

CHAPTER 4 : THE FINANCIAL SECTOR[#]

Summary

- *The low interest rate environment in Hong Kong continued in the third quarter of 2014 amid the ongoing accommodative monetary policy in the United States.*
- *The Hong Kong dollar spot exchange rate stayed close to the strong-side Convertibility Undertaking level of 7.75 per US dollar during most of the third quarter, though it softened slightly towards the end of the quarter amid worries about global economic prospects. The strong-side Convertibility Undertaking was repeatedly triggered by banks during the quarter, and the HKMA passively purchased a total of US\$9.7 billion, leading to a jump in the Aggregate Balance.*
- *Meanwhile, the trade-weighted Hong Kong dollar Nominal Effective Exchange Rate Index and Real Effective Exchange Rate Index both went up along with a stronger US dollar.*
- *The Hong Kong dollar monetary aggregates expanded at a moderate pace in the third quarter. Total loans and advances rose at a slower pace, with loans for use in Hong Kong recording decelerated growth.*
- *The local stock market exhibited sharp fluctuations in the third quarter. After rising further in July and August, the Hang Seng Index underwent a notable correction since early September on renewed concerns over a decelerating global recovery. HSI closed at 22 933 at end-September, the lowest point during the quarter and 1.1% below end-June.*

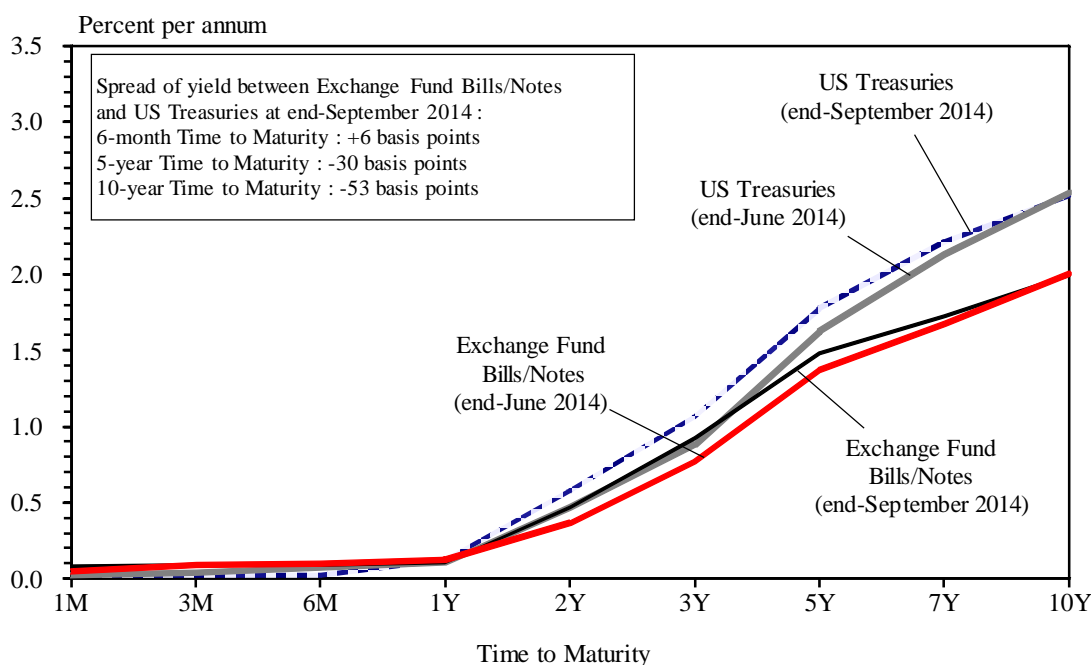
(#) *This chapter is jointly prepared by the Hong Kong Monetary Authority (HKMA) and the Economic Analysis Division.*

Interest rates and exchange rates

4.1 The low interest rate environment in Hong Kong continued in the third quarter of 2014 amid the ongoing accommodative monetary policy in the United States. With the Federal Funds Target Rate staying at 0-0.25%, the *Base Rate* under the Discount Window operated by the HKMA held unchanged at 0.5%⁽¹⁾. The *Hong Kong dollar interbank interest rates* (HIBOR) also stayed at low levels. The three-month HIBOR remained at 0.38% while the overnight HIBOR edged down from 0.20% at end-June to 0.06% at end-September.

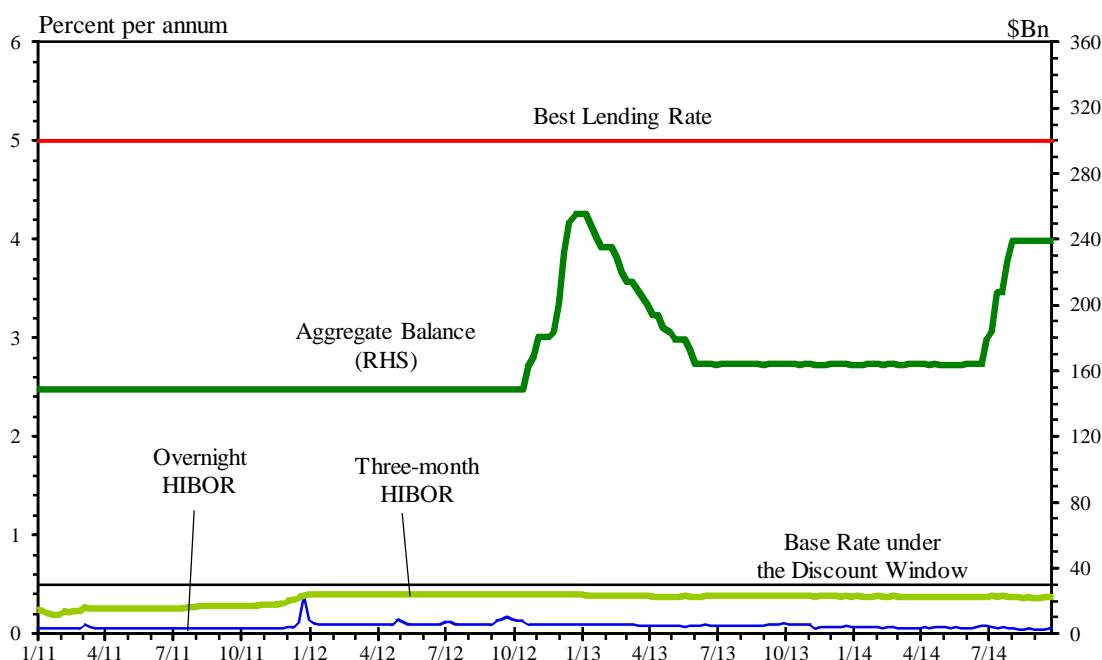
4.2 The *Hong Kong dollar* and *US dollar yields* edged up in the medium tenor (i.e. 2 to 5 years to maturity), yet were broadly unchanged at the short and long tenors. As a result, the positive yield spread between 6-month Exchange Fund Bills and 6-month US Treasury Bills widened slightly from three basis points at end-June to six basis points at end-September, while the negative yield spread between 10-year Exchange Fund Notes and 10-year US Treasury Notes held steady at 53 basis points.

