Reference Note

Stable Funding Requirement (SFR)

Background

Introduction to the SFR

1. In October 2013, the HKMA wrote to certain banks with significant loan growth to inform them that they would be required to maintain longer term stable funds to support their lending business from 2014 onwards if their loan growth in 2013 exceeds the banking sector's average.

2. The stable funding ratio in respect of the SFR is determined based on the pace of banks' loan growth. The higher the pace of loan growth, the higher the required ratio. The HKMA will regularly review the parameters in SFR calculation to take into account market conditions.

3. In calculating the stable funding requirement, consideration is given to available stable funding sources of banks including total customer deposits and capital base. Other term funds including net borrowing from Head Office / overseas offices, net inter-bank borrowings and negotiable debt instruments issued with remaining maturity over 6 months are also considered.

Reason for introducing the measure

1. An objective of the HKMA's policies is to maintain the stability of the banking system. Therefore, the HKMA has been closely monitoring the developments in local and overseas financial markets and has been paying attention to banks' business plans, their funding strategies and how they manage their liquidity risk. The HKMA also requires banks to adopt prudential measures to ensure that they have sufficient capacity to address

potential risks arising from possible significant fund outflows from Hong Kong.

2. While the overall liquidity of Hong Kong's banking system remains stable, the HKMA believes that it is necessary to take precautionary steps to reduce the impact of potential financial market instability on the banking system, the credit market and the local economy. The SFR measure requires banks to hold a certain proportion of stable funds so that these funds can support banks' lending businesses even if market liquidity should come under significant stress as a result of fund outflows.

<u>Q&A</u>

Q1. ***Other than an increase in loan growth, is this a precautionary measure in response to future US Fed tapering plan which may trigger possible significant fund outflows from Hong Kong? Has the HKMA noticed fund outflows? Does the introduction of this measure reflect an increase in credit risk or serious liquidity problem in Hong Kong banking sector?***

A1. The HKMA has been closely monitoring the developments in local and overseas financial markets. So far we have not identified any irregularities in the local banking sector or individual banks that might be caused by recent volatility in emerging markets. Statistical data indicate that the overall liquidity of Hong Kong's banking system remains stable and loan-to-deposit ratio still stands at an acceptable level. The measure introduced by the HKMA aims at ensuring that banks have sufficient capacity to address potential risks arising from possible significant fund outflows from Hong Kong so as to reduce the impact of financial market instability on the banking system, the credit market and the local economy.

Q2. ***Can you tell us the names of the banks which the HKMA has written to and what was the selection criteria? Whether local banks, Mainland banks, or foreign banks are mostly affected?***

A2. Up to the end of March 2014, 69 banks with relatively rapid loan growth were notified of the SFR measure. Banks with relatively narrow local customer deposit base but rapid loan growth are mostly affected.

Q3. ***According to the HKMA's assessment, how much stable funding should the industry reserve to fulfill the new requirements?***

A3. While banks have always maintained sufficient funds to support their lending businesses, the SFR measure requires affected banks to enhance the stability of their funds. Therefore, it is inevitable that the market demand for long-term funds will increase. When considering the introduction of this supervisory requirement, the HKMA has been cautious and conscious of the need to avoid unnecessary impact on the interest rate market. For example, we scheduled the SFR measure to be implemented from 2014 onwards so that affected banks would have sufficient time to make appropriate arrangements for their lending businesses and stable funds.

Q4. Is the SFR measure too strict? Has the measure overly interfered with banks' business operations?

A4. An objective of the HKMA's policies is to maintain the stability of the banking system. The SFR measure aims at ensuring that banks have sufficient capacity to address potential risks arising from possible significant fund outflows from Hong Kong so as to reduce the impact of financial market instability on the banking system, the credit market and the local economy. Affected banks had been given sufficient time to make appropriate arrangements for their lending businesses and stable funds.

Q5. Is the SFR an on-going supervisory measure or an ad hoc requirement created to address the current market environment? To what level should credit growth decrease before the HKMA considers easing this measure? Is the measure different from the tenor matching requirement observed by certain foreign bank branches?

A5. The SFR can be perceived as an on-going supervisory measure. The HKMA will regularly assess the market conditions and adjust the measure when necessary. Relevant considerations include credit growth rate of the banking system, structure of banks' funding source, interest rate market environment, and the risk of possible significant fund outflows from Hong Kong.

In the second half of 2011, the HKMA gradually required the Hong Kong branches of certain foreign banks to observe the tenor matching requirement to ensure that they have sufficient liquid funds. The SFR is a continuation of the tenor matching requirement to further enhance banks' liquidity risk management.

Hong Kong Monetary Authority
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