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23 November 2004

By Fax: 2869 6794

Ms Connie Szeto
Clerk to Panel on Financial Affairs
Legislative Council Building
Hong Kong

Dear Ms Szeto,

LegCo Panel on Financial Affairs ("FA Panel")
Meeting on 1 November 2004/11/18 Item VI Briefing on the draft Citibank (Hong Kong) Limited (Merger) Bill

I refer to your letter dated 3 November 2004 requesting the Administration to take follow-up actions in respect of the FA Panel meeting on 1 November 2004. The following is our response to part 3 of the List of follow-up actions.

(a) Please provide the reasons why the Administration is in support of the Bill;
(b) Please confirm whether the reasons for the proposed transfer are compatible with Government policy

The Bill provides for the transfer of the activities, assets and liabilities which constitute the retail banking business of the Hong Kong branch of Citibank N.A. (the "branch") to a wholly owned subsidiary, Citibank (Hong Kong) Limited ("CHKL"). It is the Government's policy to support reasonable proposals for bank mergers, consolidation or restructuring, which are normal commercial activities, subject to the overriding principle that these proposals will not undermine the general stability and effective working of the banking system and the protection to depositors.

As regards the present case, the Hong Kong Monetary Authority (HKMA) is satisfied that there is a reasonable business case for the branch to transfer its retail banking business to CHKL. CHKL is already operating a credit card business. The transfer will enable CHKL to provide more comprehensive service to its customers, offer CHKL with more cross-selling opportunities, and enhance CHKL's position for potential business opportunities arising from closer economic integration between Hong Kong and the Mainland. In approving the transfer, the HKMA is satisfied that the transfer will not undermine the general stability and effective working of the banking system and the protection to depositors.

(c) Please set out the impact of the proposed transfer on the capital requirements and level of supervision by HKMA on the bank concerned.

If the retail banking business continues to be operated within the branch, then there is no capital adequacy requirement[1] locally. This is in line with international banking supervisory practice that capital adequacy requirement is a matter for the home supervisor (normally meaning the supervisor at the place of incorporation). By transferring the retail banking business to a locally incorporated subsidiary, Citibank will have to inject capital into the subsidiary in order to comply with HKMA's capital adequacy requirement for locally incorporated banks.

Currently, CHKL has a share capital of HK$673 million which is substantially higher than the statutory minimum share capital requirement of HK$300 million for locally incorporated banks. The bank has indicated that as part of the transfer exercise, it will increase its capital base to between US$700 million (HK$5.46 billion) and US$1 billion (HK$7.8 billion). This is understandably smaller than the share capital of its parent due to CHKL's much smaller operation than that of its parent bank. This, however, does not mean that the protection to depositors and customers is smaller. Internationally, banking supervisors do not measure capital adequacy of banks by the absolute amount of capital they are holding. Rather, they use capital adequacy ratio ("CAR"), which measures the size of a bank's capital against the size of its assets and the amount of risk it is facing. The international standard is that banks must maintain a CAR of at least 8%. At the end of June 2004, the average CAR of all locally incorporated authorized institutions (covering banks, restricted licence banks, and deposit-taking companies) was 15.9%. The CAR of CHKL is substantially above the industry average and is substantially higher than the CAR of its parent bank which was 12.56% at end of 2003. It is the intention of CHKL to maintain a CAR that is above or in line with the average for locally incorporated authorized institutions following the transfer. In terms of capital adequacy, therefore, CHKL is in full compliance with the regulatory requirements.

Apart from capital adequacy, CHKL is also subject to the following

[1] This is expressed as the capital adequacy ratio which is the ratio of the bank's capital base (i.e. paid-up capital plus other recognised core and supplementary capital items) over its risk-weighted exposures (on-balance assets and selected off-balance sheet exposures).

supervisory requirements that are applicable to locally incorporated banks (foreign bank branches are subject to similar regulatory requirements imposed by their home regulators):

(i) As a locally incorporated bank, CHKL is required, amongst others, to establish a board of directors and to appoint a minimum of 3 independent non-executive directors. Thus, in addition to oversight by the parent bank, the local management of a locally incorporated institution is also subject to a more independent oversight by its board and the independent directors;

(ii) limits on large exposures, connected lending, shareholding in other companies, interest in land and buildings; and

(iii) more comprehensive financial disclosure including geographical distribution of income, profit and loss, assets and liabilities and off-balance sheet items, cross border claims by types of counterparties, information on asset quality and CAR, and qualitative information on risk management.

In view of the above, the HKMA considers that the transfer of the retail banking business from the branch to CHKL will not weaken its supervision of the business or the protection to the depositors and customers affected by the transfer.

Yours sincerely,

(Mrs Millie Ng)
for Secretary for Financial Services and the Treasury

c.c. CE/HKMA (Attn: Mr YK Choi)