Diagram 4.1 : The Hong Kong dollar and US dollar yield curves were broadly unchanged



4.3 Interest rates on the retail front remained low. The *Best Lending Rates* stayed unchanged at 5.00% or 5.25% in the third quarter. The *average savings deposit rate* and the *one-year time deposit rate* quoted by the major banks for deposits of less than \$100,000 also remained unchanged at 0.01% and 0.16% respectively. The *composite interest rate*⁽²⁾, which indicates the average cost of funds for retail banks, fell slightly from 0.47% at end-June to 0.40% at end-September.

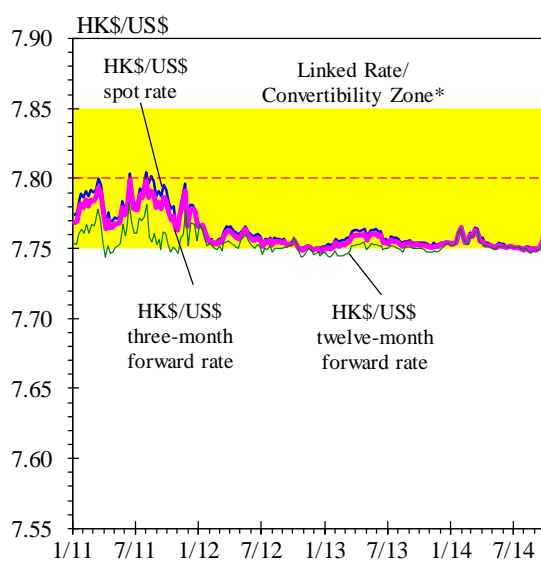
**Diagram 4.2 : Hong Kong dollar interest rates remained low
(end for the week)**



4.4 The *Hong Kong dollar spot exchange rate* stayed close to the strong-side Convertibility Undertaking level of 7.75 per US dollar during most of the third quarter, though it softened slightly towards the end of the quarter amid worries about global economic prospects. It closed at 7.764 per US dollar at end-September, compared with 7.751 at end-June. The strong-side Convertibility Undertaking was repeatedly triggered by banks from July to early August amid strong commercial and equity-related demand for Hong Kong dollar. In response, the HKMA passively purchased a total of US\$9.7 billion, thereby creating HK\$75.3 billion in accordance with the currency board principles. As a result, the Aggregate Balance jumped from \$163.9 billion at end-June to \$239.2 billion at end-September. During the quarter, the differential between the *3-month Hong Kong dollar forward rate* and spot rate edged up from +7 pips (each pip equivalent to HK\$0.0001) to +8 pips, and that between the *12-month forward rate* and spot rate increased from +8 pips to +17 pips.

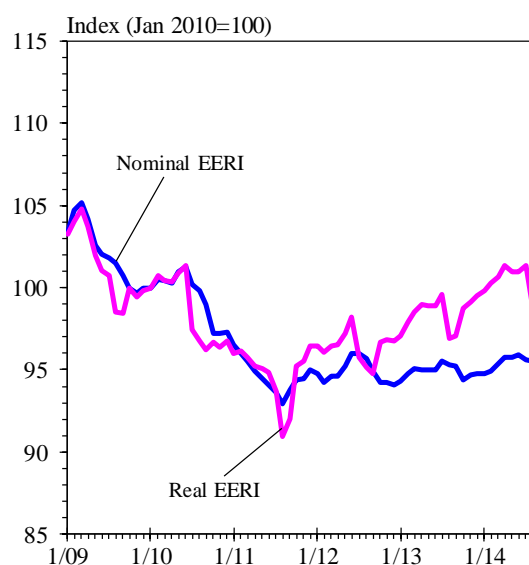
4.5 Under the Linked Exchange Rate system, movements in the Hong Kong dollar exchange rate against other currencies closely followed those of the US dollar. With the US dollar strengthening slightly against most of the major currencies, the *trade-weighted Hong Kong dollar Nominal Index* and *Real Effective Exchange Rate Index*⁽³⁾ went up by 0.2% and 1.6% respectively between June and September.

Diagram 4.3 : Hong Kong dollar stayed close to 7.75 per US dollar during most of the quarter (end for the week)



Note : (*) The shaded area represents the Convertibility Zone that was introduced in May 2005 as part of the three refinements to the Linked Exchange Rate System.

