

CHAPTER 4 : THE FINANCIAL SECTOR[#]

Summary

- *The low interest rate environment in Hong Kong continued in the third quarter of 2015 amid the ongoing accommodative monetary policy in the United States.*
- *The Hong Kong dollar spot exchange rate stayed close to 7.75 per US dollar in the third quarter. The strong-side Convertibility Undertaking was triggered intermittently in September, prompting the Hong Kong Monetary Authority (HKMA) to passively purchase a total of US\$8.7 billion from banks with \$67.3 billion.*
- *As the US dollar strengthened against most Asian currencies, the trade-weighted Hong Kong dollar Nominal and Real Effective Exchange Rate Indices rose during the third quarter.*
- *Total loans and advances switched to a mild decline of 1.5% during the third quarter, partly reflecting the weaker credit demand amid heightened uncertainties in the economic and financial environment. Within the total, loans for use in Hong Kong and outside Hong Kong fell by 1.3% and 2.0% respectively.*
- *The local stock market underwent a sharp correction in third quarter. Investment sentiment was hard hit by the slide in the global and Mainland stock markets amid growing concern about the slowdown of the Mainland economy and depreciation of the renminbi. The Hang Seng Index (HSI) fell by 20.6% from end-June to 20 846 at end-September. In parallel, trading activities cooled off, and fund raising activities turned very quiet.*

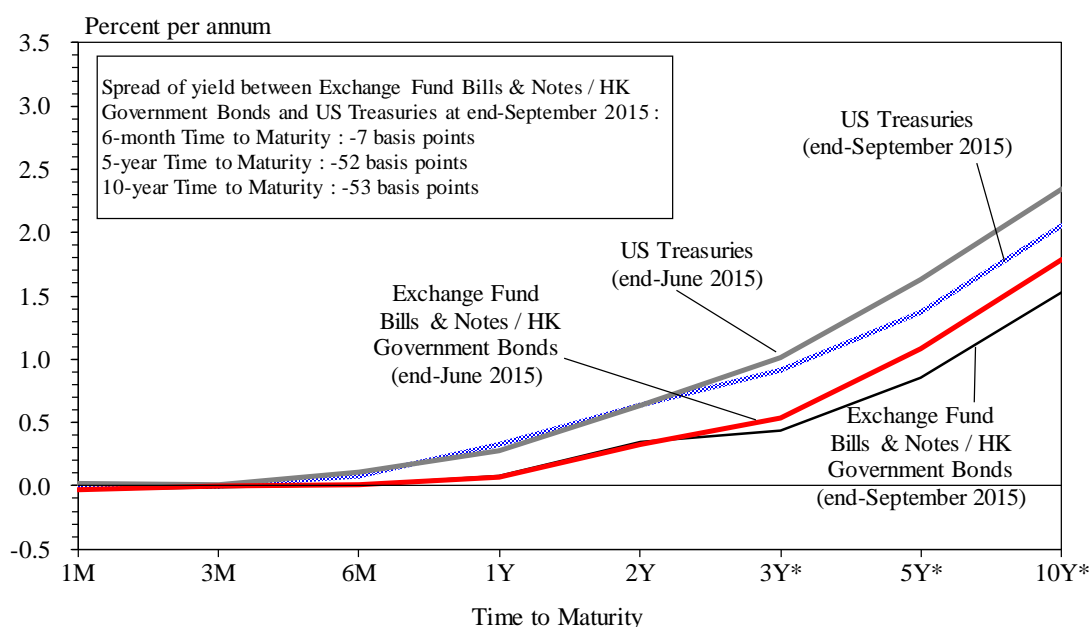
(#) *This chapter is jointly prepared by the Hong Kong Monetary Authority (HKMA) and the Economic Analysis Division.*

Interest rates and exchange rates

4.1 The low interest rate environment in Hong Kong continued in the third quarter of 2015 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% during the quarter⁽¹⁾. The *Hong Kong dollar interbank interest rates* (HIBOR) remained at low levels. The overnight HIBOR declined from 0.11% at end-June to 0.08% at end-September. The 3-month HIBOR was 0.40% at end-September, little changed from the 0.39% at end-June.

4.2 Both the *Hong Kong dollar* and *US dollar yield curves* flattened in the third quarter. Reflecting the smaller decline in Hong Kong dollar yields, the negative yield spread between 10-year Hong Kong Government Bonds and 10-year US Treasury Notes narrowed slightly from 56 basis points at end-June to 53 basis points at end-September. The negative yield spread between 6-month Exchange Fund Bills and 6-month US Treasury Bills also declined from 10 basis points to seven basis points.

