THE BANKING INDUSTRY IN CHINA 2000

中国的银行业

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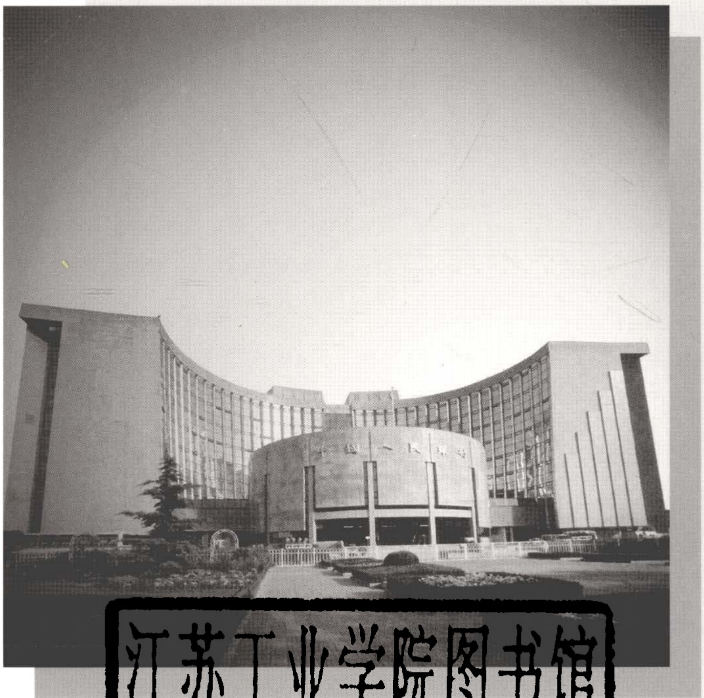

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Dai Xianglong
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I. The WTO Accession Will Have Significant Impact on the Financial Industry

China has been diversifying financial institutions and financing channels since 1985 and has promoted the development of the financial market. While bank loans currently account for two thirds of corporate financing, the proportion of direct financing through stock and corporate debt markets is rapidly growing. At the end of 1999, the aggregate assets of financial institutions amounted to RMB 17.2 trillion yuan, including RMB 10.2 trillion yuan loans. Money market is expanding with RMB 1.0542 trillion yuan state bonds outstanding at the end of 1999 and the interbank borrowing in 1999 reached RMB 329.2 billion yuan. The annual growth rate of the equity market turnover averaged 13.7 percent from 1997 to 1999. At the end of 1999, there were 90 securities companies, 949 listed companies with market value of RMB 2.6 trillion yuan, 32 percent of GDP. The insurance premium amounted to RMB 139.3 billion yuan in 1999, RMB 110 yuan per capita.

The accession to the WTO will have significant impact on China's financial market. In accordance with the Sino-US and Sino-EU agreements, the pace of liberalization will vary for banking, insurance and securities sectors. Five years after China's accession to the WTO, foreign banks will enjoy national treatment with regard to their RMB business. While foreign ownership in joint venture insurance companies will be limited to 50 percent, partial foreign ownership will be allowed in fund management corporations. And there is no commitment to open the RMB denominated securities market to foreign investors. Therefore, China's accession to the WTO will have significant impact on the banking industry through credit and money markets and to a lesser extent on the insurance industry, whereas the effect on the capital market is unclear.

China's accession to the WTO will offer opportunities for the development of bank credit and money markets. Firstly, it will encourage capital inflow. The increasing number of foreign banks will not only bring in financial capital, but also attract more foreign direct investment through better service. At the end of 1999, the accumulative foreign direct investment amounted to USD 305.9 billion. Growth of foreign investment is projected to continue in the coming years. Secondly, it will bring modern management expertise and the cutting-edge products. Thirdly, it will improve the credit and money markets and promote the financial legislation in compliance with the international practices. The accession to the WTO will also present significant challenges to the banking industry. In particular, China's banking industry will face great competition for clients, talents and market share for new products. At the moment, per capita asset of the wholly state-owned commercial banks is only one tenth of that of the foreign banks in China, and wage gap is large. We are accelerating the banking reform. The asset management companies have been established to take over and dispose of the non-performing assets of the wholly state-owned commercial banks. Efforts are being made to transform the eligible wholly state-owned commercial banks into joint-equity commercial banks with the state maintaining the controlling interest.

