres Index published by the Z/Yen Group in September ranked Hong Kong the third global centre, behind London and New York. Following the 2017 Article IV Consultation, the International Monetary Fund Staff Mission commended Hong Kong, saying the city was well placed to navigate challenges given its strong buffers, ample fiscal reserves and robust financial regulatory and supervisory frameworks.

The Financial Leaders Forum was established in August, chaired by the Financial Secretary, to discuss and provide a policy steer on strategic and forward-looking proposals to develop and strengthen Hong Kong's position as an international financial centre, having regard to the need to maintain monetary stability, financial safety and market quality.

Securities and Derivatives Market

The city's stock market capitalisation totalled about \$34 trillion as at end-2017, seventh in the world and third in Asia. At the end of the year, 2,118 public companies were listed on the Stock Exchange of Hong Kong Limited (SEHK), representing a wide range of industries from finance and property to consumer goods, information technology and telecommunications. The SEHK has ranked first for five out of the past nine years since 2009 in terms of equity funds raised via initial public offerings (IPOs). In 2017, \$128 billion was raised through IPOs. In addition to new share issues, another \$452 billion was raised on the secondary market. At the Hong Kong Exchanges and Clearing Limited (HKEX), the turnover of securitised derivatives has ranked first in the world since 2007.

At the end of 2017, 1,051 Mainland enterprises were listed on the SEHK, raising \$5.8 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 77 per cent of IPO equity funds raised in 2017.

The Hong Kong Futures Exchange Limited (HKFE) operates a futures market. Total turnover of derivatives contracts in 2017 was 215 million, the highest ever. Open interest at the year end was 11.2 million contracts.

As an international and open market, Hong Kong attracts many intermediaries from other markets to set up companies locally and most international brokerages have branches in the city. At the year end, 24.4 per cent of the 622 SEHK trading participants and 50.5 per cent of the 186 HKFE trading participants were from the Mainland or overseas markets.

The HKEX 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. These provide integrated clearing, settlement, depository and nominee services for its participants and members.

Chart 1 **Stock Market Capitalisation**

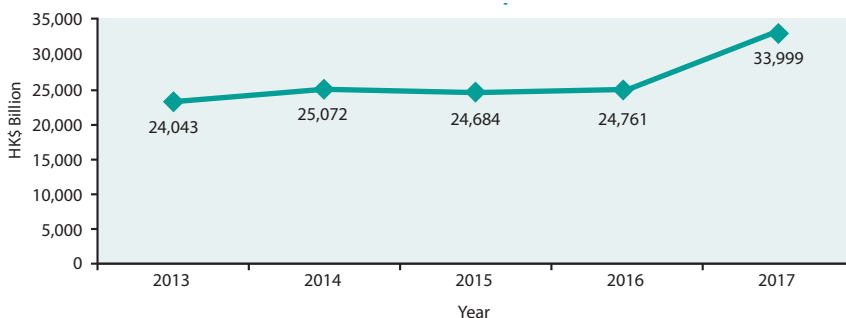
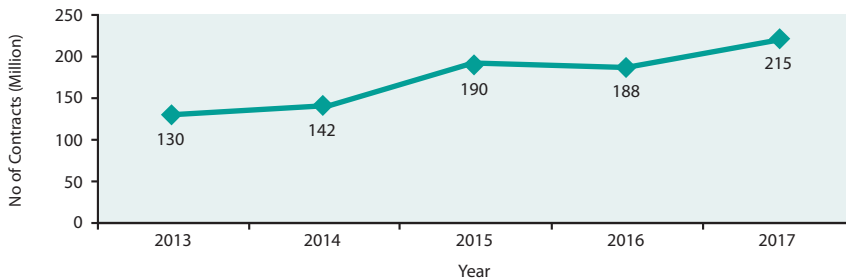


Chart 2 HKFE Turnover of Derivatives



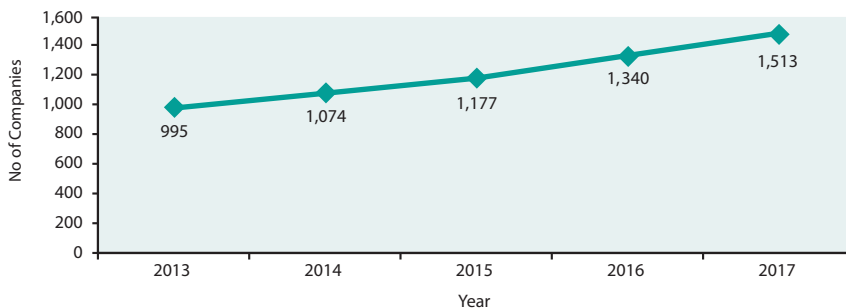
Asset Management Hub

Hong Kong is well placed as Asia's premier asset management centre, amid huge demand for wealth and asset management services on the Mainland and the city's strong nexus with the rest of Asia. The asset management business is highly international, with 66.3 per cent of the assets under management, excluding real estate investment trusts (Reits), coming from investors outside Hong Kong¹.

The city has a strong asset management foundation and world-class financial infrastructure. At the year end, 1,513 companies were licensed by or registered with the Securities and Futures Commission (SFC) to carry out asset management business locally, up 12.9 per cent from end-2016.

The government, together with other agencies, works to provide a conducive operational, regulatory and tax environment as well as improved access to other markets, thereby growing a full spectrum of asset management activities.

Chart 3 Number of Asset Management Companies



¹ Figures are quoted from the Fund Management Activities Survey for 2016, an annual SFC survey about the general state of affairs in the local fund management industry.

Global Offshore RMB Business Hub

With the continued internationalisation of the Renminbi (RMB) and the opening up of the Mainland financial markets, the currency is increasingly used in global transactions, ranging from cross-border trade and direct investment transactions to financial investment and asset management activities.

Thanks to its deep pool of liquidity, efficient financial infrastructure and multitude of cross-border portfolio flow channels, Hong Kong continues to be the largest and most important global offshore RMB business hub, offering a wide range of RMB-denominated investment products, including listed and unlisted investment funds, insurance products, currency futures, Reits, shares, derivatives products and bonds. As at end-2017, total RMB deposits, including customer deposits and outstanding certificates of deposit, amounted to RMB618.4 billion.

Hong Kong is the global leader in RMB financial intermediation activities. In 2017, according to statistics from the Society for Worldwide Interbank Financial Telecommunication, over 70 per cent of offshore RMB payments were handled by Hong Kong. The city's RMB real-time gross settlement (RTGS) system also recorded a high volume of RMB transactions, averaging RMB900 billion daily during the year.

International Banking and Payment Centre

Hong Kong was the world's sixth and Asia's second largest banking centre in terms of external positions², according to the Bank for International Settlements Quarterly Review for end-2017.

International financial institutions maintain a strong presence in Hong Kong. Of the world's top 100 banks, 75 operate in the city. At the year end, 148 of the 155 licensed banks in Hong Kong were beneficially owned by parties outside Hong Kong.

