Qualification Programme (QP) Case Analysis Competition 2010

The case

<u>Omega Asia Bank</u>

Omega Asia Bank Limited is a full-fledged banking and financial services group, with a head office located in Hong Kong, and with operations in Macau and Manila. The bank is a “licensed bank” under the supervision of the Hong Kong Monetary Authority (HKMA). The bank offers a wide range of banking and finance services including: deposit taking, trade financing, treasury services, commercial loans, consumer loans, investment and merchant banking services, and insurance underwriting and agency services.

Group History

The origins of Omega Asia Bank Limited may be traced to 1946, the immediate post World War Two period in Hong Kong. In that year Mr. Wing Yip Sang, father of current Chairman Mr. Robert Wing, began trading as Wing Finance Company, and eventually became a licensed commercial bank in 1984.

In 1973, Mr. Robert Wing began a finance business on his own account, and established Money Exchange and Investment Limited (MEI). MEI developed rapidly. It pioneered the concept of merchant banking in Hong Kong and was a pace-setter in international bullion dealing in Hong Kong. The company also became one of the major gold dealers in Asia.

In 1979, MEI moved into the share-broking business with the establishment of Omega Securities Company. In the same year, the company expanded into financial research services, secretarial services, and nominee services. Omega Group (Holdings) Limited was created to oversee the different lines of businesses.

In 1988, Mr. Wing Yip Sang wished to step down from full-time management of Wing Finance Company and Mr. Robert Wing became chief executive. His first move was to merge Omega Group (Holdings) Limited with Wing Finance Company. As a result of this merger, the Group has built a significant presence in a variety of finance operations in Hong Kong. This helped synergise the financial and human resources of the companies, propelling the Group further forward.

By 1996 the firm had expanded its operations into Macau and Manila. In the same year, the Group moved into insurance through a strategic alliance with the Platinum Fire and Marine Reinsurance Company Limited.

In line with its expansionary efforts, in 2001 the Group established a new corporate identity, Omega Asia Bank Limited, and the member companies were renamed to reflect this development. MEI became Omega Asia Credit Limited, and Wing Finance Company was renamed Omega Asia Finance Limited.

In 2004, the Group acquired the business of Platinum Fire and Marine Reinsurance Company Limited and focused on developing a comprehensive range of financial services.

The last three decades have seen the Group grow markedly in both Hong Kong and Macau, and to a lesser extent in Manila. The company has a strong commitment to Hong Kong and Macau. In recent years, it has been seeking vigorously to expand its presence in the region.

Commercial banking has been the major focus of the Group. The Group has been a major player in facilitating trade in both Hong Kong and Macau. It has been one of the prime movers in providing trade financing to its customers who had an active interest in trading with China. In light of the new business environment under the new economy, the Group has undergone a re-orientation, with investment banking, commercial banking and insurance identified as the three major lines of businesses for the new millennium.

Lines of Business

Omega Asia has a number of lines of business, which are summarised below. See Appendix 1 for a further explanation of each of these lines.

Commercial / Consumer Loans

- Mortgage loans
- Machinery and equipment financing
- Consumer goods instalment loans
- Accounts receivable financing
- Gold loans
- Various kinds of commercial lending
- Small and Medium Enterprise (SME) loans

Investment & Merchant Banking Services

- Stock broking, financial futures and options broking
- Underwriting of new issues and placement of securities
- Merger and acquisition advisory services
- Portfolio management
- Offering of unit trusts and mutual funds
- Fixed and floating-rate bonds
- Custodial services
- Secretarial, accounting and nominee services

Insurance Underwriting & Agency Services

- Fire, marine and accident insurance
- Export credit insurance
- Travel insurance
- Medical insurance
- Motor vehicles insurance
- Home insurance
- Personal accident insurance

Deposit Taking

- Current and Savings accounts in local and foreign currencies
- Fixed-term deposits in local and foreign currencies

Trade Financing

- Issuance of letters of credit
- Trust receipt financing
- Export DA / DP bill discounting and collection
- Export packing credits (EPC)
- Negotiation of export bills

Treasury Services

- Foreign exchange spot and futures dealing
- Foreign currency banknote dealing
- Mail and telegraphic transfers and demand drafts
- Physical gold and gold futures trading
- Foreign currency cheque negotiation
- Issuance of travellers' cheques

Other trading operations

- Rental cars
- Tourist advisory services

Risks

Recent events in Hong Kong and international financial markets make it clear that investments in banks and finance companies are not without risk. However, Omega Asia has enjoyed a reputation for good financial management and solid continuous profitability. Among other things this is reflected in a creditable Standard and Poors (S&P) credit rating, and ability to raise finance from investors with little difficulty.

Standard and Poors

The company has a BBB- credit rating from S&P. This is the result of a rigorous analysis of the company covering such things as asset quality, funding and liquidity, profitability, and capitalisation. S&P also consider ownership structure, governance, management experience, risk management practices, and standing in the industry. A rating of BBB- places Omega Asia in the "investment grade" category, but only just.

Types of risk faced by the company

Finance companies such as Omega Asia face a number of potential risks associated with possible insolvency. In general these potential risks include credit risk, liquidity risk, interest rate risk, currency risk, single customer exposure, related party lending, and property related issues.

