Banking Stability

The banking sector weathered the challenges of the global financial crisis ending the year with sound capital and liquidity positions. While there are signs of improving performance, as more stable financial market conditions take hold, the outlook remains uncertain. Further steps were taken in 2009 to implement international initiatives to strengthen banks' capital, liquidity and other risk management standards; and authorized institutions introduced improved measures on investor protection. The HKMA worked with the Government on planned new legislation to upgrade Hong Kong's anti-money laundering regime.

OBJECTIVES

Promoting the safety and stability of the banking system through the regulation of banking and deposit-taking businesses and the supervision of authorized institutions (AIs) is a primary function of the HKMA. The responsibility is shared among three departments:

- the Banking Supervision Department handles the day-to-day supervision of AIs
- the Banking Policy Department formulates supervisory policies to promote the safety and soundness of the banking sector
- the Banking Development Department formulates policies to promote the development of the banking industry.

REVIEW OF 2009

Risk-based supervision

The HKMA continued to fine-tune its risk-based supervisory process to keep pace with developments in the banking industry. Because of the continuing and considerable redeployment of staff resources to investigate the alleged mis-selling of Lehman Brothers-related investment products by banks, the HKMA conducted fewer on-site examinations in 2009 (142), compared with 161 in 2008. The supervisory focus was more on improving vigilance in the off-site surveillance of AIs. More frequent meetings were held in 2009 with senior management and heads of control functions of individual AIs to discuss and address emerging prudential concerns. Greater emphasis was placed on the work of the compliance and internal audit functions of AIs to ensure their business operations complied with the relevant internal control procedures and regulatory requirements. Regular stress tests conducted internally by the HKMA were strengthened to assess the asset quality, profitability and the capital position of retail banks to detect possible vulnerabilities under severe but plausible scenarios, and to identify action to be taken. For branches and subsidiaries of foreign banks, the HKMA maintained close contact with the relevant home supervisors, especially those in jurisdictions whose financial markets were hit hard by the global financial crisis, to understand developments at the banks' head offices.

Following introduction of the full deposit guarantee on all customer deposits held with all AIs in October 2008, and mindful of the potential for moral hazard that might be created by the availability of the guarantee, the monitoring of AIs' deposit movements, liquidity positions and business activities in general was stepped up to pre-empt the emergence of any imprudent business practices.

To cope with the evolving development of financial markets and innovation in financial instruments, a specialised division was established within the HKMA to strengthen the supervision of AIs' treasury activities and to conduct macro financial market surveillance. The initiative has improved the HKMA's ability to anticipate and detect emerging market developments that might give rise to prudential concerns about the banking industry. Treasury on-site examinations were conducted during the year to review the adequacy and effectiveness of AIs' treasury controls and the approval process of new financial products. Because of the volatility of financial markets, resources were also allocated to review AIs' exposures to structured investment products to ensure prudent valuation and mark-to-market adjustments were adopted by AIs to appropriately reflect the impact, if any, on their financial positions.

Banking Stability

To better utilise reduced staff resources available for on-site examinations, areas of high supervisory priority were subjected to focused thematic examinations. Of the 142 on-site examinations conducted, 84 were thematic examinations reviewing AIs' asset quality; lending to small and medium-sized enterprises under the Government Loan Guarantee Scheme; compliance with the Representation Rules under the Deposit Protection Scheme; sales of non-Lehman Brothers-related credit-linked investment products; compliance with the restrictions on renminbi trade settlement; and anti-money-laundering (AML) and counter-terrorist-financing (CFT) controls over trade financing activities. The HKMA also conducted 29 risk-based examinations and three overseas examinations on AIs' subsidiaries on the Mainland.

In addition, the specialist teams carried out 17 examinations of risk management controls covering AIs' treasury and derivatives activities; business continuity planning; migration of the Real Time Gross Settlement and Central Moneymarkets Unit systems to the SWIFTNet infrastructure; customer data protection and operational risk management, e-banking activities and technology risk management and practice; and tier-2 examinations of AIs' AML/CFT controls. Reviews were also performed for selected AIs that had received approval to use the internal ratings-based (IRB) approach for credit risk or the internal models (IMM) approach for general market risk under Basel II to ensure their continuing compliance with the relevant requirements (*see section on Basel II for details*). On the application of one AI, the HKMA conducted a review to assess that bank's readiness to use the IMM model to calculate specific risk under the Basel II market risk framework.

During the year 193 off-site reviews were conducted and 16 tripartite meetings[1] were held. Other duties included regular analysis of statistical returns and the handling of non-compliance with guidelines or statutory requirements. The supervisory teams met the boards or members of the board-level committees of six AIs.

The Banking Supervision Review Committee considered 10 cases in 2009, with seven relating to the licensing of AIs and approval of a money broker, and the other three dealing with revocation of authorization and the exercise of the Monetary Authority's powers under section 52 of the Banking Ordinance. Details of the operational supervisory work performed in 2009 are set out in Table 1.

Table 1 Operational supervision

		2009	2008
1	On-site examinations	**142**	161
	Regular examinations	**32**	57
	– risk-based	**29**	53
	– overseas	**3**	4
	Basel II – IRB and IMM reviews	**9**	8
	– IRB initial recognition assessment and follow-up examinations	**6**	5
	– IRB IT aspects	**–**	3
	– IMM internal model recognition assessment and review	**3**	–
	Credit risk management and asset quality	**26**	24
	Market risk and treasury activities	**6**	13
	Securities and investment-products related conduct examinations	**17**	11
	Compliance with the Deposit Protection Scheme representation rules	**19**	–
	AML/CFT controls	**18**	19
	IT, e-banking and operational risk	**12**	18
	Renminbi business	**3**	11
2	Off-site reviews and prudential interviews	**193**	188
3	Tripartite meetings	**16**	39
4	Meetings with boards of directors or board-level committees of AIs	**6**	2
5	Approval of applications to become controllers, directors, chief executives, alternate chief executives of AIs	**269**	301
6	Reports commissioned under section 59(2) of the Banking Ordinance	**16**	5
7	Cases considered by the Banking Supervision Review Committee	**10**	22
8	AIs that were subject to the exercise of powers under section 52 of the Banking Ordinance	**3**	5

[1] Meetings between the HKMA, the AI and its external auditors.

Sixteen reports were commissioned under section 59(2) of the Banking Ordinance to require 15 AIs to appoint external auditors to review internal control issues and to report their findings to the HKMA. The scope of 10 of these reviews involved the AIs' handling of customer complaints in relation to Lehman Brothers-related investment products. Twelve AIs also voluntarily appointed external auditors to review their controls on selected areas identified by the HKMA. Of these, six were on the selling process of retail investment products by the AIs'.

In 2009 no AI breached the requirements of the Banking Ordinance relating to the capital adequacy ratio (CAR). Due to technical errors, one foreign bank branch was found to have breached the liquidity ratio requirement. It did not pose any threat to the safety and soundness of the institution or to the interests of depositors. There was one breach of the requirements under section 81 relating to large exposures, three under section 83 on connected lending, and two under section 85 on lending to AI's employees. These breaches were assessed to be unintentional. They were rectified promptly by the relevant AIs and did not affect the interests of depositors.

