



# Hong Kong Banking Sector Consultancy Study

1 February 1999



## Outline of the presentation

- **Brief Background to the Banking Sector in Hong Kong**
  - The three-tier system
  - Market entry criteria
  
- **Hong Kong Banking Sector Consultancy Study**
  - Status of the study
  - Purpose of the study
  - Banking trends
  - Message of the study
  - Strategic mandates
  - Recommendations & implementation

### Background - The three-tier system

- In Hong Kong, only authorized institutions (AIs) are allowed to take deposits. There are three tiers of AIs, namely:
  - Licensed Banks (LBs);
  - Restricted Licence banks (RLBs); &
  - Deposit-taking Companies (DTCs)
- The main differences among the three different tiers of institutions are as follows:

	<b>LBs</b>	<b>RLBs</b>	<b>DTCs</b>
Access to deposits	current & savings accounts and deposits of all maturities	no current & savings accounts and only deposits of HK\$500k or more	only deposits of HK\$100k or above with maturity >3 mths are allowed
"one-building" condition	apply to foreign incorp. LBs	apply to foreign incorp. RLBs	not applicable
Access to RTGS	Yes	No	No
Use of "bank" name	not restricted	restricted, but with qualifications	restricted

**Background - Market entry criteria**

	<b>LBs</b>		<b>RLBs</b>	<b>DTCs</b>
	local incorp.	foreign banks		
Size criteria	Total assets>HK\$4b Total deposits>HK\$3b	Total assets>US\$16b	No size criteria	
Paid-up capital requirement	HK\$150mn	N/A	HK\$100mn (only for local RLBs)	HK\$25mn
Association with Hong Kong	be closely identified & associated with HK	N/A	N/A	N/A
Time period of presence in HK	must have been a RLB or DTC for 10 years	must have maintained a LRO for 1-2 years	no specific time for locally incorp. institutions. In practice, foreign banks should have maintained a LRO for 1-2 years	

### **Status of the Consultancy Study**

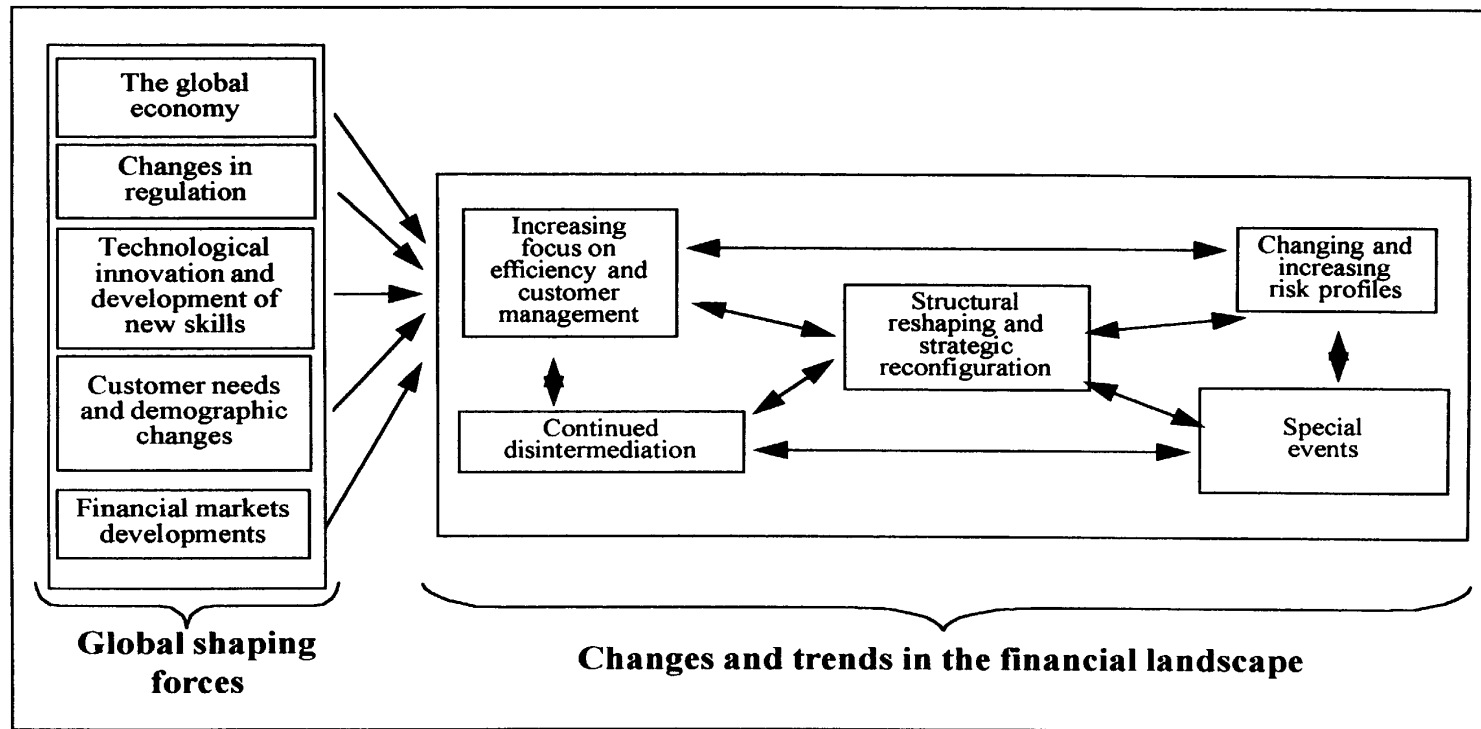
- The recommendations arising from the Study are those of the Consultants
- The Government/HKMA have not yet taken a view on the individual recommendations
- However, they do provide a coherent framework within which to consider the future development of the banking sector in Hong Kong
- Recommendations will be subject to a consultation exercise