Diagram 4.1 : Both the Hong Kong dollar and US dollar yield curves flattened in the third quarter

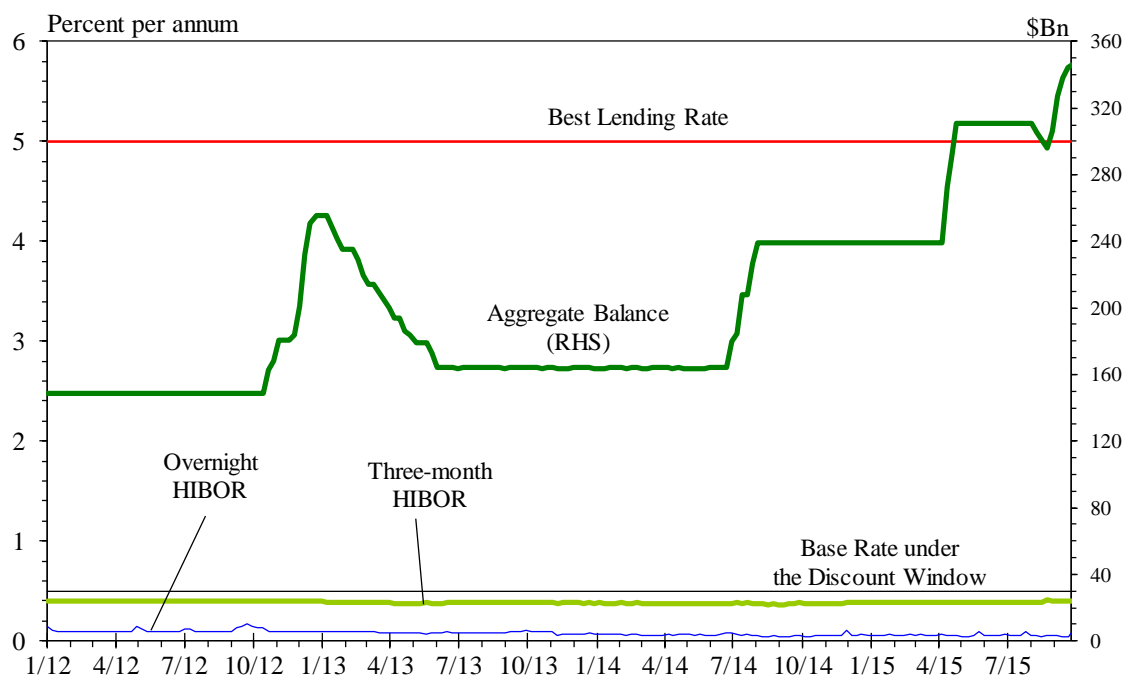


Note : (*) With the HKMA stopping new issuance of Exchange Fund Notes of tenors of three years or above since January 2015, the Hong Kong dollar yields for tenor of 3 years and above refer to those for Hong Kong Government Bonds.

4.3 Interest rates on the retail front continued to stay at low levels. The *Best Lending Rates* remained unchanged at 5.00% or 5.25% during the third quarter. The *savings deposit rate* quoted by the major banks stayed unchanged at an average of 0.01%, while the one-year time deposit rate (for deposits of less

than \$100,000) quoted by the major banks edged down from 0.15% in June to 0.14% in September. Meanwhile, the *composite interest rate*⁽²⁾, which indicates the average cost of funds for retail banks, notched down from 0.29% at end-June to 0.26% 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 7.75 per US dollar in the third quarter. Mainly driven by the conversion of offshore renminbi (RMB) into Hong Kong dollar, the strong-side Convertibility Undertaking was triggered intermittently in September, prompting the HKMA to passively purchase a total of US\$8.7 billion from banks with \$67.3 billion. As a result, the Aggregate Balance rose further from \$310.7 billion at end-June to \$345.9 billion at end-September. The spot exchange rate closed the quarter at 7.750, compared with 7.752 at end-June. The 3-month *Hong Kong dollar forward premium* edged down from six pips (each pip equivalent to HK\$0.0001) to four pips. Meanwhile, the 12-month Hong Kong dollar forward premium rose from zero pips at end-June to as high as 345 pips in late August, before declining to 80 pips at end-September.

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. As the US dollar strengthened against most Asian currencies including the RMB, the *trade-weighted Hong Kong dollar Nominal and Real Effective Exchange Rate Indices*⁽³⁾ rose by 2.9% and 3.3% respectively during

the third quarter.

