

IMPORTANT NOTICE

THIS OFFERING IS AVAILABLE ONLY TO INVESTORS WHO ARE EITHER (1) QIBS (AS DEFINED BELOW) UNDER RULE 144A OR (2) OUTSIDE THE UNITED STATES WITHIN THE MEANING OF REGULATION S UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED

IMPORTANT: You must read the following disclaimer before continuing. The following disclaimer applies to this offering memorandum, and you are therefore advised to read this disclaimer page carefully before reading, accessing or making any other use of this offering memorandum. In accessing this offering memorandum, you agree to be bound by the following terms and conditions, including any modifications to them, any time you receive any information from us as a result of such access.

NOTHING IN THIS ELECTRONIC TRANSMISSION CONSTITUTES AN OFFER OF SECURITIES FOR SALE OR SOLICITATION IN ANY JURISDICTION WHERE IT IS UNLAWFUL TO DO SO. THE SECURITIES HAVE NOT BEEN, AND WILL NOT BE, REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE **SECURITIES ACT**), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OF THE UNITED STATES AND MAY NOT BE OFFERED OR SOLD WITHIN THE UNITED STATES, EXCEPT PURSUANT TO AN EXEMPTION FROM, OR IN TRANSACTIONS NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT AND APPLICABLE STATE SECURITIES LAWS. THIS OFFERING MEMORANDUM MAY NOT BE FORWARDED OR DISTRIBUTED TO ANY OTHER PERSON AND MAY NOT BE REPRODUCED IN ANY MANNER WHATSOEVER. ANY FORWARDING, DISTRIBUTION OR REPRODUCTION OF THIS OFFERING MEMORANDUM IN WHOLE OR IN PART IS UNAUTHORISED. FAILURE TO COMPLY WITH THIS DIRECTIVE MAY RESULT IN A VIOLATION OF U.S. SECURITIES LAWS OR THE APPLICABLE LAWS OF OTHER JURISDICTIONS. IF YOU HAVE GAINED ACCESS TO THIS TRANSMISSION CONTRARY TO ANY OF THE FOREGOING RESTRICTIONS, YOU ARE NOT AUTHORISED AND WILL NOT BE ABLE TO PURCHASE ANY OF THE SECURITIES DESCRIBED THEREIN.

Confirmation of Your Representation: In order to be eligible to view this offering memorandum or make an investment decision with respect to the securities, investors must be either (1) qualified institutional buyers (**QIBs**) (within the meaning of Rule 144A under the Securities Act) or (2) outside the United States within the meaning of Regulation S under the Securities Act and, to the extent you purchase securities described in the attached offering memorandum, you will be doing so pursuant to Rule 144A or Regulation S under the Securities Act. By accepting the e-mail and accessing this offering memorandum, you shall be deemed to have represented to The Hongkong and Shanghai Banking Corporation Limited, Standard Chartered Bank, CIMB Investment Bank Berhad and National Bank of Abu Dhabi PJSC (each in its capacity as joint lead manager) (together, the **Joint Lead Managers**) and Abu Dhabi Islamic Bank PJSC, Emirates NBD Capital Limited, Hong Leong Islamic Bank Berhad, Oversea-Chinese Banking Corporation Limited, Hong Kong Branch, QInvest LLC and RHB Islamic Bank Berhad (each in its capacity as co-manager) (together, the **Co-managers**) that (1) you and any customers you represent are either (a) QIBs or (b) outside the United States and that the e-mail address that you gave us and to which this e-mail has been delivered is not located in the United States and (2) that you consent to delivery of this offering memorandum by electronic transmission.

You are reminded that this offering memorandum has been delivered to you on the basis that you are a person into whose possession this offering memorandum may be lawfully delivered in accordance with the laws of the jurisdiction in which you are located. If this is not the case, you must return this offering memorandum to us immediately. You may not, nor are you authorised to, deliver or disclose (whether orally or in writing), in whole or in part, the contents of this offering memorandum to any other person.

The materials relating to this offering do not constitute, and may not be used in connection with, an offer or solicitation in any place where offers or solicitations are not permitted by law. If a jurisdiction requires that this offering be made by a licensed broker or dealer and the Joint Lead Managers, the Co-managers or any affiliate of the Joint Lead Managers or Co-managers is a licensed broker or dealer in that jurisdiction, this offering shall be deemed to be made by such Joint Lead Managers, Co-managers or their respective affiliates in such jurisdiction.

This offering memorandum has been sent to you in an electronic form. You are reminded that documents transmitted via this medium may be altered or changed during the process of electronic transmission and consequently none of Hong Kong Sukuk 2014 Limited, the Government of Hong Kong Special Administrative Region of the People's Republic of China, the Financial Secretary Incorporated, the Joint Lead Managers, the Co-managers or any affiliate, representative, director, officer, official, employee or agent of the foregoing accepts any liability or responsibility whatsoever in respect of any difference between the offering memorandum received by you in electronic format and the electronic version initially distributed or the hard copy available to you on request to the Joint Lead Managers or the Co-managers.

You are responsible for protecting against viruses and other destructive items. Your use of this e-mail is at your own risk and it is your responsibility to take precautions to ensure that it is free from viruses and other items of a destructive nature.



The Government of the Hong Kong Special Administrative Region of the People's Republic of China

Hong Kong Sukuk 2014 Limited
(established in Hong Kong with limited liability)

US\$1,000,000,000 Trust Certificates due 2019

Issue Price: 100 per cent.

The US\$1,000,000,000 trust certificates due 2019 (the "Certificates") of Hong Kong Sukuk 2014 Limited (in its capacity as issuer, the "Issuer") will be constituted by a declaration of trust (the "Declaration of Trust") dated on or about 18 September 2014 (the "Closing Date") among the Issuer, the Government of the Hong Kong Special Administrative Region of the People's Republic of China (the "HKSAR Government" or in its capacity as obligor, the "Obligor") and DB Trustees (Hong Kong) Limited (the "Delegate"). Pursuant to the Declaration of Trust, the Issuer (in its capacity as the trustee for and on behalf of the Certificateholders (as defined herein), the "Trustee") will declare that it will hold the Trust Assets (as defined herein) upon trust absolutely for the holders of the Certificates *pro rata* according to the face amount of Certificates held by each Certificateholder in accordance with the Declaration of Trust and the terms and conditions of the Certificates (the "Conditions").

On 18 March and 18 September in each year, commencing on 18 March 2015 (each, a "Periodic Distribution Date"), the Issuer will pay Periodic Distribution Amounts (as defined herein) to Certificateholders calculated at the rate of 2.005 per cent. per annum on the outstanding face amount of the Certificates as at the beginning of the relevant Return Accumulation Period (as defined herein) on a 30/360 day basis.

The Issuer will pay such Periodic Distribution Amounts solely from the proceeds received in respect of the Trust Assets which include rental payments by the HKSAR Government (in such capacity, the "Lessee") under the Lease Agreement (as defined herein). Unless previously redeemed in the circumstances described in Condition 9, the Certificates will be redeemed on 18 September 2019 (the "Scheduled Dissolution Date") at the Dissolution Distribution Amount (as defined herein). The Issuer will pay Dissolution Distribution Amounts solely from the proceeds received in respect of the Trust Assets which include payments by the HKSAR Government under the Purchase Undertaking (as defined herein).

The Certificates are limited recourse obligations of the Issuer. An investment in the Certificates involves certain risks. For a discussion of these risks, see "Investment Considerations" beginning on page 17.

The Certificates are expected to be assigned a rating of "AAA" by Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("Standard & Poor's") and "Aa1" by Moody's Investors Services Limited ("Moody's"). A rating is not a recommendation to buy, sell or hold the Certificates (or beneficial interests therein), does not address the likelihood or timing of payment and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

Application has been made to The Stock Exchange of Hong Kong Limited (the "Hong Kong Stock Exchange") for permission to deal in, and for listing of, the Certificates by way of debt issues to professional investors only and such permission is expected to become effective on or about 19 September 2014.

Application has been made to Bursa Malaysia Securities Berhad ("Bursa Malaysia") (under an exempt regime pursuant to which the Certificates will be listed but not quoted for trading) for the listing of the Certificates. Bursa Malaysia does not take any responsibility for the contents of this document, makes no representations as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon any part of the contents of this document. Admission of the Certificates to the Official List of Bursa Malaysia (under the exempt regime) is not to be taken as an indication of a recommendation for the subscription or purchase of the Certificates or the merits of the Issuer, the HKSAR Government or the Certificates. There can be no assurance that any such listings will occur on or prior to the Closing Date or at all.

The Trustee and the HKSAR Government are Exempt Offerors as defined under Article 13(2) of the Markets Law 2012 of the Dubai Financial Services Authority (the "DFSA"). Application has been made to the DFSA for the Certificates to be admitted to the official list of securities maintained by the DFSA and to NASDAQ Dubai for such Certificates to be admitted to trading on NASDAQ Dubai without a prospectus, as such term is defined under the DFSA's Markets Law 2012. The DFSA has no responsibility, under the DFSA's Markets Laws 2012 or otherwise, for reviewing or verifying any documents in connection with the Certificates and has not approved this offering memorandum for the purposes of Articles 14 and 15 of the Markets Law 2012 nor taken steps to verify the information set out in and has no responsibility for this offering memorandum.

The Certificates have not been and will not be registered under the United States Securities Act of 1933, as amended (the "Securities Act"), or with any securities regulatory authority of any state of the United States and may not be offered, sold or delivered within the United States except pursuant to an exemption from, or in transactions not subject to, the registration requirements of the Securities Act and applicable state securities laws. Accordingly, the Certificates will be offered, sold or delivered (i) outside the United States in reliance on Regulation S ("Regulation S") under the Securities Act (the "Regulation S Certificates") and (ii) within the United States in reliance on Rule 144A under the Securities Act ("Rule 144A") only to persons reasonably believed to be "qualified institutional buyers" (each a "QIB") within the meaning of Rule 144A, acting for their own account or for the account of one or more QIBs (the "Rule 144A Certificates"). Each purchaser of the Certificates in making its purchase will be deemed to have made certain acknowledgements, representations and agreements. Prospective purchasers are hereby notified that sellers of the Rule 144A Certificates may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A. The Certificates are subject to other restrictions on transferability and resale, see "Plan of Distribution" and "Transfer Restrictions".

The Certificates will be represented by one or more global certificates in fully registered form which will be registered in the name of a nominee of The Depository Trust Company ("DTC"). It is expected that delivery of the Certificates in book-entry form will be made against payment on the Closing Date through the book-entry facilities of DTC. The Certificates may only be offered in denominations of US\$200,000 and integral multiples of US\$1,000 in excess thereof. Any sale of such Certificates may only be made in such denominations.

Beneficial interests in the Certificates will be shown on, and transfers thereof will be effected only through, records maintained by DTC and its direct or indirect participants, including Euroclear Bank SA/NV ("Euroclear") and Clearstream Banking, *société anonyme*, Luxembourg ("Clearstream, Luxembourg"). Except as described herein, definitive Certificates will not be issued in exchange for beneficial interests in global certificates.

Joint Global Coordinators, Joint Lead Managers and Joint Bookrunners

HSBC

Standard Chartered Bank

Joint Lead Managers and Joint Bookrunners

CIMB

National Bank of Abu Dhabi

Co-managers

Abu Dhabi Islamic Bank PJSC

Emirates NBD Capital

Hong Leong Islamic Bank Berhad

OCBC Bank Hong Kong Branch

QInvest

RHB Islamic Bank Berhad

The date of this offering memorandum is 10 September 2014.

This offering memorandum includes particulars given in compliance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited for the purpose of giving information with regard to the Issuer. Each of the Issuer, the Financial Secretary Incorporated (the “FSI”) and the HKSAR Government accepts full responsibility for the accuracy of the information contained in this offering memorandum and confirms, each having made all reasonable enquiries, that to the best of their knowledge and belief there are no other facts the omission of which would make any statement herein misleading.

Hong Kong Exchanges and Clearing Limited and the Hong Kong Stock Exchange take no responsibility for the contents of this offering memorandum, make no representation as to its accuracy or completeness and expressly disclaim any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this offering memorandum.

No person is authorised in connection with the offering of the Certificates to give any information or to make any representation other than as contained in this offering memorandum, and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer, the FSI, the HKSAR Government, the Joint Global Coordinators, the Joint Lead Managers, the Co-managers, the Trustee, the Delegate, the Agents (each as defined herein) or any other person. Neither the delivery of this offering memorandum nor any sale of any Certificates shall, under any circumstances, constitute a representation or create any implication that the information contained herein is correct as of any time subsequent to the date hereof or that there has been no change in the affairs of any party mentioned herein since that date.

To the fullest extent permitted by law, none of the Joint Global Coordinators, the Joint Lead Managers, the Co-managers, the Delegate or the Agents accepts any responsibility for the contents of this offering memorandum or for any statements made or purported to be made by the Joint Global Coordinators, the Joint Lead Managers, the Co-managers, the Delegate or the Agents or on its behalf in connection with the Issuer, the FSI or the HKSAR Government or the offering of the Certificates. The Joint Global Coordinators, the Joint Lead Managers, the Co-managers, the Delegate and the Agents accordingly disclaim all and any liability whether arising in tort or contract or otherwise (save as referred to above) which any of them might otherwise have in respect of this offering memorandum or any such statement.

Neither this offering memorandum nor any other information supplied in connection with the Certificates is intended to provide the basis of any credit or other evaluation or should be considered as a recommendation by the Issuer, the FSI, the HKSAR Government, the Joint Global Coordinators, the Joint Lead Managers, the Co-managers, the Trustee, the Delegate or the Agents that any recipient of this offering memorandum should purchase any of the Certificates. Each investor contemplating purchasing any Certificates should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer and the HKSAR Government. None of the Joint Global Coordinators, the Joint Lead Managers, the Co-managers, the Delegate or the Agents undertakes to review the Issuer’s, the FSI’s or the HKSAR Government’s financial condition or affairs during the life of the arrangements contemplated by this offering memorandum or to advise any investor or potential investor in the Certificates of any information relating to the Issuer, the FSI or the HKSAR Government coming to its attention.

No comment is made or advice given by the Issuer, the FSI, the HKSAR Government, the Joint Global Coordinators, the Joint Lead Managers, the Co-managers, the Trustee, the Delegate or the Agents in respect of taxation matters relating to the Certificates or the legality of the purchase of the Certificates by an investor under any applicable law.

EACH PROSPECTIVE INVESTOR IS ADVISED TO CONSULT ITS TAX ADVISER, LEGAL ADVISER, BUSINESS ADVISER AND SHARI’A ADVISER AS TO TAX, LEGAL, BUSINESS, SHARI’A AND RELATED MATTERS CONCERNING THE PURCHASE OF THE CERTIFICATES.

This offering memorandum does not constitute an offer to sell or the solicitation of an offer to buy any Certificates in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this offering memorandum and the offer or sale of the Certificates may be restricted by law in certain jurisdictions. None of the Issuer, the FSI, the HKSAR Government, the Joint Global Coordinators, the Joint Lead Managers, the Co-managers, the Trustee, the Delegate or the Agents represents that this offering memorandum may be lawfully distributed, or that any Certificates may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assumes any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Issuer, the FSI, the HKSAR Government, the Joint Global Coordinators, the Joint Lead Managers, the Co-managers, the Trustee, the Delegate or the Agents which is intended to permit a public offering of any Certificates or distribution of this offering memorandum in any jurisdiction where action for that purpose is required. Accordingly, no Certificates may be offered or sold, directly or indirectly, and neither this offering memorandum nor any advertisement nor other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this offering memorandum or any Certificates may come must inform themselves about, and observe, any such restrictions on the distribution of this offering memorandum and the offering and sale of the Certificates. In particular, there are restrictions on the distribution of this offering memorandum and the offer or sale of Certificates in the United States, the United Kingdom, Hong Kong, Singapore, Japan, Korea, the United Arab Emirates (excluding the Dubai International Financial Centre), Dubai International Financial Centre, the Kingdom of Saudi Arabia, the State of Qatar, the Kingdom of Bahrain, Kuwait, Brunei and Malaysia. See “*Plan of Distribution*”.

The Executive Shariah Committee of HSBC Saudi Arabia Limited, Standard Chartered Bank Sharia Supervisory Committee, CIMB Islamic Bank Berhad and Shaikh Nedham Mohamed Saleh Abdulrahman Yaqobi have approved that the Certificates are Shari’a compliant. The service of Shaikh Nedham Mohamed Saleh Abdulrahman Yaqobi was also procured by National Bank of Abu Dhabi PJSC. However, there can be no assurance that the transaction structure or the issue and trading of the Certificates will be deemed to be Shari’a compliant by any other Shari’a board or Shari’a scholar. None of the Issuer, the FSI, the HKSAR Government, the Joint Global Coordinators, the Joint Lead Managers, the Co-managers, the Delegate or the Agents makes any representation as to the Shari’a compliance of the Certificates and potential investors are reminded that, as with any Shari’a views, differences in opinion are possible. Potential investors should obtain their own independent Shari’a advice as to the compliance of the structure and the issue and trading of the Certificates with Shari’a principles.

THE CERTIFICATES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE U.S. SECURITIES AND EXCHANGE COMMISSION, ANY STATE SECURITIES COMMISSION IN THE UNITED STATES OR ANY OTHER U.S. REGULATORY AUTHORITY, NOR HAS ANY OF THE FOREGOING AUTHORITIES PASSED UPON OR ENDORSED THE MERITS OF THE OFFERING OF CERTIFICATES OR THE ACCURACY OR THE ADEQUACY OF THIS OFFERING MEMORANDUM. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENCE IN THE UNITED STATES.

The Certificates have not been and will not be registered under the Securities Act or with any securities regulatory authority of any state of the United States. The Certificates may not be offered, sold or delivered within the United States except pursuant to an exemption from, or in transactions not subject to, the registration requirements of the Securities Act and applicable state securities laws.

The Certificates are being offered and sold outside the United States in reliance on Regulation S and within the United States in reliance on Rule 144A only to persons reasonably believed to be QIBs. Prospective purchasers are hereby notified that sellers of the Rule 144A Certificates may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A. For description of these and certain further restrictions on offers, sales and transfers of Certificates and distribution of this offering memorandum, see “*Plan of Distribution*” and “*Transfer Restrictions*”.

IN CONNECTION WITH THE ISSUE OF CERTIFICATES, THE JOINT LEAD MANAGER(S) NAMED AS STABILISING MANAGER(S) (OR ANY PERSON ACTING ON BEHALF OF THE STABILISING MANAGER(S)) MAY EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE CERTIFICATES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL. HOWEVER, THERE CAN BE NO ASSURANCE THAT THE STABILISING MANAGER(S) (OR ANY PERSON ACTING ON BEHALF OF THE STABILISING MANAGER(S)) WILL UNDERTAKE STABILISATION ACTION. ANY STABILISATION ACTION MAY BEGIN ON OR AFTER THE ISSUE DATE AND, IF BEGUN, MAY BE ENDED AT ANY TIME, BUT IT MUST END NO LATER THAN THE EARLIER OF 30 DAYS AFTER THE ISSUE DATE OF THE CERTIFICATES AND 60 DAYS AFTER THE DATE OF THE ALLOTMENT OF THE CERTIFICATES. ANY STABILISATION SHALL BE CONDUCTED IN ACCORDANCE WITH ALL APPLICABLE LAWS AND REGULATIONS.

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENCE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES ANNOTATED, 1955, AS AMENDED (**RSA**), WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA CHAPTER 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

NOTICE TO RESIDENTS OF THE KINGDOM OF SAUDI ARABIA

THIS OFFERING MEMORANDUM MAY NOT BE DISTRIBUTED IN THE KINGDOM OF SAUDI ARABIA EXCEPT TO SUCH PERSONS AS ARE PERMITTED UNDER THE OFFERS OF SECURITIES REGULATIONS ISSUED BY THE CAPITAL MARKET AUTHORITY.

THE CAPITAL MARKET AUTHORITY DOES NOT MAKE ANY REPRESENTATION AS TO THE ACCURACY OR COMPLETENESS OF THIS OFFERING MEMORANDUM, AND EXPRESSLY DISCLAIMS ANY LIABILITY WHATSOEVER FOR ANY LOSS ARISING FROM, OR INCURRED IN RELIANCE UPON, ANY PART OF THIS OFFERING MEMORANDUM. PROSPECTIVE PURCHASERS OF THE SECURITIES OFFERED HEREBY SHOULD CONDUCT THEIR OWN DUE DILIGENCE ON THE ACCURACY OF THE INFORMATION RELATING TO THE SECURITIES. IF A PROSPECTIVE PURCHASER DOES NOT UNDERSTAND THE CONTENTS OF THIS OFFERING MEMORANDUM HE OR SHE SHOULD CONSULT AN AUTHORISED FINANCIAL ADVISER.

NOTICE TO RESIDENTS OF THE STATE OF QATAR

THE CERTIFICATES HAVE NOT BEEN AND WILL NOT BE OFFERED, SOLD OR DELIVERED AT ANY TIME, DIRECTLY OR INDIRECTLY, IN THE STATE OF QATAR (**QATAR**) IN A MANNER THAT WOULD CONSTITUTE A PUBLIC OFFERING. THIS OFFERING MEMORANDUM HAS NOT BEEN REVIEWED OR APPROVED BY OR REGISTERED WITH THE QATAR CENTRAL BANK, THE QATAR EXCHANGE OR THE QATAR FINANCIAL MARKETS AUTHORITY. THIS OFFERING MEMORANDUM IS STRICTLY PRIVATE AND CONFIDENTIAL, AND MAY NOT BE REPRODUCED OR USED FOR ANY OTHER PURPOSE, NOR PROVIDED TO ANY PERSON OTHER THAN THE RECIPIENT THEREOF.

NOTICE TO RESIDENTS OF THE KINGDOM OF BAHRAIN

THIS OFFER IS A PRIVATE PLACEMENT. IT IS NOT SUBJECT TO THE REGULATIONS OF THE CENTRAL BANK OF BAHRAIN THAT APPLY TO PUBLIC OFFERINGS OF SECURITIES AND THE EXTENSIVE DISCLOSURE REQUIREMENTS AND OTHER PROTECTIONS THAT THESE REGULATIONS CONTAIN. THIS OFFERING MEMORANDUM IS THEREFORE INTENDED ONLY FOR “ACCREDITED INVESTORS” AS DEFINED BY THE CENTRAL BANK OF BAHRAIN.

THE FINANCIAL INSTRUMENTS OFFERED PURSUANT TO THIS OFFERING MEMORANDUM MAY ONLY BE OFFERED IN MINIMUM SUBSCRIPTIONS OF US\$200,000 (OR ITS EQUIVALENT IN FOREIGN CURRENCIES).

THE CENTRAL BANK OF BAHRAIN ASSUMES NO RESPONSIBILITY FOR THE ACCURACY AND COMPLETENESS OF THE STATEMENTS AND INFORMATION CONTAINED IN THIS OFFERING MEMORANDUM AND EXPRESSLY DISCLAIMS ANY LIABILITY WHATSOEVER ARISING FROM RELIANCE UPON THE WHOLE OR ANY PART OF THE CONTENTS OF THIS OFFERING MEMORANDUM.

THE BOARD OF DIRECTORS AND THE MANAGEMENT OF THE OFFEROR ACCEPTS RESPONSIBILITY FOR THE INFORMATION CONTAINED IN THIS OFFERING MEMORANDUM. TO THE BEST OF THE KNOWLEDGE AND BELIEF OF THE BOARD OF DIRECTORS AND THE MANAGEMENT, WHO HAVE TAKEN ALL REASONABLE CARE TO ENSURE THAT SUCH IS THE CASE, THE INFORMATION CONTAINED IN THIS OFFERING MEMORANDUM IS IN ACCORDANCE WITH THE FACTS AND DOES NOT OMIT ANYTHING LIKELY TO AFFECT THE RELIABILITY OF SUCH INFORMATION.

THIS OFFERING MEMORANDUM CONTAINS INFORMATION WHICH SHOULD BE READ CAREFULLY BEFORE ANY DECISION IS MADE WITH RESPECT TO THE PROPOSALS CONTAINED THEREIN AND THE INVESTORS ARE RECOMMENDED TO TAKE THEIR OWN FINANCIAL ADVICE IN RESPECT OF ANY OF THE TERMS AND CONDITIONS OF THIS OFFERING MEMORANDUM.

NOTICE TO RESIDENTS OF MALAYSIA

THE CERTIFICATES MAY NOT BE OFFERED FOR SUBSCRIPTION OR PURCHASE AND NO INVITATION TO SUBSCRIBE FOR OR PURCHASE THE CERTIFICATES IN MALAYSIA MAY BE MADE, DIRECTLY OR INDIRECTLY, AND THIS OFFERING MEMORANDUM OR ANY DOCUMENT OR OTHER MATERIALS IN CONNECTION THEREWITH MAY NOT BE DISTRIBUTED IN MALAYSIA OTHER THAN TO PERSONS FALLING WITHIN ANY ONE OF THE CATEGORIES OF PERSONS SPECIFIED UNDER SCHEDULE 6 OR SECTION 229(1)(B), SCHEDULE 7 OR SECTION 230(1)(B) AND SCHEDULE 8 OR SECTION 257(3), READ TOGETHER WITH SCHEDULE 9 OR SECTION 257(3) OF THE CAPITAL MARKET AND SERVICES ACT 2007 OF MALAYSIA. THE SECURITIES COMMISSION MALAYSIA SHALL NOT BE LIABLE FOR ANY NON-DISCLOSURE ON THE PART OF THE ISSUER OR THE HKSAR GOVERNMENT AND ASSUMES NO RESPONSIBILITY FOR THE CORRECTNESS OF ANY STATEMENTS MADE OR OPINIONS OR REPORTS EXPRESSED IN THIS OFFERING MEMORANDUM.

AVAILABLE INFORMATION

For so long as any Certificates are “restricted securities” as defined in Rule 144(a)(3) under the Securities Act, the Issuer will, during any period that it is neither subject to Section 13 or 15(d) of the United States Securities Exchange Act of 1934, as amended (the “**Exchange Act**”), nor exempt from reporting pursuant to Rule 12g3-2(b) thereunder, nor a foreign government eligible to register securities under Schedule B of the Securities Act, furnish, upon request, to any holder or beneficial owner of Certificates or any prospective purchaser designated by any such holder or beneficial owner, the information required to be delivered pursuant to Rule 144A(d)(4) under the Securities Act.

TABLE OF CONTENTS

	Page
Forward-Looking Statements	vii
Enforcement	vii
Certain Defined Terms and Conventions	vii
Presentation of Certain Information	viii
Summary	1
Structure Diagram and Cash Flows	3
Summary of the Offering	5
Investment Considerations	17
Terms and Conditions of the Certificates	24
Global Certificates	42
Ratings	47
Description of The Issuer	48
Description of The Financial Secretary and The Financial Secretary Incorporated	49
Summary of the Principal Transaction Documents	50
Use of Proceeds	55
The Hong Kong Special Administrative Region	56
Taxation	128
ERISA Considerations	132
Plan of Distribution	134
Transfer Restrictions	140
Legal Matters	143
Clearance and Settlement	144
General Information	148

FORWARD-LOOKING STATEMENTS

This offering memorandum includes forward-looking statements. All statements other than statements of historical facts included in this offering memorandum regarding, among other things, Hong Kong's economy, fiscal condition, debt or prospects may constitute forward-looking statements. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "may", "will", "expect", "intend", "estimate", "anticipate", "believe", "continue" or similar terminology. Although the HKSAR Government believes that the expectations reflected in its forward-looking statements are reasonable at this time, there can be no assurance that these expectations will prove to be correct.

ENFORCEMENT

In the Declaration of Trust, the Certificates and the other Transaction Documents (as defined herein), the courts of the Hong Kong Special Administrative Region of the People's Republic of China (the "**HKSAR**") are to have exclusive jurisdiction to settle any disputes which may arise out of or in connection with the Transaction Documents and any disputes relating to any non-contractual obligations arising out of or in connection with the Transaction Documents.

Section 3 of the Crown Proceedings Ordinance (Cap. 300, Laws of Hong Kong) ("**CPO**") enables civil proceedings (as defined in the CPO) to be commenced against the HKSAR Government in the courts of the HKSAR. However, there are certain restrictions as to the rights and remedies available against the HKSAR Government. The HKSAR courts have no power to grant an injunction or to order specific performance, but may instead make an order declaratory of the rights of the parties. Section 21 of the CPO provides that if an order is made against the HKSAR Government, the proper officer of the HKSAR courts will, upon application, issue to the successful plaintiff a certificate containing particulars of the order. If the order provides for payment of money, the certificate will state the amount payable and the Director of Accounting Services shall pay the sum shown to be due, subject to appeal. No process of execution or attachment can be carried out to enforce satisfaction against the HKSAR Government of any judgment.

CERTAIN DEFINED TERMS AND CONVENTIONS

References to **Hong Kong** and the **HKSAR** herein are to the Hong Kong Special Administrative Region of the People's Republic of China. All references to **China** or the **PRC** herein are references to the People's Republic of China and all references to the **Mainland** are to the mainland of the PRC.

References to the **HKSAR Government** herein are to the government of the HKSAR.

References to the **HKMA** herein are to the office of the Monetary Authority, which was established on 1 April 1993. The Monetary Authority is the Chief Executive of the HKMA and the HKMA is Hong Kong's central banking institution.

References to **HK\$, HK dollars and Hong Kong dollars** are to the lawful currency of Hong Kong and all references to **U.S. dollars and US\$** are to the lawful currency of the United States. Since 1983, the Hong Kong dollar has been linked to the U.S. dollar at HK\$7.80 = US\$1.00.

References to the **MA** herein are to the Monetary Authority appointed pursuant to section 5A(1) of the Exchange Fund Ordinance (Cap. 66 of the Laws of Hong Kong).

References to tons herein are to metric tons, each of which equals approximately 2,205 pounds or 1.102 short tons. Measures of distance referred to herein are stated in kilometres, each of which equals approximately 0.62 miles.

Unless otherwise specified, percentage increases or decreases stated for periods or dates in a particular year represent increases or decreases as compared with the relevant amount for the corresponding period or date in the immediately preceding year.

PRESENTATION OF CERTAIN INFORMATION

Financial data and statistical information provided in this offering memorandum may be subsequently revised in accordance with the ongoing review by the HKSAR Government of its economic data and statistical information, and the HKSAR Government is not obligated to distribute revised data or statistical information to any investor. Financial statements prepared on a cash basis for the fiscal year ending 31 March 2013, and all prior periods, have been audited by the Director of Audit. Financial statements prepared on an accrual basis are not subject to audit. Unless otherwise indicated, financial data derived from the HKSAR Government's accounts are derived from the accounts prepared on a cash basis and all statistical information prepared by or on behalf of the HKSAR Government contained in this offering memorandum excludes information with respect to the Mainland, Macao and Taiwan.

Financial data and statistical information for calendar years 2013 and 2014, including periods therein, and the fiscal year 2013-14 may, in particular, be subject to revision as financial statements relating to those periods and any subsequent period have not yet been audited. In addition, some financial data and statistical information for calendar years 2013 and 2014, the fiscal year 2013-14, and all financial data and statistical information for fiscal year 2014-15 contained herein are provisional data or estimates based on the latest available data. These data are subject to revision. See "*The Hong Kong Special Administrative Region — Public Finance — Accrual and Cash-based Accounts*".

Unless otherwise indicated, estimates contained in this offering memorandum are estimates of the HKSAR Government. Unless otherwise indicated, references to a year refer to the relevant calendar year ended 31 December and references to **fiscal year** or to parts of two calendar years (for example, 2012-13) refer to the fiscal year of the HKSAR Government, which spans the period from 1 April to the following 31 March. Unless otherwise indicated, references to **quarters** refer to quarters of the calendar year (for example, **first quarter** or **Q1** means the first three months of the calendar year).

Unless otherwise indicated, all information contained herein is given as of the date of this offering memorandum. Certain figures included in this offering memorandum have been subject to rounding adjustments. Accordingly, figures shown for the same category presented in different tables may vary slightly and figures shown as totals in certain tables may not be an arithmetic aggregation of the figures preceding them.

SUMMARY

This summary must be read as an introduction to this offering memorandum and any decision to invest in the Certificates should be based on a consideration of this offering memorandum as a whole, including any documents incorporated by reference.

Overview of the Hong Kong Special Administrative Region

Hong Kong is one of the world's leading trade and financial centres and a gateway to the mainland (the "**Mainland**") of the People's Republic of China (the "**PRC**"). Situated on the southeast coast of China, Hong Kong is positioned at the centre of East Asia. With a total area of 1,104 square kilometres, Hong Kong is comprised of Hong Kong Island, Lantau Island, the Kowloon Peninsula and the New Territories (including 261 outlying islands).

Hong Kong benefits from a relatively stable political environment with strong institutions. It has one of the highest levels of governance in the world, underscored by the World Bank's Worldwide Governance Indicators project which ranked Hong Kong in the 90th percentile or higher in each of its aggregate indicators for Control of Corruption, Rule of Law, Regulatory Quality and Government Effectiveness in 2012.

The HKSAR Government maintains one of the world's most open economies and a business-friendly environment characterised by a relatively high degree of free trade and free flow of information, an established financial regulatory regime and legal system, and developed transportation and telecommunications infrastructure. In 2013, Hong Kong was ranked the world's eighth-largest trading economy by the World Trade Organisation (the "**WTO**") in terms of value of total merchandise trade and was home to the world's fourth-busiest container port in terms of throughput.

Over the past two decades, Hong Kong's economy, as measured by real GDP, has more than doubled in size. Hong Kong is a mature economy, with real GDP growing at 2.6 per cent. and 1.8 per cent. year-on-year in the first and second quarters of 2014, respectively. In 2013, Hong Kong's GDP at current market prices reached HK\$2.1 trillion and its per capita GDP of HK\$295,701 was among the highest in Asia.

As at 31 December 2013, the stock market in Hong Kong was the largest in Asia Ex-Japan as measured by market capitalisation. With strong market access and financing flexibility underpinned by deep local capital markets, Hong Kong has also developed into an international financial centre.

As of the date of this offering memorandum, the HKSAR Government has been assigned long-term local currency credit ratings of "AAA" by S&P, "Aa1" by Moody's and "AA+" by Fitch. For a more detailed discussion of Hong Kong, see "*The Hong Kong Special Administrative Region*".

Summary Historical Information

	Year ended 31 December					Q1	Q2
	2009	2010	2011	2012	2013	2014	
The Economy							
GDP (HK\$ billions) ⁽¹⁾ . . .	1,659.2	1,776.3	1,934.4	2,037.1	2,125.4	530.9 ⁽²⁾	517.4 ⁽²⁾
Real GDP growth rate . . .	-2.5	6.8	4.8	1.5	2.9	2.6 ⁽²⁾	1.8 ⁽²⁾
Population (in millions at year end)	7.0	7.1	7.1	7.2	7.2	n.a.	n.a.
Per capita GDP (HK\$) ⁽¹⁾ .	237,960	252,887	273,550	284,721	295,701	n.a.	n.a.
Underlying composite consumer price index (year-on-year per cent. rate of change) ⁽⁴⁾	1.0	1.7	5.3	4.7	4.0	3.8	3.5
Unemployment rate	5.3	4.3	3.4	3.3	3.4	3.1	3.2
External Sector							
Current account balance (HK\$ billions)	164.0	124.4	107.5	32.2	39.5	(4.4)	— ⁽³⁾
Capital and financial account balance (HK\$ billions)	(144.5)	(88.8)	(113.2)	(67.7)	(40.5)	29.9	— ⁽³⁾
Foreign currency reserve assets ⁽⁵⁾ (US\$ billions)	255.8	268.7	285.4	317.3	311.2	316.8	320.9
Tourism							
Total visitor arrivals (in thousands)	29,591	36,030	41,921	48,615	54,299	n.a.	28,529 ⁽⁷⁾
Total tourism expenditure associated with inbound tourism (US\$ millions)	158.3	212.2	258.7	289.4	332.0	— ⁽³⁾	— ⁽³⁾
Public Finance⁽⁶⁾							
Government revenues (HK\$ millions)	318,442	376,481	437,723	442,150	455,346 ⁽²⁾	67,159 ⁽²⁾	— ⁽³⁾
Government expenditures (HK\$ millions)	289,025	301,360	364,037	377,324	433,543 ⁽²⁾	87,096 ⁽²⁾	— ⁽³⁾
Consolidated surplus/(deficit) (HK\$ millions)	29,417	75,121	73,686	64,826	21,803 ⁽²⁾	(19,937) ⁽²⁾	— ⁽³⁾

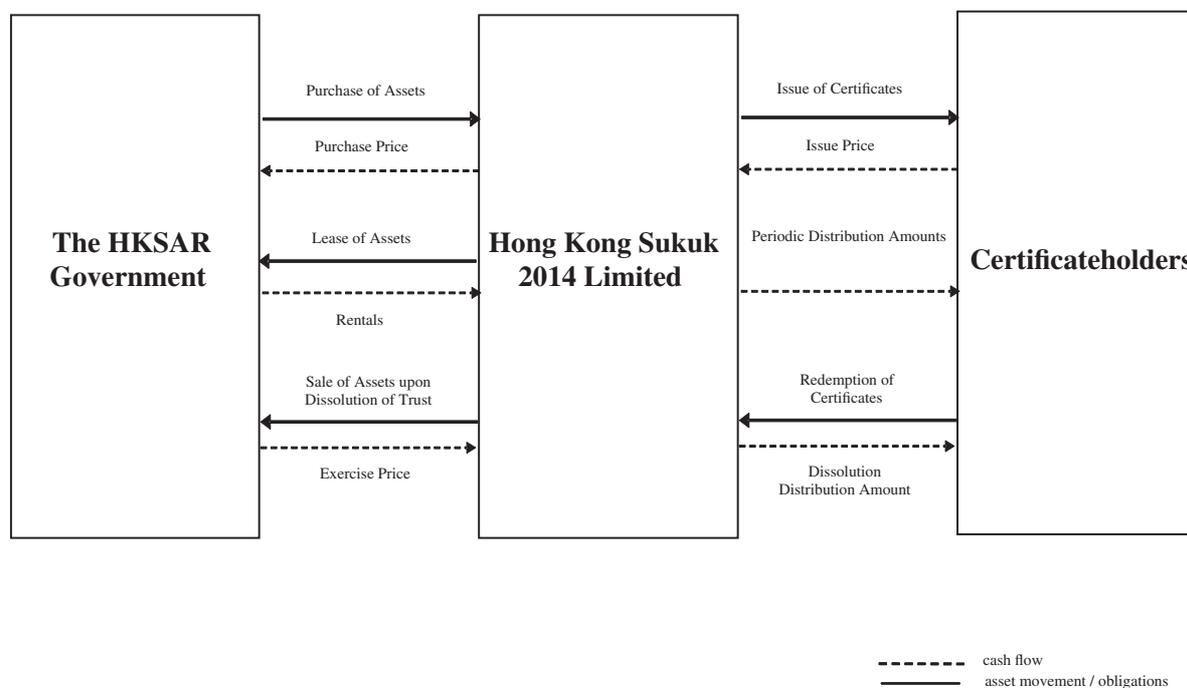
Notes:

- (1) At current market prices.
 - (2) Provisional figures.
 - (3) Figures are not available as of the date of this offering memorandum.
 - (4) After netting out effects of the HKSAR Government's one-off relief measures.
 - (5) Excludes unsettled foreign exchange contracts.
 - (6) Figures refer to fiscal year which runs from 1 April of the calendar year to 31 March of the following calendar year. Q1 refers to the three months ended 30 June 2014.
 - (7) For the six months ended 30 June 2014.
- n.a. Not applicable.

STRUCTURE DIAGRAM AND CASH FLOWS

Set out below is a simplified structure diagram and description of the principal cash flows underlying the transaction. Potential investors are referred to the terms and conditions of the Certificates and the detailed descriptions of the relevant Transaction Documents set out elsewhere in this offering memorandum for a fuller description of certain cash flows and for an explanation of the meaning of certain capitalised terms used below.

Structure Diagram



Principal cash flows

Payments by the Certificateholders and the Issuer

On the Closing Date, the Certificateholders will pay the issue price in respect of the Certificates to the Issuer, which will hold such proceeds of the issue of the Certificates as Trustee and will pay such amount to the FSI as the purchase price payable under the Purchase Agreement (as defined herein) for the Assets (as defined herein).

The Assets to be purchased by the Trustee on the Closing Date will consist of selected units in Wu Chung House, No.213 Queen's Road East, Hong Kong and Fairmont House, No.8 Cotton Tree Drive, Hong Kong that are currently owned by the FSI and used by various government departments as offices. Under the Substitution and Transfer Undertaking (as defined herein), the HKSAR Government may substitute or replace the Assets with assets the identity of which may be determined by the HKSAR Government in its sole and absolute discretion provided such assets comprise land, buildings, leasehold interests and/or building rights used for Shari'a compliant purposes.

Periodic Distribution Payments

The Trustee will, with effect from the Closing Date, lease the Lease Assets (as defined in the Lease Agreement) to the HKSAR Government. On each Periodic Distribution Date, the Lessee will pay to the Trustee an amount reflecting the rental due in respect of the Lease Assets which is intended to be sufficient to fund the Periodic Distribution Amounts payable by the Issuer under the Certificates and shall be applied by the Trustee for that purpose.

Dissolution Payment by the Obligor

On the Scheduled Dissolution Date, the Trustee and the Delegate will have the right to require the Obligor pursuant to the unconditional and irrevocable undertaking of the Obligor under the Purchase Undertaking to purchase or procure the purchase of the Lease Assets from the Trustee for an amount equal to the exercise price which is payable by the Obligor to the Trustee and is intended to fund the Dissolution Distribution Amount payable by the Issuer under the Certificates.

The Trust may be dissolved prior to the Scheduled Dissolution Date for the following reasons: (i) redemption following a Dissolution Event (as defined herein) or (ii) upon the occurrence of a Total Loss Event (as defined herein) (save where the Lease Assets are replaced as provided in the Servicing Agency Agreement (as defined herein) after the occurrence of the Total Loss Event, see “*Summary of the Offering — Summary of the Certificates — Total Loss Event*”) in accordance with Condition 9.3 (*Capital Distributions of the Trust — Dissolution following a Total Loss Event*).

In the case of (i), the amounts payable by the Issuer on the due date for dissolution will be funded by the Obligor purchasing or procuring the purchase of the Lease Assets and paying the exercise price to the Trustee pursuant to the terms of the Purchase Undertaking. In the case of (ii), the amounts payable by the Issuer on the due date for dissolution will be funded using any proceeds of insurance payable in respect of the Total Loss Event which (save where the HKSAR Government replaces the Lease Assets as referred to above) are required to be paid into the Transaction Account (as defined herein) by no later than the 30th day after the occurrence of the Total Loss Event.

Should there be any shortfall in the insurance proceeds paid into the Transaction Account for funding the amounts payable by the Issuer on the due date for dissolution in the case of (ii) above, the Servicing Agent (as defined herein) will acknowledge that it shall have failed in its responsibilities in respect of the proper insurance of the Lease Assets and will irrevocably and unconditionally undertake to pay an amount equal to such shortfall into the Transaction Account by no later than close of business on the 31st day after the Total Loss Event has occurred.

SUMMARY OF THE OFFERING

The following overview should be read as an introduction to, and is qualified in its entirety by reference to, the more detailed information appearing elsewhere in this offering memorandum. This overview may not contain all of the information that prospective investors should consider before deciding to invest in the Certificates. Accordingly, any decision by a prospective investor to invest in the Certificates should be based on a consideration of this offering memorandum as a whole.

*Words and expressions defined in the “Terms and Conditions of the Certificates” shall have the same meanings in this overview. Reference to a “Condition” is to a numbered condition of the Terms and Conditions of the Certificates (the “**Conditions**”).*

Parties:

- Issuer and Trustee:** Hong Kong Sukuk 2014 Limited (Company No. 2123499) (in its capacity as issuer, the “**Issuer**” and in its capacity as trustee, the “**Trustee**”), a company incorporated in Hong Kong as a public limited liability company on 22 July 2014 under the Companies Ordinance (Cap. 622) of Hong Kong, having its registered office at 84/F, Two International Finance Centre, 8 Finance Street, Central, Hong Kong. The Issuer has been incorporated primarily for the purpose of participating in the transactions contemplated by the Transaction Documents (as defined below) to which it is a party.
- Ownership of the Issuer:** The Issuer is owned by the FSI.
- Seller:** The FSI (in its capacity as seller, the “**Seller**”). Pursuant to the Purchase Agreement, the Seller will sell to the Trustee, and the Trustee will purchase from the Seller, the Assets (as defined in the Purchase Agreement) in accordance with the terms of the Purchase Agreement.
- Lessor:** The Trustee (in its capacity as lessor, the “**Lessor**”). Pursuant to the Lease Agreement, the Lessor will lease to the Lessee, and the Lessee will lease from the Lessor, the Lease Assets in accordance with the terms of the Lease Agreement.
- Lessee:** The HKSAR Government (in its capacity as lessee, the “**Lessee**”). Pursuant to the Lease Agreement, the Lessee will lease from the Lessor, and the Lessor will lease to the Lessee, the Lease Assets in accordance with the terms of the Lease Agreement.
- Obligor:** The HKSAR Government (in its capacity as obligor, the “**Obligor**”). In accordance with the terms of the Purchase Undertaking, the HKSAR Government will, on the Scheduled Dissolution Date or following the service of an exercise notice (the “**Exercise Notice**”) by or on behalf of the Trustee, purchase or procure the purchase of the Lease Assets from the Trustee at the Exercise Price.

Exercise Price means:

- (a) at any time, the aggregate face amount of the Certificates then outstanding; plus
- (b) all accrued but unpaid Periodic Distribution Amounts (if any) relating to the Certificates plus any Servicing Agency Expenses in respect of which a Supplementary Rental payment has not been made in accordance with the Lease Agreement.

Insurance Proceeds means the proceeds of any claim under the Insurances (as defined in the Servicing Agency Agreement).

Rental Payment Date means 18 March and 18 September in each year, commencing on 18 March 2015 and to and including 18 September 2019 or any earlier date on which the Lease Agreement is terminated in accordance with its terms.

Rental Period means the period from and including, a Rental Payment Date (or with respect to the first Rental Period from and including the Lease Commencement Date (as defined in the Lease Agreement)) to but excluding the next succeeding Rental Payment Date.

Servicing Agency Expenses means, in respect of a Rental Period, all payments made by the Servicing Agent in respect of the services provided under the Servicing Agency Agreement in relation to the Lease Assets (other than in respect of the application of any Insurance Proceeds received by the Servicing Agent towards the repair, reinstatement and/or replacement of any Lease Assets, or part thereof).

Supplementary Rental means in respect of a Rental Period, an amount equal to the Servicing Agency Expenses (if any) incurred by the Lessor in relation to the Lease Assets (as defined in the Lease Agreement) in the immediately preceding Rental Period or as notified to the Lessee by the delivery of a Rental Notice in accordance with the Lease Agreement.

Servicing Agent:

The HKSAR Government (in its capacity as servicing agent, the “**Servicing Agent**”). Under the Lease Agreement, the Lessor shall be responsible for obtaining insurance for the Lease Assets, paying all Proprietorship Taxes and Levies (as defined in the Servicing Agency Agreement) (if any) in respect of the Lease Assets and performing all major maintenance and structural repair on the Lease Assets. In accordance with the terms of the Servicing Agency Agreement, the Lessor will delegate the responsibility to perform, or procure the performance of, all major maintenance and structural repair and the payment of Proprietorship Taxes and Levies (if any) and the responsibility for ensuring that the Lease Assets are insured against a Total Loss Event, to the Servicing Agent.

Joint Global Coordinators:	The Hongkong and Shanghai Banking Corporation Limited and Standard Chartered Bank.
Joint Bookrunners and Joint Lead Managers:	The Hongkong and Shanghai Banking Corporation Limited, Standard Chartered Bank, CIMB Investment Bank Berhad and National Bank of Abu Dhabi PJSC.
Co-managers:	Abu Dhabi Islamic Bank PJSC, Emirates NBD Capital Limited, Hong Leong Islamic Bank Berhad, Oversea-Chinese Banking Corporation Limited, Hong Kong Branch, QInvest LLC and RHB Islamic Bank Berhad.
Delegate:	DB Trustees (Hong Kong) Limited (the “ Delegate ”). In accordance with the terms of the Declaration of Trust, the Trustee will unconditionally and irrevocably delegate to the Delegate the present and future powers, authorities and discretions vested in the Trustee by certain provisions of the Declaration of Trust.
Principal Paying Agent:	Deutsche Bank Trust Company Americas.
Transfer Agent and Registrar:	Deutsche Bank Trust Company Americas.
<u>Summary of the Structure and Transaction Documents:</u>	
Summary of the Structure:	An overview of the structure of the transaction and the principal cash flows is set out in the section entitled “ <i>Structure Diagram and Cash Flows</i> ”.
Summary of the Transaction Documents:	A description of the principal terms of the significant Transaction Documents is set out in the section entitled “ <i>Summary of the Principal Transaction Documents</i> ”.
<u>Summary of the Certificates:</u>	
Certificates:	US\$1,000,000,000 trust certificates due 2019.
Status of Certificates:	Each Certificate will evidence an undivided beneficial ownership interest in the Trust Assets (as defined below), subject to the terms of the Declaration of Trust and the Conditions, and will be a limited recourse obligation of the Issuer. Each Certificate will rank <i>pari passu</i> , without any preference or priority, with the other Certificates issued in accordance with the Conditions.

Trust Assets:	<p>Pursuant to the Declaration of Trust, the Trustee will declare that it will hold certain assets (the “Trust Assets”), consisting of:</p> <ul style="list-style-type: none"> (a) all of the Trustee’s rights, interest and benefit, present and future, in, to and under the Lease Assets; (b) all of the Trustee’s rights, title, interest and benefit, present and future, in, to and under the Transaction Documents (other than in relation to any representations given to the Trustee by the HKSAR Government and/or the FSI pursuant to any of the Transaction Documents); (c) all monies standing to the credit of the Transaction Account from time to time; and (d) all proceeds of the foregoing, <p>on trust absolutely for the Certificateholders as owners and beneficiaries <i>pro rata</i> according to the face amount of Certificates held by each holder of Certificates, in accordance with the Declaration of Trust and the Conditions.</p>
Closing Date:	18 September 2014.
Issue Price:	100 per cent. of the aggregate face amount of the Certificates.
Periodic Distribution Dates:	Each of 18 March and 18 September in each year commencing on 18 March 2015 and, subject to Condition 7 (<i>Periodic Distributions</i>), ending on the Scheduled Dissolution Date.
Periodic Distribution Amounts:	On each Periodic Distribution Date, the Certificateholders will receive a Periodic Distribution Amount determined in accordance with Condition 7 (<i>Periodic Distributions</i>) representing a defined share of the Rental paid by the Lessee to the Lessor pursuant to the Lease Agreement in respect of the Lease Assets.
Scheduled Dissolution Date:	18 September 2019.
Scheduled Dissolution of the Trust:	Upon receipt by the Trustee of the Exercise Price payable in accordance with the terms of the Purchase Undertaking, and unless the Certificates are previously redeemed or purchased and cancelled, the Trustee will apply the Exercise Price to redeem each Certificate at the Dissolution Distribution Amount and the Trust will be dissolved by the Trustee on the Scheduled Dissolution Date.
Dissolution Distribution Amount:	<p>In relation to each Certificate, means the aggregate of:</p> <ul style="list-style-type: none"> (a) the outstanding face amount of such Certificate; and (b) all accrued and unpaid Periodic Distribution Amounts in respect of such Certificate.

