Financial Services

Hong Kong is a major international financial centre, comprising an integrated network of institutions and markets which provide a wide range of products and services to local and international customers and investors. Hong Kong's financial markets are characterised by a high degree of liquidity and operate under effective and transparent regulations, which meet international standards.

The Government of the Hong Kong Special Administrative Region (HKSAR) abides by the principle of keeping intervention into the way in which the market operates to a minimum and has endeavoured to provide a favourable environment in which business operates. Its policy of low and simple taxation allows maximum room for business initiatives and innovation. There is a strong emphasis on the rule of law and fair market. There are no barriers of access to the market by foreign businesses and no restrictions on capital flows into and out of Hong Kong. There are also no exchange controls.

The Financial Markets: In the banking sector, at the end of April 2015, there were 157 licensed banks, 23 restricted licence banks and 21 deposit-taking companies in Hong Kong, together with 64 local representative offices of overseas banking institutions. These institutions come from 36 countries and include 71 out of the world's largest 100 banks. Together they operated a comprehensive network of about 1 376 local branches, excluding their principal place of business in Hong Kong. Banks in Hong Kong engage in a wide range of retail and wholesale banking business.

Hong Kong has been ranked first in terms of economic freedom for 21 years (1995–2015), according to the Heritage Foundation.

Hong Kong has a mature and active foreign exchange market, the development of which has been stimulated by the absence of exchange controls in Hong Kong and its favourable time zone location. Links with overseas centres enable foreign exchange dealing to continue 24 hours a day around the world. According to a triennial global survey conducted by the Bank for International Settlements in 2013, Hong Kong was the world's fifth largest foreign exchange market in terms of turnover.

The Hong Kong money market consists primarily of the interbank market. The money market is mostly utilised by institutions at the wholesale level. The Hong Kong Interbank Offer Rate (HIBOR) is determined by the supply of and demand for funds between market players, and therefore is one of the most important indicators of the price of short-term funds in Hong Kong. The daily turnover in the Hong Kong interbank market averaged HK$239 billion in February 2015.

Hong Kong's stock market was the fifth largest in the world and the third largest in Asia in terms of market capitalisation as at the end of April 2015*. Hong Kong was one of the most active markets for raising initial public offering ("IPO") funds. In 2014, US$29.8 billion were raised. A wide variety of products are traded in the stock market, ranging from ordinary shares to options, warrants, Callable Bull Bear Contracts (CBBCs), Exchange Traded Funds (ETFs), Real Estate Investment Trusts (REITs), units trusts and debt securities. As at the end of April 2015, 1 780 companies were listed on the Stock Exchange of Hong Kong (SEHK), with a market capitalisation of HK$30,995.2 billion. Among them, 896 were Mainland enterprises which have together raised around HK$4,531.4 billion from 1993 to the end of April 2015.

For the derivatives market, the Hong Kong Futures Exchange (HKFE) and the SEHK offer a wide range of futures and options products, including index futures, stock futures, interest rate futures, bond futures, gold futures, index options and stock options.

The transactions on the two exchanges are cleared and settled through their three associated clearing houses, namely, the Hong Kong Securities Clearing Company (HKSCC), the Stock Exchange of Hong Kong Options Clearing House Company (SEOCH) and the Hong Kong Futures Exchange Clearing Corporation (HKCC).

As at the end of April 2015, 27 overseas exchanges and market operators were authorised as automated trading services providers to offer their trading services to institutions in Hong Kong.

Apart from the stock market and the futures market, there is also an active over-the-counter (OTC) market which is mainly operated and used by professional institutions and trades swaps, forwards and options in relation to equities, interest rates and currencies. OTC Clearing Hong Kong Limited (OTC Clear), a subsidiary of the Hong Kong Exchanges and Clearing Limited (HKEx), commenced operation in November 2013 to provide clearing services for certain types of OTC derivative products. It now offers clearing services for inter-dealer interest rate swaps and non-deliverable forwards.