Along with the communication technology advances and intensification of the competition, an increasing number of countries have abandoned segregation of banking, insurance and securities industries. Ten years ago, China experimented with universal financial services. However, against the background of heated economy and insufficient regulatory capacity, universal financial services did not prove successful. Following the rectification of the financial industry in 1993, securities and insurance business were resegregated and subjected to supervision by different regulatory agencies. The current system is consistent with the Chinese situation. We support the innovation of banking, insurance and securities industries, especially banks in their developments of fee-based business and online banking. The People's Bank of China, Securities Regulatory Commission, Insurance Regulatory Commission will strengthen cooperation with regular exchange of supervisory information to promote the steady development of China's financial industry.

II. WTO Accession Will Bring More Opportunities for Foreign Banks

Foreign banks have been expanding their presence in China since the first foreign bank branch opened in 1981. Currently, the principal requirement on the foreign parent bank is a minimum asset size of USD 20 billion for opening branches in China and USD 10 billion for establishing a subsidiary. At the end of 1999, there were 182 branches and subsidiaries of 87 foreign financial institutions from 22 foreign countries operating in China. Their total assets in China amounted to USD 31.8 billion. They accounted for 16 percent of the foreign currency denominated loans in China. By the end of June 2000, 32 foreign banks in Shanghai and Shenzhen had been granted RMB business license. During the first five months of this year, their RMB loans increased 110 percent.

The opportunities will result from gradual easing of market access as required by WTO entry. With regard to business scope, in the first year of WTO membership, foreign banks will be granted license for all foreign exchange business, including taking deposits from and lending to households. Two years after the accession, they will be allowed to do RMB business with corporate clients and five years after the accession, with household clients. As for geographical access, the number of cities with foreign bank access to RMB business will increase by four annually in the five-year transition period, after which there will be no geographical limits with regard to local currency business. The central bank will license foreign bank branches on the prudential basis. Foreign banks with RMB license but with inadequate initial RMB position are allowed to borrow in the money market and from domestic banks to facilitate their growth. In order to prevent the excessive risk of RMB business in the absence of capital account convertibility, a maximum RMB asset to total asset ratio has been imposed. A certain ratio is also stipulated for RMB working capital to total RMB asset. Foreign banks may apply for converting their foreign currency working capital into RMB.

The opportunity for foreign banks presented by China's accession to the WTO is not limited to the gradual increase in market access. It implies more business opportunities. From 2001, China will embark on the tenth five-year plan. Strategic adjustment will be made on the national economic structure. At the same time, the strategic plan to develop the central and western part of China will be implemented. It is projected that, for the next five years, annual GDP growth will exceed 7 percent, fixed asset investment will exceed RMB 20 trillion yuan, and foreign trade will continue to grow, all of which will present great business opportunity for foreign banks.

III. We Are Capable of Preventing and Eliminating the Possible Overheating after the Accession to the WTO

From 1979 to 1999, GDP grew at an annual rate of 9.7 percent, RPI 6.5 percent, M1 20 percent and M2 23.3 percent. The sustained fast and healthy development is attributable to the successful transformation of the highly centralized planned economy into a market economy with Chinese characteristics, economic globalization and financial integration, and the successful macroeconomic management.

We have adopted a gradual approach in macroeconomic adjustment, monitoring both inflationary and deflationary risks. In 1993-94, China experienced high inflation, which peaked at 25.2 percent in 1994. It took three years to achieve a soft landing. With the combined effects of the Asian financial crisis, duplicated investment and the good grain harvest, China witnessed signs of deflation. Thanks to the active fiscal policy, sound monetary policy and structural adjustment, the defaltionary trend has been harnessed and turned around. In the first half of this year, on a year-to-year basis, GDP grew by over 8 percent, fiscal revenues by over 20 percent, and trade by over 30 percent. At the end of June, foreign exchange reserves amounted to USD 158.6 billion. For the next few years, China will sustain fast growth with greater adjustment to economic structure and greater openness.

In recent years, the central bank has been implementing a sound monetary policy. Firstly, monetary policy instruments have been utilized to increase the money supply to an appropriate extent. Secondly, credit structure has been adjusted. Loans for fixed asset investment have increased for projects financed by government bonds. Consumer credit has developed and agricultural loans have increased. New financial products have been introduced vigorously. Thirdly, a financial stability program has been put in place to strengthen financial supervision and regulation. Asset management companies have been established to take over and dispose of the non-performing assets of the wholly state-owned commercial banks. Small and medium-sized financial institutions were restructured. Financial supervision has been strengthened to curtail new non-performing assets. The sound monetary policy has been effective in promoting dynamic growth of the national economy.

