

## Message

Over the past year, Hong Kong, like all economies in the region, has been hard hit by the Asian financial turmoil. The financial markets have been under acute stress and test primarily by a series of external developments.

Amidst the turmoil, volatility and uncertainty, the SAR Government has never lost sight of the long-term interest of Hong Kong to develop itself further as an international financial centre. In fact, one of the important lessons that we have learned over the Asian financial turmoil is that our fundamental strengths and sound regulatory framework have enabled Hong Kong to remain the premier international financial centre in the region and we should continue to step up our efforts to sharpen our competitiveness.

The Financial Market Review we have completed in April this year has yielded many useful recommendations. Our strong commitment to the linked exchange rate is augmented by a further refined currency board system. We have also introduced seven technical measures in September to further strengthen the currency board arrangements and make them less susceptible to manipulation by speculators to produce extreme condition in the interbank market and interest rates. On the other hand, we have completed the implementation of a number of the recommendations and measures for the securities and futures markets and introduced further in September the 30-point programme of measures. These efforts together would further enhance the robustness of the regulatory regime of our financial markets and strengthen the efficiency and transparency in our market. Our goal has been, and will always be, to maintain an open and well-regulated market on a level playing field, thereby increasing the attractiveness and competitiveness of Hong Kong.

Looking beyond the current turmoil and the immediate future, we have been addressing in earnest the longer term issues of strengthening the financial infrastructure of Hong Kong. Important ground work has been done but much more detailed and technical studies need to be commissioned to augment this ambitious project. Further preparatory work to implement the Mandatory Provident Fund System is also under way, with the establishment of the Mandatory Provident Fund Authority in September 1998. Our aim is to ensure that Hong Kong remains in the forefront of financial market developments by providing an environment that facilitates the utilisation of the most advanced technical know-how and state-of-the-art technologies for us to meet the challenges of the 21st century.

A handwritten signature in black ink, appearing to be 'Rafael S Y Hui', written in a cursive style with large, sweeping loops.

(Rafael S Y Hui)  
Secretary for Financial Services

# International Financial Centre

Our Policy Objective is to maintain and enhance Hong Kong's status as a major international financial centre through the provision of an appropriate economic and legal environment for an open, fair and efficient market.

The indicators we will use to measure our achievement of this Policy Objective are –

- the extent to which Hong Kong's financial infrastructure meets international standards
- the extent to which Hong Kong's business laws provide a level playing field
- the extent to which our financial regulatory regime meets international standards
- the setting up of the first overseas office of the Bank for International Settlements in Hong Kong

## Key Result Areas (KRAs)

To ensure that this Policy Objective can be achieved, we must deliver results in a number of key areas, that is, we must –

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The following sections of this booklet explain the importance of these KRAs, describe the broad thrust of our efforts, and outline the indicators which we are using to assess progress. Each section lists the new key initiatives being taken to achieve our objectives and pinpoints the agency accountable for each initiative and the specific targets which we intend to meet.

# I

## Maintain monetary and banking stability in Hong Kong

Hong Kong is an externally-oriented economy with a high proportion of its GDP derived from international trade and investment. The maintenance of a stable exchange rate is essential to the promotion of international trade and to the status of Hong Kong as an international financial centre.

The Government is fully committed to the maintenance of the linked exchange rate system. The robustness of the link is underpinned by sound economic fundamentals, characterised by substantial foreign exchange reserves, strong fiscal discipline, a healthy banking system as well as an advanced financial infrastructure.

Notwithstanding the Asian currency turmoil and the Hong Kong dollar subject to pressure on several occasions, the exchange rate of the Hong Kong dollar remained remarkably stable against the US dollar in the past year.

The Hong Kong banking sector has also remained robust in the face of more difficult operating conditions. Although it is inevitable that bad debt will rise as a result of the economic downturn, banks in Hong Kong are well-placed to absorb this given their highly adequate capital and prudent management.

The Hong Kong Monetary Authority (HKMA) will continue to ensure the stability of the Hong Kong dollar exchange rate under the linked exchange rate system and enhance its supervision of authorised institutions under the Banking Ordinance to ensure soundness of the banking system. New initiatives for achieving this KRA are detailed in the following sections.