Hong Kong has robust RTGS interbank payment systems. All banks in the city maintain settlement accounts with the Hong Kong Monetary Authority (HKMA) in the Hong Kong dollar (HKD) RTGS system³. The US dollar (USD), euro and RMB RTGS systems enable transactions in these currencies to be settled in real time among banks. All four RTGS systems are linked to enable foreign exchange (forex) transactions to be settled on a payment-versus-payment basis.

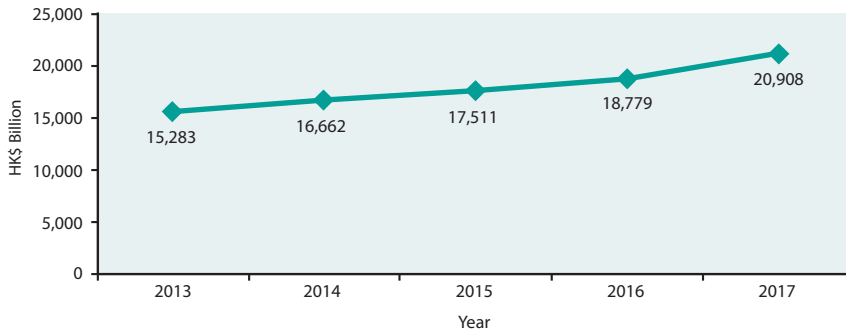
The HKMA's Central Moneymarkets Unit (CMU) provides clearing, settlement and custodian services for Exchange Fund Bills and Notes (EFBNs), government bonds and other HKD or foreign currency public and private debt securities. It is linked to a number of international and regional central securities depositories (CSDs) to enable overseas and local investors to hold and settle securities lodged with the CMU and with overseas systems respectively. In July, Bond Connect, a new initiative for mutual access between the Hong Kong and Mainland bond markets, was launched, starting first with northbound trading, which facilitates overseas investors investing in the Mainland bond market. Bond Connect transactions are settled using

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.

³ Banks may obtain intra-day and overnight liquidity through repurchase agreements with the HKMA using Exchange Fund Bills and Notes and government bonds as collateral.

the CMU's links to the two Mainland CSDs. Through its seamless interface with the RTGS systems, the CMU system is able to settle securities transactions on a delivery-versus-payment basis. Besides debt securities, the CMU provides a standardised and automated platform for the investment fund industry to streamline the handling of investment fund order instructions.

Chart 4 External Positions of AIs



Bond Market Development

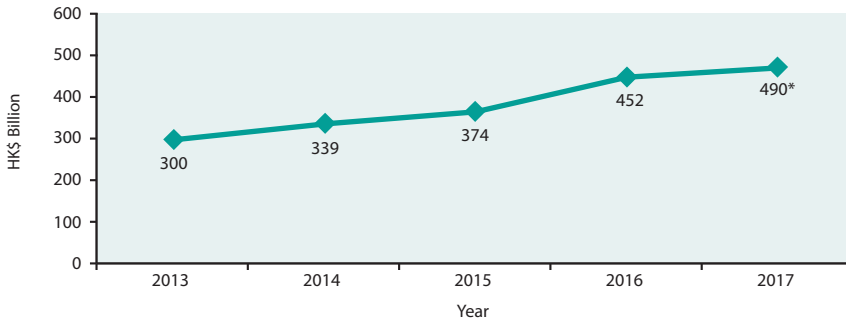
Outstanding HKD debt securities, including EFBNs, totalled \$1,802.2 billion at the end of 2017.

Chart 5 Total Outstanding HKD Debt Securities



Open Insurance Market

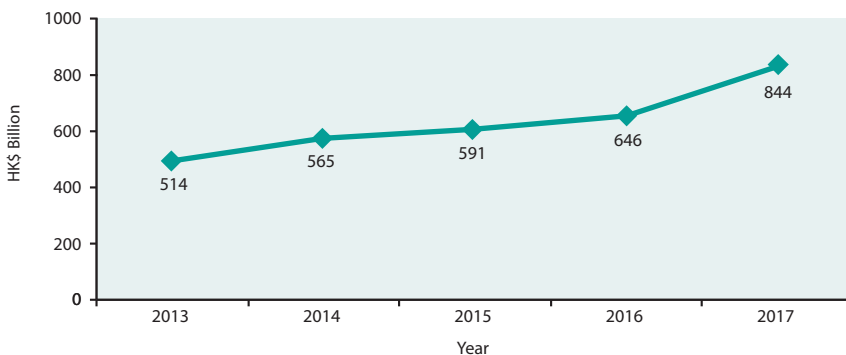
Hong Kong is one of the most open insurance centres in the world. Of the 159 authorised insurers at the year end, 71 were from the Mainland or overseas jurisdictions. Fourteen of the world's top 20 insurers were authorised to conduct insurance business in Hong Kong either directly or through a group company. The city had 18 professional reinsurers, including most of the world's top reinsurers. Gross premium income was \$489.6* billion, an increase of 8.4 per cent over 2016.

Chart 6 Annual Gross Premiums of Insurance Market

*Provisional statistics

Mandatory Provident Fund

Mandatory Provident Fund (MPF) schemes had a net asset value (NAV) of \$844 billion at the end of 2017 and an annualised rate of return of 4.8 per cent between December 2000, when the MPF System was launched, and December 2017.

Chart 7 Total NAV of MPF Schemes

Commodity Trading

Hong Kong operates one of the most active physical gold markets in the world and is among Asia's largest over-the-counter (OTC) gold trading centres. Spot gold can be traded through two closely related yet independent markets: the Chinese Gold and Silver Exchange Society and the Loco London gold market. 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, the HKEX owns the London Metal Exchange (LME), the world centre for industrial metals trading and price-risk management. More than three-quarters of global non-ferrous business are conducted on the

LME and its prices are used as global benchmarks. The average daily volume for 2017 was 624,480 lots. The LME's in-house clearing house in London, LME Clear, supports the exchange's commodity business.

Enhancing Hong Kong's Competitiveness as International Financial Centre

Hong Kong strengthens its competitiveness as an international financial centre through both enhancing the regulatory framework and promoting market development. The city will capitalise on opportunities arising from the Belt and Road Initiative and Guangdong-Hong Kong-Macao Bay Area to consolidate and enhance its position as a major platform of capital raising and financing for Mainland and overseas enterprises as well as a global hub for offshore RMB business.

Fund-raising Centre

In 2017, the SEHK ranked fourth worldwide in terms of the IPO equity funds raised, at \$128 billion. It attracted 174 new listings, including 13 transfers of listing from the Growth Enterprise Market (GEM) to the Main Board. Apart from Hong Kong and Mainland companies, 32 non-local companies, from Canada, Japan, Macao, Malaysia, Singapore, Taiwan and the United States, are also listed on the SEHK. 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.

To facilitate listings of companies from emerging and innovative sectors, the SEHK announced in December that it would introduce two new chapters to the Main Board listing rules to allow the listings of pre-revenue biotechnology issuers and issuers from emerging and innovative sectors that had weighted voting rights structures, subject to additional disclosure and safeguards. The SEHK also proposed to modify existing listing rules about overseas companies to create a new concessionary secondary listing route that will attract eligible issuers from emerging and innovative sectors to list in Hong Kong.