- *Credit Risk* is the risk of loss caused by customers not repaying their loans in full. The company performs credit evaluations on all loan customers and normally requires collateral with a registered security or by way of mortgage. Loan security may be supported by personal guarantee and/or loan insurance repayment cover. Credit evaluations are also undertaken on all business customers to whom the company provides funding and/or has recourse against. Credit risk is minimised through the company's lending policies. These generally require that the borrower holds equity in the security being pledged, equivalent to a sum that the security is likely to fall to in the event of a default. Credit managers monitor individual loan performance and take appropriate recovery action when necessary.

- *Liquidity Risk* is the risk that Omega Asia may have insufficient cash or not be able to raise enough funds at short notice, to meet commitments as they come due. Among other things, this risk can arise from a mismatch in the maturity of monetary assets and liabilities. The company manages liquidity risk by regularly forecasting future cash-flow requirements, ensuring a diverse and stable funding base, and maintaining lines of credit with major banks. The company's internal liquidity policy requires maintaining at least 8% of total secured borrowings as liquid funds or un-drawn lines of credit. In addition the firm's management team reviews liquidity on a daily basis and reports to the Board at least monthly.

- *Interest Rate Risk* arises from holding assets and liabilities that may mature or re-price in different periods. That is, market interest rates may change and impact on the company by affecting the margin between funds loaned and funds borrowed. The company monitors interest rate risk and regularly reviews interest rate exposure. The company reduces this risk by matching the re-pricing of assets and liabilities, and by entering into off balance sheet financial instruments to hedge against movements in interest rates.

- *Currency Risk* is the risk that the company may face on funds that have been loaned or borrowed offshore, due to changes in the exchange rate of the Hong Kong dollar.

- *Single Customer Exposure* is the risk that a large individual customer may default on its loan commitments. Management of Omega Asia monitors single customer exposure. No exposure may exceed 20% of Shareholders' Equity (approximately 1.5% of total assets) without full Board approval. In the past this requirement has been moot, since the company's loan book is highly diversified.

- *Related Party Lending* is the practice of lending to other entities related in some way to Omega Asia. This would include lending to subsidiary or sister companies.

- *Property Related Lending* is lending secured over real property. The company considers itself to be a cautious property lender and requires all property loans over $20,000,000 to be approved by the firm's Credit Committee. Before lending on property the company checks carefully the borrower's balance sheet, finances, experience, and business track record. Wherever possible Omega Asia is the primary financier of property projects in which they become involved.

Supervision by the HKMA

The Hong Kong Monetary Authority (HKMA) is responsible for the supervision of banking in Hong Kong. The functions of the HKMA are to help safeguard the interests of depositors and promote the general stability and effective working of the banking system. A wide variety of supervisory techniques, such as on-site examination and off-site review, are employed by the HKMA in the course of its on-going supervision of banks to ensure that various risks they face are adequately managed. In addition, the HKMA is the licensing authority for institutions seeking to operate banking business or the business of taking deposits in Hong Kong. An institution has to satisfy the HKMA, among other things, about the fitness and propriety of its owners and management, financial soundness, adequacy of internal control systems before approval is granted.

Omega Asia Bank is subject to the supervisory requirements of the HKMA. These requirements are discussed in some detail in Appendix 4. From an accounting and financial management standpoint one of the main sets of requirements relate to the necessity of maintaining certain critical financial criteria and benchmarks. Two such criteria monitored by the HKMA are the Capital Adequacy Ratio (CAR) and Credit Administration, Measurement and Monitoring.

Capital Adequacy Ratio

The HKMA's Supervisory Policy Manual has a section outlining the "Capital Adequacy Regime for Locally Incorporated Authorized Institutions". This is available in detail on the HKMA website: www.hkma.gov.hk. In broad terms the HKMA impose CAR requirements on an Authorized Institutions (AI) at two levels:

- On a solo basis, which measures the capital adequacy of an AI based on the capital strength and risk profile of the AI taking into account the combined position of its head office and branches, local and overseas;

- On a consolidated basis, which measures the capital adequacy of an AI based on its capital strength and risk profile after consolidating the assets and liabilities of such of its subsidiaries as specified by the MA for such calculation purposes.

Credit Administration, Measurement and Monitoring

In the area of credit administration this involves having a designated department dealing with the administration of the bank's various credit risk bearing portfolios. Credit measurement encompasses accounting policies, credit risk management procedures of various types, and internal risk rating systems. Credit monitoring includes monitoring systems and procedures, management information systems, and appropriate stress testing procedures. More detail of this is contained on the HKMA website.

Ethical Dilemmas

Jolene Tay, Omega Asia Bank Limited's Chief Financial Officer, and Richard Albert, Omega's General Manager of Commercial and Consumer Lending, are chatting over a coffee. By the end of the conversation Jolene is very concerned about possible ethical implications of some of the issues discussed and concludes the conversation by saying to Richard; "I am a CPA. Some of these issues have got ethical implications and I need to consider my position as a member of the Hong Kong Institute of CPAs". On returning to her office Jolene remains troubled by the conversation she had with Richard and makes a diary note in which she summarises the matters discussed:

Diary Note – Conversation with Richard Albert 15 May 2010

Special offer

Previously most lenders re-invested their funds on maturity of their deposits. With publicity surrounding the problems in some banks and finance companies, some lenders are not re-investing, choosing instead to put their funds in government bonds at lower interest rates. If this continues the company may experience a liquidity crisis. Andrew Chen (Assistant COO) will present to the next management meeting a proposal to make a special offer to consumer lenders (i.e. potential investors) for secured first-ranking debenture stock at an exclusive special (high) interest rate. He has drafted a letter stating Omega Asia "has made a good profit in the year to 31 December 2009, despite the difficult trading environment".

