

# FINANCIAL DISCLOSURE BY OVERSEAS INCORPORATED AUTHORIZED INSTITUTIONS

*The Hong Kong Monetary Authority (HKMA) introduced in December 1998 a financial disclosure package for overseas incorporated authorized institutions in Hong Kong. In respect of financial periods ending on or after 31 December 1998, overseas incorporated authorized institutions (except those which meet certain prescribed exemption criteria) are expected to publish a Disclosure Statement covering selected key financial information on their operations in Hong Kong as well as the institution as a whole. The disclosure package aims to enhance the transparency of the Hong Kong banking sector as a whole and to achieve a more level playing field in the local market between foreign and local institutions.*

## Background

Since 1994 the HKMA has, in conjunction with the banking industry, other financial regulators and the accounting profession, made significant efforts to improve the standard of financial disclosure by authorized institutions incorporated in Hong Kong. The results of this work are embodied in the “Best Practice Guide on Financial Disclosure by Authorized Institutions” (the “BPG”) which was first introduced in 1994. In each of the subsequent years, the BPG has been expanded to keep up with developments in other financial centres and as a result the standard of financial disclosure by locally incorporated institutions is now comparable with other major international financial centres. The increase in transparency of the operations of banks has also been widely acknowledged as a contributing factor to the continuing stability of the banking sector.

However, this level of transparency has not been extended to overseas incorporated institutions operating in Hong Kong. This stems from the fact that the requirement to prepare accounts under the Companies Ordinance only applies to locally incorporated companies. Therefore overseas incorporated institutions operating in branch form are not required to produce accounts for their local operations in the same way as their locally incorporated counterparts. The operating results and financial position of their Hong Kong operations are reported only to their head office with any financial information published subsequently only on an aggregate basis. This is generally the

case even for institutions which have a substantial retail and commercial presence in Hong Kong. The lack of information concerning the operation of these institutions is at odds with the significant market share they hold in Hong Kong and represents a significant gap in transparency of the domestic banking sector as a whole. To illustrate their presence in the local market, as at the end of 1998, foreign authorized institutions accounted for 59% (60% end-1997) of total loans for use in Hong Kong and 49% (50% end-1997) of total customer deposits. This situation means that a substantial portion of the information about the local banking sector is missing and that market discipline is less effective in helping to control risk taking by these banks. This also gives rise to issues regarding level playing field vis-à-vis their locally incorporated competitors when they are all competing in the same market and for the same customers, that is, foreign banks have more information about their local competitors than vice versa regarding their local operations.

At the same time, it is well recognised that financial information at the branch level, which only refers to operations at a particular location, cannot contain all the relevant information for a proper assessment to be made on the financial position of the institution as a whole. Quite often, the operations of a local branch are supported by the head office through funding arrangements and other operational assistance. Therefore disclosure of financial information at only the branch level may not provide a fair view of the institution as a whole. However, this is considered to be an issue

in determining the type of information that should be disclosed rather than a reason for deviating from the principle of transparency.

In the KPMG/Barent's Hong Kong Banking Sector Consultancy Study Report, the consultants have made similar observations and have also recommended that financial disclosure requirements for foreign institutions be introduced.

### Key financial information to be disclosed

The HKMA expects institutions incorporated outside Hong Kong (except those which meet the exemption criteria set out below) to disclose on a half-yearly basis (i.e. for the first six months of each financial year and for the whole of the financial year at year end) a Key Financial Information Disclosure Statement ("Disclosure Statement") which discloses selected financial information concerning their operations in Hong Kong as well as the institution as a whole. The disclosure items are set out at Annex I. The Disclosure Statement contains two main sections. The first section deals with financial information concerning the operations of the local branch ("Branch Information"). This includes key on-and off-balance sheet items drawn from the BPG, which aim to give an impression of the size and nature of an overseas incorporated institution's operation in Hong Kong and the quality of its assets. The information disclosed in this section covers the position of the Hong Kong offices only. The BPG was used as a basis for determining the information to be disclosed by the branch as it would provide comparability between local and overseas incorporated institutions operating in Hong Kong. Profit and loss information has not been included because, in the majority of cases, institutions operating in branch form are often subject to specific funding and provisioning requirements determined by their head office. Such requirements differ between institutions and therefore any information disclosed in this respect may be difficult to compare. This portion will however be kept under review.