Hong Kong's debt market has developed into one of the most liquid markets in the region. The Central Moneymarkets Unit (CMU) Service, established in 1990, is operated by the Hong Kong Monetary Authority (HKMA) to provide a clearing, settlement and custodian system for Exchange Fund Bills and Notes (EFBNs), Hong Kong Government Bonds and other private debt securities. The outstanding amount of the EFBNs was about HK$752.8 billion at the end of April 2015, with daily turnover in these papers averaged HK$12.6 billion. A total of HK$252.7 billion Hong Kong dollar debt securities other than the EFBNs were launched in 2014.

The Chinese Gold and Silver Exchange Society has provided a platform for gold trading in Hong Kong since the early 20th Century. In 2011, it launched the Renminbi Kilobar Gold. In 2013, it launched the platform for Loco Hong Kong Silver, quoted and settled in Hong Kong Dollar.

Hong Kong is one of the most open insurance centres in the world. As at end April 2015, there were 158 authorised insurers, 86 of which were incorporated in Hong Kong and the remaining 72 were incorporated in the

Mainland and 21 overseas countries, with Bermuda and the United Kingdom taking the lead. In recent years, Hong Kong's insurance market has shown considerable growth. According to the provisional statistics, total gross premiums of Hong Kong insurance industry in 2014 was about HK$329.7 billion.

As one of the largest asset management centres in Asia, Hong Kong continued to attract international investors to use it as the platform for investing in the region. Hong Kong's combined fund management business amounted to HK$16,007 billion as at the end of 2013. Hong Kong is also the regional centre for portfolio management activity, including Hong Kong authorised unit trusts and mutual funds and, on a larger scale, institutional fund management. As at end March 2015, there were 2 045 authorised unit trusts and mutual funds in Hong Kong. As at December 31, 2014 the net asset value of authorised unit trusts and mutual funds totalled around US$1,322 billion. To streamline the processing of investment fund transactions in order to make fund order routing and settlement safer and more efficient, the HKMA launched the CMU Fund Order Routing and Settlement Service in August 2009. This was enhanced in June 2013 to support money settlement of investment fund orders using the real-time-gross-settlement System (RTGS) in Hong Kong.

The introduction of the Mandatory Provident Fund (MPF) System since December 2000 has generated significant amounts of retirement assets, adding impetus to the further development of the financial markets. MPF is a long-term investment. Hence, apart from creating new and additional demands for investment products, MPF also contributes to greater stability in the financial markets. As at the end of March 2015, accrued net assets of MPF schemes reached HK$594.8 billion (US$76.3 billion).

Regulation of Financial Markets: In line with the international trend, Hong Kong's financial services regulatory system has evolved and developed over the years. The principal regulators are the HKMA, the Securities and Futures Commission (SFC), the Office of the Commissioner of Insurance (OCI) and the Mandatory Provident Fund Schemes Authority (MPFA). They are responsible respectively for regulation of the banking; securities and futures; insurance and retirement scheme industries.

The HKMA was established in 1993, by merging the Office of the Exchange Fund with the Office of the Commissioner of Banking. This was done primarily to ensure that the central banking functions of maintaining monetary and banking stability can be performed with a high degree of professionalism and continuity, in a manner that commands the confidence of the people of Hong Kong and the international financial community. Besides banking supervision, other functions and objectives of the HKMA include the maintenance of currency stability and promotion of the efficiency, integrity and development of the financial system. These functions and objectives are generally consistent with those of central banks around the world.

The Government is not involved in the day-to-day regulation of the securities and futures industry. The SFC, established in 1989, is an autonomous statutory body responsible for administering the laws governing the securities and futures markets in Hong Kong and facilitating and encouraging the development of these markets. It seeks to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry and to provide protection for investors. Within the regulatory framework, the SFC has regulatory oversight of the HKEx and its subsidiaries, namely the SEHK, the HKFE and four recognised clearing houses. The Government may act as a facilitator and co-ordinator of market reforms pursued by the SFC and HKEx where necessary.

Established as an office within the Government structure, the OCI administers the legislation governing the operation of insurance companies and insurance intermediaries in Hong Kong. The Commissioner of Insurance, who is appointed the Insurance Authority (IA), exercises prudential supervision of the insurance industry for protecting the interests of policy holders and promoting the general stability of the industry. To modernize the insurance industry regulatory infrastructure to facilitate the stable development of the industry, provide better protection for policyholders, and align with international practice that financial regulators should be financially and operationally independent of the Government, the Government introduced a Bill to establish an independent Insurance Authority into LegCo in April 2014.