Powers under section 52 of the Banking Ordinance

Octopus Cards Limited

Under section 53F(1) of the Banking Ordinance, the Monetary Authority (MA) revoked, on 23 May 2009, the appointment of an Advisor to advise the management of Octopus Cards Limited (OCL) on matters relating to the protection of Octopus cardholders' interests. The MA, in consultation with the Advisor, considered it no longer necessary for the appointment to remain in force as OCL had taken sufficient measures to ensure that the interests of Octopus cardholders were properly protected and safeguarded in the company's operations, and to address all the significant issues raised in the independent auditor's report on OCL's operational risk control.

Melli Bank plc

The restrictions imposed by the Monetary Authority on 25 June 2008 under section 52(1)(A) of the Banking Ordinance on the affairs, business and property of the Hong Kong Branch of Melli Bank plc remained in force during 2009. The HKMA continued to communicate regularly with the relevant authorities to monitor developments related to the branch and its Head Office in the United Kingdom, and to review the supervisory measures taken to protect the interests of its depositors.

United Commercial Bank

After the Federal Deposit Insurance Corporation (FDIC) and the Department of Financial Institutions in California entered into a consent agreement with United Commercial Bank (UCB) on the issuance of an Order to Cease and Desist ordering UCB to stop a number of unsafe and unsound banking practices and to take relevant remedial action, the Monetary Authority exercised his powers under section 52(1)(A) of the Banking Ordinance to impose restrictions on the affairs, business and property of UCB's Hong Kong Branch (UCBHK) on 11 September 2009 to protect its depositors.

UCB was put into receivership by the FDIC on 6 November 2009. The bank's global operations were subsequently acquired by East West Bank (EWB) in the US under an agreement between the FDIC and EWB. In Hong Kong, the assets and liabilities of UCBHK were being transferred to the Hong Kong Branch of East West Bank. Once the process has been completed, UCB's authorization as a licensed bank will be revoked.

CAMEL rating review

During the year meetings of the CAMEL Approval Committee were held to review and determine the composite CAMEL[2] ratings of 195 AIs. One bank subsequently requested a review of its rating and a meeting of the CAMEL Approval Review Committee, formed by members not involved in the original rating decision, was convened to consider the case.

The CAMEL ratings of licensed banks on 20 October 2009 were used as the supervisory ratings provided to the Hong Kong Deposit Protection Board for the purpose of determining the contributions to be paid by licensed banks in 2010 under the Deposit Protection Scheme.

Specialised supervisory work

Supervision of technology and operational risks

Internet banking, technology risk management and business continuity management

There was steady growth in the use of Internet banking services in 2009 with 63 AIs offering the facility in Hong Kong: the number of personal accounts increased to 6.2 million (from 5.7 million in 2008), and corporate Internet banking accounts totalled 477,000 (up from 401,000 in 2008). Since the 2005 launch of two-factor authentication for high-risk transactions conducted through personal Internet banking, 38 AIs have implemented such a mechanism and some 2.8 million account holders have registered for the service.

In 2009 the HKMA continued to work with the Hong Kong Police Force and the Hong Kong Association of Banks to promote public awareness of Internet banking security. An "e-Fraud seminar" was organised for the banking industry in February to increase the general awareness of emerging fraudulent techniques on Internet banking; and a "Clean PC Day" campaign and an "Online Story Writing Competition" were also held in the second half of the year to educate the public about the importance of computer security.

In the light of the growing number of Internet banking fraud cases reported locally and overseas involving sophisticated fraudulent techniques, the HKMA issued a circular on 13 July requiring AIs to increase their precautionary measures on Internet banking services for retail and corporate customers. In addition, the HKMA issued two circulars in April and June urging AIs to ensure the effectiveness of their business continuity plans and to put in place necessary precautionary and contingency measures because of the increased level of threat from human swine influenza.

The HKMA carried out regular on-site examinations and off-site surveillance of AIs' controls over Internet banking, technology risk management and business continuity planning. To ensure the migration of the RTGS and CMU systems to the SWIFTNet infrastructure was performed in a controlled manner, a review was conducted in May to cover the testing and business continuity arrangement of the systems. Separately, the HKMA extended the coverage of the automated control self-assessment process for technology risk management, Internet banking and business continuity management to 70 AIs (from 63 in 2008).

[2] Comprising the **C**apital adequacy, **A**sset quality, **M**anagement, **E**arnings and **L**iquidity components.

Operational risk management

The HKMA continued to improve the supervisory framework of operational risk management of AIs and assess their compliance with the necessary capital requirements under the Banking (Capital) Rules. The annual self-assessment exercise on operational risk management was extended in 2009 to cover 52 AIs (compared with 23 in 2008), including all locally incorporated licensed banks and some other selected AIs. The contents of the self-assessment template were further improved during the year to collect more operational risk-related information from the participating AIs to facilitate continued assessment and monitoring of individual AIs' risk profiles.

Supervision of securities and insurance business

The HKMA co-operates closely with the Securities and Futures Commission (SFC), the Insurance Authority and the Mandatory Provident Fund Schemes Authority on the supervision of AIs' securities, insurance and MPF-related businesses. Regular contact is made through various channels including frequent regulatory contacts, bilateral meetings as well as under the auspices of the Financial Stability Committee and the Council of Financial Regulators.

To facilitate day-to-day supervision, the HKMA continued to collect and analyse half-yearly returns on AIs' securities and insurance activities. These returns provide a general overview and industry trends of the securities and insurance activities carried out by AIs. The HKMA also invited 65 registered institutions (RIs), 15 more than in 2008, to participate in the self-assessment of compliance with the relevant rules and regulations in relation to the conduct of their regulated activities.

In 2009 the HKMA processed seven applications for registration to become RIs and five applications from RIs to engage in additional regulated activities. It also granted consents to 185 executive officers, who are responsible for supervising the securities activities of RIs; and conducted background checks on 4,828 individuals whose information was submitted by RIs for registration.

In continuation of the credit-linked notes examinations conducted in 2008 and in view of the evolving market conditions, thematic examinations were conducted on 17 RIs to examine their sales of non-Lehman Brothers related credit-linked investment products. As part of these examinations, a customer survey was conducted to gather more information about the selling process of the RIs. The HKMA is following up with the RIs concerned to ensure that areas needing improvements would be promptly addressed. Any possible cases of mis-selling or suspected breaches of regulatory requirements identified in the examinations are referred to the HKMA's Securities Enforcement Division for further action.

The Central Government's Ministry of Finance issued the first renminbi sovereign bonds in Hong Kong in September 2009. The high level of interest from the investing public prompted the banking industry to hold discussions with the HKMA on ways to streamline the selling process for the bonds while maintaining adequate investor protection. On 8 September 2009 the HKMA issued a circular setting out the simplified arrangements for selling renminbi sovereign bonds as the products' features and risks were not difficult for the average investor to understand and the suitability requirement could be achieved under the simplified procedures.