## Purpose of the Study

To recommend adjustments to the HKMA's regulatory and supervisory framework *to achieve positive benefits from global and local banking trends while limiting the risks* associated with these trends



## Global shaping forces and banking trends



## The central message of the Study

- We should embrace and manage change (rather than doing nothing and hoping for the best)
- This means removing remaining competitive barriers in order to
  - Encourage more efficient behaviour and innovation
  - Strengthen local banks' ability to compete
  - Increase Hong Kong's attractiveness as a financial centre
- But we need to do this in a safe and sound manner, e.g.,
  - Upgrade risk management capabilities at the individual bank level
  - Enhance HKMA's supervisory processes
  - Look again at depositor protection



**Strategic Mandates for the HKMA**

**To ensure that the regulatory and supervisory framework remains appropriate**

**To improve the competitive environment and attractiveness of Hong Kong as a banking centre**

**To ensure risk is prudently managed**

**To increase the level of transparency**

## Recommendations

**To ensure that the regulatory and supervisory framework remains appropriate**

- Simplify the three tier system
  - A two tier system with the distinction between the tiers being
    - access to small deposits
    - the ability to conduct banking business
- Assess gaps and overlaps between supervisors
  - Not an immediate issue
  - This will need review as the blurring of financial markets continues and banks expand their product ranges

## Recommendations

### To improve the competitive environment and attractiveness of Hong Kong as a banking centre

- **Relax the one building condition**
  - Initially to allow foreign banks to operate 3 branches
  - With a subsequent review of this number at a later date
- **Relax the time period and association with Hong Kong criteria**
  - Time period reduced to 3 years
  - Association with Hong Kong no longer relevant in global market
- **Reassess access to Real Time Gross Settlement**
  - Most international financial centres allow access by all deposit taking institutions (or are moving in this direction)
- **The remaining interest rate rules**
  - No deregulation should occur at this time or during 1999
  - In the longer term deregulation will bring a number of benefits
  - Any deregulation should be phased to allow banks and the sector to adjust risk management and product capabilities

