Questions and Answers on
Banking (Disclosure) Rules

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Part I - Introduction

These questions and answers ("Q&As") relate to the Banking (Disclosure) Rules ("the Disclosure Rules"), which came into effect on 1 January 2007. The purpose of these Q&As is to provide supplementary guidance on certain subjects which are already covered in the Guideline on the Application of the Banking (Disclosure) Rules issued by the Monetary Authority ("HKMA"). The Q&As are general in their scope and do not take into account the particular circumstances of any individual authorized institution ("AI"). Certain sections of the Disclosure Rules contain exceptions or qualifications which, although not covered in these Q&As, may still apply to particular AIs. In the case of any discrepancy between the Q&As and the Disclosure Rules, the Disclosure Rules prevail and reading these Q&As is no substitute for reading the Disclosure Rules themselves. The Q&As should not be regarded as, or be considered a substitute for obtaining, legal advice and AIs should consider obtaining legal and other professional advice before taking any action on any of the matters covered by these Q&As, particularly if they have any doubt as to how any aspect of the Disclosure Rules might apply to them. Unless otherwise stated, the terminology used in the Q&As follows that used in the Guideline on the Application of the Banking (Disclosure) Rules and the Disclosure Rules themselves.

Part II - Questions and Answers

Approach to Exemption

Q1: How will an AI know if it qualifies for an exemption from having to make disclosures under the Disclosure Rules?

Ans: An AI is required to make all applicable disclosures under the Disclosure Rules, unless it receives written notification from the HKMA informing it that it is exempt from having to make such disclosures. If an AI believes that it meets the exemption criteria stipulated in sections 3(7) or 3(8), in the case of a locally incorporated AI, or section 3(9), in the case of an overseas incorporated AI, it should ask its usual supervisory contact to review its exemption status (see the Guideline on the Application of the Banking (Disclosure) Rules (paragraph 7.7)). If the usual supervisory contact is satisfied that the AI meets the relevant exemption criteria, the HKMA will issue an exemption notice to the AI. The exemption notice will state from which Parts of the Disclosure Rules the AI is exempt.

Any exemption granted to an AI can be withdrawn by the HKMA if subsequent assessments show that the exempted AI no longer meets the exemption criteria specified in the Disclosure Rules.

It should be noted that it is not possible to exempt an AI from making semi-annual disclosures under section 3(8)(a) unless the AI is also exempt from making annual disclosures.

Disclosure Policy

Q2: According to section 5 of the Disclosure Rules, an AI incorporated in Hong Kong is required to establish a clearly defined disclosure policy not later than 6 months after the commencement of the Disclosure Rules (i.e. on or before 30 June 2007) or not later than 6 months after the date on which it became an AI, whichever is the later. The disclosure policy should be documented in writing and be approved by the AI's board of directors. Is an AI required to submit its disclosure policy to the HKMA for review or approval?

Ans: No. The Disclosure Rules do not require an AI to submit its disclosure policy to the HKMA for review or approval. However, an AI's disclosure policy should be made available for inspection when required by the HKMA (e.g. during on-site examination).

Proprietary and Confidential Information

Q3: Under what circumstances would an AI incorporated in Hong Kong be able to rely on the exemption from disclosing proprietary or confidential information under the Disclosure Rules?

Ans: An AI incorporated in Hong Kong is required to disclose proprietary or confidential information unless it has received the HKMA's prior consent to decline to give such disclosure under section 9 of the Disclosure Rules. An AI may, under section 9 of the Disclosure Rules, with the prior consent of the HKMA, decline to disclose proprietary or confidential information which it would otherwise be required to disclose under the Disclosure Rules, if :

(a) the AI discloses general information relating to the subject matter of the relevant disclosure requirement in its disclosure statement instead; and

(b) the AI includes a statement in its disclosure statement stating what information it has declined to disclose.

The HKMA expects AIs only to request this exemption in exceptional circumstances. The HKMA will only be willing to give its prior consent to an AI to use this exemption, if the AI can demonstrate to the HKMA's satisfaction that there are good reasons for such exemption being used. AIs are discouraged from seeking to use this exemption unless disclosure of the relevant information would cause contractual obligations to be breached, or would have a serious and detrimental effect on an AI's ability to profit from specific business opportunities.

Prescribed Summary

Q4: If an AI's disclosure statement contains a "prescribed summary" (pursuant to section 6(3)(a)(ii) of the Disclosure Rules, in the case of an AI incorporated in Hong Kong, or pursuant to section 88(2)(a)(ii), in the case of an AI incorporated outside Hong Kong), does the "prescribed summary" have to include a summary of the AI's disclosures?

Ans: No. A prescribed summary is only required to specify clearly where the AI's complete disclosures can be found and how they can be accessed by the general public (see the definitions in section 6(11) and 88(10) of the Disclosure Rules). Where an AI uses a prescribed summary, its disclosures must be readily accessible to the public by one of the means specified in section 6(11)(b), in the case of a AI incorporated in Hong Kong, or section 88(10)(b), in the case of an AI incorporated outside Hong Kong. If, for example, the disclosures are readily accessible to the public on the AI's Hong Kong Internet website, the AI's prescribed summary should provide the relevant website address and specify the relevant link.

Verification and Internal Review of Disclosures

Q5: Do the Disclosure Rules require information disclosed under the Rules to be the subject of statutory audit?

Ans: No. Disclosures (including financial disclosures) made under the Disclosure Rules are not required to be audited by an external auditor, (although such information may in any event have to be audited by reason of the requirements of other legislation, accounting standard setters, securities regulators, or other authorities.) However, section 8 of the Disclosure Rules does require the senior management of an AI incorporated in Hong Kong to ensure that the information to be disclosed is scrutinized and subjected to an internal review to ensure the information is not false or misleading in any material respect. Such review should be conducted by adequately qualified personnel of the AI who are independent of the staff or management responsible for preparing the information to be disclosed.

