Box 4.1

Mainland-related exposures of the Hong Kong banking sector[1]

Recently, there has been escalated interest in the growth in Mainland-related lending in the Hong Kong banking sector, as such lending has contributed a notable part to the overall loan growth of the banking sector. To better understand the situation and the risk landscape involved, the HKMA published an article titled "Mainland-related exposures" in April 2014[2]. The following paragraphs summarise the key points of the HKMA article.

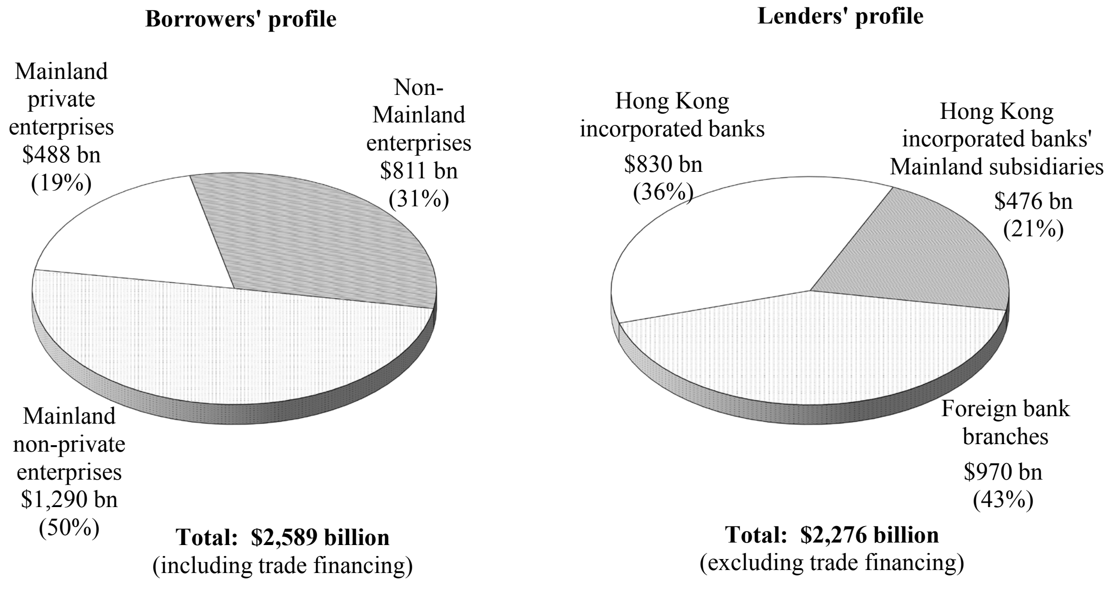
Hong Kong as a regional hub for financial intermediation

Hong Kong is a regional hub for financial intermediation. The role has become more prominent in recent years as a result of Hong Kong's increasing financial and economic integration with the Mainland and the continuous economic growth of the latter. Local and international corporates utilise the Hong Kong platform to raise funds for supporting their business ventures in the Mainland, while Mainland enterprises obtain funds here to finance their business expansion and acquisitions both on the Mainland and in other markets.

Meanwhile, foreign banks including those from Japan, Singapore, Australia and the United States recognise the unique advantage of Hong Kong and have, in recent years, increasingly participated in financial intermediation activities using their Hong Kong branches.

At end-2013, Mainland-related lending of the Hong Kong banking sector amounted to $2,589 billion, comprising $2,276 billion of customer loans and $313 billion of trade financing. Reflecting Hong Kong's status as a regional hub for financial intermediation, both the lenders and borrowers have diversified profiles. Among the borrowers, Mainland non-private enterprises, mostly large state-owned enterprises, accounted for the majority, at 50% of the total Mainland-related lending. Mainland private enterprises took up 19%, while the remaining 31% was borrowed by non-Mainland enterprises, including international corporations and Hong Kong conglomerates. On the lenders side, 43% of Mainland-related lending (excluding trade financing) was made by foreign bank branches. Hong Kong incorporated banks and their Mainland subsidiaries accounted for 36% and 21% respectively (***Chart***).

Chart : Diversified profiles of borrowers and lenders



Note: Figures in brackets denote the share of loans to the corresponding total.

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(1) This box article is jointly prepared by the HKMA and the Economic Analysis Division.
(2) For the HKMA article, please see: http://www.hkma.gov.hk/eng/key-information/insight/20140415.shtml.

Box 4.1 (Cont'd)

HKMA's regulatory framework

Given the increasing exposure of the Hong Kong banking sector to Mainland-related lending, it is important to ensure that the risks involved are properly managed. Considering the risk profile of Mainland-related lending and the high degree of heterogeneity in various aspects (e.g. lender type, borrower industry, loan use, credit risk mitigation), from the perspective of a banking supervisor, it is not appropriate to manage the risks of Mainland-related lending using across-the-board hard limits. Therefore, the HKMA's focus is on the robustness of banks' risk management systems, in particular the effectiveness of credit risk and liquidity risk management, and the resilience of banks to possible credit loss in the event of deterioration in loan quality.

Furthermore, the HKMA has stepped up its supervisory efforts in credit risk management since 2010 in light of the significant credit growth. Specifically, these efforts include: (1) regular and thematic onsite examinations of banks' credit underwriting processes; (2) Stable Funding Requirement on banks with high loan growth to ensure adequate long-term funding to support loan growth; and (3) regular supervisory stress-testing to assess banks' resilience to credit shocks.

The HKMA's assessment results show that credit risks of the Hong Kong banking sector, including those of the Mainland-related loans, are properly managed. Also, there is no sign of credit quality deterioration for Mainland-related loans. At end-2013, the classified loan ratio of the banking sector's Mainland-related lending portfolio stood at 0.29%, lower than that of the sector's total lending portfolio at 0.48%.

The HKMA will continue to closely monitor banks' asset quality and ensure that banks are resilient to credit loss throughout the economic cycle by maintaining strong capital positions and, where necessary and appropriate, regulatory reserves. It will also continue to ensure that banks will uphold their credit underwriting standards and prudently manage their liquidity risks.