



HONG KONG MONETARY AUTHORITY
香港金融管理局

Circulars

09 Mar 1999

Basle Committee on Banking Supervision's Report on "Banks' Interactions with Highly Leveraged Institutions (HLIs) and Sound Practices for Banks' Interactions with HLIs"

Our Ref: CB/POL/4/5

9 March 1999

The Chief Executive
All Authorised Institutions

Dear Sir / Madam,

Basle Committee on Banking Supervision's Report on "Banks' Interactions with Highly Leveraged Institutions (HLIs) and Sound Practices for Banks' Interactions with HLIs"

In recent years, HLIs have become significant participants in global financial markets and the scope of their interactions with banks has also expanded. This development together with the near-collapse of one of the largest of this type of institution in the US have drawn attention to the need for a full understanding and prudent management of the risks of banks' exposures to HLIs.

The Basle Committee issued in January 1999 the above report which provides an analysis of banks' transactions with HLIs and guidance on sound practices in such dealings. While it is very difficult to provide a precise definition of an HLI, the focus of the report is on large financial institutions that are subject to very little or no direct regulatory oversight and very limited public disclosure requirements, and that take on significant leverage.

The sound practice standards recommended in the report for prudent approaches to the assessment, measurement and management of banks' exposures to HLIs include the following :

1. establishing clear policies and procedures for banks' involvement with HLIs as part of their overall credit risk environment;
2. information gathering, due diligence and credit analysis of HLIs' activities, risks and operations;
3. developing more accurate measures of exposures resulting from trading and derivatives transactions;
4. setting meaningful overall credit limits for HLIs;

5. linking credit enhancement tools, including collateral and early termination provisions, to the specific characteristics of HLIs; and
6. closely monitoring credit exposures vis-à-vis HLIs, including their trading activities, risk concentration, leverage and risk management processes.

A copy of the Basle Committee's report is attached for your reference.

The Monetary Authority recommends that authorized institutions which have exposures and dealings with HLIs should review their risk management processes and systems taking into account the risk management issues discussed in the Basle Committee's report and adopt the sound practice standards mentioned therein. Sound internal risk management, including effective counterparty credit risk management, is essential to the prudent operation of authorized institutions.

While the recommendations of the Basle paper are directed at relationships with HLIs, they also have relevance to banks' dealings with other counterparties. I hope that you will find the paper helpful.

Yours faithfully,

D T R Carse
Deputy Chief Executive

c.c. HKSA (Attn: The President)

Encl
[Attachment 1](#)
[Attachment 2](#)

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