The inflow of foreign goods and capital will increase after China's accession to the WTO. The implementation of the tenth Five-year Plan, the development of the central and western part of China and the continued active fiscal policy will require an increase in money supply. The People's Bank of China will take full advantage of the current growth momentum to promote economic growth. Meanwhile, we will guard against inflation. Firstly, we will continue to conduct the sound monetary policy, press ahead with the interest rate liberalization, make timely adjustment to money supply to ensure that price increase will be contained at around 3 percent. It is projected that the money supply increase will be lower than in the previous years whereas direct financing will grow rapidly. Secondly, in coordination with bank restructuring, we will eliminate the government interference with bank operation, safeguard the banks' accountability, strengthen supervision, prevent new credit risks and lower the ratio of non-performing assets. Thirdly, we will gradually press ahead with the capital account convertibility. We will control the growth of foreign debt and guide the orientation of foreign investment. These measures together with the elimination of the institutional factors responsible for the duplicated constructions and unproductive investments will effectively prevent overheating of the economy and create a favorable macroeconomic environment.

IV. China Will Maintain the Gradual Approach Towards Capital Market Liberalization after the Accession to the WTO

The state-owned enterprises have long been relying on the state-owned banks for financing. As a result, their debt to equity ratio reached around 70 percent. Some enterprises operated with no capital at all. The non-performing assets of state-owned enterprises ballooned and many state-owned enterprises encountered difficulties because of the high indebtedness. In recent years, the central bank adjusted its monetary policies to support the capital market development. From May 1996 to June 1999, interest rates were cut on seven occasions with the intention to direct part of the household deposits towards the capital market. Meanwhile, eligible securities companies were given access to the money market and allowed to borrow from commercial banks against acceptable securities.

China is adopting a number of measures to develop and expand the capital market. In 1990, the first security exchange - Shanghai Securities Exchange - was set up. 1992 witnessed the establishment of China Securities Regulatory Commission. In December 1998, Securities Law was approved. In June 2000, total stock market capitalization amounted to RMB 1.3229 trillion yuan, 16 percent of GDP. Currently, the securities regulatory agency is improving the mechanism for stock offering by drawing on the experience of overseas stock markets, increasing the number of institutional investors, and establishing a trading board for small and medium-sized growth enterprises in the high-tech sector. It is expected that the RMB capital market will grow rapidly.

In 1996, China introduced current account convertibility. The regime has worked well. The International Monetary Fund definition for capital account convertibility involves more than 40 items. China has liberalized more than 20 of them. Currently, capital account controls are mainly limited to two forms. Firstly, the foreign borrowing by domestic entities is subject to approval on a case by case basis and a limit is imposed on the aggregate amount. This measure is based on the fact that state-owned enterprises have not developed a sufficient mechanism for self-discipline. Secondly, foreign investors can invest in B share market with foreign currency, but are excluded from the RMB denominated A share market. The rationale is that RMB stock market is still underdeveloped with small market capitalization and insufficient expertise in securities regulation. The access by foreign investors to the A share market would likely encourage overinvestment and high volatility of the market, which would in turn damage the interest of domestic and foreign investors.

In the next few years, we will continue to improve the conditions for the capital account convertibility.

Firstly, we will improve macroeconomic environment to sustain growth, control fiscal deficit and safeguard price stability. Secondly, we will develop a sound and robust financial system to guard against and resolve financial risks, improve the transparency of banking sector to strengthen the central bank's ability to adjust the economy with interest rate. Thirdly, China will expand the securities market and improve the regulatory and supervisory capability. Fourthly, we will improve balance of payments and safeguard the exchange rate stability. After the accession to the WTO, Chinese-foreign joint venture securities companies will be licensed. However, there is no commitment on the timing of granting foreign investors access to the RMB securities market. The timing of capital account convertibility and the foreign capital access into the RMB securities market will depend on the progress of the initiatives in the aforementioned four aspects.

V. Foreign Participation in Venture Capital Investment Will Be Encouraged

Under the highly centralized planned economy, the government used to bear the full costs of the research and application of high technology. Technological development was constrained. Since the introduction of reform and opening policy, technology has been recognized as the prime factor of productivity, and intellectual property rights are protected, venture capital has emerged as an industry to transform high technology into productivity, and thus secure high returns. The government has adopted a number of measures to promote venture capital for high technology. Many young people with overseas education and work experience have returned to China and made significant achievements in promoting the development of science and technology and securing high returns with domestic and foreign venture capital.