The second section of the Disclosure Statement deals with disclosures concerning the financial strength of the institution as a whole on a consolidated basis ("Bank Information"). Such

information helps place the operations of the branch within the overall context of the whole institution. Such information includes capital and capital adequacy, total assets, profitability, etc. This type of information is generally accepted and used by the market participants as indicators of the financial strength of an institution.

It should be noted that the disclosure requirements in respect of branch information include a breakdown of overdue advances by the length of time overdue and the aggregate amount of rescheduled advances. For the latter, these refer to loans 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 payment schedule. These proposals are in line with a specific recommendation of the IMF in connection with its 1997 Article IV consultation exercise in Hong Kong that more information should be provided about banks' problem loans.

In line with the requirements for locally incorporated institutions, overseas incorporated institutions should also disclose specific information about the Year 2000 problem. This includes information on progress on Year 2000 compliance in the context of both the local branch and the institution as a whole. The type of information required is similar to that applicable to listed companies in Hong Kong.

### Implementation issues

#### *Effective date*

The requirements will apply to relevant authorized institutions incorporated outside Hong Kong in two parts :

- First part - in respect of their Disclosure Statements for financial or interim financial periods ending on or after 31 December 1998, all disclosure other than overdue loans and related information i.e. Annex I, Section A, items II (vi) and (vii);
- Second part - disclosures on overdue loans and related information i.e. Annex I, Section A, items II (vi) and (vii) will be optional for

the first year. The HKMA intends that, after review of the initial round of disclosure, all relevant institutions should make these disclosures in the Disclosure Statements for financial periods ending on or after 31 December 1999.

#### *Release, display and availability of Key Financial Information Disclosure Statement*

In order to reduce the cost burden on institutions, it is not suggested that institutions should publish their Disclosure Statements in newspapers (although they may do so if they choose). Instead, these statements should be issued in the form of a press notice containing the relevant Disclosure Statement in both English and Chinese to newspapers circulating in Hong Kong within three months from the end of each financial period. A copy of the statement should also be displayed in a conspicuous position in the principal place of business of the institution in Hong Kong and in each local branch if applicable. The statement should also be made readily available to members of the public on request. Institutions should lodge a copy of the press notice with the HKMA one week prior to release. The HKMA will keep such notices in its public registry maintained under section 20 of the Banking Ordinance.

#### *Exemptions*

The recommendations apply to all overseas incorporated institutions whose Hong Kong offices currently have total assets of HK\$10 billion or more or total customer deposits of HK\$2 billion or more.

#### *Audit and certification of disclosures*

Institutions will not be required to have their Disclosure Statements audited. However, they should include a statement by the Chief Executive of the institution that the disclosure complies with the HKMA's recommendations and is not false or misleading. In cases of partial compliance, the statement of the Chief Executive should specify the areas of, and reasons for, non-compliance.

#### *Compliance*

The HKMA expects all overseas incorporated institutions other than those which meet the exemption criteria to comply with these recommendations. It will also consider whether the Banking Ordinance should be amended to include adequate disclosure of financial information as a criterion for authorization for all authorized institutions irrespective of whether they are incorporated in or outside Hong Kong. ☉

- Prepared by the Banking Policy Division

## DISCLOSURE PACKAGE FOR OVERSEAS INCORPORATED AUTHORIZED INSTITUTIONS

### Content of Key Financial Information Disclosure Statement

The Key Financial Information Disclosure Statement should contain:

#### Section A - Branch Information (Hong Kong offices only)

##### I. Balance sheet data

###### Assets

- (i) Cash and short term funds (except those included in item (iii))
- (ii) Placement with banks and financial institutions maturing between one and twelve months (except those included in item (iii))
- (iii) Amount due from overseas offices of the institution
- (iv) Trade bills
- (v) Certificates of deposit held
- (vi) Securities held for dealing purposes
- (vii) Advances and other accounts
- (viii) Investment securities
- (ix) Other investments
- (x) Fixed assets
- (xi) Total assets

###### Liabilities

- (i) Deposits and balances of other banks and financial institutions (except those included in item (iii))
- (ii) Current, fixed, savings and other deposits of customers
- (iii) Amount due to overseas offices of the institution
- (iv) Certificates of deposit issued
- (v) Issued debt securities
- (vi) Other accounts and provisions
- (vii) Total liabilities

##### II. Additional balance sheet information

- (i) Advances and other accounts
  - Advances to customers
  - Advances to banks and financial institutions
  - Accrued interest and other accounts

- (ii) Provision for bad and doubtful debts (analyse between those against advances to customers, advances to banks and financial institutions, accrued interest and other accounts if material)
  - General
  - Specific

There may be instances where provisions for loans and advances or other exposures have been set aside and maintained at overseas head offices. In such cases, the institution should disclose the provisioning policy of its head office and the amount of any specific provisions allocated for exposures maintained in the Hong Kong offices.