Supervision of treasury activities

To strengthen the HKMA's oversight of AIs' treasury and derivative activities, a specialised division was established in 2009, and market professionals with relevant knowledge were recruited. In addition to examining AIs' treasury activities and new product approval processes, the specialised division devoted considerable resources to monitoring market events with the potential to have an impact on investors of credit-linked notes, reminding banks to take appropriate action to provide assistance to affected investors.

Throughout 2009, the specialised division monitored the latest developments and impact of the global financial crisis on Hong Kong's banking sector. Different stress tests were undertaken to assess individual AIs' ability to weather possible shocks to various exposures and asset classes, including debt securities portfolios. Resources were also applied to establish market contacts and monitor emerging market and product trends with potential market risks or systemic implications.

Mainland-related businesses

Renminbi banking business

At the end of 2009, 60 AIs were conducting renminbi business. The total amount of outstanding deposits was RMB62.7 billion, a 11.9% increase over a year earlier. The amount of renminbi bonds issued in Hong Kong during the year also rose with six new issues, totalling RMB16 billion, including issuances by the Ministry of Finance and the Mainland subsidiaries of two Hong Kong AIs.

The scope of renminbi business conducted by AIs expanded substantially with the start of the renminbi trade settlement pilot scheme in July. All AIs are eligible to participate in the scheme, which covers a range of renminbi services to facilitate trade settlement in renminbi between pilot cities on the Mainland and selected areas including Hong Kong. The services cover deposit-taking, currency exchange, remittance, trade financing, cheques and interbank transfers. The HKMA issued circulars to AIs on related risk management issues and data reporting. At the end of 2009, 52 AIs were engaged in renminbi trade settlement business.

Tapping the Mainland market

A total of 13 locally incorporated banks had business operations in Mainland China. Eight of them were operating through subsidiary banks incorporated on the Mainland. The 13 locally incorporated banks continued to expand their branch network, maintaining over 270 Mainland branches or sub-branches, either directly or through subsidiary banks.

Under the Sixth Supplement to the Closer Economic Partnership Arrangement (CEPA), a new provision, effective from 1 October, was introduced to allow the branches of Hong Kong banks or their Mainland subsidiaries in Guangdong Province (including Shenzhen) to open cross-location sub-branches within the Province, thereby extending their branch network in a more cost-effective way. Four Hong Kong banks had obtained approvals for opening a total of five such sub-branches by the end of the year.

The industry's aggregate on-balance-sheet non-bank exposures to Mainland China amounted to HK$852.5 billion equivalent at the end of 2009, or 7.1% of total assets. These included exposures of HK$313.8 billion equivalent booked in the Mainland subsidiaries of Hong Kong banks. The HKMA maintains regular contact with the China Banking Regulatory Commission (CBRC) to ensure effective cross-border supervisory co-operation and co-ordination relating to these entities.

Effective from January 2009, under CEPA's Fifth Supplement, Mainland-incorporated banking subsidiaries established by Hong Kong banks are allowed to locate and operate their data centres in Hong Kong, subject to certain conditions. The HKMA and the CBRC signed a Supervisory Co-operative Arrangement in May to improve supervision of cross-border data centres in Hong Kong and on the Mainland.

Credit risk management and asset quality

In the light of intense competition for mortgage business, the HKMA issued circulars to AIs on 17 September 2009 and 8 January 2010 reminding them to be prudent in setting mortgage interest rates and to manage their interest rate risk properly.

The price of luxury properties rose during the year, particularly in the third quarter, prompting the HKMA to issue a circular to all AIs on 23 October requiring them to tighten the maximum loan-to-value ratio for properties with a value of $20 million or more from 70% to 60%. The circular also reminded AIs to be prudent in conducting property valuation and in assessing the repayment ability of borrowers. Specifically, the HKMA expects AIs to take into account the potential impact on borrowers if mortgage interest rates returned to more normal levels. The HKMA again wrote to AIs on 30 October setting out the best practices on property valuation and the computation of debt servicing ratios. AIs are required to review and assess their lending practices and, where necessary, take appropriate steps to bring them in line with the best practices set out in the HKMA circular.

In December 2008 the Government launched a Special Loan Guarantee Scheme to support small and medium-sized enterprises during the global financial crisis. To ensure AIs' compliance with the Scheme's requirements, the HKMA is conducting a round of thematic examinations focused on AIs' lending to companies covered by the guarantee. At the end of December 2009, 19 examinations had been completed; and seven more will be conducted in 2010. The results of examinations completed so far indicate AIs have generally put in place effective systems to ensure proper compliance.

Co-operation with overseas supervisors

The onset of the US sub-prime mortgage crisis and the collapse of Lehman Brothers heightened the need for supervisors to strengthen cross-border co-operation on the management of financial crises. The HKMA participated in supervisory meetings organised by the home supervisors for selected individual banking groups with significant operations in Hong Kong to discuss issues of mutual interest, including the progress of these banking groups in adopting the IRB approach. The meetings made advanced preparations for dealing with financial crises, especially in handling severe stress that might have an impact on affected banking groups. In addition, bilateral meetings were held in Hong Kong and abroad with banking supervisory authorities from France, Germany, Indonesia, Japan, Macau, Mainland China, Malaysia, the Netherlands, Singapore, South Korea, Switzerland, Taiwan, Thailand, the UK and the US. There were also regular exchanges of correspondence and other forms of communication with overseas banking supervisory authorities on institution-specific issues as well as developments in financial markets and their impact on individual banking institutions.

Lehman-related investment products

Improvements to the existing supervisory framework

On 31 December 2008 the HKMA submitted a report to the Financial Secretary with observations and information on the lessons learnt and issues identified during investigations into complaints about the sale of Lehman-related investment products. The report detailed various recommendations to further improve the regulatory framework and investor protection. The HKMA issued a circular on 9 January 2009 to require registered institutions (RIs) to implement a number of recommendations in the report, and another circular on 25 March setting out the implementation details after discussions with the banking industry. Recommendations that could be introduced quickly by RIs, such as audio-recording of the selling process, insertion of a "health-warning" statement, and clear segregation between ordinary banking business and retail securities business were implemented by September. In relation to the recommendation to introduce a periodic mystery shopping programme by the regulatory authorities, the HKMA and the SFC jointly commissioned a consultant in the second half of 2009 to prepare a programme. The consultant submitted a report with a number of recommendations to the HKMA and the SFC at the end of 2009.

On 25 September the SFC, in collaboration with the HKMA, issued a public consultation paper on proposals to upgrade protection for the investing public. The proposals included developing a product code handbook and additional requirements concerning the conduct of intermediaries, such as pre-sale disclosure of monetary and non-monetary benefits received by RIs, and a "cooling-off" period for the purchase of investment products. To facilitate the banking industry's understanding of the proposals, the HKMA and the SFC organised a workshop for intermediaries on 7 December.