Early Dissolution of the Trust:

The Trust may only be dissolved prior to the Scheduled Dissolution Date upon the:

- (a) occurrence of a Dissolution Event which is continuing; or
- (b) occurrence of a Total Loss Event.

In the case of paragraph (a), the Certificates will be redeemed in accordance with Condition 9.2 (*Capital Distributions of the Trust — Dissolution following a Dissolution Event*) and pursuant to the exercise of the Trustee's rights under the Purchase Undertaking. The Exercise Price payable under the Purchase Undertaking will be used to fund the redemption of the Certificates.

In the case of paragraph (b) the Certificates will be redeemed in accordance with Condition 9.3 (*Capital Distributions of the Trust — Dissolution following a Total Loss Event*).

Dissolution Events:

The Dissolution Events are described in Condition 13 (*Dissolution Events*). Following the occurrence of a Dissolution Event which is continuing, the Certificates may be redeemed in full at an amount equal to the Dissolution Distribution Amount in the manner described in Condition 13 (*Dissolution Events*).

Total Loss Event:

Save where the Lease Assets are replaced as provided in the Servicing Agency Agreement by the 30th day after the occurrence of a Total Loss Event, the occurrence of a Total Loss Event will result in the redemption of the Certificates and the consequent dissolution of the Trust in accordance with Condition 9.3 (*Capital Distributions of the Trust — Dissolution following a Total Loss Event*) on the date falling 10 days after the receipt of the Insurance Coverage Amount (as defined below) and/or the Total Loss Shortfall Amount (as defined below) in the Transaction Account following notification thereof by the Delegate in accordance with Condition 16 (*Notices*). The Servicing Agent is responsible for ensuring that the Lease Assets are, so long as the Certificates are outstanding, insured against a Total Loss Event. If a Total Loss Event occurs, the Servicing Agent undertakes to ensure that all Insurance Proceeds in respect thereof (if any) are paid in U.S. dollars into the Transaction Account by no later than the 30th day after the occurrence of the Total Loss Event.

If a Total Loss Event occurs and the Lease Assets are not replaced as discussed above, and an amount (if any) less than the Insurance Coverage Amount is credited to the Transaction Account (the difference between the Insurance Coverage Amount and the amount credited to the Transaction Account being the “**Total Loss Shortfall Amount**”), then the Servicing Agent will irrevocably and unconditionally undertake to pay (in same day, freely transferable, cleared funds) the Total Loss Shortfall Amount directly into the Transaction Account by no later than close of business on the 31st day after the Total Loss Event has occurred, such that the amount standing to the credit of the Transaction Account on the 31st day following the occurrence of a Total Loss Event represents the aggregate of the insurance proceeds payable in respect of a Total Loss Event (if any) and the Total Loss Shortfall Amount funded by the Servicing Agent in accordance with the terms of the Servicing Agency Agreement.

Rentals shall cease to accrue under the Lease with effect from the date on which a Total Loss Event (if any) occurs, and no additional rental payment shall be made in respect of the period between the date on which the Total Loss Event occurred and the date on which the Total Loss Shortfall Amount is paid into the Transaction Account.

See Condition 5.1 (*Trust — Summary of the Trust*).

Insurance Coverage Amount means an amount equal to the aggregate of:

- (a) the face amount of all Certificates for the time being outstanding;
- (b) an amount equal to at least 40 days’ Rental as would be calculated in accordance with the Lease Agreement; and
- (c) without duplication and double counting, an amount equal to any Servicing Agency Expenses outstanding under the terms of the Servicing Agency Agreement in relation to the Lease Assets.

Total Loss Event means the total loss or destruction of, or damage to the whole of the Lease Assets or any event or occurrence that renders the whole of the Lease Assets permanently unfit for any economic use and (but only after taking into consideration any insurances or other indemnity granted in each case by any third party in respect of the Lease Assets) the repair or remedial work in respect thereof is wholly uneconomical.

Negative Pledge:

So long as any Certificate remains outstanding, the HKSAR Government will not create or permit to subsist any Encumbrance on the whole or any part of the Exchange Fund as security for any HKSAR Government Public External Debt unless, at the same time or prior thereto, or promptly thereafter, the HKSAR Government's obligations under the Purchase Undertaking, the Lease Agreement and the Servicing Agency Agreement are secured at least equally and rateably with such HKSAR Government Public External Debt, or the HKSAR Government provides such other security for its obligations under the Purchase Undertaking, the Lease Agreement and the Servicing Agency Agreement, as approved by the holders of the Certificates in accordance with the Declaration of Trust.

For the avoidance of doubt, any Encumbrance created on the assets or revenues of any corporate entity in which the HKSAR Government has a direct or indirect equity interest or other stake (other than any entity established to own or manage any part of the Exchange Fund) shall not be considered to be an Encumbrance on the Exchange Fund or any part thereof.

Where:

Encumbrance means any lien, pledge, mortgage, security interest, deed of trust, charge or other encumbrance or arrangement any of which has the practical effect of constituting a security interest with respect to the payment of any obligations with or from the proceeds of any property, assets or revenues of any kind (including, without limitation, any equivalent created or arising under the laws of Hong Kong), it being expressly understood and agreed that bonds, alternative bonds, promissory notes or other instruments issued by the HKSAR Government, including the Certificates, pursuant to the Loans Ordinance of Hong Kong or the Loans (Government Bonds) Ordinance of Hong Kong or any re-enactment thereof, in respect of which the repayment of principal and payment of the financial charges and other amounts thereon are charged on and made payable out of the general revenues and assets of Hong Kong pursuant to those ordinances (and not otherwise), including any sinking fund arrangement as provided in such bonds, will not be construed or deemed to create any Encumbrance on the whole or any part of the Exchange Fund;

Exchange Fund means the fund established and maintained pursuant to the Exchange Fund Ordinance of Hong Kong;

External Debt means all obligations of any person, and all guarantees or indemnities by any person (whether by contract, statute or otherwise), for or in respect of borrowed money or evidenced by bonds, trust certificates, debentures, notes or similar instruments which, in each case, (1) have an original maturity in excess of one year and (2) are denominated or payable, or which, at the option of the holder thereof, may be payable, in a currency other than the currency of Hong Kong or by reference to a currency other than the currency of Hong Kong;

HKSAR Government Public External Debt means Public External Debt undertaken directly by and in the name of the HKSAR Government and backed by the full faith and credit of the HKSAR Government. Obligations, guarantees and indemnities undertaken “directly by and in the name of the HKSAR Government” do not include obligations, guarantees and indemnities undertaken by any corporate entity in which the HKSAR Government has a direct or indirect equity interest or other stake; and

Public External Debt means any External Debt which is publicly offered or privately placed in one or more securities markets and which is in the form of, or represented by, notes, bonds, trust certificates or other securities that are or may be quoted, listed or ordinarily purchased or sold on any stock exchange, automated trading system or over-the-counter or other securities market (including, without limitation, securities eligible for resale under Rule 144A).

Asset Substitution:

Pursuant to the Substitution and Transfer Undertaking entered into by the Trustee in favour of the HKSAR Government, the HKSAR Government has the right to oblige the Trustee to transfer the Lease Assets specified in a Substitution Notice (as defined in the Substitution and Transfer Undertaking), the identity of which shall be determined by the HKSAR Government in its sole and absolute discretion (the “**Substituted Lease Assets**”) against the transfer to the Trustee of the beneficial ownership in and to certain new assets (the “**New Lease Assets**”). The HKSAR Government will be obliged to certify that the value of the New Lease Assets is not less than the value of Substituted Lease Assets on the relevant Substitution Date.

In order to effect the substitution, the Trustee and the FSI will enter into a Transfer Agreement (as defined in the Substitution and Transfer Undertaking) to effect the transfer of the Substituted Lease Assets and the New Lease Assets.

Purchase of Certificates held by the Issuer or the HKSAR Government:

The Issuer or the HKSAR Government may at any time purchase Certificates in the open market or otherwise.

Transaction Account:

The U.S. dollar account (the “**Transaction Account**”) with account number AT1364.1 and maintained in the name of the Trustee with Deutsche Bank Trust Company Americas.

**Limited Recourse and
Non-Petition:**

Each Certificate will evidence an undivided beneficial ownership interest in the Trust Assets. No amount whatsoever shall be due and payable in respect of the Certificates except to the extent that funds for that purpose are available from the Trust Assets.

Under no circumstances shall the Delegate or any Certificateholder have any right to cause the sale or other disposition of any of the Trust Assets other than to the HKSAR Government or its designee in accordance with the terms of the Transaction Documents and the sole right of the Delegate and the Certificateholders against the Trustee or the HKSAR Government shall be to enforce their respective obligations under the Transaction Documents.

Prior to the date which is one year and one day after the date on which all amounts owing by Hong Kong Sukuk 2014 Limited under the Transaction Documents to which the HKSAR Government, the Lessee, the Delegate or any Certificateholder is a party have been paid in full, such party will not institute against, or join with any other person in instituting against, Hong Kong Sukuk 2014 Limited any bankruptcy, reorganisation, arrangement or liquidation proceedings or other proceedings under any bankruptcy or similar law.

Role of Delegate:

Pursuant to the Declaration of Trust, the Trustee will delegate to the Delegate all of the present and future powers, authorities and discretions vested in the Trustee by certain provisions of the Declaration of Trust. In particular, the Delegate shall be entitled to:

- a) deliver an Exercise Notice to the HKSAR Government in accordance with the Purchase Undertaking; and
- b) following a Dissolution Event, take any enforcement action against the HKSAR Government in the Trustee's name.

Face Amounts of Certificates:

The Certificates will be issued in minimum face amounts of US\$200,000 and in integral multiples of US\$1,000 in excess thereof.

**Form and Delivery of the
Certificates:**

The Certificates are (1) Regulation S Certificates and (2) Rule 144A Certificates.

Regulation S Certificates will be represented on issue by beneficial interests in one or more Regulation S Global Certificates, in fully registered form, without coupons attached, which will be deposited with the custodian for, and registered in the name of Cede & Co. as nominee for DTC. Rule 144A Certificates will be represented on issue by beneficial interests in one or more Rule 144A Global Certificates in fully registered form, without coupons attached, which will be deposited with the custodian for, and registered in the name of Cede & Co. as nominee for DTC. Beneficial interests in the Regulation S Global Certificates and the Rule 144A Global Certificates (together, the “**Global Certificates**”) will be shown on, and transfers thereof will only be effected through, records maintained by DTC and its direct or indirect participants, including Euroclear Bank SA/NV (“**Euroclear**”) and Clearstream Banking, *société anonyme*, Luxembourg (“**Clearstream, Luxembourg**”). See “*Global Certificates*” and “*Clearance and Settlement*”.

Definitive Certificates evidencing holdings of Certificates will be issued in exchange for interests in the relevant Global Certificates only in certain limited circumstances.

Clearance and Settlement:

Holders of the Certificates must hold their interest in the relevant Global Certificate in book-entry form through DTC. Beneficial interests in the Global Certificates will be shown on, and transfers thereof will only be effected through, records maintained by DTC and its direct or indirect participants, including Euroclear and Clearstream, Luxembourg. Transfers within and between DTC and any other relevant clearing system will be in accordance with the usual rules and operating procedures of the relevant clearing system. See “*Clearance and Settlement*”.

Withholding Tax:

All payments by the HKSAR Government under the Transaction Documents to which it is a party are to be made without withholding or deduction for, or on account of, any Taxes imposed in Hong Kong (or any political sub-division or authority thereof or therein having power to tax). In the event that any such deduction is made, the HKSAR Government will be required, subject to the exceptions set out in Condition 10 (*Taxation*) pursuant to the Transaction Documents, to pay to the Trustee additional amounts so that the Trustee will receive the full amount which otherwise would have been due and payable under the Transaction Documents.

All payments by the Trustee in respect of the Certificates shall be made without withholding or deduction for, or on account of, Taxes unless the withholding or deduction of the Taxes is required by law. The HKSAR Government has agreed in the Transaction Documents that, if the Trustee is required to make any payment under the Certificates after deduction or withholding for: (a) Taxes; or (b) as otherwise required by applicable law, the HKSAR Government will pay to the Trustee additional amounts so that the net amount paid by the Trustee will equal the full amount which would have been paid by the Trustee had no such deduction or withholding been made.

Use of Proceeds:

The gross proceeds of the issue of the Certificates will be paid by the Issuer (in its capacity as Purchaser) on the Closing Date to the FSI (in its capacity as Seller) as the purchase price for the Assets pursuant to the Purchase Agreement.

The proceeds received by the FSI will be credited to the Bond Fund (set up pursuant to resolution (Cap. 2S) passed on 8 July 2009 under section 29 of the Public Finance Ordinance (Cap. 2)) and then placed with the Exchange Fund.

Listing:

Application has been made to the Hong Kong Stock Exchange for the listing of, and permission to deal in, the Certificates by way of debt issues to professional investors only and such permission is expected to become effective on 19 September 2014. Certificates to be listed on the Hong Kong Stock Exchange are required to be traded with a board lot size of at least HK\$500,000 (or equivalent in other currencies).

Application has been made to Bursa Malaysia (under an exempt regime pursuant to which the Certificates will be listed but not quoted for trading) for the listing of the Certificates.

Application has been made to the DFSA for the Certificates to be admitted to the DFSA's Official List of securities and to NASDAQ Dubai for Certificates to be admitted to trading on NASDAQ Dubai. The Certificates are expected to be admitted to the DFSA's Official List on or before 21 September 2014.

Listing of the Certificates on Bursa Malaysia and NASDAQ Dubai is conditional upon satisfaction of the requirements of those exchanges.

Certificateholder Meetings:

A summary of the provisions for convening meetings of Certificateholders to consider matters relating to their interests as such is set out in Condition 17 (*Meetings of Certificateholders, Modification, Waiver, Authorisation and Determination*).

Tax Considerations:

See the section entitled "*Taxation*" for a description of certain tax considerations applicable to the Certificates.

Governing Law:

The Purchase Agreement, the Servicing Agency Agreement, the Substitution and Transfer Undertaking and the Lease Agreement (including any non-contractual obligations arising out of or in connection with the same) will be governed by, and construed in accordance with, Hong Kong Law.

The Purchase Undertaking, the Declaration of Trust, the Agency Agreement and the Certificates (including any non-contractual obligations arising out of or in connection with the same), will be governed by, and construed in accordance with, English law.

Transaction Documents:

The Declaration of Trust, the Agency Agreement, the Purchase Agreement, the Lease Agreement, the Servicing Agency Agreement, the Purchase Undertaking, the Substitution and Transfer Undertaking and any other agreements, deeds, undertakings or documents designated as such by the parties to the Transaction Documents and which can be entered into by the parties from time to time (together, the “**Transaction Documents**”).

Rating:

On issuance, the Certificates are expected to be assigned a rating of “AAA” by Standard & Poor’s Ratings Services, a division of The McGraw-Hill Companies, Inc. (“**Standard & Poor’s**”) and “Aa1” by Moody’s Investors Services Limited (“**Moody’s**”).

A rating is not a recommendation to buy, sell or hold the Certificates (or beneficial interests therein). Ratings do not address the likelihood or timing of payment and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

Selling Restrictions:

There are restrictions on the offer, sale and transfer of the Certificates in the United States, the United Kingdom, Hong Kong, Singapore, Japan, Korea, the United Arab Emirates (excluding the Dubai International Financial Centre), Dubai International Financial Centre, the Kingdom of Saudi Arabia, the State of Qatar, the Kingdom of Bahrain, Kuwait, Brunei and Malaysia. See the section entitled “*Plan of Distribution*”.

INVESTMENT CONSIDERATIONS

An investment in the Certificates involves certain risks. Prospective investors should carefully consider, in the light of their own financial circumstances and investment objectives the following factors, in addition to the matters set forth elsewhere in this offering memorandum, prior to investing in the Certificates. Each of the HKSAR Government and the Issuer believes that the factors described below represent the principal risks inherent in investing in the Certificates, but the HKSAR Government and the Issuer may be unable to pay any amounts on or in connection with any Certificate for other reasons and neither the HKSAR Government nor the Issuer represents that the statements below regarding the risks of holding any Certificate are exhaustive or that the statements below relate to any other risks not described therein. There may also be other considerations, including some which may not be presently known to the HKSAR Government or the Issuer or which the HKSAR Government or the Issuer currently deem immaterial, that may impact on any investment in the Certificates.

Prospective investors should also read the detailed information set out elsewhere in this offering memorandum and reach their own views prior to making any investment decision. Words and expressions defined elsewhere in this offering memorandum shall have the same meanings in this section.

Investment consideration relating to the Issuer

The Issuer has no operating history and must rely on payments by the HKSAR Government.

The Issuer is a newly formed entity and has no operating history. The Issuer will not engage in any business activity other than the issuance of the Certificates, the acquisition of the Assets as described herein, acting in the capacity as trustee and other activities incidental or related to the foregoing as required under the Transaction Documents.

The Issuer's only assets, which will be held in trust for Certificateholders, will be the Trust Assets, including its right to receive payments from the Lessee under the Lease Agreement and payments from the HKSAR Government under the Purchase Undertaking. Therefore the Issuer is subject to all the risks to which the HKSAR Government is subject to the extent that such risks could limit the HKSAR Government's ability to satisfy in full and on a timely basis its obligations under the Transaction Documents. Investors should therefore carefully review the description of the HKSAR herein under "*The Hong Kong Special Administrative Region*".

The ability of the Issuer to pay amounts due on the Certificates will primarily be dependent upon receipt by the Issuer from the Lessee of all amounts due under the Lease Agreement and from the HKSAR Government of the Exercise Price under the Purchase Undertaking. In the event of any shortfall in such amounts, the ability of the Issuer to meet its payment obligations under the Certificates may be adversely affected.

Investment considerations relating to the Certificates

There is currently no secondary market for the Certificates and there may be limited liquidity for Certificateholders.

There is no assurance that a secondary market for the Certificates will develop or, if it does develop, that it will provide the Certificateholders with liquidity of investment or that it will continue for the life of the Certificates. Accordingly, a Certificateholder may not be able to find a buyer to buy its Certificates readily or at prices that will enable the Certificateholder to realise a desired yield. The market value of the Certificates may fluctuate and a lack of liquidity, in particular, can have a material adverse effect on the market value of the Certificates. Accordingly, the purchase of the Certificates

is suitable only for investors who can bear the risks associated with a lack of liquidity in the Certificates and the financial and other risks associated with an investment in the Certificates. An investor in the Certificates must be prepared to hold the Certificates for any period of time up until their maturity.

The Certificates may be subject to restrictions on transfer which may adversely affect the value of the Certificates.

The Certificates have not been and will not be registered under the Securities Act or with any securities regulatory authority of any state of the United States and the Issuer has not undertaken to effect any exchange offer for the Certificates in the future. The Certificates may not be offered in the United States except pursuant to an exemption from, or in transactions not subject to, the registration requirements of the Securities Act and applicable state securities laws. The Certificates and the Agency Agreement will contain provisions that will restrict the Certificates from being offered, sold or otherwise transferred except pursuant to the exemptions available pursuant to Rule 144A and Regulation S, or other exemptions, under the Securities Act. Furthermore, the Issuer has not registered the Certificates under any other country's securities laws. Investors must ensure that their offers and sales of the Certificates within the United States and other countries comply with applicable securities laws. See "Transfer Restrictions".

The ratings on the Certificates may be changed at any time and may adversely affect the market value of the Certificates.

The Certificates are expected to be rated "AAA" by Standard & Poor's and "Aa1" by Moody's. A credit rating may not reflect all risks. The ratings may not reflect the potential impact of all risks related to the transaction structure, the market, the additional factors discussed above or any other factors that may affect the value of the Certificates. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

In general, European regulated investors are restricted under the Regulation (EC) No. 1060/2009 (as amended) (the "**CRA Regulation**") from using credit ratings for regulatory purposes, unless such ratings are issued by a credit rating agency established in the European Union (the "**EU**") and registered under the CRA Regulation (and such registration has not been withdrawn or suspended), subject to transitional provisions that apply in certain circumstances whilst the registration application is pending. Such general restriction will also apply in the case of credit ratings issued by non-EU credit rating agencies, unless the relevant credit ratings are endorsed by an EU registered credit rating agency or the relevant non-EU rating agency is certified in accordance with the CRA regulation (and such endorsement action or certification, as the case may be, has not been withdrawn or suspended). The list of registered and certified rating agencies published by ESMA on its website in accordance with the CRA Regulation is not conclusive evidence of the status of the relevant rating agency in such list, as there may be delays between certain supervisory measures being taken against a relevant rating agency and publication of an updated ESMA list.

The Certificates are limited recourse obligations.

The Certificates represent an undivided beneficial ownership interest solely in the Trust Assets. Recourse to the Issuer and the Trustee in respect of the Certificates is limited to the Trust Assets and proceeds of such Trust Assets are the sole source of payments on the relevant Certificates as set out in the Transaction Documents. Upon the occurrence of a Dissolution Event, the sole rights of each of the Delegate and, through the Delegate, the Certificateholders will be against the Trustee and the HKSAR Government to perform their respective obligations under the Transaction Documents. Certificateholders will otherwise have no recourse to any assets of the Trustee or the HKSAR Government in respect of any shortfall in the expected amounts due under the relevant Trust Assets. Reflecting the limited recourse nature of the Certificates, Certificateholders will also not be able to petition for, or join any other person in instituting proceedings for, the reorganisation, liquidation, winding up or receivership of the Trustee as a consequence of such shortfall or otherwise.

The HKSAR Government is obliged to make certain payments under the Transaction Documents directly to the Trustee, and the Delegate will have direct recourse against the HKSAR Government to recover such payments due to the Trustee pursuant to the Transaction Documents. In the absence of default by the Delegate, investors have no direct recourse to the HKSAR Government and there is no assurance that the net proceeds of the realisation of, or enforcement with respect to, the Trust Assets will be sufficient to make all payments due in respect of the Certificates. After enforcing or realising the Trust Assets and distributing the net proceeds of such Trust Assets in accordance with Condition 5.2 (*Application of Proceeds from Trust Assets*), the obligations of the Issuer in respect of the Certificates shall be satisfied and neither the Delegate nor any Certificateholder may take any further steps against the Issuer or the Trustee to recover any further sums in respect of such Certificates and the right to receive any such sums unpaid shall be extinguished. Furthermore, under no circumstances shall the Trustee, the Delegate or any Certificateholder have any right to cause the sale or other disposition of any of the Trust Assets except pursuant to the Transaction Documents (which includes the Purchase Undertaking) and the sole right of the Delegate and the Certificateholders against the Trustee or the HKSAR Government shall be to enforce the obligation of the HKSAR Government to perform its obligations under the Transaction Documents.

The Declaration of Trust may be modified without notice to Certificateholders.

The Declaration of Trust contains provisions permitting the Delegate from time to time and at any time without any consent or sanction of the Certificateholders to make any modification to the Declaration of Trust if, in the opinion of the Delegate, (i) such modification is of a formal, minor or technical nature, or (ii) such modification is made to correct a manifest or proven (to the satisfaction of the Delegate) error, or (iii) such modification, waiver, authorisation or determination is not materially prejudicial to the interest of Certificateholders and is other than in respect of a Reserved Matter. Unless the Delegate otherwise decides, any such modification shall as soon as practicable thereafter be notified to the Certificateholders and shall in any event be binding upon the Certificateholders.

The trading market for the Certificates may be volatile and may be adversely impacted by many events.

The market for the Certificates is expected to be influenced by economic and market conditions and, to varying degrees, interest rates, currency exchange rates and inflation rates in Hong Kong, the United States, Europe and other industrialised countries. There can be no assurance that events in Hong Kong, the United States, Europe or elsewhere will not cause market volatility or that such volatility will not adversely affect the price of the Certificates or that economic and market conditions will not have any other adverse effect.

Legal investment considerations may restrict certain investments.

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Prospective investors should consult their legal advisers to determine whether and to what extent: (1) the Certificates are legal investments for such prospective investors; (2) the Certificates can be used as collateral for various types of borrowing; and (3) other restrictions apply to their purchase or pledge of any Certificates. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of Certificates under any applicable risk based capital or similar rules.

The United States Internal Revenue Service may treat the Certificates as an interest in a grantor trust for federal income tax purposes, which may result in the Issuer and U.S. Holders being subject to significant penalties.

The Issuer believes that it is appropriate to treat the Certificates as representing debt obligations of the HKSAR Government and intends to do so. However, the United States Internal Revenue Service (the **IRS**) may seek to characterise the Certificates as interests in a grantor trust for U.S. federal income tax purposes. Under this characterisation, the Issuer and U.S. Holders (as defined in

“*Taxation—United States Federal Income Tax Considerations*”) would be required to comply with certain information reporting requirements applicable to foreign trusts, or risk significant penalties. The Issuer does not expect that it will provide information that would allow either itself or U.S. Holders to comply with these requirements if they were determined to be applicable. Should the IRS characterise the Certificates as interests in a grantor trust and should the Issuer be unable to provide the information necessary for itself and for U.S. Holders to comply with the foreign trust information reporting requirements, both the Issuer and U.S. Holders may be subject to significant penalties that may adversely affect the Issuer’s financial position and the returns of U.S. Holders from the Certificates. See “*Taxation—United States Federal Income Tax Considerations—Potential Alternative Characterisation*”.

There are certain restrictions as to the rights and remedies available against the HKSAR Government.

In the Declaration of Trust, the Certificates and the other Transaction Documents (as defined herein), the courts of the Hong Kong Special Administrative Region of the People’s Republic of China (the “**HKSAR**”) are to have exclusive jurisdiction to settle any disputes which may arise out of or in connection with the Transaction Documents and any disputes relating to any non-contractual obligations arising out of or in connection with the Transaction Documents.

Section 3 of the Crown Proceedings Ordinance (Cap. 300, Laws of Hong Kong) (“**CPO**”) enables civil proceedings (as defined in the CPO) to be commenced against the HKSAR Government in the courts of the HKSAR. However, there are certain restrictions as to the rights and remedies available against the HKSAR Government. The HKSAR courts have no power to grant an injunction or to order specific performance, but may instead make an order declaratory of the rights of the parties. Section 21 of the CPO provides that if an order is made against the HKSAR Government, the proper officer of the HKSAR courts will, upon application, issue to the successful plaintiff a certificate containing particulars of the order. If the order provides for payment of money, the certificate will state the amount payable and the Director of Accounting Services shall pay the sum shown to be due, subject to appeal. No process of execution or attachment can be carried out to enforce satisfaction against the HKSAR Government of any judgment.

Other investment considerations

The Certificates may not be a suitable investment for all investors.

The Certificates may not be a suitable investment for all investors. Each potential investor in the Certificates must determine the suitability of its investment in light of its own circumstances. In particular, each potential investor should:

- have sufficient knowledge and experience to make a meaningful evaluation of the Certificates, the merits and risks of investing in the Certificates and the information contained in this offering memorandum;
- have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Certificates and the impact the Certificates will have on its overall investment portfolio;
- have sufficient financial resources and liquidity to bear all of the risks of an investment in the Certificates, including where the currency of payment is different from the potential investor’s currency;
- understand thoroughly the terms of the Certificates and be familiar with the behaviour of any relevant indices and financial markets; and

- be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic and other factors that may affect its investment and its ability to bear the applicable risks.

Transfer of the Assets.

If the transfer to the Trustee of the Assets pursuant to the Purchase Agreement is for any reason found to have been, or is alleged to have been, ineffective so that the Trustee is subsequently unable to deliver the Assets to the HKSAR Government in accordance with the terms of the Purchase Undertaking, the Trustee would be able to enforce the obligation of the FSI under the Purchase Agreement to fully indemnify the Trustee for any losses arising out of or in connection with the initial sale of the Assets to the Trustee being ineffective. However, the Certificateholders will not have any rights of enforcement against the Assets (other than those specified under the Transaction Documents) and their rights are limited to the proceeds of enforcement against the FSI of its obligation to indemnify the Trustee pursuant to the terms of the Purchase Agreement.

If the Assets are not purchased by the HKSAR Government for any reason, the Delegate will seek to enforce the payment and indemnity obligations of the HKSAR Government under the Purchase Undertaking.

Certificateholders may be adversely affected by a Total Loss Event despite the Issuer's obligation to adequately insure the Properties.

Pursuant to the Lease Agreement, the Issuer is required, among other things, to insure the Properties. The Issuer has delegated this obligation to the HKSAR Government, as its servicing agent, and the HKSAR Government has undertaken in the Servicing Agency Agreement, *inter alia*, to insure the Properties in the name of the Issuer against the occurrence of a Total Loss Event at their full reinstatement value (which shall be not less than the aggregate face amount of the Certificates then outstanding plus an amount equal to at least 40 days' Rental as would be calculated in accordance with the Lease Agreement) and without duplication and double counting, an amount equal to any Servicing Agency Expenses outstanding under the terms of the Servicing Agency Agreement in relation to the Lease Assets. A Total Loss Event is defined as the total loss or destruction of, or damage to the whole of the Properties or any event or occurrence that renders the whole of the Properties permanently unfit for any economic use and (but only after taking into consideration any insurances or other indemnity granted by any third party in respect of the Properties) the repair or remedial work in respect thereof is wholly uneconomical.

Nevertheless, should such an event occur, the lease will automatically terminate and unless the HKSAR Government (in its capacity as Servicing Agent under the Servicing Agency Agreement) procures new properties by the 30th day after the occurrence of the Total Loss Event that will be made subject to a replacement lease agreement, the Certificates will be redeemed using the proceeds of the insurance received by the Issuer. In connection with such termination, potential investors should be aware that (i) rental under the Lease will cease automatically upon the occurrence of a Total Loss Event and (ii) there may be a delay in the Issuer receiving the proceeds of insurance (or shortfall amounts from the Servicing Agent) and therefore in Certificateholders receiving the full Dissolution Distribution Amount in respect of their Certificates, and no additional Periodic Distribution Amount will be paid in respect of this delay. In connection to this, the Servicing Agency Agreement provides that if sufficient insurance proceeds are not paid into the Transaction Account by the 30th day after the occurrence of the Total Loss Event, the HKSAR Government, as Servicing Agent, shall have failed in its responsibility to properly insure the Properties and accordingly, the HKSAR Government shall be required to pay any shortfall directly to the Transaction Account by no later than close of business on the 31st day after the occurrence of the Total Loss Event. The Delegate will be entitled to enforce this undertaking against the HKSAR Government on behalf of the Certificateholders.

Certificateholders may be adversely affected by a change of English law or the laws of Hong Kong.

The structure of the issue of the Certificates is based on English law and the laws of Hong Kong and administrative practices in effect as at the date of this offering memorandum. The Declaration of Trust, the Conditions, the Agency Agreement and the Purchase Undertaking are governed by and will be construed in accordance with English law, whereas the Purchase Agreement, the Lease Agreement, the Substitution and Transfer Undertaking and the Servicing Agency Agreement are governed by and will be construed in accordance with the laws of Hong Kong. No assurance can be given as to the impact of any possible change to English law, the laws of Hong Kong or administrative practices in either jurisdiction after the date of this offering memorandum, nor can any assurance be given as to whether any such change could adversely affect the ability of the Issuer to make payments under the Certificates or of the HKSAR Government and/or the FSI to comply with its obligations under the Transaction Documents to which it is a party.

Certificateholders will be reliant on DTC procedures to exercise certain rights under the Certificates.

The Certificates will be represented on issue by one or more global certificates that will be deposited with a custodian for The Depository Trust Company (“DTC”). Except in the circumstances described in the global certificates, investors will not be entitled to receive Certificates in definitive form. DTC and its direct and indirect participants, including Euroclear and Clearstream, Luxembourg, will maintain records of the beneficial interests in the global certificates. While the Certificates are represented by the global certificates, investors will be able to trade their beneficial interests only through DTC and its respective participants.

While the Certificates are represented by the global certificates, the Issuer will discharge its payment obligation under the Certificates by making payments through the relevant clearing systems. A holder of a beneficial interest in a global certificate must rely on the procedures of the relevant clearing system and its participants to receive payments under the relevant Certificates. The Issuer has no responsibility or liability for the records relating to, or payments made in respect of, beneficial interest in a global certificate.

Holders of beneficial interests in a global certificate will not have a direct right to vote in respect of the relevant Certificates. Instead, such holders will be permitted to act only to the extent that they are enabled by the relevant clearing system and its participants to appoint appropriate proxies.

There is no assurance that the Certificates will be Shari’a compliant.

The Executive Shariah Committee of HSBC Saudi Arabia Limited, Standard Chartered Bank Sharia Supervisory Committee, CIMB Islamic Bank Berhad and Shaikh Nedham Mohamed Saleh Abdulrahman Yaqobi have approved that the Certificates are Shari’a compliant. The service of Shaikh Nedham Mohamed Saleh Abdulrahman Yaqobi was also procured by National Bank of Abu Dhabi PJSC. However, there can be no assurance that the transaction structure or the issue and trading of the Certificates will be deemed to be Shari’a compliant by any other Shari’a board or Shari’a scholar. None of the Issuer, the FSI, the HKSAR Government, the Joint Global Coordinators, the Joint Lead Managers, the Co-managers, the Delegate or the Agents makes any representation as to the Shari’a compliance of the Certificates and potential investors are reminded that, as with any Shari’a views, differences in opinion are possible. Potential investors should obtain their own independent Shari’a advice as to the compliance of the structure and the issue and trading of the Certificates with Shari’a principles.

Certificateholders may be adversely affected by certain exchange rate risks and exchange controls.

The Issuer will make payments to Certificateholders in U.S. dollars. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the "**Investor's Currency**") other than U.S. dollars. These include the risk that exchange rates may significantly change (including changes due to devaluation of U.S. dollars or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls (as some have done in the past) that could adversely affect an applicable exchange rate. An appreciation in the value of the Investor's Currency relative to U.S. dollars would decrease (i) the Investor's Currency-equivalent yield on the Certificates, (ii) the Investor's Currency-equivalent value of the amounts payable on the Certificates and (iii) the Investor's Currency-equivalent market value of the Certificates. As a result, the payments received by investors may be adversely affected.

TERMS AND CONDITIONS OF THE CERTIFICATES

The following is the text of the Terms and Conditions of the Certificates which (subject to modification and except for the text in italics) will be endorsed on each Definitive Certificate (if issued) and will, save as provided in “Global Certificate”, apply to each Global Certificate:

The U.S.\$1,000,000,000 trust certificates due 2019 (the “**Certificates**”) are issued by Hong Kong Sukuk 2014 Limited (the “**Issuer**”) and represent an undivided beneficial ownership interest in the Trust Assets (as defined in Condition 5.1) held on trust (the “**Trust**”) by the Issuer in its capacity as trustee (the “**Trustee**”) for the holders of such Certificates (the “**Certificateholders**”) pursuant to a declaration of trust (the “**Declaration of Trust**”) dated on or about 18 September 2014 (the “**Closing Date**”) made between the Issuer, in its capacity as issuer and as Trustee, the Government of the Hong Kong Special Administrative Region of the People’s Republic of China (the “**HKSAR Government**”) and DB Trustees (Hong Kong) Limited as the delegate of the Trustee (the “**Delegate**”).

Payments relating to the Certificates will be made pursuant to an agency agreement dated the Closing Date (the “**Agency Agreement**”) made between the Issuer, the Trustee, the HKSAR Government, the Delegate and Deutsche Bank Trust Company Americas as principal paying agent (in such capacity, the “**Principal Paying Agent**” and, together with any further or other paying agents appointed from time to time in respect of the Certificates, the “**Paying Agents**”), as registrar (in such capacity, the “**Registrar**”) and as transfer agent (in such capacity, the “**Transfer Agent**” and, together with the Registrar and any further or other transfer agents appointed from time to time in respect of the Certificates, the “**Transfer Agents**”). The Paying Agents and the Transfer Agents are together referred to in these Conditions as the **Agents**. References to the Agents or any of them shall include their successors.

These Conditions include summaries of, and are subject to, the detailed provisions of the Transaction Documents (as defined in Condition 5.1). In these Conditions, words and expressions defined and rules of construction and interpretation set out in the Declaration of Trust shall, unless defined herein or the context otherwise requires, have the same meanings herein. Copies of the Transaction Documents are available for inspection and/or collection during normal business hours at the specified offices of the Paying Agents. The Certificateholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Transaction Documents applicable to them.

Each initial Certificateholder, by its acquisition and holding of its interest in a Certificate, shall be deemed to authorise and direct the Issuer as Trustee, on behalf of the Certificateholders, (i) to apply the sums paid by it in respect of the Certificates in making payment to the Seller as the purchase price for the Assets (as defined in Condition 5.1) and (ii) to enter into each Transaction Document to which it is a party, subject to the provisions of the Declaration of Trust and these Conditions.

1. FORM, DENOMINATION AND TITLE

1.1 Form and Denomination

The Certificates are issued in registered form in face amounts of U.S.\$200,000 and integral multiples of U.S.\$1,000 in excess thereof (each an “**Authorised Denomination**”).

Where Certificates are issued in definitive form, a Definitive Certificate (as defined below) will be issued to each Certificateholder in respect of its registered holding of Certificates. Such Definitive Certificates may either be, in the case of Certificates offered outside the U.S. in reliance on Regulation S of the United States Securities Act of 1933, as amended (the “**Securities Act**”), a **Regulation S Definitive Certificate** and, in the case of Certificates offered within the U.S. to qualified institutional buyers in compliance with the exemption from registration provided by Rule 144A of the Securities Act, a **Rule 144A Definitive Certificate** (the Regulation S Definitive Certificates and the Rule 144A Definitive Certificates together being “**Definitive Certificates**”).

Each Definitive Certificate will be numbered serially with an identifying number which will be recorded on the relevant Definitive Certificate and in the register of Certificateholders (the **Register**).

Upon issue, the Certificates offered outside the U.S. in reliance on Regulation S of the Securities Act will be represented by one or more Regulation S Global Certificates registered in the name of a nominee of, and deposited with a custodian for, The Depository Trust Company (“DTC”) for the accounts of Euroclear Bank SA/NV (“Euroclear”) and Clearstream Banking, société anonyme (“Clearstream, Luxembourg”) and the Certificates offered within the U.S. to qualified institutional buyers in compliance with the exemption from registration provided by Rule 144A of the Securities Act will be represented by one or more Rule 144A Global Certificates registered in the name of a nominee of, and deposited with a custodian for, DTC. The Conditions are modified by certain provisions contained in the Regulation S Global Certificates and the Rule 144A Global Certificates (together the “Global Certificates”). Except in certain limited circumstances, owners of interests in the Global Certificates will not be entitled to receive Definitive Certificates representing their holdings of Certificates. See “Global Certificates”.

1.2 Title

The Issuer will cause the Registrar to maintain the Register in respect of the Certificates outside the United Kingdom and in accordance with the provisions of the Agency Agreement. Title to the Certificates passes only by registration in the Register. The persons in whose names any outstanding Certificates are for the time being registered (as set out in the Register) as the holder of any Certificates will (except as ordered by a court of competent jurisdiction or otherwise required by law) be treated as the absolute owner of the Certificates for all purposes (whether or not any payment thereon is overdue and regardless of any notice of ownership, trust or any interest or any writing on, or the theft or loss of, the physical Certificate representing such Certificates) and no person will be liable for so treating the holder of any Certificate. In these Conditions, **Certificateholder** and (in relation to a Certificate) **holder** have the further meanings given thereto in the Declaration of Trust.

2. TRANSFERS OF CERTIFICATES

2.1 Transfers

Subject to Conditions 2.4 and 2.5, a Certificate may be transferred in an Authorised Denomination only by depositing the relevant Definitive Certificate, with the form of transfer on the back duly completed and signed, at the specified office of any of the Transfer Agents.

Transfers of interests in the Notes evidenced by either a Regulation S Global Certificate or a Rule 144A Global Certificate will be effected in accordance with the rules of the relevant clearing systems through which the interest is held.

2.2 Delivery of New Definitive Certificates

Each new Definitive Certificate to be issued upon any transfer of Certificates will, within five business days of receipt by the relevant Transfer Agent of the duly completed form of transfer endorsed on the relevant Definitive Certificate (or such longer period as may be required to comply with any applicable fiscal or other laws or regulations), be delivered at the specified office of the relevant Transfer Agent or mailed by uninsured mail at the risk of the holder entitled to the Certificate to the address specified in the form of transfer. For the purposes of this Condition, **business day** shall mean a day on which banks are open for business in the city in which the specified office of the Transfer Agent with whom a Definitive Certificate is deposited in connection with a transfer is located.

Where some but not all of the Certificates in respect of which a Definitive Certificate is issued are to be transferred a new Definitive Certificate in respect of the Certificates not so transferred will, within five business days of receipt by the relevant Transfer Agent of the original Definitive Certificate, be mailed by uninsured mail at the risk of the holder of the Certificates not so transferred to the address of such holder appearing on the Register or as specified in the form of transfer.

2.3 Formalities Free of Charge

Registration of any transfer of Certificates will be effected without charge by or on behalf of the Issuer or any Transfer Agent but upon payment (or the giving of such indemnity as the Issuer or any Transfer Agent may reasonably require) by the transferee in respect of any stamp duty, tax or other governmental charges which may be imposed in relation to such transfer.

2.4 Closed Periods

No Certificateholder may require the transfer of a Certificate to be registered during the period of 15 days ending on (and including) the due date for any payment of the Dissolution Distribution Amount (as defined in Condition 9.1) or any Periodic Distribution Amount (as defined in Condition 7.1).

2.5 Regulations

All transfers of Certificates and entries on the Register will be made subject to the detailed regulations concerning transfer of Certificates scheduled to the Agency Agreement. The regulations may be changed by the Issuer from time to time with the prior written approval of the Registrar and the Delegate. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Certificateholder who requests in writing a copy of such regulations.

The holder of Certificates shall be entitled to receive, in accordance with Condition 2.2 only one Definitive Certificate in respect of his entire holding of Certificates. In the case of a transfer of a portion of the face amount of a Certificate, a new Definitive Certificate in respect of the balance of the Certificates not transferred will be issued to the transferor in accordance with Condition 2.2.

3. STATUS, LIMITED RECOURSE AND NON-PETITION

3.1 Status

Each Certificate evidences an undivided beneficial ownership interest in the Trust Assets, subject to the terms of the Declaration of Trust and these Conditions, and is a limited recourse obligation of the Issuer. Each Certificate ranks *pari passu*, without any preference or priority, with the other Certificates.

The payment obligations of the HKSAR Government under the Transaction Documents are and will be direct, unconditional, unsubordinated and unsecured obligations of the HKSAR Government and will be backed by the general revenues and assets of Hong Kong and the full faith and credit of the HKSAR Government and shall at all times rank at least pari passu with all other direct, unsecured, unsubordinated and unconditional obligations of the HKSAR Government.

3.2 Limited Recourse and Non-Petition

The proceeds of the Trust Assets are the sole source of payments on the Certificates. Save as provided in the next sentence, the Certificates do not represent an interest in or obligation of any of the Issuer, the Obligor, the Lessee or the Delegate. Accordingly, Certificateholders, by

subscribing for or acquiring the Certificates, acknowledge that they will have no recourse to any assets of the Issuer, the Trustee (other than the Trust Assets), the Obligor, the Lessee or the Delegate (to the extent that each of them fulfils all of its obligations under the Transaction Documents to which it is a party) in respect of any shortfall in the expected amounts from the Trust Assets to the extent the Trust Assets have been exhausted, following which all obligations of the Issuer shall be extinguished.

Each of the Obligor and the Lessee (each as defined in Condition 5.1) is obliged to make certain payments under the Transaction Documents directly to the Trustee and the Delegate will have direct recourse against the Obligor and the Lessee to recover such payments.

The net proceeds of realisation of, or enforcement with respect to, the Trust Assets may not be sufficient to make all payments due in respect of the Certificates. If, following the distribution of such proceeds, there remains a shortfall in payments due under the Certificates, subject to Condition 14, no holder of Certificates will have any claim against the Issuer or the Trustee (to the extent the Trust Assets have been exhausted), the Obligor, the Lessee or the Delegate (to the extent that each fulfils all of its obligations under the Transaction Documents to which it is a party) or against any assets (other than the Trust Assets to the extent not exhausted) in respect of such shortfall and any unsatisfied claims of Certificateholders shall be extinguished. Under no circumstances shall the Trustee, the Delegate or any Certificateholder have any right to cause the sale or other disposition of any of the Trust Assets other than to the Obligor or its designee in accordance with the Purchase Undertaking and the sole right of the Delegate and the Certificateholders against the Trustee or the Obligor shall be to enforce their respective obligations under the Transaction Documents.

Prior to the date which is one year and one day after the date on which all amounts owing by the Issuer or the Trustee under the Transaction Documents to which the Obligor, the Lessee, the Delegate or any Certificateholder is a party have been paid in full, such party will not institute against, or join with any other person in instituting against, the Issuer or the Trustee any bankruptcy, reorganisation, arrangement or liquidation proceedings or other proceedings under any bankruptcy or similar law.

3.3 Agreement of Certificateholders

By purchasing Certificates, each Certificateholder is deemed to have agreed that notwithstanding anything to the contrary contained in these Conditions or any Transaction Document:

- (a) no amount whatsoever shall be due and payable by or on behalf of the Issuer or the Trustee except to the extent funds are available therefor from the Trust Assets and further agrees that no recourse shall be had for the payment of any amount owing hereunder or under any Transaction Document, whether for the payment of any fee or other amount hereunder or any other obligation or claim arising out of or based upon any Transaction Document, against the Issuer or the Trustee to the extent the Trust Assets have been exhausted following which all obligations of the Issuer and the Trustee shall be extinguished; and
- (b) no recourse (whether by institution or enforcement of any legal proceeding or assessment or otherwise) in respect of any breaches of any duty, obligation or undertaking of the Issuer or the Trustee arising under these Conditions or otherwise in connection with the Certificates by virtue of any law, statute or otherwise shall be had against any shareholder, officer or director of the Issuer or the Trustee in their capacity as such and any and all personal liability of every such shareholder, officer or director in their capacity as such for any breaches by the Issuer or the Trustee of any such duty, obligation or undertaking is hereby expressly waived and excluded to the extent permitted by law.

4. NEGATIVE PLEDGE

Pursuant to the Purchase Undertaking, the HKSAR Government has undertaken that, so long as any Certificate remains outstanding, the HKSAR Government will not create or permit to subsist any Encumbrance on the whole or any part of the Exchange Fund as security for any HKSAR Government Public External Debt unless, at the same time or prior thereto, or promptly thereafter, the HKSAR Government's obligations under the Purchase Undertaking, the Lease Agreement and the Servicing Agency Agreement are secured at least equally and rateably with such HKSAR Government Public External Debt, or the HKSAR Government provides such other security for its obligations under the Purchase Undertaking, the Lease Agreement and the Servicing Agency Agreement, as approved by the holders of the Certificates in accordance with the Declaration of Trust.

For the avoidance of doubt, any Encumbrance created on the assets or revenues of any corporate entity in which the HKSAR Government has a direct or indirect equity interest or other stake (other than any entity established to own or manage any part of the Exchange Fund) shall not be considered to be a Encumbrance on the Exchange Fund or any part thereof.

For the purposes of this Condition 4:

Encumbrance means any lien, pledge, mortgage, security interest, deed of trust, charge or other encumbrance or arrangement any of which has the practical effect of constituting a security interest with respect to the payment of any obligations with or from the proceeds of any property, assets or revenues of any kind (including, without limitation, any equivalent created or arising under the laws of Hong Kong), it being expressly understood and agreed that bonds, alternative bonds, promissory notes or other instruments issued by the HKSAR Government, including the Certificates, pursuant to the Loans Ordinance of Hong Kong or the Loans (Government Bonds) Ordinance of Hong Kong or any re-enactment thereof, in respect of which the repayment of principal and payment of the financial charges and other amounts thereon are charged on and made payable out of the general revenues and assets of Hong Kong pursuant to those ordinances (and not otherwise), including any sinking fund arrangement as provided in such bonds, will not be construed or deemed to create any Encumbrance on the whole or any part of the Exchange Fund;

Exchange Fund means the fund established and maintained pursuant to the Exchange Fund Ordinance of Hong Kong;

External Debt means all obligations of any person, and all guarantees or indemnities by any person (whether by contract, statute or otherwise), for or in respect of borrowed money or evidenced by bonds, trust certificates, debentures, notes or similar instruments which, in each case, (1) have an original maturity in excess of one year and (2) are denominated or payable, or which, at the option of the holder thereof, may be payable, in a currency other than the currency of Hong Kong or by reference to a currency other than the currency of Hong Kong;

HKSAR Government Public External Debt means Public External Debt undertaken directly by and in the name of the HKSAR Government and backed by the full faith and credit of the HKSAR Government. Obligations, guarantees and indemnities undertaken "directly by and in the name of the HKSAR Government" do not include obligations, guarantees and indemnities undertaken by any corporate entity in which the HKSAR Government has a direct or indirect equity interest or other stake; and

Public External Debt means any External Debt which is publicly offered or privately placed in one or more securities markets and which is in the form of, or represented by, notes, bonds, trust certificates or other securities that are or may be quoted, listed or ordinarily purchased or sold on any stock exchange, automated trading system or over-the-counter or other securities market (including, without limitation, securities eligible for resale under Rule 144A).

5. TRUST

5.1 Summary of the Trust

The Trustee will enter into a purchase agreement (the “**Purchase Agreement**”) on or about 18 September 2014 with The Financial Secretary Incorporated (the “**FSI**”) (in such capacity, the “**Seller**”). Pursuant to the Purchase Agreement the Seller will sell its beneficial ownership in and to certain assets (the “**Assets**”) to the Trustee. The Trustee will, with effect from the Closing Date, lease the Lease Assets (as defined in the Lease Agreement) (in such capacity, the “**Lessor**”) to the HKSAR Government (in such capacity, the “**Lessee**”) pursuant to a lease agreement (the “**Lease Agreement**”) to be dated the Closing Date. Under a servicing agency agreement (the “**Servicing Agency Agreement**”) to be dated the Closing Date the Lessor will appoint the HKSAR Government as servicing agent (in such capacity, the “**Servicing Agent**”) in respect of the Lease Assets.

Upon the occurrence of a Total Loss Event (as defined in Condition 9.3) (save where the HKSAR Government replaces the Lease Assets pursuant to the Servicing Agency Agreement by no later than the 30th day after the occurrence of the Total Loss Event), subject to the Delegate having received the Insurance Coverage Amount and/or the Total Loss Shortfall Amount (as described below), the Certificates will be redeemed and the Trust will be dissolved by the Trustee in accordance with Condition 9.3 on the date falling 10 days after the receipt of the Insurance Coverage Amount and/or the Total Loss Shortfall Amount in the Transaction Account. The Certificates will be redeemed in accordance with Condition 9.3 using either the proceeds of insurance payable in respect of the Total Loss Event or, if a Total Loss Event occurs and an amount (if any) less than the Insurance Coverage Amount (as defined in the Servicing Agency Agreement, which is intended to be an amount equal to the aggregate face amount of all Certificates then outstanding plus an amount equal to at least 40 days’ Rental as would be calculated in accordance with the Lease Agreement and (without duplication and double counting) an amount equal to any Servicing Agency Expenses outstanding under the terms of the Servicing Agency Agreement in relation to the Lease Assets) is credited to the Transaction Account in accordance with the Servicing Agency Agreement (the difference between the Insurance Coverage Amount and the amount credited to the Transaction Account being the “**Total Loss Shortfall Amount**”), the aggregate of the insurance proceeds so credited and the Total Loss Shortfall Amount payable by the Servicing Agent in accordance with the terms of the Servicing Agency Agreement.