- (iii) Aggregate amount of suspended interest
- (iv) Aggregate amount of advances on which interest is being placed in suspense or on which interest accrual has ceased and the aggregate amount of specific provisions made in respect of such advances.
- (v) Analysis of gross amount of advances to customers classified into the following industry categories:

###### 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

- (vi) Analysis of overdue<sup>1</sup> advances to customers<sup>2</sup>, banks and other financial institutions into the following time brackets:
- six months or less but more than three months;
  - one year or less but more than six months; and
  - more than 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 capitalised but accrued to a suspense account.

Institutions may wish to disclose the value of collateral held against the overdue loans and the amount of specific provisions made. Where an institution opts to disclose the value of collateral held, it should disclose the split of overdue advances into those which are secured and those which are unsecured and the market value if collateral held against the secured loans based on the most recent estimate. At Appendix B is an illustration recommending how an institution should make such disclosures.

- (vii) The aggregate amount of rescheduled<sup>1</sup> advances (net of those which have been overdue for over three months and reported in item (vi) above) as at the end of the financial period. Both the absolute amount and the percentage of total advances should be given.

### III. *Off-balance sheet exposures*

The contractual or notional amounts of each of the following class of off-balance sheet exposures outstanding:

### Contingent liabilities and commitments

- Direct credit substitutes
- Transaction-related contingencies
- Trade-related contingencies
- Note issuance and revolving underwriting facilities
- Other commitments
- Others (including forward asset purchases, amounts owing on partly paid shares and securities, forward forward deposits placed, asset sales or other transactions with recourse)

### Derivatives

- Exchange rate contracts (exclude forward foreign exchange contracts arising from swap deposit arrangements)
- Interest rate contracts
- Others

### IV. *Liquidity*

The average liquidity ratio for the financial period (i.e., 12 months for the end of the year Disclosure Statement and 6 months for the half-year Disclosure Statement) should be disclosed. The average liquidity ratio should be the simple average of each calendar month's average ratio calculated for the purposes of the Banking Ordinance.

### Section B - Bank Information (consolidated basis)

The information set out below should be based on the most recent consolidated accounts for the institution as a whole as at the publication date of the Disclosure Statement, i.e. either the most recent annual accounts or interim accounts, whichever is available. Where the institution is owned by a holding company and does not itself publish consolidated accounts, the corresponding consolidated information for the group of which it is a part should be disclosed. Institutions which do not publish interim accounts or publish only unconsolidated information in their interim accounts, should disclose the consolidated information in the most recent annual accounts.

<sup>1</sup> Guidance on overdue and rescheduled assets is given at Appendix A.

<sup>2</sup> Total advances to customers should correspond to the total of loans for use in Hong Kong, trade finance and other loans for use outside Hong Kong disclosed under the analysis to customers by industry sectors.

## **I. Capital and capital adequacy**

The consolidated capital adequacy ratio of the institution computed in accordance with the Basle Capital Accord or the European Community's Capital Adequacy Directive ("CAD") (whichever is applicable) as at the end of the date of the most recent annual accounts or interim accounts, whichever is available. Institutions which do not observe the Basle Capital Accord or the CAD should disclose this fact.

Institutions should disclose the aggregate amount of shareholders' funds (i.e., capital and reserves) in their most recent annual accounts or interim accounts whichever is available.

The basis used for calculating the capital adequacy ratios (including whether or not they incorporate an allowance for market risk) should be clearly stated.

## **II. Other financial information**

Information indicating the consolidated financial position as at the date of the most recent annual or interim accounts of the institution including:

- Total assets
- Total liabilities
- Total advances
- Total customer deposits (or total deposits)<sup>3</sup>
- Pre-tax profit

Institutions may also wish to include a statement to refer readers to the full annual accounts or interim accounts published by the institution (or the group of which it is a part) for further details.

