CONSUMER COUNCIL

Are Hong Kong Depositors Fairly Treated ?

A Summary and Conslusion
Prepared by the Consumer Council
Steering Group on Financial Services Based on
the Consultants Report
"An Evaluation
of the Banking Policies and Practices
in Hong Kong –
Focusing on their Impacts on Consumers"

28 February 1994

I. BACKGROUND

In his Policy Address to the Legislative Council in October 1992, the Governor, the Rt. Hon. Chris Patten, called upon the Consumer Council to join forces with the Government to work towards the development of a comprehensive competition policy for Hong Kong. In response to the Governor's call, the Consumer Council set up a Working Group on Competition Policy to identify unfair, discriminatory or anti-competitive business practices in Hong Kong and to consider how these affect consumer interests.

Services provided by banks have become essential to the daily life of the consumer with the emergence of an increasing number of new products in the banking sector. Correspondingly, the number of consumer complaints made to the Consumer Council has steadily increased indicating an obvious need to examine the causes of this consumer dissatisfaction.

In the course of this study, the Consumer Council has considered it necessary to make an overall assessment on the competition environment of the banking sector. In order to enable the Consumer Council to receive more expert advice on the issue, a Steering Group was set up. It consists of -

Chairman

Prof the Hon Edward CHEN Kwan-yiu
Director
Centre of Asian Studies
The University of Hong Kong

Members

Ms Betty HO May-foon
Lecturer
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School of Economics and Finance
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The Council has secured the service of a Consultancy Team from the Department of Economics & Finance of the City Polytechnic of Hong Kong. The Team consists of -

Coordinators

Prof Richard HO Yan-ki
Dr Stephen CHEUNG Yan-leung

Members

Dr HUANG Guobo
Dr Terence KHOO
Dr LIM Kok-chew

The views expressed in this part of the report are that of the Consumer Council after taking the findings and views of the Consultancy Team and the Steering Group into consideration. The findings of the consultants report form the latter part of this report.

The Consumer Council would like to sincerely thank the Members of the Steering Group, the Consultancy Team and all those who have contributed towards this study.

II. OBJECTIVE

The study evaluates the impact of banking policies and practices on consumers. It examines the market environment by looking into the existing legal and regulatory framework within which the market operates, market structure and degree of concentration, market behaviours and information disclosure.

This study is conducted under the constraint of certain data and information being unavailable to the Consumer Council (This is one of the reasons to support our recommendation for more information disclosure). The issues being raised in this study will heighten the public awareness on the working of Hong Kong's banking sector and will provide the basis for discussions on recommendations for improvement.

The preliminary report of the study has been sent to the Hong Kong Monetary Authority (HKMA), Secretary for Financial Services and the Hong Kong Association of Banks (HKAB) for consultation.

III. INTEREST RATE AGREEMENT

The study clearly bears out the existence of a monopsonistic market for deposits below HK$100,000 or for deposits below HK$500,000 that has less than three months' maturity in Hong Kong. This is created by (1) the existing legal and regulatory framework and (2) the lack of substitutes for the same products.

1. Legal and Regulatory Framework

(a) Hong Kong Association of Banks Ordinance:

Section 12(1)(a) - allows HKAB to make rules regarding the maximum rates of interest. Such "Rules on Interest Rates and Deposit Charges" generally apply to HK dollar deposits of $500,000 or less having a maturity below 15 months. This is referred to as the Interest Rate Agreement (IRA);

Section 21(1) - empowers HKAB to discipline any of its members to the point of expulsion from HKAB for "breach of any rule made pursuant to Section 12(1)" including the interest rate caps.

(b) The Banking Ordinance Sections (12) & (14):

It imposes legal barriers to entry by allowing Restricted Licensed Banks (RLBs) and Deposit-Taking Companies (DTCs) to take only deposits with values higher than HK$500,000 and HK$100,000 respectively. Also, DTCs shall not, without the written approval of the Monetary Authority, repay any deposit within a period of less than 3 months. RLBs and DTCs are therefore prevented by the Ordinance to take "small deposits" and deposits of shorter maturity (Appendix 1).

2. Lack of Substitutes

The monopsonistic structure is further secured by the lack of substitutes for "small deposits". There are no close substitutes for deposits governed by the Interest Rate Agreement. Even when close substitutes did emerge, HKAB would impose regulations to restrict them.

(a) HKAB contends that there are four types of financial instruments which can serve as substitutes, namely, swap deposits, US$ deposits, saving plans and money market funds.

These are not close substitutes due to their lack of liquidity and/or minimum deposit requirements.

(b) Evidence shows that when close substitutes did emerge, HKAB would impose regulations to restrict them. For example, when it came to HKAB's attention that some banks offered to automatically transfer funds from a customer's saving account to his own checking account whenever checks are drawn, HKAB disallowed such innovation to continue. Determined action has been taken to uphold HKAB's rule of no interest payment to checking accounts.

(c) HKAB's rules of not admitting any non-members to get access to the clearing services of the HKAB Clearing House further impedes the development of close substitutes such as money market fund to deposits with Licensed Banks (LBs).