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

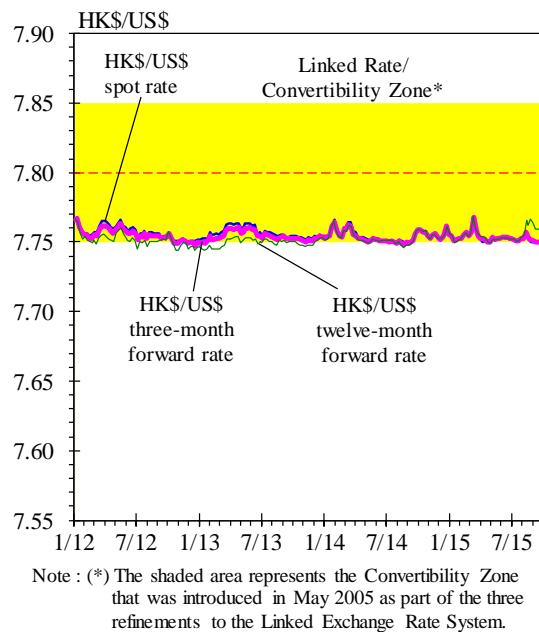
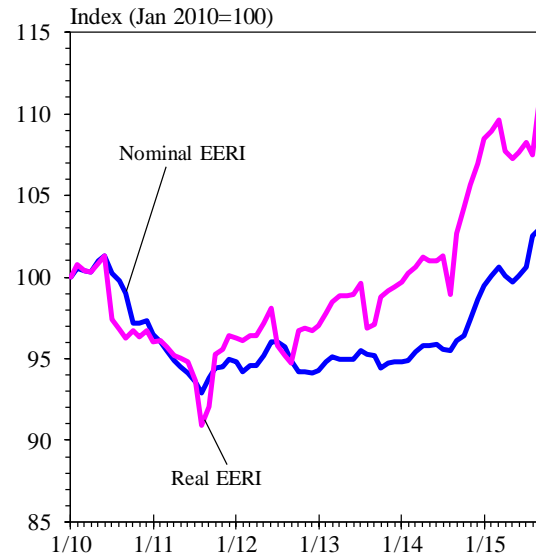


Diagram 4.4 : The trade-weighted nominal and real EERIs rose during the third quarter (average for the month)



Money supply and banking sector

4.6 After a jump during the preceding quarter, the seasonally adjusted Hong Kong dollar narrow *money supply* (HK\$M1) declined by 1.3% from end-June to \$1,264 billion at end-September. The broad money supply (HK\$M3) also decreased by 0.7% to \$5,750 billion⁽⁴⁾. Meanwhile, *total deposits* with authorized institutions (AIs)⁽⁵⁾ increased by 1.0% to \$10,659 billion. Within the total, Hong Kong dollar deposits declined by 0.6%, while foreign currency deposits increased by 2.7%.

Diagram 4.5 : Both narrow and broad money supply declined during the third quarter