## **III. Year 2000 problem**

The following information should be disclosed in respect of the Year 2000 problem. Unless otherwise indicated, the information provided should generally be based on the position of the institution as a whole. Where the corresponding

information in respect of the Hong Kong branch differs from that of the institution as a whole, this fact should be disclosed together with the relevant details on the extent of any such discrepancies.

- a) The institution's definition of what it understands as being Year 2000 compliant;
- b) The risks and uncertainties associated with the Year 2000 problem. If the institution has not made an assessment of this problem or has not determined its materiality, that fact should be stated together with an explanation of the institution's strategy for dealing with the Year 2000 problem;
- c) The institution's general plans to address the Year 2000 problem relating to its business and operations and, if material, its relationships with customers, suppliers and other relevant parties;
- d) The structure of the Year 2000 compliance program in respect of the Hong Kong branch and the institution as a whole;
- e) Details of the steps taken or planned to reduce the institution's potential exposure to the Year 2000 problem;
- f) The progress of work performed to date for both the Hong Kong branch and the institution as a whole;
- g) The date on which the institution expects to be Year 2000 compliant in respect of both its critical and non-critical systems;
- h) Whether the total estimated costs of these plans, including amounts to be spent in future periods, have been quantified, and if so, how these costs have been accounted for. Where appropriate, an indication of total costs likely to be incurred and the percentage of these costs that has already been incurred in respect of both the Hong Kong branch and the institution as a whole should be provided; and

<sup>3</sup> Where total customer deposits are not separately disclosed in the annual accounts or interim accounts, the amount of total deposits (including those from banks) of the institutions may be disclosed instead. The basis of reporting should be clearly stated.

- i) The aggregate amount of commitments authorized by the directors as at the end of the financial period in respect of Year 2000 modification costs (regardless of whether such costs will be capitalised or expensed) to the extent that this amount has not been provided for in the institution's financial statements.

It should be emphasised that the above list of disclosures in relation to the Year 2000 problem is not exhaustive. Institutions should disclose any additional information considered necessary to enable depositors and other counterparties to appraise the position of the institution as a whole.

### **Chief executive's declaration of compliance**

The statement should include a declaration by the chief executive of the branch to certify that the information disclosed complies with the HKMA's recommendations and is not false or misleading. In cases of partial compliance, the statement should specify the areas of, and reasons for, non-compliance.

### **Comparative figures**

The corresponding amounts for the immediately preceding financial period should be given for the above disclosures (i.e. for the year-end Disclosure Statement, the interim figures should be disclosed as comparative figures and for the interim Disclosure Statement, the preceding year-end figures). However, in relation to Bank Information under section B above where interim consolidated information is not provided by the institution as a whole, the annual figures should be provided as comparatives.

Where the recommendations 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 reporting period.



### Guidance notes on overdue and rescheduled assets

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 where one or both of the following conditions are met:
  - a demand for repayment has been served on the borrower but repayment has not been made in accordance with the instruction; *or*
  - the loan has remained continuously outside the approved limit that was advised to the borrower for more than the period in question (e.g. three months or six months).

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 six 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.

Rescheduled advances which have been overdue for more than three months under the revised repayment terms should be included under overdue advances and not in rescheduled advances.

\* In the case of a loan repayable on demand, the period of overdue should be counted from the date following either the repayment date specified in the demand for repayment served on the borrower or the date on which the loan first exceeded, and thereafter remained continuously outside, the approved limit notified to the borrower, whichever is earlier.



### Disclosure of value of collateral held against overdue loans

The following illustrates how an institution should disclose the collateral value of its overdue loans and the split between secured and unsecured amounts.

HK\$ million

Overdue loans	Outstanding loan amount	Market value of security	Secured amount	Unsecured amount
<b>A</b>	10	15	10	-
<b>B</b>	10	7	7	3
<b>C</b>	10	-	-	10
<b>Total</b>	<u>30</u>	<u>22</u>	<u>17</u>	<u>13</u>

Minimum information to be disclosed by the institution:

- Market value of security held against the secured overdue loans: HK\$22 million;
- Secured overdue loans: HK\$17 million; and
- Unsecured overdue loans: HK\$13 million.