

## Joseph Yam, JP: The Hong Kong Monetary Authority's main initiatives in the area of banking supervision

Speech by Mr Joseph Yam, JP, Chief Executive of the Hong Kong Monetary Authority (HKMA), at a lunch with representatives of the Finance Constituency organised by Dr David Li, held in Hong Kong on 15 January 2001.

The speech outlines the latest state of play on the HKMA's current initiatives in the area of banking supervision, as well as responding to some points raised by Dr Li on behalf of the Finance Constituency.

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1. I would like to thank David Li for arranging today's lunch with representatives of the Finance Constituency. The number of live issues in the realm of bank supervision, some of which have been set down in David's letter in advance of this lunch, is currently quite considerable, so it is useful to have this opportunity to get together to exchange views. As you will know, it is very much our style to work in close collaboration with the banking industry on developing our policies rather than to adopt a confrontational approach, and long may this continue.
2. Let me run through what I see as the HKMA's main initiatives in the bank supervision area in the next twelve months, in the course of which I will try to pick up some of the points made in David's letter. I see there being three main initiatives, namely:
  1. deposit protection;
  2. deregulation and other market reforms; and
  3. the credit reference agency.
3. On deposit protection, we are now coming to the end of the consultation period on the consultants report – in fact there are just two days left, so if you want to make a submission, you will have to hurry! Once we have collected in everyone's comments we will carefully review them and determine whether to recommend going ahead with such a scheme and, if so, exactly how it should be structured. As you will be very aware, the views of the banks on this issue are mixed, whereas LegCo has given a clear endorsement, and most other parties are also in favour. But, assuming we do go ahead, this is really only the beginning, and there will be a lot of work to be done on the design features. For example, should coverage of the scheme be limited to \$100,000, or should it be \$200,000? Should funding be ex-ante or ex-post? Should premiums be risk-based? None of these issues have been decided yet, so we welcome any constructive comments and will certainly consider them carefully.
4. One particular question that has been raised is whether deposits with RLBs and DTCs should be covered. The consultant suggested not, primarily on the grounds that excluding them would be consistent with the institutional coverage of the current priority claims provisions. Moreover, the aim of deposit protection is to protect small retail depositors, i.e. depositors with deposits of less than \$100,000, and DTCs and RLB do not have such depositors. However, the issue of whether their exclusion from coverage might adversely affect the business of RLBs and DTCs needs to be considered. Certainly one might argue that as the first \$100,000 of deposits of over \$100,000 with licensed banks would be covered, the same should apply to deposits with RLBs and DTCs. This is something that we will consider further in the light of the views that have been expressed.
5. Moving on to the issue of deregulation, July, of course, will see the full abolition of controls on interest rates. This is highly significant, as such controls are surely inimical to Hong Kong's free competition ethos. Certainly this change in the status quo will provide certain challenges for institutions, but in the long run the competition, innovation and efficiency that the removal of such barriers will engender will help to keep Hong Kong's banking sector competitive and profitable. We also, as you know, hold the view that some greater consolidation among the local banks would be desirable from this point of view, although we have not forced the issue. This is something, however, to which we would urge bank owners to give careful thought.
6. It is clear that as part of the process of deregulation of interest rates banks will be considering revising certain fees and charges. This, of course, is understandable. If deregulation is to improve competition and efficiency, banks must be free to adjust their pricing not just on interest rates but

also on fees and charges. I have absolutely no argument with this. However, I very much hope that banks will display some sensitivity on this, and will bear in mind the public interest. They should also ensure that their pricing is transparent, and that customers have good notice of any changes.

