

DISCLOSURE OF ADDITIONAL INFORMATION IN INTERIM REPORTS

Following consultation with individual authorized institutions and the two industry associations, the HKMA issued a new guideline called “Disclosure of Additional Information in Interim Reports” on 12 June 1998. The new guideline recommends listed authorized institutions and listed banking groups¹ to disclose more information about their loan books in their interim results published pursuant to the Stock Exchange Listing Rules. This is another step forward by the HKMA in its aim to increase the transparency of the banking sector and is in line with the recommendations made by the International Monetary Fund in its 1997 Article IV Consultation on Hong Kong. In addition, the HKMA intends to extend these new disclosure recommendations to other non-listed authorized institutions and work is under way to require foreign banks to make more disclosure of their operations in Hong Kong.

Introduction

At present only those locally incorporated authorized institutions which are listed (or their listed holding companies) publish their half-yearly results in the press. In most cases however the information disclosed by authorized institutions in their interim reports has been quite limited. The HKMA considers that it would enhance the transparency of the local banking sector if listed authorized institutions and listed banking groups disclose more information in their interim results. A new guideline was issued on 12 June 1998 to listed institutions and listed banking groups which recommends that the items listed in the Annex in relation to the loan portfolio of an authorized institution be disclosed.

Additional disclosure of non-performing loans

A key proposal in the new guideline is on the additional disclosure of non-performing loans. This is consistent with the recommendations of the International Monetary Fund (“IMF”). During the 1997 Article IV Consultation on Hong Kong, the IMF recommended that Hong Kong should continue to improve its financial disclosure framework in

order to reduce market uncertainty and thereby limit the risk of unwarranted contagion. In particular, the IMF recommended that individual banks should disclose more information on non-performing loans. This is a trend in the region and a number of countries have already introduced such measures as part of the improvements in their regulatory systems. It is therefore important that Hong Kong is not left behind.

There are a number of possible indicators of non-performing loans. Local banks already publish figures for advances for which interest is being placed in suspense or on which interest accrual has ceased. It is recommended that this should be supplemented by a breakdown of overdue loans (plus those which have been rescheduled). This has the merit of simplicity, objectivity and comparability. It also involves a limited reporting burden since authorized institutions already report overdue and rescheduled loans to the HKMA in the prudential returns. The HKMA will consider whether banks should in due course also publish figures for classified loans (substandard, doubtful and loss) which is a more judgmental indicator of non-performing loans.

The new guideline only covers loans and advances, which is different from the current

¹ A “listed banking group” is one whose business is predominately in banking and which either has a listed holding company or contains a listed authorized institution.

regulatory reporting that also includes other types of assets such as notes, bonds and other debt instruments held by an institution. We believe that this is sufficient for financial disclosure purpose as the assets of an authorized institution are usually dominated by its advances. The details of the recommended disclosure (e.g. the time brackets for the analysis of overdue advances) and the interpretation of "overdue" and "rescheduled" loans are given in the Annex.

Originally, the HKMA had planned to introduce these new disclosure items on overdue and rescheduled loans in the 1998 disclosure package which would then form part of the revised Best Practice Guide on Financial Disclosure by Authorized Institutions ("Best Practice Guide"). However, since disclosure of such additional information is relatively simple and would enable Hong Kong to comply with the IMF's recommendation prior to the 1998 Article IV Consultation, the HKMA considered it desirable for authorized institutions to begin disclosing such information as soon as practicable. Furthermore, while non-performing loans are expected to rise this year, early disclosure would help to reduce market uncertainty about the extent of the decline in asset quality and smooth out the flow of information. Accordingly, as a first step, the HKMA recommended that listed authorized institutions or listed banking groups should begin to disclose this type of information in their interim reports for the half-year ending on or after 30 June 1998. Institutions whose financial year ends on 30 June 1998 should disclose the relevant information in their annual accounts.

Additional disclosure on loan quality in interim reports

For the same reason, in addition to the proposal on the disclosure of overdue and rescheduled loans, the HKMA also recommended that listed authorized institutions or banking groups should disclose additional financial information relating to their loan quality in their interim reports. This would include general and specific provisions made against advances, suspended interest, a standardized breakdown of the loan book by industry sectors as well as advances on

which interest is being placed in suspense or accrual has ceased (see items 1 to 3 of the Annex for details of the disclosure items). The HKMA believes that disclosure of such information should be readily achievable as this is already disclosed in the annual accounts in accordance with the Best Practice Guide and reported to the HKMA in the prudential returns.

Basis of preparation

The additional disclosures in the interim reports should be prepared on a consolidated basis. They are also supplementary to and do not supplant any other disclosures required under the Listing Rules.