The existing legal provisions, creating a cartel and imposing an effective barrier to entry, are detrimental to market competition. Further, it has a discriminating effect on the small depositors, particularly when close substitutes are not available.

IV. MARKET BEHAVIOUR - INTEREST RATE SPREADS

A comparison of interest rate spreads in Hong Kong (i.e. between its cost of funds and lending rates) with that in other countries reveals that the market behaviour of banks in Hong Kong exemplifies a monopsonistic banking structure. Since interest rate spread is one of the most important determinants of a bank's profitability, it is a valid basis for comparison and for the estimation of monopsonistic rent that banks have extracted.

This study compares three types of interest rate spreads in Hong Kong over a period of 13 years (1978-91) with other important international financial centres such as US, Japan, UK, Australia, Malaysia and Singapore (Appendix 2). The findings are as follows:-

1. **Prime - HIBOR Spread :**

The prime rate - HIBOR spread is not determined by HKAB but adjusts itself according to the market cost of funds. Compared with the other countries, Hong Kong's spread exceeds only those of Japan and U.K. This demonstrates that in the absence of HKAB's rule or the Interest Rate Agreement, interest rates spread is closely in line with the international level.

2. **Prime - fixed-deposit rate spreads :**

The spreads for Hong Kong are consistently higher than those in the other countries; the average of the Hong Kong spreads is 1.65% per annum above that of other countries across all the maturities.

3. **Prime - savings rate spread :**

The spread for Hong Kong is estimated to be 1.79% in average higher than that in the other countries.

Since the linked exchange rate system was introduced in October 1983, fluctuations in the exchange rate between HK$ and US$ have been stabilized. In an unregulated and free market, the US$-denominated deposit rates and HK$-denominated deposit rates will be closely in line with each other. Under HKAB's restrictions, however, the interest rates of US$-denominated and HK$-denominated deposits in Hong Kong behave differently. This is reflected in the following two types of comparisons, inter-country and intra-country, between US$ and HK$ deposit rates after the exchange rate link (Appendix 3). The spreads are adjusted for the estimated foreign exchange fluctuation of 0.1% per annum.

1. **Inter-country Comparison :** US based US$ vs HK based HK$ fixed deposit rates.

In this comparison, depositors in Hong Kong tend to get paid approximately 2.2% - 2.6% lower than if they had invested their money in the U.S. in fixed deposits.

2. **Intra-country Comparison:** US$ vs HK$ savings rate with the same bank in Hong Kong

In this comparison, there is no difference in operating costs for the two savings deposit accounts. Yet the average forgone interest by depositors who deposit their money into the HK$ savings account instead of the US$ savings account is approximately 0.6% per annum.

The results show that except for the prime-HIBOR spread which is closer to international trend, the other interest rate spreads are all higher in Hong Kong than in other countries. An important point to note is that while the HIBOR rate is not regulated by HKAB and is determined by market forces, the fixed deposits rate and savings deposits rate are the subject of HKAB's Interest Rate Agreement.

The series of comparisons mentioned above clearly indicate that in Hong Kong, those making small or short maturity deposits are worse off than their counterparts in many other countries. The comparisons also highlight the crucial question of why those depositors are constantly paid a lower interest rate.

It might be argued that the wider spreads in those types of deposits are justified by the higher operating costs of banks in Hong Kong. However it should be noted that whereas the average prime-fixed deposit rate spread and the prime-savings rate spread are deviating from international trend in favour of the banks in Hong Kong, the average prime-HIBOR spread is the lowest of the three comparisons and is closer to international trend. This is due to the fact that whereas the HIBOR rate is determined by market forces and not by HKAB's Interest Rate Agreement, the relevant interest rates of the deposits in question are determined by HKAB. In view of the discriminatory practices of the banks in determining interest rates, we can see very little ground to justify wider interest rate spreads on the basis of higher operating costs.

Further, it should also be noted that the spread comparisons are made on the basis of prime rates only. It is understood that it is the practice of banks to impose a higher lending rate by adding to the prime rate a percentage of risk factor to offset any risk elements. That is to say the actual lending rates will usually be higher. Therefore the comparatively wider interest rate spreads in deposits in Hong Kong cannot be justified by higher risk factor in Hong Kong.

V. MONOPSONISTIC RENTS

Monopsonistic rent refers to the super-normal (abnormal) profit extracted by banks operating within the monopsonistic structure of the deposits market under the HKAB rule. We use the term "monopsonistic", as opposed to "monopolistic", because banks are buyers rather than sellers in the deposits market.

The total monopsonistic rent represents the monopsonistic rents extracted from three types of deposits that are subject to HKAB's restrictions: demand deposits, saving deposits and time deposits. The monopsonistic rents extracted from savings and time deposits are calculated by multiplying the net interest rate spread (between Hong Kong and other countries) to the total deposits that are covered by HKAB's rule in the respective years. (Detail calculations of the three deposits are set out in Appendix 4).

We have applied two ways of measuring the monopsonistic rents: 1. using yearly interest rate spreads, and 2. using average interest rate spreads. The results are illustrated below. Due to the lack of comparative interest rate data in other countries, monopsonistic rents for 1992 and 1993 have not been calculated.