The HKSAR Government (in such capacity, the “**Obligor**”) will enter into a purchase undertaking (the “**Purchase Undertaking**”) to be dated the Closing Date in favour of the Trustee and the Delegate, pursuant to which it will unconditionally and irrevocably undertake to purchase, or procure the purchase of, the Lease Assets from the Trustee on the Scheduled Dissolution Date (as defined in Condition 9.1) or, if earlier, on the due date for dissolution in accordance with Condition 13 at the Dissolution Distribution Amount.

The Trustee will execute a substitution and transfer undertaking (the “**Substitution and Transfer Undertaking**”) to be dated the Closing Date in favour of the HKSAR Government. Pursuant to the Substitution and Transfer Undertaking, the HKSAR Government may, by exercising its option under the Substitution and Transfer Undertaking and serving notice on the Trustee, require the substitution at any time of the Lease Assets and require the transfer of Lease Assets against the cancellation of Certificates purchased pursuant to Condition 12.

The Issuer has established a transaction account (the “**Transaction Account**”) in the name of the Issuer with the Principal Paying Agent into which the HKSAR Government (acting in its capacities as Lessee and Obligor) will deposit all amounts due to the Issuer under the Lease Agreement and the Purchase Undertaking, respectively.

Pursuant to the Declaration of Trust, the Trustee holds certain assets (the “**Trust Assets**”) consisting of:

- (a) all of the Trustee’s rights, interest and benefit, present and future, in, to and under the Lease Assets;
- (b) all of the Trustee’s rights, title, interest and benefit, present and future, in, to and under the Transaction Documents (other than in relation to any representations given to the Trustee by the HKSAR Government and/or the FSI pursuant to any of the Transaction Documents);
- (c) all monies standing to the credit of the Transaction Account from time to time; and
- (d) all proceeds of the foregoing,

on trust absolutely for the holders of the Certificates *pro rata* according to the face amount of Certificates held by each holder in accordance with the Declaration of Trust and these Conditions.

The Purchase Agreement, the Lease Agreement, the Servicing Agency Agreement, the Purchase Undertaking, the Substitution and Transfer Undertaking, the Declaration of Trust and the Agency Agreement are together referred to in these Conditions as the **Transaction Documents**.

5.2 Application of Proceeds from Trust Assets

On each Periodic Distribution Date and on any Dissolution Date (as defined in Condition 9.1), the Principal Paying Agent shall apply the monies standing to the credit of the Transaction Account in the following order of priority:

- (a) *first*, to the Delegate in respect of all amounts owing to it under the Transaction Documents in its capacity as Delegate and/or any Appointee;
- (b) *second*, to the Agents in respect of all amounts owing to them under the Transaction Documents in their respective capacities as Agents;
- (c) *third*, to the Principal Paying Agent for application in or towards payment *pari passu* and rateably of all Periodic Distribution Amounts due and unpaid;
- (d) *fourth*, only if such payment is made on a Dissolution Date, to the Principal Paying Agent for application in or towards payment *pari passu* and rateably of the Dissolution Distribution Amount or amount payable on a Total Loss Event, as the case may be;
- (e) *fifth*, only if such payment is made on a Dissolution Date, to the Servicing Agent in or towards payment of all outstanding Servicing Agency Expenses (as defined in the Lease Agreement); and
- (f) *sixth*, only if such payment is made on a Dissolution Date, to the Issuer.

6. COVENANTS

The Issuer covenants that for so long as any Certificate is outstanding, it shall not (without the prior written consent of the Delegate and as provided in Condition 17):

- (a) incur any indebtedness in respect of borrowed money whatsoever (including by way of any analogous Islamic financing transaction), or give any guarantee or indemnity in respect of any obligation of any person or issue any shares (or rights, warrants or options in respect of shares or securities convertible into or exchangeable for shares) except, in all cases, as contemplated in the Transaction Documents;

- (b) grant or permit to be outstanding any lien, pledge, charge or other security interest upon any of its present or future assets, properties or revenues (other than those arising by operation of law);
- (c) sell, lease, transfer, assign, participate, exchange or otherwise dispose of, or pledge, mortgage, hypothecate or otherwise encumber (by security interest, lien (statutory or otherwise), preference, priority or other security agreement or preferential arrangement of any kind or nature whatsoever or otherwise) (or permit such to occur or suffer such to exist), any part of its interest in any of the Trust Assets except pursuant to the Transaction Documents;
- (d) use the proceeds of the issue of the Certificates for any purpose other than as stated in the Transaction Documents;
- (e) amend or agree to any amendment of any Transaction Document to which it is a party or its articles of association;
- (f) act as trustee in respect of any trust other than the Trust or in respect of any parties other than the Certificateholders;
- (g) have any subsidiaries or employees;
- (h) redeem or purchase any of its shares or pay any dividend or make any other distribution to its shareholders;
- (i) put to its directors or shareholders any resolution for, or appoint any liquidator for, its winding up or any resolution for the commencement of any other bankruptcy or insolvency proceeding with respect to it; and
- (j) enter into any contract, transaction, amendment, obligation or liability other than the Transaction Documents to which it is a party or any permitted amendment or supplement thereto or as expressly permitted or required thereunder or engage in any business or activity other than:
 - (i) any such contract, transaction, amendment, obligation or liability in relation to its operations that is of a routine or administrative nature;
 - (ii) as provided for or permitted in the Transaction Documents;
 - (iii) the ownership, management and disposal of the Trust Assets as provided in the Transaction Documents; and
 - (iv) such other matters which are incidental thereto.

7. PERIODIC DISTRIBUTIONS

7.1 Periodic Distribution Amounts and Periodic Distribution Dates

Subject to Condition 5.2 and Condition 8, the Principal Paying Agent shall distribute to holders of the Certificates, *pro rata* to their respective holdings, out of amounts transferred to the Transaction Account, a distribution in relation to the Certificates representing a defined share of the Rental (as defined in the Lease Agreement) paid by the Lessee to the Lessor pursuant to the Lease Agreement in respect of the Lease Assets for the Certificates (the amount of such distribution, a “**Periodic Distribution Amount**”) on each Periodic Distribution Date at the rate

of 2.005 per cent. per annum (the “**Periodic Distribution Rate**”) of the face amount of the Certificates. For this purpose, **Periodic Distribution Date** means each of 18 March and 18 September in each year commencing on 18 March 2015 and, subject to Condition 7.3, ending on the Scheduled Dissolution Date (as defined below).

7.2 **Calculation of Periodic Distribution Amounts payable other than on a Periodic Distribution Date**

If a Periodic Distribution Amount is required to be calculated in respect of a period of less than a full Return Accumulation Period (the “**Relevant Period**”), the Periodic Distribution Amount shall be calculated by applying the Periodic Distribution Rate to the face amount of the Certificates and multiplying such sum by the Day Count Fraction, and rounding the resultant figure to the nearest cent, half a cent being rounded upwards or otherwise in accordance with applicable market convention.

For these purposes, **Day Count Fraction** means, in respect of the calculation of a Periodic Distribution Amount in relation to the Certificates in accordance with this Condition 7.2, the number of days in the period from (and including) the most recent Periodic Distribution Date to (but excluding) the relevant payment date (such number of days being calculated on the basis of a year of 360 days with twelve 30-day months) divided by 360.

The period from and including 18 September 2014 to but excluding the first Periodic Distribution Date and each successive period from and including a Periodic Distribution Date to but excluding the next succeeding Periodic Distribution Date is called a **Return Accumulation Period**.

7.3 **Cessation of Accrual**

No further amounts will be payable on any Certificate from and including its due date for redemption, unless default is made in payment of the Dissolution Distribution Amount in which case Periodic Distribution Amounts will continue to accrue in respect of the Certificates in the manner provided in this Condition 7.

8. **PAYMENT**

8.1 **Payments in respect of the Certificates**

Subject to Condition 8.2, payment of the Dissolution Distribution Amount and any Periodic Distribution Amount will be made by the Principal Paying Agent in U.S. dollars by wire transfer in same day funds to the registered account of each Certificateholder or by U.S. dollar cheque drawn on a bank that processes payments in U.S. dollars mailed to the registered address of the Certificateholder if it does not have a registered account. Payments of the Dissolution Distribution Amount will only be made against surrender of the relevant Certificate at the specified office of any of the Paying Agents. The Dissolution Distribution Amount and each Periodic Distribution Amount will be paid to the holder shown on the Register at the close of business on the date (the “**record date**”) being the seventh day before the date on which the Dissolution Distribution Amount or the relevant Periodic Distribution Amount, as the case may be, is paid.

*For so long as the Certificates are represented by Global Certificates deposited with a custodian for DTC, payments of the Dissolution Distribution Amount and each Periodic Distribution Amount will be made to the person shown on the relevant Register as the registered Certificateholder represented by such Global Certificates at the close of business on the Clearing System Business Day before the due date for such payment (where “**Clearing System Business Day**” means a day on which the Clearing System with which a Global Certificate is being held is open for business).*

For the purposes of this Condition 8, a Certificateholder's **registered account** means the U.S. dollar account maintained by or on behalf of it with a bank that processes payments in U.S. dollars, details of which appear on the Register at the close of business on the relevant record date, and a Certificateholder's **registered address** means its address appearing on the Register at that time.

8.2 **Payments subject to Applicable Laws**

Payments in respect of Certificates are subject in all cases to any fiscal or other laws and regulations applicable in the place of payment, but without prejudice to the provisions of Condition 10.

8.3 **Payment only on a Payment Business Day**

Where payment is to be made by transfer to a registered account, payment instructions (for value the due date or, if that is not a Payment Business Day, for value the first following day which is a Payment Business Day) will be initiated and, where payment is to be made by cheque, the cheque will be mailed, in each case by the Principal Paying Agent, on the due date for payment or, in the case of a payment of the Dissolution Distribution Amount, if later, on the Business Day on which the relevant Certificate is surrendered at the specified office of a Paying Agent for value as soon as practicable thereafter.

Certificateholders will not be entitled to any additional payment for any delay after the due date in receiving the amount due if the due date is not a Payment Business Day, if the relevant Certificateholder is late in surrendering its Certificate (if required to do so) or if a cheque mailed in accordance with this Condition 8.3 arrives after the due date for payment.

If the amount of the Dissolution Distribution Amount or any Periodic Distribution Amount is not paid in full when due, the Registrar will annotate the Register with a record of the amount in fact paid.

In this Condition **Payment Business Day** means a day on which commercial banks and foreign exchange markets in Hong Kong and New York City are open for general business and, in the case of presentation of a Certificate, in the place in which the Certificate is presented.

8.4 **Agents**

The names of the initial Agents and their initial specified offices are set out at the end of these Conditions. The Issuer reserves the right at any time, with the prior written approval of the Delegate (which approval shall not be unreasonably withheld) to vary or terminate the appointment of any Agent and to appoint additional or other Agents provided that (a) it will at all times maintain a Principal Paying Agent and a Registrar (which may be the same entity) and (b) it will at all times maintain a Paying Agent (which may be the Principal Paying Agent) that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive. Notice of any termination or appointment and of any changes in specified offices will be given to Certificateholders by the Issuer in accordance with Condition 16 and the Declaration of Trust.

In acting under the Agency Agreement and in connection with the Certificates, the Agents act solely as agents of the Issuer and (to the extent provided therein) the Trustee and the Delegate and do not assume any obligations towards or relationship of agency or trust for or with any of the Certificateholders.

9. CAPITAL DISTRIBUTIONS OF THE TRUST

9.1 Scheduled Dissolution

Unless the Certificates are previously redeemed or purchased and cancelled, the Issuer will redeem each Certificate at the Dissolution Distribution Amount on the Periodic Distribution Date falling on 18 September 2019 (the “**Scheduled Dissolution Date**”). Upon payment in full of the Dissolution Distribution Amount to the Certificateholders, the Trust will terminate, the Certificates shall cease to represent interests in the Trust Assets and no further amounts shall be payable in respect thereof and the Issuer and the Trustee shall have no further obligations in respect thereof.

In these Conditions, **Dissolution Date** means any of the Scheduled Dissolution Date and any date specified by the Delegate in accordance with Condition 13 or Condition 9.3 and **Dissolution Distribution Amount** in relation to a Certificate means its outstanding face amount plus all accrued and unpaid Periodic Distribution Amounts in respect of such Certificate.

9.2 Dissolution Following a Dissolution Event

Upon the occurrence of a Dissolution Event (as defined in Condition 13) which is continuing, the Certificates may be redeemed at the Dissolution Distribution Amount and the Trust dissolved as more particularly specified in Condition 13.

9.3 Dissolution following a Total Loss Event

Upon the occurrence of a Total Loss Event and unless the Lease Assets are replaced as provided in the Servicing Agency Agreement by the 30th day after the occurrence of the Total Loss Event, subject to the Delegate having received the Insurance Coverage Amount and/or the Total Loss Shortfall Amount (as described below), the Certificates may be redeemed and the Trust dissolved on the date falling 10 days after the receipt of the Insurance Coverage Amount and/or the Total Loss Shortfall Amount in the Transaction Account following notification thereof by the Delegate in accordance with Condition 16 (Notices). The Certificates will be redeemed at the Dissolution Distribution Amount using the proceeds of insurance payable in respect of the Total Loss Event which (save where the Lease Assets are so replaced) are required to be paid into the Transaction Account by no later than the 30th day after the occurrence of the Total Loss Event.

A **Total Loss Event** is the total loss or destruction of, or damage to the whole of, the Lease Assets or any event or occurrence that renders the whole of the Lease Assets permanently unfit for any economic use and (but only after taking into consideration any insurances or other indemnity granted by any third party in respect of the Lease Assets) the repair or remedial work in respect thereof is wholly uneconomical.

*The Servicing Agency Agreement provides that if the obligations of the Servicing Agent thereunder are not strictly complied with and as a result any insurance proceeds credited to the Transaction Account are less than the Insurance Coverage Amount (as defined therein) (the difference between the Insurance Coverage Amount and the amount (if any) credited to the Transaction Account being the “**Total Loss Shortfall Amount**”), the Servicing Agent shall be responsible for paying the Total Loss Shortfall Amount into the Transaction Account by no later than close of business on the 31st day after the Total Loss Event has occurred.*

9.4 No other Dissolution

The Issuer shall not be entitled to redeem the Certificates, and the Trustee shall not be entitled to dissolve the Trust, otherwise than as provided in this Condition 9, Condition 12 and Condition 13.

9.5 Cancellations

All Certificates which are redeemed will forthwith be cancelled and accordingly may not be held, reissued or resold.

10. TAXATION

All payments in respect of the Certificates shall be made without withholding or deduction for, or on account of, any present or future taxes, levies, imposts, duties, fees, assessments or other charges of whatever nature, imposed or levied by or on behalf of the HKSAR Government or any political sub-division or authority thereof or therein having power to tax (“**Taxes**”), unless the withholding or deduction of the Taxes is required by law. In such event, the Issuer will pay such additional amounts as may be necessary in order that the net amounts received by the Certificateholders after the withholding or deduction shall equal the respective amounts which would have been receivable in respect of the Certificates in the absence of the withholding or deduction, except that no such additional amount shall be payable in relation to any payment in respect of any Certificate:

- (a) presented for payment (where presentation is required) by or on behalf of a holder who is liable for such Taxes in respect of such Certificate by reason of having some connection with the HKSAR Government or any political sub-division or authority thereof or therein having power to tax other than the mere holding of such Certificate; or
- (b) presented for payment (where presentation is required) more than 30 days after the Relevant Date (as defined below) except to the extent that a holder would have been entitled to additional amounts on presenting the same for payment on the last day of the period of 30 days assuming, whether or not such is in fact the case, that day to have been a Payment Business Day; or
- (c) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive.

In these Conditions, references to the **Dissolution Distribution Amount** or any **Periodic Distribution Amount** payable in respect of a Certificate shall be deemed to include any additional amounts payable under this Condition 10. In addition, in these Conditions **Relevant Date** means the date on which the payment first becomes due but, if the full amount of the money payable has not been received by the Principal Paying Agent or the Delegate on or before the due date, it means the date on which, the full amount of the money having been so received, notice to that effect shall have been duly given to Certificateholders by the Issuer in accordance with Condition 16.

The Lease Agreement and the Purchase Undertaking each provide that (a) payments thereunder by the Lessee and the Obligor, respectively, shall be made without withholding or deduction for, or on account of, any present or future Taxes, unless the withholding or deduction of the Taxes is required by law and, in such case, provide for the payment by the Lessee and the Obligor, respectively, of additional amounts so that the full amount which would otherwise have been due and payable is received by the Issuer and (b) if the Issuer is required to make any payment under the Certificates after deduction or withholding for (i) any taxes or (ii) as otherwise required by applicable law, the Lessee will pay to the Lessor on demand an additional amount of Rental so that the net amount paid by the Issuer will equal the full amount which would have been paid by the Issuer had no such deduction or withholding been made.

11. PRESCRIPTION

The right to receive distributions in respect of the Certificates will be forfeited unless claimed within periods of ten years (in the case of the Dissolution Distribution Amount) and five years (in the case of Periodic Distribution Amounts) from the Relevant Date in respect thereof, subject to the provisions of Condition 8.

12. PURCHASE OF CERTIFICATES

12.1 Purchases

The Issuer or the HKSAR Government (itself or acting through an agent) may at any time purchase Certificates in any manner and at any price. Such Certificates may, at the option of the Issuer or the HKSAR Government, as the case may be, be held, resold or surrendered to the Principal Paying Agent for cancellation. Any Certificates so surrendered will forthwith be cancelled and accordingly may not be reissued or resold.

12.2 Transfer of Lease Assets

Following any purchase of Certificates by or on behalf of the HKSAR Government pursuant to Condition 12.1, the HKSAR Government may oblige the Trustee pursuant to the Substitution and Transfer Undertaking to transfer specified Lease Assets to the FSI (the “**Cancellation Lease Assets**”) against the delivery of the Certificates so purchased to the Principal Paying Agent for cancellation (the “**Cancellation Certificates**”), provided that the aggregate value (as determined by reference to the relevant internal government valuation of the Cancellation Lease Assets on the date on which the Cancellation Lease Assets were acquired by the Trustee) of the Cancellation Lease Assets (the identity of which may otherwise be determined by the HKSAR Government in its sole and absolute discretion) is not greater than the aggregate face amount of the Cancellation Certificates.

13. DISSOLUTION EVENTS

Upon the occurrence and continuation of any of the following events (“**Dissolution Events**”):

- (a) a default is made in the payment of any Periodic Distribution Amount or the Dissolution Distribution Amount and such default is not cured within 30 days of the due date for payment; or
- (b) the failure by the Issuer or the Trustee to observe or perform any other provision of these Conditions or the Declaration of Trust if, where it is not clearly impossible to remedy such failure, it is not remedied within sixty (60) calendar days following delivery to the HKSAR Government of written notice from the Delegate to remedy such; or
- (c) a Hong Kong Event (as defined in the Purchase Undertaking) occurs; or
- (d) (i) the Issuer becomes insolvent or is unable to pay its debts as they fall due, or (ii) an administrator, receiver, liquidator or similar official of the Issuer is appointed (or application for any such appointment is made) with respect to the whole or a substantial part of the undertaking, assets and revenues of the Issuer, or (iii) the Issuer takes any action for a general readjustment or deferment of any of its obligations or makes a general assignment or an arrangement or composition with or for the benefit of its creditors or declares a moratorium in respect of any of its indebtedness or any guarantee of any indebtedness given by it, (iv) the Issuer ceases or threatens to cease to carry on all or a substantial part of its business (otherwise than for the purposes of or pursuant to an amalgamation, reorganisation or restructuring whilst solvent); or

- (e) an order is made or an effective resolution is passed for the winding up, liquidation or dissolution of the Issuer; or
- (f) at any time it becomes unlawful for the HKSAR Government to perform or comply with any of its payment obligations under the Lease Agreement, the Purchase Undertaking or the Servicing Agency Agreement or any of the payment obligations of the HKSAR Government under the Lease Agreement, the Purchase Undertaking or the Servicing Agency Agreement ceases to be legal, valid, binding and enforceable on it; or
- (g) the Lessee has disposed of the whole of its leasehold interest under the Lease Agreement; or
- (h) the Lessee rejects any Rental Notice,

the Delegate shall promptly, following it becoming aware thereof, give notice of the occurrence of such Dissolution Event to the holders of Certificates in accordance with Condition 16 with a request to such holders to indicate if they wish the Certificates to be redeemed and the Trust to be dissolved; provided, however, that in the case of an event described in paragraph (b) above and paragraph (b) of the definition of Hong Kong Event, such notice may only be given if the Delegate is of the opinion that the event is materially prejudicial to the interests of the Certificateholders. If so directed or requested to do so (a) by an Extraordinary Resolution or (b) in writing by the holders of, not less than 25 per cent. of the aggregate face amount of the Certificates then outstanding (each a “**Dissolution Notice**”), the Delegate shall (subject in each case to being indemnified and/or secured and/or prefunded to its satisfaction) give notice to the Issuer, the Trustee, the HKSAR Government and all the holders of the Certificates in accordance with Condition 16 that the Certificates are to be redeemed in full at the Dissolution Distribution Amount on the date specified in such notice. Upon payment in full of such amounts, the Trust will terminate, the Certificates shall cease to represent the Trust Assets and no further amounts shall be payable in respect thereof and the Issuer and the Trustee shall have no further obligations in respect thereof.

*As set out in the Purchase Undertaking, each of the following events or circumstances shall constitute a **Hong Kong Event**:*

- (a) the failure to pay on the due date any Exercise Price payable by the HKSAR Government pursuant to this Undertaking, the Total Loss Shortfall Amount payable by the HKSAR Government pursuant to the Servicing Agency Agreement and Rental due by the HKSAR Government under the Lease Agreement (including payment of any additional amount of Rental pursuant to the Lease Agreement in respect of any additional amounts payable by the Issuer under Condition 10) and such failure to pay is not cured within 30 days of the due date for payment;
- (b) the HKSAR Government defaults in the performance of any other covenant or obligation in this Undertaking or the Declaration of Trust, and, if such default is capable of remedy such default shall continue for a period of 60 days after written notice thereof shall have been given to the HKSAR Government by the Trustee or the Delegate;
- (c) the failure by the HKSAR Government to make any payment when due of principal or financial charge in excess of U.S.\$50,000,000 (or its equivalent in other currencies) (whether upon maturity, acceleration or otherwise) on or in connection with the HKSAR Government Public External Debt, and such failure by the HKSAR Government continues for 30 days or more after the expiry of any applicable grace period following the date on which such payment became due; and
- (d) the HKSAR Government declares a suspension of, or a moratorium with respect to, the payments of the HKSAR Government Public External Debt generally.

14. ENFORCEMENT AND EXERCISE OF RIGHTS

- 14.1 Following the distribution in full of the proceeds of the Trust Assets in respect of the Certificates to the Certificateholders in accordance with these Conditions and the Declaration of Trust, neither the Trustee nor the Issuer shall be liable for any further sums and, accordingly, Certificateholders may not take any action against the Issuer or the Trustee or any other person to recover any such sum in respect of the Certificates or Trust Assets.
- 14.2 The Delegate shall not be bound in any circumstances to take any action to enforce or to realise the Trust Assets or take any action, step or proceedings against the Issuer, the Trustee and/or the HKSAR Government under any Transaction Document unless directed or requested to do so by a Dissolution Notice and only then if it shall be indemnified and/or secured and/or prefunded to its satisfaction against all liabilities to which it may thereby render itself liable or which it may incur by so doing.
- 14.3 No Certificateholder shall be entitled to proceed directly against the Issuer, the Trustee or the HKSAR Government unless the Delegate, having become bound so to proceed, fails to do so within a reasonable period of becoming so bound and such failure is continuing. Under no circumstances shall the Delegate or any Certificateholder have any right to cause the sale or other disposition of any of the Trust Assets (other than pursuant to the Purchase Undertaking) and the sole right of the Trustee, the Delegate and the Certificateholders against the Trustee, the Issuer or the HKSAR Government shall be to enforce their respective obligations under the Transaction Documents to which they are a party.
- 14.4 The foregoing paragraphs in this Condition are subject to this paragraph. After enforcing or realising the Trust Assets and distributing the proceeds of the Trust Assets in accordance with Condition 5.2 and the Declaration of Trust, the obligations of the Issuer and the Trustee in respect of the Certificates shall be satisfied and no Certificateholders may take any further steps against the Issuer, the Trustee, the Delegate or any other person to recover any further sums in respect of the Certificates and the right to receive any sums unpaid shall be extinguished.

15. REPLACEMENT OF CERTIFICATES

Should any Certificate be lost, stolen, mutilated, defaced or destroyed it may be replaced at the specified office of the Registrar upon payment by the claimant of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Issuer or the HKSAR Government may reasonably require. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

16. NOTICES

All notices to Certificateholders will be valid if:

- (a) published in a leading English language daily newspaper with general circulation in Hong Kong, Malaysia and United Arab Emirates as the Delegate may approve (and it is expected that such publication will be made in the *Asian Wall Street Journal* and the *Gulf News*) and, so long as the Certificates are listed on the Stock Exchange of Hong Kong Limited, Bursa Malaysia and NASDAQ Dubai and the rules of the relevant exchange so require, the websites of the Stock Exchange of Hong Kong Limited, Bursa Malaysia and NASDAQ Dubai (www.hkex.com.hk; www.bursamalaysia.com; and www.nasdaqdubai.com, respectively); or

- (b) mailed to them by first class pre-paid registered mail (or its equivalent) or (if posted to an overseas address) by airmail at their respective registered addresses.

The Issuer shall also ensure that notices are duly given or published in a manner which complies with the rules and regulations of any listing authority, stock exchange and/or quotation system (if any) by which the Certificates have then been admitted to listing, trading and/or quotation. Any notice shall be deemed to have been given on the day after being so mailed or on the date of publication or, if so published more than once or on different dates, on the date of the first publication. So long as the Certificates are represented by one or more Global Certificates held on behalf of DTC or its nominee, notices to Certificateholders may be given by delivery of the relevant notice to DTC for communication to entitled holders in substitution for notification as set out under (b) above. Any such notice shall be deemed to have been given to the Certificateholders on the day on which such notice is delivered to DTC.

17. MEETINGS OF CERTIFICATEHOLDERS, MODIFICATION, WAIVER, AUTHORISATION AND DETERMINATION

17.1 Meetings of Certificateholders

The Declaration of Trust contains provisions for convening meetings of the Certificateholders to consider any matter affecting their interests, including the modification or abrogation by Extraordinary Resolution of any of these Conditions or any of the provisions of the Declaration of Trust or any other Transaction Document. The quorum at any meeting for passing an Extraordinary Resolution will be one or more persons present holding or representing more than two-thirds of the aggregate face amount of the Certificates for the time being outstanding, or at any adjourned such meeting one or more persons present whatever the face amount of the Certificates held or represented by him or them, except that, at any meeting at which is to be proposed an Extraordinary Resolution for the purpose of:

- (a) modifying the Scheduled Dissolution Date or any other date for payment in respect of the Certificates;
- (b) reducing or cancelling any amount payable in respect of the Certificates;
- (c) altering the currency of payment of the Certificates;
- (d) amending any of the Issuer's or the HKSAR Government's covenants set out in the Declaration of Trust and in the Purchase Undertaking, as applicable, or any of the HKSAR Government's covenants to make a payment under any Transaction Document to which it is a party;
- (e) amending any of the Dissolution Events or Hong Kong Events;
- (f) modifying the provisions contained in the Declaration of Trust concerning the quorum required at any meeting of the Certificateholders or the majority required to pass an Extraordinary Resolution;
- (g) the sanctioning of any such scheme or proposal as is described in paragraph 19(g) of Schedule 4 to the Declaration of Trust; and
- (h) alteration of this proviso,

(each a "**Reserved Matter**")

the necessary quorum will be one or more persons present holding or representing not less than three quarters, or at any adjourned such meeting not less than one third, of the aggregate face

amount of the Certificates for the time being outstanding. To be passed at a meeting of Certificateholders, an Extraordinary Resolution requires a majority in favour consisting of not less than three quarters of the persons voting on a show of hands or, if a poll is duly demanded, a majority of not less than three quarters of the votes cast on such poll. An Extraordinary Resolution passed at any meeting of the Certificateholders will be binding on all Certificateholders, whether or not they are present at the meeting and whether or not voting.

17.2 An Extraordinary Resolution may also be passed (i) by way of an electronic consent through the relevant clearing system in accordance with the Declaration of Trust; or (ii) in writing signed by or on behalf of the holders of not less than three quarters of the aggregate face amount of the Certificates then outstanding. Any such Extraordinary Resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Certificateholders, and will be binding on all Certificateholders.

17.3 The Delegate may agree, without the consent or sanction of the Certificateholders, to any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of these Conditions or any of the provisions of the Declaration of Trust or any other Transaction Document, or determine, without any such consent or sanction as aforesaid, that any Dissolution Event shall not be treated as such (provided that, in any such case, it is not, in the opinion of the Delegate, materially prejudicial to the interests of Certificateholders) or may agree, without any such consent or sanction as aforesaid, to any modification which, in its opinion, is of a formal, minor or technical nature or to correct a manifest or proven (to the satisfaction of the Delegate) error.

17.4 In connection with the exercise by it of any of its trusts, powers, authorities and discretions (including, without limitation, any modification, waiver, authorisation or determination), the Trustee and the Delegate shall have regard to the general interests of the Certificateholders as a class (but shall not have regard to any interests arising from circumstances particular to individual Certificateholders (whatever their number) and, in particular but without limitation, shall not have regard to the consequences of any such exercise for individual Certificateholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub-division thereof) and neither the Trustee nor the Delegate shall be entitled to require, nor shall any Certificateholder be entitled to claim, from the Issuer, the Trustee, the HKSAR Government, the Delegate or any other person, any indemnification or payment in respect of any tax consequence of any such exercise upon individual Certificateholders.

17.5 Any modification, abrogation, waiver, authorisation or determination shall be binding on all the Certificateholders and, unless the Delegate agrees otherwise, shall be notified by the Issuer to the Certificateholders as soon as practicable thereafter in accordance with Condition 16.

18. INDEMNIFICATION AND LIABILITY OF THE DELEGATE AND THE TRUSTEE

18.1 The Declaration of Trust contains provisions for the indemnification of the Delegate in certain circumstances and for its relief from responsibility, including provisions relieving it from taking any action, step or proceeding unless indemnified and/or secured and/or prefunded to its satisfaction.

18.2 The Delegate makes no representation and assumes no responsibility for the validity, sufficiency or enforceability of the obligations of the HKSAR Government under the Transaction Documents and shall not under any circumstances have any liability or be obliged to account to the Certificateholders in respect of any payments which should have been made by the HKSAR Government but are not so paid and shall not in any circumstances have any liability arising from the Trust Assets other than as expressly provided in the Conditions or in the Declaration of Trust.

18.3 Each of the Trustee and the Delegate is exempted from (i) any liability in respect of any loss or theft of the Trust Assets or any cash, (ii) any obligation to insure the Trust Assets or any cash and (iii) any claim arising from the fact that the Trust Assets or any cash are held by or on behalf of the Trustee or on deposit or in an account with any depositary or clearing system or are registered in the name of the Trustee or its nominee, unless such loss or theft arises as a result of default or misconduct by the Trustee or the Delegate, as the case may be.

19. **CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999**

No rights are conferred on any person under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of these Conditions, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

20. **GOVERNING LAW AND JURISDICTION**

20.1 **Governing Law**

The Declaration of Trust and the Certificates (including any non-contractual obligations arising out of or in connection with the Declaration of Trust and the Certificates) are governed by, and will be construed in accordance with, English law.

20.2 **Jurisdiction**

All parties irrevocably agree that the courts of Hong Kong are to have exclusive jurisdiction to settle any dispute which may arise out of or in connection with the Declaration of Trust and the Certificates and any dispute relating to any non-contractual obligations arising out of or in connection with the Declaration of Trust and the Certificates (for the purpose of this clause a **Dispute**) and accordingly have submitted to the exclusive jurisdiction of the Hong Kong courts. All parties waive any objection to the courts of Hong Kong on the grounds that they are an inconvenient or inappropriate forum to settle any Dispute.

20.3 **Waiver of Interest**

Each of the Issuer, the Trustee, the HKSAR Government and the Delegate has irrevocably agreed in the Declaration of Trust that if any proceedings are brought by or on behalf of a party under the Declaration of Trust and in respect of the Certificates it will:

- (a) not claim any judgment interest under, or in connection with, such proceedings; and
- (b) to the fullest extent permitted by law, waive all and any entitlement it may have to judgment interest awarded in its favour as a result of such proceedings.

GLOBAL CERTIFICATES

Each Global Certificate contains provisions which apply to the Certificates in respect of which it is issued whilst they are represented by the relevant Global Certificate, some of which modify the effect of the Conditions. The following is a summary of those provisions. Unless otherwise defined, terms defined in the Conditions have the same meaning in paragraphs 1 to 8 below.

1. Form of the Certificates

The Certificates sold in offshore transactions in reliance on Regulation S (the “**Regulation S Certificates**”) will be represented by one or more global Regulation S certificates in fully registered form (each a “**Regulation S Global Certificate**”), which will be deposited with a custodian for and will be registered in the name of a nominee of DTC. Beneficial interests in the Regulation S Global Certificates may be held only through DTC and its direct or indirect participants including Euroclear and Clearstream, Luxembourg at any time. See “*Clearance and Settlement—Payments and relationship of participants with clearing systems*”.

The Certificates sold within the United States to QIBs in reliance on Rule 144A (the “**Rule 144A Certificates**”) will be represented by one or more global Rule 144A certificates in fully registered form (each a “**Rule 144A Global Certificate**”), which will be deposited with a custodian for and will be registered in the name of a nominee of DTC. Beneficial interests in the Rule 144A Global Certificates may only be held through DTC and its direct or indirect participants including Euroclear and Clearstream, Luxembourg at any time. See “*Clearance and Settlement—Payments and relationship of participants with clearing systems*”. Subject to certain exceptions, beneficial interests in the Rule 144A Global Certificates may only be held by persons who are QIBs, holding their interests for their own account or for the account of one or more QIBs. By acquisition of a beneficial interest in a Rule 144A Global Certificate, the purchaser thereof will be deemed to represent, among other things, that it is a QIB and that, if in the future it determines to transfer such beneficial interest, it will transfer such interest in accordance with the procedures and restrictions contained in the Rule 144A Global Certificates while the Rule 144A Certificates are represented by the Rule 144A Global Certificates. See “*Transfer Restrictions*”.

The Regulation S Global Certificates and the Rule 144A Global Certificates are referred to herein as the **Global Certificates**. Beneficial interests in the Regulation S Global Certificates and the Rule 144A Global Certificates will be subject to certain restrictions on transfer set out in the Global Certificates and in the Agency Agreement while the Certificate are represented by the Global Certificates and such Global Certificates will bear a legend as set out under “*Transfer Restrictions*”. Investors may hold interests in the Regulation S Global Certificates through Euroclear or Clearstream, Luxembourg if they are participants in those systems. Investors may also hold such interests through organisations other than Euroclear and Clearstream, Luxembourg that are participants in the DTC system. Euroclear and Clearstream, Luxembourg will hold interests in the Regulation S Global Certificates on behalf of their account holders through customers’ securities accounts in their respective names on the books of their respective depositories, which in turn will hold such interests in the Regulation S Global Certificates in customers’ securities accounts in the depositories’ names on the books of DTC. Investors may hold their interests in the Rule 144A Global Certificates directly through DTC, if they are DTC participants, or indirectly through organisations which are DTC participants.

No Regulation S Global Certificates may be transferred to a person who takes delivery in the form of a Rule 144A Global Certificates unless (i) the transfer is to a person reasonably believed to be a QIB, (ii) such transfer is made in reliance on Rule 144A, and (iii) the transferor provides the Registrar with a written certification substantially in the form set out in the Agency Agreement to the effect that the transferor reasonably believes that the transferee is a QIB

purchasing the beneficial interest for its own account or any account of a QIB, in each case, in a transaction meeting the requirements of Rule 144A and that such transaction is in accordance with any applicable securities laws of any state of the United States or any other jurisdiction. No beneficial interest in the Rule 144A Global Certificates may be transferred to a person who takes delivery in the form of a beneficial interest in the Regulation S Global Certificates unless (i) the transfer is in an offshore transaction in reliance on Rule 904 of Regulation S, and (ii) the transferor provides the Registrar with a written certification substantially in the form set out in the Agency Agreement to the effect that the transfer is being made in an offshore transaction in accordance with Regulation S.

Any Regulation S Global Certificates that is transferred to a person who takes delivery in the form of a Rule 144A Global Certificate will, upon transfer, cease to be represented by the Regulation S Global Certificate and become an interest in the Rule 144A Global Certificates, and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in the Rule 144A Global Certificates for as long as it remains such an interest. Any Rule 144A Global Certificates that is transferred to a person who takes delivery in the form of a Regulation S Global Certificate will, upon transfer, cease to be represented by the Rule 144A Global Certificate and become an interest in the Regulation S Global Certificates and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to Regulation S Global Certificates for so long as it remains represented by the Regulation S Global Certificate. No service charge will be made for any registration of transfer or exchange of Certificates, but the Issuer may require payment of a sum sufficient to cover any tax or other governmental charge payable in connection therewith.

Upon receipt of the Global Certificates, DTC or the custodian will credit, on its internal system, the respective face amount of the individual beneficial interests represented by each such Global Certificate to the accounts of persons who have accounts with DTC. Ownership of beneficial interests in a Global Certificate will be limited to persons who have accounts with DTC or persons who hold interests through direct or indirect participants, including Euroclear and Clearstream, Luxembourg. Ownership of beneficial interests in the Global Certificates will be shown on, and the transfer of that ownership will be effected only through, records maintained by DTC or its nominee (with respect to interests of participants) and the records of participants (with respect to interests of persons other than participants).

Except in the limited circumstances described below, owners of beneficial interests in Global Certificates will not be entitled to receive physical delivery of certificated Certificates.

2. **Holders**

For so long as all of the Certificates are represented by a Global Certificate and such Global Certificate is held on behalf of DTC or its nominee, each person (other than another clearing system) who has for the time being a particular aggregate face amount of such Certificate credited to his securities account in the records of DTC (each, a “**Certificateholder**”) (in which regard any certificate or other document issued by such clearing system as to the aggregate face amount of such Certificates standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated as the holder of such aggregate face amount of such Certificates (and the expression **Certificateholders** and references to **holding of Certificates** and to **holder of Certificates** shall be construed accordingly) for all purposes other than with respect to payments and/or deliveries on such Certificates, for which purpose the registered holder of the relevant Global Certificate shall be deemed to be the holder of such face amount of Certificates in accordance with and subject to its terms and the Declaration of Trust. Each Certificateholder must look solely to DTC or its nominee, for its share of each payment made to the registered holder of the relevant Global Certificate.

3. **Cancellation**

Cancellation of any Certificate represented by a Global Certificate will be effected by reduction in the aggregate face amount of the Certificates in the Register and by annotation of the appropriate schedule to the relevant Global Certificate, subject to the rules and procedures of DTC.

4. **Payments**

Payments of any Dissolution Distribution Amount and Periodic Distribution Amount in respect of Certificates represented by a Global Certificate will be made upon presentation or, if no further payment falls to be made in respect of the Certificates against presentation and last dissolution, surrender of the relevant Global Certificate at the specified office of the Principal Paying Agent or to the order of the Registrar at such office specified by the Registrar, all subject to and in accordance with the Conditions and the Declaration of Trust.

Distributions of amounts with respect to book-entry interests in the Certificates held through DTC or its nominee will be credited to the cash accounts of participants in the relevant clearing system in accordance with the relevant clearing system's rules and procedures.

A record of each payment made in respect of the Certificates will be entered into the Register by or on behalf of the Registrar and shall be *prima facie* evidence that payment has been made.

5. **Notices**

So long as all the Certificates are represented by any of the Global Certificates and each Global Certificate is held on behalf of DTC or its nominee, notices to Certificateholders may be given by delivery of the relevant notice to DTC for communication to entitled holders in substitution for notification as required by the Conditions except that, so long as the Certificates are listed on any stock exchange, notices shall also be published in accordance with the rules of such stock exchange. Any such notice shall be deemed to have been given to the Certificateholders on the day on which such notice is delivered to DTC.

6. **Registration of Title**

The Registrar will not register title to the Certificates in a name other than that of a nominee for the relevant clearing system for a period of seven calendar days preceding the due date for any payment of any Periodic Distribution Amount or the Dissolution Distribution Amount in respect of the Certificates.

7. **Transfers**

Transfers of book-entry interests in the Certificates will be effected through the records of DTC and its direct and indirect participants in accordance with their respective rules and procedures.

8. **Exchange for Definitive Certificates**

Exchange

The Rule 144A Global Certificates will be exchangeable, free of charge to the holder, in whole but not in part, for Certificates in definitive form (the “**Rule 144A Definitive Certificates**”) and

the Regulation S Global Certificates will be exchangeable, free of charge to the holder, in whole but not in part, for Certificates in definitive form (the “**Regulation S Definitive Certificates**” and, together with the Rule 144A Definitive Certificates, the “**Definitive Certificates**”) upon the occurrence of an Exchange Event.

For these purposes, **Exchange Event** means that in the case of the Global Certificates, if DTC notifies the Issuer that it is no longer willing or able to discharge properly its responsibilities as depository with respect to the Global Certificates or DTC ceases to be a “clearing agency” registered under the Exchange Act or is at any time no longer eligible to act as such and the Issuer is not able to locate a qualified successor within 90 days of receipt of such notice from DTC.

In exchange for the relevant Global Certificate, as provided in the Agency Agreement, the Registrar will deliver or procure the delivery of an equal aggregate face amount of duly executed Definitive Certificates in or substantially in the form set out in the Declaration of Trust.

Delivery

In such circumstances, the relevant Global Certificate shall be exchanged in full for Definitive Certificates and the Issuer will, at the cost of the Issuer (but against such indemnity as the Registrar or any relevant Transfer Agent may require in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such exchange), cause sufficient Definitive Certificates to be executed and delivered to the Registrar for completion, authentication and dispatch to the relevant Certificateholders. A person having an interest in a Global Certificate must provide the Registrar with (i) a written order containing instructions and such other information as the Issuer and the Registrar may require to complete, execute and deliver such Definitive Certificates and (ii) in the case of the Rule 144A Global Certificates only, a fully completed, signed certification substantially to the effect that the exchanging holder is not transferring its interest at the time of such exchange or, in the case of simultaneous sale pursuant to Rule 144A, a written certification that the transfer is being made in compliance with the provisions of Rule 144A to a purchaser that the transferor reasonably believes to be a QIB purchasing the beneficial interest for its own account or any account of a QIB, in each case, in a transaction meeting the requirements of Rule 144A and that such transaction is in accordance with any applicable securities laws of any state of the United States or any other jurisdiction. Definitive Certificates issued in exchange for a beneficial interest in the Rule 144A Global Certificates shall bear the legends applicable to transfers pursuant to Rule 144A, as set out under “*Transfer Restrictions*”.

Legends and transfers

The holder of a Definitive Certificate may transfer the Certificates represented thereby in whole or in part in the applicable Authorised Denomination by surrendering it at the specified office of the Registrar or any Transfer Agent, together with the completed form of transfer thereon. Upon the transfer, exchange or replacement of a Definitive Certificate bearing the legend referred to under “*Transfer Restrictions*”, or upon specific request for removal of the legend on a Definitive Certificate, the Issuer will deliver only Definitive Certificates that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Issuer and the Registrar such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the Issuer that neither the legend nor the restrictions on transfer set out therein are required to ensure compliance with the provisions of the Securities Act. Rule 144A Definitive Certificates will bear the same legend as the legend for the Rule 144A Global Certificates set out under “*Transfer Restrictions*”. The Rule 144A Definitive Certificates may not at any time be held by or on behalf of U.S. persons (as defined in Regulation S) that are not QIBs. Before any Regulation S Definitive Certificate may be resold or otherwise transferred to a person who takes delivery in the form of a Rule 144A Definitive Certificate, the transferor and/or

transferee, as applicable, will be required to provide the Registrar with a written certification substantially in the form set out in the Agency Agreement to the effect that the transferor reasonably believes that the transfer is (i) to a person that is a QIB purchasing the beneficial interest for its own account or any account of a QIB and (ii) in each case in a transaction meeting the requirements of Rule 144A and in accordance with any applicable securities laws of any state of United States or any other jurisdiction. Regulation S Definitive Certificate will bear the same legend as the legend for the Regulation S Global Certificates set out under “*Transfer Restrictions*”. Before any Rule 144A Definitive Certificate may be resold or otherwise transferred to a person who takes delivery in the form of a Regulation S Definitive Certificate, the transferor and/or transferee, as applicable, will be required to provide the Registrar with a written certification substantially in the form set out in the Agency Agreement to the effect that the transfer is being made to a person in an offshore transaction in accordance with Rule 904 of Regulation S.

RATINGS

It is a condition of the issuance of the Certificates that the Certificates are, upon issue, assigned a rating of “AAA” by Standard & Poor’s and “Aa1” by Moody’s.

A rating is not a recommendation to buy, sell or hold securities, does not address the likelihood or timing of prepayment and may be subject to suspension, revision or withdrawal at any time by the assigning rating organisation. A suspension, reduction or withdrawal of the ratings assigned to the Certificates may adversely affect the market price of the Certificates. See “Investment Considerations—Investment considerations relating to the Certificates”.

DESCRIPTION OF THE ISSUER

History

Hong Kong Sukuk 2014 Limited (the “**Issuer**”) was incorporated on 22 July 2014 in Hong Kong under the Companies Ordinance which provides for, among others, the constitution of companies, directors’ liabilities and powers, creditors’ rights and liquidation. It also provides that a company incorporated in Hong Kong, such as the Issuer, has the capacity and the rights, powers and privileges of a natural person which include the capacity, right and power to enter into financial transactions. The Issuer is constituted pursuant to its articles of association. The articles of association provide that the Issuer’s power to borrow and issue securities is exercised by its directors.

The Issuer is a special purpose vehicle formed primarily for the purpose of participating in the transactions contemplated by the Transaction Documents. The Issuer is wholly owned by the FSI. The Issuer has issued share capital of HK\$1.00, consisting of one share, which is fully paid up.

The registered address of the Issuer is 84/F, Two International Finance Centre, 8 Finance Street, Central, Hong Kong.

Business Activity

Since its establishment, the Issuer has not engaged in any material activities other than those regarding or incidental to the issue of the Certificates and the matters contemplated in this offering memorandum and the Transaction Documents and the authorisation of its entry into the other transactions and documents referred to in this offering memorandum to which it is or will be a party.

The Issuer has no prior operating history or prior business and will not have any substantial liabilities other than in connection with the issue of the Certificate. The Issuer has no subsidiaries and no employees.

Board and Management

The management of the Issuer is vested in the board of directors, which comprises:

Pang Sing Tong, Director Deputy Chief Executive, HKMA

Lee Tat Chi Howard, Director Executive Director (Monetary Management), HKMA

Ho Hon Kit, Director Head (Financial Stability Surveillance), HKMA

Financial Statements

The Issuer prepares audited financial statements in respect of the end of each fiscal year. The fiscal years of the Issuer end on 31 March of each year. As at the date of this offering memorandum, the Issuer has not published and does not propose to publish any financial statements.

As at the date of this offering memorandum, the Issuer does not have any indebtedness, bank overdrafts, borrowings, guarantees or contingent liabilities.

DESCRIPTION OF THE FINANCIAL SECRETARY AND THE FINANCIAL SECRETARY INCORPORATED

The Financial Secretary

The Financial Secretary is a principal government official whose primary responsibility is to assist the Chief Executive of the HKSAR Government in overseeing policy formulation and implementation in financial, monetary, economic, trade and employment matters. He exercises control over the Exchange Fund, with the assistance of the Monetary Authority.

The Certificates will be issued under the GB Programme which was established in 2009 to facilitate the issuance of bonds by the HKSAR Government. Pursuant to a resolution passed by LegCo under the Loans Ordinance (Cap. 61 of the Laws of Hong Kong) (the “**Loans Ordinance**”) on 22 May 2013, the HKSAR Government is currently authorised to borrow up to HK\$200 billion, or the equivalent in other currencies, under the GB Programme, and to credit such amounts to the Bond Fund. The Bond Fund was established pursuant to a resolution (the “**Bond Fund Resolution**”) passed by LegCo on 8 July 2009 under section 29 of the Public Finance Ordinance (Cap. 2 of the Laws of Hong Kong). On 26 March 2014, the Loans (Amendment) Bill 2014 was passed by LegCo to put in place a legal framework for alternative bond issuances under the GB Programme. Pursuant to the Loans Ordinance, any agreement between the HKSAR Government and a lender in respect of sums borrowed under the powers conferred by the Loans Ordinance shall be made in the name of the HKSAR Government and may be signed on behalf of the HKSAR Government by the Financial Secretary or by any person authorised by him in writing.

The obligor under the Certificates will be the HKSAR Government and Certificateholders will have recourse against the HKSAR Government. The HKSAR Government will therefore be the party entering into the Lease Agreement, the Purchase Undertaking and the Servicing Agency Agreement and the Financial Secretary will sign such documents on behalf of the HKSAR Government in accordance with the Loans Ordinance. Pursuant to the Bond Fund Resolution, the Financial Secretary may expend money from the Bond Fund for the purposes of making certain payments in relation to any sums that have been borrowed under the Loans Ordinance for the purposes of the Bond Fund. Should there be any shortfall of funds in the Bond Fund, pursuant to the Loans Ordinance, any sum borrowed thereunder and all interest and other charges thereon are charged upon and shall be payable out of the general revenues and assets of Hong Kong.

The Financial Secretary Incorporated

The Financial Secretary Incorporated (the “**FSI**”) is a corporation sole established under the Financial Secretary Incorporation Ordinance (Cap. 1015 of the Laws of Hong Kong) (the “**FSI Ordinance**”) by the incorporation of the Financial Secretary under that title. The FSI has the capacity pursuant to the FSI Ordinance to acquire, hold, dispose of and otherwise deal with securities and other property, to execute deeds and agreements and to do all other acts necessary or expedient to be done in the execution of such duties.

Therefore, any documents relating to the disposal or acquisition of any of the Assets, namely, the Purchase Agreement, the sale agreement under the Purchase Undertaking and the transfer agreement under the Substitution and Transfer Undertaking, will be entered into by the FSI in accordance with the FSI Ordinance for the HKSAR Government.

SUMMARY OF THE PRINCIPAL TRANSACTION DOCUMENTS

The following is a summary of certain provisions of the principal Transaction Documents and is qualified in its entirety by reference to the detailed provisions of the principal Transaction Documents. Copies of the Transaction Documents will be available for inspection and/or collection at the offices of the Principal Paying Agent (as defined in the Conditions).

Purchase Agreement

The Purchase Agreement will be entered into on the Closing Date between the Trustee (in its capacity as Purchaser) and the FSI (in its capacity as Seller) and will be governed by Hong Kong law.

Pursuant to the Purchase Agreement, the Seller will sell, transfer and convey to the Purchaser, and the Purchaser will purchase from the Seller, and accept the transfer and conveyance of, on the date of the Purchase Agreement, the beneficial ownership in and to the land and buildings described in the Purchase Agreement for US\$1,000,000,000, which shall be payable on the Closing Date, free and clear of all encumbrances or any other rights of third parties. The assets being the subject of the Purchase Agreement comprise certain land and buildings used by various government departments as offices, the details of which are set out in the Purchase Agreement (see “*Structure Diagram and Cash Flows — Principal cash flows — Payments by the Certificateholders and the Issuer*”).