Asset Management and Private Wealth Management

Fund domiciliation builds up Hong Kong's fund manufacturing capabilities by driving demand for professional services along the whole service chain, including fund management, investment advice, legal and accounting services, and sales and marketing. This allows the city to develop into an all-rounded asset management hub. At the end of 2016, the combined fund management business was valued at \$18,293 billion, of which 66.3 per cent, excluding Reits, came from non-local investors, indicating that investors outside Hong Kong see the city as a preferred investment platform⁴. At the end of 2017, there were 2,205 SFC-authorized unit trusts and mutual funds⁵, of which 755 were domiciled in Hong Kong, up 7.1 per cent from a year earlier and 147 per cent more than five years ago.

⁴ Figures are quoted from the SFC's annual Fund Management Activities Survey for 2016.

⁵ These include 125 MPF pooled investment funds offered both as retail unit trusts and for MPF purposes.

Open-ended Fund Company Structure

The government, together with the SFC, has been working to implement the legal framework for the introduction of an open-ended fund company (OFC) structure as an alternative fund vehicle to the unit trust structure. The OFC structure will allow funds to be set up in the form of companies but with the flexibility, not enjoyed by conventional companies, to create and cancel shares for investors' subscription and redemption in the funds. This additional choice would help attract more funds to domicile in Hong Kong and further develop Hong Kong as a full-service international asset management centre. The OFC regime is expected to start operation in the second half of 2018.

Mutual Recognition of Funds

In July, the SFC and Autorité des Marchés Financiers of France signed a Memorandum of Understanding on Mutual Recognition of Funds (MRF) to allow the distribution of eligible public funds in each other's market through a streamlined vetting process. The Mainland-Hong Kong MRF arrangement, launched in 2015, continued to operate smoothly during the year. As at end-2017, the regulators of the two places had authorised 60 funds, with aggregate net sales of more than RMB12.8 billion. As for the Switzerland-Hong Kong MRF scheme, launched in 2016, the Swiss Financial Market Supervisory Authority had authorised four Hong Kong funds by end-2017.

Corporate Treasury Centres

Hong Kong is Asia's premier location for multinational corporations to manage their global or regional treasury functions. Its favourable tax and regulatory environment helps attract Mainland and overseas companies to establish Corporate Treasury Centres (CTCs) in the city. The Inland Revenue Ordinance allows interest deduction in calculating profits tax for the intra-group financing business of corporations operating in Hong Kong under specified conditions, and profits tax reduction by 50 per cent for qualifying CTCs.

Asian Infrastructure Investment Bank

The Asian Infrastructure Investment Bank (AIIB) is a multilateral development bank. It plays an important role in supporting infrastructure development in Asia and promoting regional connectivity. Hong Kong became a member of the AIIB in June.

HKMA Infrastructure Financing Facilitation Office

The HKMA established the Infrastructure Financing Facilitation Office in 2016 to facilitate infrastructure investments and their financing by working with key stakeholders. Since its launch, the office has formed an effective collaborative network of key stakeholders in infrastructure investment and financing and raised the international profile of Hong Kong as an infrastructure financing centre. By end-2017, it had welcomed 78 organisations from Hong Kong, the Mainland and overseas as partners.

In March, the office held the inaugural Debt Financing and Investors' Roundtables. An equity reference term sheet was developed to devise a common language that can be understood and accepted by investors and project owners, thereby narrowing the gap in their expectations and bringing them closer to doing deals. During the year, the office also facilitated the HKMA's

commitment of US\$1 billion to the International Finance Corporation's special co-lending programme as a demonstration to attract more private-sector capital to emerging markets.

Bond Market

The Government Bond Programme promotes the development of the bond market in Hong Kong. It has a borrowing ceiling of \$200 billion. Successful issuances of institutional bonds, retail inflation-linked bonds and Islamic bonds in the past testify to the vibrancy and robustness of the local bond market.

Bonds totalling \$24.4 billion were issued to institutional investors under the programme in 2017. These included a third Islamic bond, launched in February with an issuance size of US\$1 billion and a tenor of 10 years. The issuance attracted strong demand, reflecting the attractiveness of the local bond market.

In June, under the retail part of the programme, the government issued a \$3 billion inflation-linked Silver Bond with a tenor of three years to Hong Kong residents aged 65 or above to encourage financial institutions to tap into the immense potential of the 'silver market' by introducing a larger spectrum of appropriate products.

Financial Technologies

The local financial technology (fintech) ecology has become increasingly vibrant with the concerted efforts of the government, financial regulators, innovation organisations such as Cyberport and industry players.

The Hong Kong SAR Government and the United Kingdom Government entered into a Fintech Bridge Agreement in September to foster joint collaboration in promoting financial innovation. The agreement allowed fintech firms on both sides to use the facilities and assistance available in the other place to explore new business opportunities.

InvestHK organised the second Hong Kong Fintech Week, the flagship fintech event in the city, in October to showcase Hong Kong's unique advantages in fintech. It drew some 4,000 attendees from over 50 countries and regions and more than 300 speakers.

Talent Training

The three-year Pilot Programme to Enhance Talent Training for the Insurance Sector and the Asset and Wealth Management Sector, launched in 2016, seeks to enable the community, particularly students, to better understand the wide spectrum of jobs available in these two sectors so as to attract new blood and enhance the professional competency of the sectors. The various initiatives included enhanced public education, summer internships for undergraduates, placements for graduates and a financial incentive for in-service practitioners to undergo training.

The HKMA works closely with the banking industry and professional bodies to develop modules under the Enhanced Competency Framework (ECF) for capacity building and talent development. In December, two ECF modules on treasury management and retail wealth management were launched to enhance practitioners' competency and enlarge the talent pool

of these two work streams. A third module, to develop the competency of more experienced practitioners responsible for anti-money laundering and counter-terrorist financing compliance, is being developed.

Financial Services Development Council

The Financial Services Development Council is a high-level, cross-sectoral government advisory body that collects industry views to formulate strategic proposals for the development of the industry. It published seven reports in 2017 on these subjects: reinsurance, marine insurance and captive insurance; listed structured products; fintech; distributed ledger technology; aircraft leasing and financing; tax issues regarding offshore private equity fund, and group tax loss relief. The government seeks to implement the council's recommendations where appropriate to further develop the financial services industry, provides resources and fully supports the council's work.

Improving Market Quality and Financial Consumer Education and Protection

The government drives, facilitates and coordinates initiatives to ensure the overarching regulatory framework will enhance protection for investors and promote market development in the face of both global needs and local circumstances.

Regulation of Asset Management

The SFC seeks to ensure Hong Kong's regulatory regime for asset management is in line with international regulatory developments. It issued in November the conclusions to its consultation on proposals to refine asset management regulation and point-of-sale transparency to better address conflicts of interest in the sale of investment products. Enhancements to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission and the Fund Manager Code of Conduct will take effect in 2018. In December, the SFC launched a public consultation on its proposed amendments to the Code on Unit Trusts and Mutual Funds to update the regulatory regime for SFC-authorized funds and address risks posed by financial innovation and market developments.

