



Our Ref.: C/EPB

**By Fax (2878 1670) and By Post**

3 October 2006

Mr. Simon Topping  
Executive Director (Banking Policy)  
Hong Kong Monetary Authority  
55th Floor, Two International Finance Centre  
8 Finance Street  
Central  
Hong Kong

Dear Simon,

**Consultation on Draft Banking (Disclosure) Rules**

Thank you for your letter dated 1 September 2006 inviting the Institute to comment on the Draft Banking (Disclosure) Rules (DRs).

Our comments are set out below:

**A. General comments**

We are generally uncomfortable with the need to change the wording of the definitions in Hong Kong Financial Reporting Standards (HKFRSs) in order to bring them into the DRs. We strongly prefer to have the exact wording from HKFRSs put into the DRs, but we accept the HKMA's advice that changes are necessary for legal reasons. While we understand that the HKMA's intention is to express the same meaning as that in HKFRSs, we see potential risks of confusion in interpreting the DRs when the wording is different. We anticipate that questions on interpretation will emerge when the DRs are put into practice.

We understand that authorized institutions can rely on section 7 "Interaction of other requirements" of the DRs to bridge the gap between the definitions in HKFRSs and the DRs. We encourage the HKMA to issue in due course further guidance to supplement the DRs on areas where the definitions in HKFRSs and the DRs differ.

We also anticipate that the HKMA will use its discretion under section 16 if differences between definitions in HKFRSs and those in the DRs cannot be resolved under section 7.



**B. Specific comments**

--- Please find enclosed a list of comments on specific sections of the DRs (**Annex A**). This list includes, inter alia, definitions of terms where the wording in HKFRSs and the DRs appears to lead to a different result. Where the exact wording from HKFRSs is not acceptable from a legal drafting point of view, we would like the HKMA to take due consideration of our comments.

We note that a lot of the comments made by the Institute's Expert Panel on Banking on the earlier drafts of the DRs, in particular those concerning alignment of definitions with the current HKFRSs, have been duly considered. The HKMA's effort is highly appreciated. We look forward to working with you in future to ensure that the requirements of the DRs will continue to remain aligned with the relevant HKFRSs which are subject to potential future changes.

If you have any questions on our comments, please do not hesitate to contact me (Tel: 2287 7247 or email: [patricia@hki CPA.org.hk](mailto:patricia@hki CPA.org.hk)).

Yours sincerely,

A handwritten signature in black ink that reads 'Patricia McBride'. The signature is written in a cursive, flowing style.

Patricia McBride  
Director, Standard Setting  
Hong Kong Institute of Certified Public Accountants

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Comments on HKMA Draft Banking (Disclosure) Rules			
Page Ref	Section Ref	Definitions	Comments
General			Some acronyms are not defined (e.g. ECAI and STC(S) in section 69). Cross referencing some definitions to the Capital rules also causes confusion. It may be more convenient to have one set of definitions to which the capital rules and the disclosure rules can refer.
2	2		The Interpretation section is not sufficiently comprehensive for the reader to correctly interpret the terms. The definition of a number of terms are not included e.g. fair value, financial assets, financial liabilities, undated, Mainland entities, hedge relationship. Suggest extending the definitions section.
2	2(1)	available-for-sale	The definition of "available-for-sale" refers to the definition in the draft Capital Rules. According to the Capital Rules, "available-for-sale" means (1) <u>financial assets</u> other than derivatives contracts (2) <u>financial instrument</u> other than derivatives contracts, and (3) loans. In fact, financial assets defined under HKAS 32 is a sub-set of the "financial instrument", thus (2) includes (1) and (1) can be deleted.
2	2(1)	associate	The definition of "associate" in the draft Rules is wider than the accounting standard, as the former includes a natural person.
6	2(1)	foreign currency	The definition of "foreign currency" conflicts with the definition in HKAS 21 where foreign currency is a currency other than the entity's functional currency.
7	2(1)	derivative contracts (referred to in the definition of "held-to-maturity investment")	(1) The definition of "held-to-maturity investment" refers to the term "derivative contracts" which is defined in the Capital Rules. The definition in the Capital Rules differs from the definition of derivative in HKAS 39 in that it makes no mention of size of initial investment or settlement at a future date. (2) "Derivative contract" is defined in the Capital Rules to mean a financial instrument the value of which depends on the value of one or more than one underlying exposure. This definition could potentially include vehicles such as investment holding companies.
10	2(1)	repossessed asset	The definition of "repossessed asset" refers to "an asset in respect of which the institution has acquired <u>access or control</u> (whether through court proceedings or otherwise)....". No definition has been provided for "access". We presume that "control" should be interpreted as in HKFRSs.
10 - 11	2(1)	swap deposit arrangement	"Swap deposit arrangement" refers to an arrangement involving foreign currencies, while "foreign currency" is defined on page 6 as "any currency other than HKD". Such a narrow definition excludes HKD swap deposit. Suggest amending the definition of "swap deposit arrangement"
14	3(9)	Provisions	Exemption is granted to an AI with "in aggregate total assets less <u>provisions</u> of less than \$10 billion (or the equivalent amount in foreign currency)". Does the term "provision" refer to provision against an asset or provision for liability? Suggest clarifying the term.
15	3(11)(b)		When an AI's assets or deposits rise above the exemption threshold in 1 year but drops below in the next year, in order to be exempted again, AI is required to demonstrate to the HKMA that "it is unlikely that it will cease to meet the criteria.....in the foreseeable future". How long is the foreseeable future? What are the possible ways to demonstrate this? Suggest clarifying in the draft Rules or providing operational guidance of the possible ways to demonstrate this.
19	5(b)		The draft Rules require the disclosure policy to be "approved by the institution's <u>board of directors</u> ". This requirement seems too onerous for overseas incorporated AIs. Could the disclosure policy be approved by the chief executive of their Hong Kong branches?
21	6(4)	containing, consisting	The draft Rules require the issue of a press release " <u>containing</u> the [disclosure] statement or <u>consisting</u> of the statement". These terms "consisting" and "containing" are not defined to enable an AI to understand and fulfil this requirement. We suggest that additional guidance is required.