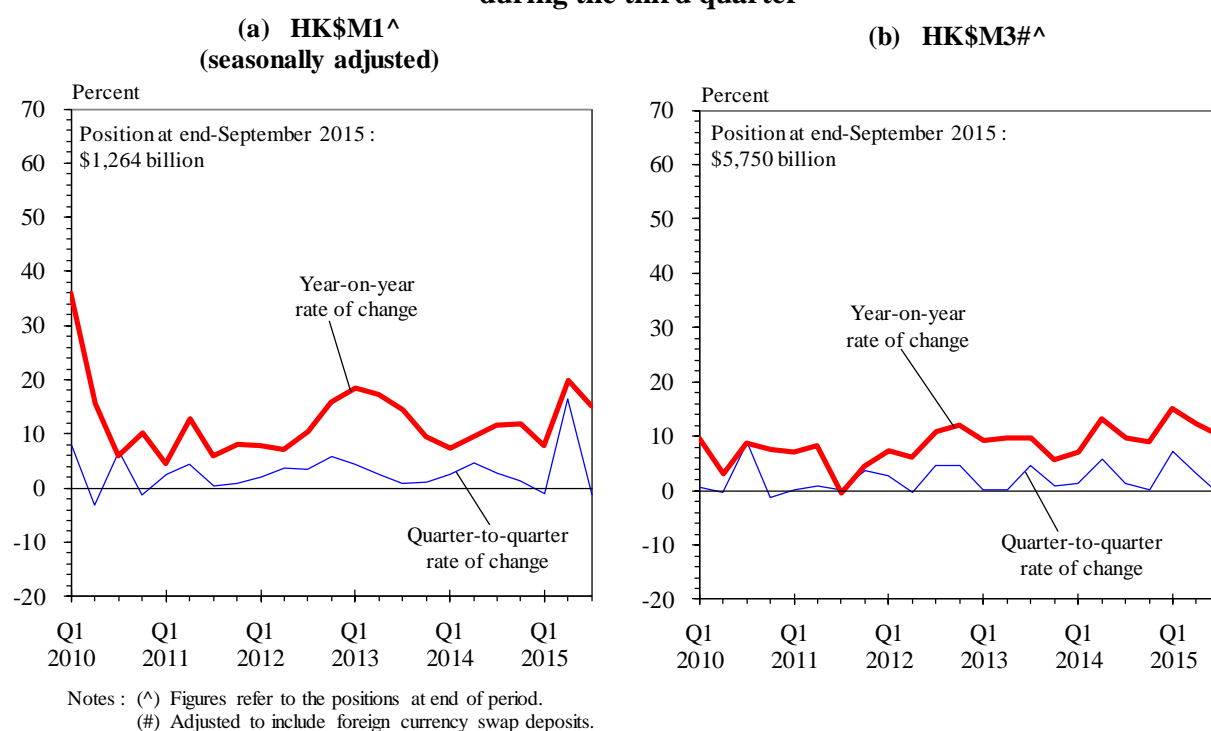


Table 4.1 : Hong Kong dollar money supply and total money supply

% change during the quarter		<u>M1</u>		<u>M2</u>		<u>M3</u>	
		<u>HK\$[^]</u>	<u>Total</u>	<u>HK\$^(a)</u>	<u>Total</u>	<u>HK\$^(a)</u>	<u>Total</u>
2014	Q1	2.5	0.8	1.4	0.9	1.4	0.9
	Q2	4.7	6.9	5.7	4.5	5.7	4.5
	Q3	2.8	3.1	1.4	2.9	1.4	3.0
	Q4	1.3	1.8	0.3	0.9	0.3	0.9
2015	Q1	-1.1	13.6	7.2	3.0	7.2	3.0
	Q2	16.5	-1.3	3.1	0.8	3.1	0.8
	Q3	-1.3	5.3	-0.6	0.1	-0.7	0.1
Total amount at end-September 2015 (\$Bn)		1,264	2,019	5,738	11,446	5,750	11,482
% change over a year earlier		15.1	20.3	10.1	4.9	10.1	4.9

Notes : (^) Seasonally adjusted.

(a) Adjusted to include foreign currency swap deposits.

4.7 *Total loans and advances* switched to a mild decline during the third quarter, partly reflecting the weaker credit demand amid heightened uncertainties in the economic and financial environment. Total loans and advances fell by 1.5% from end-June to \$7,560 billion at end-September, within which Hong Kong dollar loans and foreign currency loans fell by 2.6% and

0.2% respectively. Reflecting the relative movements in deposits and loans, the loan-to-deposit ratio for the Hong Kong dollar decreased from 79.9% at end-June to 78.4% at end-September, and the loan-to-deposit ratio for foreign currencies from 65.4% to 63.6%.

4.8 Loans for use in Hong Kong (including trade finance) declined for the second consecutive quarter, by 1.3% from end-June to \$5,242 billion at end-September. Loans for use outside Hong Kong also fell by 2.0% to \$2,318 billion. Within the former, loans to different economic sectors fared a mixed performance. Trade finance plunged by 11.6%, in part reflecting the sluggish external trade. Loans to the wholesale and retail trade decreased by 2.0%, conceivably dragged by the weak retail sales. Loans to stockbrokers plunged by another 53.4% along with the stock market corrections, while loans to financial concerns edged up by 0.3%. On the other hand, loans for purchase of residential property went up by 3.0% and loans to building, construction, property development and investment by 2.4%.

Table 4.2 : Loans and advances

All loans and advances for use in Hong Kong											
% change during the quarter		Loans to :								All loans and advances for use outside Hong Kong ^(c)	Total loans and advances
		Trade finance	Manu- facturing	Whole- sale and retail trade	Building, construction, property development and investment	Purchase of residential property ^(a)	Financial concerns	Stock- brokers	Total ^(b)		
2014	Q1	12.4	7.4	5.5	2.7	1.0	11.9	39.4	6.6	3.7	5.7
	Q2	2.4	6.6	5.4	1.6	2.1	3.4	66.7	4.4	1.7	3.6
	Q3	0.2	7.2	7.9	0.8	2.3	1.2	-38.9	1.4	3.3	1.9
	Q4	-14.5	0.0	-5.8	1.5	2.8	1.4	16.8	-1.0	5.6	0.9
2015	Q1	4.2	-3.8	1.0	1.3	2.7	-0.5	338.7	5.6	3.2	4.8
	Q2	0.7	-0.2	-1.5	4.1	1.7	4.8	-55.2	-0.5	3.4	0.6
	Q3	-11.6	0.0	-2.0	2.4	3.0	0.3	-53.4	-1.3	-2.0	-1.5
Total amount at end-September 2015 (\$Bn)		503	255	461	1,145	1,108	406	47	5,242	2,318	7,560
% change over a year earlier		-20.7	-4.0	-8.2	9.5	10.6	6.1	7.0	2.6	10.4	4.9

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 17.5% at end-June 2015. So far no AIs have encountered difficulties in complying with the statutory minimum ratios required by the HKMA under Basel III⁽⁶⁾.