The MPFA was established in September 1998 as an autonomous, statutory body to regulate, supervise and monitor the operation of the MPF System.

In the wake of the global financial crisis in 2008, a group of major economies have pledged to pursue a series of regulatory reform initiatives to enhance the resilience and stability of the global financial system. One such initiative proposed by the Financial Stability Board is the development of an effective resolution regime to resolve systemically important financial institutions in the event they become insolvent. The resolution regime aims to ensure continuity of systemically important financial services, and payments, clearing and settlement systems. The Government, together with HKMA, SFC and OCI, launched the first stage of a public consultation from January to April 2014. The second stage of public consultation on more specific details is expected to be conducted later in 2014.

Banking: Hong Kong maintains a three-tier system of deposit-taking institutions, namely, licensed banks, restricted licence banks and deposit-taking companies. They are collectively known as authorised institutions (AIs) under the Banking Ordinance. AIs may operate in Hong Kong as either locally incorporated companies or branches of foreign banks.

Only licensed banks may operate current accounts, and accept deposits of any size and maturity. Restricted licence banks are principally engaged in merchant banking and capital market activities. They may take deposits of any maturity of HK$500,000 and above. Deposit-taking companies are mostly owned by or, otherwise associated with, licensed banks and engage in a range of activities, in particular consumer finance. These companies are restricted to taking deposits of HK$100,000 or above with an original term to maturity of at least three months. Depositors of licensed banks in Hong Kong are protected by the Deposit Protection Scheme. Each depositor is entitled to compensation up to a maximum of HK$500,000.

The three-tier structure enables soundly based institutions which do not qualify for a full banking licence to apply for a restricted banking licence or a deposit-taking company registration so as to enter the local deposit-taking market or to conduct wholesale and investment banking business. The authorisation criteria for licensed banks, restricted licence banks and deposit-taking companies seek to ensure that only fit and proper institutions are entrusted with public deposits. The licensing criteria are subject to periodic reviews to ensure that they reflect the changing needs of the regulatory environment and are consistent with evolving international standards.

AIs have to comply with the provisions of the Banking Ordinance which, inter alia, require them to maintain adequate liquidity and capital adequacy ratios; to submit periodic statistical returns to the HKMA; to adhere to limitations on loans to any one customer or to directors and employees; and to seek the HKMA's approval for the appointment of directors, chief executives (including their alternatives) and for changes in control. Overseas banks which operate in branch form are not required to hold capital in Hong Kong. They are also not subject to capital ratio requirements or to capital-based limits in large exposures under the Banking Ordinance.

The legal framework for banking supervision in Hong Kong is in line with international standards including the Basel Committee's *Core Principles for Effective Banking Supervision*. The supervisory process follows a risk-based approach which puts emphasis on the evaluation of the quality of AIs internal risk management systems in respect of current and emerging risks they face. The objective is to devise a prudential supervisory system to help preserve the general stability and effective operation of the banking system, but which at the same time provides sufficient flexibility for AIs to take commercial decisions.

Securities and Futures: The HKSAR Government's policy towards the securities industry is to provide a favourable environment in the industry and a level playing field for market participants, with adequate regulation to ensure as far as possible, sound business standards, investor protection, and confidence in the institutional framework, but without unnecessary impediments of a bureaucratic or fiscal nature.

The advances in technology and globalisation of the financial markets have also intensified the competition between the markets. To strengthen the competitiveness of Hong Kong as an international financial centre, the Financial Secretary announced in his Budget Speech in March 1999 a three-pronged reform for the securities and futures market. The reform includes enhancing the infrastructure for the market; modernising the market structure through the demutualisation and merger of the two exchanges and their three associated clearing houses, and modernising and rationalising the legal framework for the regulatory regime.

