The Banking Industry after the Financial Tsunami: A Hong Kong Perspective

Presented by Prof. Frederick Ma
Change in Power - Rise of Chinese Bank

Top Ten of the Banking Industry by Market Capitalization

1. Industrial and Commercial Bank of China
2. China Construction Bank
3. HSBC Holdings PLC
4. JP Morgan Chase
5. Agricultural Bank of China
6. Bank of China
7. Bank of America
8. Wells Fargo & Co
9. CitiGroup INC
10. Rodovid Bank

Source: Bloomberg, as of 31 Aug 2010
Change in Power - Rise of Chinese Bank

China Presence in Top 500 Banks by Market Capitalization

- **China**: 16.5%
- **Europe**: 14.7%
- **US**: 13.9%
- **UK**: 8.1%
- **Japan**: 5.0%
- **Brazil**: 4.8%
- **Canada**: 4.4%
- **Australia**: 4.4%
- **Switzerland**: 3.0%
- **Others**: 25.1%

Source: Bloomberg, as of 31 August 2010

*HONG KONG - New Role, New Growth*
Change in Power - Rise of Chinese Bank

Overseas Acquisition and Expansion of Chinese Bank

• Acquisition – ICBC acquires ICBC Asia (10 Aug 2010)
  BOC acquires Heritage Fund Management SA (23 Jul 2008)
  CMB acquires Wing Lung Bank (2 June 2008)

• Joint Venture – BOC & Temasek Holding (15 Mar 2010)
  CCB & Bank of America (6 Sep 2007)
  ABC & Credit Agricole SA (23 Sep 2006)

Source: Bloomberg
Changes in Business Mix (Global)

Trading Activity of Complex Products

Trading Activity of Credit Default Swaps

Trading Activity of Equity-linked contracts

Trading Activity of Foreign Exchange Contracts

Trading Activity of Interest Rate Contracts

Source: Bank of International Settlement
Changes in Business Mix (Global)

Consumer Credit Outstanding in US
(Billions of dollars, not seasonally adjusted)

Yr 2005  2291.7
Yr 2006  2385.7
Yr 2007  2522.8
Yr 2008  2561.1
Yr 2009  2448.8
Yr 1H 2010 2418.5

Source: Board of Governors of the Federal Reserve System
Changes in Business Mix (Global)

Fall of Investment Banks

• De-leveraging & Written Down of Market Capital
  – Market cap by 40% (on average) after crisis
  – I-banks used to be highly leveraged: Bear Stearns – 30X (equity)

• Falls – Bear Stearns acquired by JP Morgan Chase (16 Mar 2008)
  – Merrill Lynch acquired by Bank of America (14 Sep 2008)
  – Lehman Brothers bankrupted (15 Sep 2008)

• Transformation – Goldman Sachs and Morgan Stanley transform from independent investment banks into commercial banking holding companies. (22 Sep 2008)

Source: Bloomberg
Changes/Challenges of Business Mix (HK)

Loan Growth by Type

- Trade Finance
- Loan for use in HK
- Loan for use outside HK

Loan Growth by Sector (Use in HK)

- Mortgage
- Financial Concerns
- Construction, Property Development/Investment
- Credit Card

Source: HKMA

HONG KONG - New Role, New Growth
Changes/Challenges of Business Mix (HK)

Low Interest Rate Environment – Pressure on Net Interest Margin(%)

Source: Banks & Fitch

Source: HKMA

<table>
<thead>
<tr>
<th>Year</th>
<th>Bank</th>
<th>Year 2007</th>
<th>Year 2008</th>
<th>Year 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>HSBC</td>
<td>2.37%</td>
<td>2.36%</td>
<td>1.92%</td>
</tr>
<tr>
<td></td>
<td>HSB</td>
<td>2.23%</td>
<td>2.36%</td>
<td>1.90%</td>
</tr>
<tr>
<td></td>
<td>BOCHK</td>
<td>2.07%</td>
<td>2.00%</td>
<td>1.69%</td>
</tr>
<tr>
<td></td>
<td>BEA</td>
<td>1.90%</td>
<td>1.85%</td>
<td>1.80%</td>
</tr>
<tr>
<td></td>
<td>DBS HK</td>
<td>2.36%</td>
<td>2.02%</td>
<td>2.05%</td>
</tr>
<tr>
<td></td>
<td>Wing Hang</td>
<td>1.90%</td>
<td>1.84%</td>
<td>1.82%</td>
</tr>
</tbody>
</table>