4.10 Hong Kong has been following the international timeline in implementing the Basel III framework. The implementation of the second phase⁽⁷⁾ of the Basel III standards commenced in 2015, with the rules on capital buffers and liquidity coverage ratio coming into effect on 1 January, and the disclosure requirements associated with these standards and with the leverage ratio on 31 March. As part of the second phase of implementation of the capital standards, the HKMA also announced the phasing in of a Countercyclical Capital Buffer (starting with 0.625% in accordance with the Basel III transitional arrangement) with effect from 1 January 2016, and the designation of five authorized institutions as domestic systemically important institutions on which the higher loss absorbency capital requirement will start to apply from 2016.

4.11 Asset quality of the local banking sector remained sound. The ratio of classified loans to total loans stayed at a low level of 0.49% at end-June, though edging up from 0.46% at end-March. The delinquency ratio for credit card lending decreased from 0.26% to 0.23%. Meanwhile, the delinquency ratio for residential mortgage loans stayed at 0.03% at end-September, unchanged from end-June.

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</u> (gross)
2014	Q1	98.42	1.12	0.46
	Q2	98.50	1.05	0.46
	Q3	98.53	1.04	0.43
	Q4	98.44	1.10	0.47
2015	Q1	98.39	1.14	0.46
	Q2	98.25	1.25	0.49

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 Different segments of the *offshore RMB business* showed a mixed performance in the third quarter. With the conversion of some offshore RMB into Hong Kong dollar, total RMB deposits (including customer deposits and outstanding certificates of deposit) dropped by 9.7% from end-June to RMB1,000.9 billion at end-September. Yet RMB trade settlement transactions handled by banks in Hong Kong surged by 30.6% over the preceding quarter to RMB2,050.1 billion in the third quarter.

4.13 Total RMB bond issuance plunged from RMB35.5 billion in the preceding quarter to RMB9.2 billion in the third quarter. Nonetheless, outstanding RMB bank loans surged by 20.8% over end-June to RMB285.4 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> (%)		
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
	Q4	176,967	826,590	1,003,557	0.25	0.53	149	1,722,857
2015	Q1	157,444	794,550	951,994	0.25	0.53	147	1,626,122
	Q2	180,445	812,479	992,924	0.25	0.53	146	1,569,670
	Q3	165,849	729,516	895,365	0.25	0.53	145	2,050,107
% change in 2015 Q3 over 2014 Q3		14.9	-8.8	-5.2	N.A.	N.A.	N.A.	27.4
% change in 2015 Q3 over 2015 Q2		-8.1	-10.2	-9.8	N.A.	N.A.	N.A.	30.6

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 Issuance of *Hong Kong dollar debt* picked up in the third quarter of 2015. With the solid increase in public sector issuance more than offsetting the decline in private sector issuance⁽⁸⁾, total gross issuance of Hong Kong dollar debt increased by 8.5% over the preceding quarter to \$641.0 billion, of which 94% was attributable to Exchange Fund papers. In parallel, the total outstanding amount of Hong Kong dollar debt securities rose by 1.4% over end-June to \$1,450.5 billion at end-September 2015, equivalent to 25.2% of HK\$M3 or 21.8% of Hong Kong dollar-denominated assets of the banking sector⁽⁹⁾.

4.15 At end-September, the total outstanding Hong Kong dollar bonds under the Government Bond (“GB”) Programme amounted to \$103.2 billion. This comprised 13 institutional issues totaling \$73.2 billion and three retail issues (iBonds) totaling \$30 billion. In addition, there were two US dollar sukuks outstanding, each with an issuance size of US\$1 billion. In the third quarter, a total of \$0.6 billion institutional GBs were issued through tenders. Also, another batch of iBond totalling \$10 billion was successfully issued in August 2015. The issuance was greeted with positive market responses, receiving around 600 000 valid applications.

**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											
2014	Annual	2,177.3	9.6	30.8	2,217.7	127.1	33.3	50.5	210.9	1.3	2,430.0
	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
	Q4	578.7	2.1	3.0	583.8	38.4	8.7	10.9	58.0	0.0	641.8
2015	Q1	491.9	4.3	7.9	504.1	54.4	4.4	10.6	69.4	0.0	573.5
	Q2	541.2	4.0	4.7	550.0	23.2	2.1	15.5	40.8	0.0	590.7
	Q3	599.9	0.8	10.6	611.3	14.8	2.8	12.0	29.6	0.0	641.0
% change in 2015 Q3 over 2014 Q3		12.4	-83.4	-35.8	10.1	-54.2	-65.9	113.8	-35.9	N.A.	6.6
% change in 2015 Q3 over 2015 Q2		10.8	-79.6	125.5	11.2	-36.4	35.6	-22.3	-27.4	N.A.	8.5
Outstanding (as at end of period) ^(c)											
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	98.5	887.6	228.9	124.4	148.1	501.5	6.9	1,395.9
	Q3	752.2	41.5	105.0	898.7	223.0	132.3	142.5	497.8	6.9	1,403.4
	Q4	752.6	41.0	98.0	891.6	232.8	137.6	141.7	512.1	6.1	1,409.8
2015	Q1	752.8	43.5	105.9	902.2	249.7	140.3	142.4	532.4	6.1	1,440.7
	Q2	753.0	43.2	94.1	890.3	245.9	140.1	148.5	534.5	5.3	1,430.1
	Q3	773.2	43.2	104.7	921.1	230.7	141.1	152.2	524.1	5.3	1,450.5
% change in 2015 Q3 over 2014 Q3		2.8	4.1	-0.3	2.5	3.5	6.6	6.9	5.3	-22.6	3.4
% change in 2015 Q3 over 2015 Q2		2.7	0.0	11.3	3.5	-6.2	0.7	2.5	-1.9	0.0	1.4