1. Measuring Monopsonistic Rents by Using Yearly Interest rate Spreads

The monopsonistic rent extracted from depositors under the existing monopsonistic banking structure is assessed to be as much as **$5.17 billion HK$ dollars for 1991, representing about 0.8% of the GDP**. The estimated monopsonistic rents from 1987 to 1991 is shown in the table below.

Estimated Monopsonistic Rents using yearly Interest Rate Spreads (HK$ Billion)

Year	Estimated Monopsonistic Rents from			Total Monopsonistic Rents Extracted from HKAB Depositors	
	Demand Deposits	Savings Deposits	Time Deposits	Total Amount	As a % of GDP
1987	0.37	0.69	0.16	1.23	0.33
1988	1.19	0.92	0.32	2.43	0.56
1989	2.44	0.19	0.58	3.21	0.64
1990	2.63	0.06	0.80	3.50	0.62
1991	2.56	1.63	0.99	5.17	0.80

2. Using Average Interest Rate Spreads

When applying an average interest rate spreads over a period of 1978-1991, **the estimated results from the alternative method show that the monopsonistic rents for 1991 and 1992 are HK$7.4 billion and HK$6.4 billion respectively.**

This method takes into account of a relatively long history of earnings of banks. It provides a meaningful analysis of bank profits as it accounts for the impact of different business cycles across the globe on both the interest rate environment as well as the profitability of banks.

Notwithstanding the insignificant difference in the estimates derived from the two methods, it is important to emphasize the degree rather than the exact amount of monopsonistic rents extracted by the banking sector.

Equity Issue

From whose pockets are these monopsonistic rents extracted? The answer is obvious: the banking sector, by imposing restrictions, taxes the less interest-sensitive and small depositors. The reason is that the more interest-sensitive can always switch to other market instruments, e.g. money-market funds, while small depositors cannot. These small depositors bearing the monopsonistic rents are mainly the young, the old, and the poor. It raises an important public policy issue and equity issue that whether the Government intends to tax these segments of the public to maintain the monopsony.

VI. JUSTIFICATION/NONJUSTIFICATION OF A MONOPSONISTIC STRUCTURE

1. Stability

The Consumer Council sees no ground to the argument that the Interest Rate Agreement introduced in 1964 should be maintained in order to guard against emergency of risky investments by banks arising from the cut-throat competition amongst banks.

The circumstances have changed since then. The banking sector is now more stable and is subject to the vigilant supervision of HKMA. In fact the key factor to bank stability is to reinforce the regulatory measures rather than to endorse monopsonistic practices.

Recent innovations in the market place to circumvent the interest rules send a strong signal that changes are required in the banking system and a prolonged artificial suppression of the market force can no longer be justified. In the US, innovations that circumvent the regulations in the financial sector resulted in a disintermediation process of deregulation. The International Monetary Fund (IMF) also states that the same is true for Nordic countries, i.e. Denmark, Sweden, Norway & Iceland. There is no reason why this would not occur in Hong Kong.

In the interest of long term stability, the Consumer Council is convinced that the gradual change now proposed is better than a sudden and forced transition. By taking the incentive now, we will be able to control the pace of deregulation, thus avoiding the "sudden impact". It would be judicious for Hong Kong to anticipate problem and work towards removing anti-competitive restriction.

Problems encountered in the banking systems overseas are said to have multiple causes, one of which is the inability of the regulator in keeping up with the developments. The Consumer Council is confident that effective measure will be taken by HKMA in implementing the deregulation that has been proposed. If necessary, HKMA can introduce additional regulation and supervisory measures to tackle any teething problems.

Equity Issue

Even if the stability argument were to be taken on board, the cost in terms of monopsonistic rent paid by "small depositors" for maintaining such short-run stability and deferring deregulation of the interest rate rules is too high to be justified on an equity basis.

Resource Allocation Issue

It is argued that by restricting entry and allowing LBs to extract monopsonistic rent, the incentive for LBs to engage in risking-taking activities can be removed. However, under this regulation, there is no limit to the monopsonistic rent to be extracted from the small depositors. Further, the wide interest rate spread distorts the saving pattern of the depositors. Many have invested disproportionately in real estate rather than in bank deposits, causing the crowding out of other business investments and bringing about inflationary pressure to the economy. The outcome is the distortion of resource allocation in the economy.

2. Operating Costs

There is no evidence to show that the operating costs for banks in Hong Kong are higher than those in most other countries. This is borne out in the prime-HIBOR spread which shows that the spread for Hong Kong is below most of the countries compared except Japan and United Kingdom. This suggests that banks in Hong Kong do not require a relatively higher spread to pay for higher operating costs.

HKAB warned that "banks would respond to deposits rate deregulation with higher service charges, including charges for many services now provided for free." The Consumer Council sees no reason why it should be so.

Firstly, a survey on bank charges has found that most services of banks are certainly not free. In terms of the number of items charged and the amount, banks in Hong Kong are not charging less than that in other countries.