Diagram 4.4 : The trade-weighted nominal and real EERIs both went up (average for the month)



Money supply and banking sector

4.6 The Hong Kong dollar monetary aggregates expanded at a moderate pace in the third quarter. The seasonally adjusted Hong Kong dollar narrow *money supply* (HK\$M1) increased by 3.1% over end-June to \$1,103 billion at end-September, and the broad money supply (HK\$M3) by 1.4% to \$5,223 billion⁽⁴⁾. Meanwhile, *total deposits* with authorized institutions (AIs)⁽⁵⁾ grew by 3.2% to \$9,920 billion, within which Hong Kong dollar deposits and foreign currency deposits increased by 1.5% and 4.8% respectively.

Diagram 4.5 : The monetary aggregates recorded modest growth

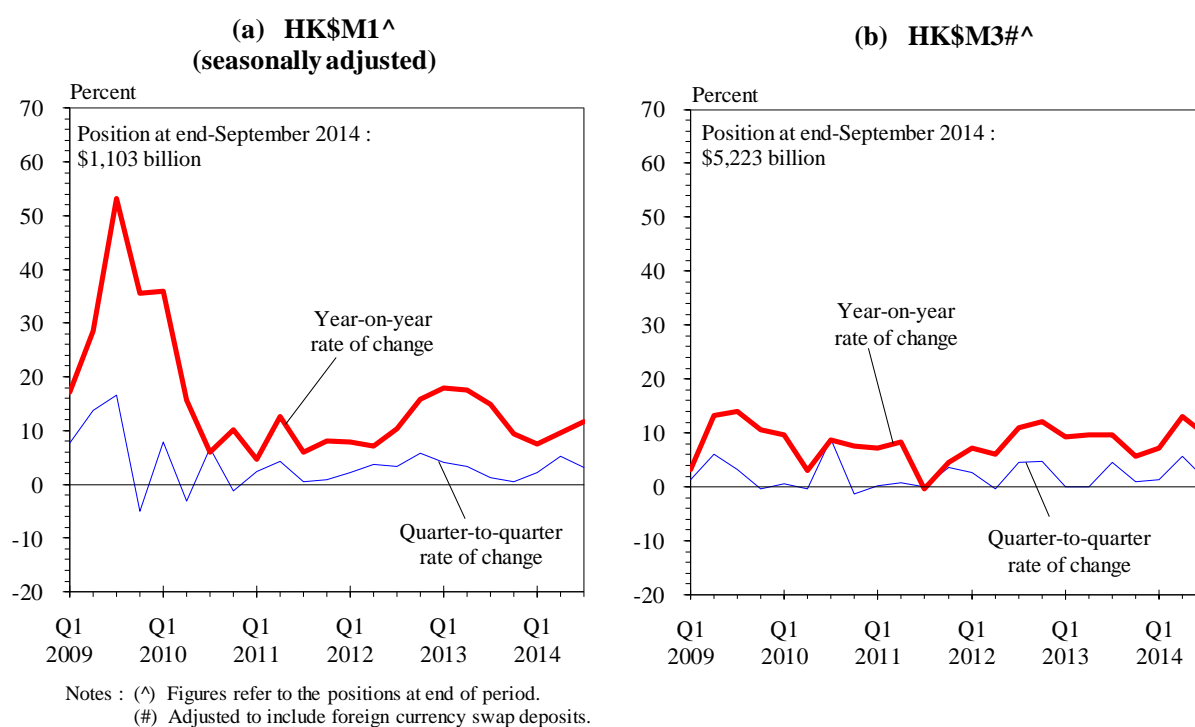


Table 4.1 : Hong Kong dollar money supply and total money supply

		<u>M1</u>		<u>M2</u>		<u>M3</u>	
<u>% change during the quarter</u>		<u>HK\$[^]</u>	<u>Total</u>	<u>HK\$^(a)</u>	<u>Total</u>	<u>HK\$^(a)</u>	<u>Total</u>
2013	Q1	4.0	1.0	0.1	1.1	0.1	1.1
	Q2	3.3	2.7	#	1.9	0.1	1.9
	Q3	1.2	3.9	4.6	5.5	4.6	5.5
	Q4	0.6	1.8	0.9	3.4	0.9	3.4
2014	Q1	2.2	0.8	1.4	0.9	1.4	0.9
	Q2	5.3	6.9	5.7	4.5	5.7	4.5
	Q3	3.1	3.1	1.4	2.9	1.4	3.0
Total amount at end-September 2014 (\$Bn)		1,103	1,678	5,212	10,911	5,223	10,947
% change over a year earlier		11.6	13.1	9.7	12.2	9.7	12.3

Notes : (^) Seasonally adjusted.

(a) Adjusted to include foreign currency swap deposits.

(#) Change of less than $\pm 0.05\%$.

4.7 Total loans and advances grew by 1.9% over end-June to \$7,210 billion at end-September. Within the total, Hong Kong dollar loans grew modestly by 0.7%, while foreign currency loans expanded by a faster 3.5%. Reflecting the relative movements in deposits and loans, the

loan-to-deposit ratio for Hong Kong dollar decreased from 82.5% at end-June to 81.8% at end-September, while that for foreign currency edged down from 65.0% to 64.2%.

4.8 Loans for use in Hong Kong (including trade finance) increased at a decelerated pace of 1.4% over end-June to \$5,111 billion at end-September, while loans for use outside Hong Kong rose by 3.2% to \$2,099 billion. Within the former, trade financing recorded a marginal increase of 0.2%. Growth in loans to financial concerns moderated to 1.2%, while loans to stockbroker plunged by 38.8% due to a correction in stock market towards the end of the quarter. Meanwhile, loans to manufacturing and wholesale and retail trade continued to grow strongly, by 7.1% and 8.0% respectively. As for property-related lending, loans to building, construction, property development and investment edged up by 0.8%, while loans for purchase of residential property expanded by 2.3%.

