HONG KONG MONETARY AUTHORITY
香港金融管理局

Circulars

28 Feb 2003

Supervisory Policy Manual (SPM) : IC-5 "Stress-testing"

Our Ref: B1/15C
B1/21C

28 February 2003

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Supervisory Policy Manual (SPM) : IC-5 "Stress-testing"

I am pleased to inform you that, following consultation with the two industry Associations, the Monetary Authority is today issuing the above SPM module as a guidance note.

Stress-testing involves the use of various techniques to assess a financial institution's potential vulnerability to adverse changes in market conditions. It has played an increasingly important role in the risk management process in recent years. The HKMA believes that stress tests, if properly designed and implemented, will enhance an AI's risk management framework and help it to be better prepared for difficult market conditions. The Basel Committee, in its proposals for the New Capital Accord, has also identified the need for AIs to conduct stress tests as part of the process for assessing capital adequacy under Pillar 2 (Supervisory Review Process).

In the light of these developments, this module serves to illustrate the use of stress tests for risk management purposes and describes the HKMA's approach to evaluating the appropriateness and effectiveness of stress tests conducted by AIs. AIs are expected to have in place a stress-testing programme that is appropriate to the nature and complexity of their business activities within one year of the effective date of this module. This recognises that some may need some time to develop or enhance their internal systems. The HKMA will monitor the progress of AIs in enhancing their stress-testing capabilities in its ongoing supervision.

The examples and illustrations of stress scenarios provided in the module are for AIs' reference only. It should be noted that the assumptions and figures contained therein are for illustrative purposes and should not be construed as forecasts by the HKMA. Each AI should determine its own stress assumptions based on the nature of its portfolios and the risks involved.

On-line access to the module is available under the icon of "Supervisory Policy Manual" in the HKMA's public (http://www.info.gov.hk/hkma) and private (http://www.hkfin.net) web-sites.

Should you have any questions relating to the module, please feel free to contact Mr Cho-hoi Hui on 2878-1485 or Mr Daniel Wong on 2878-1626.

Yours faithfully,

Simon Topping
Executive Director (Banking Policy)

c.c. The Chairman, Hong Kong Association of Banks
The Chairman, The Deposit-taking Companies Association
SFTB (Attn: Mr Edmond Lau)

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