## Indicators

The indicators which we are using to measure progress in this area are –

- the stability of the Hong Kong dollar exchange rate against the US dollar at around 7.80 and the transparency in the operation of the linked exchange rate system
- the further strengthening of the currency board arrangements in Hong Kong
- the maintenance of a regulatory framework for prudential supervision of authorised institutions which is fully in line with international standards
- the health of the local banks in terms of capital adequacy and liquidity

## Initiatives

## Targets

To review the banking supervisory regime in the light of international standards and developments of the banking sector in Hong Kong

*(Hong Kong Monetary Authority (HKMA))\**

To complete the review by end 1998

To step up monitoring and supervision of authorised institutions on a risk-based approach

*(HKMA)*

To improve speed of detection and resolution of likely financial problems

\* the brackets denote the agency with lead responsibility for the initiative

Initiatives	Targets
<p>To promote fixed rate mortgages given through the Hong Kong Mortgage Corporation to provide an additional choice for home buyers which can protect them against adverse interest rate movements (HKMA)</p>	<p>To expand the pilot scheme into a regular programme under which the Hong Kong Mortgage Corporation is committed to purchasing \$3.5 billion of fixed rate mortgages between September 1998 and March 1999</p>
<p>To improve the transparency of the banking sector (HKMA)</p>	<ul style="list-style-type: none"> <li>● To implement a new Guideline to standardise policy on how authorised institutions should recognise interest income in the profit and loss account</li> <li>● To increase the amount and frequency of disclosure by both local and foreign institutions in respect of their 1998 accounts, particularly in relation to asset quality</li> </ul>
<p>To ensure a smooth changeover to the Euro in the banking sector (HKMA)</p>	<p>To introduce legislation in 1998 to provide for continuity of contract in relation to the introduction of Euro on 1 January 1999</p>

Initiatives	Targets
<p>To further strengthen the currency board arrangements in Hong Kong (<i>HKMA</i>)</p>	<p>To implement the new measures announced in September 1998 including:</p> <ul style="list-style-type: none"> <li>● convertibility undertaking - to provide a clear undertaking to all licensed banks to convert Hong Kong dollars in their clearing accounts into US dollars at the fixed rate of HK\$7.75 to US\$1 and to move the rate of the convertibility undertaking to HK\$7.8 when market circumstances permit</li> <li>● to make technical adjustments to the operation of the Discount Window. These include: <ul style="list-style-type: none"> <li>– to remove the bid rate of Liquidity Adjustment Facility (LAF)</li> </ul> </li> </ul>



## Initiatives

## Targets

- to replace the LAF by a Discount Window and to determine the Base Rate (formerly known as the LAF Offer Rate) such that interest rates are adequately responsive to capital flows while allowing excessive and destabilising interest rate volatility to be dampened
- to remove the restriction on repeated borrowing in respect of the use of Exchange Fund papers for discounting at the Discount Window
- to issue new Exchange Fund paper only when there is an inflow of funds
- to introduce a schedule of discount rates for different percentage thresholds of holdings of Exchange Fund paper by the licensed banks for Discount Window purpose

Initiatives	Targets
	<ul style="list-style-type: none"> <li>– to retain the restriction on repeated borrowing in respect of repo transactions involving debt securities other than Exchange Fund papers and not to accept any further new issues of such paper for Discount Window purpose</li> </ul>
<p>To move towards greater transparency and disclosure on currency board operations <i>(HKMA)</i></p>	<p>To identify clearly that part of the Exchange Fund balance sheet showing currency board operations and to publish the relevant information as frequently as it is technically feasible to do so</p>

## II

### Further improve the regulatory framework

Hong Kong has a well-established regulatory framework for the financial services sector, which operates smoothly. Nevertheless, the Government will continue to further enhance the regulatory framework in the light of international experience and standards and to maintain a level playing field. New initiatives include legislative amendments to comply fully with the Basle Committee's Core Principles for Effective Banking Supervision, and review of the capital adequacy and liquidity ratios of Authorised Institutions.