Table 4.2 : Loans and advances

All loans and advances for use in Hong Kong											
		Loans to :							All loans and advances for use outside Hong Kong ^(c)		Total loans and advances
% change during the quarter		Trade finance	Manu- facturing	Wholesale and retail trade	Building, construction, property development and investment	Purchase of residential property ^(a)	Financial concerns	Stock- brokers	Total ^(b)	Hong Kong ^(c)	advances
2013	Q1	19.3	2.5	1.1	-0.7	1.7	5.1	26.3	3.1	2.9	3.0
	Q2	23.9	9.3	8.8	4.2	1.3	3.3	17.3	7.0	4.3	6.3
	Q3	7.9	4.4	6.7	4.3	0.5	3.5	125.5	3.6	8.5	5.0
	Q4	-9.8	0.8	1.6	-0.8	0.3	6.5	-53.2	-0.5	4.3	0.9
2014	Q1	12.4	7.4	5.5	2.7	1.0	12.0	38.2	6.6	3.7	5.7
	Q2	2.2	6.7	5.2	1.6	2.1	3.3	68.1	4.4	1.7	3.6
	Q3	0.2	7.1	8.0	0.8	2.3	1.2	-38.8	1.4	3.2	1.9
Total amount at end-September 2014 (\$Bn)		633	266	501	1,045	1,002	383	44	5,111	2,099	7,210
% change over a year earlier		3.7	23.6	21.9	4.3	5.8	24.7	-33.5	12.3	13.6	12.7

Notes : Some loans have been reclassified. As such, the figures are not strictly comparable with those of previous quarters.

- (a) Figures also include loans for the purchase of flats under the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme, in addition to those for the purchase of private residential flats.
- (b) Loans to individual sectors may not add up to all loans and advances for use in Hong Kong, as some sectors are not included.
- (c) Also include loans where the place of use is not known.

4.9 The Hong Kong banking sector remains resilient. The Hong Kong incorporated AIs were well capitalised, with the total capital adequacy ratio staying high at 16.1% at end-June 2014. So far no AIs have encountered difficulties in complying with the statutory minimum ratios required by the HKMA under Basel III⁽⁶⁾.

4.10 The consultation paper on the proposal for establishing and implementing a local regulatory and supervising framework for systemically important AIs in Hong Kong was generally supported by the industry. The HKMA was in the process of developing a new Supervisory Policy Manual module on systemically important banks. Separately, HKMA has been working on the implementation of the second phase of the Basel III standards which encompass the liquidity coverage ratio, the capital buffers (i.e. the “capital conservation buffer”, the “countercyclical capital buffer”, and for systemically important banks, the “higher loss absorbency requirements”), and the requirements for disclosure by banks that are associated with these standards as well as the Basel III Leverage Ratio. To this end, draft amendments to the Banking (Capital) Rules and a draft set of Banking (Liquidity) Rules are being finalised for submission to the Legislative Council in Q4 2014, with a view to having them take effect from 1 January 2015. Preparation on draft amendments to the Banking (Disclosure) Rules are likewise in progress with a view to having them take effect from the first disclosure of AIs in 2015.

4.11 Asset quality of the local banking sector remained good. The ratio of classified loans to total loans edged down further from 0.46% at end-March to 0.44% at end-June. The delinquency ratio for credit card lending stayed low at 0.22%. The delinquency ratio for residential mortgage loans remained unchanged at a low level of 0.02% at end-September.

Table 4.3 : Asset quality of retail banks*
(as % of total loans)

<u>As at end of period</u>		<u>Pass loans</u>	<u>Special mention loans</u>	<u>Classified loans (gross)</u>
2013	Q1	98.32	1.22	0.46
	Q2	98.42	1.11	0.47
	Q3	98.25	1.27	0.48
	Q4	98.33	1.20	0.48
2014	Q1	98.42	1.12	0.46
	Q2	98.51	1.05	0.44

Notes : Due to rounding, figures may not add up to 100.

(*) Period-end figures relate to Hong Kong offices and overseas branches. Loans and advances are classified into the following categories: Pass, Special Mention, Substandard, Doubtful and Loss. Loans in the substandard, doubtful and loss categories are collectively known as “classified loans”.

4.12 RMB business grew further in the third quarter. *RMB trade settlement handled by banks in Hong Kong* jumped by 75% over a year earlier to RMB1,609 billion. Meanwhile, *total deposits* (including customer deposits and outstanding certificates of deposit) edged up by 0.2% over end-June to RMB1,128 billion at end-September.

4.13 RMB bond issuance in the third quarter declined to RMB31 billion from the high base of comparison of RMB72 billion in the preceding quarter. Yet total RMB bond issuance totalled RMB164 billion in the first three quarters, 40% more than the total issuance in the entire year of 2013. Meanwhile, *outstanding RMB loans* leapt by 20% over the preceding quarter to RMB167 billion at end-September.

Table 4.4 : Renminbi deposits and cross-border renminbi trade settlement in Hong Kong

<u>As at end of period</u>		<u>Interest rates on^(a)</u>					<u>Number of AIs engaged in RMB business</u>	<u>Amount of cross-border RMB trade settlement^(c)</u> (RMB Mn)
		<u>Demand and savings deposits</u> (RMB Mn)	<u>Time deposits</u> (RMB Mn)	<u>Total deposits</u> (RMB Mn)	<u>Savings deposits^(b)</u> (%)	<u>Three-month time deposits^(b)</u> (%)		
2013	Q1	144,314	523,744	668,058	0.25	0.52	140	830,955
	Q2	127,512	570,447	697,959	0.25	0.53	140	864,366
	Q3	135,217	594,801	730,018	0.25	0.53	143	921,282
	Q4	151,055	709,417	860,472	0.25	0.53	146	1,224,349
2014	Q1	167,082	777,828	944,910	0.25	0.53	147	1,488,813
	Q2	150,696	775,218	925,914	0.25	0.53	148	1,437,291
	Q3	144,306	800,168	944,473	0.25	0.53	149	1,609,298
% change in 2014 Q3 over 2013 Q3		6.7	34.5	29.4	N.A.	N.A.	N.A.	74.7
% change in 2014 Q3 over 2014 Q2		-4.2	3.2	2.0	N.A.	N.A.	N.A.	12.0

Notes : (a) The interest rates are based on a survey conducted by the HKMA.