In addition, the HKMA was involved in assisting the Government in the preparation of the public consultation paper on an Investor Education Council and a Financial Dispute Resolution Centre. It has also been co-operating with the Legislative Council's Subcommittee to Study Issues Arising from Lehman Brothers-related Minibonds and Structured Financial Products by attending meetings and providing information and documents where possible. The HKMA will take into account recommendations from the Subcommittee's review, when completed, to further enhance the regulation of RIs' conduct of regulated activities in Hong Kong.

Resolution of complaints and investigation

Since the collapse of Lehman Brothers in September 2008, the HKMA has received a large number of complaints from customers who purchased Lehman-related investment products from banks. To deal with these complaints, the HKMA expanded its investigation workforce (up to 300 staff) by redeploying some of its own staff resources, hiring contract staff and seconding professionals from external auditing firms. The HKMA also worked closely with the SFC by referring cases to the Commission to facilitate its investigations at the institutional level. By the end of 2009, 77% of Lehman-related complaints were handled or resolved.

Minibonds

The SFC, the HKMA and 16 distributing banks reached an Agreement in July for resolution under section 201 of the Securities and Futures Ordinance on the repurchase of minibonds from eligible customers, who number about 25,000. In accordance with the Agreement, eligible customers received an initial payment of at least 60% (70% for those aged 65 or above) of their original investments in minibonds. Further payments will be made if recoveries from the realisation of the underlying collateral held in respect of minibonds are in excess of the initial payments made by banks. Nearly 98% of eligible customers accepted the repurchase offer. Separately, about 4,800 minibond customers who reached settlements with their banks prior to the section 201 Agreement are eligible for the voluntary offers made by banks in order to bring them to the same position as those eligible for the repurchase offer.

Under the section 201 Agreement, banks are required to strengthen their internal control systems and implement enhanced complaint-handling procedures to resolve complaints relating to the sale and distribution of structured investment products. Independent reviewers are also engaged to review and make recommendations on the banks' systems, processes and procedures in these areas.

Non-minibond products

Following the execution of the section 201 Agreement, the HKMA deployed more resources to the investigation of Lehman-related non-minibond cases. By the end of 2009, it had completed its investigations into almost half of these cases, with disciplinary action taken in one case and 362 cases under disciplinary process.

In December 2009 the SFC and the HKMA reached a resolution with two banks over their sale of certain fixed-coupon principal-protected equity index-linked notes issued by Lehman Brothers, in the light of the section 201 Agreement. The banks offered to repurchase these notes at 80% of the principal amount from individual customers who bought the notes from them on or after a specified date. They also agreed to make ex-gratia payments to customers who had previously reached settlements on terms that were financially less favourable than the repurchase offer, thus bringing them to the same position as those eligible for the repurchase offer.

Investigations into Lehman-related non-minibond cases are continuing and the HKMA aims to substantially complete all the remaining cases by the end of March 2010.

Review of the HKMA's work on banking stability

As a result of the global financial crisis, many issues concerning banking stability have been discussed in various local and international forums. The review of the HKMA's work on banking stability in 2008, and the comments received during the subsequent public consultation, have provided timely and useful information to support the HKMA's participation in these discussions and its formulation of supervisory policies to address issues arising from the crisis. The HKMA will continue to implement measures to cope with the challenges ahead, taking into account recommendations of the review and international and local developments.

Basel II

Enhancements to Basel II

In July 2009 the Basel Committee on Banking Supervision issued a set of enhancements to the Basel II framework to strengthen its risk coverage in the light of lessons drawn from the financial crisis. The improvements raise banks' capital requirements for trading book and securitisation exposures, provide supplemental guidance on risk management principles and strengthen disclosure in corresponding areas.

The HKMA consulted the banking industry in September on its proposals to implement the Basel Committee's enhancements in Hong Kong and, at the same time, introduced a number of refinements to the existing capital framework prompted largely by implementation experience since its introduction in January 2007. Following this consultation, preparations are underway to amend the Banking (Capital) Rules and Banking (Disclosure) Rules.

Because of the importance of the residential mortgage lending business to the local banking sector, the HKMA also consulted the industry on a proposal to retain a 10% floor for the loss-given-default estimates for residential mortgage loans under the IRB approach for calculating credit risk. The floor was originally incorporated into the capital framework as a transitional requirement expiring at the end of 2009. In similar vein, the Basel Committee decided at its meeting in December to retain the 10% floor within the Basel II framework, and work is proceeding on incorporating the amendment into the Banking (Capital) Rules.

Implementation of advanced approaches

During the year the HKMA granted approval to one AI to adopt the IMM approach under the market risk framework of the Banking (Capital) Rules, after assessing the robustness of the AI's internal model and its compliance with the requirements set out in the Rules.

The HKMA conducted follow-up reviews of selected AIs which had previously been approved to use the IRB approach for credit risk or the IMM approach for market risk. These follow-up reviews were to ascertain whether issues identified in previous on-site examinations had been fully addressed, and to ensure the AIs' continuing compliance with the requirements for using the approaches.

To facilitate supervision of AIs under the IRB approach, the HKMA improved its internal systems for analysing risk estimate data. It began conducting a benchmarking exercise to compare the risk estimates used by different AIs to calculate their capital requirements for credit risk exposures with similar or identical risk characteristics. The aim of the benchmarking exercise is to identify any outliers.

Supervisory review process (SRP)

The process provides the HKMA with a comprehensive framework for assessing AIs' capital levels and risks, including non-credit risks such as interest rate risk in the banking book, liquidity risk, and reputation and strategic risks.

The supplemental guidance on risk management principles issued by the Basel Committee in July 2009 was incorporated into the HKMA's SRP framework to further strengthen its robustness. The guidance covers firm-wide risk oversight, risk concentration, off-balance sheet exposures, securitisation and associated reputation risk, valuation of financial instruments, liquidity risk management and compensation practices as well as firm-wide stress-testing practices. The enhanced SRP framework, on which the industry has been widely consulted, is expected to take effect in the first half of 2010 after comments received in the consultation exercise have been addressed.

During the year the HKMA completed the third round of SRP assessments on Hong Kong-incorporated AIs, which included a review of their capital adequacy assessment processes (CAAPs) against supervisory standards and their progress in developing their CAAP capability. The SRP Approval Committee within the HKMA met regularly to review the assessment results for the purpose of considering the appropriate minimum CARs of AIs and other supervisory issues requiring attention. AIs were notified of the results, and were given the opportunity to request a review of their minimum CAR, although none did so in 2009.

Other Basel Committee initiatives

The Basel Committee released two important consultative documents in December: *Strengthening the Resilience of the Banking Sector* and *International Framework for Liquidity Risk Measurement, Standards and Monitoring*. These documents set out proposals to strengthen global capital and liquidity standards by:

- improving the quality, consistency and transparency of the capital base of banks
- strengthening the risk coverage of the Basel II framework in relation to counterparty credit risk
- introducing a leverage ratio to supplement the Basel II risk-based measure and help contain the build-up of excessive leverage in the banking system
- promoting the build-up of counter-cyclical capital buffers within the banking sector outside periods of stress, which can be drawn down as losses are incurred
- introducing a minimum global liquidity standard to enhance the resilience of banks against liquidity stress.