Following the Asian financial turmoil, a Financial Market Review (FMR) has been conducted. While the Review confirms that current market systems and regulatory regime for the securities and futures markets are generally adequate and effective, it also identifies various areas where improvements at a technical and operational level are warranted. An inter-agency task force has been set up under the Financial Services Bureau to keep in view the progress on the follow-up to the FMR. The Government will initiate a series of legislative amendments to implement the recommendations of the FMR report, including the proposed regulation of share margin financing activities. We will also develop detailed codes and rules for various sub-sectors to make our regulatory framework one of the most open, fair, efficient and well-regulated in the world. In addition, the Government unveiled in September this year a 30-point programme aiming at further strengthening the order and transparency of both the securities and futures markets.

## Indicators

The indicators which we are using to measure progress in this area are –

- the free and orderly operation of the regulated financial markets
- the public perception of the soundness of the regulatory framework
- compliance with international standards for regulatory practices

## Initiatives

## Targets

To introduce a Banking (Amendment) Bill to bring Hong Kong's framework of supervision fully in line with the Basle Committee's Core Principles for Effective Banking Supervision  
*(Financial Services Bureau (FSB))*

To implement the relevant amendments to the Banking Ordinance in 1999

To conduct a review of the existing minimum and trigger capital adequacy ratios of local authorised institutions based on an assessment of their individual risk profile

*(Hong Kong Monetary Authority (HKMA))*

To complete the review in 1998

Initiatives	Targets
<p>To review the current liquidity ratio system with particular focus on the quality of liquid assets held by authorised institutions <i>(HKMA)</i></p>	<p>To complete the review in 1999</p>
<p>To introduce the composite Securities and Futures Bill <i>(FSB)</i></p>	<p>To introduce the Bill into the Legislative Council in the 1998-1999 legislative year</p>
<p>To introduce and implement legislative amendments for the regulation of share margin financing activities <i>(FSB)</i></p>	<p>To introduce the relevant legislative amendments into the Legislative Council in the 1998-1999 legislative year</p>
<p>To further strengthen the discipline and transparency of the securities and futures markets <i>(FSB)</i></p>	<p>To implement the new measures in the 30-point programme concerning the short selling regime, risk management, rule enforcement, inter-market surveillance and contingency power. Where legislative amendments are necessary, to introduce the legislative proposals as soon as possible</p>

Initiatives	Targets
<p>To develop detailed codes and rules for Mandatory Provident Fund (MPF) schemes <i>(Mandatory Provident Fund Office)</i></p>	<p>To complete major parts of the exercise in 1998</p>
<p>To strengthen the regulation of insurance companies with regard to their investment portfolio, MPF-related business and oversee their work on prevention of money laundering activities <i>(Office of the Commission of Insurance and the Registrar of Occupational Retirement Schemes)</i></p>	<p>To establish a team of staff in 1999 to step up supervision of insurance companies carrying on MPF-related business and to redeploy existing resources to strengthen anti-money laundering efforts</p>
<p>To ensure that the legal framework for companies is conducive to the running of business in Hong Kong through the review of the Companies Ordinance and related bankruptcy and insolvency legislation <i>(Companies Registry/ Official Receiver's Office)</i></p>	<p>To examine the consultancy report on the Review of the Companies Ordinance and the public submissions, and the Law Reform Commission's proposals on insolvency legislation in 1999 and introduce legislative amendments if appropriate in 2000 onward</p>



## Improve the infrastructure required for a first class international financial centre

The Government is committed to maintaining Hong Kong's position as a premier international financial centre by, among other things, providing state-of-the-art financial infrastructure and a well-trained, adaptable workforce. Through these measures the Government aims to enhance the competitiveness of Hong Kong, in terms of more professional services, reduced risk and increased efficiency.

To remain competitive, it is necessary to capitalise upon the latest developments in information technology and its applications to enhance system security and efficiency of our financial infrastructure. This will require careful planning and much commitment, particularly on the part of the industry.

Even a robust physical infrastructure cannot function effectively without the input of the right calibre. Human resources have long been one of the most important assets of Hong Kong. While financial products are becoming more sophisticated and financial transactions are moving towards full automation and straight through processing, there is a need to be sure that we have a workforce that is adaptable and well-equipped to meet the challenges ahead and to reap the benefits offered by the new opportunities. The Government will co-ordinate the strategy of meeting the human resources demands of the present and future financial services sector.