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

N.A. Not available.

(a) AIs : Authorised institutions.

(b) MDBs : Multilateral Development Banks.

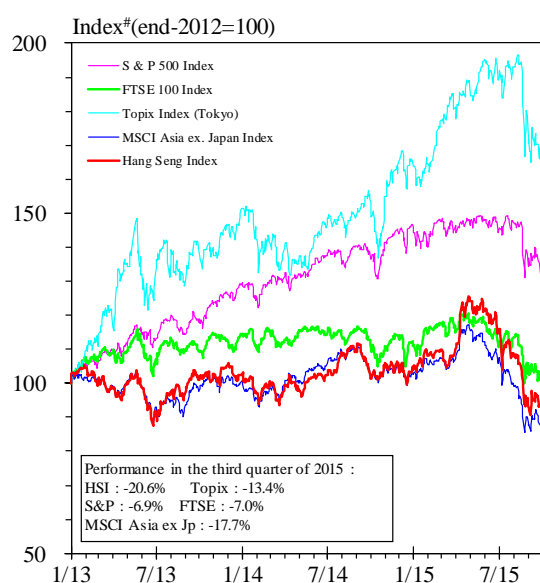
(c) Figures on AIs and hence the total have been revised downwards since more early redemption data have recently been available.

The stock and derivatives markets

4.16 The *local stock market* underwent a sharp correction in the third quarter of 2015. Investment sentiment was hard hit by the slide in the global and Mainland stock markets amid growing concern about the slowdown of the Mainland economy and depreciation of the RMB. The Hang Seng Index (HSI) fell by 20.6% from end-June to 20 846 at end-September. In parallel, the *market capitalisation* shrank by 20.3% to \$23.2 trillion. According to the World Federation of Exchanges, the local stock market was the seventh largest in the world and third largest in Asia⁽¹⁰⁾ as at end-September.

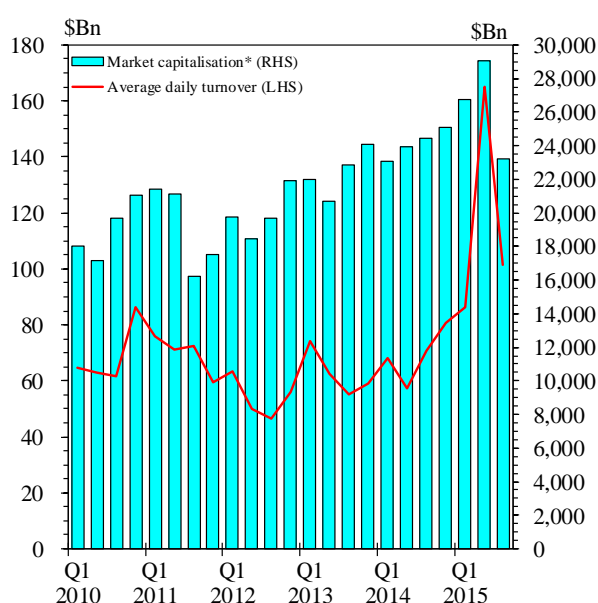
4.17 Trading activities also cooled off. *Average daily turnover* in the securities market plunged by 38.4% from the preceding quarter to \$101.5 billion in the third quarter, though it was 43.2% higher than a year earlier. As to *derivatives products*⁽¹¹⁾, the average daily trading volume of futures and options declined by 13.4% from the preceding quarter. Within the total, trading of stock options, HSI options and H-shares Index futures declined by 28.3%, 5.4% and 1.6% respectively, though that of HSI futures edged up by 1.5%. Likewise, the average daily trading value of securitised derivatives products dropped significantly by 28.8% from the preceding quarter. Within the total, while trading of derivative warrants plunged by 39.7%, that of callable bull/bear contracts recorded a 14.2% increase.

