



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:

	LBs	RLBs	DTCs
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

	LBs		RLBs	DTCs
	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

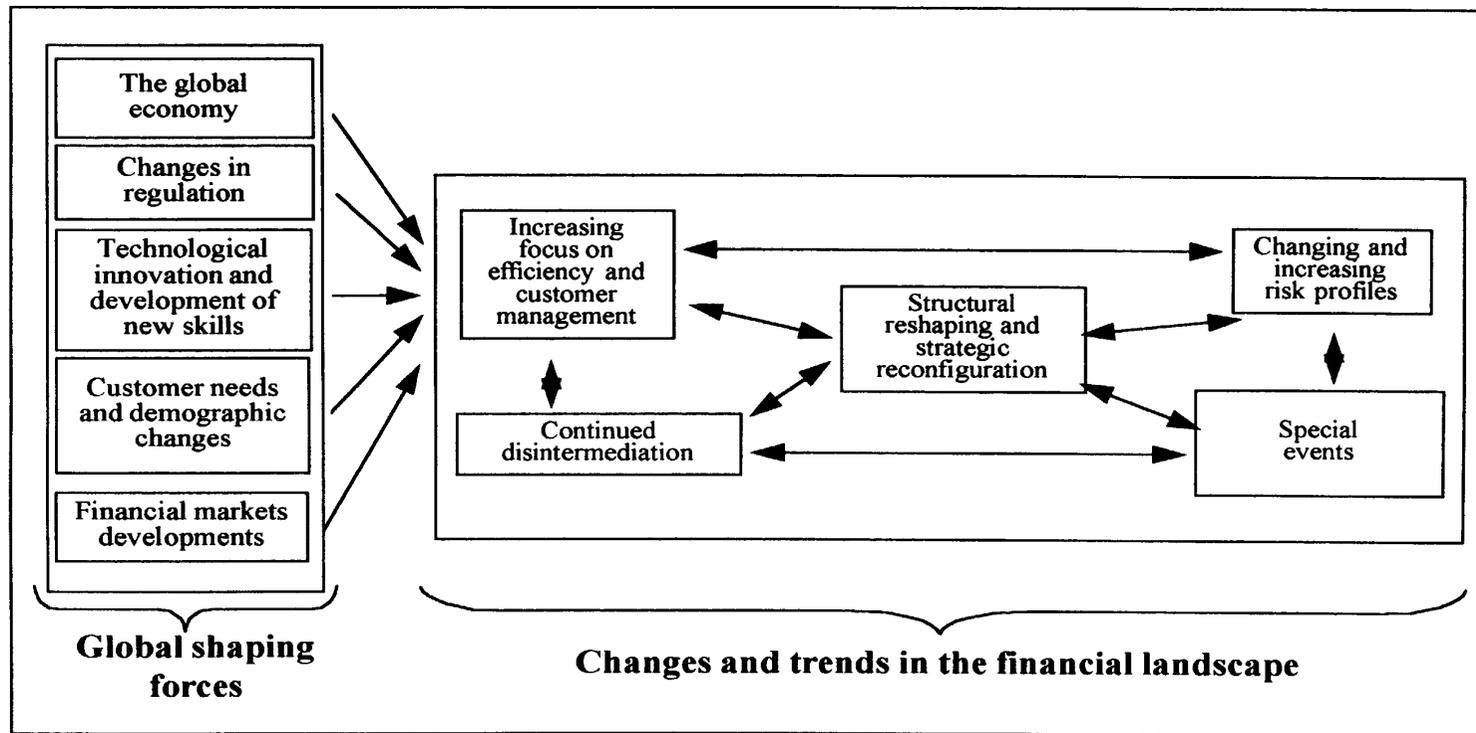
- The recommendations arising from the Study are those of the Consultants
- The Government/HKMA have not yet taken a view on the individual recommendations
- However, they do provide a coherent framework within which to consider the future development of the banking sector in Hong Kong
- Recommendations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

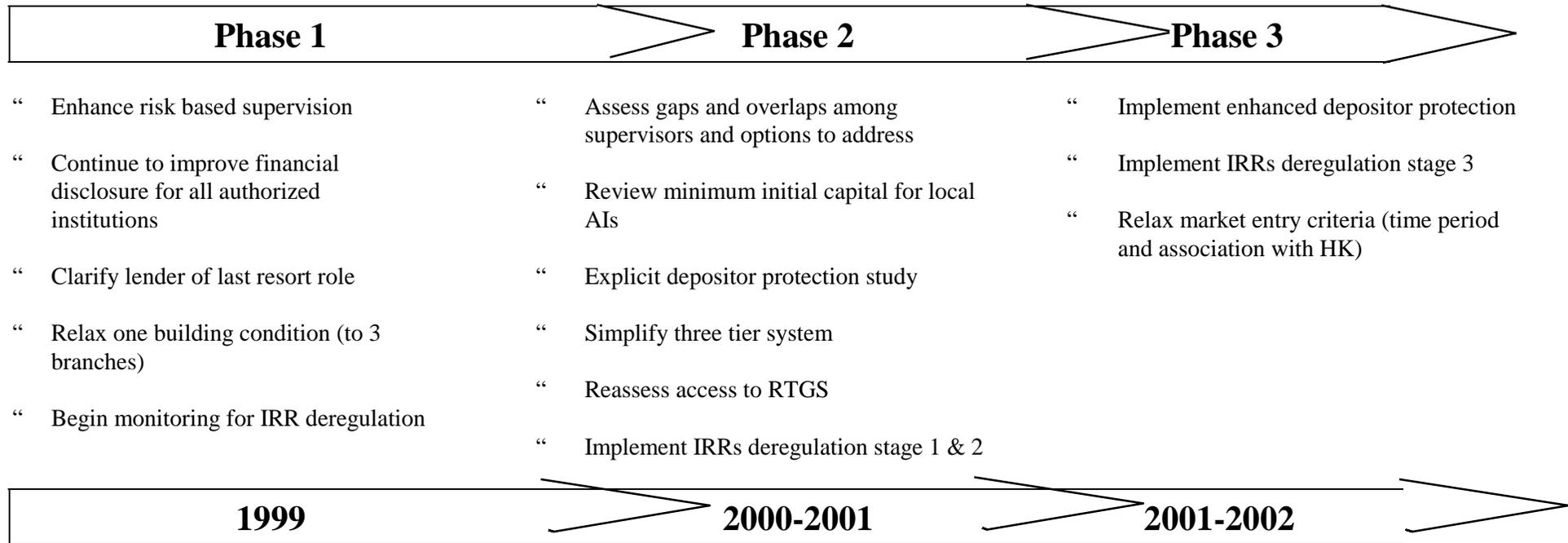
- Clarify the role of the HKMA as lender of last resort
 - The HKMA should formalise its policy and explain it to market participants
- Study alternatives for enhancing depositor protection
 - Most major international financial centres have some form of explicit deposit protection
 - An obvious alternative 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