Comments on HKMA Draft Banking (Disclosure) Rules			
Page Ref	Section Ref	Definitions	Comments
24 & 199	6(11) 88(2)(a)(ii)	prescribed summary	The definition of "prescribed summary" is unclear. It seems to require disclosure of both: - a summary of the data and information required under the draft Rules; and - how the complete information can be accessed. What constitutes "a summary of all"?
28	8	Independent	The draft Rules require the disclosed information to be "scrutinized and subjected to an <u>independent</u> internal review". Is the person "independent" of the preparing department, of Hong Kong management or of the AI as a whole? Suggest clarification.
31	11(4)		The whole section is confusing. What appears to be required is that all the information required by the draft Rules should be disclosed on a consolidated basis except information relating to capital structure and adequacy (i.e. section 24 and 45) which need to be disclosed in accordance with the basis agreed with Hong Kong Monetary Authority.
43	19(1)		The draft Rules could require disclosure of the following profit and loss items for completeness: (i) Impairment loss on property, plant and equipment (ii) Impairment loss of intangible assets
45	20(a)(v) 36, 94		The heading "loans & receivables" is too wide as it also includes placements with banks which is shown elsewhere in the balance sheet. Suggest heading for 20(a)(v): "Advances and other accounts".
46	20(a) 36, 94		The draft Rules could require disclosure of the following balance sheet terms, for completeness: (i) Acceptances on trade bills and liabilities for acceptances (ii) Deferred tax assets (iii) Intangible assets (iv) Goodwill
43, 46, 48 and 85	20(a)(v)	collective provision and specific provision	There is no definition of "specific provision" and "collective provision". Suggest referring to the definition in the Capital Rules.
47	20(b)		Loan capital and customer deposits are financial liabilities and they can be designated as FVTPL (e.g. structured deposits) or amortised costs. As a result, same disclosure requirements for CD issued and issued debt securities should also be applied to loan capital and customer deposits.
48	20(b)	other revaluation reserves	Suggest to amend the term "other revaluation reserves" as "revaluation reserve".
50, 93	22(1)(a) 38(2)(a)		"Forward FX contracts arising from swap deposit arrangements" are excluded from the category of exchange rate contracts. Are such contracts not disclosed at all or are they intended to be included under "others"?
50, 99	22(3a) 41	total fair value	It is not clear whether "total fair value" refers to gross positive and negative amounts or the net amounts.
53	24(2)(a)(iv)	published reserves	The term "published reserves" is not defined. Suggest adding the definition.
54 & 104	24(2)(b)(iii), 45(3)(b)(ii)		Given the tightening of the definition of "at fair value through P/L" under Amendment to HKAS 39 <i>The Fair Value Option</i> , is the HKMA considering a change from the requirement to include fair value gains from such securities in supplementary capital?
54 & 104	24(2)(b) 45(3)(b)(i)		Fair value change of investment properties are recognised in profit or loss for the period, and prior year changes are accumulated in retained earnings, where the AI elects the fair value option. The draft Capital Rules (section 3.9(1)(f) on p.147) refer to "any such gains not recognised on the balance sheet of the institution are excluded" from supplementary capital. Suggest changing "not recognised on the balance sheet" to "not recognised in the financial statements".
54 & 104	24(2)(b) 45(3)(b)(ii)		The term "fair value gains on the revaluation of securities not held for trading purposes" could be simplified as "fair value gains on the revaluation of AFS securities".