Secondly, the Consumer Council is not convinced of the logic in the argument that consumers actually derived benefits from the lower bank charges because of the higher interest spread. Consumer will truly benefit if the interest rate and banking charges are open to perfect competition. Perfect competition amongst banks will help contain charges at a reasonably low level. A good example is found in the case of real property, mortgage loan rates are outside the control of the Interest Rate Agreement. Keen competitive forces have served to minimize the undesirable effect arising from the tie-in sales of fire insurance covers. The size and asset of banks and their number of branches are not determining factors for competition in this market.

Equity Issue

Even if there are higher operating cost to be covered, why must the small depositors i.e., the young, the old and the poor, bear such costs? The Interest Rate Agreement under the HKAB rule pre-empt consumer preference of receiving less interest for more services or less services for higher interest rate returns.

3. Maintenance of Linked Exchange Rate

The assertion that the interest rate caps serve as an effective instrument to maintain the US$-HK$ exchange rate link is no longer true. Since the introduction of the 1988 "new accounting arrangements" between the then Exchange Fund and the Hong Kong and Shanghai Banking Corporation (HKBC), HKMA is no longer dependent on the Interest Rate Agreement to maintain the linked exchange rate and not HKAB.

Even if the HKMA believes that it is necessary for them to use deposits rates as a mean to maintain the linked exchange rate, the Financial Secretary can be empowered to impose control on Hong Kong dollar deposits rates.

Equity Issue

Moreover, it is unjustifiable on equity basis for small depositors, i.e. the young, and the old and the poor, to pay the monopsonistic rent and bear the cost of maintaining the linked exchange rate system. This should be a policy decision to be determined by the Hong Kong Government but not HKAB.

VII. MARKET CONCENTRATION

The Herfindahl Indices for HK$ saving deposits in all licensed banks within the period 1988-92 indicates that the market is highly concentrated. The markets for HK$ demand deposits and private residential mortgage loans in the LBs are also considered to be concentrated.

This study does not seek to prove a casual relationship exists between monopsony and market concentration or vice-versa; there may not be a cause and effect between the two. However the existence of high concentrations in HK$ deposits does point to the severity of the outcome of the legally created monopsonistic rents in "small deposits", particularly when the study findings revealed an uneven distribution of such rents in a few banks. Hence the established interest in this market is very strong. The objection against the Council's recommendation for the abolition of the Interest Rate Agreement comes as no surprise.

VIII. DISCLOSURE OF INFORMATION

Banks in Hong Kong reveal less information to the general public than banks in the US, UK and Japan. Inner reserves, breakdown of revenues and expenses, loan loss reserves and non-performing loans, maturity mismatching, detailed breakdown of loan portfolios, off-balance sheet items and foreseeable changes in financial conditions of banks are items that have been disclosed in other countries but not in Hong Kong.

More information disclosure can bring about stability in the financial sector. The reasons include:

- The practice of not revealing the whole truth of banks' financial position can induce speculation from depositors and financial analysts and hence can backfire.

- More disclosure of information can reduce risk-taking activities of banks, with the depositors, shareholders, financial analysts and the general public acting as a watchdog to discipline them. Hence, self-regulation can be encouraged.

- Disclosure of detailed information will bring about fairness to both depositors and shareholders, especially in the absence of deposit insurance where depositors are called to completely trust the regulator, who on the other hand, neither give guarantee in respect of the financial soundness of the banks under its surveillance nor underwrite any loss in the case of bank failure.

- Hong Kong's position as an international financial centre can be enhanced if banks disclose more information. In a survey conducted by an international credit rating agency using 1991 annual reports of banks, Hong Kong ranks eighth in the total of nine Asian countries in this respect. The survey reports that Hong Kong banks are jeopardising their regional competitiveness because of their lack of disclosure.

IX. TIE-IN SALES

Some banks in Hong Kong tie their mortgage loans to fire insurance, requiring customers to buy fire insurance from a designated company when they apply for mortgage loans. Other banks allow customers to choose an insurance company from an approved list.

Tie-in sales can harm the economic interest of consumers and allow a monopoly power in one market to exert influence in other market(s). A study of tie-in sales of mortgage loan and fire insurance has revealed that the linking of mortgage and fire insurance does not appear to give rise to generally higher premiums for the tied insurance. This is because keen competition exists in the loans and mortgage markets, where HKAB's control and cartel is absent. Another example of such competition can be found in the recent announcement by Hong Kong Bank and Hang Seng Bank of tightener measures for mortgage loans exceeding $5m at the end of January 1994. Other banks did not follow suit. This, too, reflects the keen competition in the mortgage loan market.

The Consumer Council considers that further investigation into this issue is necessary before a conclusion can be reached as to whether the economic interest of consumers has been adversely affected in this market. Areas that require additional study include the homogeneity of the insurance packages offered with and without tie-in arrangements, and the impact of using the amount of a mortgage loan, instead of reinstatement costs as insurance value for fire insurance purposes.

X. POLICY RECOMMENDATIONS

The Consumer Council recommends abolition of the Interest Rate Agreement and advocates for improvements in the Information Disclosure policy. A gradual approach has been proposed in order to provide lead time for implementation and to soften the impact on the banking sector.