For the market structure reform, the merger of the two exchanges and three clearing houses was completed on March 6, 2000 following the enactment of the enabling legislation, viz the Exchanges and Clearing Houses (Merger) Ordinance, on February 24, 2000. HKEx as the merged entity became a listed company on its own stock market on June 27, 2000. The merger seeks to create a new market structure to achieve higher efficiency, cost reduction, better risk management and to facilitate development of new products and services, thereby improving the competitiveness of the market. While the HKEx is a commercial entity, it is vested with the important public functions of maintaining a fair and orderly market and managing its risks prudently. Checks and balances are in place under the law to ensure that it would balance its public and commercial objectives in developing its business.

As regards regulatory reform, the Securities and Futures Ordinance commenced operation on April 1, 2003. The Ordinance consolidated and modernised 10 existing ordinances into a composite piece of legislation governing the securities and futures markets to keep the regulatory regime on a par with international standards and practices. The opportunity was also taken to add new regulatory elements which include introduction of a single licence for market intermediaries to streamline regulatory arrangements and reduce compliance burden; introduction of new licensing requirements to enhance the quality of intermediary services; establishment of a civil Market Misconduct Tribunal and expansion of the existing criminal route to combat market misconduct; modernising the regime for disclosure of securities interests to enhance market transparency; and instituting a flexible framework for the regulation of automated trading services to facilitate market innovation. The Ordinance provides a more transparent and coherent regulatory regime and strikes a reasonable balance between protecting investors and promoting market development. It has enhanced Hong Kong's position as a major international financial centre and the premier capital formation centre for the Mainland of China.

Insurance: The Insurance Companies Ordinance (ICO) provides for the authorisation and prudential supervision, by the IA, of all insurers carrying on insurance business in, or from, Hong Kong. It is the Government's policy to admit new insurers who are well established, financially sound and well managed. All insurers seeking authorisation from the IA are subject to the same authorisation criteria and all authorised insurers are subject to the same prudential supervision, regardless of their place of incorporation.

The ICO also provides the legal provision for the self-regulatory system of insurance intermediaries. Under the system, insurance intermediaries are required to be registered with and subject to the direct supervision by three designated self-regulatory organizations whose codes are approved by the IA. For quality assurance, insurance intermediaries are also required to pass a qualifying examination and to attend continuing professional development programmes.

Offshore Renminbi (RMB) Business in Hong Kong: Hong Kong is the world's largest offshore RMB business hub, with the world's largest offshore pool of RMB liquidity. As at end March 2015, RMB deposits and outstanding RMB certificates of deposits totalled RMB1,061.2 billion. With the development of RMB bonds, loans and equity products, Hong Kong has become the largest centre for conducting offshore RMB financing activities. As at end April 2015, outstanding RMB bonds issued in Hong Kong amounted to RMB356.2 billion. Hong Kong also serves as a platform for enterprises and financial institutions all over the world to conduct RMB trade settlement, payments, financing and investments. In the first three months of 2015, total RMB trade settlement conducted through banks in Hong Kong reached RMB1,626.2 billion. The RMB clearing platform in Hong Kong is also supporting banks from all over the world to conduct their RMB transactions. As at end March 2015, there were a total of 224 banks participating in the RMB clearing platform in Hong Kong, of which 199 were branches and subsidiaries of foreign banks and overseas presence of banks in Mainland China. Business links with overseas markets have also been established to enhance Hong Kong's position as the global hub for offshore RMB business.

MPF System: In August 1995, Hong Kong took a major step in enacting the Mandatory Provident Fund Schemes Ordinance, which provides the framework for the establishment of a privately managed, mandatory provident fund system for the working population. The ordinance was amended in March 1998 and supplemented by subsidiary regulations enacted in April 1998 and May 1999 respectively, setting out the detailed rules governing the operation of the MPF System and exemption of members covered by certain occupational retirement schemes.

As contributions are mandatory, the Government has built into the MPF System a multiplicity of measures to ensure that MPF assets are safe and secure. The measures include stringent criteria for the approval of MPF trustees; prudential supervision to ensure compliance with standards and regulations; smooth and transparent operation of schemes; as well as a compensation fund mechanism to make good losses caused by illegal conduct. The MPF System was implemented in December 2000. As at the end of March 2015 close to 100 per cent of employers, close to 100 per cent of the relevant employees and 68 per cent of the self-employed persons have participated in MPF schemes.