Property Development Funding

In doing a random check of property related lending, Richard has discovered that one of his Branch Managers has approved, without proper process, a loan to a relative of a value greater than $20m. When he looks further, he finds the Branch Manager has approved eight other loans to the same person each for $19.5m. They are for a variety of commercial and property lending. Each company is trading under a different name to hide the relationship, but they all share the same business address. Richard is wondering how to deal with this, without panicking the market.

Bonus payments

Richard has been reading the newspaper articles about executives of a collapsed finance company (a company similar to Omega Asia Bank) claiming the receivers owed them for their bonuses. It appeared the bonuses were to be paid following a report on the business. As the report was not issued by the time the company went into receivership, the executives were claiming payment. Richard wants me to check the terms of our bonuses, to make sure we will get paid no matter what happens to the company.

Updating of Prospectus

We talked briefly about the modifications needed to update the Prospectus and the possible impact of events in the market place since the current Prospectus was issued. Robert Wing has said that we need to keep the Prospectus looking very positive. Richard agrees with him and doesn't want us to investigate possible discrepancies or the impact of recent events until after the Prospectus is issued.

Worrying note

We discussed a concerning handwritten note found by Richard beside the photocopier – the note was in Andrew Chen's handwriting and was as follows:

Check Auntie Jo has got her life savings out of our company

After she has made the diary note, Jolene recognises that she needs to take the matters further as she foresees implications both for Omega and for her career. Jolene concludes that she needs to discuss her concerns with a senior colleague. After some thought she decides to approach John Holland as he is involved in the governance of Omega and is a qualified solicitor.

Jolene telephones John, who expresses concern about the possible ethical issues. John agrees to meet Jolene next week to discuss the issues raised and asks Jolene to send him an e-mail outlining Jolene's concerns and suggested possible solutions, in order that John can give the matter some thought.

Hooray Rental Cars Limited

As a consequence of the general pressure being felt within the finance industry and the drop in Omega Asia Bank Limited profits in the 2009 financial year, Jolene Tay is undertaking a review of the company's various business segments.

Hooray Rental Cars Limited was indirectly acquired by OAB on 1 January 2009, as a result of the takeover of an ailing commercial customer. Her preliminary analysis of Hooray reveals that it is not performing well.

Hooray Rental Cars Limited financial statements for the Years ended 31 December

Income Statements (HK$000's)	**2009**	**2008**	**2007**
Sales	18,350	16,375	14,935
Rental car direct expenses	(6,000)	(5,750)	(4,925)
Gross Profit	12,350	10,625	10,010
Operating Expenses	(5,900)	(5,315)	(4,875)
EBITDA	6,450	5,310	5,135
EBIT	2,650	1,810	1,685
NPBT	925	392	385
NPAT	772	327	321

Balance Sheets (HK$000's)	**2009**	**2008**	**2007**
Current Assets	3,783	2,053	3,994
Non-Current Assets	24,000	23,250	21,000
Total Assets	27,783	25,303	24,994
Current Liabilities	2,568	2,360	1,875
Long Term Liabilities	17,250	15,750	16,250
Total Liabilities	19,818	18,110	18,125
Equity:			
Share Capital	5,500	5,500	5,500
Retained Earnings	2,465	1,693	1,369
	7,965	7,193	6,869
Total Liabilities and Equity	27,783	25,303	24,994

Comparative figures:	**Industry Averages**
Gross Profit Margin	77%
Operating Expenses Ratio	25%
Net Profit Margin (EBIT / Sales)	23%
Return on Equity (EBIT / Total Equity)	27%
Return on Assets (EBIT / Non-Current Assets)	18%
Current Ratio	2.3
Ownership Ratio (equity to total assets)	48%
Fleet utilisation	72%

Fleet utilisation for Hooray Rental Cars is 59%, and on enquiring with Hooray management Jolene learned that the key issue is the handling of advance reservations. Hooray takes early bookings for peak season, but then finds that between bookings they have unused days in small blocks that aren't bookable.

Omega Asia Bank

The downturn in the Hong Kong economy has impacted adversely the financial results for Omega in the first few months of 2010. Omega's three major business segments, Banking and Finance, Insurance, and "Other" are all being affected. The Insurance segment appears the least affected and this is due largely to efficient management practices in the insurance division and the fact that the insurance industry appears to be somewhat insulated from economic fluctuations.

The Finance and Banking segment has been hit by a slowdown in both commercial and consumer lending.

The "Other" segment including Vehicle Rentals has been hit very hard by dropping tourism numbers, especially in the Free Independent Traveller (FIT) market.

This has prompted a review of the company's three business segments. Jolene Tay believes that the basis for a financial review would be provided by assessing the Economic Value Added (EVA) of the three segments. In order to carry out this analysis Jolene has assembled the following forecast segmented financial accounts for the six months ended 30 June 2010. She is reasonably confident of the accuracy of this forecast, as it is based on the actual monthly accounts for the period January to April 2010.