### Indicators

The indicators which we are using to measure progress in this area are –

- smooth operation of the critical systems and equipment in the financial services sector through the turn of the millennium
- more efficient and professional financial services comparable to those of other international financial centres

Initiatives	Targets
<p>To enhance Year 2000 readiness across the whole of the financial services sector <i>(Financial Services Bureau (FSB))</i></p>	<p>To co-ordinate the testing efforts of the financial industry in 1998 and 1999 and to develop an overall contingency plan for the sector by the end of 1999</p>
<p>To facilitate the integration and upgrading of the systems of the various exchanges and clearing systems to improve system security and efficiency with a view to achieving straight through processing of financial transactions <i>(FSB)</i></p>	<p>To complete a detailed study on the enhancement of the financial infrastructure for Hong Kong by the first half of 2000</p>
<p>To study whether a need exists for a Financial Services Institute to meet the human resource needs of the financial sector <i>(FSB)</i></p>	<p>To complete a detailed report on the demand for and supply of human resources development needs in the financial services sector in March 1999</p>
<p>To ensure the provision of an effective and efficient insolvency service through the expansion of the scheme to contract out summary court winding-up case <i>(Official Receiver's Office)</i></p>	<p>To contract out 400 summary cases in 1999-2000</p>



# IV

## Spearhead the further development of the financial market

In order to maintain our position as an international financial centre, we have to develop new products and raise our regulatory, infrastructural, analytical and statistical standards. The Government, financial regulatory bodies, the exchanges and the clearing houses will continue to move in this direction.

The Hong Kong Mortgage Corporation plays a prominent role in the development of the secondary mortgage market, which will assist in promoting banking and monetary stability, debt market development as well as home financing. Hong Kong's debt securities clearing system, the Central Moneymarkets Unit, has established bilateral linkages with Australia and New Zealand. Such linkages will reduce settlement risk of cross-border securities trade by facilitating Delivery versus Payment (DvP) settlement. A Cross Currency Payment Matching Processor is being developed to facilitate Payment versus Payment link with neighbouring economies with a view to eliminating settlement risk in foreign exchange transactions.

The implementation of the Mandatory Provident Fund System will further contribute to the development of the debt market by creating a huge demand for quality debt instruments. As regards the securities market, the possible introduction of the second board will broaden our equities market. It will also enlarge the pool of companies to be listed in Hong Kong to include private enterprises in the Mainland. Other initiatives to enhance co-operation with the Mainland will continue to be pursued.

## Indicators

The indicators which we are using to measure progress in this area are –

- the number of new financial products and services
- the range of financial products and services as compared to the world's other important financial centres
- the liquidity, breadth and depth of these developing sectors of the financial market

## Initiatives

## Targets

To attract private enterprises in the Mainland to list in Hong Kong  
*(Financial Services Bureau)*

To work with the Stock Exchange of Hong Kong and Securities and Futures Commission to develop implementation plans in 1999 for the establishment of a second board in Hong Kong

To promote the further development of the local debt market through the activities of the Hong Kong Mortgage Corporation (HKMC) and Mandatory Provident Fund schemes

*(Hong Kong Monetary Authority (HKMA))*

HKMC to increase the issuance of debt securities in 1999

Initiatives	Targets
<p>To promote bilateral linkage with other financial centres in Payment vs Payment and Delivery vs Payment transactions <i>(HKMA)</i></p>	<p>To set up a bilateral linkage between HKMA's Central Moneymarkets Unit and the Government Securities Book Entry System of the Mainland to facilitate cross-border trading and holding of Hong Kong and Mainland debt securities in 1999</p>
<p>To expand the joint cheque clearing system between Hong Kong and Shenzhen <i>(HKMA)</i></p>	<p>To address the policy and logistical issues in 1999 with the Guangdong authorities to extend the joint cheque clearing system to cover the province</p>
<p>To enhance the research capability of Hong Kong to conduct longer-term and wider monetary and banking policy analysis so as to position Hong Kong to play a leading role in research and policy analysis in the region <i>(HKMA)</i></p>	<p>To establish in 1999 a monetary institute which is affiliated to the HKMA</p>
<p>To implement an enhanced statistical system to comply with Special Data Dissemination Standards (SDDS) announced by the International Monetary Fund <i>(Census and Statistics Department)</i></p>	<p>To comply with the SDDS with effect from early 1999</p>