Incorporation of Companies: Companies are incorporated or registered under the Companies Ordinance (CO). Setting up a company in Hong Kong is very convenient. Incorporation can be completed online at the Companies Registry's e-Registry portal by completing an incorporation form and filing a copy of the company's articles of association. With the implementation of a one-stop electronic company incorporation and business registration service since March 2011, electronic Certificates of Incorporation and Business Registration Certificates can normally be obtained in one go in less than 1 hour after submission of the applications. There is also no requirement for a minimum amount of capital while capital duty has been abolished since June 1, 2012. As at April 30 2015, there were 1 278 824 local companies on the Companies Register comprising 605 public companies, 1 265 730 private companies. and 12 489 guarantee companies.

To strengthen our position as an international business and financial centre, the Government has recently completed a rewrite of the CO and brought the new CO into operation on March 3, 2014 to provide a modernised legal framework for the incorporation and operation of companies in Hong Kong.

Money Market: Hong Kong has a sizeable and active interbank market where wholesale Hong Kong dollar funds are transacted among banking institutions. The Hong Kong interbank bid and offer rates are important indicators of the liquidity situation in the financial system and are central to the pricing of Hong Kong dollar credits.

Interbank funds have always been a major source of Hong Kong dollar funding for the banking system, particularly for those banks (mostly foreign incorporated institutions) not operating extensive retail networks. The interbank market is also the venue for those banks with a large customer deposit base to invest in short term loans.

Monetary Policy: The monetary policy objective of Hong Kong is to maintain currency stability, defined as a stable external exchange value of the currency of Hong Kong, in terms of its exchange rate in the foreign exchange market against the US dollar, at around HK$7.80 to US$1. This is adopted having regard to Hong Kong being a highly externally-oriented economy. Stability of the external value of the currency has special significance to Hong Kong, both in terms of the nature of the businesses carried out in the territory and in terms of general confidence.

The Linked Exchange Rate System in Hong Kong was established in October 1983. It is characterised by Currency Board arrangements, requiring the Hong Kong dollar monetary base to be at least 100 per cent backed by, and changes in it to be 100 per cent matched by corresponding changes in, US dollar reserves held in the Exchange Fund. The monetary base includes banknotes and coins issued, the sum of the clearing accounts of licensed banks maintained with the HKMA – the Aggregate Balance – and the outstanding Exchange Fund paper. The Hong Kong dollar banknotes and coins are fully backed by, and their changes fully matched with corresponding changes in US dollars held by the Exchange Fund at the fixed exchange rate of HK$7.80 to US$1. Since September 1998, the HKMA has provided a clear undertaking to licensed banks to convert Hong Kong dollars in their clearing accounts into US dollars. On May 18, 2005 the HKMA introduced a strong-side Convertibility Undertaking to buy US dollars from licensed banks at 7.75, and announced the shifting of the weak-side Convertibility Undertaking from 7.80 to 7.85, so as to achieve symmetry around the Linked Rate of 7.80. Within the Convertibility Zone defined by the levels of the Convertibility Undertakings, the HKMA may choose to conduct market operations consistent with Currency Board principles with the aim of promoting the smooth functioning of the money and foreign exchange markets.

Development of the Debt Market: Over the past decades, a number of measures have been taken to promote the development of the local debt market, including the issuance of EFBN, and the establishment of the Central Moneymarkets Unit (CMU) in 1990. The Exchange Fund paper programme has encouraged the growth of the debt market by supplying high quality Hong Kong dollar debt paper and providing a benchmark yield curve for Hong Kong dollar debt. The establishment of the CMU provides an efficient clearing and settlement system for Hong Kong dollar as well as non-Hong Kong dollar denominated bonds, while the linkages with other overseas clearing systems facilitate cross border investment in debt instruments. The listing of Exchange Fund Notes on the SEHK since August 1999 has broadened the investor base to include retail investors. In June 2007, the HKMA also extended the CMU BID bond tendering service to other debt securities issuers as an additional channel for issuing debt securities in Hong Kong. The Ministry of Finance (MoF) of the Central Government started to use the CMU BID service in 2010 to issue renminbi sovereign bonds in Hong Kong, and has continued to do so annually since then. Beginning from the 2012 MoF issuance, the HKMA also established the "HKMA CMU Central Bank Placement Co-ordinating Window" to help expand the investor base to central banks and monetary authorities. These measures helped promote the development of Hong Kong's offshore renminbi bond market.