Regulation of OTC Derivatives

As part of a broader effort to improve transparency, mitigate systemic risk and prevent market abuse, the SFC issued its conclusion to a consultation on a proposed regulatory capital regime for licensed firms engaged in OTC derivatives activities and other changes to the Securities and Futures (Financial Resources) Rules. The proposals, subject to further consultation, will be implemented to reflect recent market development and enhance Hong Kong's position as a risk management hub.

To strengthen the management of conduct and financial risks in transactions and business dealings with related parties, a separate consultation was launched in December, proposing to refine the scope of regulated activities and provide further clarity about the OTC derivatives licensing regime.

International Banking Standards

As a member of the Basel Committee on Banking Supervision and the Financial Stability Board, Hong Kong is diligent in implementing international standards on banking regulation, including the Basel III framework and other post-crisis reform packages. The city implements the international standards through amending the Banking Ordinance and issuing rules supplemented by regulatory guidance.

Deposit Protection

Hong Kong maintains a robust deposit protection regime which underpins the stability of the banking system. The Deposit Protection Scheme protects eligible deposits held with banks in Hong Kong by guaranteeing compensation up to \$500,000, thereby ensuring the confidence of depositors in the banking system.

Anti-Money Laundering and Counter-Terrorist Financing

Money laundering and terrorist financing is a global problem that can undermine the integrity and stability of international financial markets. Being an international financial centre and an externally oriented economy, Hong Kong is inevitably exposed to such threats from within the city and more so from other places. As a member of the Financial Action Task Force, Hong Kong has put in place a robust, mature and effective regulatory regime for anti-money laundering and counter-terrorist financing over the years to safeguard the integrity of its business environment and reputation as an international financial centre.

The city's regulatory framework was reinforced with the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Bill 2017, which prescribed statutory customer due diligence and record-keeping requirements for designated non-financial businesses and professions, and the Companies (Amendment) Bill 2017, which required companies incorporated in Hong Kong to maintain beneficial ownership information.

Regulation of Stored Value Facilities and Retail Payment Systems

With the Payment Systems and Stored Value Facilities Ordinance in force, the regulatory regimes for stored value facilities (SVFs) and retail payment systems (RPSs) have been put into operation. By the end of 2017, the HKMA had issued 13 SVF licences, in addition to which three banks had rolled out SVFs. The SVF industry continued to grow during the year as the licensees introduced new services and expanded their business networks. In August, the HKMA began oversight of four RPSs through designation under the ordinance to promote safety and efficiency of the local retail payment industry.

Risk-based Capital Regime for Insurance Industry

The Insurance Authority (IA) is engaging stakeholders in developing a risk-based capital (RBC) regime for Hong Kong's insurance industry. It plans to conduct the second quantitative impact study in 2018 to collect industry data so it can calibrate risk charges and determine the prescribed capital requirements. The IA will consult the industry on a draft Guideline on Enterprise Risk Management and Own Risk and Solvency Assessment in the first half of 2018 with a view to issuing it by year end.

Resolution Regime for Financial Institutions

The Financial Institutions (Resolution) Ordinance establishes a cross-sectoral resolution regime for financial institutions in Hong Kong and confers powers on the Monetary Authority, the SFC and the IA as the resolution authorities for within-scope financial institutions under their respective purview. Its main provisions came into operation in July together with a piece of subsidiary legislation on protected arrangements, namely the Financial Institutions (Resolution) (Protected Arrangements) Regulation. The resolution regime is designed to meet the international standards set by the Financial Stability Board in its 'Key Attributes of Effective Resolution Regimes for Financial Institutions'.

The resolution authorities will continue to develop resolution planning and the associated standards for financial institutions in order to improve the resolvability of financial institutions such that in the event of a financial institution's non-viability, resolution may take place in an orderly manner. This work would support the operation of the resolution regime in Hong Kong, which would in turn contribute to financial stability.

Investor Education Centre

The Investor Education Centre is dedicated to improving the financial knowledge and capabilities of Hong Kong people by delivering impartial financial information, tools, educational resources and programmes through its consumer brand, The Chin Family.

The centre organised the Hong Kong Money Month campaign between February and March to encourage the public to take action in planning and managing their finances. As the secretariat for the Hong Kong Strategy for Financial Literacy, it coordinates and harnesses the efforts of stakeholders from the government, financial and education sectors and the community to improve financial literacy in Hong Kong.

Financial Dispute Resolution Centre

The Financial Dispute Resolution Centre administers in an independent and impartial manner the Financial Dispute Resolution Scheme to facilitate the resolution of monetary disputes between individual customers and financial institutions by 'mediation first, arbitration next'. Following a public consultation on how to enhance its service, the centre will implement measures in phases in 2018 to raise the accessibility and flexibility of its service.

Auditor Regulatory Reform

The international trend is for oversight of the regulation of auditors of public interest entities to be independent of the profession itself. The government, having conducted a public consultation exercise and discussed with stakeholders the detailed proposals, will introduce an amendment bill into the Legislative Council in 2018 to implement the reform.

Money Lenders

The government tackles money lending-related malpractice through enforcement, public education and publicity, advisory services to the public, and stringent licensing conditions on money lenders. The effectiveness of these measures is kept under review.

Corporate Insolvency Law

The Companies (Winding Up and Miscellaneous Provisions) (Amendment) Ordinance 2016 aims to improve and modernise Hong Kong's corporate winding-up regime to increase creditor protection, streamline the winding-up process and enhance its integrity. It came into operation in February 2017.

Hong Kong as China's Global Financial Centre

Capital Formation Centre and Global Investment Platform for Mainland

Hong Kong is the ideal centre for Mainland enterprises to raise capital. The growing presence of Mainland companies listed on the SEHK has in turn increased the breadth and depth of Hong Kong's securities and futures markets through a greater diversity of products and of constituent stocks in the equity market. Mainland enterprises also raise capital in Hong Kong through the issuance of bonds, project financing and loan syndication. Moreover, they can leverage Hong Kong's position as an international business centre and its world-class investment banking services to invest in international markets via mergers and acquisitions.

Offshore RMB Business

Hong Kong remained the leading and most important offshore RMB hub in 2017. As at the year end, the offshore RMB deposit pool in Hong Kong, including customer deposits and outstanding certificates of deposit, amounted to RMB618.4 billion, while RMB bank lending and outstanding RMB bonds stood at RMB144.5 billion and RMB212.4 billion respectively. RMB trade settlement handled by banks in Hong Kong totalled RMB3.9 trillion in 2017.

Qualified institutions show interest in developing funds which invest in Mainland onshore markets via the Renminbi Qualified Foreign Institutional Investor (RQFII), Stock Connect, Bond Connect and China Interbank Bond Market (CIBM)⁶. At the end of 2017, there were 41 fund management companies managing 59 SFC-authorized unlisted funds investing onshore via these channels with an aggregate NAV of RMB6.8 billion, and 29 SFC-authorized exchange-traded funds (ETFs) investing onshore via these channels with an aggregate NAV of RMB34.1 billion.