China is accelerating the efforts to establish and improve the venture capital mechanism, firstly, by supporting the development of small and medium-sized enterprises. In order to encourage the banks to lend to small and medium-sized enterprises, the interest rate floating band has been expanded for loans to small and medium-sized enterprises. Guarantee companies have been established with the funding from local governments, enterprises and households to provide guarantee for loans to small and medium-sized enterprises. Secondly, venture capital funds are being established. The State Council has promulgated regulations governing venture capital funds, stipulating the funding and appraisal of technological achievements and the exit mechanism. Several dozen venture capital funds have been established. Although these funds have only moderate resources at the moment, broad prospects await them in future development. Thirdly, while standardizing the main trading board dominated by large state-owned enterprises, we plan to initiate a second board for the small and medium-sized growth companies involved in high technology to attract venture capital.

戴相龍

PERFECTING EXCHANGE ADMINISTRATION TO PROMOTE HEALTHY DEVENLOPMENT OF EXTERNAL SECTORS

Wu Xiaoling
Director General
The State Administration of
Foreign Exchange

During the twenty years of opening up to the outside world, the reform on the exchange administration system in China has attained considerable achievements, initially established the exchange administration system in line with the requirements of socialist market economy, realized RMB convertibility under the current account, and kept effective administration on the capital account. These efforts contributed to promoting rapid and healthy growth of national economy and further opening up to the outside world.

The current exchange administration system in China is characterized by the following: (1) It adopts single, managed floating exchange rate system based on market supply and demand; (2) It institutes the system of exchange sale and purchase by banks under which qualifying enterprises retain exchange earnings under the current account within limits, designated exchange banks hold turnover position for exchange sale and purchase within prescribed limit, and the inter-bank exchange market handles bona fide transactions; (3) It implements RMB convertibility under the current account, establishes verification system of import payments and export receipts and continues to improve supervision on exchange under the current account; (4) It adheres to the prudential principle with regard to the liberalization of the capital account, differentiates exchange receipts and payments under the current account from those under the capital account, moderately controls the scale of external debt, reasonably arranges external debt structure and rigorously enforces exchange administration under the capital account; (5)It establishes the BOP reporting system, and the system of external debt monitoring and statistics; (6)It strengthens operation and management of foreign exchange reserves.

The main functions of the State Administration of Foreign Exchange (SAFE) lie in managing, monitoring, analyzing the statistics of inflow and outflow of foreign exchange under main items of BOP in line with relevant laws from the point of view of BOP and BOP statements, and conversion between RMB and foreign currencies. Following RMB convertibility under the current account on Dec 1, 1996, fundamental changes took place on current account administration. Ex anti examination and approval on every exchange purchase was replaced by authenticity verification. Enterprises may use exchange under the current account without a predetermined plan and without examination and approval from the SAFE and handle exchange conversion and payment only with relevant genuine and valid vouchers and commercial documents. Meanwhile, we still adopt exchange administration on the capital account. Exchange receipts under the capital account shall be repatriated with exceptions stipulated by the State Council. Exchange receipts under the capital account by domestic institutions (including foreign-funded firms) must be put in special exchange accounts in banks, and could be sold to designated exchange banks only with approval from the SAFE. Exchange purchase and payment under the capital account could be conducted in banks by presenting verified documents after the approval from the SAFE. RMB convertibility under the current account and effective administration on the capital account propelled export and import and utilization of foreign funds and contributed to the orderliness and stability of foreign exchange flows.

In 1999, by striving to overcome various difficulties, China reached her preset national economic development targets, and made new achievements in the process of economic reform and opening-up as well as in modernization construction. GDP increased by 7.1 per cent, and the quality of economic development was improved. Export showed dramatic recovery. The export value in the year expanded by 6.1 per cent and trade surplus amounted to USD 29.2 billion. The capital inflows kept strong momentum with the real utilization of FDI achieving USD 40.4 billion.

With the effectual macro adjustment and the recovery of the overall economy, in 1999, China made a favorable achievement in external sectors. The RMB was basically stable. The foreign exchange reserves amounted to USD 154.7 billion, and both the current account and the capital and financial account in BOP achieved surpluses.

In 1999, the SAFE took active steps to carry out policies on promoting export and attracting capital inflows under the unified guidance of the State Council. By learning lessons from the Asian financial crisis, and in order to meet the challenges of accessing the WTO, the SAFE also took measures to improve administrations and services. With the aim at 'well founded presentation, well administration, and good service', great efforts were paid in upgrading administration, perfecting regulations and improving services. All these measures have helped to improve the investment environment, facilitate enterprises' businesses and maintain the BOP and the stability of RMB exchange rate.