The consultation period is scheduled to end on 16 April 2010. The HKMA encouraged the Hong Kong Association of Banks and the Deposit-taking Companies Association to co-ordinate a response from their members to the Basel Committee. Further amendments to the Banking (Capital) Rules and Banking (Disclosure) Rules will be required for the adoption of these measures in Hong Kong.

Improving the supervisory policy framework

Revision of the liquidity regime

The global financial crisis has highlighted the importance of both sound liquidity risk management systems and the holding of sufficient levels of liquidity within banks to bolster their resilience in stressed situations, particularly those of a severe, prolonged and market-wide nature.

As an initial step to strengthening the local liquidity regime, the HKMA has developed supervisory guidance to implement the systems, controls and disclosure standards contained in the *Principles for Sound Liquidity Risk Management and Supervision* issued by the Basel Committee in September 2008. The HKMA guidance takes into account the results of a self-assessment conducted by AIs in early 2009 to assess their compliance with the Committee's *Principles* as well as other relevant international guidance to address the lessons of the crisis. The guidance will be issued for formal industry consultation in early 2010. In order to monitor and assess AIs' compliance with the enhanced liquidity risk management standards, the HKMA's supervisory process will be correspondingly refined and strengthened.

Compensation practices

To address risk management concerns arising from the design of financial firms' remuneration policies, where incentives for excessive risk-taking have been identified as one of the many factors contributing to the financial crisis, the Financial Stability Board (FSB) issued a set of *Principles for Sound Compensation Practices* in April 2009 and a set of corresponding *Implementation Standards* in September 2009. The HKMA supports the risk management concepts embedded in the FSB's *Principles* and has developed, in consultation with the industry, a draft "Guideline on a Sound Remuneration System" to promote the incorporation of the FSB's *Principles* and *Standards* into AIs' remuneration practices.

Counterparty credit risk (CCR)

Following industry consultation, the HKMA issued a new supervisory guideline on "Counterparty Credit Risk Management" in June. The guideline sets out the risk management standards AIs are expected to have in place, and the HKMA's supervisory approach, for CCR management. AIs were given a nine-month period (from June) to review and make any necessary enhancements to their existing CCR management systems based on the standards contained in the guideline.

Internal audit function

In July the HKMA issued, after consultation with the banking industry, a new supervisory guideline on AIs' "Internal Audit Function" setting out its expectations on the key role, responsibilities and qualities of an AI's internal audit function, and to describe the approach the HKMA will adopt in assessing its effectiveness. The guideline serves to reinforce the importance of the internal audit function in providing an ongoing independent evaluation of the adequacy of an AI's internal control systems, which are essential in addressing new risks in the constantly changing operating environment.

Stress testing

The HKMA regularly performs supervisory stress tests on selected AIs aimed at assessing their resilience to potential risks and vulnerabilities. Although the stress-testing results over the course of the year reflected a satisfactory level of resilience to stress within the banking sector, the HKMA remains vigilant in monitoring individual AIs' financial capacity to weather adverse economic and market conditions.

In the light of the lessons of the global financial crisis and the *Principles for Sound Stress Testing Practices and Supervision* issued by the Basel Committee in May 2009, the HKMA has taken steps to refine and develop its supervisory stress-testing approach. Hypothetical stress scenarios have been streamlined to provide better risk focus and the scope of the stress tests has been expanded to cover AIs' exposures to complex structured products. Bank-specific stress tests were conducted by supervisory staff on selected retail banks to supplement the HKMA's regular sector-wide stress tests, and more use was made of the stress-testing results in determining supervisory plans for individual AIs.

Market risk management

A primary focus in the aftermath of the global financial crisis has been the strengthening of the market risk framework given the significant losses that surfaced in the trading books of some global banks. To bolster market risk management standards in Hong Kong, the HKMA has compiled a new supervisory guideline on "Market Risk Management" that addresses key elements of an effective market risk management system, drawing on recent observations and recommendations arising from the financial crisis. The HKMA plans to release this draft guideline for industry consultation in 2010.

Prevention of money laundering and terrorist financing

Addressing issues on customer due diligence and record keeping identified by the Financial Action Task Force on Money Laundering (FATF) in its *Mutual Evaluation Report of Hong Kong* in 2008, the Government decided to introduce legislation to improve Hong Kong's AML/CFT regime.

The HKMA participated in the working group formed by the Financial Services and the Treasury Bureau to develop the legislative proposals. The Bureau published a conceptual framework in July 2009 for public consultation. After taking into account the comments received, a second consultation paper containing detailed legislative proposals was published in December. The HKMA will continue to provide support during the legislative process.

The HKMA has also been discussing with the Hong Kong Association of Banks and the Deposit-taking Companies Association a series of amendments to the HKMA's *Guideline on Prevention of Money Laundering* and its *Supplement* to address other issues relating to the banking sector identified by FATF in its evaluation. Once finalised, the revised *Guideline* and *Supplement* are expected to be issued in early 2010.

To monitor AIs' compliance with the HKMA's *Guideline* and *Supplement*, the HKMA's AML/CFT specialist teams completed 18 on-site examinations of AIs during the year, including 12 tier-2 examinations and six thematic examinations focusing on preventive measures in relation to trade finance.

International co-operation

The HKMA continues to participate in various international and regional forums for banking supervisors. In June the HKMA became a member of both the Basel Committee and its governing body, the Group of Central Bank Governors and Heads of Supervision. The HKMA also participates in various Basel Committee initiatives through its membership of the Committee's working groups, including the Liquidity Working Group, the Definition of Capital Sub-Group and the Standards Implementation Group.

Regionally, the HKMA chairs the EMEAP Working Group on Banking Supervision, and is a member of the South East Asia, New Zealand and Australia Forum of Banking Supervisors.

Accounting and disclosure

Prudent valuation

Recognising the critical importance of sound valuation to risk management, financial reporting and capital regulation, the Basel Committee published a paper on *Supervisory Guidance for Assessing Banks' Financial Instrument Fair Value Practices* in April 2009. The prudent valuation guidance in the Basel II framework was also revised in July to converge more with existing accounting guidance on fair value measurement and to cover not just trading book positions, but all positions subject to fair value accounting. In addition, the International Accounting Standards Board (IASB) issued an Exposure Draft on *Fair Value Measurement* in May, which is expected to be finalised in 2010. To reflect these developments within its supervisory framework, the HKMA is revising its supervisory guideline on the "Use of Fair Value Option for Financial Instruments". The revised guideline, which is intended to be applicable to all AIs' positions subject to fair value accounting, is expected to be released for industry consultation in the first half of 2010.