In July, the RQFII quota for Hong Kong was raised from RMB270 billion to RMB500 billion, once again the highest in the world. The increase enhances the cross-border use and circulation of RMB funds between Hong Kong and the Mainland, deepens the connectivity between the two markets and reinforces Hong Kong's status as the global offshore RMB business hub.

Stock Connect

The Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect have continued to enhance cross-border market accessibility since they were launched in 2014 and 2016 respectively.

⁶ The unlisted funds and ETFs that invest in the Mainland onshore markets via the RQFII, Stock Connect, Bond Connect and CIBM are RMB-denominated funds which primarily invest in Mainland securities markets through the RQFII quota, Stock Connect, Bond Connect and CIBM.

International investors can trade in over 570 shares listed on the Shanghai Stock Exchange and over 940 shares listed on the Shenzhen Stock Exchange. Mainland investors are also offered a wide range of choices, with over 440 Hong Kong-listed stocks available through Stock Connect.

In November, the SFC and the China Securities Regulatory Commission (CSRC) announced their agreement to introduce an investor identification regime for northbound trading under both Stock Connects. This regime will entail the real-time transfer of investor information by the SEHK and its subsidiaries to Mainland exchanges and the CSRC. This highlights efforts to bolster Hong Kong-Mainland regulatory cooperation in combating market misconduct through effective monitoring. A similar identification regime for southbound trading is being planned after the start of the regime for northbound trading.

Bond Connect

Northbound trading under Bond Connect has been operating smoothly since its launch in July. The programme marks an important milestone in the development of mutual capital market access between Hong Kong and the Mainland. It enables eligible overseas investors to access, for the first time, the Mainland interbank bond market through financial infrastructural connections established between the Mainland and overseas bond markets. Bond Connect facilitates investors' participation in the bond markets, improves connectivity between market infrastructures and promotes the healthy development of the bond markets, thereby enhancing Hong Kong's status as an international financial centre and the global offshore RMB business hub.

Mainland and Hong Kong Closer Economic Partnership Arrangement

The Closer Economic Partnership Arrangement (CEPA) gives Hong Kong's financial service providers and professionals greater market access and flexibility in their Mainland operations. It also enhances Hong Kong's attractiveness to market users and strengthens the city's competitiveness as an international financial centre and the premier capital formation centre for Mainland enterprises.

The National 13th Five-Year Plan states that the Central People's Government will step up efforts to further open up its markets to Hong Kong and advocate enhancement of the CEPA. The Mainland and Hong Kong signed the Investment Agreement and Economic and Technical Cooperation Agreement on 28 June to enhance the CEPA in line with a modern and comprehensive free trade agreement, providing for the promotion and protection of increasing investments between the two places as well as fostering economic and technical cooperation and exploring new areas of cooperation. In particular, commitments on financial cooperation cover many financial services sectors, including accounting, insurance, securities and banking.

Banking

Hong Kong maintains three tiers of deposit-taking institutions: licensed banks (LBs), restricted licence banks (RLBs) and deposit-taking companies (DTCs)⁷. They are known collectively as authorised institutions (AIs) under the Banking Ordinance and are licensed by the HKMA.

The city has one of the world's highest concentrations of banking institutions. At the end of 2017, there were 155 LBs, 19 RLBs and 17 DTCs. These 191 AIs maintained a network of 1,261 local branches. There were also 49 representative offices of banks incorporated outside Hong Kong.

Hong Kong Monetary Authority

The HKMA maintains 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; promotes stability and integrity of the financial system, including the banking system; helps maintain Hong Kong's status as an international financial centre, including the maintenance and development of Hong Kong's financial infrastructure, and manages 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 people on terms different from those of the civil service to attract personnel of suitable experience and expertise. It is accountable to the Financial Secretary, who is advised by the Exchange Fund Advisory Committee (EFAC) in the control of the Exchange Fund.

The Banking Advisory Committee and Deposit-taking Companies Advisory Committee are established under the Banking Ordinance to advise on policy matters. They are chaired by the Financial Secretary and comprise members from banking 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 preserve the stability and effective working of the banking system, while at the same time providing flexibility for AIs to make commercial decisions.

Recent Developments

The Hong Kong banking sector remained sound in 2017. As part of efforts to strengthen the resilience of the banking system, the Banking (Amendment) Bill 2017 was introduced into LegCo in October. It aims to implement the latest Basel standards on the financial exposure limits of AIs, as well as the recovery planning requirements promulgated by the Financial Stability Board. The Banking (Capital) (Amendment) Rules 2017 and the Banking (Liquidity) (Amendment) Rules 2017 were also passed by LegCo in November to implement the latest Basel III requirements from 1 January 2018.

⁷ Only LBs may conduct full banking services, including 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.

The asset quality of the banking sector stayed healthy, the liquidity positions of AIs remained robust, and locally incorporated AIs continued to be well capitalised.

At the end of 2017, total deposits and total loans and advances of AIs amounted to \$12,752.5 billion and \$9,313.7 billion respectively, marking increases of 8.7 per cent and 16.1 per cent from a year earlier. Total assets rose 10.1 per cent to \$22,731.3 billion.

Statistics on AIs

	2015	2016	2017
AIs	199	195	191
Of which:			
LBs	157	156	155
RLBs	24	22	19
DTCs	18	17	17
Local branches of AIs	1,370	1,289	1,261
Total deposits (\$ billion)	10,749.7	11,727.3	12,752.5
Total loans and advances (\$ billion)	7,534.5	8,023.4	9,313.7
Total assets (\$ billion)	19,181.1	20,652.3	22,731.3

The HKMA keeps a vigilant watch on the property mortgage business of AIs. It has introduced eight rounds of countercyclical macroprudential measures since 2009 to strengthen the risk management of AIs' mortgage lending business and the ability of mortgage borrowers to cope with a potential property market downturn.

Following the launch of the Fintech Facilitation Office in 2016, the HKMA stepped up its efforts in developing Hong Kong as a fintech hub in Asia. It published the second Distributed Ledger Technology (DLT) Whitepaper to address implementation issues. The proof-of-concept results described in the whitepaper led seven local banks to build a Hong Kong Trade Finance Platform. The HKMA also began research on a central bank digital currency, launched with Cyberport a Haccelerator platform to run competitions, organised with the Hong Kong Applied Science and Technology Research Institute a Fintech Career Accelerator Scheme to nurture talent, started formulating a policy framework on an Open Application Programming Interface for the banking sector and entered into agreements with Shenzhen, Singapore and Dubai on fintech cooperation, including a joint project with the Monetary Authority of Singapore to build a cross-border trade finance platform based on DLT.