It should be recognized that although the recommendations at present only apply to listed authorized institutions and banking groups, the HKMA, in line with its original intention, will incorporate similar requirements for other locally incorporated institutions for the year end. It will also, in due course, bring forward recommendations for increased disclosure by foreign banks operating in Hong Kong. This is in recognition of the fact that a number of foreign banks have a substantial retail and commercial presence in the territory. It would therefore be appropriate that foreign banks should disclose more information about their activities in Hong Kong to further enhance the effectiveness of market discipline and to achieve a more level playing field for all banks in the sector. ☯

– Prepared by the Banking Development Division

ANNEX

Recommended additional disclosure items for inclusion in interim reports of listed authorized institutions

1. Advances and other accounts

- Advances to customers
- Advances to banks and financial institutions
- Accrued interest and other accounts
- Provision for bad and doubtful debts:
 - Specific
 - General

2. The breakdown of the gross amount of advances to customers by industry sectors which are considered to be significant to the institution. In order to achieve consistency of reporting among authorized institutions, the information should be disclosed in accordance with the industry categories set out below. The types of advances that should be included in the respective categories should follow that contained in the return on "Quarterly Analysis of Loans and Advances and Provisions (MA(BS)2A)". Institutions may also break items down into more detailed sub-categories if they so wish.

- Loans for use in Hong Kong
 - Industrial, commercial and financial
 - Property development
 - Property investment
 - Financial concerns
 - Stockbrokers
 - Wholesale and retail trade
 - Manufacturing
 - Transport and transport equipment
 - Others
 - Individuals
 - Loans for the purchase of flats in the Home Ownership Scheme and Private Sector Participation Scheme
 - Loans for the purchase of other residential properties
 - Credit card advances
 - Others
- Trade finance
- Loans for use outside Hong Kong

3. Advances on which interest is being placed in suspense or on which interest accrual has ceased, the amount of such interest and the amount of specific provisions made against such loans.

4. The gross amount of advances (including those to banks and other financial institutions) which have been overdue for:

- six months or less but over three months
- one year or less but over six months
- over one year

Both the absolute amount and the percentage of total advances should be given for each maturity bracket. The amount of gross advances above should be shown net of any interest that has been capitalized but accrued to a suspense account.

Authorized institutions may also wish to disclose the amount of specific provisions made against the above overdue advances and the amount of collateral held in respect of such advances in order to put the analysis of overdue advances in perspective.

5. The amount of rescheduled advances (net of those which have been overdue for over three months and reported in item 4 above) as at the end of the financial period.

Comparative figures

The corresponding amounts for the immediately preceding financial period should be given for the above disclosures.

Where the recommendations in respect of overdue and rescheduled advances are applied for the first time, and it is impractical to apply the recommendations retrospectively, the recommendations in respect of the comparatives need not apply for the first financial period.

Guidance Notes

Overdue advances can be broadly classified into the following types -

- i. Loans with a specific expiry date e.g. a term loan, inward bill loan, advance against trust receipt, packing loan and other loans of similar nature - these loans should be treated as overdue where the principal or interest on it is overdue and remains unpaid as at the end of the financial period.
- ii. Loans repayable by regular instalments e.g. residential mortgage loans, hire purchase loans and personal loans - these loans should be treated as overdue when an instalment payment is overdue and remains unpaid as at the end of the financial period.
- iii. Loans repayable on demand e.g. demand loans and overdrafts - these loans should be treated as overdue when a demand for repayment has been served on the borrower but repayment has not been made in accordance with the instruction and the loan remains unpaid as at the end of the financial period.

The period of overdue of a loan which has a determinable due date should be counted from the date following such due date. The whole amount of a loan should be classified as overdue even if part of it is not yet due and the date used to determine whether it is overdue should be the earliest due date of such a loan. For example, if the longest overdue instalment of a loan repayable by monthly instalments has been overdue for more than 6 months as at the end of the financial period, the entire amount of the loan should be reported as overdue for more than six months.

Rescheduled advances refer to those that have been restructured or renegotiated because of a deterioration in the financial position of the borrower or of the inability of the borrower to meet the original repayment schedule and include loans for which the revised repayment terms, either

of interest or of loan repayment period, are 'non-commercial' to the institution. Rescheduled advances do not include the following:

- Loans rescheduled in response to the changes in market conditions provided that at the time of rescheduling, the loans have been serviced normally, the credibility of the borrowers is not in doubt and the rescheduled loans are priced at interest rates equal to the current market interest rates for new loans with similar risks.
- Rescheduled loans which have been serviced in compliance with the rescheduled terms for a continuous period of 12 months. 