Lease Agreement

The Lease Agreement will be entered into on the Closing Date between the HKSAR Government (in its capacity as Lessee), the Trustee (in its capacity as Lessor) and the Delegate and will be governed by Hong Kong law.

Under the terms of the Lease Agreement, the Lessor will lease to the Lessee, and the Lessee will lease from the Lessor, the assets purchased pursuant to the Purchase Agreement (the “**Lease Assets**”) on the basis of consecutive six-month rental periods for a cumulative period commencing on the Closing Date and extending to the Scheduled Dissolution Date unless (i) the Lease is terminated on an earlier date (as a result of the occurrence of a Dissolution Event or Total Loss Event) or (ii) the Lease is extended in accordance with the Purchase Undertaking where the HKSAR Government (in its capacity as Obligor) fails to pay all or part of the Exercise Price when due (See “*Summary of the Principal Transaction Documents — Purchase Undertaking*”), in which case it shall mean the last day of the Additional Lease Period (as defined in the Purchase Undertaking) (the “**Lease Term**”).

The Lessee will agree to use the Lease Assets at its own risk. Accordingly, the Lessee shall bear the entire risk of loss of or damage to the Lease Assets or any part thereof arising from the negligent usage or operation thereof by the Lessee. In addition, the Lessor shall not be liable (and the Lessee will waive any claim or right, howsoever arising, to the contrary) for any indirect, consequential or other losses, howsoever arising, in connection with the Lessee’s negligent use or operation of the Lease Assets.

The Lessee shall, at its own cost and expense, be responsible for the performance of all Ordinary Maintenance and Repair (as defined in the Lease Agreement) required for the Lease Assets.

The Lessor shall be responsible for (i) the performance of all Major Maintenance and Structural Repair (as defined in the Lease Agreement), (ii) the payment of any proprietorship or other relevant taxes and levies, and (iii) insuring the Lease Assets, and the Lessee will acknowledge that the Lessor may procure that the Servicing Agent, in accordance with the terms and conditions set out in the Servicing Agency Agreement, shall perform, or shall procure the performance of, the Major Maintenance and Structural Repair on behalf of the Lessor, the payment of such taxes and levies and the insurance of the Lease Assets.

All payments by the Lessee to the Lessor under the Lease Agreement shall be paid in full without any deduction or withholding for or on account of any tax unless required by law and without set-off (save in respect of the set-off of any Servicing Agency Expenses (as defined in the Servicing Agency Agreement) against the payment of any Supplementary Rental (as defined in the Lease Agreement) as provided in the Servicing Agency Agreement) or counterclaim of any kind and, in the event that there is any deduction or withholding for or on account of tax, the Lessee shall pay all additional amounts as will result in the receipt by the Lessor of such net amounts as would have been received by it if no deduction or withholding had been made. The payment obligations of the Lessee under the Lease Agreement will be direct, unconditional, unsubordinated and unsecured obligations of the Lessee and (save for such mandatory exceptions as may be provided by applicable legislation and regulations) shall at all times rank at least *pari passu* with all other direct, unsecured, unsubordinated and unconditional obligations of the Lessee.

The rental payable under the Lease Agreement will be used for the payment of the Periodic Distribution Amounts payable on the Periodic Distribution Dates. The Lessee will be obligated to pay such rentals on each Rental Payment Date or any earlier date on which the lease of the Lease Assets is terminated in accordance with the terms of the Lease Agreement.

The Lease Agreement provides that it shall automatically terminate, but without prejudice to any right or remedy the Lessor may have under any Transaction Document or by law, if a Total Loss Event occurs and (unless the Lease Assets are replaced as provided in the Servicing Agency Agreement by no later than the 30th day after the occurrence of the Total Loss Event) the Lessor will be entitled to any insurance proceeds payable as a result of the Total Loss Event. The Lease Agreement may not otherwise be terminated prior to the expiry of the Lease Term unless the Certificates have been redeemed in full and all the parties to the Lease Agreement agree that it shall be so terminated.

The Declaration of Trust

The Declaration of Trust will be entered into on the Closing Date between the HKSAR Government, the Issuer, the Trustee and the Delegate and will be governed by English law.

Pursuant to the Declaration of Trust, the Trustee will declare the Trust for the benefit of the Certificateholders over all of its rights, title, interest and benefit, present and future, in, to and under the Lease Assets and the Transaction Documents (other than in relation to any representations given to the Trustee by the FSI or the HKSAR Government pursuant to any of the Transaction Documents), all monies standing to the credit of the Transaction Account from time to time and all proceeds of the foregoing (“**Trust Assets**”).

Pursuant to the Declaration of Trust, the Trustee will, in relation to the Certificates, *inter alia*:

- (a) hold the Trust Assets on trust absolutely for the Certificateholders as owners and beneficiaries *pro rata* according to the face amount of Certificates held by each Certificateholder; and
- (b) act as trustee in respect of the Trust Assets, distribute the income from the Trust Assets and perform its duties in accordance with the provisions of the Declaration of Trust.

In the Declaration of Trust, the Trustee by way of security for the performance of all covenants and obligations of the Trustee will irrevocably and unconditionally appoint the Delegate to be its delegate and attorney and in its name and on its behalf execute, deliver and perfect all documents and to exercise all of the present and future powers, authorities and discretions (including but not limited to the authority to request instructions from any Certificateholders and the power to sub-delegate and to make any determinations to be made under the Declaration of Trust) vested in the Trustee by the Declaration of Trust that the Delegate may consider to be necessary or desirable in order to perform the present and future powers, authorities and discretions vested in the Trustee by the relevant provisions of the Declaration of Trust (provided that no obligations, duties or covenants of the Trustee pursuant to the Declaration of Trust shall be imposed on the Delegate by virtue of this delegation) and

make such distributions from the Trust Assets as the Trustee is bound to make in accordance with the Declaration of Trust. The appointment of such delegate by the Trustee is intended to be in the interests of the Certificateholders and does not affect the Trustee's continuing role and obligations as sole trustee.

The Delegate will undertake in the Declaration of Trust that, following it becoming aware of the occurrence of a Dissolution Event in respect of any Certificates and subject to Condition 13, it shall (a) promptly notify the Certificateholders of the occurrence of such Dissolution Event with a request to such Certificateholders to indicate if they wish the Certificates to be redeemed and the Trust to be dissolved, and (b) subject to being indemnified and/or secured and/or prefunded to its satisfaction against all liabilities to which it may thereby render itself liable or which it may incur by so doing, take all such actions, steps or proceedings as are necessary to enforce the obligations of the HKSAR Government and/or the FSI under the Declaration of Trust and any other Transaction Document to which the HKSAR Government and/or the FSI is a party.

The Declaration of Trust specifies, *inter alia*, that:

- (a) following the distribution in full of the proceeds of the Trust Assets in respect of the Certificates to the Certificateholders in accordance with the Conditions and the Declaration of Trust, the Issuer shall not be liable for any further sums and, accordingly, the Certificateholders may not take any action against the Issuer, the Trustee, the Delegate or any other person to recover any such sum in respect of the Certificates or the Trust Assets;
- (b) no Certificateholder shall be entitled to proceed directly against the Issuer, the FSI and/or the HKSAR Government unless the Delegate having become bound so to proceed, fails to do so within a reasonable period of becoming so bound and such failure is continuing. Under no circumstances shall the Delegate or any Certificateholders have any right to cause the sale or other disposition of any of the Trust Assets (other than pursuant to the Purchase Undertaking), and the sole right of the Trustee, the Delegate and the Certificateholders against the Trustee, the Issuer, the FSI or the HKSAR Government shall be to enforce their respective obligations under the Transaction Documents to which the Issuer, the Trustee, the FSI or the HKSAR Government are a party;
- (c) the Delegate shall not be bound in any circumstances to take any action to enforce or realise the Trust Assets or take any action, step or proceedings against the Issuer, the Trustee, the FSI and/or the HKSAR Government under any Transaction Document unless directed or requested to do so by a Dissolution Notice and then only if it is indemnified and/or secured and/or prefunded to its satisfaction against all liabilities to which it may thereby render itself liable or which it may incur by so doing; and
- (d) after enforcing or realising the Trust Assets and distributing the proceeds of the Trust Assets in accordance with Condition 5.2 and the terms of the Declaration of Trust, the obligations of the Issuer, the Trustee and the Delegate in respect of the Certificates shall be satisfied and no Certificateholder may take any further steps against the Issuer, the Trustee or the Delegate or any other person to recover any further sums in respect of the Certificates and the right to receive any such sums unpaid shall be extinguished.

Purchase Undertaking

The Purchase Undertaking will be executed on the Closing Date by the HKSAR Government (the "**Obligor**") in favour of the Trustee and the Delegate and will be governed by English law.

The Obligor will irrevocably and unconditionally grant to the Trustee and the Delegate the rights to require the Obligor to purchase or procure the purchase of the Lease Assets from the Trustee on the Scheduled Dissolution Date or any earlier due date for dissolution following the occurrence of a Dissolution Event, as the case may be, at the Exercise Price (being the aggregate face amount of the

Certificates then outstanding plus all accrued but unpaid Periodic Distribution Amounts (if any) relating to the Certificates plus any Servicing Agency Expenses in respect of which a rental payment has not been made in accordance with the Lease Agreement). If the Delegate exercises its option prior to the Scheduled Dissolution Date, an exercise notice will be required to be delivered by the Delegate under the Purchase Undertaking.

The Obligor will undertake in the Purchase Undertaking that if it fails to pay all or part of any Exercise Price when due (the “**Outstanding Exercise Price**”), it will irrevocably, unconditionally and automatically continue to lease the Relevant Lease Assets from the Trustee and act as servicing agent in respect of the Relevant Lease Assets with effect from the date immediately following the due date for payment of the Outstanding Exercise Price on the terms and conditions, *mutatis mutandis*, of the Lease Agreement and Service Agency Agreement until payment of the Exercise Price in full is made by it. For this purpose, **Relevant Lease Assets** means the Lease Assets.

The Obligor will agree in the Purchase Undertaking that all payments by it under the Purchase Undertaking will be made without any deduction or withholding for or on account of tax unless required by law and without set-off (save as described above) or counterclaim of any kind and, in the event that there is any deduction or withholding for or on account of tax, the Obligor shall pay all additional amounts as will result in the receipt by the Issuer of such net amounts as would have been received by it if no deduction or withholding had been made. The payment obligations of the Obligor under the Purchase Undertaking are and will be direct, unconditional, unsubordinated and unsecured obligations of the Obligor and (save for such mandatory exceptions as may be provided by applicable legislation and regulations) shall at all times rank at least *pari passu* with all other direct, unsecured, unsubordinated and unconditional obligations of the Obligor.

The Obligor has agreed in the Purchase Undertaking that each of the following events shall constitute a Hong Kong Event:

- (a) the failure to pay on the due date any Exercise Price payable by the HKSAR Government pursuant to the Purchase Undertaking, the Total Loss Shortfall Amount payable by the HKSAR Government pursuant to the Servicing Agency Agreement and Rental due by the HKSAR Government under the Lease Agreement (including payment of any additional amount of Rental pursuant to the Lease Agreement in respect of any additional amounts payable by the Issuer under Condition 10) and such other failure to pay is not cured within 30 days of the due date for payment;
- (b) the HKSAR Government defaults in the performance of any other covenant or obligation in the Purchase Undertaking or the Declaration of Trust, and, if such default is capable of remedy such default shall continue for a period of 60 days after written notice thereof shall have been given to the HKSAR Government by the Trustee or the Delegate;
- (c) the failure by the HKSAR Government to make any payment when due of principal or financial charges in excess of US\$50,000,000 (or its equivalent in other currencies) (whether upon maturity, acceleration or otherwise) on or in connection with the HKSAR Government Public External Debt, and such failure by the HKSAR Government continues for 30 days or more after the expiry of any applicable grace period following the date on which such payment became due; and
- (d) the HKSAR Government declares a suspension of, or a moratorium with respect to, the payments of the HKSAR Government Public External Debt generally.

Substitution and Transfer Undertaking

The Substitution and Transfer Undertaking will be executed on the Closing Date by the Trustee in favour of the Obligor and will be governed by Hong Kong law.

Pursuant to the Substitution and Transfer Undertaking, the Obligor may, by exercising its rights under the Substitution and Transfer Undertaking, oblige the Trustee to transfer the relevant Lease Assets to the Obligor upon the issue of an Exercise Notice by the Obligor on (i) their substitution with assets of a value not less than the value of such Lease Assets or (ii) the delivery to the Principal Paying Agent for cancellation of Certificates with an aggregate face amount not greater than the value of such Lease Assets.

Servicing Agency Agreement

The Servicing Agency Agreement will be entered into on the Closing Date by the HKSAR Government (in its capacity as Servicing Agent) and the Trustee (in its capacity as Lessor) and will be governed by Hong Kong law.

Pursuant to the Servicing Agency Agreement, the Servicing Agent will be responsible on behalf of the Lessor for carrying out all Major Maintenance and Structural Repair (as defined in the Lease Agreement), the payment of Proprietorship Taxes and Levies (if any) charged, levied or claimed in respect of the Lease Assets and for effecting all appropriate insurances in respect of the Lease Assets.

Notwithstanding the appointment of the Servicing Agent, the Lessee shall, at its own cost and expense, be responsible for the performance of all Ordinary Maintenance and Repair required for the Lease Assets.

The Servicing Agency Agreement provides that if on the occurrence of a Total Loss Event the Servicing Agent receives notice from the HKSAR Government that Replacement Lease Assets (as defined in the Servicing Agency Agreement) are available on or before the 30th day after the occurrence of the Total Loss Event, the Trustee shall purchase such Replacement Lease Assets from the HKSAR Government by way of the payment by the Servicing Agent on behalf of the Trustee of the relevant insurance proceeds (or the assignment of the rights to such insurance proceeds) to the HKSAR Government and the transfer to the HKSAR Government by the Trustee of any residual interest it may hold in the Lease Assets (including any remaining rights in respect of any insurance proceeds) on the terms and subject to the conditions of an agreement substantially in the form of the Purchase Agreement in consideration for the sale, transfer and assignment by the HKSAR Government of the Replacement Lease Assets to the Trustee.

Agency Agreement

The Agency Agreement will be executed on the Closing Date between the HKSAR Government, the Issuer, the Trustee, the Delegate, the Principal Paying Agent, the Registrar and the Transfer Agent and will be governed by English law.

Pursuant to the Agency Agreement, provision will be made for, *inter alia*, payment of all sums due in respect of the Certificates.

USE OF PROCEEDS

The gross proceeds of the issue of the Certificates will be paid by the Issuer (in its capacity as “**Purchaser**”) on the Closing Date to the FSI (in its capacity as “**Seller**”) as the purchase price for the Assets pursuant to the Purchase Agreement.

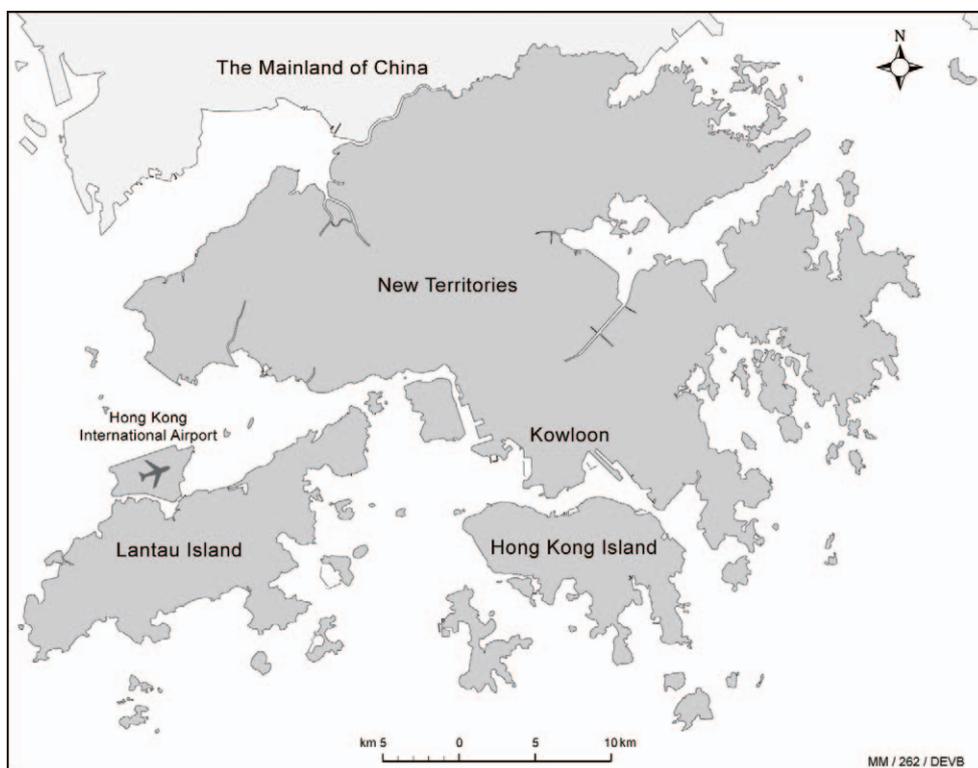
The proceeds received by the FSI will be credited to the Bond Fund (set up pursuant to resolution (Cap. 2S) passed on 8 July 2009 under section 29 of the Public Finance Ordinance (Cap. 2)) and then placed with the Exchange Fund.

THE HONG KONG SPECIAL ADMINISTRATIVE REGION

Overview

Hong Kong is one of the world’s leading trade and financial centres and a gateway to the Mainland of the PRC. Situated on the southeast coast of China, Hong Kong is positioned at the centre of East Asia. With a total area of 1,104 square kilometres, Hong Kong is comprised of Hong Kong Island, Lantau Island, the Kowloon Peninsula and the New Territories (including 261 outlying islands).

On 1 July 1997, Hong Kong became a Special Administrative Region of the PRC in accordance with Article 31 of the Constitution of the PRC. In accordance with the Constitution of the PRC, the National People’s Congress (the “NPC”) enacted the Basic Law (the “**Basic Law**”) of the Hong Kong Special Administrative Region (the “**HKSAR**”), which came into effect on 1 July 1997. The Basic Law prescribes the systems to be practised in the HKSAR. Hong Kong benefits from a relatively stable political environment with strong institutions. It has one of the highest levels of governance in the world, underscored by the World Bank’s Worldwide Governance Indicators project which ranked Hong Kong in the 90th percentile or higher in each of its aggregate indicators for Control of Corruption, Rule of Law, Regulatory Quality and Government Effectiveness in 2012.



Population and Society

Hong Kong is one of the most densely-populated regions in the world. As at 31 December 2013, Hong Kong had a total population of 7.2 million, a population density of approximately 6,680 persons per square kilometre.

The official languages in Hong Kong are Chinese and English. Hong Kong is largely a biliterate (for written Chinese and English) and trilingual (for Cantonese, Putonghua and spoken English) society.

The population enjoys religious freedom as a fundamental right protected by the Basic Law. The various religious traditions practised in Hong Kong include, among others, Buddhism, Christianity, Islam, Taoism, Confucianism, Hinduism, Sikhism and Judaism. Many religious bodies have established schools and provided health and welfare facilities.

With respect to education, the HKSAR Government provides 12 years of free primary and secondary education. For the 2013-14 academic year, Hong Kong had approximately 969 kindergartens, 569 primary schools, 514 secondary schools, 60 special education schools, one institute of vocational education and eight University Grants Committee-funded institutions. Education represents the largest share of HKSAR Government's budget: an estimated HK\$75.4 billion will be spent on education for the 2014-15 fiscal year, representing approximately 18.3 per cent. of total estimated government expenditure.

Hong Kong has a dual-track system for public and private healthcare. The HKSAR Government provides comprehensive public medical and healthcare services, which patients receive either for free or at a relatively low cost. As at 31 December 2013, healthcare professionals registered with their respective boards and councils amounted to: 13,203 doctors, 2,310 dentists, 6,743 registered traditional Chinese medicine practitioners and 45,846 nurses. As at 31 December 2013, there were approximately 36,720 hospital beds in the territory, representing slightly fewer than five beds per thousand persons. Given the location and climate of Hong Kong, the number of travellers and the density of its population, Hong Kong is in close liaison with Mainland health authorities and other countries as well as with the World Health Organisation for the detection, prevention and control of communicable diseases.

The following table presents a selection of the latest comparative statistics for 2013 as published by the World Bank:

Comparative Statistics for 2013

	<u>Hong Kong</u>	<u>PRC</u>	<u>Japan</u>	<u>Singapore</u>	<u>South Korea</u>
Gross National Income per capita (US\$) ⁽¹⁾	38,420	6,560	46,140	54,040	25,920
Nominal GDP (US\$ billions)	274.0	9,240.3	4,901.5	297.9	1,304.5
Life expectancy at birth (in years) ⁽²⁾	83	75	83	82	81

Notes:

1. Using Atlas methodology.
2. Figures for 2012.

Source: World Bank Open Data as accessed on 14 August 2014

Constitution and Government

The HKSAR was formally established on 1 July 1997 and the Basic Law came into force on the same day. The NPC enacted the Basic Law in accordance with the Constitution of the PRC. The Basic Law prescribes the systems to be practised in Hong Kong to ensure the implementation of the basic policies of the PRC regarding Hong Kong. These basic policies have been set out in the Sino-British Joint Declaration. Under the “one country, two systems” principle, the Mainland's socialist system and

policies shall not be practised in Hong Kong and the previous capitalist system and way of life shall remain unchanged for 50 years from the HKSAR's formal establishment. The Basic Law provides that the NPC authorises the HKSAR to exercise a high degree of autonomy and enjoy executive, legislative and independent judicial power, including that of final adjudication, in accordance with the provisions of the Basic Law. The power of amendment of the Basic Law is vested in the NPC. The Standing Committee of the NPC (the "NPCSC") has the power of interpretation and has authorised the courts of the HKSAR to interpret, on their own in adjudicating cases, the provisions of the Basic Law which are within the limits of the autonomy of the HKSAR. The courts of the HKSAR may also interpret other provisions of the Basic Law in adjudicating cases, although the Court of Final Appeal would need to seek an interpretation from the NPCSC if the relevant Basic Law provisions concern affairs which are the responsibility of the Central People's Government of the PRC (the "CPG") or concern the relationship between the central authorities of the PRC and the HKSAR.

Government Structure

According to the overall framework of the Basic Law, the political structure of the HKSAR is an executive-led structure headed by the Chief Executive. Under Article 43 of the Basic Law, the Chief Executive is the head of the HKSAR and represents the HKSAR. The Chief Executive is accountable to the CPG and the HKSAR. The Chief Executive is also responsible for implementing the Basic Law. The Chief Executive's power is derived from the authorisation by the NPC through the Basic Law. Under the Basic Law, the Chief Executive is elected by a broadly representative election committee consisting of members from various sectors of the society, and is appointed by the CPG. See "*Recent Constitutional and Political Developments*". The term of office of the Chief Executive is five years, and he or she may serve for not more than two consecutive terms. The current Chief Executive is Mr. Leung Chun-ying, whose term of office began in July 2012.

The HKSAR Government, led by the Chief Executive, comprises policy bureaux and departments. The policy bureaux formulate policies and initiate legislative and financial proposals. Departments implement laws and policies and provide direct services to the public. There are currently 12 policy bureaux, each headed by a Director of Bureau, collectively forming the HKSAR Government Secretariat, and 56 departments, most of which are responsible to the relevant bureau secretaries.

The Chief Secretary for Administration, the Financial Secretary and the Secretary for Justice, and the 12 Directors of Bureaux are principal officials and are accountable to the Chief Executive. They are appointed to the Executive Council (described below).

The Executive Council

The Executive Council ("**ExCo**") assists the Chief Executive in formulating HKSAR Government policy and, as at 31 December 2013, comprised 29 members, including the three Secretaries, 12 Directors of Bureaux, and 14 non-official members. All ExCo members are appointed by the Chief Executive.

Under the Basic Law, except for the appointment, removal and disciplining of officials and the adoption of measures in emergencies, the Chief Executive is required to consult ExCo before making important policy decisions, introducing bills into the Legislative Council ("**LegCo**"), making subordinate legislation or dissolving LegCo. If the Chief Executive does not accept a majority opinion of ExCo, he must put the specific reasons on record. The Chief Executive, after consultation with ExCo, also determines appeals, petitions and objections under those ordinances conferring a statutory right of appeal.

The Legislative Council

LegCo is the legislature of Hong Kong with the following powers and functions, as provided in the Basic Law:

- to enact, amend or repeal laws in accordance with the provisions of the Basic Law and legal procedures;
- to examine and approve budgets introduced by the HKSAR Government;
- to approve taxation and public expenditure;
- to receive and debate the policy addresses of the Chief Executive;
- to raise questions on the work of the HKSAR Government;
- to debate any issue concerning public interests;
- to endorse the appointment and removal of the judges of the Court of Final Appeal and the Chief Judge of the High Court;
- to receive and handle complaints from Hong Kong residents;
- to commence the procedure for impeachment of the Chief Executive by a motion initiated jointly by one-fourth of all members of the LegCo; if a motion for investigation is passed, to establish an independent investigation committee chaired by the Chief Justice of the Court of Final Appeal to investigate the matter; to pass a motion of impeachment by a two-third majority where appropriate; to report the motion to the CPG for decision; and
- to summon, as required when exercising the above-mentioned powers and functions, persons concerned to testify or give evidence.

The Basic Law states that LegCo shall be constituted by election. The election for the fifth (and current) term of LegCo (the “**fifth-term LegCo**”) was held in September 2012. The term of office for the fifth-term LegCo is four years which began on 1 October 2012. The fifth-term LegCo includes 70 members, with 35 members returned by geographical constituencies through direct elections and 35 members returned by functional constituencies. Among the 35 functional constituency seats, 30 are traditional functional constituency seats which represent substantial and important sectors of community. The other five seats are nominated by elected District Council members and are elected on a “one person, one vote” basis by all registered voters who do not have a right to vote in traditional functional constituencies. See “— *Recent Constitutional and Political Developments*” below for a further discussion of the recent development for the method for forming LegCo in 2016.

District Administration

The Basic Law provides that district organisations, which are not organs of political power, may be established in the HKSAR. Their powers and functions and method for formation are prescribed by law. A total of 18 District Councils have been established in Hong Kong to advise the HKSAR Government on, amongst others, district affairs and to promote recreational and cultural activities and environmental improvements within the districts. At present, District Councils are comprised of elected, appointed and, in rural areas, ex-officio members.

Legal System

The legal system of Hong Kong is based on the rule of law and the independence of the judiciary. The common law, rules of equity, customary law and nearly all of the over 600 ordinances that were previously in force in Hong Kong before 1 July 1997 have been maintained by the Basic Law and continue to apply after 1 July 1997, except for any that contravenes the Basic Law. The laws in force in Hong Kong include the Basic Law, laws previously in force as maintained by the Basic Law, the national laws listed in Annex III to the Basic Law and laws enacted by LegCo.

The Judiciary

The judiciary is responsible for the administration of justice in Hong Kong. It hears all prosecutions and civil disputes. It is independent from the executive and legislative branches. Furthermore, the Basic Law states that the courts will exercise judicial power independently and free from any interference.

The Chief Justice is the head of the judiciary and is assisted in the overall administration by the Judiciary Administrator. The Court of Final Appeal is the highest appellate court in Hong Kong. The Chief Justice presides over the Court of Final Appeal. Below the Court of Final Appeal are the High Court (comprised of the Court of Appeal and the Court of First Instance), the District Court, the Magistrates' Courts and five tribunals (the Lands Tribunal, Labour Tribunal, Small Claims Tribunal, Obscene Articles Tribunal and Coroner's Court).

According to the Basic Law, the Chief Executive appoints the judges of the Hong Kong courts on the recommendation of the Judicial Officers Recommendation Commission. For the appointment of judges of the Court of Final Appeal and the Chief Judge of the High Court, the Chief Executive is required to obtain the endorsement of LegCo and report such appointment to the NPCSC for the record.

The power of interpretation of the Basic Law vested in the NPCSC, by virtue of Article 67(4) of the Constitution of the PRC and Article 158(1) of the Basic Law, is a part of the constitutional order in the HKSAR since its establishment. The Court of Final Appeal has held that an interpretation by the NPCSC is valid and binding and that the courts of Hong Kong are under a duty to follow such interpretation.

Proceedings against the HKSAR Government

The Crown Proceedings Ordinance of Hong Kong (the "CPO") sets out the manner in which civil proceedings (as defined in the CPO) may be taken in the courts of Hong Kong for the purpose of enforcing claims against the HKSAR Government.

Ordinary principles of contract law are applicable to contracts entered into by the HKSAR Government. The CPO enables civil proceedings against the HKSAR Government to be brought in the courts of the HKSAR for matters such as the recovery of a debt or liquidated sum due under a contract or statute, an unliquidated sum due under a statute and damages for breach of contract.

The CPO contains various limitations as to the rights and remedies available against the HKSAR Government in civil proceedings, including the following:

- an order for the payment of money cannot be enforced against the HKSAR Government by usual modes of enforcing a judgment. Section 21 of the CPO provides that if an order is made against the HKSAR Government, the proper officer of the courts of the HKSAR will, upon application, issue to the successful plaintiff a certificate containing particulars of the order. If the order provides for payment of money, the certificate will state the amount payable and the Director of Accounting Services shall pay the sum shown to be due, subject to appeal. No process of execution or attachment can be carried out to enforce satisfaction against the HKSAR Government of any judgment;

- in civil proceedings against the HKSAR Government, the HKSAR courts have no power to:
 - (i) grant an injunction or to make an order for specific performance but may, instead, make an order declaratory of the rights of the parties, or
 - (ii) make an order for the recovery of land or the delivery of other property but may, instead, make an order declaring that the plaintiff is entitled as against the HKSAR Government to the land or property or to the possession of the same;
- no default judgments can be entered against the HKSAR Government, except with the permission of the court;
- no third party proceedings can be commenced against the HKSAR Government, except with the permission of the court; and
- no summary judgments can be entered against the HKSAR Government.

Independent Commission Against Corruption

The Independent Commission Against Corruption (“**ICAC**”) was established by the ICAC Ordinance in 1974 to fight corruption holistically through investigation, prevention and education. Under the Basic Law, ICAC is guaranteed independence and is headed by a Commissioner who is directly responsible to the Chief Executive. ICAC comprises the office of the Commissioner and three functional departments — Operations, Corruption Prevention and Community Relations. ICAC derives its legal powers to investigate and pursue corruption crimes under three specific ordinances — the ICAC Ordinance, the Prevention of Bribery Ordinance and the Elections (Corrupt and Illegal Conduct) Ordinance.

International Organisations and Conferences

Hong Kong participates in international organisations and conferences in various capacities. As part of the Mainland delegation, representatives from the HKSAR Government participate in certain international organisations and conferences limited to sovereign states, such as the International Monetary Fund, the World Intellectual Property Organisation, the International Civil Aviation Organisation and the International Telecommunications Union. Using the name “Hong Kong, China”, Hong Kong also participates on its own as a full member in certain international organisations and conferences not limited to states, including the World Trade Organisation (“**WTO**”), the World Customs Organisation, the Asia-Pacific Economic Cooperation (“**APEC**”) and the Asian Development Bank.

Relationship with the Mainland

Defence and Foreign Affairs

The Basic Law provides that the CPG shall be responsible for the defence and foreign affairs of the HKSAR. The HKSAR Government shall be responsible for the maintenance of public order in the Region. Military forces stationed by the CPG in Hong Kong for defence shall not interfere in the local affairs of the Region. In addition to abiding by national laws of the PRC, members of the garrison shall abide by the laws of the HKSAR. Expenditure for the garrison shall be borne by the CPG.

The Office of the Commissioner of the Ministry of Foreign Affairs of the People’s Republic of China in the HKSAR was established by the CPG to deal with foreign affairs relating to Hong Kong. The CPG also authorises the HKSAR to conduct relevant external affairs on its own in accordance with the Basic Law. Since 1 July 1997, the HKSAR Government has established communication channels with the Office of the Commissioner of the Ministry of Foreign Affairs in handling the external affairs of Hong Kong in accordance with the Basic Law.

Economic Affairs

Hong Kong's relationship with the Mainland with respect to economic matters has strengthened since 1 July 1997. The Individual Visit Scheme under the Mainland and Hong Kong Closer Economic Partnership Arrangement ("CEPA") enabled Mainland residents with permanent household registration in selected cities to apply to stay in Hong Kong for not more than seven days on each visit. In 2012, this scheme directly generated HK\$26.1 billion in value added, or 1.3 per cent. of Gross Domestic Product ("GDP"), and more than 110,000 jobs, or 3.1 per cent. of total employment. The implementation of CEPA has fostered the economic integration between Hong Kong and the Mainland, bringing significant benefits to Hong Kong's economy. For more information regarding CEPA, please see "*—External Economy — Mainland and Hong Kong Closer Economic Partnership Arrangement*" below.

In recent decades, Hong Kong has benefited from its growing economic relations with the Mainland. The Mainland has long been Hong Kong's largest trading partner and Hong Kong continues to be the largest external investor in the Mainland. According to Mainland statistics, the cumulative value of Hong Kong's realised direct investment in the Mainland reached US\$666 billion at the end of 2013, accounting for approximately 48 per cent. of the total inward direct investment to the Mainland. According to Mainland statistics, Hong Kong accounted for nearly 10 per cent. of the Mainland's external trade in 2013 and 57.6 per cent. of the Mainland's outward foreign direct investment stock as at the end of 2012. Hong Kong is the key intermediary platform for the Mainland's trade with the rest of the world. Approximately 25 per cent. of the Mainland's trade volume was intermediated by Hong Kong in the form of offshore trade or re-exports in 2012.

Financial links between Hong Kong and the Mainland have strengthened substantially over the years, on the back of the surge in cross-boundary business activities. Mainland's total trade increased 20-fold in the past two decades, and Hong Kong has benefited from this growth. Visible trade between Hong Kong and the Mainland in 2013 was approximately five times of that in 1993, representing an approximate 9 per cent. per annum growth in value terms.

Recent Constitutional and Political Developments

Arrangements for the Election of the next Chief Executive and LegCo

Article 45 of the Basic Law provides for the selection of the Chief Executive and that the "ultimate aim is the selection of the Chief Executive by universal suffrage upon nomination by a broadly representative nominating committee in accordance with democratic procedures."

In December 2007, the 31st Session of the NPCSC decided that the election of the fifth term of the Chief Executive in 2017 may be implemented by the method of universal suffrage and that after the Chief Executive is selected by universal suffrage, the election of the LegCo may be implemented by the method of electing all the members by universal suffrage.

On 17 October 2013, the Chief Executive established the Task Force on Constitutional Development (the "**Task Force**") to handle public consultation on the methods for selecting the Chief Executive in 2017 and for forming LegCo in 2016. The Task Force is headed by the Chief Secretary for Administration, and the Secretary for Justice and the Secretary for Constitutional and Mainland Affairs are the two other members of the Task Force.

In May 2014, the Task Force completed a five-month public consultation on the electoral methods for the Chief Executive in 2017 and LegCo in 2016. Proposals for electoral reforms will be considered and implemented in accordance with certain procedures known as the “Five-Step Process of Constitutional Development” as follows:

- the Chief Executive to make a report to the NPCSC as to whether there is a need to amend the two electoral methods;
- a determination to be made by the NPCSC as to whether the electoral methods need to be amended;
- the resolutions on the amendments to be introduced by the HKSAR Government to LegCo and be endorsed by a two-thirds majority of all the members of LegCo;
- consent to be given by the Chief Executive to the resolution as passed by LegCo; and
- the relevant bill to be reported by the Chief Executive to the NPCSC for approval or for the record.

On 15 July 2014, the Chief Executive completed the first step of this process by submitting a report to the NPCSC regarding amendments to the electoral methods. The report stated the Chief Executive’s view that the community of Hong Kong generally hopes for implementation of universal suffrage through “one person, one vote” for the election of the Chief Executive in 2017, and that, accordingly, there is a need to amend Annex I to the Basic Law to implement universal suffrage for selecting the Chief Executive in 2017; whereas Annex II to the Basic Law concerning the method for forming the LegCo would not need to be amended at this time for the 2016 LegCo election. With respect to the second step, the NPCSC has decided on a framework for issues relating to the selection of the Chief Executive by universal suffrage. The framework allows for two to three candidates to run for Chief Executive in 2017. The candidates must first win the support of over half of a 1,200-member nominating committee, which will be similar in composition to the existing Chief Executive election committee, in order to stand for the election.

Throughout this process, the public has been actively engaged in conveying their opinions regarding the reform process and their suggestions for electoral reform. Some members of the public have expressed dissatisfaction with the framework announced by the NPCSC. The Chief Executive has urged the public to take a pragmatic approach in viewing the NPCSC’s decision, as the framework allows for the implementation of universal suffrage for the 2017 Chief Executive election.

The HKSAR Government will soon launch the second round of consultations on the arrangement for the 2017 Chief Executive election and the Chief Executive has called on the public to participate in the exercise.

THE ECONOMY

Overview

The HKSAR Government maintains one of the world's most open economies and a business-friendly environment characterised by a relatively high degree of free trade and free flow of information, an established financial regulatory regime and legal system, and developed transportation and telecommunications infrastructure. In 2013, Hong Kong was ranked the world's eighth-largest trading economy by the WTO in terms of value of total merchandise trade and was home to the world's fourth-busiest container port in terms of throughput. Hong Kong is an important hub for trade and business. Hong Kong has been ranked the world's freest economy for the past twenty years by the Heritage Foundation, based on 10 economic freedoms grouped under four categories: rule of law, government size, regulatory efficiency and market openness. Hong Kong was also ranked as one of the top global financial centres in the world by The Z/Yen Group of Companies' Global Financial Centres Index based on five broad areas of competitiveness: business environment, financial sector development, infrastructure, human capital and reputational and general factors.

Over the past two decades, Hong Kong's economy, as measured by real GDP, has more than doubled in size. Hong Kong is a mature economy, with real GDP growing at 2.6 per cent. and 1.8 per cent. year-on-year in the first and the second quarters of 2014, respectively. In 2013, Hong Kong's GDP at current market prices reached HK\$2.1 trillion and its per capita GDP of HK\$295,701 was among the highest in Asia.

As at 31 December 2013, the stock market in Hong Kong was the largest in Asia Ex-Japan as measured by market capitalisation. With strong market access and financing flexibility underpinned by deep local capital markets, Hong Kong has also developed into an international financial centre.

As at the date of this offering memorandum, the HKSAR Government has been assigned long-term local currency credit ratings of "AAA" by S&P, "Aa1" by Moody's and "AA+" by Fitch.

Key Economic Events from 2005 to 2014

During the period from 2005 to 2007, Hong Kong's economy grew robustly in line with the global economic boom at the time. The economy recorded significant growth rates, with real GDP growing by 7.4 per cent., 7.0 per cent. and 6.5 per cent. in 2005, 2006 and 2007, respectively. This strong growth trend was interrupted by the global financial crisis that emerged in 2008 (the "**2008 Global Financial Crisis**") and the global recession that unfolded during 2008 and 2009. As a result of the negative impact on Hong Kong and its major trading partners, Hong Kong suffered a significant slowdown in economic activities beginning in the second half of 2008. The economic downturn, especially the severe decline in external demand, weakened domestic private consumption and investment. Real GDP growth moderated to 2.1 per cent. in 2008 and the economy slipped into recession in 2009, with real GDP contracting by 2.5 per cent. Labour market conditions deteriorated with a steep rise in the unemployment rate to 5.3 per cent. in 2009.

As the global economy began to recover in mid-2009, Hong Kong's economy staged a broad-based recovery in 2010, with real GDP rising by 6.8 per cent. Both domestic and external demand recovered strongly in 2010, with the former underpinned by improved labour market conditions and the latter bolstered by strong economic performance on the Mainland and in other emerging market economies.

In 2011, the economic growth momentum slowed down, with real GDP growth moderating to 4.8 per cent. The slower growth reflected a slackening in the external sector amid an increasingly austere global environment, in particular the deepening European sovereign debt crisis and sluggish recovery in the United States. Nevertheless, domestic demand was resilient, underpinned by favourable labour market conditions, rising household income, solid consumer confidence and expanding investment activity. Inflationary pressure increased sharply in the first half of 2011, with the headline consumer price inflation reaching a post-1997 high of 5.3 per cent. for the year.

In 2012 and 2013, the Hong Kong economy grew at a moderate pace, with real GDP growth at 1.5 per cent. and 2.9 per cent., respectively, amid external pressures stemming from Europe's adverse sovereign debt conditions, especially in 2012, and the United States' unsteady economic performance. Domestic demand increased steadily and export performance improved gradually in 2013. Consumer price pressure receded in line with the slower economic growth and weaker imported inflation, but the labour market remained relatively strong. However, the uncertainties surrounding the normalisation of the U.S. monetary policy, slow improvement in the Eurozone economy and heightened geopolitical tensions in various parts of the world continue to pose notable risks. Real GDP grew by 2.6 per cent. year-on-year in the first quarter of 2014 and 1.8 per cent. in the second quarter. Given the current economic environment, the Hong Kong economy is expected to attain modest growth for the year as a whole. As of 15 August 2014, the HKSAR Government's GDP growth forecast for 2014 as a whole is 2-3 per cent.

Economic Policy

Under the "one country, two systems" principle, the HKSAR Government continues to adopt economic policies that create a business-friendly environment and respect the functions of a market economy. There are no import tariffs. Wine duty has been exempted since early 2008 and revenue duties are levied only on locally manufactured or imported tobacco, alcoholic liquors, methyl alcohol and some hydrocarbon oils. There is also a tax payable on first registration of motor vehicles.

Although it provides economic infrastructure both through direct services and by co-operation with public utility enterprises, the HKSAR Government's major role is to provide a suitable and stable framework for commerce and industry to function efficiently and effectively.

In February 2014, the Financial Secretary presented the 2014-15 Budget Speech, stressing the importance of enhancing the competitiveness of Hong Kong's economy, promoting the holistic development of society and creating more business and employment opportunities so that people can realise their aspirations and improve their living standards. The key areas for future development are investing in people, addressing demand for land supply, providing care for the ageing population and improving healthcare. Regarding Hong Kong's long-term fiscal planning, the Financial Secretary discussed recommendations for containing Government expenditure growth, preserving the revenue base and saving for the future.

The expanding and ageing population is expected to require increases in social welfare and health services expenditure. According to a report published by the Working Group on Long-Term Fiscal Planning (the "**Working Group**"), the total population of Hong Kong is estimated to grow to 8.5 million in 2041, an approximately 18 per cent. increase from 2013; within the same period, the age group of 65 and above is forecast to grow by 161 per cent. Meanwhile, the size of the labour force is expected to decline, which may negatively impact economic growth and government revenue. As such, in its March 2014 report, the Working Group recommended containing overall government expenditure growth within the forecast nominal GDP growth rates and to keep public expenditure at or around 20 per cent. of GDP, preserving, stabilising and broadening the revenue base to ensure meeting long-term needs and setting up a savings scheme for the future with reference to the experiences of other economies.

Gross Domestic Product

The table below shows Hong Kong's GDP and its main expenditure components for the periods indicated:

Gross Domestic Product and Its Main Expenditure Components at Current Market Prices

	For the year ended 31 December					Q1	Q2	Q3	Q4	Q1	Q2 ⁽²⁾
	2009	2010	2011	2012	2013	2013			2014		
(HK\$ billions)											
Private consumption											
expenditure	1,013.6	1,090.2	1,224.4	1,315.0	1,404.5	343.9	353.6	338.0	369.0	356.9	368.5
Government consumption											
expenditure	152.5	157.4	168.5	185.3	198.0	50.9	47.4	49.6	50.1	54.3	51.1
Gross domestic fixed capital											
formation	339.6	386.9	455.3	517.4	507.1	115.9	127.0	125.6	138.5	118.0	123.9
Changes in inventories	22.9	37.5	11.7	-3.7	-2.3	5.7	-8.1	-1.7	1.7	8.6	6.0
Export of goods ⁽¹⁾	2,500.1	3,068.4	3,420.1	3,591.8	3,816.4	871.9	929.1	1,000.3	1,015.1	870.7	949.6
Exports of services	672.8	829.0	941.2	1,003.0	1,063.2	256.4	249.3	271.5	286.1	265.4	245.2
Imports of goods ⁽¹⁾	2,703.0	3,395.1	3,848.2	4,116.4	4,394.9	1,024.1	1,100.3	1,117.4	1,153.2	1,028.7	1,111.2
Imports of services	339.3	398.1	438.6	455.4	466.6	113.9	107.1	118.4	127.3	114.2	115.6
Gross Domestic Product	1,659.2	1,776.3	1,934.4	2,037.1	2,125.4	506.7	490.8	547.7	580.1	530.9	517.4

Notes:

- Imports and exports of goods are valued on free on board (f.o.b.) basis, instead of on cost insurance freight (c.i.f.) basis, as is the on-going practice for the merchandise trade statistics.
- Provisional figures.

Source: Census and Statistics Department.

The table below shows the year-on-year rate of change of Hong Kong's real GDP and its main expenditure components for the periods indicated:

Rate of Change in Real GDP by Main Expenditure Component

	For the year ended 31 December					Q1	Q2	Q3	Q4	Q1	Q2 ⁽²⁾
	2009	2010	2011	2012	2013	2013			2014		
(year-on-year percentage change)											
Private consumption											
expenditure	0.2	6.1	8.4	4.1	4.3	6.3	4.7	2.7	3.6	1.5	1.2
Government consumption											
expenditure	2.3	3.4	2.5	3.6	2.3	1.9	3.1	2.3	2.0	2.6	2.7
Gross domestic fixed capital											
formation	-3.5	7.7	10.2	6.8	3.3	-3.0	7.6	2.7	5.3	3.5	-5.6
Exports of goods ⁽¹⁾	-12.5	17.3	3.4	1.8	6.6	8.8	6.1	6.1	5.7	0.5	2.3
Exports of services	0.4	14.7	5.5	2.2	5.5	4.7	7.7	5.0	4.7	3.3	-2.3
Imports of goods ⁽¹⁾	-9.5	18.1	4.7	3.0	7.4	9.5	7.6	6.6	6.1	1.2	1.1
Imports of services	-5.0	11.1	3.5	1.9	2.0	0.3	-0.7	2.6	5.5	-0.8	5.0
Gross Domestic Product	-2.5	6.8	4.8	1.5	2.9	2.9	3.0	3.0	2.9	2.6	1.8

Notes:

- Imports and exports of goods are valued on f.o.b. basis, instead of on c.i.f. basis.
- Provisional figures.

Source: Census and Statistics Department.

Hong Kong has exhibited a high degree of resilience in the face of external shocks. This can be seen in its relatively fast recovery from the 2008 Global Financial Crisis where real GDP rebounded in 2010 with 6.8 per cent. growth, compared to the 2.5 per cent. real GDP decrease in 2009. In 2013, Hong Kong's real GDP growth was 2.9 per cent.

Private consumption expenditure (“PCE”) grew by an average annual rate of 4.6 per cent. in real terms during 2009 to 2013, higher than the real GDP growth of 2.7 per cent. over the same period, due to the improving employment and income conditions as well as the general positive trends in local asset prices.

Government consumption expenditure (“GCE”) grew by an average annual rate of 2.8 per cent. in real terms during 2009 to 2013. The relatively steady growth in GCE partly reflected the HKSAR Government's long-standing commitment to fiscal discipline.

Overall investment spending, as represented by gross domestic fixed capital formation (“GDFCF”), increased by an average annual rate of 4.8 per cent. in real terms from 2009 to 2013. After decreasing by 3.5 per cent. in 2009 amid the 2008 Global Financial Crisis, real GDFCF rebounded by 7.7 per cent. in 2010 and then recorded further increases of 10.2 per cent., 6.8 per cent. and 3.3 per cent. in 2011, 2012 and 2013, respectively, reflecting sustained private sector investment as well as major infrastructure projects.

Inflation

The table below shows the year-on-year rate of change in the Composite Consumer Price Index (“CCPI”) and the underlying CCPI, net of the effects of the HKSAR Government's one-off relief measures (mainly comprising the HKSAR Government's payment of public housing rentals, rates concession and subsidies for household electricity charges) for the periods indicated:

Rate of Change in Composite Consumer Price Indices

	For the year ended 31 December					Q1	Q2
	2009	2010	2011	2012	2013	2014	
	(year-on-year percentage change)						
Composite Consumer Price Index . .	0.5	2.4	5.3	4.1	4.3	4.2	3.6
Underlying Composite Consumer Price Index	1.0	1.7	5.3	4.7	4.0	3.8	3.5

Source: Census and Statistics Department.

Hong Kong has experienced five consecutive years of consumer price inflation during 2009 to 2013. The CCPI rose by 0.5 per cent., 2.4 per cent., 5.3 per cent., 4.1 per cent. and 4.3 per cent. in 2009, 2010, 2011, 2012 and 2013, respectively, while the corresponding increases of the underlying CCPI after netting out one-off relief measures were 1.0 per cent., 1.7 per cent., 5.3 per cent., 4.7 per cent. and 4.0 per cent., respectively. Inflation was low in 2009 as the Hong Kong economy slipped into recession, but rose gradually in 2010 and peaked in 2011 alongside Hong Kong's economic recovery, the surge in international food and commodity prices, as well as the rising private housing rentals. Inflation moderated in 2012 and 2013 along with weaker imported inflation and slower economic growth. As a result of the abatement in rental cost pressures and the still-modest imported inflation (i.e. inflation due to an increase in the price of imports), Hong Kong consumer price inflation continued to ease in the first half of 2014.

Employment and Earnings

Unemployment Rate

The table below shows the labour force, employment and unemployment rates for the periods indicated:

Labour Force, Employment and Unemployment

	For the year ended 31 December					Q1	Q2	Q3	Q4	Q1	Q2
	2009	2010	2011	2012	2013	2013				2014	
Total labour force (in thousands)	3,660.3	3,631.3	3,703.1	3,785.2	3,858.8	3,838.0	3,863.1	3,871.5	3,865.6	3,833.9	3,872.3
Labour force participation rate (per cent.)	60.8	59.6	60.1	60.5	61.2	61.0	61.3	61.3	61.1	60.5	60.9
Number of employed persons (in thousands) . .	3,467.6	3,474.1	3,576.4	3,660.7	3,728.0	3,704.0	3,729.9	3,737.2	3,747.0	3,714.8	3,744.7
Number of unemployed persons (in thousands) . .	192.6	157.2	126.7	124.5	130.8	134.0	133.3	134.3	118.7	119.1	127.6
Unemployment rate (per cent.) ⁽¹⁾	5.3	4.3	3.4	3.3	3.4	3.5	3.3	3.4	3.2	3.1	3.2

Note:

1. Quarterly unemployment rates are seasonally adjusted.

Source: General Household Survey, Census and Statistics Department.

As the economy recovered from the 2008 Global Financial Crisis, the unemployment rate has generally declined and remained relatively low since 2011.

Employment by Sector

The table below sets forth the percentage share by sector for the periods indicated:

Employment by Economic Sector

	For the year ended 31 December				
	2009	2010	2011	2012	2013 ⁽¹⁾
	(percentage of total)				
Manufacturing	3.8	3.2	3.1	3.0	2.9
Construction	7.5	7.5	7.6	8.0	8.3
Import/export, wholesale and retail trades and accommodation and food services ⁽²⁾	32.7	33.0	32.3	31.9	31.5
Transportation, storage, postal and courier services, and information and communications	11.9	11.7	11.6	11.5	11.5
Financing and, insurance, real estate, and professional and business services	18.4	18.9	19.2	19.4	19.5
Public administration, and social and personal services	25.1	25.1	25.6	25.6	25.8
Other sectors	0.6	0.5	0.5	0.5	0.5
All sectors ⁽³⁾	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Notes:

1. Provisional figures.
2. Accommodation services sector covers hotels, guesthouses, boarding houses and other establishments providing short term accommodation.
3. The total for all sectors may not equal the sum of each sector due to rounding.