In September, the HKMA announced a number of initiatives that would prepare Hong Kong for its move into a new era of smart banking. On the supervisory front, the HKMA enhanced its Fintech Supervisory Sandbox to version 2.0, with new features including a chatroom facility accessible to both banks and technology firms, and the establishment of linkages among the sandboxes of the HKMA, SFC and IA so as to provide a single point of entry for trials of cross-sector fintech products. The HKMA also launched a Banking Made Easy initiative to identify and minimise regulatory friction in online customer journeys regarding remote onboarding and account maintenance, online finance and online wealth management. The existing Guideline

on Authorization of Virtual Banks is under review to facilitate the introduction of virtual banking in Hong Kong.

Securities and Futures

Hong Kong's securities market is operated by the SEHK and its futures market by the HKFE, both wholly owned subsidiaries of the HKEX. The total equity funds raised increased 18.3 per cent in 2017 to \$580 billion, while the securities market's total turnover rose 32.4 per cent to \$21.7 trillion, with 44.3 trillion shares traded.

ETFs offer investors a wide range of investment exposure to world, regional and Mainland indices and commodities. During the year, 22 new ETFs, including leveraged and inverse products, were authorised, bringing the total number of SEHK-listed ETFs to 133. The introduction of leveraged and inverse products has brought new trading and hedging tools to investors, while the issuance of ETFs with multiple trading counters in the HKD, USD and RMB has provided additional flexibility in the settlement and trading of ETFs. Turnover of ETFs was about \$1 trillion.

Statistics on Securities Market (Main Board and GEM)

	2015	2016	2017
Number of listed companies (year end)	1,866	1,973	2,118
Total market capitalisation (year end) (\$ billion)	24,684	24,761	33,999
Total equity funds raised (\$ billion)	1,116	489	580
Total securities market turnover (\$ billion)	26,091	16,396	21,709
Total number of shares traded (billion)	53,694	45,612	44,283
Number of derivative warrants (DWs) listed (year end)	4,590	3,705	6,094
Turnover of DWs (\$ billion)	4,504	2,727	3,008
Number of callable bull/bear contracts (CBBCs) listed (year end)	1,630	1,844	3,374
Turnover of CBBCs (\$ billion)	1,837	1,372	1,189
Number of ETFs listed (year end)	133	133	106
Turnover of ETFs (\$ billion)	2,171	1,011	1,065

In the derivatives market, 214.85 million futures and options contracts were traded, 14.2 per cent more than in 2016. Trading of major derivatives products included Hang Seng Index (HSI) Futures, with a total turnover of 31.49 million contracts; Hang Seng China Enterprises Index Futures with a turnover of 28.85 million contracts; HSI Options with a turnover of 10.13 million contracts; Hang Seng China Enterprises Index Options with a turnover of 19.78 million contracts; and Stock Options with a turnover of 105.84 million contracts.

Statistics on Derivatives Market Turnover (million contracts)

	2015	2016	2017
All options and futures contracts	190	188	215
Of which:			
HSI Futures	21	32	31
H-shares Index Futures	33	33	29
HSI Options	8	9	10
H-shares Index Options	15	19	20
Stock Options	92	74	106

At the end of 2017, there were 41 SFC-authorised automated trading services providers, comprising mainly regulated foreign exchanges and clearing houses, and other regulated entities. They provide automated trading services by means of electronic facilities, instead of a recognised exchange company or recognised clearing house, to transact or settle transactions in securities, futures and OTC derivatives.

Securities and Futures Commission

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

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

Investment products – The SFC maintains a robust regulatory regime for, and performs its gate-keeping functions in, authorising investment products offered to the public in Hong Kong under the SFO and monitoring compliance with disclosure and other requirements. It formulates policies about the regulation of the asset management industry, and pursues initiatives that facilitate market growth and product innovation with the overall goal to develop Hong Kong as a full-service international asset management centre and preferred location of fund domicile.

Listings and takeovers – The SFC oversees the SEHK's listing-related functions and the merger, takeover, privatisation and share buy-back activities of public companies in Hong Kong. It conducts a daily review of corporate announcements under the statutory corporate conduct and inside information disclosure provisions. It vets listing applications alongside the SEHK, in addition to enhancing listing rules.

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

Enforcement – The SFC takes firm and prompt action to combat misconduct in the securities and futures markets. It can discipline licensed intermediaries through reprimands, suspensions, licence revocations and fines. It can also deal with market misconduct cases, such as insider dealing and market manipulation, by bringing them to the Market Misconduct Tribunal⁸ or initiating criminal proceedings. In addition, the SFC can apply to the court for injunctive and remedial orders against wrongdoers in favour of victims. Using the full spectrum of its regulatory tools, the SFC strives to protect the interests of the investing public and send strong deterrent messages to the markets.

The Investor Compensation Company Limited is a wholly owned SFC subsidiary established under the SFO to manage the Investor Compensation Fund. It receives and assesses claims and pays from the fund those claims deemed valid in respect of defaults of licensed intermediaries and authorised financial institutions.

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 Tribunal (SFAT). Other checks and balances include the Process Review Panel for the SFC, the Ombudsman and the courts.

Recent Developments

At the end of 2017, there were 44,050 licensed entities, including securities brokers, futures dealers, investment and corporate finance advisers and fund managers as well as their representatives, and 119 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)

	2015	2016	2017
Licensed entities	41,347	42,544	44,050
Of which:			
Licensed corporations	2,172	2,411	2,660
Licensed individuals	39,175	40,133	41,390
Registered institutions	119	121	119

The SFC implemented a new Manager-In-Charge regime in 2017 to enhance the accountability of the senior management of licensed corporations to better align with the responsible officer regime and to promote awareness of their existing obligations and liabilities. One of the key measures under the regime is to require licensed corporations and corporate licence applicants to submit their up-to-date management structure and organisational charts to the SFC on an ongoing basis.

⁸ The Market Misconduct Tribunal 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.

To clarify the SEHK's role as the primary front-line regulator and the SFC's role as the statutory regulator, the SFC and SEHK published conclusions to a joint consultation, launched in 2016, on proposed enhancements to the SEHK's decision-making and governance structure for listing regulation. Under the SFC's new front-loaded regulatory approach, it engages in targeted intervention at an early stage to protect markets and investors and has increased its direct presence in more serious listing matters which fall within the scope of the Securities and Futures (Stock Market Listing) Rules or the SFO.

In addition, the SFC published a guidance note on the duties of directors of listed companies and financial advisers regarding valuations in corporate transactions; a statement on the liability of valuers for disclosure of false or misleading information; and guidelines on the standards of conduct expected of sponsors, underwriters and placing agents for the listing and placing of new GEM stocks.

In view of the Belt and Road Initiative, the SFC issued a statement in April outlining factors it would take into account when reviewing the proposed listing of infrastructure project companies. This will help Hong Kong leverage opportunities presented by this initiative.

Separately, the SFC enhanced the position limit regime for futures and options contracts in June following the conclusion of a public consultation.

To promote fintech development, the SFC launched its Regulatory Sandbox in September to provide a confined regulatory environment for firms to conduct regulated activities utilising fintech.