		6 Months to 30 June 2010		
Forecast Income Statement (HK$ m)	**Total**	**Bank/Fin**	**Insurance**	**Other**
Total Operating Income	7,741	3,931	3,291	519
Net insurance claims / change in policyholders' liabilities	(1,880)		(1,880)	
Net Operating Income before Impairment Charges	5,861	3,931	1,411	519
Loan impairment charges	(692)	(692)		
Net Operating Income	**5,169**	**3,239**	**1,411**	**519**
Total Operating Expenses	(1,381)	(829)	(290)	(262)
Operating Profit	**3,788**	**2,410**	**1,121**	**257**
Net gains from financial investments and fixed assets	55	55		
Net Profit Before Tax	**3,843**	**2,465**	**1,121**	**257**
Taxation expense	(634)	(407)	(185)	(42)
Net Profit After Tax	**3,209**	**2,058**	**936**	**215**

Forecast Balance Sheet (HK$ m)	6 Months to 30 June 2010			
	Total	Bank/Fin	Insurance	Other
Assets				
Total Financial and Trading Assets	319,686	274,920	29,214	15,552
Investment properties	1,180			1,180
Premises and equipment	3,226	1,936	677	613
Interest in leasehold land	250	250		
Intangible assets	21,541	21,541		
Other assets	5,234			5,234
Deferred taxation assets	92	92		
Total Assets	**351,209**	**298,739**	**29,891**	**22,579**
Liabilities				
Current bank customer trading accounts	148,646	148,646		
Current interest bearing liabilities	28,591	28,591		
Current trading liabilities	21,968	13,181	4,613	4,174
Total Current Financial and Trading Liabilities	199,205	190,418	4,613	4,174
Other current liabilities	7,029	4,217	1,477	1,335
Liabilities to customers under insurance contracts	19,945		19,945	
Current tax liabilities	901	541	189	171
Total Current Liabilities	227,080	195,176	26,224	5,680
Fixed term deposits	96,751	84,591		12,160
Deferred tax liabilities	323	323		
Total Liabilities	**324,154**	**280,090**	**26,224**	**17,840**
Total Shareholders' Equity	**27,055**	**18,649**	**3,667**	**4,739**
Total Liabilities and Shareholders' Equity	**351,209**	**298,739**	**29,891**	**22,579**

An emergency Board meeting has been called to discuss immediate company strategies to address issues currently being faced by Omega, most of which were caused by the recent economic recession. Jolene is aware that in order to carry out an EVA analysis, a calculation of the overall company cost of capital will be necessary. She has accessed the company's WACC calculation prepared in January 2010. This showed a WACC of 8%.

Future Growth Opportunities

The Group wishes to expand its investment banking business and has recently established two new operating companies to foster this – Omega Asia Securities Limited and Omega Asia Wealth Management Limited. This two companies will be engaged in such activities as: underwriting, securities broking, options trading, commodity futures broking, distribution of derivatives and structural products, portfolio management, and investment advisory services.

The Group is in the process of expanding operations into Mainland China, especially the Pearl River Delta, and Hong Kong. Even in the uncertain economic and financial climate of 2009, this appears to be a wise strategic move, especially in the areas of venture capital and corporate finance.

There is also recognition that the company needs to engineer significant improvements to its client support systems. For commercial clients the improvement will focus on client interface, including the rollout of ATMs and improvement of internet services. For the investors and corporate customers of the Group the changes will focus on foreign exchange and bullion trading systems, stock and futures broking, and commercial banking operations.

Appendix 1 – Explanatory Notes on Lines of Business

Commercial / Consumer Loans

- Mortgage loans – lending to businesses on the basis of the security of real estate. Such loans are normally in the form of fixed term “table mortgages” involving regular repayments of interest and principal.
- Machinery and equipment financing – usually term loans and/or finance leases up to a five year term.
- Consumer goods instalment loans, including motor vehicle loans and consumer appliances of various types. Terms for such loans are rarely more than three years.
- Accounts receivable financing – either in the form of “factoring” or term loans with receivables pledged as security.
- Gold loans - instant loans against customers’ gold jewellery and ornaments. Such loans are usually up to HK$1,000,000 and up to 80% of value for any purpose.
- Small and Medium Enterprise (SME) loans. These are loans fostered by the HKSAR government’s SME Loan Guarantee Scheme (SGS) and Special Loan Guarantee Scheme (SpGS). They involve two types of loans. First, “Business Installations and Equipment Loans” - financing to help SMEs acquire business installations and equipment to enhance business efficiency. Second, “Working Capital Loans” - extra funds for SMEs to meet working capital needs for general business uses so as to grasp opportunities for business expansion. SMEs can either apply for “Business Installations and Equipment Loans” or “Working Capital Loans”, or a combination of both. The aggregate loan amount can be up to HK$12,000,000. Maximum loan period can be up to five years.