The liberalization process will take 4 years to complete from 1994 through 1997.

Interest Rate Agreement

The Interest Rate Agreement should be abolished step by step commencing 1995 and to be completed by 1997:

1995 - to abolish the interest rate cap for time deposits;

1996 - to allow banks to pay interest on demand deposits;

1997 - to abolish the interest rate cap for saving deposits.

Information Disclosure

The process will also take 3 years to complete:

1994 - Disclosure on the asset quality of the banks namely to disclose detailed loan portfolios and loan loss reserves and non-performing loans;

1995 - further disclosure of information which would enable members of the public to assess the risk return of the bank's investment, i.e. to disclose detailed sources of income and expenses in profit and loss items and maturity mismatching and to disclose the genuine earnings (without transfer to/from inner reserves).

1996 - banks should disclose full inner reserves.

Proposed Schedule for the Implementation of Policies

Policies Recommendations	1994	1995	1996	1997
Pricing				
Demand Deposits			✓	
Savings Deposit				✓
Time Deposits		✓		
Information Disclosure				
Earnings		**D**		
Inner Reserves			**D**	
Detailed Loan Portfolios	**D**			
Detailed Profit & Loss Items		**D**		
Loan Loss Reserves & Non-Performing Loans	**D**			
Maturity Mismatching		**D**		

Notes: ✓ = Abolish interest rate rule.
D = Disclosure.

Appendices

Appendix 1

Table 1

Restriction on Deposits Imposed By the Banking and HKAB Ordinances

The Banking Ordinance, 1992, permits only three types of institutions to collect deposits in Hong Kong: Licensed Banks (LBs), Restricted Licensed Banks (RLBs) and Deposit-Taking Companies (DTCs). The following are the restrictions on the types of deposits that they are permitted to accept under the Banking Ordinance, 1992. The current restrictions have been in place since 1990, whereby the minimum deposit size of DTCs were increased from HK$50,000 to HK$100,000.

Type of Institution	Minimum Deposit Size	Minimum Maturity	Restrictions
Licensed Bank (LB)	None	None	HKAB
Restricted Licensed Bank (RLB)	HK$500,000	None	None
Deposit-Taking Company (DTC)	HK$100,000	3 months	None

Table 2

International Comparisons of Prime Rate - Inter-Bank-Offer-Rate (HIBOR) Spread

A survey of the spread of the prime rate above the inter-bank offer rate (WP) from various countries for 1/1978-12/1991. This spread gives us a measure of the relative minimum profit margins for banks across the globe. The data is from the International Financial Statistics tapes/IMF for all countries except Hong Kong. We use the Pacific-Basin Capital Market Research Centre Database (PACAP) for Hong Kong.

Countries	Prime-Inter Bank Offer Rate (%)	
	Mean	Standard Deviation
Australia	3.55	2.48
Malaysia	2.77	1.77
U.S.A.	1.87	0.73
Singapore	1.70	1.26
Hong Kong	**1.55**	**1.41**
U.K.	1.32	2.62
Japan	0.49	1.20

Table 3

International Comparison of Prime Rate - Fixed-Deposit-Rate Spread

Comparison of prime rate-fixed deposit (FD) rate spread for the one, three, six and twelve month deposits for 1/1978-12/1991. The average of Hong Kong's spreads above other countries for the all the maturities and countries is 1.65% per annum.

	Prime - Fixed-Deposit-Rate Spreads (%)			
	1 month	3 months	6 months	12 months
Hong Kong	3.99	3.78	3.50	2.90
Malaysia	3.13	2.73	2.54	2.19
Singapore	0.86	3.01	2.70	
U.S.A.	1.99	1.88	1.76	
Japan	0.73	0.71	0.82	
Summary Statistics of the size of Hong Kong's interest rate spread above the other countries				
Average	2.04	1.70	1.54	0.71
Maximum	3.26	3.08	2.68	na
Minimum	0.86	0.77	0.79	na

Table 4

Table of Average Monthly Prime-Savings Spread for Each Year, 1978-1991

The data for all countries except Hong Kong is obtained from the IMF database. For Hong Kong, we use the PACAP database. Abbreviations used: Aus=Australia, Mal=Malaysia, and Sing = Singapore

(in %)

Year	Hong Kong	U.K.	Germany	Japan	Aus.	Mal.	Sing.	H.K. Average in excess of countries
1978	4.10	3.17	4.27	3.73	1.94	2.38	2.42	1.12
1979	5.29	2.21	3.49	3.06	1.75	2.00	2.30	2.82
1980	5.63	2.04	4.09	2.85	2.00	1.52	2.35	3.15
1981	6.04	2.58	4.95	3.43	2.54	-1.17	2.94	3.50
1982	6.00	-0.58	5.96	3.56	2.22	-0.96	3.01	3.80
1983	5.75	-1.35	5.49	3.38	3.23	3.06	2.74	2.99
1984	5.56	-1.55	4.96	3.25	4.71	1.81	1.99	3.03
1985	4.77	1.20	5.09	3.10	5.50	2.40	2.94	1.40
1986	4.42	0.82	5.04	3.70	5.90	3.63	2.93	0.75
1987	4.52	0.28	5.16	3.45	6.06	5.19	3.21	0.63
1988	4.75	1.80	5.04	3.27	6.60	3.93	3.23	0.77
1989	4.71	7.84	4.44	3.32	6.42	2.40	3.00	0.14
1990	4.50	8.53	4.52	3.39	6.38	1.26	2.69	0.04
1991	4.81	6.17	4.84	3.70	5.93	0.94	2.95	0.71
Average '78 - 91	5.07	2.38	4.81	3.37	4.37	2.00	2.76	1.79