The SFC signed fintech cooperation agreements with the Dubai Financial Services Authority, Securities Commission Malaysia and Australian Securities and Investments Commission.

On the enforcement front, the SFC took disciplinary action to maintain market integrity. The disciplined SFC licensees comprised 21 individuals and 17 corporations, with fines totalling \$463.09 million.

Separately, nine individuals and four corporations were convicted for criminal offences including the provision of false or misleading statements, short selling, unlicensed activities and failure to disclose interests.

In November, the SFAT upheld the SFC's disciplinary action against the Hong Kong arm of a private banking business for systemic failures in the marketing and sale of derivatives products prior to the onset of the global financial crisis. The bank was fined \$400 million, suspended from advising on securities and partially suspended from dealing in securities for one year.

Insurance

At the end of 2017, there were 159 authorised insurers, 88 of which were incorporated in Hong Kong while the remaining 71 were incorporated on the Mainland or in overseas jurisdictions.

During the past five years, the Hong Kong insurance industry grew 13.2 per cent on average annually. In 2017, gross premiums amounted to \$489.6* billion, a 8.4 per cent increase over 2016. The total revenue premiums of in-force long-term business rose 8.7 per cent to \$441.5* billion. Individual life insurance remained the leading business, accounting for \$412.9* billion, or 93.5* per cent, of total revenue premiums, with 12.7* million corresponding policies.

General insurance business rose to \$48.1* billion from \$45.5 billion in 2016, representing a 5.7 per cent increase in gross premiums. The growth was driven mainly by an increase in gross premiums of accident and health business, comprising medical business. The overall underwriting performance of general insurance business declined from a profit of \$1.8* billion to a loss of \$0.8* billion.

Statistics on Insurance Business

	2015	2016	2017
Number of authorised insurers	157	160	159
Of which:			
Incorporated in Hong Kong	86	87	88
Incorporated on the Mainland or overseas	71	73	71
Premium income (\$ billion)	374.1	451.7	489.6
Total gross premiums			
Of which:			
Long-term in-force business (Office/Revenue premiums)	328.1 [^]	406.2 [^]	441.5* [#]
General insurance (Gross premiums)	46	45.5	48.1*

[^] Office premiums

[#] Revenue premiums

* Provisional statistics

At the end of 2017, there were 99,264 individual insurance intermediaries, comprising 9,489 Chief Executives or Technical Representatives (TRs) of 759 broker firms, 25,842 Responsible Officers or TRs of 2,447 agency firms, and 63,933 individual agents and their 39 TRs.

Insurance Authority

The IA assumed statutory functions on the regulation of insurance companies on 26 June 2017. It will take over the regulation of insurance intermediaries from the three Self-Regulatory Organisations (SROs)⁹ in mid-2019.

The IA is financed by fees payable by insurance companies and insurance intermediaries, user fees for providing specific services by the IA, and a levy on insurance premiums payable by policyholders.

⁹ The three SROs are the Insurance Agents Registration Board established under the Hong Kong Federation of Insurers, the Hong Kong Confederation of Insurance Brokers and the Professional Insurance Brokers Association.

As a member of the International Association of Insurance Supervisors, Hong Kong is required to observe international principles and standards in its insurance supervisory regime. The IA works closely with regulators in other jurisdictions in regulating major insurance groups and takes part in supervisory colleges organised by the home regulators of such groups.

Recent Developments

To achieve full cost recovery in the long run, the IA will start collecting a levy of 0.04 per cent on insurance premiums from policyholders through insurance companies from 1 January 2018. The levy rate will increase gradually until it reaches the target level of 0.1 per cent in 2021-22. A levy cap applies in each policy.

The IA has been closely monitoring the development and application of technology in the insurance industry (insurtech) and helping market participants tackle insurtech-related regulatory issues. The various initiatives launched include:

- the Insurtech Sandbox – to facilitate a pilot run of innovative insurtech applications by authorised insurers to be applied in their business operations;
- a Fast Track for Applications for Authorisation of New Insurers Owning and Operating Solely Digital Distribution Channels – a pilot scheme to expedite applications for new authorisation as a means to promote insurtech development in Hong Kong;
- an insurtech facilitation team – to enhance communication with businesses involved in the development and application of insurtech in Hong Kong, and to promote Hong Kong as an insurtech hub in Asia. Following the team's efforts, the IA entered into a cooperation agreement with the UK Financial Conduct Authority on 21 September and the Dubai Financial Services Authority on 7 December to enhance collaboration in supporting fintech innovation; and
- a Working Group on Embracing Fintech in Hong Kong under Future Task Force – to explore the future of the insurance sector and draw up recommendations.

Mandatory Provident Fund System

As one of the pillars of retirement protection, the MPF System helps the Hong Kong workforce set aside savings for retirement. Unless exempted, employees and self-employed persons (SEPs) aged 18 to 64 are required to join an MPF scheme. At the end of 2017, about 85 per cent of the employed population were covered by the MPF System or other forms of retirement schemes.

The MPF System is employment-based. An employer is required to contribute 5 per cent of an employee's relevant income (RI) as mandatory contribution for the employee, subject to a maximum RI level. Employees are required to make the same amount of contributions for themselves unless their RIs are below the minimum level. SEPs must also contribute 5 per cent of their RIs, subject to the minimum and maximum levels.

MPF benefits, comprising 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.

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

	2015	2016	2017
Number of MPF-enrolled participants (Estimated rate)			
Employers	276,000 (100%)	277,200 (100%)	280,200 (100%)
Relevant employees	2,548,800 (100%)	2,583,800 (100%)	2,581,100 (100%)
SEPs	205,300 (68%)	202,200 (68%)	205,000 (70%)
<i>MPF schemes</i>			
Number of registered schemes	38	36	32
Number of approved constituent funds	459	484	469
Aggregate NAV (\$ billion)	591	646	844
<i>MPF-exempted Orso registered schemes¹⁰</i>			
Number of schemes	3,382	3,294	3,195
Number of participating employees	337,627	333,394	329,021
Aggregate NAV (\$ billion)	290	294	301

MPF schemes are privately managed and stringently regulated. At the year end, there were 14 active approved MPF trustees providing MPF schemes and funds and 32,388 registered MPF intermediaries engaging in regulated activities such as selling and advising on MPF schemes.

Mandatory Provident Fund Schemes Authority

The Mandatory Provident Fund Schemes Authority (MPFA), established under the Mandatory Provident Fund Schemes Ordinance, regulates and supervises the MPF System. It ensures compliance with MPF legislative requirements, thus protecting the interests of scheme members. It monitors MPF trustees, investigates cases of non-compliance, conducts inspections and takes enforcement action. It arranges programmes to strengthen the public's understanding of new developments in the MPF System and to educate scheme members on MPF investments. The MPFA is also the Registrar of Occupational Retirement Schemes.

¹⁰ MPF-exempted Orso registered schemes are occupational retirement schemes set up voluntarily by employers and registered under the Occupational Retirement Schemes Ordinance before the launch of the MPF System, and subsequently granted exemption from MPF requirements.