Investment & Merchant Banking Services

- Stock broking, financial futures and options broking. A member of the management team holds “trading rights” for the Hong Kong Stock Exchange and the Hong Kong Futures Exchange.
- Underwriting of new issues and placement of securities. Omega Asia offers underwriting services including financial and procedural advice, and the handling of the actual issue.
- Merger and acquisition advisory services. There is a small management team providing advice and services to clients in relation to potential mergers and acquisitions.
- Portfolio management. Management of investment portfolios for personal and corporate customers.
- Offering of unit trusts and mutual funds. These are various funds offering to clients a portfolio of investments. There are a variety of funds offering a range of risk/return profiles. There are additional risks associated with these funds, since they are not protected by the Hong Kong Deposit Protection Scheme.
- Fixed and floating-rate bonds. Fixed rate bonds carry a fixed interest rate to maturity. Floating rate bonds carry an interest rate at a fixed percentage above a base interest rate such as the 90 day LIBOR, HIBOR or SHIBOR.
- Custodial services. These are private lock box services for clients.
- Secretarial, accounting and nominee services. Secretarial and accounting services are self-explanatory. Nominee services are provided for clients to ensure confidentiality in relation to sensitive business transactions.
- IPO's application and financing

Insurance Underwriting & Agency Services

The bank's insurance division offers a full range of insurance products. These are self-explanatory and include:

- Fire, marine and accident insurance
- Export credit insurance
- Travel insurance
- Medical insurance
- Motor vehicles insurance
- Home insurance
- Personal accident insurance

Deposit Taking

- Current and Savings accounts in local and foreign currencies. Current accounts involve a variety of trading accounts for personal and corporate customers. There are a variety of savings accounts offering competitive interest rates based upon the term of the account. Many of these accounts are for terms of less than a year.
- Fixed-term deposits in local and foreign currencies. Many of these deposits are for terms of one year or more. The accounts include regular term deposits, deferred interest term deposits, floating rate term deposits and capital drawdown term deposits.

Trade Financing

- Issuance of letters of credit. A Letter of Credit (LC) is a document issued by the bank that essentially acts as an irrevocable guarantee of payment to a beneficiary. This means that if you do not perform your obligations, your bank pays. In Hong Kong, the letter of credit is used widely in import/export transactions. For example, if the LC is the source of repayment of an import transaction this means that the overseas exporter will get paid with the redemption of the letter of credit.
- Trust Receipt (TR) financing. This is a form of financing in which the security interest in the underlying assets is pledged, not by the delivery of the assets as in a conventional pledge. For example, after a LC is opened and an import shipment has arrived, you are supposed to pay against your LC issued. Alternatively, you may apply for TR financing from the bank to assist you in paying your purchases.

  The bank will pay your purchases on your behalf through a loan called TR financing and entrust the cargo to you. You will undertake to sell the cargo, and use the sales proceeds to repay the bank. The balance is your profit in this business transaction.
- Export DA / DP bill discounting and collection. DA refers to "documents against acceptance" and DP refers to "documents against payment". *DA financing* involves a time draft. The bill of lading and the time draft are forwarded through banking channels. The buyer agrees to make payment within a certain number of days after they accept the draft. Normally this permits the buyer to obtain possession of the goods and may give the buyer enough time to sell them before the obligation to pay the draft becomes due. In *DP financing*, after the export, the exporter submits the documents with a bill of exchange to their bank, who send to the buyer's bank. The buyer pays the amount to their bank and get the documents in order to uplift the goods. From the standpoint of the exporter, this is safer than DA financing.

- Export packing credits (EPC). These are available to the exporters, for financing purchase, processing, manufacturing or packing of goods prior to shipment. This would mean any loan or advance extended to a customer by the bank on the basis of:
    - Letter of Credit opened in the favour of the customer or in favour of some other person, by an overseas buyer.
    - A confirmed and irrevocable order for the export of goods.
    - Any other evidence of an order or export having been placed on the exporter or some other person, unless lodgement of export order or Letter of Credit with the bank has been waived.
- Negotiation of export bills. The bank will use their expertise to negotiate favourable terms for their customers.
- Invoice factoring

Treasury Services

The company offers a variety of treasury services including:

- Foreign exchange spot and futures dealing.
- Foreign currency banknote dealing.
- Mail and telegraphic transfers and demand drafts.
- Physical gold and gold futures trading. This is still a significant part of the bank's business.
- Foreign currency cheque negotiation.

Other Trading Operations

- As a result of the takeover of an ailing commercial customer, the company operates a small rental car business.
- As a complement to its foreign exchange operations, the company has a small tourist advisory service.

Appendix 2 – Financial Statements for the Years Ended 31 December

Omega Asia Bank

Consolidated Income Statement (HK$ m)	**2009**	**2008**
Interest Income	**13,086**	**17,203**
Interest Expense	(4,970)	(9,844)
Net Interest Income	**8,116**	**7,359**
Fee Income	2,852	3,841
Fee Expense	(368)	(398)
Net Fee Income	**2,484**	**3,443**
Trading Income	727	840
Net (loss)/income from financial instruments	(516)	953
Dividend Income	42	27
Net earned insurance premiums	6,175	4,851
Other operating income	351	373
Total Operating Income	**17,379**	**17,846**
Net insurance claims / change on policyholders' liabilities	(5,731)	(5,334)
Net Operating Income before Impairment Charges	11,648	12,512
Loan impairment charges	(1,406)	(288)
Net Operating Income	**10,242**	**12,224**
Operating Expenses:		
Employee compensation and benefits	(1,726)	(1,793)
General and administrative expenses	(1,426)	(1,342)
Depreciation of premises and equipment	(216)	(174)
Amortisation of intangible assets	(32)	(16)
Total Operating Expenses	**(3,400)**	**(3,325)**
Operating Profit	**6,842**	**8,899**
Net gains from financial investments and fixed assets	133	358
Share of profits from associates	906	561
Net Profit Before Tax	**7,881**	**9,818**
Taxation expense	(1,300)	(1,718)
Net Profit After Tax	**6,581**	**8,100**