Diagram 4.6 : The local stock market underwent a sharp correction in the third quarter



Note : (#) Position at end of month.

Diagram 4.7 : Market capitalisation shrank, and trading activities cooled off



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 <u>options</u>	Total futures and options traded*	Derivative warrants (\$Mn)	Callable bull/bear contracts (\$Mn)	Total securitised derivatives traded (\$Mn)^
2014	Annual	69 098	30 440	89 005	301 797	576 676	8,277	4,980	13,257
	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
	Q4	73 141	34 162	106 657	374 821	696 281	9,709	5,426	15,135
2015	Q1	64 351	27 727	108 774	363 322	672 678	14,715	6,226	20,941
	Q2	81 541	35 129	154 553	523 860	946 336	28,693	7,228	35,921
	Q3	82 744	33 238	152 006	375 780	819 085	17,312	8,255	25,567
% change in 2015 Q3 over 2014 Q3		24.0	11.2	92.0	23.6	47.1	76.8	56.0	69.5
% change in 2015 Q3 over 2015 Q2		1.5	-5.4	-1.6	-28.3	-13.4	-39.7	14.2	-28.8

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 In tandem with the stock market correction, fund raising activities turned very quiet 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)⁽¹²⁾, plunged by 78% from the preceding quarter or 65% from a year earlier to \$139.4 billion. Yet reflecting the strong performance in the first half, total equity capital raised in the first three quarters still soared by 39% over a year earlier to \$851.1 billion. Within the total, the amount of funds raised through IPOs dwindled by 75% from the preceding quarter to \$26.9 billion in the third quarter. Nonetheless, Hong Kong still ranked the first globally in terms of the amount of funds raised through IPO in the first three quarters of 2015 combined, raising a total of \$156.4 billion.

4.19 Mainland enterprises continued to play a prominent role in the Hong Kong stock market. At end-September 2015, a total of 920 Mainland enterprises (including 212 H-share companies, 144 “Red Chips” companies and 564 private enterprises) were listed on the Main Board and GEM, accounting for 51% of the total number of listed companies and 62% of total market capitalisation. In the third quarter, Mainland-related stocks accounted for 72%

of equity turnover and 61% of total equity fund raised on the Hong Kong stock exchange.

4.20 Having received substantial market support in the earlier consultation, in July the Hong Kong Exchange and Clearing Limited announced the introduction of Volatility Control Mechanism (VCM) in its securities and derivatives markets and Closing Auction Session (CAS) in its securities market. The VCM⁽¹³⁾ is designed to safeguard market integrity from extreme price volatility arising from automated trading and to contain systemic risks caused by inter-connectedness of Hong Kong's securities and derivatives markets, particularly with respect to benchmark index products. On the other hand, the CAS⁽¹⁴⁾ is to meet the needs of investors by enabling trade execution at the securities' closing prices, which is a key investment mandate of certain funds and commonly adopted in developed securities markets. Subject to rule amendments and market readiness, the CAS and the VCM are tentatively scheduled to roll out in the securities market in sequence from mid-2016, while the VCM is tentatively targeted to roll out in the derivatives market in the last quarter of 2016.

4.21 To further enhance the transparency of the over-the-counter (OTC) derivatives market, in late September the HKMA and the Securities and Futures Commission jointly launched a consultation on introducing the first phase of mandatory clearing and the second phase of mandatory reporting under the OTC derivatives regime. The first phase of mandatory clearing aims to mandate the clearing of certain standardised interest rate swaps entered into between major dealers. Meanwhile, the second phase of mandatory reporting is to expand the existing reporting regime through requiring the reporting of transactions of all OTC derivative products and widening the scope of information to be reported.

Fund management and investment funds

4.22 Dragged by the stock market correction, the fund management business recorded a lacklustre performance in the third quarter. The aggregate net asset value of the approved constituent funds under the *Mandatory Provident Fund (MPF) schemes*⁽¹⁵⁾ declined by 9.5% from end-June to \$561 billion at end-September. The monthly average gross retail sales of *mutual funds* plunged by 35.9% from the preceding quarter to US\$5.5 billion in July-August⁽¹⁶⁾. The amount of net assets managed by *retail hedge funds* fell further during the quarter⁽¹⁷⁾.

Insurance sector

4.23 The *insurance sector*⁽¹⁸⁾ continued to record notable growth in the second quarter of 2015. Gross premium income from long-term business rose distinctly, by 17.3% over a year earlier. Within the total, premium income from non-investment linked plans soared by 24.7%, though that from investment-linked plans declined by 23.8%. Meanwhile, gross and net premium from general business continued to record moderate increase of 2.8% and 2.5% respectively.

