Hong Kong Monetary Authority 香港金融管理局

D T R Carse OBE JP
Deputy Chief Executive (Banking)

簡達恆 OBE JP
副總裁(銀行)

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23 October 1995

The Chief Executive
All locally incorporated licensed banks

Dear Sir/Madam,

Best Practice Guide on Financial Disclosure by Authorized Institutions

Further to my letter of 10 August, we have revised the Best Practice Guide on Financial Disclosure by Authorized Institutions to incorporate the recommendations in Phases I and II of the 1995 disclosure package and the recommendation to disclose balance sheet inner reserves in banks' 1995 accounts. A copy of the revised Best Practice Guide is attached. The recommendations in respect of Phases I and II of the 1995 package are the same as those set out in my letters of 19 December 1994 and 10 August 1995.

Please note that the Banking (Amendment) Ordinance 1995 (the Ordinance), which is expected to come into effect in November 1995, will provide legal backing for the Guide. The new Seventh Schedule of the Ordinance has introduced a continuing authorization criterion which provides that in relation to an institution incorporated in Hong Kong, the Monetary Authority (MA) must be satisfied that it presently discloses, and will if authorized continue to disclose, adequate information about the state of its affairs and its profit and loss accounts in its audited annual accounts and in other parts of its annual report. The MA considers that relevant authorized institutions which comply fully with this Guide have fulfilled that authorization criterion. Failure to meet the criterion would be a ground for revocation of authorization (although the MA would have the discretion to decide whether to revoke).

The Stock Exchange intends to amend the Listing Rules to include the attached recommendations thus requiring all listed banks to comply with these additional disclosure provisions in respect of their annual accounts for financial years ending on or after 31 December 1995.

The HKMA will continue to discuss with the Stock Exchange and the Securities and Futures Commission proposals for the 1996 accounts, covering areas such as cash flow statements and market risk exposure.

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30th Floor 3 Garden Road Hong Kong 香港花園道3號30樓
Telephone (852) 2878 1688 Facsimile (852) 2878 1690 Telex 64282 COFB HX

Should you have any questions on the Guide, please feel free to contact Mr. Eddie Yue (2878 8110) or Mr. Andrew Li (2878 1651).

Yours faithfully,

D T R Carse
Deputy Chief Executive (Banking)

c.c. The Chairman, Hong Kong Association of Banks
President, Hong Kong Society of Accountants
Securities and Futures Commission
(Attn.: Mrs. Laura Cha)
The Stock Exchange of Hong Kong
(Attn.: Mr. Herbert Hui)

Enc. [illegible]

BEST PRACTICE GUIDE ON FINANCIAL DISCLOSURE BY AUTHORIZED INSTITUTIONS

I. Introduction

1.1 This Best Practice Guide ("the Guide") is issued by the Hong Kong Monetary Authority (HKMA) to set out the minimum standards which the HKMA recommends authorized institutions to adopt in respect of information to be disclosed in their annual accounts for financial years ending on or after 31 December 1995. The HKMA expects all authorized institutions incorporated in Hong Kong, except the smaller restricted licence banks (RLBs) and deposit-taking companies (DTCs), to comply with this Guide (see paragraphs 3.2 and 3.4).

1.2 The recommendations in this Guide are supplementary to and do not supplant any other disclosures required under relevant legislation, accounting standards, or which are necessary to show a true and fair view. Hence, in addition to the disclosures recommended in this Guide, authorized institutions will need to take account of the other existing disclosure requirements under the Companies Ordinance, the Stock Exchange Listing Rules, and the applicable Statements of Standard Accounting Practice where relevant.

II. Background

2.1 Banks and deposit-taking institutions play a significant and influential role in the efficient running of an economy and its monetary system. Most individuals and corporate bodies have an interest in such institutions either as depositors, borrowers or investors. There is considerable public interest in their well-being and in the adequacy of the financial information which institutions disclose in their published annual accounts i.e. whether such information sufficiently reflects the performance and financial strength of the institution during and at the end of the reporting period.

Exemptions under the Companies Ordinance

2.2 By virtue of an exemption from the disclosure requirements set out in the Tenth Schedule of the Companies Ordinance, banks incorporated in Hong Kong are permitted to disclose less information than other companies. In essence, the exemption means that :

(a) banks need only provide limited balance sheet information;

(b) banks do not need to provide a breakdown of income, operating expenses and charge for bad and doubtful debts in their profit and loss account; and

(c) banks are able to maintain inner reserves and can make undisclosed transfers to or from them.

