

**Legislative Council Panel on Financial Affairs
Meeting on 21 February 2011**

**Consultation Conclusions on the
Proposed Statutory Codification of Certain Requirements to
Disclose Price Sensitive Information by Listed Corporations**

Request for Information

In relation to proposed “Safe Harbour D - When the Government’s Exchange Fund or a central bank provides liquidity support to the listed corporation”, to provide information on (a) the consideration of the Hong Kong Monetary Authority (“HKMA”) in deciding whether and when such incidents should be disclosed to the public, and (b) in the case of deciding to keep such incidents secret, the accountability arrangements that HKMA would be subject to for the operation of Exchange Fund and its other regulatory activities conducted in such incidents

Reply:

- (a) Considerations of the HKMA in deciding whether or when liquidity support should be disclosed to the public

In line with the function of promoting the stability and effective working of the banking system as set out in Section 7 of the Banking Ordinance (Cap. 155), the HKMA acts as the lender of last resort (“LOLR”) to the banking system in Hong Kong. The LOLR function is to provide temporary liquidity support to an authorized institution (“AI”) facing short-term funding problems with a view to preventing the illiquidity of the AI from precipitating a situation of insolvency or failure, which may, either by itself or through spreading contagion to other institutions, damage the stability of the Hong Kong Dollar exchange rate or the local financial systems.

On whether or when to make public disclosure on the provision of LOLR support to an AI in need of liquidity support, the HKMA will carefully assess if the disclosure would undermine the purpose of the LOLR of maintaining the stability of the exchange rate or the financial systems. For example, the possibility that the disclosure may aggravate the situation of a crisis or give rise to wider systemic problems such as heightening the public nervousness about the stability of the banking system and turning an invisible bank run to a visible bank run. Consequently, disclosure of the provision of liquidity assistance will not help avoid but stimulate panic or contagion and thereby contributing to the build-up of systemic risk. A lesson learned from the Northern Rock crisis in 2007 in the United Kingdom is that disclosure of emergency liquidity assistance provided to the bank by Bank of England not only failed to help restore public confidence in the problem bank, but rather triggered a run on the bank until the eventual nationalisation of the bank. This is because there is a level of stigmatization attached to the liquidity support (i.e. institutions receiving such facility may be perceived as financially vulnerable). The problem of stigmatization could be avoided if such liquidity support operations were conducted covertly.

It should also be noted that, from a financial stability viewpoint, it may be difficult to ascertain whether it is safe to reveal past liquidity assistance at any particular point in time. This is because such incident, once disclosed, even if the disclosure is made a long time after the occurrence of the incident and the financial conditions of the AI concerned has returned to normal, the public may still be skeptical about the financial soundness of the AI, causing another round of unnecessary panic in the market.

- (b) The accountability arrangements that HKMA would be subject to for the operation of the Exchange Fund

The means available to the HKMA to take on the role of LOLR are provided by the Exchange Fund, the use of which is governed by the Exchange Fund Ordinance (“EFO”) (Cap. 66). Section 3(1) of the EFO states that the Fund shall be used primarily for such purposes as the Financial Secretary (“FS”) thinks fit affecting, either directly or indirectly, the exchange value of the currency of Hong Kong and for other purposes incidental thereto. In addition to using the Exchange Fund for this primary purpose, Section 3(1A) of the EFO provides that FS may, with a view to maintaining Hong Kong as an international financial centre, use the Exchange Fund as he thinks fit to maintain the stability and the integrity of the monetary financial systems of Hong Kong. Under Section 5B of the EFO, FS has delegated day-to-day decisions on the use of the Exchange Fund under Section 3(1A) to the Monetary Authority (“MA”). In exercising this power, MA shall have regard to the primary purpose of the Exchange Fund.

The HKMA sets out the principles on which it would be prepared to act as LOLR in its “Policy Statement on the Role of The Hong Kong Monetary Authority as Lender of Last Resort” published in March 2009. The Policy Statement sets out the preconditions for granting LOLR support, the instruments that can be used to secure LOLR support, as well as funding support requiring specific approval from FS where the criteria set out in the Policy Statement are not met. It makes it clear that in considering whether to provide LOLR support to an AI, the guiding principle must be whether the failure of that institution, if it is deprived of liquidity assistance, would damage the stability of the exchange rate, monetary or financial systems. This guiding principle is in line with the requirements of Section 3(1) and 3(1A) of the EFO, which make it clear that the use of the Exchange Fund must be for systemic purpose.

Where there is a banking crisis, an internal committee of the HKMA involving senior executives responsible for banking-related matters would be activated for assessing the situation of the crisis and making recommendations to MA on the proposed actions to deal with the crisis including whether LOLR support should be made available to the problem AI concerned having regard to the requirements stipulated in the LOLR Policy Statement. The assessments and recommendations of the committee would be properly documented. MA would, as an established practice, keep FS informed of the developments of a banking crisis including his decision on provision of LOLR support.

Hong Kong Monetary Authority
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