Financial instruments and provisioning standards

In response to a call from the G20, the IASB has undertaken a series of initiatives to address issues on accounting standards for financial instruments, fair value measurement, provisioning, off-balance sheet exposures, and the related required disclosures. In November 2009 the IASB published a final standard on the classification and measurement of financial instruments (*IFRS 9: Financial Instruments*). The Hong Kong Institute of Certified Public Accountants (HKICPA) incorporated the standard into the Hong Kong Financial Reporting Standards, also in November, for mandatory application with effect from 1 January 2013 and for non-mandatory application for 2009 year-end reporting. The HKMA will monitor AIs' plans to adopt the standard and assess the impact on their financial reporting.

The IASB is expected to publish in 2010 a new standard on the impairment of financial instruments based on an expected loss model. An Exposure Draft was issued in November 2009 for consultation. Final standards on consolidation and de-recognition to improve the accounting and transparency of off-balance sheet activities are also expected to be issued in 2010.

The HKMA will closely monitor developments in these accounting standards and assess the implications for its supervisory policy framework.

Disclosure

In March additional requirements were incorporated into International Financial Reporting Standard (IFRS) 7 *Financial Instruments: Disclosures* to improve disclosure with respect to fair value measurement and liquidity risks associated with structured credit products, complex financial instruments and off-balance sheet entities.

In their interim reporting in 2008 Hong Kong-incorporated AIs began adopting the recommendations of the Senior Supervisors Group *Report on Leading-Practice Disclosures for Selected Exposures* in respect of their holdings of financial instruments. Following the HKICPA's adoption of the enhancements to *IFRS 7* in March 2009, the AIs will further augment their corresponding disclosures for their financial year-end reporting in 2009 and thereafter. Although the exposure of the Hong Kong banking sector to complex financial instruments is comparatively small, the HKMA requires all AIs to be transparent in their disclosure of any such exposures and to adopt a prudent approach in the valuation, including calculation of the impairment charges, for these exposures in their financial statements.

Credit data sharing

At the end of December 2009, 120 AIs were sharing commercial credit data through the Commercial Credit Reference Agency (CCRA), and the scheme contained the credit data of more than 104,000 business enterprises, about 19% of which were sole proprietorships and partnerships. The continued development of the CCRA has helped to further strengthen the credit risk management capacity of AIs, thereby improving access to credit by the small and medium-sized enterprises.

The HKMA started discussions with the Privacy Commissioner for Personal Data in October on a proposal to expand the scope of consumer credit data sharing to cover positive mortgage data. This will enable AIs to better manage their credit risk and price the credit facilities they offer to their customers more accurately. Borrowers should also benefit. As more information about the overall credit-worthiness of borrowers becomes available to AIs, credit-worthy borrowers will be better positioned to obtain loans more quickly and on better terms.

Consumer protection

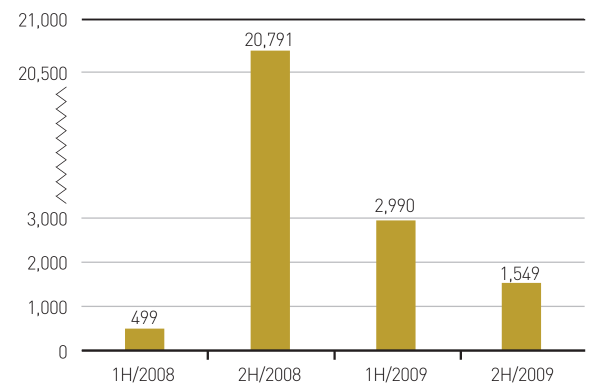
Code of Banking Practice

The industry's overall state of compliance with the Code of Banking Practice remained satisfactory. In the industry's self-assessment covering the period from June 2006 to May 2008, approximately 98% of AIs reported full compliance, or almost full compliance[3], with the Code.

Customer complaints

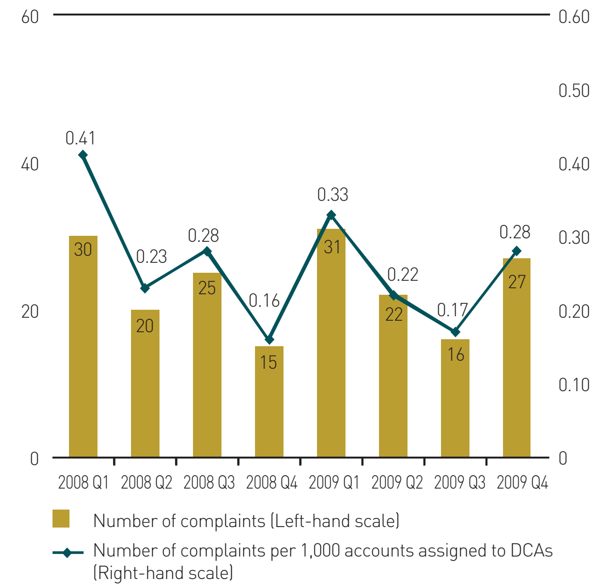
The HKMA received 4,539 complaints about services provided, or products sold, by AIs in 2009, compared with 21,290 the previous year (Chart 1). The significant difference was due to the large number of Lehman-related complaints received in 2008.

Chart 1 Complaints about services or products of AIs received by the HKMA



The number of complaints received by AIs relating to their debt collection agents (DCAs) was 96 in 2009, compared with 90 in 2008 (Chart 2). The HKMA will continue to monitor the situation to ensure that AIs remain vigilant in overseeing the activities of their DCAs.

Chart 2 DCA complaints received by AIs



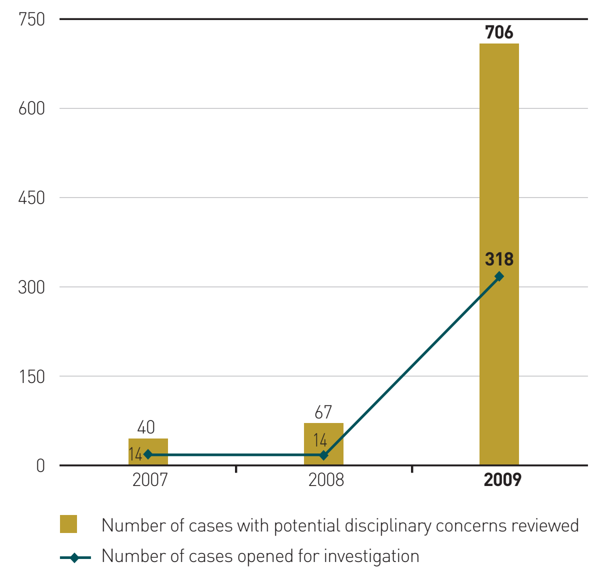
Securities enforcement

The HKMA has a shared responsibility with the SFC for enforcing the rules and regulations on RIs and the executive officers and relevant individuals in the conduct of regulated activities.

[3] With five or fewer instances of non-compliance.