2.3 The exemptions do not apply to RLBs and DTCs. Nonetheless, the disclosure made by these companies prior to their 1994 accounts was still modest relative to most other international financial centres.

2.4 The exemption under the Companies Ordinance was originally introduced in recognition of the special nature of banks. They are heavily reliant on external funding from customer deposits or interbank borrowing and their capital and earnings are vulnerable to fluctuations in asset values, creditworthiness of their borrowers, the business cycle and monetary conditions. The exposure of banks to such fluctuations means that they are vulnerable to a loss of confidence on the part of depositors. Banking problems can quickly spread, calling into question the stability of the system as a whole. This led to the view, in a number of countries including Hong Kong, that it was preferable for banks not to disclose full information about their performance and business so as to prevent bad news from causing a loss of confidence.

The need for change

2.5 The need to maintain the stability of the banking system should be given considerable weight in considering the appropriate extent of financial disclosure by banks. However, the Hong Kong banking system is now well-capitalised and profitable, and the supervisory regime has been strengthened. Moreover, the international trend is towards greater transparency and accountability. Maintaining a limited level of disclosure by banks in Hong Kong could become counterproductive as it may lead to a lower than justified perception of authorized institutions in Hong Kong by depositors, counterparties, overseas regulators and rating agencies. This may affect their ability to conduct international business or to raise capital.

The new approach

2.6 The HKMA has been working closely with the banking industry since December 1993 to develop proposals to increase the scope of financial disclosure by

authorized institutions in Hong Kong. A Working Party on Financial Disclosure chaired by the HKMA and comprising representatives of authorized institutions was set up in January 1994 to formulate recommendations.

2.7 The Stock Exchange of Hong Kong (SEHK), which has a locus in relation to listed banks, presented its own proposals for greater financial disclosure by listed banks in a discussion paper issued in March 1994 to the public.

2.8 Comments from the banking industry and the accounting profession reflected a general support for a common disclosure framework for both listed and non-listed authorized institutions. A joint technical working group comprising representatives from the HKMA, SEHK and the Securities and Futures Commission (SFC) was set up to develop joint recommendations in respect of additional information to be disclosed by authorized institutions. The first package which applied to accounts of authorized institutions for financial periods ended on or after 31 December 1994, was issued in September 1994. The 1995 (Phase I and II) disclosure packages which are intended to apply to authorized institutions' accounts ending on or after 31 December 1995, were issued in December 1994 and August 1995 respectively. The recommendations for the 1994 and 1995 packages have been endorsed in principle by the Hong Kong Association of Banks, the Deposit-Taking Companies Association and the Hong Kong Society of Accountants.

2.9 As part of the effort to improve financial disclosure by authorized institutions, the HKMA undertook in mid-1995 a review of the disclosure of balance sheet inner reserves in the light of the additional disclosures made by banks in the 1994 accounts. The review concluded that the disclosure of transfers to inner reserves in the 1994 accounts had not caused any major adverse impact on the banks and that the disclosures in the 1994 accounts had already prepared the way for disclosure of balance sheet inner reserves. The banks consulted by the HKMA have raised no objection to making the disclosure in their 1995 accounts. In light of the above, the HKMA announced on 26 September 1995 its decision to recommend the disclosure of balance sheet inner reserves in the 1995 accounts of banks.

III. Implementation

Applicability and Effective Date

3.1 The recommendations in section IV are intended to apply to all licensed banks and the larger RLBs and DTCs incorporated in Hong Kong in respect of their annual accounts for financial years ending on or after 31 December 1995.

3.2 Larger RLBs and DTCs are defined for this purpose as those which currently have total assets of HK$1 billion or more or total customer deposits of HK$300 million or more (for further details see Annex A). To maintain consistency in reporting, RLBs and DTCs which adopted the disclosure recommendations in the Guide in their 1994 accounts are expected to continue reporting on that basis (including subsequent changes to the Guide) notwithstanding that they may fall below the exemption thresholds in subsequent financial years.

3.3 The recommendations set out in Section IV are intended as a minimum standard of disclosure. Institutions which wish to disclose information in addition to that recommended in this Guide, and RLBs and DTCs below the exemption thresholds which intend to adopt the recommendations in their accounts, are welcome to do so.

