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**Joint Statement by Mr. Huh, Ms. Mahasandana, Ms. Kashima, Mr. Nagase, and Mr. Yoo
on People's Republic of China - Hong Kong Special Administrative Region
(Preliminary)
Executive Board Meeting
May 21, 2021**

We thank staff for the informative FSSA report on the Hong Kong Special Administrative Region (SAR) and Mr. Jin and Mr. Law for their insightful buff statement.

We appreciate the completion of the FSAP, which was delayed owing to the COVID-19 pandemic, and staff's call for a stand-alone Board meeting to ensure the timeliness of the information. Nonetheless, to fully analyze the current economic conditions, risks, and outlook and discuss the necessary policies, we encourage staff to conduct the next Article IV consultation without delay, incorporating the analysis and takeaways of the FSAP. **We broadly concur with the thrust of staff's assessment and would like to give the following comments for emphasis.**

Systemic Risk Assessment

We concur with staff's assessment that Hong Kong SAR's financial system appears to be broadly resilient to severe macro-financial shocks, but there are pockets of vulnerabilities that warrant ongoing vigilance. Sound macroeconomic conditions and prudential policies have provided Hong Kong SAR with important buffers to cope with the current cyclical slowdown and future shocks, as evidenced in the adverse scenario stress tests. However, Hong Kong SAR is facing macro-financial vulnerabilities such as its extensive linkages to Mainland China, stretched real estate valuations, and exposure to shifts in global market and domestic risk sentiment. We

encourage the authorities to tackle these vulnerabilities by closely monitoring their developments and undertaking the necessary policy reforms in line with staff's recommendations, in particular enhancing oversight over banking groups covering both foreign branches and local subsidiaries. We also encourage the authorities to continue to preserve the rule of law and strengthen the high-quality regulatory framework consistent with international standards and best practices to maintain Hong Kong SAR's reputation as a major international financial center. *In this regard, we would like to hear staff's view on the impact of the social unrest in Hong Kong SAR since 2019 on the economy and its status as a financial center so far.*

While staff assesses the Hong Kong Monetary Authority (HKMA)'s banking supervision and regulation to be strong, we support ongoing efforts to ensure the supervisory and crisis management tools are robust to weather future shocks. The crisis management framework has been strengthened since the 2014 FSAP, but staff notes there is scope for further enhancement. *Can staff elaborate on their discussion with the authorities of these recommendations and how to ensure their effectiveness?*

Macprudential Policies

The institutional framework for macroprudential policies (MaPP) of Hong Kong SAR is functioning well, but further improvements are needed. We positively note that the MaPP has played a key role in supporting financial stability particularly in the context of rising house prices and strengthening capital buffers in the banking sector. As there remains a risk of house price corrections, however, the authorities should reduce leakages in MaPP by enhancing surveillance over non-bank lenders. In addition, we encourage the authorities' further efforts in collecting more comprehensive and granular data on cross-border exposures. We agree with staff's assessment that the current stance on MaPP, including countercyclical capital buffers (CCyB) remains appropriate.

Climate Change Risk Analysis

Climate change poses growth and financial stability risks to Hong Kong SAR's economy and its financial sector in both the short and long run. We note that recent studies indicate that climate change may have adverse effects on Hong Kong SAR's GDP growth in the longer term, and its insurers' stock prices and price/book ratios are already adversely affected by physical risk. In this regard, we welcome the authorities' efforts to address climate change risks such as promoting climate-focused scenario analysis. In addition, we appreciate staff's analysis in BOX 1 of the report

and encourage them to continue their efforts on this front. *With reference to the recommendation to incorporate climate risk in the systemic risk analysis, can staff comment on the readiness of Hong Kong SAR in terms of data availability to facilitate a meaningful analysis?*

Financial Integrity

To sustain Hong Kong SAR's reputation as a leading global financial center, the authorities should continue to take necessary actions to enhance its anti-money laundering and combating the financing of terrorism regime (AML/CTF). We welcome the Financial Action Task Force (FATF)'s assessment that Hong Kong SAR has a strong legal and institutional framework and the authorities generally have a good understanding of the ML/TF risks they are exposed to. We encourage the authorities' ongoing efforts to implement the FATF's recommendations.

Fintech and Financial Innovation

Hong Kong SAR, with its traditional strengths in financial services, is an important fintech hub in Asia. We welcome that fintech industries in Hong Kong SAR are rapidly growing thanks to the proactive approach taken by the authorities. We expect Hong Kong SAR to continue to take the lead in developing fintech initiatives, supported by continued coordination among regulators across relevant sectors. At the same time, we recognize the importance of the authorities' close monitoring of developments and mitigating risks surrounding this area. Thus, we encourage staff to deepen their analysis and provide necessary policy advice on this front. *In this regard, we welcome staff's elaboration on the 'more holistic activities-based approach'.*