In 2000, China is going to access the WTO membership, which indicates the Chinese economy will integrate into the world economy further. Confronted with the unprecedented challenges and opportunities, the SAFE will improve the administration further in two aspects by placing maintaining external equilibrium at the center. One is to consolidate the fundamental construction of regulations, network and internal controls; another is to strengthen the cooperation and coordination with other departments. The SAFE will collect efforts to deal with the relationships between regulation and deregulation, striking against illegal activities and facilitating legal businesses. All in all, the SAFE will try its best to create a favorable financial environment to facilitate foreign trade and foreign investment and to make further achievements in propelling the healthy development of China's external economy.

吴晓灵

LATEST DEVELOPMENTS OF THE MONETARY AND BANKING SECTORS IN HONG KONG

Joseph Yam, Jp
Chief Executive
Hong Kong Monetary Authority

1. Having gone through a sharp economic adjustment induced by the Asian financial crisis, Hong Kong has rebounded sharply since the second quarter of 1999. GDP grew strongly by 14.3% and 10.8% in the first and second quarters of 2000 respectively following an increase of 3.1% in 1999. The downward adjustments in prices and wages moderated, while the unemployment rate declined further. Along with the turnaround in economic conditions, the banking sector environment in Hong Kong has also improved substantially.

Monetary Stability

2. The currency board system in Hong Kong, strengthened by the technical measures introduced in September 1998, functioned smoothly and effectively to deliver a stable Hong Kong dollar. The market exchange rate stayed close to exchange rate of the Convertibility Undertaking in respect of the bank balances held with the Hong Kong Monetary Authority (HKMA).

3. The exercise that started from 1 April 1999, to converge the exchange rates used for the Convertibility Undertakings for the bank balances and for the bank notes continued. There was a graduate movement of 1 pip each calendar day for the exchange rate of the Convertibility Undertaking for the bank balances. Convergence at 7.8000, which has always been the exchange rate used for backing the note issue, was achieved on 12 August 2000. No disruptions occurred in the foreign exchange and money markets during the whole process.

4. To enhance transparency and promote a better understanding of the currency board operations in Hong Kong, the Currency Board Account has been published since March 1999. This Account shows the monetary base on its liabilities side, and the backing assets on its assets side. As at 31 July 2000, the monetary base stood at HK$ 207.6 billion, while the backing assets totaled HK$ 230.2 billion, implying a backing ratio of 110.87%.

Performance of the Banking Sector

5. 1999 was a year of consolidation for the banking industry in Hong Kong, as authorised institutions focused on improving their balance sheets and dealing with problem loans. Since the fourth quarter of 1999, the operational environment turned more positive, along with the recovering economy, stable domestic interest rates and ample liquidity within the banking system. Concerns about credit risk tended

to ease and banks became more willing to lend as liquidity increased. The recent general improvement in banks' asset quality also led to a substantial decline in the aggregate bad debt charge, which, together with an increase in net interest margin, resulted in a 50% rise in the pre-tax operating profits of local banks in the first half of 2000 compared with the same period in the previous year.

6. Funding costs eased in the course of 1999 as a result of ample liquidity in the banking sector. This was largely attributable to a continued growth in customer deposits and a decline in lending volume. Funding costs eased further in the first quarter of 2000 but moved higher in the second quarter resulting from a tightening in interbank liquidity. During the first half of 2000, the average one-month HIBOR rose by 19 basis points to 6.00% after increasing by 61 basis points in the second half of 1999, while the average one-month time deposit rate rose by 20 basis points to 4.69%, compared with a decrease of 2 basis points in the second half of 1999. The average spread between one-month HIBOR and the best lending rate also widened to 293 basis points during the first half of 2000, compared with 265 basis points in the second half of 1999. The widened interest rate spread was attributable mainly to the faster growth in the best lending rate than one-month HIBOR in the first half of 2000. The net interest margin (annualised) rose to 2.39% in the first half of 2000 from 2.27% in the same period of 1999.

7. Total customer deposits rose by 10.1% at end-June 2000 over a year ago, after rising by 7.6% in 1999. Total loans shrank further in the first half of 2000 as a result of the continued contraction in Japanese banks' Euroyen lending activities. Nevertheless, the drop in total loans and advances by 10.4% year-on-year at end-June 2000 represents a significant moderation from declines of 19.8% and 14.9% in 1998 and 1999 respectively. Domestic lending in Hong Kong dollars has started to pick up, but the growth in the first half of 2000 has been modest despite the strong economic recovery. Reflecting the continued growth in Hong Kong dollar loans and a modest pickup in Hong Kong dollar deposits, the Hong Kong dollar loan-to-deposit ratio of the banking sector rose to 91.6% at end-June 2000, compared with 91.3% at the end of 1999.

