Press release

LCQ2 : Stabilising the financial system of Hong Kong

Wednesday, October 22, 2008

Following is a question by the Hon Jeffrey Lam and a reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (October 22):

Question:

As the Hong Kong financial market is affected by the financial turmoil in the United States (US) and has become highly volatile recently, the Hong Kong Monetary Authority (HKMA) introduced five measures at the end of last month to provide liquidity assistance to banks so as to stabilise the local financial system. In this connection, will the Government inform this Council:

(a) as banks may use US government bonds as collateral for borrowing from HKMA through the Discount Window, whether HKMA will ask the banks concerned to provide additional collateral or make partial repayment when the value of the relevant bonds depreciates due to their credit ratings being downgraded; if not, whether HKMA will fully underwrite the risks concerned;

(b) of the current number of banks to which HKMA has provided loans and the amounts involved; whether it has assessed, with the introduction of the above measures, if the stability of the Hong Kong dollar will be affected should banks rush to make borrowings and cause the Hong Kong interbank offered rate to surge; if the assessment result is in the affirmative, how the Government will react; and

(c) given that there is criticism that there are loopholes in the existing accounting system of the financial institutions, how HKMA ensures that, after the introduction of the above measures, the accounts of banks will be effectively monitored and scrutinised to safeguard against malpractices in order to protect the interests of investors?

Reply:

President,

(a) When HKMA provides liquidity assistance to banks, the latter must provide suitable collateral assets. HKMA would prudently decide whether these assets are suitable for use as collateral for the relevant loan as well as the applicable haircut having regard to the quality of these assets. The so called haircut is an arrangement under which the relevant loan amount is adjusted downward in accordance with the possible fluctuation of market value of the collateral. Under normal circumstance, haircut can reduce the risk to be borne by the loan provider in the possible scenario that the value of the collateral falls below the relevant loan amount. Under the arrangements by which HKMA provides liquidity assistance to banks, while HKMA is entitled to request supplement of suitable collaterals by banks, it would not lightly resort to requesting banks for immediate repayment of part of the loan.

(b) During the period from October 2 to October 20, a number of banks have obtained liquidity assistance from HKMA through the aforesaid measures, involving an amount of about HK$7.9 billion. According to the information of HKMA, such amount is not large when compared with the scale of transaction in the interbank market. The main reason for banks to conduct collateral borrowing with HKMA is pre-emptive in nature, for preserving liquidity to meet their own contingency needs.

The Hong Kong banking system is fundamentally sound, with capitalisation well above international standards. In the light of the instability and tremendous stress in the global financial system and with a view to enhancing the stability framework of the banking system and ensuring that banks are provided with liquidity in case of need, HKMA announced on September 30 that with effect from October 2 for a period of six months until the end of March 2009, HKMA will provide liquidity assistance on request from licensed banks through the following five measures -

- First, the eligible securities, for access by individual licensed banks to liquidity assistance through the Discount Window, will be expanded to include US dollar assets of credit quality acceptable to HKMA.

- Second, the duration of liquidity assistance provided to individual licensed banks through the Discount Window will be extended, at the request of individual licensed banks and on a case-by-case basis, from overnight money only to maturities of up to three months.

- Third, the 50% threshold for the use of Exchange Fund paper as collateral for borrowing through the Discount Window at HKMA Base Rate will be raised to 100%. In other words, the 5% premium (or penalty) over the Base Rate for the use of Exchange Fund paper beyond the 50% threshold, as collateral for borrowing through the Discount Window, will be waived.

- Fourth, HKMA will, in response to requests from individual licensed banks and when it considers necessary, conduct foreign exchange swaps (between US dollar and Hong Kong dollar) of various durations with licensed banks.

- Fifth, HKMA will, in response to requests from individual licensed banks and when it considers necessary, lend term money of up to one month to individual licensed banks against collateral of credit quality acceptable to HKMA.

HKMA is aware that strain in the interbank market, in particular in the shorter end, has somehow eased after implementation of the aforesaid five temporary measures. As we can see, the new measures are conducive to increasing banks' confidence in the supply for funds, leading to less aggressive biddings for funds by banks and bringing about a positive impact on easing the strain in the interbank market. In the light of the continued nervousness and concern about counterparty risks in the global financial scene, however, there is a sustained elevation of US dollar interest rates. Under this circumstance, it is expected that Hong Kong dollar's term interest rates would unlikely be brought down in the near future.

The Hong Kong money market is currently operating orderly and smoothly. Exchange rate of Hong Kong dollar is also generally stable. HKMA will continue to closely monitor the development of the Hong Kong dollar market and conduct appropriate market operation in case of need in order to maintain the stability of Hong Kong dollar.

(c) As regards the requirements of and regulation on monitoring and scrutinising bank accounts, HKMA follows the "Core Principles for Effective Banking Supervision" issued by the Basel Committee on Banking Supervision as well as the relevant laws of Hong Kong.

When approving the authorisation of authorised institutions (AIs) (including banks), the Monetary Authority (MA) should satisfy that the concerned AI has adhered to or is able to adhere to a series of authorisation criteria, including implementation of an adequate accounting system for complying with the statutory financial reporting requirements under the Companies Ordinance and making timely and accurate reporting of information to MA; AIs incorporated in Hong Kong should disclose information on their state of affairs, profit and loss and capital adequacy in their annual accounts; in accordance with the Banking Ordinance, AIs should have in place standard procedures for periodically reviewing the adequacy of their provisions for losses on financial assets. Failure to maintain adequate provisions is a ground for revocation of the authorisation of the concerned institution.

MA has also issued the Banking (Disclosure) Rules under the Banking Ordinance, setting out the spectrum of information that should be disclosed by AIs on a regular basis. This includes making robust risk disclosure in the light of the market conditions at the time of disclosure.

On enforcement, HKMA assesses the adequacy of AIs' accounting systems, information disclosure and provisions for losses through on-site examinations and off-site reviews. HKMA will also exchange views with the concerned AI and the latter's external auditor at tripartite meetings. MA can request AIs to submit regular or ad hoc auditor's reports on the adequacy of their control systems or other specific areas of supervisory interest or concern.

HKMA will seriously handle non-compliant cases of banks and take appropriate follow-up, with a view to ensuring adequate protection regarding the interests of depositors and investors.

Ends