Q6: If the CEO and CFO of an AI incorporated in Hong Kong review the AI's disclosures to ensure that the information is not false or misleading in any material respect, can such review form part of the internal review required by section 8 of the Disclosure Rules, given that their teams are responsible for preparing the disclosures?

Ans: No. Section 8(2) of the Disclosure Rules states that "the internal review should be carried out by adequately qualified personnel who are <u>independent of the institution's staff or management responsible for preparing the information </u>........". In practice neither the CEO nor the CFO is likely to be sufficiently independent of those preparing the disclosures to meet this requirement.

Q7: Will the HKMA consider issuing guidance on how the internal review should be conducted?

Ans: No. The HKMA does not intend to issue such guidance. It is up to an individual AI to ensure that the degree of scrutiny employed and the scope of the internal review undertaken, are sufficient to ensure that the disclosures are not false or misleading in any material respect.

Q8: Is it necessary for the internal audit staff of an AI incorporated in Hong Kong to carry out the internal review referred to in section 8(1) of the Disclosure Rules?

Ans: No. The Disclosure Rules require only that the internal review be carried out by adequately qualified personnel of the AI who are independent of the staff or management responsible for preparing the information which the AI is required to disclose (see section 8(2)). The Disclosure Rules do not specify that the personnel carrying out the review must be drawn from an AI's internal audit staff. The review may be carried out by personnel drawn from different teams within the AI (for example, personnel from the AI's internal audit staff might review the internal controls in place for compiling the information to be disclosed, whilst personnel from compliance might review the information itself), provided such personnel satisfy the criteria in section 8(2) of the Disclosure Rules.

Q9: Do the Disclosure Rules require the senior management of an AI incorporated in Hong Kong to scrutinize and review the information to be disclosed by the AI?

Ans: No. Although the Disclosure Rules require the senior management of such an AI to ensure that the information to be disclosed is scrutinized and subjected to internal review to ensure that the information is not false or misleading in any material respect, the senior management itself is not required to carry out such scrutiny or review (or indeed its own additional review). However, under section 6(3)(b) of the Disclosure Rules an AI is required to ensure that the disclosures made are not false or misleading in any material respect. If an AI fails to comply with the Disclosure Rules every director, chief executive and manager of that AI commits a criminal offence under section 60A of the BO (as amended by Banking (Amendment) Ordinance 2005). Accordingly, the senior management may in any event wish to review the disclosures before they are issued.

Specific Provisions

Q10: Why is the term "specific provisions" still used in the Disclosure Rules when it is no longer applicable under the Hong Kong Accounting Standard (HKAS) 39?

Ans: The term "specific provisions" is defined in the definitions section of the Banking (Capital) Rules (section 2) and has been incorporated into the Disclosure Rules, by virtue of section 2(2) of the Disclosure Rules. The definition of "specific provisions" closely follows the definition of "individual impairment allowances" contained in the accounting standards and is intended to have the same meaning.

Impaired Loans

Q11: **Separate disclosure of information relating to impaired loans is required by the Disclosure Rules. Although the term "impaired loans" is not defined in the Disclosure Rules, the conditions in which an asset is impaired are explained in the accounting standards (HKAS 39, paragraphs 58-70). Is it correct to adopt the concept of "impairment" applied in accounting standards for the purpose of the Disclosure Rules? Is the term broadly equivalent to "classified and non-performing loans" used for prudential reporting purposes?**

Ans: The term "impaired loans" is not intended to be limited to the scope of "impairment" applied in HKAS 39. The policy intention is that the term "impaired loans" as used in the Disclosure Rules extends to all loans recognized as non-performing for prudential reporting purposes.

Disclosure of Regulatory Reserve

Q12: **Sections 20 and 36 of the Disclosure Rules require an AI incorporated in Hong Kong to disclose its reserves, broken down into regulatory reserve, revaluation reserves where maintained, and other material types of reserves. If an AI earmarks a certain part of its general reserves as a regulatory reserve will it have to disclose this as a regulatory reserve?**

Ans: Yes. An AI is required to make appropriate disclosure of its regulatory reserve regardless of the methodology (i.e. appropriation or earmarking) it uses to maintain such reserve. Section 36(2) specifies that an AI should (in its disclosure statement for its annual reporting period) also disclose the nature and purpose of the reserve. An AI which maintains a regulatory reserve should make reference to the sample disclosure note published by the Hong Kong Institute of Certified Public Accountants.

Sample Disclosure Templates for IRB Banks

Q13: **The SPM module entitled "Guideline on Application of the Banking (Disclosure) Rules" includes a sample disclosure template for AIs using the STC Approach. Will the HKMA consider providing a similar template for AIs using the IRB Approach (referred to here as "IRB AIs")?**

Ans: The HKMA considers it inappropriate to provide disclosure templates for IRB AIs at this stage because the majority of AIs that intend to adopt the IRB Approach are subsidiaries of major international banks whose home country regulators may issue their own disclosure templates in due course. If the HKMA issued templates, and those templates differed from those of an AI's home country regulator, this would merely serve to increase the reporting burden on the AI concerned. Rather, it is the HKMA's intention to allow an AI to make use of group-level disclosures to the greatest extent possible provided always that the criteria under s.7(d) and (e) of the Disclosure Rules are met. Nonetheless, the HKMA will keep the situation under review and will reconsider the issue in the light of any further guidance provided by relevant home country regulators. In the meantime, if any AIs encounter any difficulties in preparing their disclosures in accordance with the Disclosure Rules, they are welcome to consult the HKMA.