Source: HKMA
Changes/Challenges of Business Mix (HK)

Banks strike for Loan Growth

(HKD, in Billions)

- Loans in HK
- Loans outside HK
- Trade Finance
- Others

Source: HKMA
Changes/Challenges of Business Mix (HK)

Expansion of RMB Business

Total RMB Deposits

No of Authorized Institutions

(RMB, in Millions)

Source: HKMA
Challenges from Current Business Mix

• Growth opportunities: Private Banking
  – Emerging wealth management business from High-Net-Worth-Individuals from Mainland China

• Industry responses in face of new opportunities:
  – Major banks to increase headcounts in Asia-Pacific to serve the growing high-earning segment
Change in Regulatory Environment (US)

Dodd-Frank Wall Street Reform and Consumer Protection Act (Effective 21 Jul 2010)

- Promote the financial stability of the United States by improving accountability and transparency in the financial system
- To end "too big to fail"
- To protect the American taxpayer by ending bailouts
- To protect consumers from abusive financial services practices
Change in Regulatory Environment (US)

Key provisions:

• Increasing monitoring, supervision and investor protection
  – Enhanced capital requirement and leverage limit

• Expanded scope of liquidation to prevent “too big to fail”
  – Orderly Liquidation Authority

• Strengthened Volcker Rule and bank regulation
  – Prohibitions on proprietary trading and investment in & sponsoring PE/ HF

• Increased regulation of OTC Swap Market
  – From OTC to exchange traded
Change in Regulatory Environment (EC)

• New regulatory bodies created on 23 Sep 2009 with increased regulatory power
  – European Systemic Risk Board (ESRB)
  – European System of Financial Supervisors (ESFS)

• Establishment of European Securities and Markets Authority (ESMA)
  – Includes provisions to prohibit financial products when there is a risk to investor protection
  – Widens scope of the ability to develop technical binding standards
Change in Regulatory Environment (UK)

From Financial Services Authority (FSA) to Bank of England (BOE)

• Announcement on 16 Jun 2010 of the plan to abolish the FSA & separate its responsibilities to new agencies & BOE

• New bodies that will be in operation by the end of 2012
  – Financial Policy Committee
  – Prudential Regulation Authority
  – Consumer Protection Markets Authority
  – Banking Commission
Change in Regulatory Environment (HK)

• Guideline on Remuneration System

HKMA
- Adopt Fixed and Variable Incentives, Mix of instruments or Long Term Performance
- Include both financial and non-financial factors
- Impact on AI’s supervisory CAMEL rating and existing minimum capital requirements
- Enhance public disclosure of remuneration
- Expect to take prompt action and achieve consistency with its principles within 2010

Source: HKMA & SFC
Change in Regulatory Environment (HK)

- **Business practices (Wealth Management)**
  - Physical Segregation of Business
  - Full Audio Recording for Investment Transactions
  - Enhanced Suitability
  - Pre-investment Cooling Off Period (PICOP)

- **SFC**
  - New Structured Investment Product Handbook
  - Cooling Off Period for Long Tenor Products
  - Investors Characterization
Latest Development in Regulatory Environment

• The Basel III Accord (Basel Committee on Banking Supervision)
  – Time Frame – phase in from 1 January 2013 through to 1 January 2019

<table>
<thead>
<tr>
<th>Calibration of the Capital Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital requirements and buffers (all numbers in percent)</td>
</tr>
<tr>
<td>Minimum</td>
</tr>
<tr>
<td>4.5</td>
</tr>
<tr>
<td>Conservation buffer</td>
</tr>
<tr>
<td>Minimum plus conservation buffer</td>
</tr>
<tr>
<td>Countercyclical buffer range*</td>
</tr>
</tbody>
</table>

* Common equity or other fully loss absorbing capital

➢ Banks in HK are not much affected in view of current capital level
  (average Total Capital = 15.7%, Common Equity ≈ 10.4%)

Source: Bank of International Settlement
Conclusions – A HK Perspective

We are faced with the challenges...
- To repair professional/industry image
- To regain investor/consumer confidence
- To adjust business strategies in light of more stringent regulatory & operating environment
Conclusions – A HK Perspective

Yet with the new opportunities...

- Increased mobility: Cross-border businesses & new potential customer group - Mainlanders
- The Internationalization of RMB:
  - Hong Kong’s role as the offshore RMB center
  - Potential development of a whole range of RMB products

What to expect?
- Local banking industry will continue to be competitive
- Mainland Chinese banks’ presence will be stronger in the future (M&A?)
Thank You