4.24 The Insurance Companies (Amendment) Bill 2014 was passed by the Legislative Council in July 2015. The Bill provides for, among other things, the establishment of the Independent Insurance Authority (IIA) and a statutory licensing regime for insurance intermediaries. The set-up of the IIA would help modernise the regulatory infrastructure for the stable development of the industry, provide better protection for policyholders, and comply with the relevant international requirements of a regulator that is financially and operationally independent of the Government and industry. Also, the statutory licensing regime would replace the existing self-regulatory system, and help ensure a robust regulatory regime for the intermediaries and strengthen public confidence in the industry.

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	
2014	Annual	43,896	30,299	3,010	97,357	16,052	176	451	114,036	157,932
	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
	Q3	11,534	7,936	853	24,652	4,317	47	120	29,136	40,670
	Q4	9,169	5,998	619	25,744	4,138	50	98	30,030	39,199
2015	Q1	12,939	9,053	645	32,060	4,249	52	121	36,482	49,421
	Q2	10,943	7,888	58	28,909	3,210	42	80	32,241	43,184
% change in 2015 Q2 over 2014 Q2		2.8	2.5	-90.9	24.7	-23.8	5.0	50.9	17.3	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.

Highlights of policy and market developments

4.25 The profits tax exemption for offshore funds has been extended to private equity funds since 17 July 2015. Under the arrangement, transactions conducted by eligible offshore private equity funds in respect of securities of eligible overseas portfolio companies would be able to enjoy profits tax exemption. The exemption would help attract private equity fund managers to expand their business in Hong Kong and hire related professional services, thereby conducive to the further development of the asset management industry.

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 2015, there were 157 licensed banks, 24 restricted licence banks and 18 deposit-taking companies in Hong Kong. Altogether, 199 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, and for banks classified as systemically important (either globally or domestically), a Higher Loss Absorbency requirement ranging from 1% to 3.5%, all to be met by common equity. In addition, Basel III introduces a supplementary leverage ratio as a backstop to risk-weighted capital measures and the 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.
- (7) The Basel III standards have started being phased in since 1 January 2013 and are scheduled to be fully implemented on 1 January 2019 according to the Basel III implementation timeline. 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.
- (8) The figures for private sector debt may not represent a full coverage of all the Hong Kong dollar debt paper issued.
- (9) 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.
- (10) 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.
- (11) At end-September 2015, there were 82 classes of stock options contracts and 40 classes of stock futures contracts.

- (12) At end-September 2015, there were 1 065 and 211 companies listed on the Main Board and GEM respectively.
- (13) The VCM is applicable during Continuous Trading Session (CTS) except the first 15 minutes of the morning and afternoon CTS and the last 15 minutes of the afternoon CTS. It is applicable to the 81 Hang Seng Index and Hang Seng China Enterprise Index constituent stocks and the eight related index futures contracts. If the market tries to trade these stocks / contracts at a price of more than 10% / 5% away from its last traded price 5 minutes ago, a 5-minute cooling-off period will be triggered. During the cooling-off period, the affected stock / contract will be only allowed to trade within a fixed band. Normal continuous trading will resume when the 5-minute cooling off period ends and the stock / contract cannot be subject to the VCM again in the same trading session.
- (14) The CAS works as follows:
- Blocking Period : In the first period (4:00-4:01 pm), a reference price, which sets the allowable price limit of the CAS ($\pm 5\%$ from the reference price), is calculated for each CAS security.
 - Order Input Period : In the second period (4:01-4:06 pm), at-auction orders and at-auction limit orders within the $\pm 5\%$ price limit can be entered, amended or cancelled.
 - No-Cancellation Period : In the third period (4:06-4:08 pm), prices of new at-auction limit orders must be between the lowest ask and highest bid of the order book, and no orders can be amended or cancelled.
 - Random Closing Period : In the last period (4:08-4:10 pm), the order rules from the No-Cancellation period apply and the market closes randomly within two minutes. After the period, there's order matching for all CAS securities.
- (15) At end-September 2015, there were 19 approved trustees. On MPF products, 35 master trust schemes, two industry schemes and one employer sponsored scheme, comprising altogether 457 constituent funds, were approved by the Mandatory Provident Fund Schemes Authority. A total of 277 000 employers, 2.55 million employees and 206 000 self-employed persons have participated in MPF schemes.
- (16) 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 2015, the survey covered a total of 1 165 active authorised funds.
- (17) At end-September 2015, there were three SFC-authorised retail hedge funds with combined net asset size of US\$114 million. The amount of net assets under management dropped by 13% from the end-June 2015 level, and represented a decrease of 29% from that at end-2002, the year when the hedge funds guidelines were first issued.
- (18) At end-September 2015, there were 157 authorised insurers in Hong Kong. Within this total, 44 were engaged in long-term insurance business, 94 in general insurance business, and 19 in composite insurance business. These authorised insurers come from 23 countries and territories (including Hong Kong).