8. The asset quality of local banks has improved since the fourth quarter of 1999, after deteriorating to a historic low in the third quarter. For local banks as a whole, the combined ratio of overdue loans (overdue for more than three months) and rescheduled loans to total loans rose from 5.12% at the end of 1998 to a high of 7.54% at the end of September 1999 before moderating to 6.38% at the end of June 2000. The ratio of 'classified loans' (i.e. loans classified as substandard, doubtful and loss) declined from 10.33% of total loans at the end of September 1999 to 8.67% at the end of June 2000. The general improvement in local banks' asset quality also led to a substantial decline in the aggregate bad debt charge, at 0.25% (annualised) of total average assets in the first half of 2000, compared with 0.64% (annualised) in the same period of last year and 0.55% (annualised) in the second half of 1999.

9. In the first half of 2000, the pre-tax operating profits of the local banks from their Hong Kong operations rose by more than 50% over the same period in 1999. Discounting the temporary effects due to the reduction in bad debt charge, the pre-provision operating profits still grew by about 15% compared with a year ago. The recovery was helped by a wider net interest margin and a significant increase in income from fees and commissions, despite the continuing competition for residential mortgage loans. This represents further improvement from the outturn in 1999, whereby pre-tax operating profits increased by 15.2% and post-tax profits by 22.6%, in sharp contrast to the declines of 32.9% and 33.8% respectively in 1998.

10. The consolidated capital adequacy ratio of all locally incorporated institutions remained high at 18.7% at end-June 2000, up slightly from 18.8% at the end of 1999.

Banking Sector Reform

11. Having carefully evaluated the recommendations arising from a consultancy study and the response from public consultation, the HKMA announced in July 1999 a three-year reform programme to further develop the banking sector in Hong Kong. The objectives of the reform programme are two-fold: first, to encourage market liberalisation and enhance competitiveness in the banking sector; and, secondly, to strengthen banking infrastructure with the objective of enhancing the safety and soundness of the sector.

12. Since the reform programme was announced, a number of the policy initiatives have already been

implemented according to the programme schedule. In September 1999, the HKMA relaxed the 20-year-old 'one branch' policy for foreign banks. Foreign banks are now allowed to operate from three separate buildings rather than one. This measure provides foreign banks with greater flexibility in doing business and will further enhance Hong Kong's reputation as a free and open financial centre. Furthermore, restricted licence banks have been allowed access to the Real Time Gross Settlement (RTGS) system since the second quarter of 2000, whereas access was restricted to only licensed banks in the past.

13. On 3 July 2000, the Interest Rate Rules (IRRs) on time deposits with a maturity of less than 7 days and the prohibition on benefits for all depositors (other than Hong Kong dollar savings and current accounts) were lifted. This was the first of a two-phased plan to deregulate the remaining IRRs in order to promote competition in the banking sector. The second phase, which will remove the IRRs on savings and current accounts, is scheduled to take place 12 months after Phase 1 of the deregulation, provided that the economic and financial environment at that time is not unfavourable.

14. The work on other policy initiatives is also progressing smoothly. A consultancy study on enhancing deposit protection has been completed. The study has critically assessed the effectiveness of the current deposit protection arrangements established under the priority claims payment system for small depositors under the Companies Ordinance; and considered the relative cost and benefit of an explicit insurance system, alternative means of deposit protection and the status quo. Based on these assessments, the consultant has put forward their recommendations on how to improve deposit protection in Hong Kong with a view to enhance the stability of the banking system. A full public consultation in respect of the consultant's recommendations will take place in the fourth quarter of 2000.

15. A consultation paper on establishing a commercial credit reference agency (CCRA) was issued in July 2000, following completion of a study. The study finds that the establishment of a fully-fledged CCRA would bring about significant benefits to Hong Kong in terms of improving the banking industry's credit risk management and reinforcing borrower discipline, thereby enhancing the safety and soundness of the banking system. Commercial customers would also benefit from higher transparency which would result in more competitive loan pricing. Results of the consultation which ends in mid-September 2000 will be studied carefully before any final decision will be made.

Electronic Banking

16. Electronic banking is one of the key strategic challenges facing the Hong Kong banking sector. More than 20 banks have already launched transactional internet banking services or mobile phone banking in Hong Kong, and many others are at an advanced stage of planning and development. The HKMA's role is to provide a regulatory environment in which banks will properly manage the risks arising from electronic banking, while not standing in the way of these developments. Given the rapid pace of development in this area, the HKMA will step up its efforts to ensure that the regulatory framework continues to evolve and keep pace with technological developments. The HKMA has recently issued a guideline on the authorisation of virtual banks and a guidance note on the management of security risks in electronic banking services. It is also considering other issues including offshore banking activities conducted over the internet. The HKMA is establishing a specialist team of examiners with the necessary skills and technical knowledge to conduct more focused examinations on electronic banking activities of banks.