Source: *Composite Employment Estimates, Census and Statistics Department.*

Hong Kong's services sector is among the most developed in Asia. Of those employed in 2013, 88.3 per cent. were engaged in the services sectors, including 31.5 per cent. in import/export, wholesale and retail trades, and accommodation and food services; 25.8 per cent. in public administration, and social and personal services; 19.5 per cent. in financing and insurance, real estate, and professional and business services; and 11.5 per cent. in transportation, storage, postal and courier services and information and communications. Only 2.9 per cent. worked in the manufacturing sector and 8.3 per cent. in the construction sector.

Earnings

The table below shows the movement of earnings in real terms as measured by the real indices of payroll per person engaged by economic sector for the periods indicated:

Rate of Change in Earnings in Real Terms by Economic Sector⁽¹⁾⁽²⁾

	For the year ended 31 December				
	2009	2010	2011	2012	2013
	(year-on-year percentage change)				
Manufacturing	-4.1	0.1	2.1	3.9	-0.8
Import/export and wholesale trades	-2.5	-0.3	7.2	0.4	-1.0
Retail trade	-2.1	1.5	6.3	5.7	2.3
Transportation, storage, postal and courier services	-1.3	1.6	-1.2	-2.7	1.0
Accommodation and food service activities	-1.6	1.0	4.1	2.0	2.3
Information and communications	-0.4	0.1	2.2	4.0	1.0
Financial and insurance activities	-4.2	4.1	7.0	0.5	0.4
Real estate activities	-2.6	-0.4	5.2	3.6	1.4
Professional and business services	0.1	*	-3.1	0.7	2.6
Social and personal services	1.2	-4.6	-2.1	3.6	-0.8
All sectors ⁽³⁾	*	-0.2	2.4	2.3	1.1

Notes:

1. Earnings include all regular and guaranteed payments such as basic pay and stipulated bonuses and allowances, overtime pay and other non-guaranteed or irregular bonuses and allowances.
 2. The real indices of payroll per person engaged are derived by deflating the nominal indices of payroll per person engaged by the 2009/10-based Composite CPI.
 3. Excludes the construction sector.
- “*” refers to percentage change within +/- 0.05 per cent.

Source: Labour Earnings Survey, Census and Statistics Department.

Earnings increased by 2.4 per cent. in real terms between 2010 and 2011, partly attributed to the implementation of a statutory minimum wage of HK\$28 per hour on 1 May 2011. The statutory minimum wage rate increased to HK\$30 per hour on 1 May 2013.

Employment Benefits

The Employment Ordinance of Hong Kong provides for various employment-related benefits and entitlements for employees. These include, among other things, provisions regarding wage protection, rest days, paid holidays, paid annual leave, sickness allowance, maternity protection, severance payment, long service payment, employment protection, termination of employment contract and protection against anti-union discrimination.

Mandatory Provident Fund (“MPF”)

The MPF system is a fully funded and privately managed contribution system. Since December 2000, the Mandatory Provident Fund Schemes Ordinance has required all employers to enrol their relevant employees, and self-employed persons to enrol themselves in MPF schemes, which are regulated by the Mandatory Provident Fund Schemes Authority. Employees and employers are required to contribute five per cent of the employee’s income as mandatory contributions, subject to a maximum of HK\$30,000 per month or HK\$1,000 per day. Employees with income less than HK\$7,100 per month or HK\$280 per day are not required to contribute. As at 31 May 2014, approximately 99.3 per cent. of employers, 100.0 per cent. of employees and 61.3 per cent. of self-employed persons have enrolled in MPF schemes.

Trade Unions

Trade unions must be registered under the Trade Unions Ordinance of Hong Kong (“TUO”), which is administered by the Registry of Trade Unions. Once registered, a trade union becomes a body corporate and enjoys immunity from certain civil suits. As at 31 December 2013, 858 unions (comprising 809 employee unions, 18 employers’ associations and 31 mixed organisations of employees and employers) and eight trade union federations were registered under the TUO. There have only been a few work stoppages in Hong Kong each year in recent years, and the HKSAR Government is not engaged in any material dispute with any trade union. The HKSAR Government has not entered into any collective bargaining agreement with any civil service staff association or union.

Small and Medium Sized Enterprises

Small and medium sized enterprises (“SMEs”) are an important pillar of Hong Kong’s economy and employment market. As at March 2014, approximately 316,000 business units in Hong Kong were SMEs. They accounted for over 98 per cent. of the total business units and provided jobs to nearly 1.3 million persons, or approximately 47 per cent. of private sector employment. Most of the SMEs were in the import/export trade and wholesale industries, followed by the retail industry. SMEs in these industries accounted for over 50 per cent. of the SMEs in Hong Kong and represented approximately half of the employment among SMEs in 2013.

Gross Domestic Product

Overview

The following table shows the percentage contribution to GDP by economic sector at basic prices for the periods indicated:

GDP by Economic Sector⁽¹⁾⁽²⁾

	For the year ended 31 December			
	2009	2010	2011	2012
	(percentage of total GDP)			
Agriculture, fishing, mining and quarrying	0.1	0.1	*	0.1
Manufacturing	1.8	1.8	1.6	1.5
Electricity, gas and water supply, and waste management	2.2	2.0	1.8	1.8
Construction	3.2	3.3	3.4	3.6
Services	92.7	93.0	93.1	93.0
Import/export, wholesale and retail trades	23.4	23.8	25.9	25.4
Accommodation and food services ⁽³⁾	3.1	3.2	3.5	3.6
Transportation, storage, postal and courier services	6.3	7.9	6.3	6.0
Information and communications	3.0	3.2	3.3	3.5
Financing and insurance	16.2	16.3	16.1	15.9
Real estate, professional and business services	11.0	10.8	11.3	11.5
Public administration, social and personal services	18.2	17.0	16.5	16.8
Ownership of premises	11.5	10.6	10.3	10.3
Gross Domestic Product at basic prices	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>

Notes:

1. Figures for 2013 were not available as at the date of this offering memorandum.
2. “*” refers to a percentage contribution of less than 0.05 per cent.
3. Accommodation services cover hotels, guesthouses, boarding houses and other establishments providing short term accommodation.

Source: Census and Statistics Department.

The following table shows the percentage change in real GDP by economic sector for the years indicated:

Rate of Change in Real GDP by Economic Sector

	For the year ended 31 December				
	2009	2010	2011	2012	2013
	(percentage change)				
Agriculture, fishing, mining and quarrying . .	-4.6	3.9	0.8	-3.2	1.3
Manufacturing	-8.2	3.3	0.7	-0.8	0.1
Electricity, gas and water supply, and waste management	1.5	-0.2	0.6	1.4	-0.7
Construction	-7.5	15.6	18.3	8.3	1.1
Services	-1.7	6.9	5.2	1.8	2.9
Import/export, wholesale and retail trades .	-9.5	16.7	9.1	1.9	3.6
Accommodation and food services ⁽¹⁾	-11.3	9.5	8.3	1.8	3.7
Transportation, storage, postal and courier services	-5.5	6.0	7.2	0.9	2.5
Information and communications	1.3	1.5	2.8	2.8	4.2
Financing and insurance	4.1	6.3	6.5	0.8	5.6
Real estate, professional and business services	1.6	2.5	2.6	3.1	0.1
Public administration, social and personal services	3.0	2.2	1.8	2.1	2.6
Ownership of premises	0.3	0.8	0.7	1.1	0.4

Note:

1. Accommodation services cover hotels, guesthouses, boarding house and other establishments providing short term accommodation.

Source: Census and Statistics Department.

Primary production (including agriculture, fisheries, mining and quarrying) is insignificant in Hong Kong in terms of both value-added contribution to GDP and share in total employment, as Hong Kong is a predominantly city economy.

Secondary production (comprising manufacturing, construction and supply of electricity, gas and water), which had a significant direct value-added contribution to the economy in the early 1980s, has since diminished in relative importance. In particular, the contribution from manufacturing has decreased from 12.7 per cent. in 1992 to 3.7 per cent. in 2002, and further to 1.5 per cent. in 2012.

The Hong Kong economy has become increasingly service-oriented since the 1980s. Hong Kong has leveraged its geographical proximity and cultural ties with the Mainland as well as its strong market institutions to re-orientate itself towards service activities. As a result, the share of GDP of the tertiary sector, or the services sector (comprising import/export, wholesale and retail trades; accommodation and food services; transportation, storage, postal and courier services; information and communications; financing and insurance; real estate, professional and business services; public administration, social and personal services; and ownership of premises), rose progressively over the years. Development on the employment front was similar, with the tertiary sector's share of employment increasing noticeably while that in the secondary production sector continued to shrink over the past two decades.

Between 2008 and 2013, the services sector grew by a cumulative 16 per cent. in real terms, outpacing the corresponding 14 per cent. growth of the overall economy. Among the constituent services sectors, wholesale and retail trades showed the fastest cumulative growth of almost 70 per cent. This, coupled with the 11 per cent. growth in accommodation and food services, reflected the solid domestic demand and vibrant inbound tourism. Notwithstanding the 2008 Global Financial Crisis and euro debt crisis during this period, financing and insurance recorded solid growth of approximately 26 per cent. Import and export trade saw a 13 per cent. increase over the period, while transport and storage services grew steadily by 10 per cent.

The tertiary sector is the largest contributor to GDP with its contribution increasing from 79.9 per cent. in 1992 to 88.9 per cent. in 2002, and further to 93.0 per cent. in 2012. In 2012, import/export, wholesale and retail trades continued to render the largest contribution to GDP, with a share of 25.4 per cent. This was followed by public administration, social and personal services (16.8 per cent.), financing and insurance (15.9 per cent.) and real estate, professional and business services (11.5 per cent.).

Principal Economic Areas

Hong Kong's economy comprises a diverse range of fields. Major economic areas include trade, business and financial services, real estate, tourism, transport and logistics, construction and telecommunications.

Trade

Many factors contribute to Hong Kong's international status as a major trade centre in Asia. These include an economic policy of free enterprise and free trade and a sophisticated commercial infrastructure. The cornerstone of Hong Kong's external trade policy is the rule-based multilateral trading system under the WTO. Given the externally-oriented and open nature of Hong Kong's economy, trade contributes significantly to Hong Kong's economic growth. See “ — *External Economy — Foreign Trade*” below for more information.

Business and Financial Services

To build on Hong Kong's strength as a global financial centre, the HKSAR Government has been working to enhance the quality of the local financial markets and increase their depth and breadth, to keep abreast of local and international developments and to further optimise Hong Kong's regulatory framework. The financial services industry also provides a catalyst for the growth of related sectors such as professional and commercial services. High quality financial services underpin Hong Kong's position as an international business hub, helping local enterprises to seize business opportunities and attracting Mainland and overseas companies to use Hong Kong as a platform for raising funds and developing regional business.

Banking

Hong Kong's banking sector has maintained healthy capital adequacy ratios, and experienced a decreasing level of classified loans and a generally adequate level of liquidity. The consolidated capital adequacy ratio of locally incorporated authorized institutions (“AIs”) was maintained at 15.9 per cent. at the end of the first quarter of 2014, well above the minimum international standard of 8 per cent. The retail banks' classified loan ratio decreased to 0.46 per cent. at the end of the first quarter of 2014 from 0.48 per cent. at the end of the previous quarter. For a more detailed discussion regarding the banking system, the performance of the banking sector and its supervision, see “ — *The Financial and Monetary System — Banking System.*”

Money Markets

The Hong Kong money market consists primarily of the interbank market. The money market is mostly utilised by institutions at the wholesale level. The Hong Kong Interbank Offered Rate (“**HIBOR**”) is determined by the supply of and demand for funds between market players and, therefore, is one of the most important indicators of the pricing of short-term funds in Hong Kong. The daily Hong Kong dollar interbank transactions averaged HK\$204.5 billion in June 2014.

Dealings in Hong Kong dollars are underpinned by a currency link of HK\$7.80 to US\$1.00, which was introduced in 1983 and has remained the cornerstone of HKSAR’s monetary policy. For a discussion of the currency link and Hong Kong’s monetary system, see “— *The Financial and Monetary System — Monetary System.*”

Securities and Futures Markets

The Stock Exchange of Hong Kong Limited (the “**SEHK**”) and Hong Kong Futures Exchange Limited (the “**Hong Kong Futures Exchange**”) operate the securities market and the futures market in Hong Kong, respectively. The total market capitalisation of the securities market, including the Main Board of the SEHK (the “**Main Board**”) and the Growth Enterprise Market (“**GEM**”) of the SEHK, as at 31 December 2013 was HK\$24,042.8 billion, 10 per cent. higher compared to 31 December 2012.

As at 31 December 2013, there were a total of 1,643 companies listed on the Main Board and GEM. Of these, 797 were Mainland enterprises, constituting 57 per cent. by market capitalisation and 72 per cent. by annual equity turnover value. In 2013, there were 110 newly listed companies on the Main Board and GEM, of those 78 were Mainland enterprises. For a discussion of the performance of the securities and futures market and its regulation and supervision, see “— *The Financial and Monetary System — Securities and Futures Markets.*”

Funds

The Hong Kong funds industry is characterised by a significant presence of global fund managers.

According to the Fund Management Activities Survey 2013 conducted by the Securities and Futures Commission (“**SFC**”) on the asset management activities among licensed corporations, registered institutions and insurance companies, the combined fund management business amounted to HK\$16,007 billion as at the end of 2013, over 70 per cent. of which came from non-Hong Kong investors. Of the total combined fund management business, HK\$11,417 billion resulted from asset management business, HK\$2,752 billion from other private banking business of registered institutions and HK\$1,661 billion from fund advisory business of licensed corporations.

As at 31 December 2013, there were 995 companies licensed or registered to carry out asset management business in Hong Kong and 1,908 unit trusts and mutual funds authorised by the SFC.

Insurance

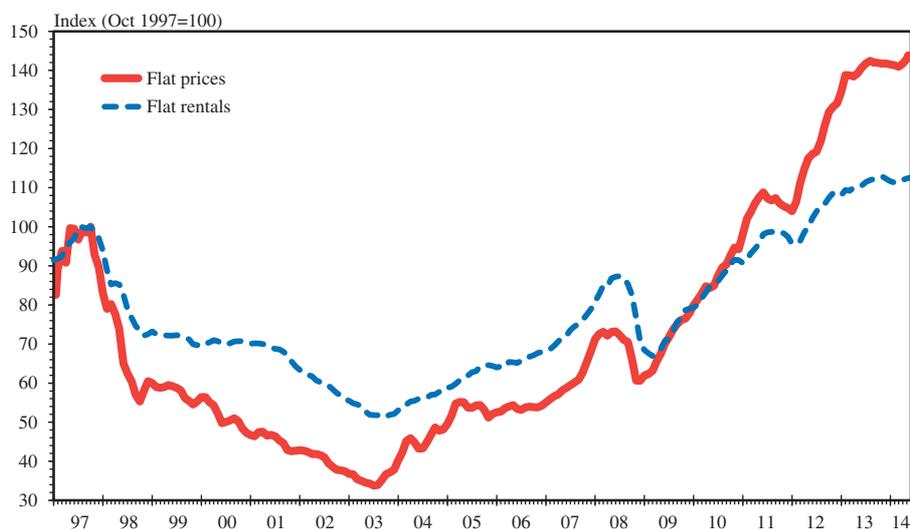
As at 30 June 2014, there were 158 authorised insurers in Hong Kong, of which 94 were pure general insurers, 44 were pure long-term insurers and the remaining 20 were composite insurers. As at the same date, there were 2,463 insurance agencies, 41,878 individual agents and 27,188 responsible officers/technical representatives registered with the Insurance Agents Registration Board. According to the provisional statistics for 2013, total gross premiums of the Hong Kong insurance industry increased by 13.9 per cent. to \$290.7 billion.

Real Estate

The real estate sector plays an important role in Hong Kong's economy, as developments in the property market affect other sectors. Fluctuations of property prices in Hong Kong also affect the wealth of the community and, consequently, consumer and investor behaviour.

The chart below shows the flat price and rental indices for the periods indicated:

Residential property prices and rentals



Source: Rating and Valuation Department.

The 2008 Global Financial Crisis resulted in lay-offs, shop closures and rising unemployment rates in 2009. The uncertainties in the economic outlook led banks to adopt a more cautious approach to lending. These global factors resulted in noticeable drops in property values and rental prices in real estate beginning in the second half of 2008. The HKSAR Government put forward relief measures to support economic growth. With the inflow of capital and low interest rates stimulating market demand, prices increased across all property sectors and returned to the pre-crisis levels by the end of 2009/early 2010. Further supported by a tight demand-supply balance, property prices on the whole continued to record significant increases in the past few years.

The property market cooled off visibly after the HKSAR Government introduced further demand-side management measures in late February 2013, and was further subdued by the U.S. Federal Reserve's signal in the mid-year to reduce asset purchases and the uncertainties surrounding the global economic outlook. Macroprudential measures were also introduced by the HKMA to prevent excessive expansion in mortgage lending and to reduce the leverage of borrowers and ensure better repayment ability, thereby enhancing the resilience of the banking sector to possible declines in property prices. The last round of tightening measures was implemented in February 2013. As a result of these measures, the average loan-to-value ratio of new mortgages in 2013 was approximately 55 per cent., lower than the average of approximately 64 per cent. for the period of January to October 2009 before the first round of tightening measures for residential property mortgage lending was introduced. On the other hand, the low interest rate environment and improvement in Hong Kong's overall economic performance provided support to property prices. In 2013, trading activity fell significantly and the upward movement of residential real estate prices decelerated noticeably. To forestall the build-up of risks in the property market, the HKSAR Government, in addition to continuing its demand-side management

and macroprudential measures, resumed regular land sale and exerted efforts to increase flat and land supply in the short, medium and long terms. Under the sustained effects of the latest package of demand-side management measures, contraction in transaction volume and moderation in price increase were seen in the non-residential property sector.

Land Supply Policy

All land in Hong Kong is state property. The HKSAR Government is responsible for its management, use and development, and for its leasing or granting for use or development. Under Article 7 of the Basic Law, the revenue derived therefrom is exclusively at the disposal of the HKSAR Government.

Government land planned for private development is usually sold by public auction or tender. Land may also be disposed of by private treaty grant in certain circumstances in accordance with government policies.

To meet the housing demands and various needs of the Hong Kong community, the HKSAR Government has adopted a multi-pronged strategy to increase land supply in the short, medium and long term, through the continued and systematic implementation of a series of measures, including the optimal use of developed land as far as practicable and identification of new land for development. Short- and medium-term measures include land use reviews for rezoning suitable sites, increasing development intensity as appropriate and urban renewal. Long-term land supply initiatives include new development areas, new town extensions, reviews of brownfield sites and deserted agricultural land in the New Territories, planning for the development of the New Territories North and Lantau, exploring reclamations outside Victoria Harbour and development of caverns and underground space.

Tourism

Tourism is one of the main economic sectors for Hong Kong. Expenditures of inbound visitors to Hong Kong recorded significant growth in the past decade. Total tourism expenditure associated with inbound tourism reached a record high of HK\$332.0 billion in 2013. This represented a cumulative surge of 373 per cent. over 2003, or an average annual growth rate of 16.8 per cent. during the period. Apart from a sustained influx of inbound visitors, the surge in total tourism expenditure was also driven by rising per capita spending of visitors.

Per capita spending by same-day inbound visitors grew by a 11.4 per cent. per annum in the past decade to HK\$2,378 in 2013. Among them, per capita spending of Mainland visitors, was HK\$2,721, well above the HK\$741 per capita spending by non-Mainland visitors. In the first quarter of 2014, per capita spending by same-day inbound visitors increased by 21.4 per cent. to HK\$2,637 over the same period of 2013. Among them, per capita spending of Mainland visitors increased by 18.9 per cent. to HK\$2,979.

By comparison, per capita spending of overnight visitors grew at a more moderate pace of 4.9 per cent. per annum over the last decade, with per capita spending reaching HK\$8,123 in 2013. In 2013, the per capita spending of Mainland overnight visitors was HK\$8,937, which is approximately 37 per cent. above that of the non-Mainland overnight visitors. In the first quarter of 2014, per capita spending of overnight visitors declined by 3.0 per cent. over the same period of 2013 to HK\$7,804. Among them, per capita spending of Mainland overnight visitors declined by 3.7 per cent. to HK\$8,444. The decline was mainly due to the decrease in overall spending by Mainland visitors, particularly on high-value goods, as well as shortened average length of stay.

In 2013, Mainland arrivals amounted to 40.7 million, accounting for 75.0 per cent. of total arrivals. Of all Mainland arrivals, 27.5 million, or 67.4 per cent., were visitors under the Individual Visit Scheme, up by 18.7 per cent. compared to 2012. The number of non-Mainland visitors, at approximately 13.6 million, has remained relatively stable over the past few years. In the first half of 2014, the Mainland continued to be the largest visitor source market with 21.8 million arrivals, accounting for 76 per cent. of total arrivals.

The table below sets out selected statistics relating to the tourism sector for the periods indicated:

Key Tourism Indicators

	For the year ended 31 December					For the six months ended 30 June
	2009	2010	2011	2012	2013	2014
	Total visitor arrivals (in thousands) .	29,591	36,030	41,921	48,615	54,299
The Mainland	17,957	22,684	28,100	34,911	40,745	21,823
North Asia	1,823	2,208	2,305	2,333	2,141	1,139
Southeast and South Asia	2,885	3,501	3,751	3,652	3,718	1,820
Europe, Africa and the Middle East	1,969	2,174	2,194	2,228	2,254	1,109
The Americas	1,568	1,750	1,821	1,778	1,666	833
Other	3,389	3,714	3,750	3,713	3,776	1,805
Average length of stay of overnight visitors (nights)	3.2	3.6	3.6	3.5	3.4	3.3
Hotel occupancy rate (per cent.)	78	87	89	89	89	89
Total tourism expenditure associated with inbound tourism (HK\$ billion)	158.3	212.2	258.7	289.4	332.0	— ⁽¹⁾

Note:

1. Figure not available as of the date of this offering memorandum.

Source: Hong Kong Tourism Board.

Transport and Logistics

Transport and logistics is an important sector of the economy and Hong Kong is home to a leading container port and a large international airport. A network of container line services with approximately 380 weekly sailings connects the port of Hong Kong with approximately 550 destinations worldwide. There are over 100 airlines operating approximately 1,010 passenger and cargo flights every day.

Container Port

Hong Kong is one of the few major international ports in the world where port facilities are wholly privately-owned and operated. The Hong Kong Port Development Council, a non-statutory advisory board comprising members appointed by the Chief Executive, advises on development strategy and promotes the container port.

Hong Kong has been a container port for more than four decades. In 2013, Hong Kong was one of the world's busiest container ports, handling 22.4 million twenty-foot equivalent units during the year. The port is a vital aspect of the economic infrastructure, handling 90 per cent. of Hong Kong's total cargo throughput. In 2013, 187,500 ships, comprising both ocean-going vessels and river trade vessels for cargo and passenger traffic, visited the port of Hong Kong.

Container terminals are situated in the Kwai Chung-Tsing Yi basin. There are nine terminals operated by five different operators, namely Modern Terminals Ltd, Hongkong International Terminals Ltd, COSCO-HIT Terminals (Hong Kong) Limited, CSX World Terminals Hong Kong Ltd and Asia Container Terminals Ltd. They occupy 279 hectares of land, providing 24 berths and 7,694 metres of deep water frontage.

The Hong Kong International Airport

The Hong Kong International Airport (the “**HKIA**”) is operated and maintained by the Airport Authority Hong Kong (the “**AA**”), a statutory corporation established in December 1995 under the Airport Authority Ordinance. The AA is required to conduct business in accordance with prudent commercial principles. The AA is wholly-owned by the HKSAR Government.

The table below shows the passenger and freight throughput at the Hong Kong International Airport for the periods indicated:

Key Indicators of Hong Kong International Airport

	For the year ended 31 December				
	2009	2010	2011	2012	2013
Passenger throughput ⁽¹⁾ (million persons) . . .	45.0	49.8	52.8	55.7	59.3
Freight throughput (million tons)	3.3	4.1	3.9	4.0	4.1

Note:

1. Arrival and departure passengers include transfer but exclude transit

Source: Civil Aviation Department.

Rail Network

Railways play a vital role in serving the transport needs of Hong Kong. They account for approximately 40 per cent. of domestic public transport and approximately 56 per cent. of the land-based cross-boundary passenger trips by the end of June 2014. As high speed off-road mass carriers, railways provide fast, reliable and comfortable services, reduce the pressure on the road network, and avoid many of the environmental problems associated with road traffic.

The existing railway network in Hong Kong has a total rail length of over 200 kilometres. In June 2007, LegCo passed the Rail Merger Ordinance, which provides the legal framework for the merger between the MTR Corporation Limited (“**MTRCL**”) and the Kowloon-Canton Railway Corporation. Following the merger, the post-merger corporation, the MTRCL, operates both the Mass Transit Railway (“**MTR**”) system and Kowloon-Canton Railway (“**KCR**”) system. The MTRCL was granted a 50-year franchise to operate the MTR and KCR systems with effect from 2 December 2007.

Aside from the railway network operated by the MTRCL, other fixed track systems in Hong Kong include the Tramway and the Peak Tram. The latter has been essentially a tourist and recreational facility since the 1980s.

Cross-boundary links

The Hong Kong-Zhuhai-Macao Bridge (“**HZMB**”) is under construction and, upon completion, will connect the three main cities situated in the Pearl River Delta. It consists of a main bridge beginning in Mainland waters together with boundary crossing facilities and link roads within the three cities. The function of the bridge is to meet the demand for passenger and freight land transport between Hong Kong, the Mainland (particularly the region of Pearl River West) and Macao, to establish a new land transport link between the east and west banks of the Pearl River and to enhance the economic and sustainable development of the three cities. Construction of the main bridge commenced in December 2009. The HZMB Main Bridge is a project taken forward jointly by the Mainland, Hong Kong and Macao governments. Apart from the governments’ capital cost (RMB15.73 billion in total), the three governments have in-principle agreed that the remaining project cost for the HZMB Main

Bridge will be financed by bank loans. The three governments finalised the details of the loan arrangements in January 2011. To connect with the HZMB Main Bridge, boundary crossing facilities and link roads have to be set up within the respective territories of the three governments. Such construction projects are being financed and carried out by the respective three governments.

The Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link (“XRL”) is under construction and, upon completion, will be approximately 26 kilometres long, connecting Hong Kong with Guangzhou and Shenzhen in the Mainland. The XRL will run from the terminus in West Kowloon, and connect with the Mainland section at Shenzhen. It aims to reduce traveling time and foster greater social, cultural and economic integration between Hong Kong and the Mainland. This project was first proposed in 2000 and was authorised in 2009. Construction of the Hong Kong section commenced in January 2010.

Kai Tak Cruise Terminal

The Kai Tak Cruise Terminal is built on the former runway of the Kai Tak Airport. It is built by the HKSAR Government with a capital investment of HK\$8.2 billion, aiming to promote the development of cruise tourism in Hong Kong. The terminal building is designed to enable efficient circulation of passengers and offer space as a venue for non-cruise events during off-peak seasons. Construction of the Kai Tak Cruise Terminal commenced in May 2010. The first berth of the terminal went into operation in June 2013, which can accommodate the existing largest cruise vessels in the world. The second berth is expected to be commissioned in 2014 to accommodate additional cruise vessels.

Construction

The construction sector has generally performed well due to the strong growth of the real estate sector. The overall gross value of construction work performed by main contractors, in real terms, has been rising since 2009. In the first quarter of 2014, the gross value of construction work performed by main contractors amounted to HK\$34.6 billion, a 5.2 per cent. year-on-year increase.

The rise in public expenditure on infrastructure in recent years has mainly been driven by the ten mega infrastructure projects and transport infrastructure projects which were announced in 2007. These include the Guangzhou-Shenzhen-Hong Kong Express Rail Link, HZMB, the Kai Tak Development, and developments in the North East New Territories and Hung Shui Kiu.

Public Sector Land Development

Housing.

The main elements of the public housing programme are public rental housing (“PRH”) and subsidised sale flats.

The HKSAR Government’s housing policy objectives are to:

- assist grassroots families to secure public housing to meet their basic housing needs;
- assist the public to choose accommodation according to their affordability and personal circumstances, and encourage those who can afford it to buy their own homes;
- provide subsidised home ownership flats on top of PRH so as to build a progressive housing ladder; and
- maintain the healthy and steady development of the private property market, with priority to be given to meet Hong Kong permanent residents’ needs.

The main agency involved in the implementation of the public housing programme is the Hong Kong Housing Authority (“HA”). The HA is a statutory body established in 1973 under the Housing Authority Ordinance of Hong Kong. The Housing Authority is responsible for, among other things, planning, building managing and maintaining different types of public housing, including rental housing estates, interim housing estates and transit centres. Besides housing, the HA also owns and operates some flatted factories, ancillary commercial facilities and other non-domestic-use facilities.

Public housing is built on land provided by the HKSAR Government normally at either no land cost or a percentage of the development cost as land cost to the HKSAR Government. As at 31 March 2014, there were a total of 2.42 million households in Hong Kong, among which approximately 725,600 households lived in PRH of the HA. Furthermore, approximately 376,300 households lived in subsidised sale flats, most of which are Home Ownership Scheme flats provided by the HA. In total, almost half of the households in Hong Kong are living in housing units with government subsidies. The vast majority of those households live in housing units provided by the HA.

Urban Renewal

Hong Kong’s building stock is ageing rapidly. There are at present approximately 5,400 buildings aged 50 years or above in Hong Kong. The number is projected to increase by over 500 a year over the next decade.

The Urban Renewal Authority (“URA”) was established in May 2001 under the Urban Renewal Authority Ordinance of Hong Kong as the statutory body to undertake, encourage, promote and facilitate the regeneration of the older urban areas of Hong Kong. The URA implements an urban renewal programme as set out in its annual business plan and five-year corporate plan approved by the Financial Secretary. When preparing its corporate plan, the URA must follow the guidelines of the Urban Renewal Strategy (“URS”) published by the HKSAR Government from time to time. To provide the URA with the financial resources to take forward the urban renewal programme, which aims to be self-financing in the long run, the HKSAR Government injected HK\$10 billion into the URA by tranches from 2002-03 to 2006-07. The HKSAR Government also supports the URA financially through a waiver of land premiums for redevelopment sites.

To better meet the changing public aspirations for urban renewal, the HKSAR Government promulgated a new URS on 24 February 2011 based on a broad consensus reached during an extensive two-year public consultation exercise conducted by the Development Bureau to replace the 2001 URS.

One of the new initiatives under the 2011 URS is the establishment of the Urban Renewal Trust Fund. With an endowment of HK\$500 million from the URA, the Urban Renewal Trust Fund was established in August 2011 to: (i) provide an independent funding source to support the operation of social service teams to provide assistance for residents affected by urban redevelopment projects implemented by the URA, (ii) to support social impact assessments and other related planning studies to be proposed by the District Urban Renewal Forum and (iii) to support heritage preservation and district revitalisation projects to be proposed by non-governmental organisations and other stakeholders in the overall context of urban renewal. The Urban Renewal Trust Fund is managed by an independent board and its members are nominated by the Secretary for Development.

Telecommunications

The Communications Authority (“CA”) regulates the telecommunications and broadcasting industries in Hong Kong in accordance with the Broadcasting Ordinance, the Telecommunications Ordinance, the Unsolicited Electronic Messages Ordinance, the Communications Authority Ordinance and the Broadcasting (Miscellaneous Provisions) Ordinance. The Office of the Communications Authority (“OFCA”), as the CA’s executive arm and secretariat, assists the CA in administering and enforcing the relevant ordinances governing the broadcasting and telecommunications sectors. Since 2003, the HKSAR Government has opened to competition all sectors of the telecommunications market — local and external, services-based and facilities-based.

In 2012, the gross output of the telecommunications sector amounted to approximately HK\$69 billion and employed approximately 18,000 persons. All sectors of Hong Kong’s telecommunications market have been liberalised with no foreign ownership restrictions. The HKSAR Government’s objectives are to provide a level playing field in the telecommunications market and ensure that consumers get the best services available in terms of capacity, quality and price.

The local fixed carrier services market is fully liberalised. There is no pre-set limit on the number of licences issued, nor deadline for applications. Furthermore, there is no specific requirement on network rollout or investment. The level of investment will be determined by the market. As at July 2014, there were 21 licensees permitted to provide local fixed carrier services on a competitive basis.

Fixed broadband Internet access services are very popular in Hong Kong. With the increased competition and coverage of broadband service using asymmetric digital subscriber line, fibre-to-the-building/fibre-to-the-home, hybrid fibre coaxial cable and other technologies, broadband networks cover virtually all commercial buildings and households. As at June 2014, there were 205 Internet service providers licensed to provide broadband services. As at April 2014, there were approximately 2.24 million registered customers using fixed broadband services with speeds up to 1000 Megabits per second. As at April 2014, in the residential market, 83.1 per cent. of households are using fixed broadband service. Internationally, Hong Kong’s fixed broadband penetration rate and average broadband speed are among the highest in the world.

EXTERNAL ECONOMY

Balance of Payments and International Investment Position

The following table sets out Hong Kong's balance of payments for the periods indicated:

Balance of Payments

	For the year ended 31 December					Q1
	2009	2010	2011	2012	2013	2014
(HK\$ billions, except percentages)						
Current Account Balance⁽¹⁾	164.0	124.4	107.5	32.2	39.5	-4.4
Balance on goods	103.0	25.6	-58.2	-146.7	-203.3	-74.6
Balance on services	27.6	78.8	132.7	169.8	221.4	67.7
Primary income	49.8	37.6	52.8	29.5	42.2	7.3
Secondary income	-16.4	-17.6	-19.8	-20.3	-20.7	-4.9
Capital and Financial Account Balance⁽¹⁾	-144.5	-88.8	-113.2	-67.7	-40.5	29.9
Capital account	-3.0	-4.4	-2.0	-1.4	-1.6	-0.1
Financial account	-141.5	-84.4	-111.2	-66.2	-38.9	30.0
Financial non-reserve assets ⁽²⁾ . .	471.0	-25.3	-24.4	122.7	19.0	62.2
Direct investment	-28.4	-122.0	1.9	-102.6	-115.5	-82.3
Portfolio investment	-310.1	-442.5	-11.0	-31.6	-333.6	-11.5
Financial derivatives	24.6	18.7	20.9	15.2	8.1	18.1
Other investment	784.9	520.6	-36.2	241.7	460.1	137.9
Reserve assets ⁽²⁾	-612.5	-59.1	-86.8	-188.9	-57.9	-32.2
Net Errors and Omissions⁽³⁾	-19.5	-35.5	5.7	35.5	0.9	-25.5
Overall Balance of Payments	<u>612.5</u>	<u>59.1</u>	<u>86.8</u>	<u>188.9</u>	<u>57.9</u>	<u>32.2</u>
Overall Balance of Payments as percentage of GDP	36.9	3.3	4.5	9.3	2.7	6.1

Notes:

1. In accordance with the accounting rules adopted in compiling balance of payments, a positive value for the balance figure in the current account represents a surplus whereas a negative value represents a deficit. In the capital and financial account, a positive value indicates a net financial inflow while a negative value indicates a net outflow. As increases in external assets are debit entries and decreases are credit entries, a negative value for the reserve assets represents a net increase while a positive value represents a net decrease.
2. The estimates of reserve and non-reserve assets under the balance of payments framework are transaction figures. Effects of valuation changes (including price changes and exchange rate changes) and reclassifications are not taken into account.
3. In principle, the net sum of credit entries and debit entries is zero. In practice, discrepancies between the credit and debit entries may occur for various reasons as the relevant data are collected from many sources. Equality between the sum of credit entries and that of debit entries is brought about by the inclusion of a balancing item which reflects net errors and omissions.

Source: Census and Statistics Department. The balance of payments statistics of Hong Kong are compiled in accordance with the international standards as stipulated in the Sixth Edition of the Balance of Payments and International Investment Position Manual released by the International Monetary Fund (IMF) in 2009.

Hong Kong recorded an overall balance of payments surplus in each of the five years from 2009 to 2013. In 2013, there was a balance of payments surplus of HK\$57.9 billion, or 2.7 per cent. of GDP, compared to a surplus of HK\$188.9 billion, or 9.3 per cent. of GDP, in 2012, due mainly to a larger net outflow of portfolio investment.

Hong Kong recorded a balance of payments surplus of HK\$32.2 billion, or 6.1 per cent. of GDP, in the first quarter of 2014, compared with a surplus of HK\$44.8 billion, or 7.7 per cent. of GDP, in the fourth quarter of 2013.

Hong Kong's net international investment position ("IIP") was strong during 2009 to 2013. IIP is a balance sheet showing the stock of external financial assets and liabilities of an economy at a particular point in time. The difference between the external financial assets and liabilities is the net IIP of the economy, which represents either its net claim on or net liability to the rest of the world. External financial assets consist of financial claims on non-residents and gold bullion held as reserve. External financial liabilities refer to financial claims of non-residents on residents of the economy.

The table below shows Hong Kong's net IIP for the periods indicated:

Net International Investment Position

	As at end of					Q1
	2009	2010	2011	2012	2013	2014
	(HK\$ billions, except percentages)					
Net IIP.	5,702.2	5,171.1	5,522.9	5,591.8	5,951.2	6,463.9
Ratio to GDP (percentage)	344	291	286	275	280	301

Source: Census and Statistics Department.

As at 31 December 2013, Hong Kong's external financial assets and liabilities amounted to HK\$29,086.8 billion and HK\$23,135.6 billion, respectively, resulting in a net IIP of HK\$5,951.2 billion, or 280 per cent. of GDP. At the end of the first quarter of 2014, Hong Kong's external financial assets and liabilities amounted to HK\$29,414.8 and HK\$22,950.9 billion, respectively, resulting in a net IIP of HK\$6,463.9 billion, or 301 per cent. of GDP.

Current Account

The current account measures the flows of goods, services, primary income and secondary income between residents and non-residents. The primary income account shows the amounts receivable and payable abroad in return for providing or obtaining use of labour, financial resources or natural resources to or from non-residents. The secondary income account records current transfers between residents and non-residents. Current transfers are transactions in which real or financial resources that are likely to be consumed immediately or shortly are provided without the receipt of equivalent economic values in return. Examples include workers' remittances, donations, official assistance and pensions.

For the five years from 2009 to 2013, the current account surplus decreased from HK\$164.0 billion in 2009 to HK\$32.2 billion in 2012 before increasing to HK\$39.5 billion in 2013. The narrowing trend in current account surplus was primarily due to the deteriorating visible trade, or merchandise trade, balance, which was in turn a combined result of weak external demand and resilient domestic demand. However, because of thriving inbound tourism, invisible trade, or trade in services, surplus rose substantially to partly offset the visible trade deficit. Primary income recorded a steady net inflow over the same period while secondary income saw a small net outflow in each of the five years.

The current account recorded a deficit of HK\$4.4 billion, or 0.8 per cent. of GDP, in the first quarter of 2014, compared with a deficit of HK\$1.9 billion, or 0.4 per cent. of GDP, in the same quarter of 2013. On a year-on-year comparison, the increase in the current account deficit in the first quarter of 2014 was due to an increase in the visible trade deficit, a decrease in the net inflow of primary income, and a slight increase in the net outflow of secondary income, partly offset by an increase in the invisible trade surplus.

Capital and Financial Account

During 2009 to 2013, Hong Kong recorded a capital and financial account deficit. This was principally attributable to a significant net outflow of portfolio investment, which was driven by the substantial acquisition of non-resident equity and debt securities by Hong Kong residents, as well as a large increase in reserve assets. Direct investment also recorded a net outflow during most of the five-year period, as outflow of direct investment outpaced the inflow, while financial derivatives and other investment recorded a net inflow.

In the first quarter of 2014, a small net outflow of HK\$0.1 billion was recorded in the capital account, equal to that in the fourth quarter of 2013. An overall net inflow of financial non-reserve assets amounting to HK\$62.2 billion was recorded in the first quarter of 2014, as against an overall net outflow of HK\$0.4 billion in the fourth quarter of 2013. The overall net inflow recorded in the first quarter of 2014 was the result of a net inflow due to the cash settlement of financial derivatives and a net inflow of other investment, partly offset by a net outflow of direct investment and a net outflow of portfolio investment.

Foreign Trade

Merchandise Trade

The table below shows the values of merchandise trade in imports, domestic exports, re-exports and total exports for the years shown:

Merchandise Trade

	For the year ended 31 December				
	2009	2010	2011	2012	2013
	(HK\$ billions)				
Imports	2,692.4	3,364.8	3,764.6	3,912.2	4,060.7
Domestic exports	57.7	69.5	65.7	58.8	54.4
Re-exports	2,411.3	2,961.5	3,271.6	3,375.5	3,505.3
Total Exports	2,469.1	3,031.0	3,337.3	3,434.3	3,559.7

Source: *Census and Statistics Department*

During 2009 to 2013, the value of merchandise exports increased at an average annual rate of 4.7 per cent. After the sharp decline of 12.6 per cent. in 2009, the value of merchandise exports grew notably by 22.8 per cent. in 2010. However, the growth slowed to 10.1 per cent., 2.9 per cent., and 3.6 per cent. in the 2011, 2012 and 2013, respectively, mainly because of the unsteady economic recovery in the United States, the recession in the European Union amid the sovereign debt crisis, and their adverse effects on the Asian economies.

Re-exports grew at an average annual rate of 5.1 per cent. in value terms during 2009 to 2013, and accounted for 98.5 per cent. of Hong Kong's merchandise exports in 2013, compared to 96.8 per cent. in 2008. Domestic exports declined at an average annual rate of 9.7 per cent. over the same period.

For the first six months of 2014, domestic exports increased 3.7 per cent. and re-exports increased 2.8 per cent. in value terms compared to the same period in 2013, against a background of moderate global economic growth.

Hong Kong's merchandise imports followed a broadly similar pattern as the exports, as a large share of imports was associated with re-export trade. The value of imports declined by 11.0 per cent. in 2009, followed by a 25.0 per cent. increase in 2010, and then the rate of growth slowed to 11.9 per cent., 3.9 per cent. and 3.8 per cent. in 2011, 2012 and 2013, respectively.

For the first six months of 2014, imports increased 3.3 per cent. in value terms compared to the same period in 2013.

Domestic Exports and Re-exports by Commodity Divisions

The table below shows the value of goods exported from Hong Kong by commodity for the five principal commodity divisions for the periods indicated:

Value of Exports of Goods by Commodity Divisions

	For the year ended 31 December					Q1	Q2
	2009	2010	2011	2012	2013	2014	
	(HK\$ billions)						
Total Exports	2,469.1	3,031.0	3,337.3	3,434.3	3,559.7	817.5	900.3
<i>Within which:</i>							
Domestic exports	57.7	69.5	65.7	58.8	54.4	12.7	14.9
Miscellaneous manufactured articles	10.3	11.6	12.6	12.4	11.9	2.5	3.2
Plastics in primary forms	5.5	7.4	6.9	5.7	5.4	1.2	1.4
Metalliferous ores and metal scrap	2.4	4.1	5.0	4.3	4.0	0.9	1.0
Tobacco and tobacco manufactures	2.0	2.2	2.5	3.0	3.1	0.8	0.9
Electrical machinery, apparatus and appliances, and electrical parts thereof	4.9	4.8	3.9	3.2	2.7	0.6	0.6
Re-exports	2,411.3	2,961.5	3,271.6	3,375.5	3,505.3	804.8	885.3
Electrical machinery, apparatus and appliances, and electrical parts thereof	645.8	838.4	896.1	914.2	995.1	239.7	276.2
Telecommunications and sound recording and reproducing apparatus and equipment	406.7	500.5	559.5	628.4	698.0	153.1	167.0
Office machines and automatic data processing machines	248.5	331.7	377.0	423.7	410.0	95.4	97.1
Miscellaneous manufactured articles	208.8	209.5	232.0	236.6	223.4	44.7	49.4
Articles of apparel and clothing accessories	172.5	183.6	187.8	173.1	168.4	34.7	35.8

Source: Census and Statistics Department.

Exports of Goods by Main Market

The table below shows exports of goods by main market for the periods indicated:

Value of Exports of Goods by Main Market

	For the year ended 31 December					Q1	Q2
	2009	2010	2011	2012	2013	2014	
	(HK\$ billions)						
Total Domestic Exports	57.7	69.5	65.7	58.8	54.4	12.7	14.9
The Mainland	26.7	31.2	30.7	26.0	24.8	5.2	6.5
The United States of America	7.3	8.4	7.2	6.8	5.4	0.9	1.3
Singapore	2.2	2.9	2.6	2.7	2.5	0.5	0.6
Taiwan	1.9	2.8	3.0	2.7	2.4	0.5	0.6
Macao	1.0	1.2	1.4	1.7	1.9	0.5	0.4
Asia-Pacific Economic Co-operation ⁽¹⁾	47.2	56.1	53.0	47.0	44.6	9.7	11.9
European Union ⁽²⁾	5.1	6.6	4.6	2.9	2.9	0.8	0.8
Total Re-exports	2,411.3	2,961.5	3,271.6	3,375.5	3,505.3	804.8	885.3
The Mainland	1,236.6	1,567.0	1,716.7	1,831.7	1,924.5	432.6	486.1
United States	277.9	323.7	323.6	331.7	325.9	72.2	79.4
Japan	107.2	125.6	133.6	142.8	134.0	31.9	31.8
India	51.5	73.5	92.9	76.3	83.0	21.6	22.7
Taiwan	52.8	65.8	82.3	78.1	74.9	17.7	19.3
Asia-Pacific Economic Co-operation ⁽¹⁾	1,932.8	2,403.3	2,629.8	2,761.9	2,854.5	647.1	715.1
European Union ⁽²⁾	303.6	332.9	355.2	330.2	331.6	75.1	83.7

Notes:

1. Includes all APEC group economies, including the Mainland, Taiwan, Japan and the United States.
2. Includes all European Union members, including the United Kingdom and Germany. On 1 July 2013, one new member joined the European Union (“EU”). Together with the 27 original members, there were a total of 28 members in the EU. Statistics on merchandise trade with the EU in this table are compiled based on the new coverage, which may be different from previously reported figures.

Source: Census and Statistics Department.

Retained Imports

The table below shows the value of imports of goods by end-use for the periods indicated:

Value of Retained Imports of Goods by End-Use

	For the year ended 31 December					Q1	Q2
	2009	2010	2011	2012	2013	2014	
	(HK\$ billions)						
Total Retained Imports	687.3	874.7	1,026.1	1,056.6	1,104.5	262.8	292.8
Foodstuff	78.6	92.0	109.3	114.9	131.8	32.8	34.2
Consumer goods	137.6	184.1	250.5	265.1	267.9	67.0	72.7
Raw materials and semi-manufactures	247.1	326.9	327.6	306.3	341.3	91.9	98.6
Capital goods	137.1	154.8	197.0	234.5	231.0	39.9	55.4
Fuels	86.8	116.2	141.6	135.7	132.1	30.7	30.4

Source: Census and Statistics Department.

The table below shows the imports of goods by source for the periods indicated:

Value of Imports of Goods by Source

	For the year ended 31 December					Q1	Q2
	2009	2010	2011	2012	2013	2014	
	(HK\$ billions)						
Total Imports	2,692.4	3,364.8	3,764.6	3,912.2	4,060.7	941.6	1,039.5
The Mainland	1,249.4	1,529.8	1,696.8	1,840.9	1,942.1	424.5	480.3
Japan	236.4	308.2	318.6	311.6	286.3	64.1	74.4
Taiwan	175.6	224.8	240.9	244.9	261.9	64.3	78.3
Singapore	174.7	237.4	254.6	246.3	246.4	62.8	66.9
United States of America	142.1	179.2	211.4	204.5	219.7	49.7	53.3
Asia-Pacific Economic Co-operation ⁽¹⁾	2,308.9	2,896.2	3,172.5	3,309.1	3,434.9	788.1	886.0
European Union ⁽²⁾	208.7	247.3	303.9	305.5	315.2	72.9	76.0

Notes:

1. Includes all APEC group economies, including the Mainland, Taiwan, Japan and the United States.
2. Includes all European Union members, including the United Kingdom and Germany.

Source: Census and Statistics Department.

Trade in Services

The table below shows Hong Kong's trade in services, in accordance with the balance of payments basis, for the periods indicated:

Trade in Services

	For the year ended 31 December					Q1
	2009	2010	2011	2012	2013	2014
	(HK\$ billions)					
Exports of services	501.3	625.7	710.7	764.0	817.9	210.6
Imports of services	473.7	546.9	578.0	594.3	596.6	142.8
Total trade in services	975.0	1,172.6	1,288.8	1,358.3	1,414.5	353.4
Net exports of services	27.6	78.8	132.7	169.8	221.4	67.7

Source: Census and Statistics Department

During 2009 to 2013, exports of services grew at an average annual rate of 8.5 per cent. in value terms and imports of services grew at an average annual rate of 1.1 per cent. in value terms.

The following table shows exports and imports of services by the largest service groups:

Value of Exports and Imports of Services by Major Service Group

	For the year ended 31 December					Q1
	2009	2010	2011	2012	2013	2014
	(HK\$ billions)					
Total Exports of Services	501.3	625.7	710.7	764.0	817.9	210.6
Travel	127.2	172.5	221.5	256.5	302.0	77.5
Transport	183.6	232.0	250.1	248.5	243.0	57.7
Financial services	87.5	101.6	111.9	120.7	128.9	37.6
Other services	103.0	119.6	127.2	138.3	144.0	37.7
Total Imports of Services	473.7	546.9	578.0	594.3	596.6	142.8
Travel	120.5	134.8	148.1	155.7	164.5	38.6
Transport	101.0	122.0	139.4	142.6	142.1	33.5
Manufacturing services	134.3	148.9	139.5	138.9	130.0	28.6
Financial services	24.4	27.5	30.2	30.5	33.2	9.7
Other services	93.4	113.7	120.9	126.6	126.8	32.5

Source: Census and Statistics Department.

In 2013, travel and transport were the two largest service components in exports of services, contributing HK\$302.0 billion and HK\$243.0 billion, respectively, to total exports of services. Their shares in total exports of services were 36.9 per cent. and 29.7 per cent., respectively. Other significant components in exports of services were financial services and other services, contributing HK\$128.9 billion, or 15.8 per cent., and HK\$144.0 billion, or 17.6 per cent., respectively, to total exports of services.

In 2013, travel, transport and manufacturing services were the three largest service components in imports of services, contributing HK\$164.5 billion, HK\$142.1 billion and HK\$130.0 billion, respectively, to total imports of services. Their contribution to in total imports of services were 27.6 per cent., 23.8 per cent. and 21.8 per cent., respectively. Other significant components in imports of services were financial services and other services, contributing HK\$33.2 billion, or 5.6 per cent., and HK\$126.8 billion, or 21.3 per cent., respectively to total imports of services.

In 2012, the Mainland and the United States were the major destinations of exports of services, with values at HK\$269.4 billion, or 36.6 per cent. of total exports of services, and HK\$114.7 billion, or 15.6 per cent., respectively. They were followed by the United Kingdom, Japan and Taiwan, with values at HK\$48.2 billion, or 6.6 per cent., HK\$39.4 billion, or 5.4 per cent., and HK\$33.1 billion, or 4.5 per cent., respectively.