7. In addition to interest rate deregulation, there are a number of other market reform measures originating from the consultancy report published a year or so ago which are still being progressed. For example, later this year we will consider whether there should be some further relaxation of the restriction on the opening of branches by foreign banks which have entered the market since 1978. We also plan to review whether the three-tier system of authorisation might be reduced to two tiers, although we do not plan to visit this issue until next year – i.e. 2002 - and have quite an open mind on this. This is rather later than we originally intended. But it reflects the fact that we believe that the present system is working reasonably well and that there is no pressing need to change. We are also heavily preoccupied with deposit insurance and the outcome of that exercise may influence the way in which the three tier structure is modified – most obviously, whether the deposit threshold for DTCs should continue to be set at \$100,000.
8. Also on the back burner for the time being is consideration of whether there should be any change to the minimum paid-up capital requirements for locally-incorporated AIs. This obviously is tied in to some extent with the reform of the three-tier structure, as if we did amalgamate the RLBs and DTCs into a single class we would have to decide what the minimum paid-up capital requirement for the class should be. This is something we will have to consider in due course, but we are of course well aware that a higher requirement would have implications for some of the smaller DTCs, and we will certainly have regard to this. Aside from any change related to the reform of the three-tier structure, we don't at present have any other plans in relation to the minimum capital requirements, although at some point we may want to consider updating them in line with inflation.
9. On the third initiative I mentioned, the credit reference agency, some of you may know that we have established a working group to take this initiative further. The consultation we conducted indicated that there was quite widespread support for such an agency, although having said that it is fair to say that there was quite a diversity of opinion on various aspects. The working group will investigate this further and try to arrive at a recommended way forward. But we hope that something can be done in this area, as most seem to agree that such an agency would be beneficial.
10. So that brings me to the end of what I see as the three main initiatives, but let me also comment on a few other outstanding matters. First is the vexed question of the approval of managers. I must confess we have been a little taken aback by some of the reaction to this proposal, which seems to question our motives for seeking such a power. All I can say is that we have no ulterior motives. We simply feel that if individuals are to fill important positions in banks then steps should be taken to ensure that they are fit and proper for the position. Clearly it is the banks' responsibility to select individuals and satisfy themselves as to their credentials, and you can be assured that we have absolutely no desire to second-guess these decisions. However, it is a fact that we may, on occasion, have access to information on an individual which the bank does not have. We would see ourselves, therefore, as acting as very much a second line of defence – and only in exceptional cases. A number of banks see the logic in this and support our proposals. Others remain less enthusiastic. But we are consulting the industry further on this and I hope that something that is acceptable to all can be arrived at.
11. Next is the issue of the review of the Code of Banking Practice, in relation to which it is suggested in David's letter that some people are unhappy about the stance taken by the HKMA. On this, I am afraid, I have rather less sympathy than on other issues with those who raise concerns. I do not believe that any of the changes promoted in the Working Group, such as in relation to credit cards and also to fees and charges, are unreasonable. Indeed, most banks seem to have accepted the rationale for changes such as the \$500 card loss limit, which brings Hong Kong into line with international practice. I believe that the banks must appreciate that issues relating to terms and conditions and other aspects of customer service are a legitimate matter of public interest and concern. In the past, it is true, the HKMA has not been as closely involved in consumer matters. This, however, is something that is changing, not because we particularly desire it but because it seems to be what the public expect. We plan, therefore, to review our involvement in this area so as to determine exactly what our role should be.

12. Finally, there have been concerns expressed that the HKMA's supervision has become more intrusive and that requests for information are sometimes excessive. This is certainly something we are aware of, however I should point out that we don't ask for information just for the sake of it. If we ask for some new information, or for an institution to increase the frequency of its reporting, there is always a very good reason for it. I know that we asked for a lot of additional information, particularly following the onset of the Asian financial crisis, but I make no apology for this, as I can assure you it was necessary for our monitoring of the banking sector, and of individual institutions, through the crisis. But having said that, we are of course very well aware of the burden that this places on institutions, and can assure you that we will continue to keep our information requirements under review with this in mind. We are also aware of the need to ensure that our staff deal with the banks with the appropriate degree of sensitivity, that they only make requests which are reasonable, and that they try to explain why particular things are required. This is quite a challenge for us, but it is something we must work on nevertheless.
13. This brings me to the end of my remarks. I have not said anything on the bankruptcy laws or tax issues, which were two issues I was asked to address, but I don't think there is much I can say on these areas except that we appreciate the banks' views and will reflect these to the appropriate authorities as appropriate. Certainly we are aware of the rising trend in personal bankruptcies and the possible impact of this on delinquencies, and this is something we are watching closely. We are also in dialogue with the Privacy Commissioner and other parties to try to get the scope of the credit data that can be released to credit agencies increased, which would perhaps help in this area.
14. I hope these comments have been of interest to you all. Let me end on a positive note. We are all part of a highly successful industry here in Hong Kong. As banking regulator, it is the HKMA's objective to promote a safe and stable banking system. To achieve this we need the banking industry to be successful, profitable, competitive, innovative, and responsive to change, and this surely is your objective too. So let's continue to work together on initiatives such as those I have discussed today so as to ensure the continued prosperity of our industry.
15. Thank you.