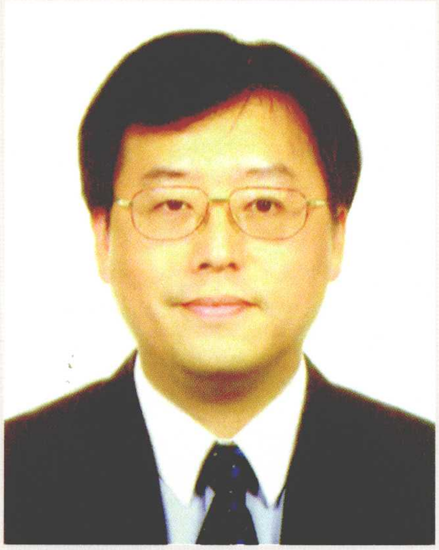
17. With respect to strengthening the banking infrastructure by enhancing the safety and soundness of the sector, the HKMA has implemented a risk-based supervisory approach, which consists of a structured methodology designed to establish a prospective view on the risk profile of authorised institutions. This enables the supervisory process in a direct and specific way to focus on the areas of greatest risk to an institution and be more proactive and better positioned to pre-empt any serious threat to the stability of the banking system, as a result of any current or emerging risks. This improved supervisory approach, which focuses on the level of risks and the quality of the risk management system to identify, measure, monitor and control the risks is being introduced for local banks in Hong Kong during 2000. It is expected that the risk-based process will be expanded next year to include the foreign banks operating in Hong Kong.

Looking ahead

18. The HKMA will continue to identify and, if thought fit, to introduce measures to refine the operation of the currency board in Hong Kong. This will ensure that Hong Kong augurs well with the potentially destabilising effects of globalisation and benefits from the greater efficiency in international financial activities.

19. The operating environment for the banking sector in Hong Kong is expected to continue to improve in 2000. While loan growth has been modest, stable funding conditions and a decline in provisions for bad and doubtful debts should bring about further recovery in profits. Notwithstanding the improvement in asset quality, banks have a continuing need to monitor closely the quality of their loan portfolios and introduce appropriate measures to strengthen credit controls in the light of our experience during the Asian crisis. As it has around the world, the banking environment in Hong Kong will undoubtedly become more competitive and complex. This will present new opportunities for banks, but it will also pose formidable strategic challenges, not least on decisions about merger and business alliance.

20. The process of banking sector reform in Hong Kong will continue. Important steps in the pipeline include further deregulation of the IRRs, enhancement of deposit protection, establishment of a CCRA, review of the three-tier licensing system and market entry criteria. Further work is in progress to continuously improve the financial disclosure standards, enhance the risk-based supervisory approach, and promote higher standards of corporate governance. At the same time, the HKMA will focus on ensuring that supervisory policies and practices are able to address the needs and special challenges created by the rapid development of electronic banking.



Anselmo Teng
Chairman of the Board of Directors
Monetary Authority of Macau

The reform policy which has been in place since the end of the 1970s has not only been the major driving force for the significant economic growth in the mainland, but has also contributed towards the economic development of both Hong Kong and Macau. Resulting with the favourable economic situation in the region, Macau achieved stable and yet remarkable economic growth during the last two decades.

On the other hand, after certain instability following the revolution in April 1974 in Portugal, the political situation started to stabilise in the 1980s. As a result the administration over Macau was strengthened and thus allowed Macau to be in a better position for economic growth.

The previous administration of Macau realised the need, as a result of the rapid pace of economic development driven by the factors mentioned above, to create better conditions for further growth of the financial sector. And in this regard more timely, appropriate and stringent regulatory framework appeared to be imminent.

To start with, an institution, the Issuing Institute of Macau (IEM), was created in 1980 as the regulator of the financial sector of Macau, which includes banking, insurance and other credit related activities. The main objective was to ensure sound growth of the sector and to protect the interests of those involved as allowed by law. Apart from the functions mentioned above, the IEM was also responsible for the issuing of the local currency, the pataca, as well as the management of the exchange reserve of Macau. Besides, relevant decree laws were also enacted. On the banking side, the newly amended decree law was published on 3 August 1982. After eleven years of implementation, and realising the need to cope with the fast-changing banking industry, the Financial System Act of Macau was published on 5th July 1993. On the insurance side, respective legislations were effected on 28th December 1981, 20th February 1989 and 30th June 1997 in order to cope with the pace of the development of the insurance industry.