For imports of services, the Mainland and the United States were also the major sources, with values at HK\$252.9 billion, or 42.8 per cent. of total imports of services, and HK\$62.8 billion, or 10.6 per cent., respectively. They were followed by Japan, the United Kingdom and Singapore, with values at HK\$38.7 billion, or 6.6 per cent., HK\$32.5 billion, or 5.5 per cent., and HK\$26.8 billion, or 4.5 per cent., respectively.

Foreign Direct Investment

The table below shows the inflow of inward direct investment by major investor country or territory during the periods indicated:

Inflow of Inward Direct Investment by Major Investor Country/Territory⁽¹⁾⁽²⁾

	For the year ended 31 December			
	2009	2010	2011	2012
	(HK\$ billions)			
Direct investment liabilities ⁽³⁾	420.7	642.6	748.2	580.9
Total of all countries/territories ⁽³⁾	430.5	548.0	751.8	544.3
The Mainland	214.8	288.2	318.1	232.7
British Virgin Islands	122.3	236.9	151.5	191.9
Bermuda	53.8	28.7	40.3	73.0
Netherlands	45.6	26.0	59.6	37.8
United States	-4.1 ⁽⁴⁾	-152.9 ⁽⁴⁾	21.9	-120.8 ⁽⁴⁾

Notes:

1. At market value. Figures for 2013 were not available as at the date of this offering memorandum.
2. Country/territory here refers to the immediate source economy. It does not necessarily reflect the country/territory from which the funds are initially mobilised.
3. The total of all countries/territories is different from the aggregate direct investment liabilities due to the adoption of different presentation principles, with the former compiled based on the "directional principle" and the latter based on the "asset/liability principle" in accordance with the international statistical standards. The total of all countries/territories is referred to in calculating the shares of individual countries/territories, while the direct investment liabilities is referred to in the analysis on aggregate statistics.
4. The negative inflows were either due to repayment of loans to non-resident affiliates, or equity withdrawal, or both.

Source: Census and Statistics Department.

The table below shows the inflow of inward direct investment by major economic activity during the periods indicated:

Inflow of Inward Direct Investment by Major Economic Activity of Hong Kong Enterprise Groups ⁽¹⁾⁽²⁾⁽³⁾

	<u>For the year ended 31 December</u>			
	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
	(HK\$ billions)			
Direct investment liabilities ⁽⁴⁾	420.7	642.6	748.2	580.9
Total of all economic activities ⁽⁴⁾	430.5	548.0	751.8	544.3
Investment and holding, real estate, professional and business services	257.6	442.3	412.2	441.9
Banking	78.9	122.6	133.4	60.2
Import/export, wholesale and retail trades	64.0	51.4	125.6	101.5
Financing (except banking, investment and holding companies)	14.4	19.6	-21.5 ⁽⁵⁾	21.3
Transportation, storage, postal and courier services	18.4	31.0	44.3	-4.7 ⁽⁵⁾

Notes:

1. At market value. Figures by major economic activity for 2013 were not available as at the date of this offering memorandum.
2. A Hong Kong enterprise group (“HKEG”) mainly consists of a Hong Kong parent company, its Hong Kong subsidiaries, associates and branches.
3. For an enterprise group, economic activity refers to the major economic activity of the whole enterprise group in Hong Kong. If an HKEG is engaged in a wide variety of activities, the economic activity is determined on the basis of the economic activity in respect of which the operating revenue is predominant.
4. The total of all economic activities is different from the aggregate direct investment liabilities due to the adoption of different presentation principles, with the former compiled based on the “directional principle” and the latter based on the “asset/liability principle” in accordance with the international statistical standards. The total of all economic activities is referred to in calculating the shares of individual economic activities, while the direct investment liabilities is referred to in the analysis on aggregate statistics.
5. The negative inflows were either due to repayment of loans to non-resident affiliates, or equity withdrawal, or both.

Source: Census and Statistics Department.

In 2012, total inflow of direct investment (“DI”) liabilities amounted to HK\$580.9 billion compared to HK\$748.2 billion in 2011. The inflow mainly arose from the operating profits of Hong Kong enterprises that were not distributed to direct investors but retained as reinvestment of earnings. The inflow was mostly concentrated in investment and holding, real estate and professional and business services, but also covered such sectors as import/export, wholesale and retail trades, banking and financing.

Hong Kong's Economic Relationship with the Mainland

The Mainland is Hong Kong's largest trading partner and, since the Mainland's "Reform and Opening-up" policy was implemented in 1978, Hong Kong has established close economic links with the Mainland, particularly in the Pearl River Delta area. The HKSAR Government has maintained contact with the Mainland authorities at different levels through various government bureaux and departments, the offices of the HKSAR Government in the Mainland, as well as quasi-government bodies such as the Hong Kong Trade Development Council. Communication is also achieved through mechanisms such as the CEPA Joint Steering Committee and government-to-government regional cooperation mechanisms such as the Hong Kong/Guangdong Cooperation Joint Conference and the Pan-Pearl River Delta Regional Co-operation and Development Forum ("PPRD"). Participants in the annual PPRD include the HKSAR, the Macao Special Administrative Region, Guangdong Province, Fujian Province, Jiangxi Province, Hunan Province, Guangxi Province, Hainan Province, Sichuan Province, Guizhou Province and Yunan Province.

Hong Kong as an International Capital Formation Centre for the Mainland

Hong Kong imposes no restrictions on foreign currency exchange or participation in its stock market. In the past decade, Hong Kong has become one of the most important international fund-raising centres for Mainland enterprises. From 2003 to 2013, Mainland enterprises raised a total of HK\$3,002.6 billion on the SEHK. As at 31 December 2013, the combined market capitalisation amounted to HK\$13,690.6 billion.

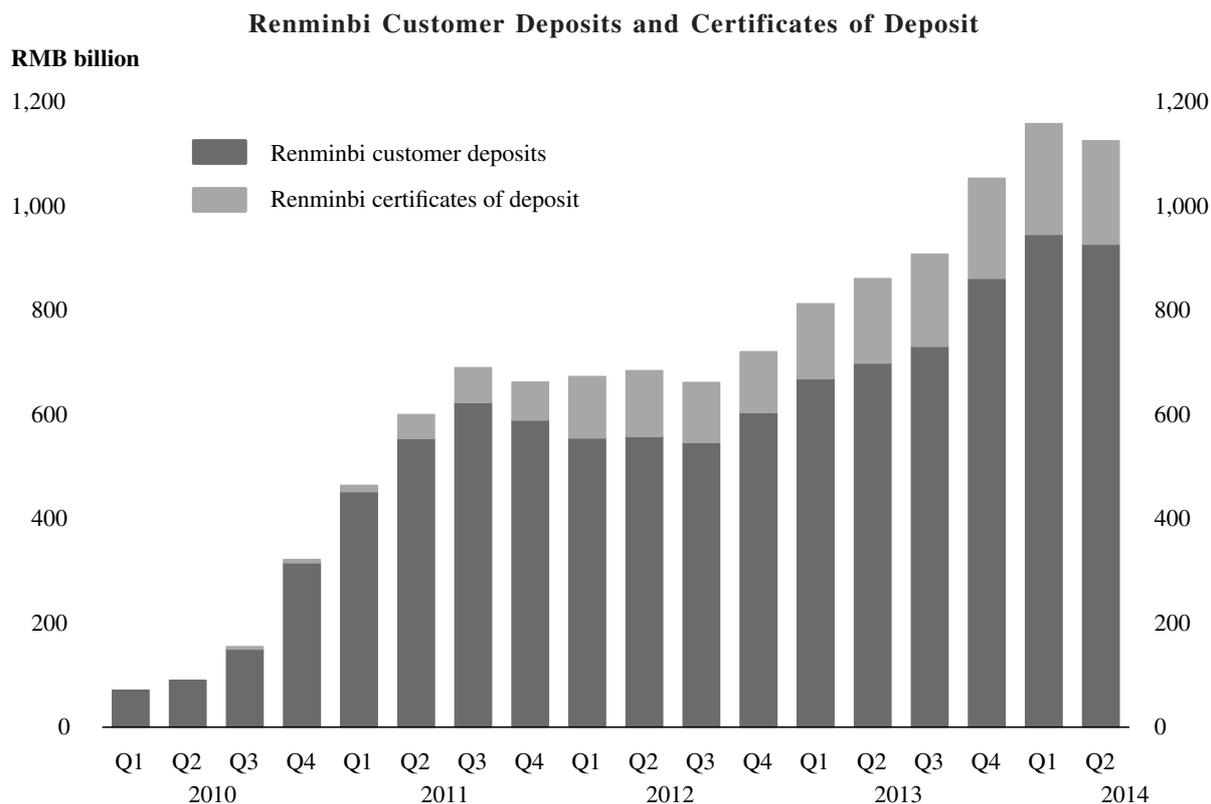
Apart from the equity market, Mainland enterprises raise capital in Hong Kong through the issuance of bonds, project financing and loan syndication. Mainland enterprises also have access to investment banking services in Hong Kong such as corporate finance, mergers and acquisitions and restructuring advice. For more information on Renminbi financing, see "*— Financial and Monetary System — Bond Market — Dim Sum Bond Market*" below.

Hong Kong as an Offshore Renminbi Business Centre

Hong Kong pioneered the development of the offshore Renminbi business and is a major offshore Renminbi centre. Moreover, the PRC's Twelfth Five-Year Plan provides support for the development of the HKSAR as an offshore Renminbi business centre. As at 30 June 2014, outstanding Renminbi customer deposits and certificates of deposit amounted to RMB926 billion and RMB199 billion, respectively, totalling RMB1,125 billion. In 2013, Renminbi trade settlement handled by banks in Hong Kong exceeded RMB3.8 trillion. For the first half of 2014, the amount reached RMB2.9 trillion, an increase of approximately 73 per cent. from the same period in 2013. Renminbi financing activities are vibrant. Renminbi bond issuances amounted to RMB117 billion in 2013, and RMB130 billion in the first half of 2014. Outstanding Renminbi bonds amounted to RMB382 billion as at 30 June 2014. The Renminbi lending business of Hong Kong banks has also been expanding, with outstanding Renminbi loans amounting to RMB139 billion as at 30 June 2014, up approximately 26 per cent. from RMB110 billion a year ago. With the increasing use of Renminbi in cross-border trade and offshore financial activities, the average daily turnover of Hong Kong's Renminbi Real Time Gross Settlement ("RTGS") system reached RMB700 billion in June 2014, almost double the RMB395 billion in 2013. As at 30 June 2014, the Renminbi RTGS system had 222 participating banks, of which 196 were subsidiaries and branches of foreign banks or overseas presence of Mainland banks.

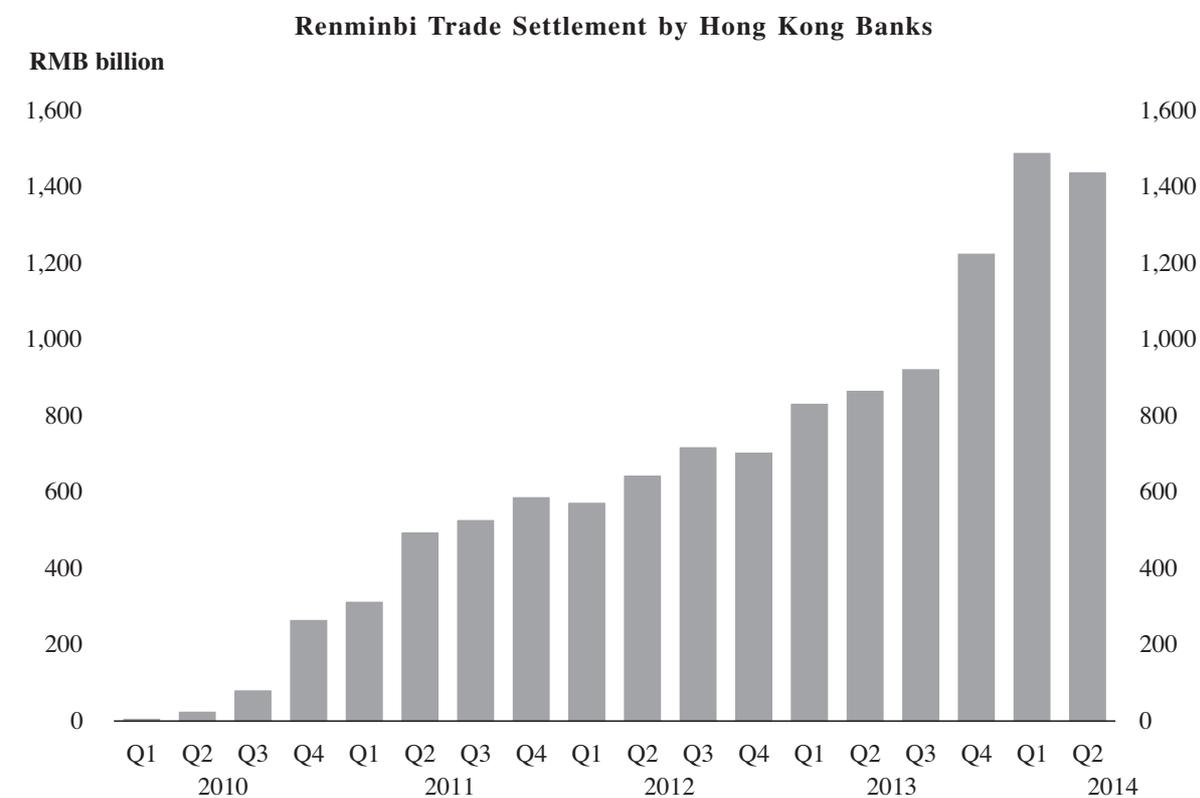
Moreover, there is an expanding range of Renminbi instruments and financial products in the Hong Kong market, including currency forwards and futures, insurance products and various listed and unlisted investment funds, accessing both the onshore and offshore markets. Daily turnover of

offshore Renminbi foreign exchange spot and forward transactions together has reached US\$30 billion equivalent, according to market estimates. The graph below shows Renminbi deposits in Hong Kong for the periods indicated:



Source: HKMA

The graph below shows Renminbi trade settlement handled by Hong Kong banks during the periods indicated:



Source: HKMA

Advancements have also been made to the Renminbi payment and settlement platform. Since January 2013, and with the support of the People's Bank of China Shenzhen Central Sub-Branch, the clearing houses in Hong Kong and Shenzhen have started a pilot arrangement that links Hong Kong's Renminbi RTGS system with the Shenzhen Financial Settlement System. The arrangement extends the operating hours of the cross-border Renminbi payment services between Hong Kong and the Mainland from 4:30 p.m. to 10:30 p.m., initially and further to 11:00 p.m. from 1 July 2014, enabling Hong Kong's Renminbi clearing platform to more fully support Mainland and overseas Renminbi payments. In addition, the HKMA enhanced the Renminbi liquidity facility arrangement for banks in Hong Kong in 2013, by shortening the required notice period for obtaining one-week Renminbi funds under this arrangement from two business days to one, and introducing the provision of one-day funds on a next-day (T+1) basis as well as overnight funds on a same-day (T+0) basis. The amount of overnight funds to be provided is expected to be up to approximately RMB10 billion total in a single day.

Mainland and Hong Kong Closer Economic Partnership Arrangement

CEPA is the first free trade agreement ever concluded by the Mainland and Hong Kong. The main text of CEPA was signed on 29 June 2003 and came into full implementation on 1 January 2004. Since its inception, the two sides have been adopting a building block approach to expand the scope and content of CEPA. The latest Supplement X to CEPA was signed on 29 August 2013 and the liberalisation measures for trade in services took effect from 1 January 2014. Inclusive of measures in Supplement X, there are 403 liberalisation measures for trade in services under CEPA.

Under CEPA, Hong Kong service suppliers can enjoy preferential access in various service sectors in the Mainland market. On trade in goods, the Mainland has applied a zero tariff to all imported goods of Hong Kong origin that meet the mutually agreed CEPA rules of origin. Under the trade and investment facilitation framework of CEPA, both sides have agreed to enhance co-operation in 10 areas.

Shanghai-Hong Kong Stock Connect

In April 2014, the China Securities Regulatory Commission and the SFC approved the development of a pilot programme for Shanghai-Hong Kong Stock Connect, which will establish mutual stock market access between the Mainland and Hong Kong. The pilot programme operates between the SEHK, the Shanghai Stock Exchange ("SSE"), China Securities Depository and Clearing Corporation ("ChinaClear") and the Hong Kong Securities Clearing Company Limited ("HKSCC").

Under the programme the SSE and SEHK will enable investors to trade eligible shares listed on each other's market through local securities firms or brokers. ChinaClear and HKSCC will establish a direct link for cross-boundary clearing and each will become the other's clearing participant to provide clearing services for the programme.

The programme is aimed at enhancing the overall strength of both capital markets by deepening cooperation and communication and promoting the internationalisation of the Renminbi and development of Hong Kong as an offshore Renminbi business centre by enabling Mainland investors to directly participate in the Hong Kong stock market.

External Trade Relations

Under Article 116 of the Basic Law, Hong Kong is a separate customs territory from the Mainland and may, using the name "Hong Kong, China," participate in relevant international organisations and international trade agreements. Article 151 of the Basic Law also provides that the HKSAR may on its own conclude and implement agreements with foreign states in the economic, trade and other

appropriate fields under the name of “Hong Kong, China”. Hong Kong will consider entering into free-trade agreements with other economies so long as they are in Hong Kong’s interests, can contribute to multilateral trade liberalisation and are consistent with the principles and provisions of the WTO.

Hong Kong’s Participation in the WTO

Hong Kong is a founding member of the WTO. Its separate membership reflects Hong Kong’s autonomy in the conduct of its external trade relations.

The WTO aims to provide a fair, predictable and rules-based multilateral trading system for trade in goods, services and trade-related intellectual property rights. It promotes the liberalisation of international trade and serves as a forum for multilateral trade negotiations and dispute settlement among its members. Active participation in the WTO’s multilateral trading system is the cornerstone of Hong Kong’s external trade policy.

Hong Kong’s participation in the WTO is guided by two objectives:

- to sustain the momentum of trade liberalisation, especially in areas of interest to Hong Kong, such as tariffs and services; and
- to strengthen and update the multilateral rule-based trading system so that it remains an effective framework to promote trade expansion and liberalisation, as well as to protect Hong Kong against any arbitrary and discriminatory actions taken by its trading partners.

In December 2005, Hong Kong hosted the Sixth WTO Ministerial Conference. Every four years, WTO members undergo a WTO Trade Policy Review to evaluate their trade objectives, policies and practices. Hong Kong’s last review occurred in 2010 and the Trade Policy Review body of the WTO commended Hong Kong’s open, market-oriented economy and liberal foreign investment regime. The next review will occur in November 2014.

Regional Economic Cooperation

APEC is a regional forum established in 1989 for high-level government-to-government dialogue and cooperation on trade and economic issues. Hong Kong joined APEC in 1991.

From 2009 to 2013, the average annual growth rate in bilateral trade between Hong Kong and other APEC economies was approximately 10 per cent. In 2013, such bilateral trade increased by approximately 4 per cent. to HK\$6,334 billion from HK\$6,118 billion in 2012 (compared with an increase of approximately 4 per cent. for Hong Kong’s total trade in 2013 against 2012). Hong Kong is also an important trading hub between the Mainland and other APEC economies. From 2009 to 2013, the average annual growth rate for re-export trade between the Mainland and other APEC economies through Hong Kong was approximately 11 per cent. In 2013, such re-export trade increased by 4 per cent. to HK\$3,457 billion from HK\$3,321 billion in 2012 (compared with an increase of 4 per cent. for Hong Kong’s total re-exports in 2013 against 2012).

The Pacific Economic Cooperation Council (“PECC”), founded in 1980, is a non-governmental regional forum comprised of government officials, business leaders and academics working in their personal capacity to enhance trade, investment and economic development in the Pacific region. Hong Kong joined PECC in May 1991 as a full and separate member.

International Reserves

Hong Kong's foreign currency reserves, which are held in the Exchange Fund, totalled US\$325.0 billion not including unsettled foreign exchange contracts as at 31 July 2014. The day-to-day management of the Exchange Fund is conducted by the HKMA. See “— *Financial and Monetary System — The Exchange Fund.*”

Although Hong Kong participates in IMF activities under the PRC's membership, it is not a member of the IMF. In accordance with Article 106 of the Basic Law, the HKSAR Government will use its financial revenues exclusively for its own purpose, and these revenues will not be remitted to the CPG. In addition, under Article 113 of the Basic Law, the Exchange Fund will be managed and controlled exclusively by the HKSAR Government.

FINANCIAL AND MONETARY SYSTEM

The Hong Kong Monetary Authority

The HKMA, established in 1993, functions as Hong Kong's central banking institution. The HKMA has four main functions: maintaining the stability of the Hong Kong dollar within the framework of the Linked Exchange Rate System; promoting the stability and integrity of Hong Kong's financial system, including the banking system; managing Hong Kong's Exchange Fund; and helping to maintain Hong Kong's status as an international financial centre, including maintaining and developing Hong Kong's financial infrastructure.

The Exchange Fund Ordinance of Hong Kong (the “**Exchange Fund Ordinance**”) empowers the Financial Secretary to appoint a Monetary Authority (the “**MA**”) (who is the Chief Executive of the HKMA) to assist the Financial Secretary in performing his functions under the Exchange Fund Ordinance and to perform such other functions as are assigned by other ordinances or by the Financial Secretary. The powers, functions and responsibilities of the MA are set out in the Exchange Fund Ordinance, the Banking Ordinance of Hong Kong (the “**Banking Ordinance**”), the Clearing and Settlement Systems Ordinance of Hong Kong and other relevant ordinances.

Functions and Responsibilities

An Exchange of Letters dated 25 June 2003 (the “**Exchange of Letters**”) sets out the division of functions between the Financial Secretary and the MA as well as the delegations made by the Financial Secretary to the MA under the Exchange Fund Ordinance and other ordinances. The Exchange of Letters states that the Financial Secretary should determine the monetary policy objective and the structure of the monetary system of Hong Kong, namely currency stability, defined as a stable exchange value at around HK\$7.80 to US\$1.00, maintained by currency board arrangements (as described further below). The MA is responsible for achieving the monetary policy objective, including determining the strategy, instruments and operational means for doing so. The MA is also responsible for maintaining the stability and integrity of the monetary system of Hong Kong.

In addition, the Financial Secretary, assisted by the Secretary for Financial Services and the Treasury, determines the policies for maintaining the stability and integrity of Hong Kong's financial system and the status of Hong Kong as an international financial centre. Accordingly, the MA is responsible for:

- promoting the general stability and effectiveness of the banking system;
- developing the debt market, in co-operation with other relevant bodies;
- matters relating to issuing and circulating legal tender notes and coins;
- promoting the safety and efficiency of the financial infrastructure through the development of payment, clearing and settlement systems and, where appropriate, the operation of these systems; and
- promoting, in co-operation with other relevant bodies, confidence in Hong Kong's monetary and financial systems, and appropriate market development initiatives to help strengthen the international competitiveness of Hong Kong's financial services.

The Exchange Fund, through which cover of legal tender notes and coins issued in circulation and most of the financial assets of the HKSAR Government are held, is under the control of the Financial Secretary. The MA, under delegation from the Financial Secretary, is responsible to the Financial Secretary for the use and investment management of the Exchange Fund.

Governance Arrangements

The Exchange Fund Advisory Committee (“**EFAC**”), which was established under the Exchange Fund Ordinance, advises the Financial Secretary in relation to the Exchange Fund. The Financial Secretary is ex-officio chairman of EFAC. Other members, including the MA, are appointed in a personal capacity by the Financial Secretary under the delegated authority of the Chief Executive. EFAC advises the Financial Secretary on investment policies and strategies for the Exchange Fund. The EFAC also advises the Financial Secretary on the HKMA’s annual administration budget as the operating and staff costs of the HKMA are paid for by the Exchange Fund.

The Banking Advisory Committee, established under section 4(1) of the Banking Ordinance, advises the Chief Executive of Hong Kong on matters relating to the Banking Ordinance, in particular banks and the carrying on of banking business. The Deposit-Taking Companies Advisory Committee, established under Section 5(1) of the Banking Ordinance, performs similar functions to the Banking Advisory Committee in relation to deposit-taking companies and restricted licence banks.

Monetary System

Hong Kong introduced a linked exchange rate system (the “**Linked Exchange Rate System**”) in 1983 which sets the value of the Hong Kong dollar at HK\$7.80 to US\$1.00. The structure of the monetary system is characterised by currency board arrangements, which require the Hong Kong dollar monetary base, described below (the “**Monetary Base**”), to be at least fully backed by, and changes in it to be fully matched by corresponding changes in, U.S. dollar reserves held in the Exchange Fund at the fixed exchange rate of HK\$7.80 to US\$1.00. Hong Kong’s Monetary Base comprises the following components:

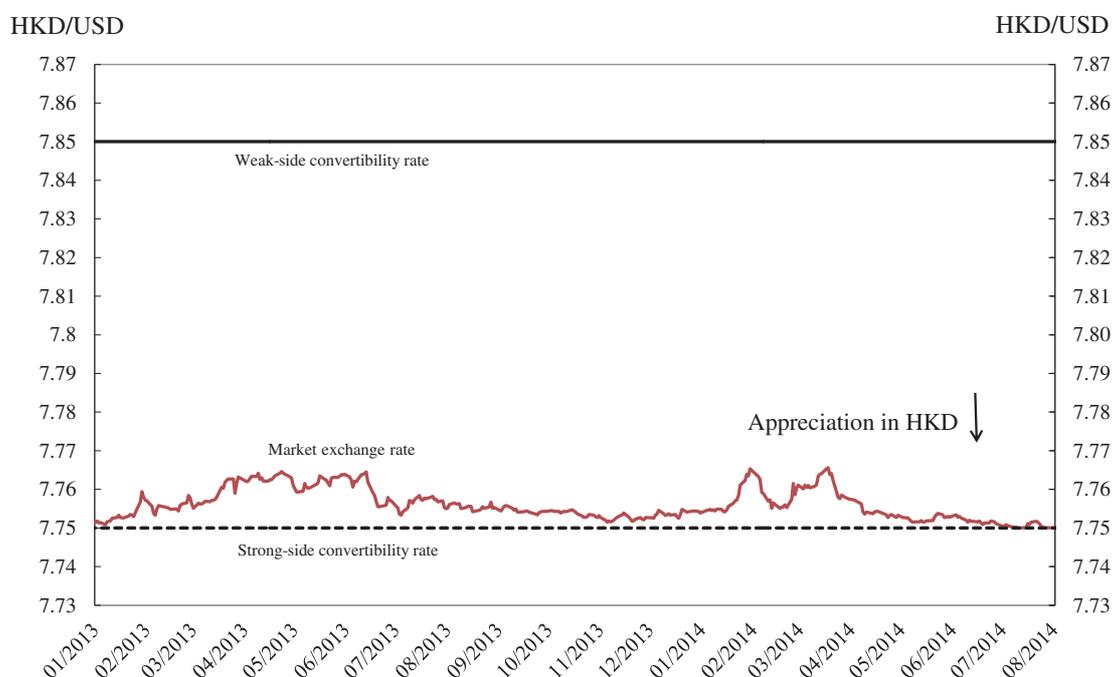
- Certificates of Indebtedness, which provide full backing to the banknotes issued by the three note-issuing banks;
- Government-issued notes and coins in circulation;
- the sum of the balances on the clearing accounts maintained by banks with the HKMA (known as the “**Aggregate Balance**”); and
- the outstanding amount of Hong Kong dollar debt securities issued by the HKMA on behalf of the HKSAR Government (“**Exchange Fund Bills and Notes**”) which are for the account of and payable from the Exchange Fund.

The Hong Kong dollar exchange rate is maintained through an interest rate adjustment mechanism known as the “**Convertibility Undertaking**”. In Hong Kong, the HKMA operates Convertibility Undertakings on both the strong side and the weak side of the linked rate of 7.80, known as the “**Convertibility Zone**”. Under the strong-side Convertibility Undertaking, the HKMA undertakes to buy U.S. dollars from licensed banks at 7.75, and as a result the Aggregate Balance will expand to push down Hong Kong dollar interest rates. Under the weak-side Convertibility Undertaking, the HKMA undertakes to sell US dollars at 7.85, and as a result, the Aggregate Balance will contract to drive up Hong Kong dollar interest rates. Within the Convertibility Zone between 7.75 and 7.85, the HKMA may choose to conduct market operations consistent with currency board principles with the aim of promoting the smooth functioning of the money and foreign exchange markets.

During 2013 and the first half of 2014, the Hong Kong dollar exchange rate remained stable within the Convertibility Zone, despite the December 2013 announcement by the U.S. Federal Open Markets Committee of its decision to reduce monthly asset purchases. The Convertibility Undertaking was not triggered and the HKMA did not conduct any foreign exchange operations within the Convertibility Zone during this period, leaving the total Aggregate Balance before discount window generally unchanged at HK\$163.9 billion as at 30 June 2014. Between 1 July 2014 and 5 August 2014, the

strong-side Convertibility Undertaking was triggered multiple times, partly due to strong corporate demand for Hong Kong dollars amid merger and acquisition activities and dividend distributions. As a result, the Aggregate Balance increased by HK\$75.3 billion to HK\$239.2 billion on 7 August 2014.

The following chart illustrates the Hong Kong dollar market exchange rate compared to the U.S. dollar for the periods indicated:



Source: HKMA.

Unlike many central banks worldwide, the HKMA has a limited role with respect to the following functions:

- *Banknote Issue.* This function is principally undertaken by three commercial banks: Bank of China (Hong Kong) Limited, The Hongkong and Shanghai Banking Corporation Limited and Standard Chartered Bank (Hong Kong) Limited. The HKSAR Government has issued HK\$10 currency notes since 2002 and all denominations of coins in circulation.
- *Banker to the HKSAR Government.* Other than managing the fiscal reserves which are held by the Exchange Fund, the HKMA does not provide ordinary banking services to the HKSAR Government, a function historically performed by commercial banks.

Hong Kong's base rate determines the interest rate at which banks may obtain overnight Hong Kong dollar liquidity from the HKMA. The base rate is currently set at 50 basis points above the prevailing U.S. federal fund target rate or the average of the five-day moving averages of the overnight and one-month HIBORs, whichever is higher. The HKMA announces the base rate every day before the interbank market opens in Hong Kong.

Banking System

Structure of the Banking System

Hong Kong maintains a three-tier system of deposit-taking institutions, namely, licensed banks, restricted license banks and deposit-taking companies. These are collectively known as authorised institutions (“AIs”) under the Banking Ordinance. AIs may operate in Hong Kong as either locally incorporated companies or branches of foreign banks. The MA is the licensing authority for all three types of AIs.

- Licensed banks may operate current and savings accounts, accept deposits of any size and maturity from the public, pay or collect cheques drawn by or paid in by customers and use the name “bank” without restriction.
- Restricted license banks are principally engaged in wholesale and capital markets activities. They may take deposits of any maturity of at least HK\$500,000 from the public.
- Deposit-taking companies are generally owned by, or otherwise associated with, licensed banks. They engage in a range of specialised activities, including consumer and trade finance and securities business. These companies take deposits of at least HK\$100,000, with an original term to maturity of at least three months.

The authorisation criteria for licensed banks, restricted license banks and deposit-taking companies are intended to ensure that only fit and proper institutions are entrusted with public deposits. The HKMA conducts periodic reviews of the authorisation criteria and, when necessary, introduces amendments to reflect the changing needs of the regulatory environment in light of new international standards.

Hong Kong has one of the highest concentrations of banking institutions in the world. 70 of the largest 100 banks in the world have an operation in Hong Kong. As at 30 June 2014, Hong Kong had 159 licensed banks, 20 restricted licence banks, 23 deposit-taking companies and 15 approved money brokers.

Overseas banks may establish local representative offices in Hong Kong. A local representative office is not allowed to engage in any banking business. Its role is confined mainly to liaison work between the bank and its customers in Hong Kong.

Performance of the Banking Sector

The tables below set out the performance ratios of the banking sector for the periods indicated:

Performance Ratios of the Banking Sector⁽¹⁾

	ALL AIs				
	For the year ended 31 December				
	2009	2010	2011	2012	2013
	(in percentages)				
Asset Quality⁽²⁾					
As a percentage of total credit exposures ⁽³⁾					
Total outstanding provisions/impairment allowances	0.63	0.47	0.42	0.39	0.35
Classified ⁽⁴⁾ exposures:					
Gross	1.10	0.60	0.49	0.40	0.36
Net of specific provisions/ individual impairment allowances.	0.71	0.34	0.28	0.24	0.22
Net of all provisions/ impairment allowances.	0.47	0.14	0.07	0.01	0.00
As a percentage of total loans					
Total outstanding provisions/ impairment allowances	0.96	0.71	0.63	0.60	0.55
Classified ⁽⁴⁾ loans:					
Gross	1.61	0.83	0.69	0.58	0.54
Net of specific provisions/ individual impairment allowances.	1.07	0.46	0.41	0.35	0.35
Net of all provisions/ individual impairment allowances.	0.65	0.13	0.06	(0.02)	(0.01)
Overdue for over 3 months and rescheduled loans	0.92	0.58	0.47	0.42	0.36
Profitability					
Return on assets (operating profit)	0.73	0.82	0.80	0.84	1.03
Return on assets (post-tax profit)	0.64	0.76	0.72	0.74	1.05
Net interest margin.	1.11	1.02	0.98	1.08	1.12
Cost-income ratio.	58.0	58.1	55.4	54.8	49.0
Bad debt charge to total assets.	0.13	0.05	0.07	0.08	0.06
Liquidity					
Loan to deposit ratio (all currencies)	51.5	61.6	66.9	67.1	70.4
Loan to deposit ratio ⁽⁵⁾ (Hong Kong dollar) . .	71.2	78.1	84.5	79.8	82.1

Notes:

- (1) Figures relate to Hong Kong office(s) only except where otherwise stated.
- (2) Figures relate to Hong Kong office(s) and for the locally incorporated AIs included therein, also their overseas branches.
- (3) Credit exposures include loans and advances, acceptances and bills of exchange held, investment debt securities issued by others, accrued interest, and commitments and contingent liabilities to or on behalf of non-banks.
- (4) Denotes loans or exposures graded as “substandard,” “doubtful” or “loss.”
- (5) Includes swap deposits.

Source: HKMA.

Loans to Customers inside Hong Kong by Economic Sector (All AIs)

	As at 31 December				
	2009	2010	2011	2012	2013
	(HK\$ billions)				
Hong Kong's visible trade	175	274	351	383	550
Manufacturing	127	162	189	184	217
Transport and transport equipment	151	168	193	216	248
Building, construction and property development and investment	687	827	918	928	993
Wholesale and retail trade	150	229	314	351	418
Financial concerns (other than authorised institutions)	186	235	264	273	327
Individuals:					
to purchase flats in the Home Ownership Scheme, the Private Sector Participation Scheme and the Tenants Purchase Scheme	52	51	46	42	42
to purchase other residential property	647	745	805	873	909
other purposes	222	256	292	333	390
Others	250	315	340	397	437
Total⁽¹⁾	<u>2,646</u>	<u>3,262</u>	<u>3,711</u>	<u>3,980</u>	<u>4,530</u>

Note:

1. Defined as loans for use in Hong Kong plus trade financing loans.

Source: HKMA.

Deposits from Customers (All AIs)

	As at 31 December				
	2009	2010	2011	2012	2013
	(HK\$ billions)				
Hong Kong Dollar (including swap deposits) .					
Demand	477	511	546	639	686
Savings	1,767	1,835	1,671	2,011	2,077
Time	1,130	1,270	1,523	1,526	1,628
Total	<u>3,374</u>	<u>3,617</u>	<u>3,740</u>	<u>4,176</u>	<u>4,391</u>
Foreign Currency					
Demand	231	287	333	456	511
Savings	932	1,078	1,234	1,380	1,619
Time	1,845	1,880	2,284	2,284	2,657
Total	<u>3,007</u>	<u>3,245</u>	<u>3,851</u>	<u>4,120</u>	<u>4,787</u>

Source: HKMA.

Hong Kong's banking sector is generally strong, well-capitalised and funded largely by deposits. The banking sector is therefore well-positioned to respond to any negative impact from global monetary tightening or sharp increases in interest rates as a result of tightened liquidity.

From 2009 to 2013, Hong Kong's banking sector has generally maintained healthy capital adequacy ratios, with a declining level of classified loans and a generally adequate level of liquidity. The Hong Kong banking sector performed well in 2013, despite the U.S. debt ceiling crisis and the uncertainties over the pace of the U.S. Federal Reserve's tapering of its quantitative easing measures. The HKMA took steps to contain the potential adverse impact of these conditions, including introducing a stable funding requirement for AIs in October 2013 to ensure AIs could maintain stable business operations when market liquidity came under stress. Asset quality and liquidity positions of retail banks remained sound, and locally incorporated AIs continued to be well-capitalised.

In order to strengthen the banking system's capacity against the potential impact of U.S. interest rate normalisation on Hong Kong's property and mortgage markets, the HKMA launched its sixth round of countercyclical prudential measures in February 2013. These included raising the interest rate hike assumption for property mortgage loans' approval to 300 basis points and lowering the maximum applicable loan-to-value ratio for non-residential mortgages. As a result of these prudential measures and the HKSAR Government's demand management tax measures, Hong Kong's property transaction volume dropped significantly in 2013. Upward movement in property prices decelerated, and the growth in residential mortgage loans slowed from 7.6 per cent. in 2012 to 3.9 per cent. in 2013. Meanwhile, the aggregate credit growth in the banking sector accelerated from 9.6 per cent. in 2012 to 16.0 per cent. in 2013. Credit growth in the banking sector slowed in the fourth quarter of 2013. Retail banks' total loans and advances rose by 4.3 per cent. in the first quarter of 2014 compared to the previous quarter. According to the Opinion Survey of Credit Condition Outlook conducted by the HKMA, AIs anticipated an increase in loan demand, particularly for loans to non-bank Mainland entities, syndicated loans as well as loans for use outside Hong Kong, but anticipated weaker demand for property related lending in 2014.

With Hong Kong's closer economic relationship with the Mainland, Hong Kong's banking sector is likewise increasingly exposed to the Mainland economy. These exposures result from Mainland and overseas corporates expanding cross-border trade and investment activities, relatively low funding costs in Hong Kong compared to the Mainland and credit demand diverted to Hong Kong from the Mainland due to the Mainland's tighter liquidity conditions.

Banking Supervision

The legal framework for banking supervision in Hong Kong is established by the Banking Ordinance. Under the Banking Ordinance, the MA is the licensing authority responsible for the authorisation, suspension and revocation of licenses for all three types of AIs. Checks and balances are provided in the Banking Ordinance with the requirement that the MA consult the Financial Secretary on important authorisation decisions, such as suspension or revocation. The Chief Executive in Council (being the Chief Executive of Hong Kong acting after consultation with the Executive Council) is the appellate body for hearing appeals against decisions made by the MA. In addition, there are two statutory committees, the Banking Advisory Committee and the Deposit-Taking Companies Advisory Committee, established to advise on matters relating to banking and deposit-taking business. Moreover, it is the HKMA's general policy to consult widely on matters affecting its supervisory approach, and public consultations are generally undertaken on significant matters, such as deposit protection and banking reform.

AIs must comply with the provisions of the Banking Ordinance which, among other things, require them to maintain minimum liquidity and capital adequacy ratios, to submit periodic returns to the HKMA on required financial information, to adhere to limitations on loans to any one customer or to directors and employees and to seek approval for the appointment of controllers, directors and senior management.

The HKMA seeks to maintain a regulatory framework that is consistent with international standards, especially those recommended by the Basel Committee on Banking Supervision (“**Basel Committee**”).

The HKMA’s supervisory approach is based on a policy of “continuous supervision” through a combination of on-site examinations, off-site reviews, prudential meetings, and co-operation with external auditors and meetings with boards of directors. Since 2000, the HKMA has been using a risk-based supervisory framework for all AIs. This approach puts emphasis on evaluation of the quality of risk management practices and internal controls in respect of various types of risks faced by AIs. On-site examinations are typically limited to areas of highest risk at AIs. The HKMA uses its supervisory resources flexibly and is responsive to changing patterns of risk in the banking sector. Amid uncertainties over fiscal issues and economic recovery in the U.S. and Europe, volatilities in emerging markets and increased risk in the local property market in recent years, the HKMA has been monitoring closely AIs’ management of credit and liquidity risks, Mainland-related business and property-related lending, and stress-testing to ensure the resilience of the banking sector against any abrupt changes in the macroeconomic environment.

In conducting supervision, the HKMA has regard to all the activities of a locally-incorporated AI in Hong Kong and overseas. In addition to regulating and supervising banking business, the HKMA is also responsible for day-to-day supervision of AIs’ securities business if this is carried out in the bank itself (but not if it is carried out in a subsidiary, in which case supervision is the responsibility of the Securities and Futures Commission). Regulation and supervision of banks’ insurance activities is the responsibility of the Office of the Commissioner of Insurance and the relevant self-regulatory organisations such as the Insurance Agents Registration Board. However, irrespective of whether or not the HKMA regulates or supervises an AI’s non-banking activities, its supervisory approach is intended to ensure that the risks that such activities, and other activities within the group, may pose to the financial position or reputation of the AI are taken into account.

The HKMA also supervises overseas offices of Hong Kong incorporated banks, which includes on-site visits and examination of data. In the case of institutions incorporated outside Hong Kong and operating in Hong Kong in branch form, overall responsibility for ensuring the safety and soundness of each AI rests with the relevant home country supervisor, but the HKMA extends applicable prudential standards to the Hong Kong operation (generally, all standards except those relating to capital adequacy), while also endeavouring to maintain close contact with the home supervisor to ensure the full and timely exchange of relevant information.

One of the statutory functions of the HKMA is to promote and encourage proper standards of conduct and sound and prudent business practices amongst AIs. In April 2010, the HKMA established a Banking Conduct Department to provide greater focus to its work in this area. The HKMA cooperates closely with the SFC, the Office of the Commissioner of Insurance and the Mandatory Provident Fund Scheme Authority in supervising AIs’ businesses related to securities, insurance and MPFs.

Banking Reform

In recent years, the HKMA has undertaken a number of reforms to assist in the future development of the banking sector, particularly in light of the 2008 Global Financial Crisis. As part of measures to tackle the “too-big-to-fail” problem, the HKMA has pushed ahead with the preparatory work for the establishment of an effective resolution regime for financial institutions in Hong Kong, with the launch in early 2014 of the first round of public consultation on the proposed regime. The proposed regime seeks to establish a common framework for resolution under which a designated administrative authority could intervene to achieve the orderly resolution of a failing financial institution, by securing continuity of the critical financial services it provides and protecting wider financial stability and public funds. The resolution regime would offer an alternative to existing insolvency proceedings, where its use is justified on financial stability grounds. The HKMA also engaged the banking sector

to develop the Treat Customers Fairly Charter, which was supported and signed up to by all 22 retail banks in Hong Kong in October 2013, pledging to provide customers with greater protection. In 2013, the HKMA also significantly strengthened its manpower to supervise banks' anti-money laundering work and to enhance bank management's risk awareness and governance culture in this area.

The HKMA implemented the first phase of the Basel Committee on Banking Supervision's Basel III capital standards and their associated disclosure requirements in 2013. Work is currently in progress to prepare for the implementation of the next phase of Basel III (in relation to capital buffers, liquidity coverage ratio ("LCR") and associated disclosures, as well as the leverage ratio disclosures). Preparations for drafting the implementing rules for that phase is in progress, with a view to having the rules in place by 1 January 2015. Full implementation is expected by 1 January 2019.

In respect of the new Basel III liquidity standards, namely the LCR and the net stable funding ratio ("NSFR"), the HKMA will make a set of new Banking (Liquidity) Rules to give effect to the LCR starting 1 January 2015. For the NSFR, the HKMA intends to follow the Basel timetable to implement this standard from 1 January 2018. Implementation strategies in this regard will be developed after the Basel Committee completes its modifications of this standard.

Prudential Supervisory Policies

In addition to these reform measures, the HKMA has taken steps with the aim of improving the quality of its supervision. These include initiatives in areas such as, among others, the prevention of money laundering and terrorist financing, consumer protection (the Code of Banking Practice), electronic banking and technology risk management and business continuity planning.

Recent new policies and guidelines have focused primarily on improving AIs' risk management policies and procedures, such as in the areas of general risk management controls, stress testing, recovery planning credit risk, interest rate risk, market risk, liquidity risk, foreign exchange risk and technology risk. The HKSAR Government believes that this will help to ensure that prudential standards in Hong Kong remain on par with international best practices, and that AIs in Hong Kong institute best practice risk management policies and procedures.

Securities and Futures Markets

The Hong Kong Stock Exchange and Futures Exchange

The securities market and the futures market in Hong Kong are operated by the SEHK and the Hong Kong Futures Exchange, respectively. Both the SEHK and the Hong Kong Futures Exchange are wholly-owned subsidiaries of the Hong Kong Exchanges and Clearing Limited ("HKEx"), which is a recognized exchange controller under the Securities and Futures Ordinance ("SFO").

The SEHK is a recognized exchange company under the SFO. It operates and maintains a stock market in Hong Kong and is the primary regulator of stock exchange participants with respect to trading matters and of companies listed on the Main Board and the GEM of the SEHK.

The Hong Kong Futures Exchange is also a recognized exchange company under the SFO. It operates and maintains a futures market in Hong Kong and is the primary regulator of futures exchange participants with respect to trading matters.

The HKEx also owns and operates the clearing houses of the SEHK and the Hong Kong Futures Exchange, namely Hong Kong Securities Clearing Company Limited ("HKSCC"), HKFE Clearing Corporation Limited ("HKCC") and the SEHK Options Clearing House Limited ("SEOCH"). HKSCC and SEOCH provide services for the clearing and settlement of securities and stock option transactions, respectively, including trades and transactions effected on, or subject to the rules of, the SEHK. HKCC provides services for the clearing and settlement of transactions on the Hong Kong Futures Exchange.

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

The HKSCC, a wholly-owned subsidiary of the HKEx, operates the Central Clearing and Settlement System (the “**CCASS**”) for securities trading on the SEHK. The CCASS is an automated book-entry system that handles the settlement of securities. In addition to brokers and custodians, CCASS services are also available to retail investors.

As at 31 December 2013, Hong Kong had the largest stock market in Asia Ex-Japan, as measured by market capitalisation. As at 31 December 2013, there were 1,643 companies listed on the SEHK, including the Main Board and GEM, with a total market capitalisation of HK\$24 trillion.

The turnover of exchange traded funds and real estate investment trusts also reached record highs of HK\$903.1 billion and HK\$82.4 billion, respectively, in 2013. Furthermore, in 2013, the total turnover of HKEx’s securitized derivatives (derivative warrants and callable bull/bear contracts) ranked first in the world for the seventh consecutive year.

The trading volume of the H-shares Index Futures and Options, Mini H-shares Index Futures, Flexible H-shares Index Options and Stock Futures reached new record highs in 2013. In addition, various futures and options contracts, including H-shares Index Futures and Options, HSI Dividend Point Index Futures and Renminbi Currency Futures reached new record highs in terms of open interest.

The Performance of the Hong Kong Stock Exchange

The table below shows the total market capitalisation and daily trading volume of the SEHK and the Hang Seng Index, an index of the leading stocks listed on the SEHK, for the periods indicated:

Market Statistics of the Hong Kong Stock Exchange

	For the year ended 31 December				
	2009	2010	2011	2012	2013
Market Capitalisation (HK\$ billion)					
Mainboard					
Total	17,769.3	20,942.3	17,452.7	21,871.7	23,908.8
Red-chips	3,862.1	4,380.7	3,999.1	4,835.3	4,815.3
H-shares	4,686.4	5,210.3	4,096.7	4,890.9	4,906.6
GEM					
Total	105.0	134.7	84.6	78.4	134.0
Red-chips	6.6	5.3	3.4	3.8	13.1
H-shares	27.1	20.2	4.6	5.1	6.0
Turnover (HK \$billion)					
Mainboard					
Total	15,439.5	17,076.4	17,091.1	13,267.5	15,185.8
Red-chips	1,936.6	1,928.7	1,699.5	1,459.8	1,704.4
H-shares	5,152.8	4,700.8	4,662.8	3,681.4	4,217.4
GEM					
Total	75.8	133.7	63.0	33.5	78.8
Red-chips	1.5	2.3	0.6	0.4	7.2
H-shares	15.5	16.9	4.0	0.8	4.2
Hang Seng Index (index value)	21,872.50	23,035.45	18,434.39	22,656.92	23,306.39

Source: *HKEx*

The SEHK markets showed healthy signs of growth in 2013 in terms of market capitalisation and trading activity. The total market capitalisation of the securities market as at 31 December 2013 was HK\$24,042.8 billion, an increase of approximately 10 per cent. compared to 31 December 2012. The average daily securities market turnover was HK\$62.6 billion in 2013, an increase of approximately 16 per cent. from 2012. In 2013, the highest single-day turnover in the securities market was HK\$128.4 billion while the lowest was HK\$38.6 billion. The total turnover of futures and options in 2013 was 130,028,864 contracts, an increase of 9 per cent. compared with the previous year. In 2013, there were 110 newly listed companies on the Main Board and GEM, of these, 78 were Mainland enterprises. Mainland enterprises raised HK\$312.2 billion of equity funds in Hong Kong in 2013. Total equity funds raised was HK\$378.9 billion, of which the funds raised through IPOs increased year-on-year by 88 per cent. to HK\$169.0 billion. The remaining HK\$209.9 billion was raised through post-IPO fundraising.

The Hang Seng Index reached its highest daily closing level in 2013 on 2 December (24,038 points) and closed the year at 23,306 points, an increase of 3 per cent. from the end of 2012. The Hang Seng China Enterprises Index (HSCEI or H-shares Index) dropped by 5 per cent. to 10,816 points over the year. The Hang Seng China-Affiliated Corporations Index (the Red-chips Index) closed at 4,553 points, less than 1 per cent. higher than the level at the end of 2012. The S&P/HKEx GEM Index rose by 21 per cent. to 461 points over 2013.

Total securities market turnover in 2013 was HK\$15,264.6 billion, up 15 per cent. year-on-year. The average daily turnover for the overall market in 2013 increased year-on-year by 16 per cent. to HK\$62.6 billion — HK\$62.2 billion for the Main Board (up 16 per cent. from 2012) and HK\$323 million for GEM (up 138 per cent. from 2012). The HKEx derivatives (futures and options) market in 2013 recorded total trading volume of 130 million contracts and average daily trading volume of 532,905 contracts (both up 9 per cent. from 2012). The average daily trading volumes of futures products and options products were 210,553 contracts and 322,353 contracts respectively.

Regulation of Hong Kong's Securities and Futures Markets

The SFC is the statutory regulator for Hong Kong's securities and futures markets. It is an independent statutory body established in 1989 by the Securities and Futures Commission Ordinance of Hong Kong. The Securities and Futures Commission Ordinance and nine other securities and futures related ordinances were consolidated into the SFO, which came into operation on 1 April 2003. The SFC is responsible for administering the laws governing the securities and futures markets in Hong Kong and facilitating and encouraging the development of these markets. The regulatory objectives of the SFC, as set out in the SFO, are:

- to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
- to promote the understanding by the public of the operation and function of the securities and futures industry;
- to provide protection for members of the public investing in or holding financial products;
- to minimise crime and misconduct in the securities and futures industry;
- to reduce systemic risks in the securities and futures industry; and
- to assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry.