Table 5

Comparison of Fixed Deposit Rates in US and HK

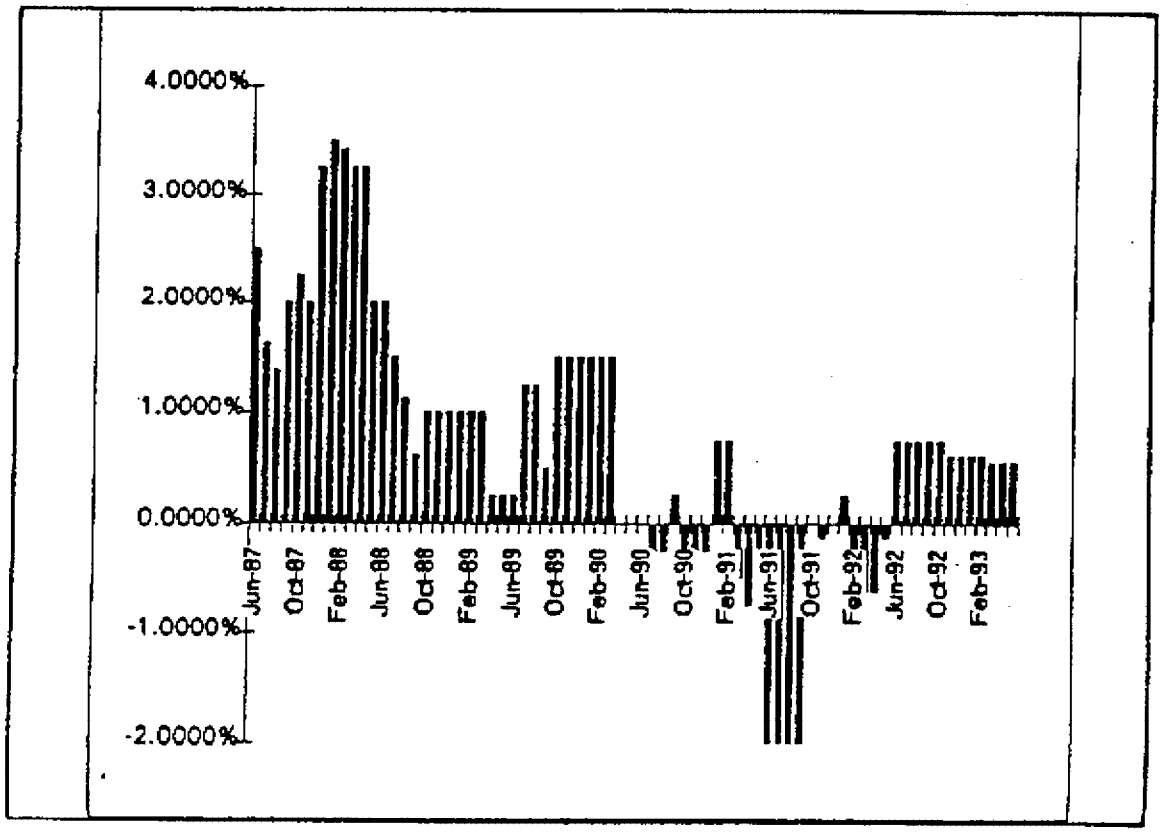
This table shows the average size of the difference of the US$-denominated FD above the alike HK$-denominated deposits.

10/83 - 12/91 (After Exchange Rate Link)	Fixed Deposits	
	1 month	6 months
Average	2.700	2.320
Standard Deviation	1.560	1.657
Min	-1.141	-1.471
Max	6.609	5.669

Figure 1

Difference of US$- and HK$-savings deposit rate from American Express Bank

A plot of the difference of the annual interest rate of a US$-denominated savings deposit above HK$-denominated savings deposit for June 1987-May 1993, as quoted by the American Express Bank.



Methodology of Calculating Monopsonistic Rents

We have applied two ways of measure to calculate the monopsonistic rents: 1. calculation based on yearly interest rate spreads and 2. calculation based on average interest rate spreads. The estimated total monopsonistic rent is the sum of monopsonistic rents extracted from three types of deposits that are subject to HKAB's restrictions: (a) demand deposits (checking accounts), (b) savings deposits and (c) time deposits.

1. Calculation based on yearly interest rate spreads

(a) Demand Deposits

The monopsonistic rent extracted from demand deposits is the interest forgone by the depositors. It is measured by multiplying the estimated interest rate forgone to total demand deposits.

