

Review of the Hong Kong Monetary Authority's Work on Banking Stability

by

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Objective of the Review

- How the HKMA can best discharge its functions in promoting the general stability and effective working of the banking system under the Banking Ordinance (BO).
- Taking into account recent and likely future developments in Hong Kong's banking system and the changing nature of the risks facing the system.
- Main focus on the HKMA's regulatory and supervisory functions.

Methodology

- Desktop research of external publications and HKMA documents.
- Case files relating to individual authorized institutions (AIs).
- Discussions with HKMA staff.
- Interviews with various stakeholders of HKMA.
- Written contributions from HKAB and DTCA.

Main trends and issues for the banking system

- Dealing with the impact of the global financial crisis
 - Since the report was written the crisis has intensified and broadened.
- Managing the growing economic integration with the Mainland
 - New business opportunities for Hong Kong banks but also increased risk.
- Coping with the erosion of financial boundaries
 - Increases the importance of effective regulatory cooperation within Hong Kong.

Review and recommendations on the HKMA's regulatory and supervisory functions

- Governance issues relevant to banking stability.
- The MA's functions and powers in the BO.
- The supervisory framework.
- The policy framework.
- Authorization.
- Safety net arrangements.

Governance issues relevant to banking stability

- Exercise of the MA's powers on banking stability is subject to various checks and balances.
- Recommendations are related to:
 - *enhancement of effectiveness of the Advisory Committees*
 - *right of appeal to an independent tribunal under the BO*
 - *Hong Kong Association of Banks should consider a strategic review of its role*
 - *further refinement of the HKMA's business plan.*

The MA's functions and powers in the BO

- The MA should maintain primary focus on prudential issues, but should remain involved in consumer protection issues that are related to the stability and effective working of the banking system.
- Not necessary for the MA to be given a specific statutory responsibility for consumer protection.
- Main recommendations are that the HKMA should:
 - *consider setting out in a formal guideline how it sees its role in consumer protection*
 - *not be involved in resolution of individual disputes between banks and their customers*
 - *consider whether the MA's powers of sanction, investigation and intervention in the BO should be strengthened.*

The supervisory framework

- The HKMA's supervision is generally well-regarded by the industry and outside commentators such as the rating agencies.
- But need to ensure risk assessment is properly focussed and prioritised, and does not impose an excessive burden on AIs and HKMA staff.
- Main recommendations for the HKMA are related to:
 - *streamlining and rationalising the off-site review and on-site examination processes*
 - *enhancing macro-prudential surveillance*
 - *managing the issue of high staff turnover.*

The policy framework

- The HKMA's extensive set of policies largely complies with the revised Basel Core Principles for Effective Banking Supervision.
- Main recommendations are that the HKMA should:
 - *develop policies in line with the recommendations issued by the Basel Committee in response to the sub-prime crisis*
 - *in particular, review the capital and liquidity regimes*
 - *fill the remaining gaps in the policy framework*
 - *review the structure of the policy framework.*

Authorization

- Current three-tier structure of AIs seems more complex than it needs to be, particularly given the decline in the number of RLBs and DTCs and their minimal share of deposits.
- Main recommendation for the HKMA is that:
 - *the current three-tier structure should be reduced to two-tiers – banks and other “deposit-takers.”*

Safety net arrangements

- The need for effective deposit protection has been highlighted by the current crisis.
- Temporary 100% deposit guarantee has been introduced in Hong Kong as a precautionary measure
 - Will remain in force until end-2010.
- When this lapses, the deposit protection arrangements that should apply in “normal” conditions will need to be considered
- Main recommendation of the review is that:
 - *the DPS should review the level of deposit protection and the potential of raising the protection limit without increasing the premium.*

Overall assessment

“No fundamental deficiencies in the regulatory and supervisory framework or processes have been identified. But a number of enhancements can be made which will provide an even sounder foundation to cope with the challenges ahead.”

Next steps

- HKMA is considering the review recommendations and the comments received from the public consultation exercise.
- It aims to produce a policy response to the review recommendations in the first half of 2009.