## Recommendations

### To ensure risk is prudently managed

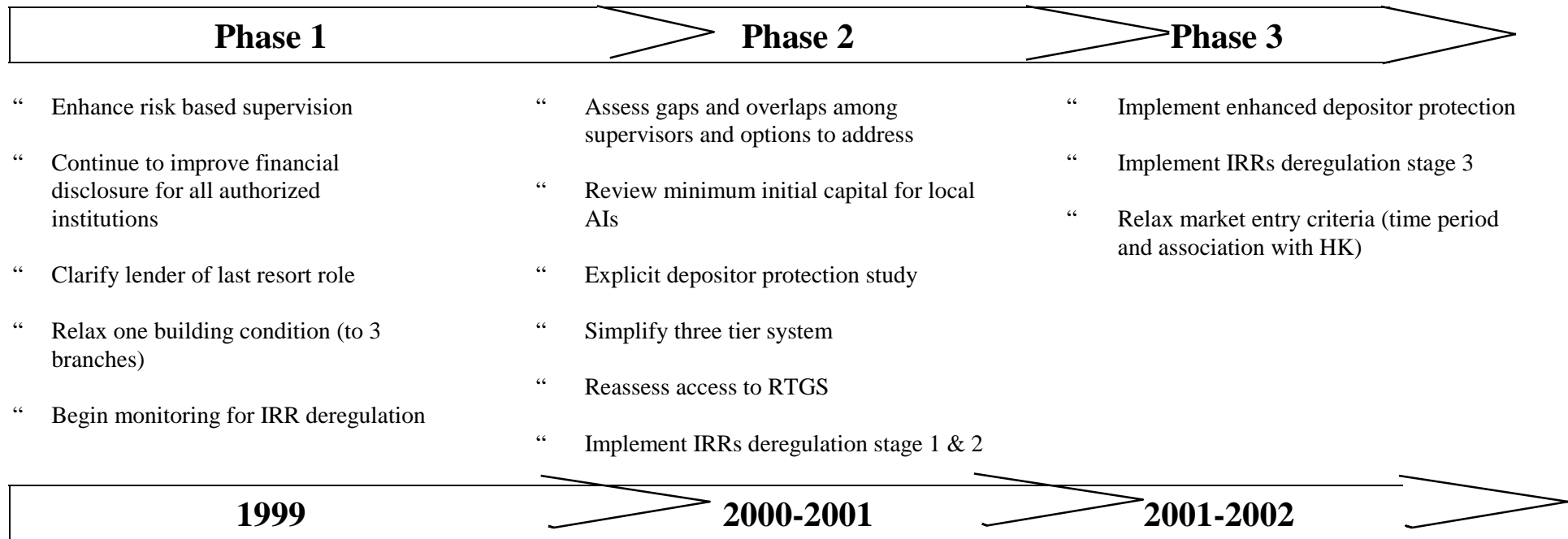
- Clarify the role of the HKMA as lender of last resort
  - The HKMA should formalise its policy and explain it to market participants
- Study alternatives for enhancing depositor protection
  - Most major international financial centres have some form of explicit deposit protection
  - An obvious alternative would be to enhance the existing scheme to provide immediate pay-out
- Review minimum initial capital requirements for local banks
  - The current amount of HK\$150m has not been changed since 1989 and is out of step with minimum assets requirements
- Enhance risk based supervision
  - Strategy and policy are in line with other leading financial centres
  - The recommendations focus on enhancing execution capabilities

## Recommendations

### To increase the level of transparency

- The HKMA has already introduced financial disclosure requirements for foreign branch banks
- The HKMA should continue its work to improve the disclosure requirements of all authorized institutions as markets develop

**Suggested implementation plan**



## **Way forward**

- Further detailed discussions will take place with the banking industry and other parties
- The Government and the HKMA will decide their final position on the recommendations in the light of the comments received in the consultation exercise