Compliance

3.4 The Banking (Amendment) Ordinance 1995, which is expected to come into effect in November 1995, includes adequate disclosure of financial information as one of the criteria for continuing authorization (i.e. criteria that apply to institutions not only at the time of authorization but thereafter) under the Banking Ordinance. Paragraph 11 of the new Seventh Schedule provides that in relation to an institution incorporated in Hong Kong , the Monetary Authority must be satisfied that it presently discloses, and will if authorized continue to disclose, adequate information about the state of its affairs and its profit and loss account in its audited annual accounts and in other parts of its annual report. This Guide sets out the Monetary Authority's expectations with respect to financial disclosure by authorized institutions to which this Guide applies. It is important to note that failure to meet this authorization criterion would be a ground for revocation of authorization (although the Monetary Authority would have the discretion to decide whether to revoke).

3.5 SEHK has incorporated the 1994 disclosure package and Phase I of the 1995 package into its Listing Rules in November 1994 and April 1995 respectively. It also intends to incorporate the 1995 (Phase II) package and the recommendation for banks to disclose balance sheet inner reserves in their 1995 accounts into the Listing Rules before the end of 1995.

Statement of Compliance

3.6 Authorized institutions to which the recommendations in section IV apply should include a statement in their directors' report on the extent of compliance with this Guide and the reason for any non-compliance. In cases of full compliance, a

general statement that the annual accounts have fully complied with the recommendations of this Guide should be made. In cases of partial compliance, the statement in the directors' report should specify the areas of, and reasons for, non-compliance.

IV. Recommendations of the Joint Technical Working Group

Profit and Loss Account

4.1 An authorized institution should include the following information in the profit and loss account or the notes to the financial statements. Institutions should exercise judgement in deciding on the relative prominence given to each disclosure item, having regard to the overall clarity of the financial statements.

Interest income
Interest expense
Other operating income
- Gains less losses arising from dealing in foreign currencies
- Gains less losses from other dealing activities
- Net fees and commission income (see paragraph 4.2)
- Dividend income (analyse into listed and unlisted)
- Others

Operating expenses
- Staff costs
- Premises and equipment expense, excluding depreciation (analyse where material)
- Depreciation charge
- Other operating expenses

Charge for bad and doubtful debts
Gains less losses from disposal of tangible fixed assets and long-term investments (analyse where material)
Exceptional item (in accordance with HK SSAP 2)
Taxation charge
- Hong Kong tax
- Overseas tax
- Deferred tax, if any

Extraordinary item (in accordance with HK SSAP 2)
As an appropriation :
* Transfers to or from inner reserves
Transfers to or from reserves

(* This will depend on the treatment of disclosure of inner reserves to be agreed between individual banks and their auditors (see paragraph 4.12))

4.2 In relation to the net fees and commission income, the gross figures should be disclosed where they are material and are necessary for the appreciation of the true extent of fee-based activities engaged in by the institution.

4.3 In relation to the taxation charge, the basis on which the Hong Kong profits tax is computed should be disclosed.

4.4 An authorized institution should disclose any material amount set aside to provisions other than those for depreciation, renewals or diminution in value of assets or any material amount withdrawn from such provisions and not applied for the purposes thereof.

Balance Sheet

4.5 An authorized institution should disclose the following information in the balance sheet or in the notes to the financial statements. Again, institutions should exercise judgement in deciding on the relative prominence given to each disclosure item, having regard to the overall clarity of the financial statements.

Assets

Cash and short-term funds
- Cash and balances with other banks and financial institutions
- Money at call and short notice
- Treasury bills (including Exchange Fund Bills)

Placements with banks and financial institutions maturing between one and twelve months

Trade bills (provisions should be shown if material)

Certificates of deposit

Securities held for dealing purposes (analyse into listed and unlisted)

Advances and other accounts
- Advances to customers
- Advances to banks and financial institutions
- Accrued interest and other accounts (analyse where material)
- Provisions 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

Investment securities (for each class below analyse into listed and unlisted and disclose market values of listed securities)
- Equity
- Debt

Investments in associated companies

Tangible fixed assets (for each major class of assets including investment properties disclose the information as set out below)
- cost or valuation
- the additions, revaluations and disposals made during the period
- the amount provided or written off for depreciation or diminution in value of these assets during the period
- the accumulated depreciation, and
- the net book value