Both the banking and the insurance industry have achieved remarkable growth over the years as a result of the establishment of the appropriate regulatory institution and the timely establishment of legislative and supervisory practices. The government also realised the need, after years of solid experience, to define clearly the authority and responsibilities of the regulatory institution. In that regard, the Monetary and Foreign Exchange Authority of Macau (AMCM) was created on 1st July 1989. The newly established institution was assigned with clearly defined functions and administrative, financial and patrimonial autonomy.

On 20th December 1999, the Macau Special Administrative Region was established upon the return to the motherland. In order to be more in line with common practice, the name of the institution has been simplified as 'The Monetary Authority of Macau' while the abbreviation, AMCM, which has been in use since 1989, is maintained. The autonomy and all functions and responsibilities of AMCM remain unchanged.

In addition, the Macau SAR government assigned to AMCM with the responsibility of managing the reserve fund of the Macau SAR effective from the 1st of April 2000.

The Main Responsibities and Future Priorities of the Monetary Authority of Macau

The AMCM supervises the monetary, financial, foreign exchange and insurance operations according to the terms established in the regulatory statutes governing each respective area. Besides, it also advises the SAR government on policies which facilitate the sustainability of the long-term growth of the finance sector and thereby achieving the purpose of long-term financial stability and development. Besides, AMCM is also prepared for streamlining the legal framework, as well as adopting international best practices for the development of Macau as an offshore service center. AMCM is also responsible to monitor the external solvency of the local currency, the pataca, and ensure its full convertibility. In fact to promote the wider use of the pataca has been one of the major tasks during a long period of time.

Constant effort on our part to keep up with the latest developments, practices and standards of prudential supervision as recommended by international authorities will also be a continuing requirement. The local market situation will also be assessed in conjunction so that regulatory practices and standards, which can comply both with international requirements and meet local needs, can be established and updated in order to maintain financial stability in the process of the globalisation of the financial market.

For the purpose of preserving financial stability, our efforts as regulators should also be reinforced by the efforts and discipline of the management of the operators and market discipline. A minimum level of interference within the framework of supervisory requirements would allow better business growth and profitability.

On the other hand, the insurance sector needs more focus in terms of streamlining the regulatory practice and creating conditions to help the growth of the sector. Besides, more effort will be assigned in amending certain provisions of the existing relevant legislation in order to cater for the changing condition of the society and to ensure the effect of the legislation.

In regards the supervision of securities and foreign exchange brokers, appropriate legislation will be put forward in order to regulate their practice. There have been certain grey areas and malpractice in this sector and the need to put them in order is imminent.

In the area of reserves management, over the years considerable resources have been allocated in developing appropriate strategies and practical guidelines; as well as system applications in portfolio management with particular focus in risks management and optimising investment returns. The main objective is to ensure proper return of the reserves of the Macau SAR.

In the new era of the twenty first century, telecommunications will drive the development of the market place. The efficient transmission of financial information through electronic means will help increase the overall efficiency of the financial market. Internet banking, insurance and securities trading, will be much a fact of life. Different services in this internet era will be more personalised and diversified. We are preparing ourselves to tackle this challenge with appropriate regulatory and contemporary measures.

As the regulatory institution of the financial system, it is in our best interests to improve the quality and efficiency of our work through effective management of resources inside the authority including, but not limited to human resources, information technology, and channels of communication. Besides, the collection and sharing of the latest market information, increasing transparency and better communications with the market will also be effective means. At international level, strengthening the relationship with supervisory authorities in neighbouring region and overseas countries and participation of relevant activities will be our constant effort also.

In the new century, financial institutions must gradually improve professionalism and keep pace with financial development. Therefore, one of our key tasks this year will be the establishment of a training institute with the specific responsibility of training personnels in the finance sector in order to improve their quality and competency.

Apart from the constant effort of the Monetary Authority of Macau in undertaking the above-mentioned tasks within the short to medium term, we also need to focus on the long-term stable growth of the finance sector. In particular, the development of the sector in the mainland will provide ample opportunities for financial institutions which will be deemed to meet the criteria for business development in the mainland. It is our hope to contribute our part towards the long-term development of the financial services business in the mainland.

In conclusion, we must all work together and each meeting our responsibilities and reinforcing each other so that we will be in an even better position to manage and supervise an evolving, evermore complex sector in the process of the globalisation of the financial services industry.