(b) Period average figures.

(c) Figures during the period.

N.A. Not available.

The debt market

4.14 The Hong Kong dollar debt market picked up in the third quarter of 2014. Total issuance for Hong Kong dollar debt securities edged up by 1.3% over the preceding quarter to \$601.3 billion. Within the total, public sector debt issuance increased slightly by 2.1%, as a jump in new debts issued by the Government and statutory bodies/government-owned corporations more than offset the slight decrease in Exchange Fund papers. Meanwhile, a plunge in new debts issued by non-MDBs overseas borrowers pulled private sector debt issuance lower by 8.3%, despite a significant growth in new issuance by AIs and local corporations⁽⁷⁾. As a result, the Hong Kong dollar debt market expanded slightly, with the total outstanding balance rising by 0.5% to \$1,404.2 billion at end-September. This was equivalent to 26.9% of HK\$M3 or 22.5% of Hong Kong dollar-denominated assets of the entire banking sector⁽⁸⁾.

4.15 As to the Government Bond (“GB”) Programme, three bond tenders were held under the institutional part in the third quarter of 2014, i.e. a \$2 billion 5-year re-opening tender in July, a \$1 billion 10-year new issuance tender in August and a \$3.5 billion 2-year re-opening tender in September. As to the retail part, this year’s iBond was issued in August, with the issuance size of \$10 billion. A total of 488 170 valid applications were received for a total of around \$28.79 billion in principal amount of bonds. Later in September the Government successfully issued the inaugural sukuk (“the Sukuk”) under the Government Bond Programme. The Sukuk, with an issuance size of US\$1 billion and a tenor of 5 years, was greeted with favourable market responses and attracted orders exceeding US\$4.7 billion. Its issuance marked the world’s first US dollar sukuk originated by an AAA-rated government and signified an important milestone in the development of the Islamic capital market in Hong Kong. At end-September 2014, the outstanding size of Hong Kong dollar bonds issued under the GB programme amounted to \$103.5 billion, including 12 institutional issues for \$73.5 billion, and three retail issues (iBonds) for \$30 billion.

**Table 4.5 : New issuance and outstanding value of
Hong Kong dollar debt securities (\$Bn)**

	Exchange Fund paper	Statutory bodies/govern ment-owned corporations	Govern -ment	Public sector total	AIs ^(a)	Local corporations	Non-MDBs overseas borrowers ^(b)	Private sector total	MDBs ^(b)	Total
New Issuance										
2013 Annual	2,123.4	10.7	30.0	2,164.1	143.0	25.6	23.1	191.7	0.9	2,356.8
Q1	508.9	3.5	7.0	519.4	32.5	11.6	6.1	50.3	0.0	569.7
Q2	537.6	5.0	13.0	555.6	39.5	2.2	7.5	49.2	0.0	604.7
Q3	532.0	1.1	7.0	540.1	43.2	6.6	2.4	52.2	0.9	593.2
Q4	545.0	1.1	3.0	549.1	27.8	5.2	7.1	40.0	0.0	589.1
2014 Q1	525.4	2.5	7.5	535.4	33.3	9.8	13.3	56.4	1.3	593.1
Q2	539.5	0.2	3.8	543.5	23.2	6.5	20.6	50.3	0.0	593.8
Q3	533.6	4.9	16.5	555.1	32.2	8.3	5.6	46.2	0.0	601.3
% change in 2014 Q3 over 2013 Q3	0.3	348.8	135.7	2.8	-25.3	25.4	130.4	-11.6	-	1.4
% change in 2014 Q3 over 2014 Q2	-1.1	2,985.6	334.2	2.1	39.0	27.8	-72.8	-8.3	-	1.3
Outstanding (as at end of period)										
2013 Q1	708.6	45.7	72.0	826.4	249.7	123.0	145.8	518.5	10.2	1,355.1
Q2	750.1	43.2	85.0	878.3	250.9	117.0	149.0	516.9	9.9	1,405.0
Q3	750.6	40.1	88.5	879.2	248.1	122.9	148.1	519.2	10.4	1,408.7
Q4	751.2	39.8	91.5	882.5	250.1	127.9	148.7	526.7	10.2	1,419.4
2014 Q1	751.5	40.1	95.5	887.1	249.0	130.4	150.9	530.3	11.1	1,428.4
Q2	752.0	37.1	99.3	888.4	228.9	124.4	148.1	501.5	6.9	1,396.7
Q3	752.2	41.5	105.8	899.5	223.0	132.3	142.5	497.8	6.9	1,404.2
% change in 2014 Q3 over 2013 Q3	0.2	3.5	19.5	2.3	-10.1	7.6	-3.8	-4.1	-33.8	-0.3
% change in 2014 Q3 over 2014 Q2	#	11.8	6.5	1.3	-2.6	6.4	-3.8	-0.7	#	0.5

Notes : Figures may not add up to the corresponding totals due to rounding and may be subject to revisions.

(a) AIs : Authorized institutions.

(b) MDBs : Multilateral Development Banks.

N.A. Not available.