During the year the HKMA reviewed 706 cases (other than those related to Lehman-related investment products) with potential disciplinary concerns and opened investigations into 318 of them (Chart 3). Investigations of seven cases were completed. Five of them were related to unregistered dealings, unauthorised transactions and other misconduct, which the HKMA has either commenced disciplinary proceedings or recommended to the SFC to commence disciplinary proceedings.

Chart 3 **Cases with potential disciplinary concerns reviewed by the HKMA**



As a result of recommendations made by the HKMA, the SFC banned two former relevant individuals from re-entering the industry for a specified period by exercising its sanctioning power under the Securities and Futures Ordinance.

Deposit Protection Scheme (DPS)

On 14 October 2008 the Financial Secretary announced the use of the Exchange Fund to guarantee the repayment of all customer deposits held in Hong Kong with all AIs with immediate effect until the end of 2010 following the principles of the DPS. To ensure all AIs (including restricted licence banks and deposit-taking companies that are not DPS members) are making appropriate representation in respect of the deposits protected by the deposit guarantee, the HKMA has stepped up monitoring AIs' compliance with the relevant representation requirements. By the end of December 2009, 19 compliance examinations had been conducted, and 19 more will be completed in the first half of 2010. The results of the examinations completed so far showed that AIs had generally established proper policies and procedures to comply with the relevant representation requirements.

With the assistance of the HKMA, the Hong Kong Deposit Protection Board completed the two-phase review of the DPS that began in late 2008 and the public consultation on the recommendations arising from the review. The recommendations, including improvements to protection under the DPS and measures to improve payout efficiency and transparency of its coverage, received broad support. The Board also started drafting legislative amendments to effect the recommendations and aims to implement them immediately after the full deposit guarantee offered by the Exchange Fund expires at the end of 2010.

Apart from reforming the DPS, the Board continued to maintain and enhance the effectiveness and efficiency of its operation under the existing framework. The Board monitored Scheme members' compliance with DPS rules and guidelines through a number of mechanisms, including self-assessments for DPS representation requirements, compliance reviews for standards on Scheme members' information systems and records, and auditor's reports for accuracy of Scheme members' returns for contribution assessment. Simulations and a rehearsal were conducted to promote the readiness of the DPS to pay out. Information systems and procedures for payouts were upgraded and tested. The Board also arranged extensive publicity to raise public awareness and understanding of the deposit protection arrangements in Hong Kong.

The HKMA formed a tripartite working group with Bank Negara Malaysia and the Monetary Authority of Singapore to map out a co-ordinated strategy for the three jurisdictions to exit from their respective full deposit guarantees by the end of 2010 as scheduled.

Licensing

At the end of 2009, Hong Kong had 145 licensed banks, 26 restricted licence banks, 28 deposit-taking companies and 16 approved money brokers. During the year the HKMA granted banking licences to five foreign banks and one deposit-taking company licence to a subsidiary of a foreign bank. The HKMA also granted a certificate of approval to one money broker. Five licensed banks, one restricted licence bank, one deposit-taking company and one money broker revoked their authorization or approval during the year.

PLANS FOR 2010 AND BEYOND

Supervisory focus

Credit risk, capital and liquidity management

The outlook for the global economy remains uncertain. The HKMA will continue to closely monitor the asset quality of individual AIs and assess the adequacy of their systems of internal controls for managing credit risk. AIs must continue to observe prudent lending practices including in property-related lending amid the low interest rate environment and rising asset prices. In the first half of 2010, the HKMA will conduct thematic examinations to ensure AIs' compliance with the reduced maximum loan-to-value ratio for luxurious properties and the best practices on property valuation and assessment of borrowers' repayment ability specified in the relevant HKMA circulars.

AIs must remain vigilant against the risk of significant adjustments in the flow of funds and asset prices, particularly if there is a change in the low interest rates environment or market expectations. The HKMA will ensure that AIs have effective capital and liquidity management processes that are capable of withstanding severe market volatility.

Mainland-related business

The HKMA's supervisory policies and practices will be upgraded as appropriate to ensure new risks arising from AIs' growing business integration with the Mainland are well managed. Because of the growing importance of Mainland operations to local banks in Hong Kong, the HKMA will work with the China Banking Regulatory Commission and conduct on-site examinations of local banks' Mainland subsidiaries to ensure they manage their businesses prudently.

Cross-border supervisory co-operation

The global financial crisis underscored the importance of effective cross-border co-operation among regulators, especially in crisis management. The HKMA will seek to strengthen communication and co-operation with the relevant overseas regulatory authorities. In particular, efforts will be made to improve supervisory contacts for discussion of bank-specific matters and other issues of mutual interest, such as the latest trends of market links between Hong Kong and other major international financial centres, relevant financial market developments and international supervisory policy discussions.

Supervision of technology and operational risks

Internet banking, technology risk management and business continuity management

In 2010 the HKMA plans to conduct thematic examinations to cover controls put in place by AIs over customer data protection to prevent data leakage incidents from happening. Separately, with the growing trend in developing standalone personal computer-based systems and utilising end-users' computer workstations to process sensitive information, examinations are planned to cover AIs' controls over the development and use of critical business systems running on these end-user computer workstations.

In addition, detailed on-site examinations will be conducted on AIs' critical systems supporting the Basel II project. Continuous monitoring of AIs' implementation of Phase II of the SWIFTNet migration project will also be performed through an off-site surveillance programme.

Operational Risk

The operational risk management specialist team will identify and address emerging operational risks of AIs through specialist on-site examinations and off-site reviews. The existing self-assessment on operational risk management is planned to be extended in 2010 to cover certain non-locally incorporated AIs with significant involvement in private banking business in Hong Kong.

Supervision of securities and insurance business

The HKMA will step up its supervisory efforts in both off-site surveillance and on-site examinations of AIs' securities and insurance activities. With this in mind, the HKMA has centralised the supervisory resources into a division focusing on regulating the securities and insurance businesses of AIs with additional manpower being deployed. The HKMA will require major AIs active in this area to complete a regular survey on the sale of investment products to further strengthen the HKMA's off-site surveillance work and risk-based supervision. More risk-based and thematic on-site examinations will be conducted to ensure AIs' compliance with the latest regulatory measures.

The HKMA and the SFC will jointly launch a mystery shopping programme in 2010, following receipt of a consultant's study report in late 2009. An external service provider will be engaged to conduct the exercise with the programme focusing on the sale of unlisted securities and futures products by intermediaries.

The HKMA will also work closely with the SFC and the industry to implement new regulatory measures and streamline the selling process for relatively simple investment products. Co-operation with the Government on the review of the present regulatory framework over securities activities in Hong Kong will also continue.

Supervision of treasury activities

In addition to conducting comprehensive and thematic examinations of AIs' treasury and derivative activities, the specialised division will devote more resources to establishing market contacts to improve the monitoring of emerging market trends and early identification of market risk issues with systemic implications. While the general framework for effective macro-prudential surveillance is still being devised by international regulatory bodies, the specialised division plans to upgrade the HKMA's surveillance in 2010 through various initiatives including:

- a comprehensive review of the existing returns and surveys to identify and rectify information gaps
- refining the scope and coverage of stress-testing of local retail banks
- developing experimental forward-looking indicators for detecting systemic risk, taking into account both experience from the private sector and ongoing developments internationally
- implementing recommendations from the newly created cross-department working group on macro prudential surveillance.