Recent Developments

In 2012, the SFC put forward measures to reform the IPO sponsors regime, intended to encourage sponsors to take a responsible, proactive and constructive role when leading IPOs and to maintain investor confidence in Hong Kong's IPO market. They emphasise early, comprehensive due diligence and a properly drafted prospectus. These new requirements began coming into effect for listing applications submitted on or after 1 October 2013.

Additionally, the SFC established a dedicated corporate regulation team to review company announcements, circulars and reports and conduct periodic in-depth reviews of companies, in line with a broader and more proactive approach in the SFC's oversight of corporate conduct of listed companies.

Bond Market

Hong Kong has a developed bond market. International investors are free to invest in debt instruments issued in Hong Kong. Companies in Hong Kong can finance their business by issuing various kinds of debt, either in Hong Kong dollars or foreign currencies. In the Hong Kong dollar bond market, public sector bonds include Exchange Fund Bills and Notes, the HKSAR Government bonds issued under the Government Bond Programme (“**GB Programme**”) and bonds issued by statutory bodies and

government-owned entities. For more information on bonds issued under the GB Programme, see “ — *Government Bond Programme*” below. Other bonds include those issued by Hong Kong entities such as AIs and non-bank corporations, and overseas entities such as the World Bank group and Asian Development Bank.

There is no local credit rating agency in Hong Kong. Debt issuers are rated by established international rating agencies. Among these, Moody’s, S&P, Fitch and Rating and Investment Information, Inc. have offices in Hong Kong.

Tracking the global debt market Hong Kong dollar debt issuances by the private issuers fell 20.1 per cent. to HK\$191.7 billion in 2013 compared to 2012. The decrease in issuance activities was particularly prevalent among the AIs. The amount of debt securities issued by AIs decreased nearly 25 per cent. in 2013.

Issuances of Hong Kong dollar debt securities by the non-AI private sector issuers also fell in 2013. In particular, issuance activities dropped significantly in the second and third quarters of 2013 and recovered only slightly in the fourth quarter.

The following table shows the outstanding amount of Hong Kong dollar debt instruments for the years 2009 to 2013:

Outstanding Amount of Hong Kong Dollar Debt Instruments

	As at 31 December				
	2009	2010	2011	2012	2013
	(HK\$ millions, period end)				
Exchange Fund	534,062	653,138	655,413	657,384	751,151
Government ⁽¹⁾	7,000	25,500	49,500	68,500	91,500
AIs	194,590	218,866	228,943	263,418	250,104
Local corporates	79,962	85,575	97,284	116,188	127,937
Multilateral Development Banks (“MDBs”)	24,348	15,513	14,731	10,271	10,214
Non-MDB overseas issuers	200,686	186,166	163,724	147,669	148,698
Statutory bodies and government-owned corporations	66,643	60,592	51,034	45,159	39,816
Total	1,107,291	1,245,350	1,260,629	1,308,590	1,419,420

Note:

- Government Hong Kong Dollar debt instruments comprises Hong Kong Dollar denominated government-issued bonds, including those under the GB Programme.

Source: HKMA.

Dim Sum Bond Market

The first offshore Renminbi bond was issued in Hong Kong in 2007. The offshore Renminbi bond market in Hong Kong, commonly known as the dim sum bond market, had an outstanding amount of bonds of RMB382 billion as at 30 June 2014, according to market statistics.

Issuances in the offshore Renminbi market reached RMB117 billion in 2013 and RMB130 billion in the first half of 2014.

There were also signs of increasing diversification in the issuer base beyond Hong Kong and Mainland entities. In 2013, issuances by entities incorporated outside the Mainland and Hong Kong amounted to approximately 48 per cent. of the total volume compared with approximately 14 per cent. in 2010.

Islamic Finance

Islamic finance has been growing rapidly worldwide in recent years. The development of Islamic finance in Hong Kong is a natural extension of Hong Kong's role as an international financial centre, widening the range of financial products, broadening the types of market players, and adding to the breadth, depth and diversity of Hong Kong's financial market. Hong Kong's existing strengths in the conventional financial services industry serves as a solid foundation for developing Islamic finance.

The HKSAR Government has been working to promote the development of Islamic finance in Hong Kong in four broad areas, namely, (i) putting in place necessary infrastructure, (ii) enhancing Hong Kong's international profile and linkages, (iii) promoting market knowledge of Islamic finance, and (iv) encouraging product development.

In terms of infrastructure, the Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Bill 2013, passed by LegCo on 10 July 2013, has enhanced the competitiveness of Hong Kong in the development of a sukuk market as the legislation levels the playing field by providing a comparable taxation framework for sukuk vis-à-vis conventional bonds. More recently, the Loans (Amendment) Bill 2014 was passed by LegCo on 26 March 2014, putting in place a legal framework for the HKSAR Government to issue sukuk under the GB Programme.

The HKMA and SFC also maintain close partnerships with key Islamic financial markets such as Malaysia and Dubai. For instance, the SFC signed memoranda of understanding with the Dubai Financial Services Authority and with Securities Commission Malaysia in 2008 and 2009 respectively, while the HKMA similarly signed memoranda of understanding with the Dubai International Financial Centre Authority and the Bank Negara Malaysia in 2008 and 2009 respectively, to foster co-operation in the development of Islamic finance. Building on such co-operation, the HKMA joined hands with Bank Negara Malaysia in 2013 to set up a private sector-led Joint Forum on Islamic Finance (the "**Forum**") to strengthen collaboration between market participants in Hong Kong and Malaysia. The Forum's first meeting was held in December 2013.

To promote market awareness, understanding and participation in Islamic finance, the HKMA worked closely with overseas central banks, international organisations and local stakeholders in organising a number of Islamic finance seminars and workshops for market participants. For example, HKMA is an associate member of the Islamic Financial Services Board ("**IFSB**") and has jointly organised and hosted seminars with the IFSB.

A range of Islamic financial products and services have been launched in Hong Kong over the past few years, including global sukuk listed on the SEHK, Islamic funds, Islamic banking windows and Islamic syndicated loans.

Wealth and Asset Management

Hong Kong is well-equipped for the asset management business in terms of market access, investor base and supporting hard and soft infrastructure. 17 private banks have opened for business in Hong Kong since 2009, bringing the total to 47 banks offering private banking services to their clients. For more information about fund management, please see "*— The Economy — Principal Economic Areas — Business and Financial Services — Funds*" above.

Hong Kong is a centre for private equity firms, hedge funds, private banks and exchange traded funds. It has also been a testing ground for the liberalisation of the Mainland's financial markets through schemes such as the Qualified Domestic Institutional Investors (QDII), Qualified Foreign Institutional Investors (QFII) and the RMB Qualified Foreign Institutional Investors (RQFII).

To enhance the operational, regulatory and tax environment for fund managers in Hong Kong, the Financial Secretary announced in the 2013-14 budget a number of measures to further develop the fund management industry, including a proposal to extend the profits tax exemption to include offshore private equity funds, and an initiative to enhance Hong Kong's legal infrastructure for investment fund vehicles by introducing a new open-ended fund company structure to complement the existing unit trust structure, with the aim of providing market participants more flexibility in establishing and operating funds in Hong Kong and attracting more funds to domicile in Hong Kong.

Financial Infrastructure

The HKMA plays a key role in developing a safe and efficient financial infrastructure in Hong Kong, which is essential to the stability and integrity of the monetary and financial systems. Hong Kong has developed a sound financial infrastructure expediting economic transactions and financial intermediation in the region based on a multi-currency, multi-dimensional platform, and introduced a number of improvements to further facilitate payment flows and enable banks to use liquidity more efficiently. The platform, which handles real-time transactions in major foreign currencies and the Hong Kong dollar, and covers diverse financial intermediation channels including banking, equity and debt, helps consolidate Hong Kong's position as an international financial centre. Hong Kong's financial infrastructure meets current best international standards, and closely supports the city's economic development.

In response to industry demands and international developments, new components have been added to broaden the scope and increase the depth of the financial infrastructure in Hong Kong. For example, order routing and settlement system for investment funds, a trade repository for OTC financial derivatives and retail payment infrastructure.

Financial infrastructure in Hong Kong fall into four broad types:

- payment systems for the settlement of interbank payments;
- debt securities settlement system for the settlement and custody of debt securities;
- trade repository for OTC derivatives; and
- domestic and external system links to provide payment-versus-payment (“**PvP**”) and delivery-versus-payment (“**DvP**”) services, locally and across the border respectively.

Hong Kong Dollar Interbank Payment System

Introduced in 1996, the Hong Kong dollar Real Time Gross Settlement (“**RTGS**”) system, also known as the Hong Kong dollar Clearing House Automated Transfer System (“**CHATS**”), enables safe and efficient settlement of interbank payments denominated in the Hong Kong dollar. Interbank payments are settled continuously on a deal-by-deal basis across the book of the HKMA without netting. In addition to settling large-value payments between banks, the system also handles bulk clearing and settlement of cheques, stock market-related payments and other small-value bulk electronic payments, such as Easy Pay System (“**EPS**”), auto-credit and auto-debit transactions, and automatic teller machine transfers. Besides providing interbank payment services, payments arising from the HKMA's monetary operations are also conducted through the Hong Kong dollar RTGS system.

The Hong Kong dollar RTGS system has a single-tier membership structure. With the Exchange Fund Ordinance providing the legal basis for access to the system, licensed banks in Hong Kong are required to join the system and maintain Hong Kong dollar settlement accounts with the HKMA. Restricted licence banks in Hong Kong may also apply to the HKMA for access to the system, and applications will be assessed against the access criteria set out in the HKMA circulars “Access to the Real Time Gross Settlement System” issued on 29 December 1999 and 19 May 2000. As an on-going

effort of the HKMA to eliminate settlement risks for foreign exchange transactions, with the Financial Secretary's approval, the HKMA allowed the CLS Bank International to have limited access to the system in late 2004 to facilitate the inclusion of the Hong Kong dollar in the foreign exchange transactions to be settled through the Continuous Linked Settlement system on a PvP basis.

Central Moneymarkets Unit

The HKMA established the Central Moneymarkets Unit (“CMU”) in 1990 to provide computerized clearing and settlement facilities for Exchange Fund Bills and Notes. In December 1993, the HKMA extended the service to other Hong Kong dollar debt securities. The CMU offers an efficient, safe and convenient clearing and custodian system for Hong Kong dollar debt instruments. Since December 1994 and gradually over the years, the CMU has developed external links with regional debt securities settlement systems (in Australia, the Mainland and South Korea) and with international debt securities settlement systems (such as Euroclear and Clearstream) to assume a more global reach. These links allow overseas investors to hold and settle debt securities lodged with the CMU, and local investors to hold and settle debt securities lodged with overseas systems.

The CMU service was further extended to non-Hong Kong dollar debt securities in January 1996. In December 1996, a seamless interface between the CMU and the Hong Kong dollar RTGS interbank payment system was established. This enables the CMU system to provide real-time and batch DvP services to its members. The CMU was further linked to the U.S. dollar, Euro and Renminbi RTGS systems in December 2000, April 2003 and March 2006, respectively, to provide real time DvP capability for debt securities and also intraday and overnight repo facilities for the U.S. dollar and Euro and Renminbi payment systems in Hong Kong.

In 2013, the CMU processed an average daily value of HK\$24 billion (377 transactions) in secondary market transactions.

Over-the-Counter Derivatives Market Reforms

The 2008 Global Financial Crisis triggered a global movement to improve transparency and reduce counterparty risks in the OTC derivatives markets, resulting in reforms to the OTC derivatives markets on various fronts. The reform measures adopted by the international regulatory community include requiring all OTC derivatives transactions be reported to trade repositories and all standardized OTC derivatives transactions be cleared through central counterparty (“CCP”) clearing facilities.

A trade repository is a centralised registry that maintains an electronic database of records of OTC derivatives transactions. By collecting and providing OTC derivatives transaction information to regulatory authorities, a trade repository plays a vital role in supporting authorities to carry out their market surveillance responsibilities, which will help maintain financial stability. It also helps improve market transparency, promotes standardisation and ensures availability and quality of transaction data.

To meet international standards, the HKMA announced in December 2010 to develop a trade repository in Hong Kong (“HKTR”). At the same time, the HKMA has been working in concert with the SFC, the Financial Services and the Treasury Bureau and other stakeholders to develop a regulatory regime for the OTC derivatives market (“**OTC Regulatory Regime**”) under the SFO, including mandatory requirements for reporting specified OTC derivatives transactions to the HKTR and clearing specified OTC derivatives transactions through designated CCPs. In response to the call of the international regulatory community to speed up on the implementation of trade reporting, the HKMA introduced a set of interim reporting requirements in June 2013 under the Banking Ordinance. Under the interim reporting requirements, licensed banks are required to report specified OTC derivatives transactions among themselves to the HKTR. The Securities and Futures (Amendment) Ordinance 2014, which provides for the broad regulatory framework for the OTC derivatives market in Hong Kong, was passed by LegCo in March 2014. The HKMA and SFC are working together in

preparing the detailed rules for implementing the OTC Regulatory Regime. In July 2014, the HKMA and SFC launched a public consultation on the draft detailed rules for the mandatory reporting and related record keeping obligations, which marked the first of a series of consultations on the draft detailed rules for the OTC Regulatory Regime.

Cross-border Payments

In addition to the foreign currency payment systems within Hong Kong, linkages have been developed in recent years to facilitate payment flows between Hong Kong and the Mainland, as well as other countries.

Guangdong Province of the Mainland. Launched in phases since January 1998, these links cover cross-border RTGS payments in Hong Kong dollars and U.S. dollars, and check clearing in Hong Kong dollars, U.S. dollars and Renminbi, and direct debit transfers in Hong Kong dollars and Renminbi, with Guangdong Province including Shenzhen. The use of these links, which helps expedite payments and remittances between Hong Kong and Guangdong, has been rising gradually with the increasing economic integration between Hong Kong and the Mainland.

Mainland. Cross-border payment arrangements involving the Mainland's Domestic Foreign Currency Payment System were established in March 2009 to facilitate foreign currency funding and liquidity management of Mainland banks and commercial payments. The cross-border payment arrangements currently cover four currencies, namely the Hong Kong dollar, U.S. dollar, Euro and British pound.

Macao. The one-way joint clearing facility for Hong Kong dollar and U.S. dollar checks between Hong Kong and Macao was launched in August 2007 and June 2008, respectively, reducing the time required for clearing Hong Kong dollar and U.S. dollar checks drawn on banks in Hong Kong and presented in Macao from four or five days to two days.

Malaysia. A link between the Ringgit RTGS system in Malaysia (the "**RENTAS system**") and the U.S. dollar RTGS system in Hong Kong came into operation in November 2006. The link helps eliminate settlement risk by enabling PvP settlements of foreign exchange transactions in Ringgit and U.S. dollars during Malaysian and Hong Kong business hours. This is the first cross-border PvP link between two RTGS systems in the region.

Indonesia. The PvP link between Hong Kong's U.S. dollar RTGS system and Indonesia's Rupiah RTGS system was launched in January 2010. The link helps eliminate settlement risk by enabling PvP settlements of foreign exchange transactions in Rupiah and U.S. dollars during Indonesian and Hong Kong business hours.

Thailand. The PvP link between Hong Kong's U.S. dollar RTGS system and Thailand's Thai Baht RTGS system ("**BAHTNET**") was launched in July 2014. The link helps eliminate settlement risk by enabling PvP settlements of foreign exchange transactions in Thai Baht and U.S. dollars during Thailand and Hong Kong business hours.

*Continuous Linked Settlement ("**CLS**") system.* The CLS system, operated by CLS Bank International, is a global clearing and settlement system for cross-border foreign exchange transactions. It removes settlement risk in these transactions by settling them on a PvP basis. The Hong Kong dollar joined the CLS system in 2004.

Regional CHATS. This is an extension of the RTGS systems in Hong Kong in the regional context. Regional payments in Hong Kong dollars, U.S. dollars, Euros and Renminbi can use the RTGS platform in Hong Kong to facilitate cross border or cross bank transfers in those currencies.

The Exchange Fund

The Exchange Fund Ordinance established the Exchange Fund, which is under the control of the Financial Secretary. The Exchange Fund is managed by the HKMA under powers of the Financial Secretary under the Exchange Fund Ordinance which are delegated by the Financial Secretary to the MA. Since its establishment in 1935, the Exchange Fund has held the backing to the banknotes issued in Hong Kong. In 1976, the backing for coins issued and the bulk of the foreign currency assets held in the HKSAR Government's General Revenue Account were also transferred to the Exchange Fund. As at 31 March 2014, the Exchange Fund's liabilities and fund equity primarily consist of certificates of indebtedness, government-issued currency notes and coins, the Aggregate Balance, outstanding Exchange Fund Bills and Notes, placements by banks and other financial institutions and placements by the fiscal reserves, HKSAR government funds and other statutory bodies. The Exchange Fund currently holds the official reserves of Hong Kong predominantly in foreign currency assets, including cash, short-term deposits, foreign government bonds, equities and gold.

The Exchange Fund's statutory use, as provided in the Exchange Fund Ordinance, is primarily to affect, either directly or indirectly, the exchange value of the currency of Hong Kong. Its functions were extended with the enactment of the Exchange Fund (Amendment) Ordinance 1992 by introducing a secondary use of maintaining the stability and integrity of Hong Kong's monetary and financial systems, with a view to maintaining Hong Kong as an international financial centre.

The fiscal reserves are deposited with the Exchange Fund to allow for centralised investment management of public funds. As such, the Exchange Fund and fiscal reserves are managed and invested together but remain two separate and distinct funds. Fiscal reserves assets may be used to enhance the resources available to the Exchange Fund though those amounts represent money borrowed for the account of the Exchange Fund and will have to be repaid on demand.

Similarly, the Bond Fund is also placed with the Exchange Fund for investment purposes. For more information, please see "*—Public Finance —Government Bond Programme*" below.

The HKMA manages the Exchange Fund. Apart from ensuring that the fund meets its statutory roles, one of the HKMA's principal day-to-day activities is the active management of the fund's assets. These are held mainly in the form of marketable interest-bearing instruments and equities in certain foreign currencies. To meet the operational needs of the HKSAR Government, part of the Exchange Fund is also held in Hong Kong dollar denominated securities.

The HKMA regularly reviews its investment strategy and operations. In line with the statutory purposes for which the Exchange Fund was created and maintained, the investment style and strategy are similar to those of comparable central banks and monetary authorities. An investment strategy appropriate for a long-term fund, such as a benchmark approach and use of the long term capital markets, has been adopted, and a wide range of currencies and instruments has been used.

To meet the objectives of preserving capital, providing U.S. dollar backing to the Monetary Base, providing liquidity to maintain financial and currency stability and generating an adequate long-term return, the Exchange Fund is broadly managed under three major portfolios, namely the backing portfolio ("**Backing Portfolio**"), the investment portfolio ("**Investment Portfolio**") and the long-term growth portfolio ("**Long-Term Growth Portfolio**"). The Backing Portfolio holds highly liquid US dollar-denominated assets to provide full backing to the Monetary Base as required under the currency board arrangements. The Investment Portfolio is invested primarily in the bond and equity markets of the member countries of the Organisation for Economic Co-operation and Development to preserve the value and long-term purchasing power of the assets. The Long-Term Growth Portfolio holds private equity and real estate investments.

In 2007, a strategic portfolio (“**Strategic Portfolio**”) was established to hold shares in the HKEx acquired by the HKSAR Government for the account of the Exchange Fund for strategic purposes and to demonstrate the HKSAR Government’s long-term support for the HKEx by enabling the HKSAR Government, over the longer term, to contribute as a shareholder to the promotion of the HKEx’s strategic development. Because of the unique nature of this portfolio, it is not included in the assessment of the investment performance of the Exchange Fund.

Based on the audited financial statements for the year ended 31 December 2013, the **Exchange Fund Group** (comprising the Exchange Fund and its subsidiaries) recorded an investment income of HK\$71.9 billion (comprising interest income of HK\$17.2 billion, dividend income of HK\$11.5 billion, income from investment properties of HK\$1.8 billion, net realised and unrealised gains of HK\$40 billion and net exchange gain of HK\$1.4 billion). The investment income of HK\$71.9 billion included a gain of HK\$48 million in the Strategic Portfolio. Surplus for the year was HK\$20.8 billion and other comprehensive income for the year amounted to HK\$9.7 billion.

The investment return of the Exchange Fund after excluding the Strategic Portfolio was 2.7 per cent. in 2013. The average return was 3.5 per cent. over the past five years, from 2009 to 2013.

The investment return of the Exchange Fund for 2012 and 2013, as well as the compounded annual investment return and domestic inflation rate, as measured by the compounded annual Hong Kong composite CPI, for the period from 1994 to 2013 are set out in the table below:

Investment Return of the Exchange Fund ⁽¹⁾

	2012	2013	Compounded Annual Investment Return (1994-2013)	Compounded Annual Hong Kong Composite CPI (1994- 2013) ⁽²⁾
Investment return in Hong Kong dollar terms ⁽³⁾	4.4	2.7	5.4	2.0

Notes:

1. Investment return calculation excludes the holdings in the Strategic Portfolio.
2. Composite CPI is calculated based on the 2009/2010-based series.
3. The investment returns of 2001 to 2003 are in U.S. dollar terms.

Source: HKMA.

As at 31 December 2013, the Exchange Fund Group’s assets amounted to HK\$3,116.6 billion, of which HK\$526.9 billion are equity securities.

The accumulated surplus of the Exchange Fund Group (the “**Accumulated Surplus**”) is the total net profit earned by the Exchange Fund over the years. Accordingly, when a loss is incurred in the use of the Exchange Fund, it can be offset with the Accumulated Surplus. The Accumulated Surplus as at 31 December 2013, 2012, 2011, 2010 and 2009 was HK\$658.0 billion, HK\$637.3 billion, HK\$576.0 billion, HK\$597.6 billion and HK\$558.2 billion, respectively.

The currency mix of the Exchange Fund Group's assets as at 31 December 2013 (including forward transactions) is set out in the table below:

Currency Mix of the Exchange Fund Group's Assets

	<u>As at 31 December 2013</u>	
	(HK\$ billions)	(percentage of total)
U.S. dollar	2,281.8	73.2
Hong Kong dollar	311.0	10.0
Others ⁽¹⁾	<u>523.8</u>	<u>16.8</u>
Total	<u><u>3,116.6</u></u>	<u><u>100.0</u></u>

Note:

1. Other currencies included mainly the Australian dollar, Canadian dollar, Euro, Renminbi, Sterling and Yen.

Source: HKMA.

The foreign currency reserve assets of Hong Kong amounted to US\$255.8 billion, US\$268.7 billion, US\$285.4 billion, US\$317.3 billion, and US\$311.2 billion as at 31 December 2009, 2010, 2011, 2012 and 2013, respectively. As at 31 July 2014, the total foreign currency reserve assets amounted to US\$325.0 billion not including unsettled foreign exchange contracts.

PUBLIC FINANCE

Overview

The principles underlying the HKSAR Government's management of public finances are set forth in the Basic Law, which stipulates that:

- The HKSAR shall have independent finances, and shall use its revenues exclusively for its own purposes.
- The HKSAR shall practise an independent taxation system, taking the low tax policy previously pursued in Hong Kong as reference.
- The HKSAR shall follow the principle of keeping expenditure within the limits of revenues in drawing up its budget and strive to achieve a fiscal balance, avoid deficits and keep the budget commensurate with the growth rate of its GDP.
- LegCo shall exercise the power to approve the budget of the HKSAR Government

The HKSAR Government implements these constitutional provisions by striving to maintain a low and simple tax regime and exercising fiscal prudence. Consistent with these constitutional provisions, the Public Finance Ordinance (“PFO”) stipulates a system for the control and management of Hong Kong's public finances and defines the respective powers and functions of the legislature and the executive. Pursuant to the PFO, the Financial Secretary submits to the LegCo an annual set of estimates of revenue and expenditure. The estimates are developed against the background of a medium-range forecast to ensure that full regard is given to the longer-term trends in the economy. The financial year starts from 1 April and ends on 31 March.

A government department can only incur expenditure up to the amounts stated in the expenditure estimates and for the purposes approved by the LegCo. If during the financial year a department needs to change the expenditure estimates and spend more money, it must obtain authorisation from the LegCo or relevant authorities with delegated powers.

The HKSAR Government has a prudent fiscal policy, demonstrated by 10 consecutive years of budget surpluses and an accumulation of significant fiscal reserves. For 2013-14, the HKSAR Government recorded a surplus of HK\$21.8 billion. Fiscal reserves as at 31 March 2014 stood at HK\$755.7 billion, or 35.6 per cent. of GDP. Government revenue in 2013-14 amounted to HK\$455.3 billion and expenditure amounted to HK\$433.5 billion. Public expenditure includes government expenditure and expenditure by other public bodies. In 2012-13, public expenditure totalled HK\$400.2 billion, an increase of 3.8 per cent. over the previous year, within which some HK\$277.2 billion (or 69.3 per cent.) was of a recurrent nature.

Government's Financial Accounts

The HKSAR Government uses the General Revenue Account for revenue collection and day-to-day departmental expenditure. In addition, the HKSAR Government controls its other finances through a series of fund accounts established under Section 29 of the Public Finance Ordinance of Hong Kong. The HKSAR Government also transfers amounts as necessary to and from the funds listed below.

- The Capital Works Reserve Fund is funded mainly by land premium proceeds and finances mainly public works projects, land acquisitions, capital subventions, major systems and equipment items and computerisation projects. The Financial Secretary may transfer any surplus funds to the General Revenue Account. LegCo may also approve appropriations from general revenue to the Capital Works Reserve Fund.

- The Capital Investment Fund finances the HKSAR Government's capital investments through equity injections and provision of loans. Examples include equity injections in the AA, MTRCL and the URA, capital investments in the HA and loans made available to the Hong Kong Science and Technology Parks Corporation. Its funding is derived mainly from appropriation from the General Revenue Account, loan repayments, and dividend and interest income.
- The Civil Service Pension Reserve Fund is a reserve fund for meeting payment of civil service pensions in the unlikely event that the HKSAR Government cannot meet its liabilities for such payment from the General Revenue Account. It is funded by investment income and, where necessary, appropriation from the General Revenue Account.
- The Disaster Relief Fund finances grants for humanitarian aid in relief of disasters that occur outside Hong Kong. Its funding is derived from appropriations from the General Revenue Account and investment income.
- The Innovation and Technology Fund finances projects to help promote innovation and technology upgrading in manufacturing and service industries in order to increase productivity and enhance competitiveness, to further the long-term economic development of Hong Kong. It is funded mainly from investment income.
- The Land Fund was established at the time of the establishment of the HKSAR to receive and hold all of the assets transferred from the then HKSAR Government Land Fund which was set up in 1986 by the Chinese side of the Joint Liaison Group for the purpose of holding land premium income in trust for the benefit of the HKSAR Government. With the establishment of the HKSAR Government, the HKSAR Government Land Fund assets were handed over to the HKSAR Government, which determines how the Fund's assets should be expended. The fund's income is derived from investment income.
- The Loan Fund finances loans and advances, such as student loans, made available by the HKSAR Government. Its income is derived mainly from appropriation from the General Revenue Account and principal and interest receipts on its loan portfolio.
- The Lotteries Fund finances social welfare services through grants, loans and advances. Its income is derived mainly from the proceeds of the Mark Six Lottery and investment income.
- The Bond Fund was established in connection with the GB Programme to promote the development of the bond market in Hong Kong by providing more diversified investment products. The Bond Fund is not part of the fiscal reserves and is managed separately from other HKSAR Government accounts.

In accounting terms, public expenditure is taken to include the HKSAR Government's expenditure plus expenditure by the HA and trading funds. The HA, operating through the Housing Department, is financially autonomous. The HKSAR Government provides the authority with capital and land on concessionary terms to build public housing for rent and for sale. The trading funds include entities such as the post office which are self-financing and allowed to retain revenue generated to meet expenditure in providing services and to finance future expansion. The HKSAR Government subventions (grants and payments) to institutions in the private or quasi-private sectors are included, but not spending by organisations in which the HKSAR Government has only an equity stake (such as MTRCL and the AA). Similarly, debt repayments and equity payments are excluded as they do not reflect the actual consumption of resources by the HKSAR Government.

Management of Expenditure and Revenue

The HKSAR Government manages its finances in light of its rolling five-year, medium-range forecast of expenditure and revenue. This provides a model for the HKSAR Government's overall consolidated financial position.

The HKSAR Government aims to manage public finance in order to ensure that government expenditure, over time, does not grow faster than the economy as a whole. The budget presented by the Financial Secretary to LegCo in February of each year is developed against the background of the medium-range forecast to ensure that the budget reflects this goal in light of the longer-term trends of the economy.

Actual revenue and expenditure amounts have largely been consistent with budget forecasts. In the 2012 Budget Speech, the Financial Secretary forecasted that government expenditure would be HK\$393.7 billion and revenue would be HK\$390.3 billion for 2012-13. Actual expenditure amounted HK\$377.3 billion and actual revenue amounted to HK\$442.1 billion for 2012-13. In the February 2013 Budget Speech, the Financial Secretary forecasted that government expenditure would be HK\$440 billion and revenue would be HK\$435.1 billion. The 2013-14 provisional estimates for actual expenditure and actual revenue are HK\$433.5 billion and HK\$455.3 billion, respectively.

In the 2014-15 budget, the Financial Secretary announced wide-ranging measures to boost Hong Kong's economy and enhance the city's competitiveness, such as expanding public wireless internet access, assisting in planning for a new runway at the Hong Kong International Airport and investing in waste recycling and treatment facilities. The Financial Secretary also unveiled a HK\$20 billion package of relief measures for various sectors of the community and outlined the HKSAR Government's financial planning strategy amid an ageing population and shrinking workforce.

The relevant figures, together with the estimates for fiscal year 2014-15, are summarized below:

HKSAR Government Consolidated Balance

	Fiscal year		
	2012-13	2013-14 ⁽¹⁾	2014-15 ⁽²⁾
	(HK\$ billions)		
Government Expenditure	377.3	433.5	411.2
Revenue	442.1	455.3	430.1
Surplus/(deficit) after repayment of bonds and notes . . .	64.8	21.8	9.1

Notes:

1. Provisional figures.
2. Estimated figures.

Source: *Financial Services and the Treasury Bureau (The Treasury Branch)*.

In preparing its budget for 2014-15, the HKSAR Government made, among others, the following assumptions:

- real GDP growth of 3-4 per cent., with a trend growth rate in real terms of 3.5 per cent. per annum for the four year period 2015 to 2018;
- GDP deflator to increase 1 per cent. in 2014, to increase at a trend rate of 2 per cent. per annum for the four year period 2015 to 2018; and

- CCPI to increase 4.6 per cent. in 2014, with an underlying CCPI increase of 3.7 per cent. after netting out effects of various one-off relief measures, and for the period 2015-2018, the trend rate of increase for the underlying CCPI of 3.5 per cent. per annum.

These figures represent the HKSAR Government's forecast made in February 2014, with respect to the HKSAR Government's economy for 2014. While the HKSAR Government believes its assumptions and estimates were reasonable when made, some events are beyond its control, and actual outcomes will depend on future events. Accordingly, no assurance can be given that economic results will not differ materially from these assumptions and estimates.

Accrual and Cash-Based Accounts

The HKSAR Government's budget and core accounts are prepared on a cash basis. In addition, accrual-based consolidated accounts are made publicly available. The accrual-based accounts include not only the General Revenue Account and the funds established under the PFO of Hong Kong, but also other funds established by the HKSAR Government for specific purposes, such as the Quality Education Fund, the HA, government business enterprises (such as the AA and MTRC) and the Exchange Fund, through which most of the HKSAR Government's financial assets are held.

Under the Audit Ordinance of Hong Kong, the Director of Accounting Services is required to submit to the Director of Audit, within five months from the fiscal year end, a statement of the assets and liabilities as well as a statement of the receipts and payments in respect of the General Revenue Account and each of the funds established under Section 29 of the PFO of Hong Kong other than the Lotteries Fund, which is audited separately. The Director of Audit issues his report on the financial statements prepared on a cash basis in October of each year. The accounts prepared on an accrual basis are not subject to an audit.

The HKSAR Government Revenue and Expenditure

The HKSAR Government's revenues are principally derived from taxes, while its expenditures are principally for education, social welfare, health and infrastructure. For fiscal year 2014-15, infrastructure is estimated to account for 18.9 per cent. of total government expenditure, followed by education (18.3 per cent.), social welfare (15.1 per cent.) and health (13.8 per cent.).

The following table sets out the cash-based accounts of the HKSAR Government revenues and expenditures for the fiscal years indicated:

HKSAR Government Revenues and Expenditures

	Fiscal year					
	2009-10	2010-11	2011-12	2012-13	2013-14 ⁽¹⁾	2014-15 ⁽²⁾
	(HK\$ millions)					
Revenue						
Operating revenue						
Internal revenue						
Earnings and profits						
tax	123,184	143,007	176,822	182,442	183,506	177,530
Stamp duties	42,383	51,005	44,356	42,880	41,515	43,800
Bets and sweeps tax . . .	12,767	14,759	15,761	16,565	18,066	18,938
Air passenger departure tax	1,617	1,813	1,947	2,029	2,244	2,263
Utilities, fees and charges						
	13,925	14,846	16,792	15,277	15,849	18,205
General rates	9,957	8,956	9,722	11,204	14,911	20,586
Duties	6,465	7,551	7,725	8,977	9,720	9,322
Motor vehicle taxes	4,816	6,657	7,070	7,466	8,338	8,127
Other revenue	47,746	51,206	59,226	57,766	61,143	50,111
Total Operating Revenue . . .	<u>262,860</u>	<u>299,800</u>	<u>339,421</u>	<u>344,606</u>	<u>355,292</u>	<u>348,882</u>
Capital revenue	<u>55,582</u>	<u>76,681</u>	<u>98,302</u>	<u>97,544</u>	<u>100,054</u>	<u>81,165</u>
Total revenue	<u>318,442</u>	<u>376,481</u>	<u>437,723</u>	<u>442,150</u>	<u>455,346</u>	<u>430,047</u>
Expenditure						
Operating expenditure						
Recurrent Expenditure						
Personal emoluments . . .	50,794	51,018	54,690	58,218	60,710	63,222
Personnel-related						
expenses	20,317	21,594	23,606	26,135	28,702	32,815
Departmental expenses .	20,740	21,005	22,614	23,926	25,268	26,935
Other charges	42,818	41,476	44,888	47,934	56,720	65,198
Subventions	86,511	88,080	96,698	106,108	112,989	118,090
Additional						
commitments	—	—	—	—	—	1,173
Total Recurrent Expenditure	<u>221,180</u>	<u>223,173</u>	<u>242,496</u>	<u>262,321</u>	<u>284,389</u>	<u>307,433</u>
Non-recurrent						
expenditure	13,187	16,120	53,950	40,621	53,325	8,538
Additional commitments . .	—	—	—	—	—	9,029
Total non-recurrent expenditure	<u>13,187</u>	<u>16,120</u>	<u>53,950</u>	<u>40,621</u>	<u>53,325</u>	<u>17,567</u>
Total operating expenditure .	<u>234,367</u>	<u>239,293</u>	<u>296,446</u>	<u>302,942</u>	<u>337,714</u>	<u>325,000</u>
Capital expenditure	<u>54,658</u>	<u>62,067</u>	<u>67,591</u>	<u>74,382</u>	<u>95,829</u>	<u>86,163</u>
Total expenditure	<u>289,025</u>	<u>301,360</u>	<u>364,037</u>	<u>377,324</u>	<u>433,543</u>	<u>411,163</u>

Notes:

1. Provisional figures.
2. Original estimates.

Source: Financial Services and the Treasury Bureau (The Treasury Branch).

Public Expenditure

As set out in the Appendix to the 2014-15 Budget Speech, the Government aims to keep public expenditure at or below 20 per cent. of GDP. The Financial Secretary considers that it is a suitable level as it ensures that the HKSAR Government will not consume excessive social resources and that government expenditure will be kept at a level commensurate with government revenue. Historically, government revenue exceeded this level in only seven out of the past 40 financial years. Public expenditure is estimated to be 19.8 per cent. of GDP for fiscal year 2014-15.

Revenue Sources

The major sources of revenue are profits tax, salaries tax and stamp duties on stock and property transactions. Other significant sources include revenue from rates, bets and sweeps tax, investment returns and land premium.

The HKSAR Government earns tax revenue as well as non-tax revenue, all as shown in the table below:

HKSAR Government Revenues Breakdown

	Fiscal year					
	2009-10	2010-11	2011-12	2012-13	2013-14 ⁽¹⁾	2014-2015 ⁽²⁾
	(percentage of total)					
Tax Revenue	65.3	64.2	62.9	63.2	63.3	67.6
Direct Tax						
Earnings and profits tax . .	38.7	38.0	40.4	41.2	40.3	41.2
Profits tax	24.1	24.8	27.1	28.4	26.5	27.3
Salaries tax	13.0	11.8	11.8	11.4	12.2	12.3
Personal assessment . . .	1.1	1.0	1.0	0.9	1.0	1.0
Property tax	0.5	0.4	0.5	0.5	0.6	0.6
Indirect Tax	26.6	26.2	22.5	22.0	23.0	26.4
Air passenger departure tax	0.5	0.5	0.5	0.5	0.5	0.5
Bets and sweeps tax	4.0	3.9	3.6	3.8	4.0	4.4
Duties	2.0	2.0	1.8	2.0	2.1	2.2
Estate duty	0.1	0.1	0.0	0.0	0.1	0.0
Fees and charges (tax-loaded)	1.6	1.4	1.6	1.2	1.1	1.7
General rates	3.1	2.4	2.2	2.5	3.3	4.8
Motor vehicles taxes	1.5	1.8	1.6	1.7	1.8	1.9
Royalties	0.5	0.6	1.1	0.6	1.0	0.7
Stamp duties	13.3	13.5	10.1	9.7	9.1	10.2
Non-Tax Revenue	34.7	35.8	37.1	36.8	36.7	32.4
Asset sales	0.1	0.0	0.0	0.1	0.0	0.0
Fees and charges (non tax-loaded)	1.7	1.7	1.5	1.5	1.5	1.6
Investment income and interest	10.6	9.0	8.5	8.6	8.1	6.3
Land premium	12.4	17.4	19.3	15.7	18.5	16.3
Properties and investments	4.2	4.2	3.9	4.4	4.6	4.8
Utilities	1.1	0.9	0.8	0.8	0.9	0.9
Other income ⁽³⁾	4.6	2.6	3.1	5.7	3.1	2.5
Total revenue	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Notes:

1. Provisional figures.
2. Original estimates.
3. Other income includes fines, forfeitures and penalties; and loans, reimbursements, contributions and other receipts of General Revenue Account, and also revenue from various funds.

Source: Financial Services and Treasury Bureau (Treasury Branch)

Profits Tax

Profits tax is charged only on profits arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong. Profits of unincorporated businesses are taxed at 15 per cent. whereas profits of corporations are taxed at 16.5 per cent. Assessable profits are determined from the profits made in the relevant accounting year for each year of assessment. There is no withholding tax on dividends paid by corporations, and dividends received from corporations are exempt from tax.

In 2012-13, the HKSAR Government received approximately HK\$125.6 billion in profits tax, or approximately 28.4 per cent. of total revenue. In 2013-14, the HKSAR Government received approximately HK\$120.9 billion in profits tax, or approximately 26.5 per cent. of total revenue. For 2014-15, profits tax is estimated to amount to HK\$117.6 billion, or 27.3 per cent. of total revenue.

Land Premium

Land premium consists of revenue generated from (i) sales by public auction and tender, (ii) modification of existing leases, exchanges and extensions, (iii) private treaty grants and (iv) fees received in respect of short term waivers of land use restrictions. Land premium is credited to the Capital Works Reserve Fund. Land premium contributed HK\$69.6 billion, or 15.7 per cent. of total revenue in 2012-13 and HK\$84.3 billion, or 18.5 per cent. of total revenue in 2013-14. It is estimated to contribute HK\$70.0 billion, or 16.3 per cent. of total revenue, in 2014-15.

Salaries Tax

Salaries tax is charged on emoluments arising in or derived from Hong Kong. Tax payable is calculated on a sliding scale which varies from 2 per cent. to 17 per cent. on every \$40,000 increment of income (after deductions and allowances). The total tax is restricted to a maximum of 15 per cent. of income after deductions and before allowances. Salaries tax contributed HK\$50.5 billion, or 11.4 per cent. of total revenue, in 2012-13 and HK\$55.6 billion, or 12.2 per cent. of total revenue, in 2013-14. It is estimated to amount to HK\$52.9 billion, or 12.3 per cent. of total revenue, for 2014-15.

Stamp Duties

Stamp duty is imposed on different classes of documents relating to transactions of immovable property, leases and share transfers. For the sale or transfer of immovable property, stamp duties are based on the value of the consideration and consist of (i) an ad valorem stamp duty, (ii) an additional special stamp duty introduced in November 2010 for residential properties bought and resold within 24 or 36 months and (iii) a buyer's stamp duty introduced in October 2012 for the acquisition of residential properties. Stamp duties on leases depend upon the term of the lease and the amount of rent. Stamp duties for transfers of Hong Kong stock vary depending on the value of consideration. The revenue from stamp duties accounted for HK\$42.9 billion, or 9.7 per cent. of total revenue, in 2012-13 and HK\$41.5 billion, or 9.1 per cent. of total revenue, in 2013-14. For 2014-15, revenue from stamp duties is estimated to amount to HK\$43.8 billion, or 10.2 per cent. of total revenue.

Other Revenue

Other tax revenue sources include, among others, property tax, personal assessment, bets and sweeps tax, duties assessed on certain commodities, general rates, and motor vehicles taxes. The HKSAR Government also derives revenue from non-tax sources. These include, among others, asset sales, fees and charges, investment income and interest, properties and investments and utilities.

Government Indebtedness and Contingent Liabilities

Indebtedness

As at 31 March 2014, HKSAR Government debt consists of HK\$11.2 billion in outstanding government bonds and notes. Of this amount, HK\$9.7 billion matured on 1 August 2014 and has been repaid. The remaining HK\$1.5 billion notes will be due in July 2019 and are denominated in Hong Kong dollars with an interest rate of 5.125 per cent. Government debt does not include bonds issued under the GB Programme. For more information see “— *Government Bond Programme*” below.

On an accrual basis, the HKSAR Government held HK\$1,465.2 billion in consolidated net assets as at 31 March 2013. Provision for pensions, outstanding bonds and notes and other liabilities amounted to HK\$714.7 billion, HK\$81.7 billion and HK\$56.7 billion, respectively, on an accrual basis. After netting off these liabilities, the consolidated net assets of HK\$1,465.2 billion included HK\$628.1 billion in net assets of the Exchange Fund, HK\$486.1 billion of general reserve and HK\$351.0 billion of capital expenditure reserve.

HKSAR has not defaulted on the payment of any principal of and any interest on any external or internal indebtedness.

Government Bond Programme

The GB Programme is an initiative of the HKSAR Government to promote the further and sustainable development of the local bond market. Through the GB Programme, the HKSAR Government aims to increase the breadth and depth of the local bond market so that the bond market can complement the equity market and the banking sector to serve as an effective channel of financial intermediation. The development of a mature local bond market will also help promote the efficient allocation of funds, thereby promoting financial stability, strengthening Hong Kong’s status as an international financial centre and promoting economic development. Pursuant to a resolution passed by LegCo in May 2013, the HKSAR Government is authorised to borrow up to a maximum principal amount outstanding at any time of HK\$200 billion or equivalent under the GB Programme. Further increases to the maximum amount would require LegCo approval.

The HKSAR Government maintains a strong fiscal position. Under the GB Programme, the HKSAR Government is not subject to any rigid issuance target and can flexibly determine the size and tenor of individual government bond issues, subject to prevailing market conditions and demand.

The HKMA, as representative of the HKSAR Government in the implementation of the GB Programme, is tasked with coordinating the offering of government bonds and managing the investment of the sums raised under the GB Programme, which are credited to the Bond Fund. The Bond Fund is placed with the Exchange Fund for investment purposes and receives investment income based on a fixed rate sharing arrangement in order to preserve capital and generate reasonable investment returns to cover financial obligations and liabilities under the GB Programme. As at 30 June 2014, the balance of the Bond Fund was HK\$102.9 billion. Any shortfall of funds for fulfilling the financial obligations and liabilities of the HKSAR Government under the GB Programme will be financed from the general revenues and assets of the HKSAR Government.

As at 15 August 2014, HK\$70.0 billion institutional bonds and HK\$30.0 billion retail bonds were outstanding.

Outstanding Institutional Bonds under the Government Bond Programme

Expected maturity date	Original maturity	Coupon (per cent. p.a.)	Outstanding size (HK\$ bn)
2014	5-year	2.07	10.0
2015	3-year	0.46	6.5
	5-year	1.43	11.5
2016	3-year	0.34	6.5
	5-year	0.97	7.0
2017	3-year	1.02	3.0
2018	5-year	0.61	4.0
2019	5-year	1.47	5.0
2020	10-year	2.93	6.7
2021	10-year	2.46	4.0
2023	10-year	1.10	4.8
2024	10-year	2.22	1.0
Total			70.0

Source: HKMA.

Contingent Liabilities

As at 31 March 2013, the HKSAR Government had the following contingent liabilities:

- (i) guarantee to the Hong Kong Export Credit Insurance Corporation for liabilities under contracts of insurance amounting to HK\$29,475 million;
- (ii) guarantees provided under the SME Loan Guarantee Scheme amounting to HK\$7,452 million;
- (iii) guarantees provided under the Special Loan Guarantee Scheme amounting to HK\$50,955 million;
- (iv) guarantees provided under the Special Concessionary Measures under the SME Financing Guarantee Scheme amounting to HK\$20,924 million;
- (v) legal claims, disputes and proceedings amounting to HK\$7,821 million;
- (vi) possible capital subscriptions to the Asian Development Bank amounting to HK\$6,391 million; and
- (vii) guarantees provided for a commercial loan of the Ocean Park Corporation amounting to HK\$1,388 million.

Additionally, in June 2014, the HKSAR Government became the guarantor for a HK\$1,707 million medium term note programme of the Hong Kong Science and Technology Parks Corporation. Guarantees by the HKSAR Government are considered and approved by the Financial Secretary on a case-by-case basis.

Under the accrual-based accounts, the contingent liabilities of the HKSAR Government are greater than in the cash-based accounts, as they include, among other things, various guarantees by the HA and claims against the HA with respect to litigation. As at 31 March 2013, these included: i) financial

exposure on the default guarantees of HK\$35,868 million provided for mortgage loans of flats sold under certain schemes of the HA amounting to HK\$33 million and ii) financial exposure on Structural Safety Guarantee covering 27,941 units of flats under certain HA schemes, the amount of which could not be reasonably ascertained.

Fiscal Reserves

The total balance of the General Revenue Account and the eight funds (Capital Works Reserve Fund, Capital Investment Fund, Civil Service Pension Reserve Fund, Disaster Relief Fund, Innovation and Technology Fund, Land Fund, Loan Fund and Lotteries Fund) constitute the fiscal reserves. Fiscal reserves as at 31 March 2014 stood at HK\$755.7 billion. The HKSAR Government estimates that its fiscal reserves will be HK\$764.8 billion at 31 March 2015.

Fiscal reserves are placed with the Exchange Fund for investment purposes. Effective from 1 April 2007, the investment income of the fiscal reserves for any given year is calculated on the basis of the average annual investment return of the Exchange Fund's Investment Portfolio for the past six years or the average annual yield of three-year Exchange Fund Notes for the previous year subject to a minimum of zero per cent, whichever is the higher.

The following table sets forth the fiscal reserves for the periods indicated:

HKSAR Government Fiscal Reserves

	Fiscal year				
	2009-2010	2010-11	2011-12	2012-13	2013-14 ⁽¹⁾
	(in HK\$ millions, except percentages)				
Fiscal reserves as at 31 March ⁽¹⁾	520,281	595,402	669,088	733,914	755,717
Fiscal reserves (as percentage of GDP)	31.4	33.5	34.6	36.0	35.6

Note:

1. Provisional figures.

Source: Financial Services and the Treasury Bureau (The Treasury Branch).

TAXATION

Hong Kong Taxation

This is a summary of the Hong Kong tax considerations relating to the Certificates. It is not complete and therefore does not constitute tax advice. You should consult your own tax adviser about the tax consequences of investing in the Certificates, particularly if you are subject to special tax rules.

The Certificates are issued as part of a wider transaction which has been structured to fall within amendments made to the Inland Revenue Ordinance (Cap. 112) and Stamp Duty Ordinance (Cap.117) by the Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Ordinance in July 2013.

Accordingly, the Certificateholders should be regarded as holding a debt instrument for Hong Kong profits tax purposes and Periodic Distribution Amounts which accrue to or are paid to the Certificateholders should be regarded as interest for Hong Kong profits tax purposes. The Certificateholders should not be regarded as having any interest in or ownership of the Assets for profits tax or stamp duty purposes.

The Certificates should be alternative bonds issued in connection with a borrowing by the Government under Section 2A(2) of the Loans Ordinance (Cap. 61). Therefore:

- the Certificateholders should be able to take advantage of subsections (1)(ca) and (1)(cb) of Section 26A of the Inland Revenue Ordinance ‘Exclusion of certain profits from tax’; and
- the Certificates should not be considered ‘Hong Kong stock’ for the purposes of the Stamp Duty Ordinance.

On the basis outlined above, the following Hong Kong profits tax and stamp duty analysis should apply to the Certificateholders:

- No profits tax or withholding tax is payable in Hong Kong on any payments made by the Issuer on any Certificates.
- No profits tax is payable in Hong Kong on any profits arising from the resale of any Certificates.
- No stamp duty is payable in Hong Kong on the issue or transfer of any Certificates.

United States Federal Income Tax Considerations

The following summary describes certain material U.S. federal income tax considerations of the ownership and disposition of Certificates that may be relevant to a U.S. Holder (as defined below). This summary applies only to U.S. Holders that purchase Certificates for cash at original issuance at the initial issue price and that will hold Certificates as capital assets. This summary is based on the provisions of the U.S. Internal Revenue Code of 1986, as amended (the “Code”), and administrative and judicial interpretations of the Code and U.S. Treasury Regulations, all as in effect as of the date of this summary, and all of which are subject to change, possibly with retroactive effect, which could affect the consequences described below. This summary has no binding effect or official status of any kind, and we cannot assure U.S. Holders that the conclusions reached below would be sustained by a court if challenged.

For purposes of this discussion, a **U.S. Holder** is a holder of Certificates that is a beneficial owner of such Certificates and is:

- a U.S. citizen;

- an individual resident in the United States for U.S. federal income tax purposes;
- a domestic corporation, or other entity taxable as a corporation, organised under the laws of the United States or of any U.S. state or the District of Columbia;
- an estate the income of which is includible in its gross income for U.S. federal income tax purposes without regard to its source; or
- a trust, if either: a U.S. court is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all the substantial decisions of the trust, or the trust has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

This summary does not address all aspects of U.S. federal income taxation that may be relevant to particular U.S. Holders in light of their particular circumstances, or to U.S. Holders subject to special rules, including, without limitation:

- retirement plans;
- insurance companies;
- persons that hold Certificates as part of a “straddle,” “synthetic security,” “hedge,” “conversion transaction” or other integrated investment;
- persons that enter into “constructive sales” involving Certificates or substantially identical property with other transactions;
- persons whose functional currency is not the U.S. Dollar;
- expatriates or former long-term residents of the U.S.;
- U.S. branch operations of foreign corporations;
- banks or financial institutions;
- dealers or traders in securities or currencies;
- tax-exempt organisations;
- persons subject to the alternative minimum tax;
- regulated investment companies;
- real estate investment trusts; and
- persons subject to the mark-to-market rules.