Liabilities

Deposits and balances of other banks and financial institutions

Current, fixed, savings and other deposits of customers

Certificates of deposit

Issued debt securities

Deferred taxation, if any (disclose in accordance with HK SSAP 12)

Other accounts and provisions

Capital Resources

Loan capital (types, coupon rates and maturities should be disclosed)

Minority interests

Share capital

Reserves (analyse into the various material types of reserves including property and other revaluation reserves, where maintained)

4.6 An authorized institution should disclose details of the movements in provisions for bad and doubtful debts (including provisions against trade bills where material) during the period. The movements in provisions need not be analysed by categories of assets but should be analysed into those in respect of general and specific provisions. Details of such movements to be disclosed should include :

Amounts charged to the profit and loss account in the period for losses on doubtful advances, etc,

Amounts of advances, etc written off in the period,

Amounts recovered of advances, etc written off in previous years,

Interest suspended on doubtful advances, etc, if applicable,

Suspended interest recovered during the period, if applicable and

Exchange adjustments, if any.

4.7 An authorized institution should disclose the aggregate amount of advances on which interest is being placed in suspense or on which interest accrual has

ceased, together with the aggregate amount of specific provisions made in respect of such advances. Where the specific provisions were made after taking into account the value of collateral in respect of such advances, an institution may wish to indicate this in order to put the level of provisioning in perspective.

4.8 The maturity profile of debt securities included within investment securities should be disclosed, and analysed into those maturing within one year, those after one year but within five years and those after five years and undated. The analysis into the relevant maturity groupings should be based on the remaining period at the balance sheet date to the contractual maturity date.

4.9 The gross amount (before accumulated depreciation) of tangible fixed assets included in the financial statements should be analysed between those included at cost and those included at valuation, if any. For those fixed assets that have been included at valuation, the years in which those assets were valued and the values should be disclosed and in the case of assets that have been valued during the financial period, the following should be disclosed :

- the names of the persons who valued them and particulars of their qualifications for doing so, and
- the bases of valuation used by such persons.

4.10 Of the premises (including investment properties) which are contained in tangible fixed assets how much is ascribable to those held freehold and those held on a lease (categorised into long lease, medium-term lease and short lease) should be disclosed. A distinction should also be made between those held on lease in Hong Kong and those held outside Hong Kong.

4.11 An authorized institution should disclose details of the movements in reserves during the period, including the surplus or deficit on revaluation of properties.

4.12 An authorized institution should disclose any inner reserves previously maintained in the balance sheet. The precise treatment is a matter for individual banks and their auditors to decide.

Off-Balance-Sheet Exposures

4.13 An authorized institution should disclose the contractual or notional amounts of each significant class of off-balance-sheet financial instruments or contracts outstanding. These should include but are not limited to the following items :

Contingent liabilities and commitments :

Direct credit substitutes
Transaction-related contingencies
Trade-related contingencies
Note issuance and revolving underwriting facilities
Other commitments
- With an original maturity of under 1 year or which are unconditionally cancellable
- With an original maturity of 1 year and over

Others (including forward asset purchases, amounts owing on partly paid shares and securities, forward forward deposits placed, asset sales or other transactions with recourse) - analyse where material

Derivatives :

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

4.14 In relation to derivatives, where material an authorized institution should provide an analysis of the aggregate notional amounts of each significant class of instruments. These should include but are not limited to the following, where significant :

Exchange rate contracts
- Forwards and futures
- Swaps
- Options purchased
- Options written

Interest rate contracts
- Forwards and futures
- Swaps
- Options purchased
- Options written
- Others - analyse where material

4.15 An authorized institution should analyse the aggregate notional amounts of each significant class of derivatives instrument into those entered into for trading or hedging purposes.

4.16 The contractual or notional amounts of off-balance sheet instruments provide only an indication of the volume of business outstanding at the balance sheet date and bear little relation to the underlying risks of the exposure. An authorized

institution should also provide risk exposure information on its off-balance-sheet instruments. In particular, it should report :

(a) the aggregate credit risk weighted amounts of its contingent liabilities and commitments, exchange rate contracts, interest rate contracts and other derivatives, if any.

(b) the aggregate replacement costs of its exchange rate contracts, interest rate contracts, and other derivatives, if any.