The interest rate forgone can be estimated by using either

- historical actual savings rates less 1%,

or - historical actual savings rates less 1% plus prime - savings-rate spreads between Hong Kong and other countries;

where 1% represents the operating cost of a checking account above that of a savings account.

We recognize that even if banks are allowed to pay interest on checking account, a small amount of deposit may not warrant such interest payment. The information on account mix, in particular the percentage of such small amount deposit in total demand deposit, is not available. As such, we have adopted a more conservative measure by using the historical actual saving rates less 1%, without adding the interest rate spread, in order to discount the above factor from the measuring of monopsonistic rent extracted from demand deposits.

Monopsonistic Rent from Demand Deposits using yearly interest rate spread (HK$ Billion)

Year	Demand Deposits	Interest Rate Forgone (Actual Savings Rate less 1%)	Monopsonistic Rent Extracted from Demand Deposits
1987	$37	1.00%	$0.37
1988	$49	2.44%	$1.19
1989	$51	4.79%	$2.44
1990	$54	4.88%	$2.63
1991	$69	3.71%	$2.56

(b) Savings Deposits

The monopsonistic rent extracted from savings deposits is the total interest forgone calculated by using total savings deposits multiplied by the difference of prime - savings-rate spreads between Hong Kong and other countries.

Monopsonistic Rent from Savings Deposits using yearly interest rate spread (HK$ Billion)

Year	Savings Deposits	Prime-Savings Spreads for HK above that in other countries	Monopsonistic Rent Extracted from Savings Deposits
1987	$110	0.63%	$0.69
1988	$119	0.77%	$0.92
1989	$135	0.14%	$0.19
1990	$159	0.04%	$0.06
1991	$229	0.71%	$1.63

(c) Time Deposits

The time deposits that are covered by HKAB's rule is estimated to be 17.9%.

The monopsonistic rent extracted from time deposits is obtained by multiplying the yearly difference of prime - fixed-deposits-rate spreads between Hong Kong and other countries to the portion of time deposits that are covered by HKAB's rule. The latter is contained in the Annual Report of the Commissioner of Banking 1991.

Monopsonistic Rent from Time Deposits using yearly interest rate spread (HK$ Billion)

Year	17.9% of Time Deposits	Prime-FD spreads across all maturaties for HK above that in other countries	Monopsonistic Rent Extracted from Time Deposits
1987	$23	0.72%	$0.16
1988	$32	1.01%	$0.32
1989	$36	1.62%	$0.58
1990	$43	1.87%	$0.80
1991	$47	2.09%	$0.99

2. Calculation based on Average Interest Rate Spreads

(a) Demand Deposits:

$$(H - 1\%) \times \text{total value of demand deposits of each year} = \text{monopsonistic rent of the respective year}$$

where H = average historical annual savings of deposit rates in Hong Kong for 1978-91; and allowing higher operating costs for demand deposit, i.e. 1% (in the case of saving deposits, operating costs should have been included and reflected in the spread).

(b) Savings Deposits:

$$1.79\% \times \text{total value of savings deposits of each year} = \text{monopsonstic rent of the respective year}$$

where 1.79% is the average difference of prime-savings rate spread between Hong Kong and other countries for the period 1978 - 91.

(c) Time Deposits

$$1.65\% \times 17.9\% \times \text{total value of time deposits of each year} = \text{monopsonistic rent of the respective year}$$

where 1.65% is the average difference of prime-fixed deposit rate spread between Hong Kong and other countries for the period 1978 - 91; as only 17.9% of time deposit is covered by the Interest Rate Agreement, therefore the portion on which monopsonistic rents can be extracted is 0.3% (i.e. 17.9% x 1.65%) of such deposit.

Monopsonistic Rents based on average Interest-rate Spreads ($ Billion)

Year	Estimated Monopsonistic Rents from			Total Monopsonistic Rents	
	Demand Deposits	Savings Deposits	Time Deposits	Total Amount	As a % of GDP
1987	0.37	1.96	0.38	2.71	0.74
1988	1.19	2.13	0.53	3.85	0.89
1989	2.44	2.41	0.59	5.45	1.09
1990	2.63	2.84	0.71	6.18	1.11
1991	2.56	4.09	0.78	7.43	1.16
1992	1.16	4.38	0.87	6.40	0.86

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Evaluation of the Banking Policies and Practices in Hong Kong - Focusing on their Impacts on Consumers

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Executive Summary

1. The regulatory framework in Hong Kong in the form of interest rate cartel among Licensed Banks (LBs) creates an oligopsony for deposits below HK$100,000 or for deposits below HK$500,000 that has less than three months' maturity. There exists a varieties of instruments that are not governed by the interest rate cartel, e.g., CDs and swap deposits, but they are not perfect substitutes to bank deposits, especially for small depositors. The HKAB rules of not admitting any non-members to get access to the clearing services of the HKAB Clearing House further impedes the development of close substitutes to LB deposits.

