

**Response to Follow-up Question Raised by Hon Mrs Regina IP LAU
Suk-ye (letter of 4 January 2010 from the Clerk to the Subcommittee)**

1. I have also a question arising from information provided by the Hong Kong Monetary Authority in SC(1)-M40. In regard to meetings held between senior staff of the HKMA and Board members of local banks from 2003-08 as part of HKMA's prudential supervision, I am puzzled as to why the number of such meetings diminished considerably in 2008, when the sub-prime crisis in the US was already fairly noticeable. Bear in mind that in February 2007, HSBC already made a warning about its earnings shortfall because of its sub-prime losses in the US. Furthermore, interbank lending rates in Europe registered a sharp rise on 7 August 2007, and on 9 August 2007, BNP Paribas suspended withdrawals from three funds invested in US sub-prime market. Given these warning signs, why did HKMA officials scale down its consultations with local banks as part of its prudential regulation?
 - 1.1 It should be noted that having prudential meetings with the board members of local banks is only one of the means adopted by the HKMA in carrying out prudential supervision of and maintaining communications with such banks. Compared with previous years, the number of such meetings held by the HKMA reduced in 2008 because the HKMA had allocated supervisory resources during the year to monitor and manage the impact of the worsening US sub-prime mortgage situation and the subsequent global financial crisis faced by the banking sector in Hong Kong.
 - 1.2 As the global financial crisis continued to widen and affected more asset classes and overseas institutions in 2008, the HKMA stepped up its monitoring of the direct and indirect exposures of authorized institutions

(AIs) by requiring additional regular reports to be submitted, maintaining close dialogue with the management of AIs, and performing on-site visits and stress tests. Monitoring of AIs' liquidity position was stepped up to ensure that they have adequate high-quality assets available. The HKMA also required banks to adopt a prudent approach in making impairment charges for sub-prime-related exposures.

- 1.3 In addition, the HKMA redeployed a substantial amount of supervisory resources during the year to handle the extra workload arising from complaints relating to stock accumulators and, since mid-September 2008, the investigation of alleged mis-selling of Lehman Brothers-related investment products by banks.