Recent Developments

The default investment strategy was launched on 1 April to standardise the default investment arrangement of all MPF schemes. The major features of the strategy are a globally diversified investment approach and age-based de-risking. Management fees and recurrent out-of-pocket expenses are capped at, respectively, 0.75 per cent and 0.2 per cent of the NAV of the constituent funds under the default investment strategy. The launch of the strategy is a major reform of the MPF System to provide scheme members with better retirement protection.

The government and the MPFA aim to put in place by 2022 a centralised electronic platform to standardise, streamline and automate MPF scheme administration.

Company Registration

The Companies Registry administers and enforces the Companies Ordinance. It registers local and non-Hong Kong companies and statutory returns, de-registers defunct solvent companies and provides the public with services and facilities for inspecting and obtaining company information kept by the registry. It also processes applications for money lenders' licences and maintains a register of money lenders for inspection by the public.

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

The registry provides electronic search services through the Cyber Search Centre, which handles more than 99 per cent of company searches. The public may also retrieve company information through the Company Search Mobile Service any time and anywhere.

Electronic Certificates of Incorporation and Business Registration Certificates are normally issued together less than one hour after receipt of the applications through the e-Registry portal. A full-scale electronic filing service covering all specified forms is also available. Electronic forms can be filed and made available for searching within 24 hours to facilitate business. The registry launched a free mobile application, CR eFiling, to facilitate the filing of electronic forms in February.

Companies Registry Statistics

	2015	2016	2017
New local companies	139,209	144,883	160,229
Local companies on the register	1,288,666	1,341,223	1,383,946
New non-Hong Kong companies	894	874	1,028
Non-Hong Kong companies on the register	10,029	9,983	10,434

Individual and Corporate Insolvencies

The Official Receiver's Office ensures 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 Official Receiver or a private-sector insolvency practitioner investigates the affairs of the bankrupt or wound-up company, realises assets and distributes dividends to creditors. The Official Receiver also prosecutes insolvency-related offences under the Bankruptcy Ordinance and 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

	2015	2016	2017
Bankruptcy Orders	9,750	8,919	7,627
Interim Orders in IVAs	588	501	529
Winding-up Orders	305	325	296

Professional Accountancy

The Hong Kong Institute of Certified Public Accountants, established under the Professional Accountants Ordinance, registers certified public accountants (CPAs); carries out practice reviews and regulates the professional conduct and standards of members; sets and maintains financial reporting, auditing and ethical standards for the profession; and conducts training and qualifying examinations.

Statistics on CPAs, CPA firms and corporate practices

	2015	2016	2017
Total number of CPAs	39,201	40,806	42,237
Number of practising CPAs	4,428	4,598	4,735
Number of practising CPA firms	1,267	1,284	1,292
Number of corporate practices	491	524	555

The institute issues the Hong Kong Financial Reporting Standards, which 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, investigates Hong Kong-listed entities' non-compliance with accounting standards as well as their auditors' auditing and reporting irregularities. The council also reviews the financial statements of listed entities regularly.

Statistics on FRC's work

	2015	2016	2017
Number of investigations completed ¹¹	9	11	11
Number of enquiries completed ¹²	-	1	-

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

Monetary Policy

The city's monetary policy objective is currency stability, defined as a stable external exchange value of the HKD, in terms of its exchange rate in the forex market against the USD, at around HK\$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 – the USD reserves held in the Exchange Fund at the fixed exchange rate of HK\$7.80 to US\$1. In Hong Kong, the monetary base includes the amount of currency notes and coins issued, the aggregate balance¹³, and the outstanding amount of 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 EFAC oversees the Currency Board system and recommends to the Financial Secretary measures to enhance the robustness and effectiveness of the Currency Board arrangements.

¹¹ The FRC is empowered under the Financial Reporting Council Ordinance to conduct independent investigations into possible auditing and reporting irregularities concerning listed entities.

¹² The FRC is also empowered under the ordinance to conduct independent enquiries into possible non-compliance with accounting requirements on the part of listed entities.

¹³ 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.

Monetary Situation

The HKD monetary situation was stable in 2017. The forex market operated in a smooth and orderly way. During the year, the HKD exchange rate eased and traded between HK\$7.7542 and HK\$7.8265 to US\$1. The easing was driven by interest arbitrage activities amid widening negative gaps between HKD and USD interest rates as US monetary policy continued to normalise. This reflects the normal functioning of the Linked Exchange Rate System. The HKD exchange rate closed the year at HK\$7.8137 to US\$1. The Convertibility Undertaking was not triggered during the year.

The HKD money market also operated in a smooth and orderly manner in 2017. Average daily turnover of HKD interbank transactions was around \$337.2 billion. Interbank liquidity remained ample, with short-dated interbank interest rates staying low, except for intermittent tightness due to several well-received IPOs in the second half of 2017. Longer-dated rates moved higher, largely following, but remaining below, their USD counterparts. Separately, the HKMA issued an additional \$80 billion of Exchange Fund Bills to meet banks' strong demand. The additional issuances were well received and had little impact on local money market conditions. The issuances were made in strict accordance with currency board principles. During the year, there was little change of the monetary base, which stood at about \$1.7 trillion at year end. The aggregate balance declined to about \$180 billion and the outstanding amount of EFBNs in market value increased to \$1,047 billion. Looking ahead, HKD interest rates are expected to rise gradually as US monetary conditions continue to normalise.

Exchange Fund

The 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 investment management of the Exchange Fund. The fund is managed as distinct portfolios to meet the objectives of preserving capital, fully backing the entire monetary base, providing liquidity to maintain financial and monetary stability and preserving the fund's long-term purchasing power. The Backing Portfolio holds highly liquid USD-denominated assets to fully back the monetary base. The Investment Portfolio aims to preserve the fund's long-term purchasing power.

The fund's asset allocation strategy is guided by an investment benchmark determined by the Financial Secretary in consultation with the EFAC. A Strategic Portfolio holds all HKEX shares acquired for strategic purposes by the Financial Secretary using the fund. To better manage risks and enhance returns in the medium and long term, the HKMA has been diversifying part of the fund's investment in a prudent and incremental manner into a wider variety of asset classes, including private equity and real estate investments.

At the end of 2017, the fund had total assets of \$4,015.3 billion and an accumulated surplus of \$713.1 billion¹⁴.

Another function related to the 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 HK\$7.80 to US\$1.

Through the HKMA, the government issues \$10 currency notes and coins in denominations of \$10, \$5, \$2, \$1, 50 cents, 20 cents and 10 cents. The value of all notes and coins in circulation at the end of 2017 was \$468 billion.

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.fdr.org.hk

Financial Reporting Council: www.frc.org.hk

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

Financial Services Development Council: www.fsd.org.hk

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

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

Hong Kong Strategy for Financial Literacy: www.hksfl.hk

Insurance Authority: www.ia.org.hk

Investor Education Centre: www.hkiec.hk

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

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

Securities and Futures Commission: www.sfc.hk

The Chin Family: www.thechinfamily.hk

¹⁴ 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.