COMMISSIONER OF BANKING
HONG KONG

香港
銀行業監理處

Pol 6/3

Our Ref.: CB/POL/1/9/5 VIII

18 October 1991

The Chief Executive
All Authorised Institutions

Dear Sir,

Guidelines on exercise of new discretions introduced by the Banking (Amendment)(No.2) Ordinance 1991

A set of guidelines (copies attached) have been published in the Gazette on 18 October 1991 under section 7(3) of the Banking Ordinance indicating the manner in which this Office proposes to exercise the discretions introduced by the Banking Amendment (No.2) Ordinance 1991 in respect of the following areas:

(a) application of the statutory limits under Part XV on a consolidated basis (section 79A);

(b) financial exposures secured by cash deposits, guarantees, undertakings etc. that would be accepted by the Commissioner of Banking for exemption from the statutory limit for advances to a single party (section 81(6)(b));

(c) comfort letters acceptable to the Commissioner of Banking (section 81(6)(b)); and

(d) exemption of exposures acquired under underwriting or sub-underwriting contracts (section 81(6)(i) and 87).

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These guidelines have been developed in close consultation with the Hong Kong Association of Banks, the Hong Kong Deposit-taking Companies Association and the Banking and Deposit-taking Companies Advisory Committees. Where appropriate, the comments of these bodies have been incorporated into the guidelines. I wish to emphasize that this is not a one-off exercise - the guidelines will need to be further developed as we gain experience of operating them and build up case law. In this respect, your further views and suggestions to improve the guidelines will be welcome.

It has been suggested that we should state in the guidelines the administration's policy of giving reasons in the exercise of discretions. While we still remain of the view that it is not a matter for the guidelines, we can give the assurance that it is the Office's firm policy that reasons will be given in the exercise of discretions.

Apart from the above general points, I would also like to draw your attention to the following specific matters concerning each guideline.

Consolidation

You should note that section 79A(3) already protects a subsidiary of an authorised institution from suit by its clients for breach of confidentiality by reason of the submission of information to the parent institution for the purpose of complying with the consolidation requirement. In cases where an overseas subsidiary is restricted by local law from disclosing information to your institution, we will be prepared to exempt such subsidiaries from consolidation under section 79A(2), subject to the condition that adequate internal controls and limits are in place to guard against concentration of risks in these subsidiaries. Such controls should enable the parent to assess exposure with reasonable accuracy and timeliness against limits set by it, and to cause the subsidiary to take action to avoid incurring additional exposure which would breach those limits and to reduce any exposure which has exceeded those limits.

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It is not always necessary to consolidate all subsidiaries. The discretion is with the Commissioner to decide which subsidiaries are to be included. It is therefore important that institutions should inform us of any additions and deletions of subsidiaries, and any changes to the principal activities of the subsidiaries.

Cash deposits, guarantees and other undertakings

Please note that in paragraph 4(b) of the guideline, we will normally require the charge over the deposit in favour of the lending institution to have absolute priority i.e. there should be no encumbrances of prior or equal ranking.

Paragraph 5(a) of the guideline stipulates that we will normally expect the guarantor/indemnifier/participant to be ..... a bank which is under adequate supervision. There has been some concern about the interpretation of 'adequate supervision'. While it is difficult to come up with a set of entirely objective tests for the matter, the Commissioner will wish to satisfy himself about the nature and scope of the supervision exercised by the relevant supervisory authority in the home country of the bank in question, and particularly whether that supervisory authority subscribes to the Basle Committee on Banking Supervision's guidelines on capital adequacy.

Underwriting of securities

Concern was expressed during the consultation about how account will be taken of the Bank of England maxima in the interim, and the Securities and Futures Commission's capital adequacy rules in the long term, in determining the basis for controlling institutions' underwriting exposures. These are presently being examined. Institutions will be consulted once we can be more specific on these matters. The long term objective of the regime will be to achieve

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some consistency in treatment between banking and securities intermediaries acting as underwriters. Another task which needs to be carried out in parallel is to ascertain the experience and track record of institutions in underwriting, in particular the type and size of deal and securities involved. These facts must be established before any meaningful in-house limits can be agreed with individual institutions.

It has also been suggested that "bought deals" should be included in the regime for controlling underwriting exposures. As bought deals involve the acquisition of securities as principal from the outset, they are riskier than conventional underwriting exposures; and we think it prudent not to include them in the underwriting regime at present. Bought deals are in any case currently uncommon in Hong Kong. Holdings of securities under bought deals will thus be caught, as with other on-balance sheet exposures, within the terms of section 81 or 87, as the case may be. We will, however, keep a close eye on development of the market in this respect; and if circumstances warrant it, appropriate changes will be made to the guideline and the Ordinance.

These guidelines are primarily issued for the guidance of authorised institutions incorporated in Hong Kong as amendments have been made to the Ordinance to apply the statutory limits in Part XV only to locally incorporated institutions, but they have been promulgated for a wider audience including overseas incorporated institutions as they contain prudent and sound practices expected of banking institutions in incurring large credit and other exposures.

Yours faithfully,

(D T R Carse)
Commissioner of Banking

c.c. Chairman,
Hong Kong Association of Banks

Chairman,
Hong Kong Deposit-taking Companies Association