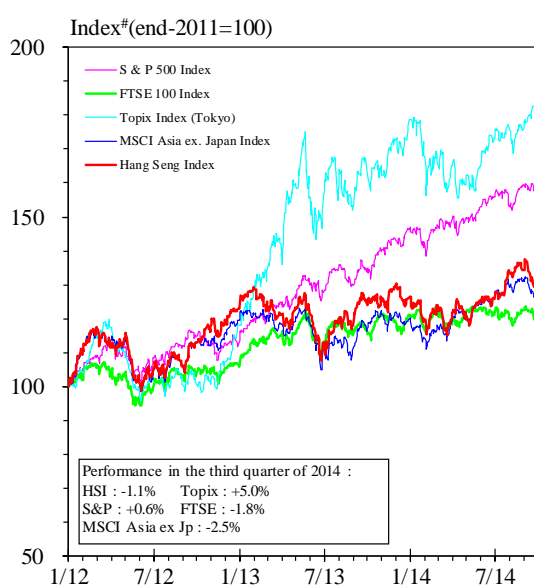
(#) Change of less than $\pm 0.05\%$.

The stock and derivatives markets

4.16 The *local stock market* exhibited sharp fluctuations in the third quarter of 2014. The Hang Seng Index (HSI) rose further in July and August, as market sentiment was boosted by the expected implementation of the Shanghai-Hong Kong Stock Connect and the hopes for a strengthening global economy in the latter part of the year. Nonetheless, after reaching a high of 25 318 in early September, it underwent a notable correction amid renewed concerns over a decelerating global recovery. HSI closed at 22 933 at end-September, the lowest point during the quarter and 1.1% below end-June. Meanwhile, the *market capitalisation* rose modestly, by 2.0% to \$24.4 trillion. According to the World Federation of Exchanges, the local stock market was the sixth largest stock exchange in the world and second largest in Asia⁽⁹⁾.

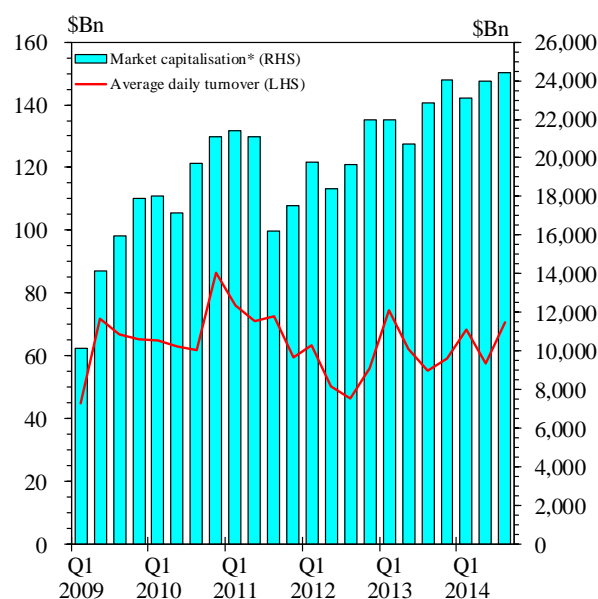
4.17 Trading activities showed some pick-up in the third quarter. *Average daily turnover* in the securities market rebounded sharply by 23.3% from the preceding quarter or 28.4% from a year earlier to \$70.9 billion. Likewise, trading of *derivatives products*⁽¹⁰⁾ increased. The average daily trading volume of futures and options rose by 12.2% over the preceding quarter, with trading of H-shares Index futures, HSI futures, HSI options and stock options going up by 2.0%, 2.8%, 3.7% and 21.0% respectively. The average daily trading value of securitised derivatives products soared by 43.9%, within which trading of derivative warrants and callable bull/bear contracts surged by 52.9% and 29.9% respectively.

Diagram 4.6 : The Hang Seng Index showed some sharp fluctuations in the third quarter of 2014



Notes : (#) Position at end of month.

Diagram 4.7 : Market capitalisation rose further, and trading activities showed some pick-up



Note : (*) Position at end of quarter.

Table 4.6 : Average daily turnover of derivatives products of the Hong Kong market

		Hang Seng Index <u>futures</u>	Hang Seng Index <u>options</u>	H-shares Index <u>futures</u>	Stock options <u>options</u>	Total futures and options <u>traded*</u>	Derivative warrants <u>(\$Mn)</u>	Callable bull/bear contracts <u>(\$Mn)</u>	Total securitised derivatives traded <u>(\$Mn)^</u>
2013	Annual	80 247	35 252	85 538	249 295	532 905	7,309	5,202	12,510
	Q1	82 570	38 464	77 111	278 115	552 686	10,268	6,032	16,301
	Q2	91 137	43 304	87 653	256 162	563 658	7,150	5,433	12,583
	Q3	78 192	31 109	87 853	217 169	503 305	6,190	5,250	11,441
	Q4	69 587	28 614	89 157	247 867	514 398	5,783	4,138	9,920
2014	Q1	71 607	28 842	92 576	274 757	554 700	7,077	5,090	12,167
	Q2	64 897	28 810	77 613	251 375	496 449	6,404	4,074	10,478
	Q3	66 730	29 887	79 181	304 098	556 968	9,791	5,290	15,081
% change in 2014 Q3 over 2013 Q3		-14.7	-3.9	-9.9	40.0	10.7	58.2	0.8	31.8
% change in 2014 Q3 over 2014 Q2		2.8	3.7	2.0	21.0	12.2	52.9	29.9	43.9

Notes : (*) Turnover figures for individual futures and options are in number of contracts, and may not add up to the total futures and options traded as some products are not included.

(^) Comprising derivative warrants and callable bull/bear contracts.