It should also indicate whether these amounts take into account the effects of bilateral netting arrangements.

Transactions with Group Companies

4.17 Where an authorized institution has entered into transactions with group companies, it should disclose the nature of the relationship and analyse the balances due to or from the various categories of group companies as at balance sheet date.

Assets Pledged as Security

4.18 An authorized institution should disclose the aggregate amount of secured liabilities and the nature and carrying values of the assets pledged as security.

Principal Accounting Policies

4.19 The principal accounting policies adopted in determining the profit or loss for the period and in stating the financial position should be disclosed by way of note to the accounts.

4.20 A description of the principal accounting policies adopted in respect of off-balance-sheet transactions should be given in the notes to the financial statements. As a minimum, the notes should include an explanation of the accounting practices adopted for valuation and income recognition.

Supplementary Financial Information

4.21 An authorized institution should disclose the following information, either as part of the accompanying information to its financial statements or as part of the financial statements themselves.

Segmental information

4.22 For the following segmental reporting purposes, a geographical or business segment should generally be reported where it contributes 10% or more of the relevant disclosure item.

4.23 Where consolidated financial statements are presented, segmental information need only be presented on the basis of the consolidated financial statements.

4.24 An authorized institution should report financial information for the various geographical areas which are considered to be significant to the institution. The financial information to be disclosed should include but is not limited to :

Profit/loss before taxation, extraordinary items, and minority interest
Total assets

The above information by geographical areas should be based on the location of the principal operations of the subsidiary or, in the case of the authorized institution itself, on the location of the branch responsible for reporting the results or booking the assets. The basis should be clearly stated.

4.25 An authorized institution is also recommended to report the above financial information for the various classes of business (e.g. commercial banking, investment banking, securities business, insurance business, etc.) which are considered to be significant to the institution. The institution should describe the activities of each reported class of business. However, this will be optional in respect of the accounts for the financial year ending prior to December 1996. Where an institution chooses not to disclose this information in quantitative form in the 1995 accounts, it should as a minimum provide a general description of the main classes of business in which it is engaged.

4.26 An authorized institution should disclose the breakdown of the gross amount of advances to customers (including advances booked in overseas branches and subsidiaries) by industry sectors which are considered to be significant to the institution. The information to be disclosed should be based on the broad industry sectors as set out below but institutions may choose to give a more detailed breakdown if they so wish. The basis of classification should be clearly stated.

Industrial and commercial companies
Building, construction and property development
Financial concerns (other than banks and financial institutions)
Individuals
All others

An institution may find that disclosing information about the extent to which the above advances are backed by collateral or other security indicates better the extent of credit risk. Disclosure of any such additional information is encouraged.

4.27 A note providing further guidance on the disclosure of segmental information is at Annex B.

Other financial information

4.28 An authorized institution should disclose the following information supplementary to its financial statements :

(a) the capital adequacy ratio at balance sheet date, computed in accordance with the Third Schedule of the Banking Ordinance. Where an institution is required to compute a consolidated ratio by the HKMA, that ratio should be published. Otherwise, the solo ratio should be published; and

(b) the average liquidity ratio for the last month of the financial period, computed in accordance with the Fourth Schedule of the Banking Ordinance. Where the basis of computation has been agreed with the HKMA, an institution may choose to include overseas branches and/or subsidiaries in the calculation of the liquidity ratio (rather than Hong Kong offices only).

The basis of computation should be clearly stated and should be consistently applied each year.

Comparative Figures and Transitional Arrangements

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

4.30 Where the recommendations in respect of segmental information 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 year.

Terminology

4.31 Institutions should consider the guidance note on terminology at Annex C in determining the classification of items within the disclosures contained in the

Guide. Institutions should provide sufficient descriptions in their accounting policy notes or other notes on the accounts to enable the users of the financial statements to understand how material items have been dealt with.

Presentation and Layout

4.32 The above recommendations present a broad framework of financial disclosure by authorized institutions. The precise method of presentation in the accounts and the layout is a matter for individual institutions to agree with their auditors.

Hong Kong Monetary Authority
October 1995

Annex A

Application of the recommendations to RLBs and DTCs

Paragraph 3.1 and 3.2 of the Best Practice Guide indicate that the recommendations in the Guide are intended to apply to RLBs and DTCs which currently have total assets of HK$1 billion or more or total customer deposits of HK$300 million or more. Any RLB or DTC which meets either one of the size criteria is recommended to adopt the recommendations in the Best Practice Guide.