Comprehensive quantitative impact studies

In 2010 the Basel Committee will conduct a comprehensive quantitative impact assessment of the proposed new capital and liquidity standards it issued for consultation in December 2009, to permit calibration of an appropriate total level and quality of capital and appropriate minimum liquidity requirements. The calibrated standards will be phased in as financial conditions improve and the economic recovery is assured, with the aim of implementation by the end of 2012. The Committee will also consider suitable grandfathering arrangements to ensure a smooth transition to the new standards.

The impact assessment will be conducted on banks through banking supervisors in different jurisdictions. The HKMA will participate in this exercise and will also conduct its own impact study on a broader selection of AIs to better understand the likely impact of the new standards and provide a basis for the development of its implementation strategy for the standards in Hong Kong.

Basel II

Amendments to Banking (Capital) Rules & Banking (Disclosure) Rules

The HKMA intends to complete the legislative process to amend the Banking (Capital) Rules and the Banking (Disclosure) Rules within 2010 in respect of the proposals issued for industry consultation in September 2009. The HKMA will also introduce, after appropriate consultation, corresponding changes to the reporting framework to reflect the amendments to the Rules.

Implementation of advanced approaches

The HKMA will continue with the recognition process for AIs applying to adopt the IRB approach and conduct follow-up reviews of selected AIs previously approved to adopt modelling approaches within the Basel II framework, to ensure their satisfactory compliance with the supervisory criteria for using these approaches.

The HKMA will complete its benchmarking of the risk estimates generated for the calculation of credit risk under the IRB approach and discuss the results with individual outlier AIs and recommend adjustment of their risk-component estimates to appropriate levels, if considered necessary.

Capital Adequacy Assessment Process (CAAP)

The HKMA will continue to monitor AIs' progress in developing their internal CAAPs. In addition to reviewing AIs' policies and methodologies, the HKMA will evaluate the effectiveness of their CAAPs, and how they are integrated into AIs' daily risk management processes. Where necessary, more guidance will be provided to assist individual AIs in enhancing their existing systems to implement the CAAP standards.

Revision of liquidity supervisory framework

The HKMA intends to release its enhanced supervisory guidance on systems, controls and disclosure for liquidity risk management, designed to align with the Basel Committee's revised liquidity guidance, within the first half of 2010, after industry consultation. Proposals for other revisions to the existing liquidity regime will continue to be developed and released for consultation. These will include new quantitative liquidity requirements, taking into account the Basel Committee's proposed new global liquidity standard, and a correspondingly revised reporting framework.

Development of supervisory policies

Credit risk transfer

The HKMA will develop a supervisory guideline on "Credit Risk Transfer" to provide more comprehensive guidance on the risk management of credit derivatives and securitisation business, incorporating relevant guidance issued by the Basel Committee as well as the latest international supervisory practices.

Supervisory review process

The HKMA will formally issue a revised guideline on the "Supervisory Review Process" in the first half of 2010 after addressing comments received during the industry consultation conducted towards the end of 2009. In addition, the stress-testing methodologies currently used under the SRP framework will be improved by taking into account new Basel Committee guidance and lessons learned from the financial crisis. The HKMA will also continue to identify areas where the SRP framework can be further improved to ensure it remains current and robust.

Stress testing

The HKMA intends to revise its existing supervisory guideline on "Stress-testing" to incorporate experiences drawn from the financial crisis, and to align the guidance with the recommendations and principles issued by international organisations and supervisory groups, notably the *Principles for Sound Stress Testing Practices and Supervision* issued by the Basel Committee in May 2009.

Other risk management guidance

In addition to a new guideline on market risk management, the HKMA proposes to issue for industry consultation revised guidelines on "General Risk Management Controls", "Reputation Risk Management" and "Strategic Risk Management" to reflect relevant international standards and observed best practices.

Prevention of money laundering and terrorist financing

The HKMA will be closely involved in the legislative process for the proposed new legislation on customer due diligence and record-keeping requirements, and in the drafting of new industry guidance to support the legislation. Efforts will be made to engage the industry at various stages in the process. At the same time, the HKMA will continue to conduct institution-specific and thematic examinations to ensure AIs remain vigilant in the fight against money laundering and terrorist financing.

Accounting and disclosure

Accounting standards

In view of the substantial changes to be made to accounting standards as a result of the IASB's recent initiatives, the HKMA will work with the banking industry to monitor these developments and assess the implications for its supervisory policy framework.

Provisioning

The HKMA is a firm supporter of forward-looking provisioning practices resulting in earlier and more stable provisioning levels. It currently requires Hong Kong-incorporated AIs to maintain non-distributable regulatory reserves in excess of individual and collective impairment allowances to cater for expected future losses. In the light of the release by the IASB of its final standard on impairment of financial instruments and the issue of further guidance on prudent provisioning by the Basel Committee, the HKMA will consider whether (and if so what) changes may be needed to its supervisory regime in meeting the objective of promoting forward-looking provisioning.

Disclosure

In addition to implementing the disclosure requirements contained in the Basel Committee's enhancements to the Basel II framework, issued in July 2009, the HKMA will continue to ensure the disclosure regime for AIs in Hong Kong is in line with the improved disclosure standards published by the HKICPA and observed best practices.

Credit data sharing

Further development of the existing credit data sharing arrangements will be pursued by the HKMA where it considers this will be conducive to the stability of the banking system. One example is the proposed introduction of positive mortgage data sharing. The HKMA will work with the industry to promote credit data sharing, thereby supporting and enhancing the credit risk management capacity of AIs.

Consumer protection

The HKMA will continue to promote improvements in banking practices through its participation in the Code of Banking Practice Committee. It will also monitor AIs' compliance with the Code through periodic self-assessments and the handling of complaints about services and products provided by AIs. The HKMA will keep these arrangements under review and introduce new measures for improved monitoring as appropriate.

Securities enforcement

The HKMA aims to substantially complete investigations of all outstanding Lehman-related cases by the end of March 2010 and then deploy resources to accelerate investigations into the outstanding non-Lehman-related cases. The HKMA will also continue to assist the Government in reviewing the present regulatory framework governing the sale of investment products to retail investors.

Deposit protection

The HKMA will assist the Hong Kong Deposit Protection Board in operating and improving the DPS. Priority will be given to implementing the recommendations from the review in 2009 so they are ready to take effect, on schedule, at the beginning of 2011 to coincide with the expiry of the Exchange Fund's full deposit guarantee. The Board will provide early guidance to banks on the changes to be made to the various operational aspects of the DPS to enable them to make corresponding adjustments to their systems and processes. It will also launch a comprehensive publicity campaign to draw public attention to the impending changes, including the expiry of the full deposit guarantee.