Annex 1

Typical Specialised Committees of the Board

Instead of involving the full board in handling every matter, specialised committees can be established to address matters which require detailed review or in-depth consideration. Some typical committees are described below, but as made clear in paragraph 2.2 of the Guideline, the number and nature of committees in an individual institution will depend on its size and other characteristics.

1. Executive Committee

The Executive Committee usually handles matters which require the board's review, but arise between full board meetings and is used most commonly in large banking institutions. It can relieve the full board of detailed review of information and operational activities. Generally, all major functions of the institution will be subject to review and approval by this Committee, and the work of the other board committees will be co-ordinated by it.

2. Credit Committee

The Credit Committee ensures that the institution's lending policies are adequate and lending activities are conducted in accordance with established policies and relevant laws and regulations. It also serves the vital role of monitoring loan portfolio quality and ensures that management follows adequate procedures to identify problems early, recognise adverse trends, take appropriate corrective actions and maintain adequate provisions for loan losses. It should pay particular attention to the procedures for monitoring compliance with statutory lending limits. In some institutions, it also participates in evaluating credit applications and making credit decisions.

3. Asset and Liability Committee ("ALCO")

The ALCO is an important feature in the effective management of the assets and liabilities of a bank. The most fundamental function of ALCO is to oversee the institution's operations relating to interest rate risk and liquidity risk and in particular to ensure that the institution has adequate funds to meets its obligations. Other functions of ALCO will be dependent on the institution's size and assets/liabilities mix. It is essential to have a balanced representation in ALCO to represent both the assets and liabilities sides of the balance sheet. The ALCO is therefore composed of the senior staff of the bank including usually the chief executive, the chief financial officer, the treasurer, the chief lending officer and the officer in charge of deposit taking.

Other members such as division heads of corporate and retail banking may also be found in ALCOs of larger banks.

4. Remuneration Committee

The Remuneration Committee provides oversight of remuneration of senior management and other key personnel and ensures that remuneration is consistent with the institution's culture, strategy and control environment. It should make recommendations to the board on the institution's remuneration policy framework and specific remuneration packages for each of the senior executives and key personnel. Executive directors should preferably play no part in decisions on their own remuneration to avoid conflicts of interest. The full board should approve the relevant remuneration policies and packages based on the Committee's recommendations.

5. Nomination Committee

The Nomination Committee ensures that only the most competent individuals, who can contribute to the bank and discharge their responsibilities in the interests of all shareholders, are appointed to the board and key management positions. It is responsible for making recommendations to the board on all new appointments of directors and senior executives such as the chief executive, alternate chief executive, chief financial officer, etc. Since the Committee is involved in recommending appointments of senior executives, it should have a majority of non-executive directors on it to assure its independence. The full board should make appointments based on the Committee's recommendations.

6. Audit Committee

Please refer to paragraph 10.1 of the Guideline.

Annex 2

Banking Ordinance
(incorporating the provisions of the Banking (Amendment) Ordinance 1999)

Breaches of Provisions for which Directors of Authorized Institutions may be individually liable

Section No.	**Description**
11	Carrying out banking business without a valid banking licence
12 and 14	Breach of restrictions on business of taking deposits of restricted licence banks and deposit-taking companies
16	Breach of conditions attached to the institution's authorization
18	Breach of conditions attached to the Monetary Authority's consent to the institution continuing to hold a deposit after variation of authorization
20	Failure to provide information as required by the Monetary Authority for maintaining a register of authorized institutions, etc
22	Breach of conditions attached to the Monetary Authority's consent to the institution continuing to hold a deposit after revocation of authorization
24	Breach of conditions attached to the Monetary Authority's consent to the institution continuing to hold a deposit during the period of temporary suspension of authorization
25	Breach of conditions attached to the Monetary Authority's consent to the institution continuing to hold a deposit during the period of suspension of authorization

44 and 49	Failure to obtain the Monetary Authority's approval for the opening of local branches or overseas branches or representative offices
50	Failure to provide information on overseas branches or representative offices as required by the Monetary Authority
51A	Failure to obtain the Monetary Authority's approval for the establishment, acquisition or maintenance of overseas banking corporations
52, 53B, 53C, 53H and 56	Breach of requirements or restrictions imposed on the institution under Part X of the Banking Ordinance
59	Failure to conduct annual audit and commission reports as required by the Monetary Authority on the institution's state of affairs, profit and loss or systems of control
59A	Failure to notify the Monetary Authority of the removal or cessation of duties of auditor
60	Failure to exhibit and lodge audited financial statements, etc in the manner as required by the Monetary Authority
60A*	Failure to disclose information relating to financial affairs of the institution
63	Failure to submit returns, etc or reports on accuracy of returns and control systems as required by the Monetary Authority
64	Failure to provide information (name, business address and nature, etc) on the institution's connected companies to the Monetary Authority
65	Failure to notify the Monetary Authority of alteration in constitution of the institution
66	Failure to notify the Monetary Authority of cessation of business of taking deposits or banking business
67	Failure to notify the Monetary Authority of the institution's inability to meet obligations or payment

* This section will come into effect as soon as practicable subject to the conversion of the existing guidelines on financial disclosure into subsidiary legislation.