The HKMA intends to use the figures which RLBs and DTCs report in respect of item 21 (Total assets less provisions) and item 5.4 (Total deposits from customers) of the Return of Assets and Liabilities of an Authorized Institution (Form MA(BS)I) to determine whether a RLB or DTC meets the above size criteria. To ensure that institutions know in advance whether or not they should adopt the recommendations in the Best Practice Guide and to avoid the effects of one-off fluctuations at the end of financial year, the average of the relevant figures reported in the twelve month period up to end-August will be adopted for this purpose.

Annex B

Guidance notes on segmental reporting

Geographical segments

1. Depending on both the institution's activities and the nature of the markets concerned, reportable geographical segments may be based on continents, other regional areas, whether compatible for geographical or economic reasons, and/or individual countries. An institution's operations within Hong Kong are considered to be a separate geographical segment.

Intra-group items

2. Institutions will need to determine, in the light of their individual circumstances, whether it would be more meaningful to include or exclude intra-group items when preparing segmental information. Where the individual segmental analysis is shown inclusive of intra-group transactions, it will be necessary to show separately the aggregate of intra-group items deducted in order to reconcile to the consolidated totals for profits and assets.

General

3. Where an institution operates predominantly in one class of business or geographical area (i.e. where the dominant segment's profit and total assets each constitute more than 90% of the related totals for all segments), the institution need only provide a description of the class of business or indicate the geographical area in which the institution predominantly operates.

4. Where allocation of an item of revenue, expense, or assets cannot be made to segments on a reasonable basis, no allocation should be made and the unallocated amount should be adjusted against the revenue, expense, or assets of all segments. The unallocated amounts should be disclosed. Where allocation of an item involves a material judgement, the basis of allocation should be clearly stated.

5 In the event that segments are redefined in subsequent years, an institution should disclose the nature, reason for and the effects of such change, where the change has a material effect on the segment information.

6. When a particular segment exceeds the 10% threshold for the first time, comparative figures for the previous year should be provided. Conversely, when a segment falls below the 10% threshold in the year of reporting the segmental information should still be disclosed if the prior year comparatives were above the 10% level in the previous year.

Annex C

Guidance note on Terminology

"Gains less losses arising from dealing in foreign currencies" refer to the profits less losses from foreign exchange transactions including those from foreign exchange derivatives.

"Gains less losses from other dealing activities" include profits less losses from dealing in instruments such as securities, commodities, precious metals, derivatives based on these items and other derivatives such as interest-rate derivatives.

"Premises and equipment expense" include rents and rates, insurance of premises and equipment, lighting, heating, maintenance costs and Electronic Data Processing expenses.

"Charge for bad and doubtful debts" refers to the net amount charged or credited to the profit and loss account in respect of provisions for bad and doubtful debts and bad debt recoveries.

"Long-term investments" include investment securities and investments in associated companies.

"Banks and financial institutions" refer to institutions authorized under the Banking Ordinance and institutions which are regarded as banks by the appropriate supervisory authorities in their place of incorporation, and include central banks.

"Cash and balances with other banks and financial institutions" mean cash in the till and demand deposits with other banks and financial institutions.

"Money at call and short notice" refers to deposits of up to a maximum of one month to maturity.

"Treasury bills (including Exchange Fund Bills)" include all such bills regardless of maturity and including those held for dealing purposes.

"Trade bills" refer to all purchased bills of exchange in relation to trade transactions.

"Certificates of Deposit" include all Certificates of Deposit regardless of maturity (including those held for dealing purposes).

"Securities held for dealing purposes" are defined as all other money market or capital market securities held for trading.

"**Advances to banks and financial institutions**" include placements with banks and financial institutions of more than one year.

"**Investment securities**" include all other money market or capital market securities held for purposes other than dealing purposes.

"**Debt security**" refers to any security representing a creditor relationship with an enterprise. It also includes preference shares that by their terms either must be redeemed by the issuer or are redeemable at the option of the investor. Thus, it includes, among other items, corporate bonds, convertible debt, commercial paper, and all securitized debt instruments. Holdings of a bank's own debt securities should not be included, even if they are held on a market maker's book; they should be netted against the amount of issued debt securities shown on the liabilities side.