Omega Asia Bank

Consolidated Balance Sheet (HK$ m)	**2009**	**2008**
Assets		
Cash and balances with banks and other financial institutions	12,411	8,432
Advances to banks and other financial institutions	34,790	56,515
Trading assets	34,194	5,195
Financial assets designated at fair value	3,899	6,946
Derivative financial instruments	3,552	2,351
Advances to customers	169,421	154,185
Financial investments	90,579	122,146
Investments in associates	4,435	3,080
Investment properties	1,297	1,291
Premises and equipment	3,545	3,397
Interest in leasehold land	275	282
Intangible assets	21,693	1,445
Other assets	5,752	7,732
Deferred taxation assets	101	1
Total Assets	**385,944**	**372,998**
Liabilities		
Current trading accounts and current savings accounts	174,772	171,856
Current interest bearing liabilities	19,994	20,478
Current trading liabilities	24,141	24,074
Total Current Financial and Trading Liabilities	218,907	216,408
Other current liabilities	7,724	8,925
Liabilities to customers under insurance contracts	21,918	16,543
Current tax liabilities	990	740
Total Current Liabilities	249,539	242,616
Fixed term deposits	106,320	101,470
Deferred tax liabilities	355	683
Total Liabilities	**356,214**	**344,769**
Shareholder's Equity		
Share capital	4,780	4,780
Retained profits	20,176	16,437
Other reserves	1,906	4,144
Proposed dividends	2,868	2,868
Total Shareholders' Equity	**29,730**	**28,229**
Total Liabilities and Shareholders' Equity	**385,944**	**372,998**

Appendix 3 - Board of Directors and Senior Management

Mr. Robert Wing is Chairman and Chief Executive Officer of the Company. He has over 35 years business and finance experience, earlier running his own finance business. In 1988, he followed his father, Mr. Wing Yip Sang, as Chief Executive of Omega Asia Bank. Since then the company has expanded its range of finance and banking products, and also diversified geographically into Macau and Manila.

Mr. Alwyn Chan has served as an Executive Director since 1999. He has previously worked for Morgan Stanley Inc. in institutional equity sales and “XYZ (Holdings) Limited”, a Hong Kong listed company, as Executive Director focusing on mergers and acquisitions and private equity. He is a graduate of the Harvard Business School.

Mr. John G. Holland qualified as a solicitor with “Allan Jones” a firm of London solicitors in 1988 and in Hong Kong in 1991. He has been the Senior Partner of the Hong Kong office of “Allan Jones” since 1983 specialising in shipping, commercial litigation and arbitration, medical and professional indemnity law. He has been an Independent Director of Omega Asia since 1997.

Mr. Sean O’Brien, previously a senior partner in an accounting firm and an international tax specialist, is Executive Director of “ABC Consultancy Ltd.” in Hong Kong. He has over 30 years experience in providing professional consultancy services in Hong Kong and internationally. He has been an independent Director of Omega Asia since December 2005.

Mr. Jose R. Perano is employed as General Manager of a large Philippines Public Sector Bank and has over 30 years commercial banking experience. He has held various positions in the Bank and corporate level assignments as General Manager such as Inspection & Audit Department, Corporate Services, Law, Security, General Operations and Chief Finance Officer. A post graduate (MBA) and Certified Associate of Philippines Institute of Bankers, Mr. Perano is on our Board since September 2008.

Senior Management

Mr. Jilnaut Ng serves as Chief Operating Officer (COO) of Omega Asia. He has a bachelor’s degree in economics and finance from the University of Hong Kong. He has over 20 years of commercial and corporate banking experience in Hong Kong.

Mr. Andrew Chen serves as Assistant COO of Omega Asia. He is a Commerce and Law graduate and is a Certified Associate of the Hong Kong Institute of Bankers. He has over 15 years of commercial banking experience.

Ms. Jolene Tay is Chief Financial Officer (CFO) of Omega Asia. She is qualified Hong Kong CPA and for eight years was employed by a big four accounting firm in Hong Kong. She has been with Omega Asia since 2004.

Appendix 4 - How the HKMA Supervises Banks

(Extract from "Banking Supervision in Hong Kong", HKMA Background Brief No. 2)

The HKMA's supervisory approach is based on a policy of "continuous supervision". This involves on-going monitoring of authorized institutions (AI) through the use of a variety of techniques, including:

1) On-site examinations
2) Off-site reviews
3) Prudential meetings
4) Meetings with the board of directors
5) Co-operation with external auditors
6) Sharing of information with other supervisors

The aim is to try to ensure that any problems affecting authorized institutions are detected and addressed at an early stage.

Focusing on the management of risks

Every business carries inherent risks. Banking business is no exception. Sound risk management is therefore essential to promote stability in both individual institutions and in the banking system as a whole. In 1999 the HKMA introduced a risk-based supervisory approach to Hong Kong. The objective of this approach is to ensure that authorized institutions have the necessary risk management systems in place to identify, measure, monitor and control risks inherent in their business operations. The approach enables potential problems to be detected and tackled at an early stage, thereby reducing the risk of bank failure. The eight major types of inherent risks identified by the HKMA are:

- Credit
- Interest rate
- Market
- Liquidity
- Operational
- Legal
- Reputation
- Strategy

The risk profile of an authorized institution is determined by balancing the level of inherent risks with the quality of its risk management systems. A risk management rating is then assigned and factored into the CAMEL rating of the institution. CAMEL is an internationally recognised framework for assessing Capital adequacy, Asset quality, Management, Earnings and Liquidity.