In addition to the RTGS System, the HKMA launched the US Dollar and Euro RTGS Systems in 2000 and 2003 respectively, which facilitates the efficient settlement of US dollar and Euro denominated debt securities on a real-time basis within the Asian time zone. In 2007, the HKMA launched the Renminbi RTGS System to cater for clearing and settlement of the renminbi in Hong Kong. To help participating banks better serve their customers in the region, the CMU began operating on all Hong Kong general holidays, with the exception of January 1 (a worldwide holiday), in November 2009 to support intraday/overnight repo facilities of the US Dollar, Euro and Renminbi RTGS Systems. To enhance the inter-operability of the Systems with the global system so as to attract overseas users, CMU and the four RTGS Systems fully migrated from a proprietary system to an open platform riding on SWIFTNet in July 2010.

The HKEx introduced the three-year Exchange Fund Notes futures contract in November 2001 so as to provide a risk management instrument for the debt market. To encourage bond listings, the HKEx reduced the listing fees for debt securities from July 1, 2002. Besides, the government put forward a number of measures to streamline the regulations and procedures in issuing and listing debt securities.

To promote the further and sustainable development of the local bond market, the Government Bond Programme, consisting of the institutional bond issuance programme and the retail bond issuance programme, was established in 2009. Institutional bonds totalling HK$72.6 billion, with tenors ranging from three to ten years, were outstanding as at end June 2015. As regards the retail part, two issues of three-year inflation-linked bonds totalling HK$20 billion offered to Hong Kong residents were outstanding. The retail issuances have further enhanced the investing public's awareness of and interest in bonds and hence promoted the development of a retail bond market in Hong Kong.

Continued efforts have been made to enhance the retail bond market, including educating the public about bond investment; reviewing the regulations relating to the public offering of debt securities; and the issuance of bonds targeting at retail investors through the bank network by the HKMC since 2001. The implementation of the MPF System in December 2000 added impetus to the further growth of the debt market as well as fund management business.

Oversight of Financial Market Infrastructures (FMIs): The Clearing and Settlement Systems Ordinance (CSSO) helps promote the general safety and efficiency of clearing and settlement systems that are material to the monetary or financial stability of Hong Kong or to the functioning of Hong Kong as an international financial centre. Under the CSSO, the Monetary Authority (MA) is empowered to designate and oversee such clearing and settlement systems. The Ordinance also provides statutory backing to the finality of settlement for transactions made through systems designated under the Ordinance by protecting the settlement finality from insolvency laws or any other laws. The MA issues certificates of finality to designated systems meeting certain criteria specified in the Ordinance. The CMU, Hong Kong dollar Clearing House Automated Transfer System (CHATS), Continuous Linked Settlement (CLS) System, US dollar CHATS, Euro CHATS and Renminbi CHATS have been designated and each was issued a certificate of finality. The MA is also responsible for overseeing the trade repository (TR) established in Hong Kong in 2013. The TR maintains a centralized electronic record of data of eligible OTC derivative transactions. In overseeing the FMIs under its purview, the MA has incorporated the new international standards (i.e. the *Principles for Financial Market Infrastructures* (PFMI) jointly published by the Committee on Payments and Market Infrastructures of the Bank for International Settlements and the International Organization of Securities Commissions in April 2012) in its oversight framework.

Participation in international and regional financial organisations: Through active participation in the Financial Stability Board, and international standard-setting bodies such as the Basel Committee on Banking Supervision, International Organisation of Securities Commissions and International Association of Insurance Supervisors, Hong Kong has been contributing to the development of global financial regulatory reform on various fronts. Hong Kong is also a member of the Asian Development Bank and Asia Pacific Economic Cooperation.

The HKSAR Government and financial regulators play an active role in the Financial Action Task Force and the Asia-Pacific Group on Money Laundering, to ensure that our anti-money laundering and counter financing of terrorism regime is in line with those standards and practices.

* Source: World Federation of Exchanges and London Stock Exchange Group

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