In addition, this summary does not address the effect of any applicable U.S. state or local tax laws or any federal estate, gift or alternative minimum tax consequences, or any consequences arising under the laws of any taxing jurisdiction other than the U.S. This summary also does not consider the tax treatment of persons who own Certificates through a partnership or other pass-through entity. If a partnership (including for this purpose, any entity treated as a partnership for U.S. federal income tax purposes) holds Certificates, the tax treatment of a partner generally will depend upon the status of the partner and the activities of the partnership. If a U.S. Holder is a partner in a partnership that holds Certificates, such holder is urged to consult its own tax adviser regarding the specific tax consequences of the ownership and disposition of Certificates.

No ruling is being requested from the U.S. Internal Revenue Service (the “IRS”) and no legal opinion is being given regarding the tax consequences of investing in the Certificates and no assurance can be given that the IRS or the courts will agree with the discussions set forth herein. Investors should consult their own tax advisers in determining the tax consequences to them of holding Certificates, including the application to their particular situation of the U.S. federal income tax considerations discussed below, as well as the application of state, local, foreign or other tax laws.

Overview

The Issuer intends to treat the Trust as a mere agency or security device which is disregarded for U.S. tax purposes, and to treat the Certificates under the rules applicable to debt instruments for U.S. tax purposes. Under this characterisation, U.S. Holders will be subject to U.S. federal income taxation as if they owned debt instruments instead of Certificates in the Trust, and will not be required to take account of income and expenses incurred at the level of the Trust. The following summary does not discuss Certificates that are issued at more than a de minimis discount for U.S. federal income tax purposes. In the event that the Issuer issues Certificates at more than a de minimis discount, the applicable pricing term sheet may describe the material U.S. federal income tax consequences thereof.

Periodic Distribution Amounts

Taxation of the Certificates under the U.S. tax rules applicable to debt instruments means that Periodic Distribution Amounts will be treated for U.S. tax purposes as payments of interest. Accordingly, a U.S. Holder will be required to include Periodic Distribution Amounts in its income as ordinary income at the time that such distributions are accrued or are received (in accordance with the holder’s method of tax accounting). Such income will be treated as foreign source income for purposes of calculating that U.S. Holder’s foreign tax credit limitation. The limitation on foreign taxes eligible for foreign tax credit is calculated separately with respect to specific classes of income. For this purpose, such income should generally constitute “passive income.” Any foreign income taxes withheld from payments of Periodic Distribution Amounts will be included in the income of U.S. Holders as ordinary income and will likewise be deductible to U.S. Holders, or, alternatively, U.S. Holders may be eligible for a U.S. foreign tax credit subject to various limitations. The rules relating to foreign tax credits are extremely complex. U.S. Holders should consult their own tax advisers regarding the availability of a foreign tax credit and the application of the foreign tax credit rules to their particular circumstances.

Sale, Exchange or Retirement of Certificates

A U.S. Holder’s tax basis in a Certificate generally will equal the U.S. dollar cost of such Certificate to such holder. Upon the sale, exchange or retirement of a Certificate, a U.S. Holder generally will recognise gain or loss equal to the difference between the amount realised on the sale, exchange or retirement (less any amounts in respect of accrued Periodic Distribution Amounts, which will be taxable as ordinary income) and the holder’s tax basis in such Certificate.

Any gain or loss recognised by a U.S. Holder on the sale, exchange or retirement of a Certificate generally will be U.S. source capital gain or loss. For U.S. Holders who are individuals, trusts or estates, which hold the Certificates for more than one year, capital gains may be taxed at lower rates than ordinary income. The deductibility of capital losses is subject to certain limitations.

Potential Alternative Characterisation

The Issuer believes that it is appropriate to treat the Certificates as representing debt obligations of the Obligor and intends to do so. However, the IRS may seek to characterise the Certificates as interests in a grantor trust for U.S. federal income tax purposes. Under this characterisation, while the taxation of the income, gain or loss attributable to the Certificates would be essentially the same as the consequences described above, the Issuer and U.S. Holders would be subject to certain information reporting applicable to foreign trusts. U.S. Holders that fail to comply with these information

reporting requirements in a timely manner could be subject to significant penalties, including a penalty of up to 35 per cent. of the amount paid for a Certificate and 35 per cent. of distributions received from the Issuer. Moreover, a U.S. Holder that fails to file the appropriate information return within 90 days after the date on which the IRS mails notice of such failure to the holder may be liable for a penalty (in addition to the penalty described in the preceding sentence) of US\$10,000 for each 30-day period (or fraction thereof) during which such failure continues after the expiration of such 90-day period. A U.S. Holder could also be liable for penalties equal to 5 per cent. of the gross value of the portion of the trust owned by a U.S. Holder at the close of the year, if the Issuer failed to file a U.S. annual information return and provide each U.S. Holder with a foreign grantor trust owner statement. Similar penalties would be applicable to the Issuer for failure to comply. The Issuer does not expect that it will provide information that would allow either itself or U.S. Holders to comply with foreign trust reporting obligations if they were determined to be applicable. U.S. Holders should consult their own tax advisers as to the potential application of the foreign trust reporting rules and the tax consequences generally with respect to an investment in the Certificates.

Information Reporting and Backup Withholding

Payments of Periodic Distribution Amounts and other proceeds made to certain U.S. Holders of Certificates by a U.S. paying agent or other U.S.-related financial intermediary in respect of Certificates may be subject to information reporting. In addition, a U.S. Holder may be subject to 28 per cent. backup withholding tax in respect of such payments if such holder fails to provide its taxpayer identification number, to certify that such U.S. Holder is not subject to backup withholding, or otherwise to comply with the applicable requirements of the backup withholding rules. Persons holding Certificates who are not U.S. Holders may be required to comply with applicable certification procedures to establish that they are not U.S. Holders in order to avoid the application of such information reporting requirements and backup withholding tax in respect of payments made in the United States or through a U.S.-related financial intermediary. Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules from a payment to a holder of Certificates generally may be claimed as a credit against such holder's U.S. federal income tax liability provided that the required information is furnished to the IRS. Holders of Certificates should consult their own tax advisers as to their qualification for exemption from backup withholding and the procedure for obtaining an exemption. Additionally, individual U.S. Holders may be required to report to the IRS certain information with respect to their beneficial ownership of the Certificates. Investors who fail to report required information could be subject to substantial penalties.

Medicare Tax

For taxable years beginning after 31 December 2012, a U.S. Holder that is an individual or estate, or a trust that does not fall into a special class of trusts that is exempt from such tax, is subject to a 3.8 per cent. tax on the lesser of (1) such U.S. Holder's "net investment income" (or undistributed "net investment income" in the case of estates and trusts) for the relevant taxable year and (2) the excess of such U.S. Holder's modified adjusted gross income for the taxable year over a certain threshold (which in the case of individuals will be between US\$125,000 and US\$250,000, depending on the individual's circumstances). A U.S. Holder's net investment income will generally include its gross interest income and its net gains from the disposition of the Certificates, unless such interest or net gains are derived in the ordinary course of the conduct of a trade or business (other than a trade or business that consists of certain passive or trading activities). If you are a U.S. Holder that is an individual, estate or trust, you are urged to consult your tax adviser regarding the applicability of this tax to your income and gains in respect of your investment in the Certificates.

THE ABOVE DISCUSSION IS NOT INTENDED TO CONSTITUTE A COMPLETE ANALYSIS OF ALL TAX CONSEQUENCES RELATING TO THE ACQUISITION, OWNERSHIP AND DISPOSITION OF CERTIFICATES. PROSPECTIVE PURCHASERS OF CERTIFICATES SHOULD CONSULT THEIR OWN TAX ADVISERS CONCERNING THE TAX CONSEQUENCES APPLICABLE TO THEIR PARTICULAR CIRCUMSTANCES.

ERISA CONSIDERATIONS

The U.S. Employee Retirement Income Security Act of 1974, as amended (“**ERISA**”), and Section 4975 of the U.S. Internal Revenue Code of 1986, as amended (the “**Code**”), impose certain restrictions on (i) employee benefit plans (as defined in Section 3(3) of ERISA) that are subject to Part 4, Title I of ERISA, (ii) plans (as defined in Section 4975(e)(1) of the Code) that are subject to Section 4975 of the Code, including individual retirement accounts and Keogh plans, (iii) any entities (including insurance company general accounts) whose underlying assets could be deemed to include plan assets by reason of a plan’s investment in such entities (each of the foregoing, a “**Plan**”) and (iv) persons who have certain specified relationships to a Plan or its assets (“parties in interest” under ERISA and “disqualified persons” under the Code; collectively, “**Parties in Interest**”). ERISA also imposes certain duties on persons who are fiduciaries of Plans subject to ERISA, and ERISA and Section 4975 of the Code prohibit certain transactions between a Plan and Parties in Interest with respect to such Plan. Violations of these rules may result in the imposition of excise taxes and other penalties and liabilities under ERISA and the Code.

ERISA and Section 4975 of the Code prohibit a broad range of transactions involving plan assets and Parties in Interest, unless a statutory or administrative exemption is available. Parties in Interest that participate in a prohibited transaction may be subject to penalties imposed under ERISA and/or excise taxes imposed pursuant to Section 4975 of the Code, unless a statutory or administrative exemption is available. These prohibited transactions generally are set forth in Section 406 of ERISA and Section 4975 of the Code. Certain exemptions from the prohibited transaction provisions of Section 406 of ERISA and Section 4975 of the Code may be applicable, however, depending in part on the type of Plan fiduciary making the decision to acquire the Certificates and the circumstances under which such decision is made. Included among these exemptions are Section 408(b)(17) of ERISA and Section 4975(d)(20) of the Code (relating to transactions between a person that is a party in interest (other than a fiduciary or an affiliate that has or exercises discretionary authority or control or renders investment advice with respect to assets involved in the transaction) solely by reason of providing services to the plan, provided that there is adequate consideration for the transaction), Prohibited Transaction Class Exemption (“**PTCE**”) 91-38 (relating to investments by bank collective investment funds), PTCE 84-14 (relating to transactions effected by a qualified professional asset manager), PTCE 95-60 (relating to transactions involving insurance company general accounts), PTCE 90-1 (relating to investments by insurance company pooled separate accounts) and PTCE 96-23 (relating to transactions determined by in-house asset managers). Prospective investors should consult with their advisors regarding the prohibited transaction rules and these exceptions. There can be no assurance that any of these exemptions or any other exemption will be available with respect to any particular transaction involving the Certificates.

Certain employee benefit plans, including governmental plans (as defined in Section 3(32) of ERISA), certain church plans (as defined in Section 3(33) of ERISA), and non-U.S. plans (as described in Section 4(b)(4) of ERISA) are not subject to the prohibited transaction rules of ERISA or the Code but may be subject to similar rules under other applicable laws or documents. Accordingly, assets of such plans may be invested in the Certificates without regard to the prohibited transaction considerations under ERISA and the Code described below, subject to the provisions of other applicable federal, state, local or non-U.S. law similar to ERISA or Section 4975 of the Code (“**Similar Law**”).

The term “plan assets” is defined in Section 3(42) of ERISA. The U.S. Department of Labor, the governmental agency primarily responsible for the administration of ERISA, has issued a final regulation (29 C.F.R. Section 2510.3-101), which, together with Section 3(42) of ERISA, set out the standards that will apply for determining what constitutes the assets of a Plan (collectively, the “**Plan Asset Regulation**”). Under the Plan Asset Regulation, if a Plan invests in an “equity interest” of an entity that is neither a “publicly-offered security” nor a security issued by an investment company registered under the Investment Company Act, the Plan’s assets include both the equity interest and an undivided interest in each of the entity’s underlying assets, unless it is established that the entity is an “operating company” or that equity participation in the entity by “benefit plan investors” (which

are essentially Plans) is not “significant.” The Plan Asset Regulation generally defines equity participation in an entity by “benefit plan investors” as “significant” if 25 per cent. or more of the value of any class of equity interest in the entity is held by “benefit plan investors.” If the assets of the Issuer were deemed to be plan assets of a Plan, the Issuer would be subject to certain fiduciary obligations under ERISA and certain transactions that the Issuer might enter into, or may have entered into, in the ordinary course of business might constitute or result in non-exempt prohibited transactions under ERISA or Section 4975 of the Code and might have to be rescinded.

The Issuer intends that the Certificates be treated as indebtedness and not an “equity interest” for purposes of the Plan Assets Regulation. However, because neither the Issuer nor the Trustee will be able to monitor which holders of the Certificates are “benefit plan investors,” each initial purchaser of the Certificates and each subsequent transferee will be deemed to have acknowledged, represented and agreed, by its purchase or holding of Certificates, that (A) it is not and for so long as it holds Certificates will not be (i) a Plan or (ii) a governmental, church or non-U.S. plan subject to Similar Law (a “**Similar Law Plan**”) unless, under this subsection (ii), its acquisition holding and disposition of the Certificates would not result in a violation of any Similar Law, and (B) it and any person causing it to acquire any of the Certificates agrees to indemnify and hold harmless the Issuer, the Trust, the Trustee, the Initial Purchasers and their respective affiliates from any cost, damage or loss incurred by them as a result of it being or being deemed to be a Plan or Similar Law Plan.

PLAN OF DISTRIBUTION

Subject to the terms and conditions stated in the certificate subscription agreement dated 10 September 2014 (the “**Certificate Subscription Agreement**”) between the Issuer, the HKSAR Government, the joint lead managers named below (the “**Joint Lead Managers**”) and the co-managers named below (the “**Co-managers**” and, together with the Joint Lead Managers, the “**Managers**”), each of the Managers has severally agreed to subscribe, and the Issuer has agreed to sell to that Manager, the face amount of Certificates set forth opposite that Manager’s name:

Managers

The Hongkong and Shanghai Banking Corporation Limited	US\$ 235,000,000
Standard Chartered Bank	US\$ 235,000,000
CIMB Investment Bank Berhad	US\$ 235,000,000
National Bank of Abu Dhabi PJSC	US\$ 235,000,000
Abu Dhabi Islamic Bank PJSC	US\$ 10,000,000
Emirates NBD Capital Limited	US\$ 10,000,000
Hong Leong Islamic Bank Berhad	US\$ 10,000,000
Oversea-Chinese Banking Corporation Limited, Hong Kong Branch	US\$ 10,000,000
QInvest LLC	US\$ 10,000,000
RHB Islamic Bank Berhad	US\$ 10,000,000
Total	US\$1,000,000,000

The Certificate Subscription Agreement provides that the obligations of the Managers to pay for and accept delivery of the Certificates are subject to the approval of certain legal matters by their counsel and certain other conditions.

Separate provision has been made among the HKSAR Government, the Issuer and the Joint Lead Managers for payment of management and selling commissions in respect of the offering and sale of the Certificates. The Issuer has also agreed to reimburse the Managers for certain expenses related to the offering.

The Issuer and the HKSAR Government have jointly and severally agreed to indemnify the Managers against certain liabilities, including liabilities under the Securities Act, or to contribute to payments the Managers may be required to make because of any of those liabilities.

The Certificates are a new issue of securities for which there currently is no market. The Managers have advised the Issuer that they intend to make a market in the Certificates as permitted by applicable law. However, there is no obligation for the Managers to make a market and if they do, they may discontinue such market making at any time at their discretion.

The Managers propose to offer the Certificates initially at the offering price on the cover page of this offering memorandum. After the initial offering, the offering price may change. None of the Issuer, the FSI, the HKSAR Government or the Managers have taken any action, nor will the Issuer, the FSI, the HKSAR Government or the Managers take any action, in any jurisdiction that would permit a public offering of the Certificates, or the possession, circulation or distribution of this offering memorandum or any other material relating to the HKSAR Government or the Certificates in any jurisdiction where action for that purpose is required. Accordingly, an investor may not offer or sell, directly or indirectly, any Certificate and may not distribute or publish either this offering memorandum or any other offering material or advertisements in connection with the Certificates, in or from any country or jurisdiction except in compliance with any applicable rules and regulations of such country or jurisdiction.

In connection with the offering of the Certificates, each Manager and/or its affiliate(s) may act as an investor for its own account and may take up Certificates in the offering and in that capacity may retain, purchase or sell for its own account such securities and any securities of the Issuer or the HKSAR Government or related investments and may offer or sell such securities or other investments otherwise than in connection with the offering. Accordingly, references herein to the Certificates being offered should be read as including any offering of the Certificates to the Managers and/or their affiliates acting in such capacity. Such persons do not intend to disclose the extent of any such investment or transactions otherwise than in accordance with any legal or regulatory obligation to do so.

United States

The Certificates have not been and will not be registered under the Securities Act or with any securities regulatory authority of any state of the United States, and may not be offered or sold within the United States except pursuant to an exemption from, or in transactions not subject to, the registration requirements of the Securities Act and applicable state securities laws.

The Certificates are being offered and sold outside the United States in reliance on Regulation S. The Certificate Subscription Agreement provides that the Managers may directly or through their respective U.S. broker-dealer affiliates arrange for the offer and resale of the Certificates within the United States only to QIBs in reliance on Rule 144A.

In addition, until 40 days after the commencement of the offering of any Certificates, an offer or sale of Certificates within the United States by a dealer, whether or not participating in this offering, may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A or another exemption from registration under the Securities Act. See “*Transfer Restrictions*” for a description of other restrictions on the transfer of the Certificates.

As used herein, the term “United States” has the meaning given to it in Regulation S.

United Kingdom

Each Manager has represented, warranted and agreed that:

- (a) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the Financial Services and Markets Act 2000 (“**FSMA**”)) received by it in connection with the issue or sale of the Certificates in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer and the HKSAR Government; or
- (b) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Certificates in, from or otherwise involving the United Kingdom.

Hong Kong

Each Manager has represented, warranted and agreed that (a) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any Certificates other than (i) to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong (the “**Securities and Futures Ordinance**”) and any rules made under that Ordinance; or (ii) in other circumstances which do not result in the document being a “prospectus” as defined in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) of Hong Kong or which do not constitute an offer to the public within the meaning of that Ordinance; and (b) it has not issued or had in its possession for the purposes of issue, whether in Hong Kong or elsewhere and will not issue or have in its possession for the purposes of issue any advertisement, invitation or document relating to the Certificates, which is directed at, or the contents of which are likely to be accessed or read by, the

public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to Certificates which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” as defined in the Securities and Futures Ordinance and any rules made under that Ordinance.

Singapore

Each Manager has acknowledged that this offering memorandum has not been registered as a prospectus with the Monetary Authority of Singapore and the Certificates will be offered pursuant to exemptions under the Securities and Futures Act, Chapter 289 of Singapore (the “**Securities and Futures Act**”). Accordingly, each Manager has severally represented and agreed that it has not offered or sold or made the subject of an invitation for subscription or purchase nor may this offering memorandum or any other document or material in connection with the offer or sale, or invitation for subscription or purchase of any Certificates be circulated or distributed, whether directly or indirectly, to any person in Singapore other than (a) to an institutional investor under Section 274 of the Securities and Futures Act, Chapter 289 of Singapore (the “**SFA**”), (b) to a relevant person pursuant to Section 275(1) of the SFA, or any person pursuant to Section 275(1A) of the SFA, and in accordance with the conditions specified in Section 275 of the SFA or (c) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

Where the Certificates are subscribed or purchased under Section 275 of the SFA by a relevant person which is:

- (a) a corporation (which is not an accredited investor (as defined in Section 4A of the SFA)) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor;
- (b) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary is an individual who is an accredited investor,

Securities (as defined in Section 239(1) of the SFA) of that corporation or the beneficiaries’ rights and interest (howsoever described) in that trust shall not be transferable for 6 months after that corporation or that trust has acquired the Certificates pursuant to an offer under Section 275 of the SFA except:

- (i) to an institutional investor or to a relevant person defined in Section 275(2) of the SFA, or to any person arising from an offer referred to in Section 275(1A) or Section 276(4)(i)(B) of the SFA; or
- (ii) where no consideration is or will be given for the transfer; or
- (iii) where the transfer is by operation of law; or
- (iv) pursuant to Section 276(7) of the SFA or Regulation 32 of the Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations.

Japan

The Certificates have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (Act No. 25 of 1948, as amended; the “**FIEA**”) and each Manager has represented and agreed that it will not offer or sell any Certificates, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (as defined under Item 5, Paragraph 1, Article 6 of the Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949, as amended)), or to others for re-offering or resale, directly or indirectly, in Japan or to, or for the benefit of, a resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the FIEA and any other applicable laws, regulations and ministerial guidelines of Japan.

Korea

The Certificates have not been and will not be registered under the Financial Investment Services and Capital Markets Act. Each Manager has represented and agreed that it has not offered, sold or delivered and will not offer, sell or deliver, directly or indirectly, any Certificates in Korea or to, or for the account or benefit of, any Korean resident (as such term is defined in the Foreign Exchange Transaction Law), except as otherwise permitted under applicable Korean laws and regulations. Furthermore, each Manager is aware that a holder of any Certificates will be prohibited from offering, selling or delivering any Certificates, directly or indirectly, in Korea or to any resident of Korea for a period of one year from the date of issuance of the Certificates, except as otherwise permitted by applicable Korean laws and regulations. Each Manager has further represented that it will take commercially reasonable best measures as an underwriter in the ordinary course of its business to prevent the Certificates from being offered, sold or delivered to any resident of Korea within one (1) year from the issuance of the Certificates.

United Arab Emirates (excluding the Dubai International Finance Centre)

Each Manager has represented and agreed that the Certificates have not been and will not be offered, sold or publicly promoted or advertised by it in the United Arab Emirates other than in compliance with any laws applicable in the United Arab Emirates governing the issue, offering or the sale of securities.

Dubai International Financial Centre

Each Manager has represented and agreed that it has not offered and will not offer the Certificates to any person in the Dubai International Financial Centre unless such offer is:

- (a) an “Exempt Offer” in accordance with the Markets Rules (MKT) module of the Dubai Financial Services Authority (the “**DFSA**”); and
- (b) made only to persons who meet the Professional Client criteria set out in Rule 2.3.2 of the DFSA Conduct of Business Module.

Kingdom of Saudi Arabia

Any investor in the Kingdom of Saudi Arabia or who is a Saudi person (a “**Saudi Investor**”) who acquires Certificates pursuant to any offering should note that the offer of Certificates is a private placement under Article 10 or Article 11 of the “Offer of Securities Regulations” as issued by the Board of the Capital Market Authority resolution number 2-11-2004 dated October 4, 2004 and amended by the Board of the Capital Market Authority resolution number 1-28-2008 dated August 18, 2008 (the “**KSA Regulations**”). Each Manager has represented and agreed that it shall not offer, sell or advertise the Certificates to any person in the Kingdom of Saudi Arabia other than to “Sophisticated Investors” under Article 10 of the KSA Regulations or by way of a limited offer under Article 11 of the KSA Regulations and that any offer of the Certificates to a Saudi Investor will be made through a person authorised by the Capital Market Authority to carry on the activity of arranging (as specified in Article 12 of the KSA Regulations) and following a notification to the Capital Market Authority under and in accordance with the KSA Regulations. Each Manager has represented and agreed that any offer of Certificates will comply with the KSA Regulations.

The offer of Certificates shall not therefore constitute a “public offer” pursuant to the KSA Regulations, but is subject to the restrictions on secondary market activity under Article 17 of the KSA Regulations. Any Saudi Investor who has acquired Certificates pursuant to a private placement under Article 10 and/or Article 11 of the KSA Regulations may not offer or sell those Certificates to any person unless the offer or sale is made through an authorized person appropriately licensed by the

Saudi Arabian Capital Market Authority and: (a) the Certificates are offered or sold to a Sophisticated Investor; (b) the price to be paid for the Certificates in any one transaction is equal to or exceeds Saudi Riyal 1 million or an equivalent amount; or (c) the offer or sale is otherwise in compliance with Article 17 of the KSA Regulations.

State of Qatar

Each Manager has represented and agreed that it has not offered or sold, and will not offer or sell or deliver, directly or indirectly any Certificates in the State of Qatar including the Qatar Financial Centre, except: (a) in compliance with all applicable laws and regulations of the State of Qatar including the Qatar Financial Centre; and (b) through persons or corporate entities authorised and licensed to provide investment advice and/or engage in brokerage activity and/or trade in respect of foreign securities in the State of Qatar.

Kingdom of Bahrain

Each Manager has represented and agreed that it has not offered or sold, and will not offer or sell any Certificates except on a private placement basis to persons in the Kingdom of Bahrain who are “accredited investors”.

For this purpose, an **accredited investor** means:

- (a) an individual holding financial assets (either singly or jointly with a spouse) of US\$1,000,000 or more;
- (b) a company, partnership, trust or other commercial undertaking which has financial assets available for investment of not less than US\$1,000,000; or
- (c) a government, supranational organisation, central bank or other national monetary authority or a state organisation whose main activity is to invest in financial instruments (such as a state pension fund).

Kuwait

Each Manager has represented and agreed that the Certificates have not been and will not be offered, sold, promoted or advertised by it in the State of Kuwait other than in compliance with the Decree Law No. 31 of 1990 and the implementing regulations thereto, as amended, and Law No. 7 of 2010 and the bylaws thereto, as amended governing the issue, offering and sale of securities.

No private or public offering of the Certificates is being made in the State of Kuwait, and no agreement relating to the sale of the Certificates will be concluded in the State of Kuwait. No marketing or solicitation or inducement activities are being used to offer or market the Certificates in the State of Kuwait.

Brunei

This offering memorandum does not, and is not intended to constitute an invitation, offer, sale or delivery of Certificates or other securities in Brunei Darussalam. This offering memorandum is not intended to be a prospectus. It is for information purposes only. This offering memorandum may not be distributed or redistributed to and may not be relied upon or used by any person in Brunei Darussalam. Any offers, acceptances, subscription, sales and allotments of Certificates, shares or other securities shall be made outside Brunei Darussalam. This offering memorandum is neither registered with nor approved by the Brunei Darussalam Registrar of Companies, Registrar of International Business Companies, the Brunei Darussalam Ministry of Finance, the Monetary Authority of Brunei Darussalam and the Shari’a Financial Supervisory Board. The Certificates, shares or other securities are not registered, licensed or permitted by the authority designated under the Mutual Funds Order 2001, the Securities Order 2001, the Shari’a Financial Supervisory Board or by any other government agency or under any law in Brunei Darussalam.

Malaysia

Each Manager has represented and agreed that:

- (a) this offering memorandum has not been registered as a prospectus with the Securities Commission Malaysia (the “SC”) under the Capital Markets and Services Act 2007 of Malaysia (“CMSA”); and
- (b) accordingly, the Certificates have not been and will not be offered for subscription or purchase, nor will any invitation to subscribe for or purchase the Certificates be made, directly or indirectly, nor may this offering memorandum, any application for the Certificates or any document or other material in connection with the offering, this offering memorandum or the Certificates be circulated or distributed in Malaysia, other than to persons falling within Schedule 6 or Section 229(1)(b) and Schedule 7 or Section 230(1)(b) and Schedule 8 or Section 257(3), read together with Schedule 9 or Section 257(3) of the CMSA, subject to any law, order, regulation or official directive of Central Bank of Malaysia, the SC and/or any other regulatory authority from time to time.

Settlement and Delivery

The HKSAR Government and the Issuer expect that delivery of the global certificates will be made against payment therefor on or about the Closing Date, which will be on or about the fifth business day following the date of pricing of the Certificates. Under Rule 15c6-1 of the U.S. Securities Exchange Act, trades in the secondary market generally are required to settle in three business days, unless the parties to a trade expressly agree otherwise. Accordingly, purchasers who wish to trade the Certificates on the date of pricing or the next succeeding business day will be required, by virtue of the fact that the Certificates initially will settle on or about T+5, to specify alternative settlement arrangements to prevent a failed settlement. Settlement procedures in other countries will vary. Purchasers of Certificates may be affected by such local settlement practices and purchasers of Certificates who wish to trade Certificates on the date of pricing or the next succeeding business day should consult their own adviser.

Relationship of Managers with the HKSAR Government

In the ordinary course of business, some of the Managers and certain of their affiliates engage from time to time in various investment banking and advisory services for the HKSAR Government, for which they have received customary compensation.

General

Each of the Managers has represented, warranted and agreed that it will comply to the best of its knowledge and belief in all material respects with all applicable securities laws and regulations in force in any jurisdiction in which it offers or sells the Certificates or possesses or distributes the Offering Memorandum and will obtain any consent, approval or permission required by it for the offer or sale by it of the Certificates under the laws and regulations in force in any jurisdiction to which it is subject or in which it makes such offers or sales and no Manager shall have any responsibility therefor.

These selling restrictions may be modified by agreement between the Issuer, the HKSAR Government and the Managers following a change in relevant law, regulation or directive.

No representation is made that any action has been taken in any jurisdiction that would permit a public offering of the Certificates, or possession or distribution of this offering memorandum, or any other offering material in any country or jurisdiction where action for that purpose is required.

If a jurisdiction requires that the offering be made by a licensed broker or dealer and the Managers or any affiliate of the Managers is a licensed broker or dealer in that jurisdiction, the offering shall be deemed to be made by that Manager or its affiliate on behalf of the Issuer in such jurisdiction.

TRANSFER RESTRICTIONS

Due to the following significant transfer restrictions applicable to the Certificates, investors are advised to consult legal counsel prior to making any reoffer, resale, pledge, transfer or disposal of the Certificates.

The Certificates have not been and will not be registered under the Securities Act or any other securities laws, and may not be offered or sold in the United States except pursuant to an effective registration statement or in accordance with an applicable exemption from, or in transactions not subject to, the registration requirements of the Securities Act. Accordingly, the Certificates are being offered and sold in the United States only to persons reasonably believed to be QIBs in reliance on Rule 144A. The Certificates are being offered and sold outside the United States in offshore transactions pursuant to Regulation S.

Any reoffer, resale, pledge, transfer or other disposal, or attempted reoffer, resale, pledge, transfer or other disposal, made other than in compliance with the restrictions noted below shall not be recognised by the FSI, the HKSAR Government, the Issuer or the Delegate.

Rule 144A Transfer Restrictions

Each purchaser of the Rule 144A Certificates in the United States will be deemed to have acknowledged, represented and agreed that it has received a copy of the offering memorandum and such other information as it deems necessary to make an informed investment decision and that:

- (1) It is:
 - (a) a QIB as defined in Rule 144A;
 - (b) aware, and each beneficial owner of the Rule 144A Certificates has been advised, that the sale of such Certificates to it is being made in reliance on Rule 144A; and
 - (c) acquiring the Rule 144A Certificates for its own account or for the account of one or more QIBs.
- (2) It understands that the Rule 144A Certificates have not been and will not be registered under the Securities Act or with any securities regulatory authority of any state of the United States and may be offered, sold, pledged or otherwise transferred only:
 - (a) outside the United States in an offshore transaction in accordance with Regulation S under the Securities Act;
 - (b) pursuant to an exemption from registration under the Securities Act provided by Rule 144 thereunder (if available);
 - (c) within the United States to a person whom it reasonably believes is a QIB that is purchasing for its own account or for the account of one or more QIBs, in a transaction meeting the requirements of Rule 144A under the Securities Act; or
 - (d) pursuant to an effective registration statement under the Securities Act,

in each case in accordance with any applicable securities laws of any state of the United States.
- (3) It understands that Rule 144A Certificates sold in the offering will constitute “restricted securities” within the meaning of Rule 144 under the Securities Act, and for so long as they remain “restricted securities” such Rule 144A Certificates may not be transferred except as described in paragraph (2).

- (4) It understands that Rule 144A Certificates will bear a legend to the following effect, unless the Issuer determines otherwise in compliance with applicable law:

“THIS CERTIFICATE HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE “**SECURITIES ACT**”), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OF THE UNITED STATES AND ACCORDINGLY MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED OR DISPOSED OF WITHIN THE UNITED STATES EXCEPT PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT AS SET FORTH IN THE FOLLOWING SENTENCE.

BY ITS ACQUISITION HEREOF, THE HOLDER (1) REPRESENTS THAT IT IS A “QUALIFIED INSTITUTIONAL BUYER” (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT), (2) AGREES THAT IT WILL NOT RESELL OR OTHERWISE TRANSFER THIS CERTIFICATE EXCEPT (A) WITHIN THE UNITED STATES TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF ONE OR MORE QUALIFIED INSTITUTIONAL BUYERS IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A UNDER THE SECURITIES ACT, (B) OUTSIDE THE UNITED STATES IN AN OFFSHORE TRANSACTION IN COMPLIANCE WITH RULE 904 OF REGULATION S UNDER THE SECURITIES ACT, (C) PURSUANT TO THE EXEMPTION FROM REGISTRATION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT (IF AVAILABLE) OR (D) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT AND (3) AGREES THAT IT WILL DELIVER TO EACH PERSON TO WHOM THIS CERTIFICATE IS BEING TRANSFERRED A NOTICE SUBSTANTIALLY TO THE EFFECT OF THIS LEGEND.

BY ITS ACQUISITION HEREOF, THE HOLDER REPRESENTS THAT (A) IT IS NOT AND FOR SO LONG AS IT HOLDS THIS CERTIFICATE (OR ANY INTEREST HEREIN) WILL NOT BE (I) AN “EMPLOYEE BENEFIT PLAN” AS DEFINED IN SECTION 3(3) OF THE U.S. EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, AS AMENDED (“**ERISA**”) THAT IS SUBJECT TO TITLE I OF ERISA, (II) A “PLAN” AS DEFINED IN AND SUBJECT TO SECTION 4975 OF THE U.S. INTERNAL REVENUE CODE OF 1986, AS AMENDED (THE “**CODE**”), (III) AN ENTITY WHOSE UNDERLYING ASSETS COULD BE DEEMED TO INCLUDE PLAN ASSETS BY REASON OF AN EMPLOYEE BENEFIT PLAN OR PLAN’S INVESTMENT IN SUCH ENTITY, OR (IV) A GOVERNMENTAL, CHURCH OR NON-U.S. PLAN WHICH IS SUBJECT TO ANY STATE, LOCAL, OTHER FEDERAL LAW OF THE UNITED STATES OR NON-U.S. LAW THAT IS SUBSTANTIALLY SIMILAR TO THE PROVISIONS OF SECTION 406 OF ERISA OR SECTION 4975 OF THE CODE (“**SIMILAR LAW**”) UNLESS, UNDER THIS SUBSECTION (IV), THE ACQUISITION, HOLDING AND DISPOSITION OF THIS CERTIFICATE WOULD NOT VIOLATE THE APPLICABLE PROVISIONS OF ANY SIMILAR LAW, AND (B) IT WILL NOT SELL OR OTHERWISE TRANSFER THIS CERTIFICATE (OR ANY INTEREST HEREIN) TO ANY PERSON WITHOUT FIRST OBTAINING THE SAME FOREGOING REPRESENTATIONS AND WARRANTIES FROM THAT PERSON.

IN CONNECTION WITH ANY TRANSFER, THE HOLDER WILL DELIVER TO THE REGISTRAR SUCH OPINIONS OF COUNSEL, CERTIFICATES AND/OR OTHER INFORMATION AS IT MAY REASONABLY REQUIRE IN FORM REASONABLY SATISFACTORY TO IT AS PROVIDED FOR IN THE DECLARATION OF TRUST TO CONFIRM THAT THE TRANSFER COMPLIED WITH THE FOREGOING RESTRICTIONS AS PROVIDED FOR IN THE DECLARATION OF TRUST.

ANY RESALE OR OTHER TRANSFER OF THIS CERTIFICATE (OR BENEFICIAL INTEREST HEREIN) WHICH IS NOT MADE IN COMPLIANCE WITH THE RESTRICTIONS SET FORTH HEREIN WILL BE OF NO FORCE AND EFFECT, WILL BE NULL AND VOID AB INITIO AND WILL NOT OPERATE TO TRANSFER ANY RIGHTS TO THE TRANSFEREE.”.

- (5) The Issuer, the FSI, the HKSAR Government, the Registrar, the Managers and their affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements. If it is acquiring any Certificates for the account of one or more QIBs, it represents that it has sole investment discretion with respect to each such account and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such account.

Regulation S Transfer Restrictions

Each purchaser of the Regulation S Certificates and each subsequent purchaser of such Regulation S Certificates in resales will be deemed to have acknowledged, represented and agreed that it has received a copy of the offering memorandum and such other information as it deems necessary to make an informed investment decision and that:

- (1) It is purchasing the Regulation S Certificates in an “offshore transaction” (as defined in Regulation S) and the Regulation S Certificates have not been offered to it by means of any “directed selling efforts” (as defined in Regulation S).
- (2) It understands that the Regulation S Certificates have not been and will not be registered under the Securities Act or with any securities regulatory authority of any state of the United States and may be offered, sold, pledged or otherwise transferred only pursuant to an exemption from registration under the Securities Act.
- (3) It understands that the Regulation S Certificates, unless otherwise determined by the Issuer in accordance with applicable law, will bear a legend substantially in the following form:

“THIS CERTIFICATE HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE “**SECURITIES ACT**”), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OF THE UNITED STATES AND ACCORDINGLY MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED OR DISPOSED OF WITHIN THE UNITED STATES EXCEPT PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT.”

- (4) The Issuer, the FSI, the HKSAR Government, the Registrar, the Managers and their affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements.

ERISA Transfer Restrictions

Each purchaser or transferee of the Certificates will be deemed to have acknowledged, represented and agreed that (a) it is not and is not acting on behalf of: (i) a Plan, or (ii) a governmental, church or non-U.S. plan unless, under this subsection (ii), the acquisition, holding and disposition of the Certificate would not violate the applicable provisions of any Similar Law and (b) it will not sell or otherwise transfer any Certificates or interest to any person without first obtaining the same foregoing representations and warranties from that person.

LEGAL MATTERS

The validity of the Certificates will be passed upon for the HKSAR Government by Norton Rose Fulbright, counsel to the HKSAR Government as to matters of Hong Kong, English and U.S. federal law. Certain legal matters will be passed upon for the Joint Global Coordinators and Managers by Allen & Overy, counsel to the Joint Global Coordinators and Managers as to matters of Hong Kong, English and U.S. federal law.

CLEARANCE AND SETTLEMENT

The information set out below is subject to any change in or reinterpretation of the rules, regulations and procedures of DTC, Euroclear or Clearstream, Luxembourg currently in effect. The information in this section concerning such clearing systems has been obtained from sources that the Issuer believes to be reliable, but none of the Issuer, the FSI, the HKSAR Government, the Joint Global Coordinators, the Joint Lead Managers, the Co-managers, the Agents or the Delegate takes any responsibility for the accuracy of this section. The Issuer and the HKSAR Government only take responsibility for the correct extraction and reproduction of the information in this section. Investors wishing to use the facilities of any of the clearing systems are advised to confirm the continued applicability of the rules, regulations and procedures of the relevant clearing system. None of the Issuer, the FSI, the HKSAR Government nor any other party to the Agency Agreement will have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the Certificates held through the facilities of any clearing system or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Book-entry ownership

The Certificates will be evidenced on issue by the Regulation S Global Certificates, registered in the name of a nominee of, and shall be deposited with a custodian for, DTC for the accounts of Euroclear and Clearstream, Luxembourg, and the Rule 144A Global Certificates (registered in the name of a nominee of, and shall be deposited with a custodian for, DTC).

The Issuer, and a relevant joint lead manager appointed for such purpose that is an eligible DTC participant, will make application to DTC for acceptance in its book-entry settlement system of the Certificates represented by the Regulation S Global Certificates and the Rule 144A Global Certificates. The Issuer will also make application to Euroclear and/or Clearstream, Luxembourg for acceptance in their respective book-entry systems in respect of the Certificates to be represented by the Regulation S Global Certificates. The Regulation S Global Certificates and Rule 144A Global Certificates will each have a CUSIP, an ISIN and a Common Code. The Rule 144A Global Certificates and the Regulation S Global Certificates will be subject to restrictions on transfer contained in a legend appearing on the front of such Global Certificate, as set out under “*Transfer Restrictions*”. In certain circumstances, as described below, transfers of interests in the Rule 144A Global Certificates may be made as a result of which such legend may no longer be required.

Upon the Global Certificates being registered in the name of a nominee of, and deposited with a custodian for, DTC, DTC will electronically record the nominal amount of the Certificates held within the DTC system. Investors may hold their beneficial interests in the Global Certificates directly through DTC if they are participants in the DTC system, or indirectly through organisations (including Euroclear and Clearstream, Luxembourg) which are direct or indirect participants in such system (together, such direct and indirect participants of DTC shall be referred to as “**DTC participants**”). All interests in the Global Certificates, including those held through Euroclear or Clearstream, Luxembourg may be subject to the procedures and requirements of DTC. Those interests held through Euroclear, Clearstream, Luxembourg may also be subject to the procedures and requirements of such system.

Payments and relationship of participants with clearing systems

Each of the persons shown in the records of DTC as the holder of a Certificate represented by a Global Certificate must look solely to DTC for his share of each payment made by the Issuer to the holder of such Global Certificate and in relation to all other rights arising under such Global Certificate, subject to and in accordance with the respective rules and procedures of DTC. The Issuer expects that, upon receipt of any payment in respect of Certificates represented by a Global Certificate, DTC or its nominee will immediately credit the relevant participants’ or accountholders’ accounts in the relevant clearing system with payments in amounts proportionate to their respective beneficial interests in the face amount of the relevant Global Certificate as shown on the records of the relevant clearing system

or its nominee. The Issuer also expects that payments by DTC participants to owners of beneficial interests in a Global Certificate held through such DTC participants will be governed by standing instructions and customary practices. Save as aforesaid, such persons shall have no claim directly against the Issuer in respect of payments due on the Certificates for so long as the Certificates are represented by such Global Certificate and the obligations of the Issuer will be discharged by payment to the registered holder, as the case may be, of such Global Certificate in respect of each amount so paid. None of the Issuer, the Delegate or any Agent shall have any responsibility or liability for any aspect of the records relating to or payments made on account of ownership interests in any Global Certificate or for maintaining, supervising or reviewing any records relating to such ownership interests.

Transfer of Certificates

Transfers of interests in the Global Certificates within Euroclear, Clearstream, Luxembourg and DTC will be in accordance with the usual rules and operating procedures of the relevant clearing system. The laws of some states in the United States require that certain persons take physical delivery in definitive form of securities. Consequently, the ability to transfer interests in the Rule 144A Global Certificates to such persons may be limited. Because DTC can only act on behalf of participants, who in turn act on behalf of indirect participants, the ability of a person having an interest in the Rule 144A Global Certificates to pledge such interest to persons or entities that do not participate in DTC, or otherwise take actions in respect of such interest, may be affected by the lack of a physical certificate in respect of such interest.

Beneficial interests in the Regulation S Global Certificates will be effected only through records maintained by DTC and its direct or indirect participants, including Euroclear and Clearstream, Luxembourg. In the case of Certificates to be cleared through Euroclear, Clearstream, Luxembourg, and/or DTC, transfers may be made at any time by a holder of an interest in the Regulation S Global Certificates to a transferee who wishes to take delivery of such interest through the Rule 144A Global Certificates provided that any such transfer will, subject to the applicable procedures of Euroclear, Clearstream, Luxembourg and/or DTC from time to time, only be made upon receipt by any transfer agent of a written certificate from Euroclear or Clearstream, Luxembourg, as the case may be, (based on a written certificate from the transferor of such interest) to the effect that such transfer is being made to a person that the transferor reasonably believes is a QIB within the meaning of Rule 144A purchasing the Certificates for its own account or any account of a QIB, in each case in a transaction meeting the requirements of Rule 144A and in accordance with any applicable securities laws of any state of the United States. Any such transfer made thereafter of the Certificates represented by such Regulation S Global Certificates will only be made upon request through Euroclear or Clearstream, Luxembourg by the holder of an interest in the Regulation S Global Certificates to the Delegate or other agent of details of that account at DTC to be credited with the relevant interest in the Rule 144A Global Certificates. Transfers at any time by a holder of any interest in the Rule 144A Global Certificates to a transferee who takes delivery of such interest through the Regulation S Global Certificates will, subject to the applicable procedures of Euroclear, Clearstream, Luxembourg and/or DTC from time to time, only be made upon delivery to any transfer agent of a certificate setting forth compliance with the provisions of Regulation S and giving details of the account at Euroclear or Clearstream, Luxembourg, as the case may be, and DTC to be credited and debited, respectively, with an interest in each relevant Global Certificate.

Subject to compliance with the transfer restrictions applicable to the Certificates described above and under “*Transfer Restrictions*”, cross-market transfers between DTC, on the one hand, and directly or indirectly through Euroclear or Clearstream, Luxembourg accountholders, on the other, will be effected by the relevant clearing system in accordance with its rules and through action taken by the custodian of the Global Certificates, the Registrar, the Principal Paying Agent and other paying agent.

On or after the Closing Date, transfers of Certificates between accountholders in Euroclear and/or Clearstream, Luxembourg and transfers of Certificates between participants in DTC will generally have a settlement date three business days after the trade date (T+3). The customary arrangements for delivery versus payment will apply to such transfers.

Cross-market transfers between accountholders in Euroclear or Clearstream, Luxembourg and DTC participants will need to have an agreed settlement date between the parties to such transfer. Because there is no direct link between DTC, on the one hand, and Euroclear and Clearstream, Luxembourg, on the other, transfers of interests between the Global Certificates will be effected through the Principal Paying Agent and other paying agents, the custodian of the Global Certificates, the Registrar and any transfer agent receiving instructions (and where appropriate certification) from the transferor and arranging for delivery of the interests being transferred to the credit of the designated account for the transferee. Transfers will be effected on the later of (i) three business days after the trade date for the disposal of the interest in the relevant Global Certificate resulting in such transfer and (ii) two business days after receipt by the Principal Paying Agent or other paying agent or the Registrar, as the case may be, of the necessary certification or information to effect such transfer. In the case of cross-market transfers, settlement between Euroclear or Clearstream, Luxembourg accountholders and DTC participants cannot be made on a delivery versus payment basis. The securities will be delivered on a free delivery basis and arrangements for payment must be made separately.

For a further description of restrictions on transfer of the Certificates, see “*Transfer Restrictions*”.

DTC will take any action permitted to be taken by a holder of Certificates only at the direction of one or more DTC participants in whose accounts with DTC interests in the Global Certificates are credited and only in respect of such portion of the aggregate nominal amount of the relevant Global Certificate as to which such DTC participant or participants has or have given such direction. However, the custodian of the Global Certificates will surrender the relevant Global Certificate for exchange for individual definitive certificates in certain limited circumstances.

DTC is a limited purpose trust company organised under the laws of the State of New York, a “banking organisation” under the laws of the State of New York, a member of the US Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code and a “clearing agency” registered pursuant to the provisions of Section 17A of the Exchange Act. DTC was created to hold securities for its participants and facilitate the clearance and settlement of securities transactions between participants through electronic computerised book- entry changes in accounts of its participants, thereby eliminating the need for physical movement of certificates. Direct participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organisations. Indirect access to DTC is available to others, such as banks, securities brokers, dealers and trust companies, that clear through or maintain a custodial relationship with a DTC direct participant, either directly or indirectly.

Although Euroclear, Clearstream, Luxembourg and DTC have agreed to the foregoing procedures in order to facilitate transfers of beneficial interests in the Global Certificates among participants and accountholders of Euroclear, Clearstream, Luxembourg and DTC they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. None of the Issuer, the Delegate or any Agent will have any responsibility for the performance by Euroclear, Clearstream, Luxembourg or DTC or their respective direct or indirect participants or accountholders of their respective obligations under the rules and procedures governing their operations.

While the Global Certificates are lodged with DTC, Certificates represented by individual definitive certificates will not be eligible for clearing or settlement through Euroclear, Clearstream, Luxembourg, or DTC.

Individual Definitive Certificates

Registration of title to Certificates in a name other than a custodian or its nominee for DTC will be permitted only in the circumstances set forth in “*Global Certificates—Exchange for Definitive Certificates*”. In such circumstances, the Issuer and the Delegate will cause sufficient individual definitive certificates to be executed and delivered to the Registrar for completion, authentication and despatch to the relevant Certificate holder. A person having an interest in a Global Certificate must provide the Registrar with certain information as specified in the Agency Agreement.

Pre-issue trades settlement

It is expected that delivery of Certificates will be made against payment therefor on the Closing Date, which could be more than three business days following the date of pricing. Under Rule 15c6-1 under the Exchange Act, trades in the secondary market generally are required to settle within three business days (“**T+3**”), unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade Certificates on the date of pricing or the next succeeding business day will be required, by virtue of the fact the Certificates initially will settle beyond T+3, to specify an alternative settlement cycle at the time of any such trade to prevent a failed settlement. Settlement procedures in other countries will vary. Purchasers of Certificates may be affected by such local settlement practices and purchasers of Certificates who wish to trade Certificates on the date of pricing or the next succeeding business day should consult their own adviser.

GENERAL INFORMATION

Authorisation

The entry by the HKSAR Government and/or the FSI into the transactions contemplated by the Transaction Documents was authorised under the Loans Ordinance (Cap. 61). The Issuer was established on 22 July 2014 for the purpose of issuing the Certificates and entering into the Transaction Documents.

Listing

Application has been made to the Hong Kong Stock Exchange for the listing of, and permission to deal in, the Certificates by way of debt issues to professional investors only and such permission is expected to become effective on 19 September 2014. Certificates to be listed on the Hong Kong Stock Exchange are required to be traded with a board lot size of at least HK\$500,000 (or equivalent in other currencies).

Application has been made to Bursa Malaysia (under an exempt regime pursuant to which the Certificates will be listed but not quoted for trading) for the listing of the Certificates.

Application has been made to the DFSA for the Certificates to be admitted to the DFSA's Official List of securities and to NASDAQ Dubai for Certificates to be admitted to trading on NASDAQ Dubai. The Certificates are expected to be admitted to the DFSA's Official List on or before 21 September 2014.

Listing of the Certificates on Bursa Malaysia and NASDAQ Dubai is conditional upon satisfaction of the requirements of those exchanges.

Documents Available

For so long as any Certificates remain outstanding, copies (and English translations where the documents in question are not in English) of the following documents will be available, during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted), for inspection and/or collection at the offices of the Principal Paying Agent in New York City:

- (a) the Transaction Documents;
- (b) this offering memorandum.

Clearing Systems

The Global Certificates have been accepted for clearance through DTC. The ISIN for the Rule 144A Certificates is US43858LAA44. The CUSIP for the Rule 144A Certificates is 43858L AA4. The Common Code for the Rule 144A Certificates is 110294131. The ISIN for the Regulation S Certificates is USY35527AA11. The CUSIP for the Regulation S Certificates is Y35527 AA1. The Common Code for the Regulation S Certificates is 110293496.

Significant or Material Change

There has been no significant change in the financial or trading position of the Issuer and/or the HKSAR Government and no material adverse change in the financial position or prospects of the Issuer, in each case, since the date of its incorporation.

Litigation

The Issuer is not and has not been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer is aware) in the 12 months preceding the date of this offering memorandum which may have or have in such period had a significant effect on the financial position or profitability of the Issuer.

Financial Statements

The first financial year of the Issuer will end on 31 March 2015.

The Issuer will prepare annual reports and audited financial statements, but will not prepare interim accounts. The Issuer will ensure that copies are made available free of charge at the registered office of the Principal Paying Agent in New York City.

The Issuer has no subsidiaries.

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Hong Kong

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of the People's Republic of China**

**Government's Representative
Monetary Authority**
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Hong Kong

DELEGATE

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PRINCIPAL PAYING AGENT, TRANSFER AGENT AND REGISTRAR

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