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54 & 104	24(2)(b) 45(3)(b)(ii), (iii)		The Capital Rules (section 3.10(3) on p.153) requires deduction from supplementary capital of any overall deficit arising from the revaluation of securities not held for trading purposes and securities designated as FVTPL. Suggest specifying the "fair value gains" in draft Rules as " <u>fair value gains less losses</u> " other than those already recognised through the <u>income statement</u> .
54 & 104	24(2)(b) 45(3)(b)(vi)	Surplus provisions	The term "surplus provisions" is not defined. Suggest clarifying as "surplus provisions determined in the Capital Rules section 3.14(2)(b)" (on p.160).
62	26(2)	the extent	It is not clear whether " <u>the extent</u> to which loans and advances....are covered by collateral or other security" refers to the percentage of the value of collateral to loans and advances, or the description of loans to which industry sector are secured. If the former interpretation is correct, (1) please clarify what is meant by the value of collateral and how to determine that value, is it expected to be the current market value, the discount present value using the original effective interest rate or the lower of loan amount and collateral value for each loan, similar to the illustrative examples in Annex G of FD-1? (2) whether the percentage applies to each industry sector?
62	26(3)(c)		Currently, the breakdown of "the amount of new provisions charged to profit or loss" by counterparty type or industry sector is not required. In order to fulfil this, an AI will need to analyse each counterparty type or industry type's write-off, recoveries and unwind discount, which will be very time consuming.
72	32	hedge of net investment in a foreign operation	HKAS 21 contains two notions of currency (a) functional currency- currency in which the AI notionally keeps its books and records (b) presentation currency – currency used in the financial statements. The definition should use the "functional currency" notion (formal definition is in HKAS 21). Wording of "prepared" could be taken to mean "presentation currency". Suggested wording for (a)(ii) - "the activities of which are based or conducted in a currency other than that of the primary economic environment in which the institution operates".
73	32(e)	related party	Part (e) of the definition refers to a relative within the meaning of section 79(1) of the Banking Ordinance. This is different in scope from the definition of "close member of the family" in HKAS 24. Suggest replacing Part (e) with "is a person whom any person falling within paragraph (a) or (d) may be expected to influence, or be influenced by, that person in his dealings with the institution".
81	35(3)(a)		Als set aside provisions for depreciation and impairment loss of assets according to HKAS 16, 32, 38, 39 and 40. If the intention is to require disclosure of all provisions recognised in accordance with standards such as HKAS 19 and HKAS 37, then the requirement needs to be reworded. For example, the DRs could specify "set aside for provisions that are classified as liabilities....".
94	38(4)(b)		Als may have derivatives which are hedging economically amortised cost assets or liabilities. Further many Als' derivative activity are driven by customer requests as opposed to speculative trading. The above types of derivatives do not clearly fall under any of the categories listed in section 38(4)(b). Suggest the following categories: (i) those which qualify as hedges for accounting purposes (ii) those which do not qualify as hedges for accounting purposes but which are managed in conjunction with the financial instruments designated at fair value through profit or loss (iii) those entered into for other purposes including trading .
99	41		Suggest adding exemption for fair value disclosure under HKFRS 7 (i.e. copy paragraph 29 of HKFRS 7 in section 41)
101	43		The draft Rules requires disclosure of "the institutions' policy for lending to related parties". We suggest that there should be clarification on the extent of the disclosure required in the operational guidance.
106	45(6), (7)		It is not clear whether "core capital ratio" is calculated on a consolidated basis or solo basis.

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Page Ref	Section Ref	Definitions	Comments
108	46(1)(c)		The breakdown of major business activities involves operating assets and profit and loss items. Accordingly the breakdown is not only consistent with the figures in "audited income statement" but also the figures in balance sheet. Suggest amending the term to be "audited financial statements".
109	46(4), 46(5)(b)		The 10% threshold for geographical analysis is based on assets, liabilities, income or profit "arises from, or is booked, in a single country or geographical segment". A loan, which was originated in China but booked in the HK branch, could be classified in 2 geographical segments. Suggest deleting the term "arises from" in 46(4) and deleting 46(5)(b).
110	46(5)(a)		If the segmental information is disclosed based on the location where the business is booked, is it necessary to disclose the type of entity booking the business. These may be cases where an institution operates both a branch and a subsidiary in one location in which case the disclosure will become overly lengthy.
132	58(1)	recognized credit derivative contracts	The term "recognized credit derivative contracts" is defined in the Capital Rules. Suggest referring to the definition in the Capital Rules.
132	58(1)	banking book trading book	The terms "banking book" and "trading book" are defined in the Capital Rules. Suggest referring to the definition in the Capital Rules.
155	69(1)(a)		This requires "a description of its involvement in each of the securitization transactions". While the securitization market may not be big at this time in HK, it may grow significantly. We wonder if it would be more useful to require disclosure of "each type", or allow for some summarised data.
209 & 212	93(1e) & 94(a)(vii)(D)		An overseas incorporated AI may not adopt HKFRS/IFRS, and it may not have equivalent provision charge for impaired loans and receivables and collective and specific provisions. Suggest clarifying what disclosure requirements apply in such cases.
223	100(1)(a), (1)(b), (2)(a) and (2)(b)		The terms "gross amount" in section 100(1)(a) and "absolute amount" in section 100(1)(b) appear to have the same meaning.