69	Failure to notify the Monetary Authority of the sale or disposal of the business of taking deposits or banking business, etc and obtain Monetary Authority's approval for such changes
70C	Failure to notify the Monetary Authority of any directions or instructions given by a prohibited indirect controller
70D	Issue of shares or making payments in contravention of restrictions imposed by the Monetary Authority under section 70B(3)
72A	Failure to notify the Monetary Authority of changes in controllers, directors, chief executive, etc
73	Failure of prohibited person specified in this section to obtain the Monetary Authority's consent to his/her acting as an employee of the institution
74	Failure to make appointment of a chief executive and alternate chief executive(s)
80	Breach of restrictions on granting advances, etc against the security of the institution's own shares, etc
81, 83 and 85	Breach of limitations on maximum exposure to individual entities or groups of entities, and advances to directors, etc as well as employees
86	Breach of restrictions imposed by the Monetary Authority on moneys placed with foreign bank
87, 87A, 88, and 90	Breach of limitations on shareholding, acquisition of share capital, interest in land and aggregate holdings under sections 83, 87 and 88
91	Failure to provide a proof of compliance with sections 80, 81, 83, 85, 86, 87, 88 or 90
95	Non-compliance with the notice served by the Monetary Authority in respect of false, etc advertisements by the institution

96	Making prohibited representations, etc in any manner that the institution has been approved by the Government, the Financial Secretary or the Monetary Authority
99, 100, 103 and 104	Failure to notify the Monetary Authority of breach of the minimum capital adequacy and liquidity ratios and take remedial action as required by the Monetary Authority to restore the ratios
106	Breach of 5%-rule of limitation on creation of charges over the institution’s assets without the Monetary Authority’s approval and failure to notify the Monetary Authority of material civil proceedings against the institution
117 and 118	Failure to co-operate with the inspector as appointed by the Financial Secretary under section 117
123	Deliberate deception by wilfully making false entry in any book of records, etc
124	Receipt of gift, commission, etc for personal benefit, etc for procuring for any person any loans, etc from the institution
132	Failure to use English or Chinese language and Arabic system of numerals in books, accounts, returns, etc

Annex 3

Description of key risks

Credit Risk

The risk arising from the potential that a borrower or counter-party will fail to perform on an obligation. The assessment of credit risk involves evaluating both the probability of default by counter-party, obligor or issuer and the exposure or financial impact in the event of default.

Interest Rate Risk

The risk to an institution's financial condition resulting from adverse movements in interest rates. The factors which need to be considered in determining the level of interest rate risk associated with the activities conducted at the institution include re-pricing risk, basis risk, yield curve risk and options risk.

Market Risk

The risk to an institution's condition resulting from adverse movements in market rates or prices, such as foreign exchange rates, or commodity/equity prices. The primary determinant of the market risk of a business line is the volatility of the relevant markets. However, it is recognised that the strategy of the business line can significantly impact sensitivity of an institution's portfolio to changes in market rates. For example, a trading strategy that focuses exclusively on intermediation between end-users will tend to result in less market risk than a purely proprietary strategy. Thus, the assessment of inherent market risk must consider the interaction between market volatility and business strategy.

Liquidity Risk

The potential that an institution will be unable to meet its obligations as they come due because of an inability to liquidate assets or obtain adequate funding (referred to as "funding liquidity risk") or that it cannot easily unwind or offset specific exposures without significantly lowering market prices because of inadequate market depth or market disruptions ("market liquidity risk").

Operational Risk

The risk arising from the potential that inadequate information systems, operational/transactional problems (relating to service or product delivery), breaches in internal controls, fraud or unforeseen catastrophes will result in unexpected losses.

The evaluation of operational risk involves an assessment of both product and institution-specific factors. The relevant product factors include the maturity of the market, the need for significant fund movements, the impact of a breakdown of segregation of duties, and the level of complexity and innovation in the marketplace. Institution-specific factors can significantly increase or decrease the basic level of operational risk.

Reputation Risk

The potential that negative publicity regarding an institution's business practices, whether true or not, will cause a decline in the customer base, costly litigation or revenue reductions.

Legal Risk

The risk arising from the potential that unenforceable contracts, lawsuits or adverse judgements may disrupt or otherwise negatively affect the operations or financial condition of the institution.

Strategic Risk

The current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of response to industry changes. This risk is a function of the compatibility of an organisation's strategic goals, the business strategies developed to achieve those goals, the resources deployed against those goals, and the quality of implementation. The resources needed to carry out business strategies are both tangible and intangible. They include communication channels, operating systems, delivery networks, and managerial capacities and capabilities. The organisation's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other environmental changes.