The overall rating is expressed through the use of a numerical scale of 1 through 5 in ascending order of supervisory concern. The risk-based supervisory approach was first applied in 2000 to small and medium sized local banks and was introduced to large local banks and branches of foreign banks in 2001.

The impact of the Asian financial crisis in the late 1990s served to highlight the importance of a sound credit risk management system within authorized institutions. Asset quality has always been a major focus of the HKMA in its regular on-site examinations and off-site reviews of AIs. General guidance on how AIs should manage credit risk is laid down in a number of guidelines in the HKMA's *Supervisory Policy Manual* 2, including that entitled *General Principles of Credit Risk Management* issued in January 2001.

The HKMA has also issued guidance on the management systems for other major types of risk, such as market and liquidity risks. The increasing risks in a rapidly changing operating environment also call for high standards of corporate governance within AIs to ensure that there is adequate board oversight of the risk management and control systems. Under a guideline on *Corporate Governance of Locally Incorporated Authorized Institutions* issued in 2001, AIs are required to review their current practices and to make every effort to adopt the minimum standards included in the guideline.

1) On-site examinations — taking a close look

A key supervisory tool for effective supervision of authorized institutions is on-site examination. On-site examinations are conducted by the HKMA's own examination teams on all AIs irrespective of their place of incorporation. For locally incorporated AIs, on-site examinations may cover their overseas branches and subsidiaries. The examinations enable the HKMA to obtain a first-hand knowledge of how an institution is managed and controlled, which is particularly useful for assessing asset quality and the adequacy of risk management systems and internal controls of AIs. At present, the frequency of on-site examinations ranges from one to three years. The actual examination frequency normally depends on an AI's overall CAMEL rating. An examination may take the form of either a comprehensive examination or a targeted examination. A comprehensive examination covers the full range of an AI's operations. This includes adequacy of capital and liquidity, quality of assets, treasury operations, high-level controls, compliance with the Banking Ordinance and internal controls, such as controls for prevention of money laundering. A targeted examination focuses on specific areas of concern that the HKMA has identified during the course of its off-site supervision. For AIs engaging in derivatives, securities or Mandatory Provident Fund-related business, specialised examinations of these activities are conducted to ensure that they are adequately managed and comply with the relevant laws, regulations and codes of conduct.

In an on-site examination, the examination team normally reviews an AI's policies and procedures and how they are being applied. The team interviews staff at various levels and conducts tests on transactions. At the end of the examination, the team discusses the main findings and conclusions with the senior management of the AI. A formal report is then issued to the AI, after which its corrective actions to implement the HKMA's recommendations is closely monitored.

2) Off-site reviews – enabling continuous supervision

To ensure continuous supervision, the on-site examination is supplemented by on-going off-site surveillance of the financial conditions of individual authorized institutions and the quality of their management and systems for controlling exposures and limiting risks. Off-site surveillance includes regular analysis of statistical returns and an annual comprehensive review of the performance and financial position of AIs.

3) Prudential meetings – regular management contacts

The annual off-site review of an authorized institution is usually followed by a prudential meeting with its senior management. This regular management dialogue enables the HKMA to understand how an AI's management controls its operations and views its business situation and prospects. The HKMA can also make use of such opportunity to clarify specific issues and discuss prudential concerns with the AI's management. For AIs belonging to a banking group, prudential meetings may be held both at group level and with individual subsidiaries of the group. The HKMA may also hold discussions with an AI's overseas head office.

4) *Meetings with the board of directors*

To promote a high standard of corporate governance in the banking sector in Hong Kong, the representatives of the HKMA also meet the board of directors of each local bank every year. During these meetings, an assessment is given to the board about the bank's performance, the quality of its risk management and internal controls and issues requiring attention.

5) *Cooperation with external auditors*

External auditors play an important role in the supervisory process. The HKMA's relationship with an AI's external auditors takes a number of forms:

- Auditors are required under the Banking Ordinance to certify, usually once a year, whether an AI's banking returns have been compiled correctly. This provides the HKMA with an independent opinion on the reliability of the prudential statistics submitted.
- Auditors are also required, usually once a year, to report on the following areas:
    - Controls relating to the compilation of prudential returns.
    - Controls to ensure compliance with various provisions in the Ordinance.
    - For AIs incorporated in Hong Kong, controls to ensure the maintenance of adequate provisions.
- Auditors may be commissioned to review certain internal control systems of an AI on an ad hoc basis.
- Annual tripartite discussions are held with AIs and their auditors in respect of matters of concern identified during the annual audit.
- The HKMA should receive a copy of the auditors' management letter to an AI. Any cause for prudential concern would be discussed with the AI and, if necessary, its auditors.