4.18 Having stayed generally subdued in the past two years or so, fund raising activities staged a strong rebound in the third quarter. *Total equity capital raised*, comprising new share floatations and post-listing arrangements on the Main Board and the Growth Enterprise Market (GEM)⁽¹¹⁾, soared by 272% over the preceding quarter or 626% over a year earlier to a high level of \$392.1 billion. Within the total, the amount of funds raised through initial public offerings also surged by 36.5% over the low base in the preceding quarter to \$49.2 billion.

4.19 Mainland enterprises continued to play a dominant role in the Hong Kong stock market. A total of 857 Mainland enterprises (including 195 H-share companies, 130 “Red Chips” companies and 532 private enterprises) were listed on the Main Board and GEM, accounting for 50% of the total number of listed companies and 59% of total market capitalisation at end-September 2014. During the third quarter, Mainland-related stocks accounted for 69% of equity turnover and 92% of total equity fund raised in the Hong Kong stock exchange.

4.20 To increase the transparency in the over-the-counter (OTC) derivative market, in July the HKMA and the Securities and Futures Commission (SFC) jointly launched a consultation on the draft Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping) Rules. The consultation focused on the detailed requirements for the mandatory reporting and related record keeping obligations under the new OTC derivative regulatory regime. The consultation ended on 18 August 2014, and the SFC is now working with the HKMA on the submissions received with a view to issuing the consultation conclusions in due course.

4.21 In August the revised Code on Real Estate Investment Trusts (REITs) was gazetted and subsequently took effect. The revisions allow greater flexibility in the investment scope of REITs with respect to property development activities and financial instrument, subject to additional safeguards and regulatory measures. This will help to promote the long-term growth of Hong Kong's REIT market in a manner that protects investors' interests and market confidence.

4.22 During the third quarter of 2014, further progress has been made for the development of the Shanghai-Hong Kong Stock Connect ("the programme"), a pilot programme announced in April for establishing mutual stock market access between Shanghai and Hong Kong⁽¹²⁾. In August and September, one round of connectivity test and two rounds of market rehearsals have been successfully conducted for participants to ascertain their system readiness for the programme, to familiarise themselves with the trading features of Northbound trading, and to test their trading and clearing operations. The Hong Kong stock exchange would analyse the results from the test and market rehearsals and take follow-up actions as appropriate.

Fund management and investment funds

4.23 Most segments in the fund management business expanded during the third quarter. The aggregate net asset value of the approved constituent funds under the *Mandatory Provident Fund (MPF) schemes*⁽¹³⁾ edged up by 0.7% to \$547 billion between end-June and end-September. The monthly average gross retail sales of *mutual funds* rose by 12.1% from the preceding quarter to US\$7.7 billion in July and August⁽¹⁴⁾. Meanwhile, the amount of net assets managed by *retail hedge funds* declined⁽¹⁵⁾.

Insurance sector

4.24 In the second quarter of 2014, the *insurance sector*⁽¹⁶⁾ expanded further. Gross premium income from long-term business rose by another 18.2% over a year earlier, though there was varied performance for different segments. Premium income from non-investment linked plans increased by a sharp 32.0% while that from investment-linked plans plummeted by 24.8%. Meanwhile, gross premium and net premium for general business went up modestly, by 2.1% and 3.4% respectively.

Table 4.7 : Insurance business in Hong Kong* (\$Mn)

		General business			Premium for long-term business [^]				Gross premium from long-term business and general business	
		Gross premium	Net premium	Underwriting profit	Individual life and annuity (non-linked)	Individual life and annuity (linked)	Other individual business	Non-retirement scheme group business		All long-term business
2013	Annual	42,120	29,179	3,038	73,015	19,132	156	285	92,588	134,708
	Q1	12,359	8,759	657	17,527	4,919	36	53	22,535	34,894
	Q2	10,428	7,446	864	17,570	5,597	40	61	23,268	33,696
	Q3	10,512	7,314	671	18,910	3,831	40	50	22,831	33,343
	Q4	8,821	5,660	846	19,008	4,785	40	121	23,954	32,775
2014	Q1	12,551	8,668	902	23,770	3,387	39	180	27,376	39,927
	Q2	10,642	7,697	636	23,191	4,210	40	53	27,494	38,136
% change in 2014 Q2 over 2013 Q2		2.1	3.4	-26.4	32.0	-24.8	#	-13.1	18.2	13.2

Notes : (*) Figures are based on provisional statistics of the Hong Kong insurance industry.

(^) Figures refer to new business only. Retirement scheme business is excluded.

(#) Change of less than $\pm 0.05\%$.

Highlights of policy and market developments

4.25 In September the HKMA and the Financial Services and the Treasury Bureau jointly issued a consultation paper on the proposed enhancements to the Deposit Protection Scheme (DPS). As a statutory scheme established to protect depositors and reduce the risks of bank runs during a banking crisis, DPS has been a key component of the financial safety net that contributes to the stability of the financial system. To accelerate the process of making deposit compensation to depositors when a bank fails, it is proposed to adopt the “gross

payout” approach to determine DPS compensation (i.e. a depositor would be compensated up to the protect limit without the need to set-off the depositor’s liabilities in the same bank at the time of payout), to provide more certainty for determining the reference date used for calculating the compensation amount, and to enable the use of electronic communication channels under certain circumstances to notify depositors of the compensation arrangements and other details. The Government would carefully study the comments received and would take them into account in preparing the legislative amendments.