"**Equity security**" refers to any security representing an ownership interest in an enterprise (e.g. common shares, preference shares or other capital stock). However, it does not include convertible debt or preference shares that by its terms either must be redeemed by the issuing enterprise or is redeemable at the option of the investor.

"**Loan Capital**" refers to subordinated liabilities such as loans, debentures, floating rate notes, etc.

"**Deposits and balances of other banks and financial institutions**" refer to all amounts (excluding those in the form of debt securities and certificates of deposits) arising out of banking transactions owed to other banks and financial institutions.

"**Issued debt securities**" refer to all negotiable securities other than stocks, shares, and Certificates of Deposit.

"**Group companies**" refer to the following categories : the ultimate holding company, any subsidiary of the ultimate holding company (including any intermediate holding company of the institution) and any subsidiary of the institution.

"**Direct credit substitutes**" are irrevocable off-balance-sheet obligations which carry the same credit risk as a direct extension of credit. They include guarantees, the confirming of letters of credit, standby letters of credit serving as financial guarantees for loans, securities and other financial liabilities. They include also liabilities arising from acceptances on accommodation bills but exclude any such bills which have been discounted by the institution itself. Risk participations and any other similar commitments where the institution has undertaken to repay the financial obligation of a customer on his failure to do so should also be included.

"**Transaction-related contingencies**" refer to contingent liabilities arising from an irrevocable obligation to pay a beneficiary when a customer fails to perform some contractual, non-financial obligation. They include those arising from performance

bonds, bid bonds, warranties and standby letters of credit related to a particular transaction.

"Trade-related contingencies" are contingent liabilities arising from trade related obligations. They include letters of credit issued, acceptances on trade bills, shipping guarantees issued and any other trade related contingencies. However, liabilities arising from confirmation of letters of credits issued by another institution should be regarded as direct credit substitutes.

"Note issuance and revolving underwriting facilities" are arrangements whereby a borrower may draw down funds up to a prescribed limit over a predefined period through the issue of notes which the institution has committed to underwrite.

"Other commitments" include the undrawn portion of any binding arrangements which obligate the institution to provide funds at some future date. Commitments with an original maturity of less than 1 year, or which can be unconditionally cancelled at any time by the institution at its discretion, other than for "force majeure" reasons, include any revolving or undated/open-ended commitments, e.g. overdrafts or unused credit card lines, providing that they can be unconditionally cancelled at any time and are subject to credit revision at least annually. Original maturity is defined as the length of time between the date the commitment is made and the earliest date on which the institution can, at its option, unconditionally cancel the commitment.

"Forward asset purchases" refer to commitments to purchase at a specified future date and on prearranged terms, a loan, security or other asset from another party, including those under a put option written by the institution.

"Amounts owing on partly paid shares and securities" refer to the unpaid portion of shares or securities which the issuer of such shares or securities may call for at a future date.

"Forward forward deposits placed" refer to agreements between the institution and another party whereby the institution will place a deposit at an agreed rate of interest with that party at some predetermined future date.

"Asset sales or other transactions with recourse" include asset sales where the holder of the asset is entitled to put the asset back to the institution within an agreed period or under certain prescribed circumstances, e.g. deterioration in the value or credit quality of the asset concerned.

"Derivatives" refer to financial contracts whose value depends on the value of one or more underlying assets or indices.

"Hedging" transactions are those entered into to reduce risk by taking a position which offsets existing or anticipated exposure to a change in market rates or prices

other than those on the trading book, for example, those entered into to manage interest rate or foreign exchange risks.

"**Trading**" transactions means the institution's proprietary positions in financial instruments which are intentionally held for short term resale and/or which are taken on by the institution with the intention of benefiting in the short term from actual and/or expected differences between their buying and selling prices, or from other price or interest-rate variations, and positions in financial instruments arising from matched principal brokering and market making, or positions taken in order to hedge other elements of the trading book.

"**Replacement cost**" is defined as the cost of replacing all contracts (including those traded on exchanges, foreign exchange contracts with original maturity of 14 calendar days or less, and the unmatured forward leg of foreign exchange swaps but excluding the forward foreign exchange contracts arising from swap deposit arrangements) which have a positive value when marked to market.

"**Credit risk weighted amount**" refers to the amount as computed in accordance with the Third Schedule of the Banking Ordinance.