6) *Sharing information with other supervisors*

The HKMA maintains regular contacts with other local and overseas supervisors to exchange views on matters relating to AIs. In this regard, the HKMA has the legal authority under the Banking Ordinance to disclose information to supervisors outside Hong Kong to assist them to exercise their functions. This is however subject to the condition that the relevant supervisors have adequate secrecy provisions to safeguard the confidentiality of the information disclosed. Locally, the HKMA may also disclose information to other supervisors such as the Securities and Futures Commission, Office of the Commissioner of Insurance, or Mandatory Provident Fund Authority under similar circumstances. Sharing of information with other supervisors is important particularly given the emergence of financial conglomerates with cross-sector business and international operations, and the growing linkages among different types of financial institutions.

Power to collect information

The HKMA has the authority to collect prudential data from authorized institutions both routinely and on an ad hoc basis. This power extends to any holding company, subsidiary or sister company of an AI if the HKMA considers it necessary for its supervision. Regular statutory returns cover information about assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, loan classification, foreign exchange position, interest rate risk, market risk as well as securities and Mandatory Provident Fund-related activities. Internal management information, such as financial budgets and forecasts as well as bad and doubtful debt reports, may also be required by the HKMA for review, together with such other information as the AI's internal policy statements on particular areas of operations, including money laundering prevention, and information on subsidiaries.

Consolidated supervision

The HKMA has various powers to prevent undesirable affiliations or structures. Locally incorporated authorized institutions planning to establish overseas branches, subsidiaries and representative offices have to seek the prior approval of the HKMA. In determining whether to grant an approval, the HKMA takes into account the institution's business plan for the proposed operation, the financial implications involved and the institution's ability to manage and exercise adequate controls over the operation. The economic and political situation of the country in which the AI proposes to set up its overseas operation is also considered, as is the country's secrecy rules and its methods of supervising financial institutions. This is particular important from the supervisory angle because the HKMA needs to ensure that sufficient information can be obtained about the overseas operation, either through on-site examinations or by other means.

AIs incorporated in Hong Kong are supervised on a consolidated basis in respect of their capital adequacy, concentration of exposures and liquidity. The main objective of this is to enable the HKMA to assess any weaknesses within a banking or financial group that may have an impact on the AI itself, and to take defensive or remedial action when necessary.

When supervising banking groups, the HKMA takes a flexible approach in the scope of consolidated supervision in order to accommodate different types of structures. As a general rule, however, the group's local and overseas offices and financial subsidiaries would be included. Non-bank companies are included in the consolidation if they undertake "financial" business, such as hire purchase, credit cards, or leasing. Where non-bank subsidiaries (for example, securities firms or insurance companies) are themselves adequately supervised by other supervisors, the HKMA will also rely heavily on their co-operation to ensure effective overall supervision of the banking group.

Supervision of electronic banking

There has been a growing interest among banks in using electronic means to deliver services to customers. This brings with it the need for new forms of risk management. In May 2000, the HKMA issued a guideline on *Authorization of Virtual Banks*. This guideline is aimed at institutions that deliver banking services primarily through the Internet or other electronic channels. The HKMA does not object to the establishment of virtual or Internet-based banks in Hong Kong provided that they can satisfy the same criteria that apply to conventional banks.

To strengthen the supervisory framework for electronic banking, the HKMA issued two further guidance notes entitled *Management of Security Risks in Electronic Banking Services* and *Independent Assessment of Security Aspects of Transactional E-banking Services* in July and September 2000 respectively. The second of these guidance notes stresses the need for banks to commission regular independent assessments of the security of their e-banking services. In addition, to better monitor the development of e-banking, the HKMA has established a specialist team and has arranged technical briefings for supervisory staff. An external consultant has also been appointed to assist the specialist team in developing an on-site examination programme focusing on e-banking activities and general information on technology controls.

The HKMA will continue to develop its supervisory framework in line with international practices, including those being developed by the Basel Committee on Banking Supervision. The role of the HKMA is to help AIs to control the risks of electronic banking while not standing in the way of its continuing development.

The Summary

Omega Asia Bank Limited is a full-fledged banking and financial services group, with a head office located in Hong Kong, and operations in Macau and Manila. The bank is a “licensed bank” under the supervision of the Hong Kong Monetary Authority (HKMA). The last three decades have seen the Group grow markedly in both Hong Kong and Macau, and to a lesser extent in Manila. In recent years, it has been seeking vigorously to expand its presence in the region. In light of the new business environment under the new economy, the Group has undergone a re-orientation, with investment banking, commercial banking and insurance identified as the three major lines of businesses, while non core businesses are grouped under "other" sector pending for the strategic review by the Board of Directors.

In the last two years, the finance industry in Hong Kong has been hard hit by the financial tsunami in 2008. In 2010, the economy of Hong Kong has showed sight of recovery amid global economic recovery, especially Mainland China. Assume that your team are members of the Board and management, how would your team address the following:

Questions:

1. Outline the ethical dilemmas that Jolene believes arising in the issues she had jotted down in her diary note and suggest possible actions that your team would recommend Jolene, as CFO, could take to address each ethical dilemma outlined.
2. Undertake a numerical analysis of the Hooray Rental Cars financial statements and advise on any specific actions that could address the issues your team identified.
3. Undertake an Economic Value Added (EVA) analysis for the six months forecast ended 30 June 2010 for the three segments of Omega Asia Bank and make a recommendation to the Board regarding the short term strategy in relation to the three business segments.
4. By carrying out a research, where appropriate, how would you grow the businesses in the next five years?