Notes :

- (1) Prior to 9 October 2008, the Base Rate was set at either 150 basis points above the prevailing US Federal Funds Target Rate (FFTR) or the average of the five-day moving averages of the overnight and one-month HIBORs, whichever was higher. Between 9 October 2008 and 31 March 2009, this formula for determination of the Base Rate was temporarily changed by reducing the spread of 150 basis points above the prevailing FFTR to 50 basis points and by removing the other leg relating to the moving averages of the relevant interbank interest rates. After a review of the appropriateness of the new Base Rate formula, the narrower 50 basis point spread over the FFTR was retained while the HIBOR leg was re-instated in the calculation of the Base Rate after 31 March 2009.
- (2) In December 2005, the HKMA published a new data series on composite interest rate, reflecting movement in various deposit rates, interbank and other interest rates to closely track the average cost of funds for banks. The published data enable the banks to keep track of changes in funding cost and thus help improve interest rate risk management in the banking sector.
- (3) The trade-weighted Nominal Effective Exchange Rate Index (EERI) is an indicator of the overall exchange value of the Hong Kong dollar against a fixed basket of other currencies. Specifically, it is a weighted average of the exchange rates of the Hong Kong dollar against some 15 currencies of its major trading partners, with the weights adopted being the respective shares of these trading partners in the total value of merchandise trade for Hong Kong during 2009 and 2010.

The Real EERI of the Hong Kong dollar is obtained by adjusting the Nominal EERI for relative movements in the seasonally adjusted consumer price indices of the respective trading partners.

- (4) The various definitions of the money supply are as follows:

M1 : Notes and coins with the public, plus customers’ demand deposits with licensed banks.

M2 : M1 plus customers’ savings and time deposits with licensed banks, plus negotiable certificates of deposit (NCDs) issued by licensed banks, held outside the monetary sector as well as short-term Exchange Fund placements of less than one month.

M3 : M2 plus customers' deposits with restricted licence banks and deposit-taking companies, plus NCDs issued by such institutions and held outside the monetary sector.

Among the various monetary aggregates, more apparent seasonal patterns are found in HK\$M1, currency held by the public, and demand deposits.

- (5) AIs include licensed banks, restricted licence banks and deposit-taking companies. At end-September 2014, there were 159 licensed banks, 20 restricted licence banks and 23 deposit-taking companies in Hong Kong. Altogether, 202 AIs (excluding representative offices) from 31 countries and territories (including Hong Kong) had a presence in Hong Kong.
- (6) Basel III was introduced by the Basel Committee in December 2010 (and subsequently revised in June 2011) to strengthen the resilience of banks and banking systems in the light of lessons drawn from the global financial crisis. It tightens the definition of regulatory capital and increases the minimum common equity requirement from 2% to 4.5% of risk-weighted assets and the Tier 1 capital from 4% to 6% (with the total capital ratio remaining at 8%); requires banks to hold a Capital Conservation Buffer of 2.5% during good times and a Countercyclical Capital Buffer in the range of 0% to 2.5% (or higher at national discretion) at times of excessive credit growth, both to be met by common equity. It introduces a supplementary leverage ratio as a backstop to risk-weighted capital measures and enhances the transparency of the capital base. In addition, Basel III introduces two liquidity standards i.e. the Liquidity Coverage Ratio (LCR) to promote short term liquidity resilience and the Net Stable Funding Ratio (NSFR) to encourage more stable funding structures. The LCR is scheduled to take effect from 1 January 2015, starting with a minimum required level of 60% which is to be stepped up by 10 percentage points annually until achieving 100% by 1 January 2019. The NSFR is scheduled to take effect from 1 January 2018. The revision to the standard is expected to be finalised in October 2014. The first phase of Basel III standards, which covers revised minimum capital requirements calculated based on a stricter definition of capital base and a wider risk coverage, took effect in Hong Kong with the amendments to the Banking (Capital) Rules (by way of the Banking (Capital) (Amendment) Rules 2012) coming into operation since 1 January 2013. To implement the Basel Committee's disclosure requirements associated with these standards, amendments were introduced in the Banking (Disclosure) Rules (by way of the Banking (Disclosure) (Amendment) Rules 2013) which took effect from 30 June 2013.
- (7) The figures for private sector debt may not represent a full coverage of all the Hong Kong dollar debt paper issued.
- (8) Assets of the banking sector include notes and coins, amount due from AIs in Hong Kong as well as from banks abroad, loans and advances to customers, negotiable certificates of deposit (NCDs) held, negotiable debt instruments other than NCDs held, and other assets. Certificates of indebtedness issued by Exchange Fund and the counterpart bank notes issued are nevertheless excluded.
- (9) The ranking is made by the World Federation of Exchanges, a global trade association for the securities exchange industry. Its membership comprises 64 securities exchanges, covering almost all globally recognised stock exchanges.
- (10) At end-September 2014, there were 77 classes of stock options contracts and 41 classes of stock futures contracts.

- (11) At end-September 2014, there were 1 521 and 200 companies listed on the Main Board and GEM respectively.
- (12) For details, see 4.25 and footnote (13) of chapter 4 in the First Quarter Economic Report 2014.
- (13) At end-September 2014, there were 19 approved trustees. On MPF products, 36 master trust schemes, two industry schemes and one employer sponsored scheme, comprising altogether 471 constituent funds, were approved by the Mandatory Provident Fund Schemes Authority. A total of 272 000 employers, 2.50 million employees and 210 000 self-employed persons have participated in MPF schemes.
- (14) These figures are obtained from the Sales and Redemptions Survey conducted by the Hong Kong Investment Funds Association on their members, and cover only the active authorised funds that have responded to the survey. At end-August 2014, the survey covered a total of 1 191 active authorised funds.
- (15) At end-September 2014, there were three SFC-authorised retail hedge funds with combined net asset size of US\$190 million. The amount of net assets under management dropped by 22.4% from the end-June level, and represented an increase of 1.1 times of that at end-2002, the year when the hedge funds guidelines were first issued.
- (16) At end-September 2014, there were 156 authorised insurers in Hong Kong. Within this total, 44 were engaged in long-term insurance business, 93 in general insurance business, and 19 in composite insurance business. These authorised insurers came from 23 countries and territories (including Hong Kong).