2. A survey of the prime rate-interbank-offer-rate spread shows that Hong Kong spread only exceed those of Japan and the U.S. indicating that there is no evidence that Hong Kong banks require a relatively higher spread to pay for the higher operating costs. Moreover, the number of items and the amount charged by banks in Hong Kong are not less than that of other countries.

3. The prime-fixed deposits interest rate spreads for Hong Kong are consistently higher than those in other countries. The prime-savings interest rate spread is also found to be 1.79% higher than the other countries. It is also found that depositors in Hong Kong tend to get paid approximately 2.2-2.6% lower than if they had invested their money in the U.S. in fixed deposits. For savings deposits, the average forgone interest by the depositor who deposits her money into the HK$ account instead of the US$ account lost approximately 0.6% per annum, after adjusting for exchange rate changes.

4. The monopsonistic rents extracted by HKAB members are estimated to be HK$7.1 billion, HK$8.7 billion, and HK$8.0 billion for 1990-1992 representing approximately 1% of the GDP.

5. It is also found that banks in Hong Kong reveal less information to the general public compared to those in U.S. and Japan. In views of the fact that Hong Kong does not have deposit insurance and Hong Kong depositors have gained maturity over the years, it is recommended that banks should disclose more information and thus be implemented by stages over a number of years.

6. We suggest to abolish the interest rate rule over a number of years: abolish the interest rate cap for time deposits in 1995, allow banks to pay interest on demand deposits starting 1996, and abolish the interest rate cap for the savings deposit and starting 1997.

7. We suggest banks to disclose detailed information on loan portfolios and loan loss reserves & non-performing loans starting 1994; to disclose the genuine earnings (without transfer to/from the inner reserves), detailed sources of income and expenses and maturity mismatching starting 1995; and to disclose full inner reserves by 1996.

8. In studying the case of tying of mortgage and fire insurance, for banks that practice tying, we do not find any evidence suggesting that consumers are paid for a more expensive package. We, therefore, refrain to make any policy recommendations here. However, we do encourage banks that are practising tie-in sale to give consumers more freedom of choices.

I. Introduction

The objective of this research is to evaluate the impact of banking policies and practices in the banking sector on consumers. The term policy here means a broad spectrum of policies that are either explicitly imposed by the government in the forms of regulations or with an implicit endorsement by the government. It is expected that regulation would increase efficiency only when it promotes disclosure of information, offsets other government policies that reduce efficiency, or offsets imperfections in the market that reduce efficiency.

Policies can be grouped into five general categories: allocation, pricing, supervision and solvency, institutional structure, and information.

1. Allocative policies include guarantees against risk or failure, taxation, portfolio composition restrictions, and foreign exchange control.

2. Pricing policies would include interest rate policy, monetary policy, foreign exchange controls, and taxation.

3. Supervision and solvency would include solvency requirements, fitness and character, and guarantees against risk or failure.

4. Institutional structure would include structural rules, ownership requirements and the payment policies.

5. Information would include disclosure of information.

It must be emphasized that this research will focus on studying whether consumers are fairly treated under the existing policies. In this connection, the relevant policy types to be evaluated would be allocation, pricing, institutional structure, and information. As the major allocative policy, i.e., guarantee against risk in the form of deposit insurance has been examined by the government, we will put the focal point on issues relating to pricing and information and treat institutional structure as a side issue. The competitive structure in terms of market concentration will also be examined in order to shed light on the pricing and information disclosure behaviour of financial institutions.

Section II examines the pricing policy and ascertains whether the regulatory framework of the banking system in Hong Kong potentially creates a oligopolistic market of financial services, especially for small deposits (less than HK$100,000). We will also measure the monopsonistic rents collected by banks in Hong Kong.

Section III describes the institutional framework and examines market concentration of banking activities in Hong Kong. We analyze the market share of individual banks in Hong Kong on an annual basis from 1988 to 1992 for selected asset and liability items including demand deposit, savings deposit, time deposits, private residential mortgage loans, and other loans for use in Hong Kong.

Section IV analyzes the existing disclosure policy of the Hong Kong banking system and compares it with those in U.S., Japan, U.K., and Singapore. We also examine if a more complete disclosure policy is associated with a more unstable financial system.

Section V examines the practice of tie-in sales in the banking industry using the case of tying of mortgage and fire insurance.

Section VI gives the policy recommendations.

II. PRICING POLICY

Legal Structure

The intent of this section is to study the effects of the Hong Kong Association of Banks (HKAB) and the Banking Ordinances on the pricing practices in the banking industry in Hong Kong. We argue that these two ordinances create a monopsonistic market for:

(1) Deposits that are protected from competition from other types of deposit-taking companies;

(2) Deposits that have rates that are governed by the interest rate ceilings set by the HKAB Committee.[1]

By the HKAB Ordinance, deposits from (1) are also in (2). Since the list of deposits in (2) originated from the Interest Rate Agreement (IRA, 1964) amongst banks, they are sometimes referred to as IRA-covered deposits.

We estimate, conservatively, the monopsonistic rents extracted by the totality of the HKAB members to be HK$7.1 Billion, HK$8.7 Billion, and HK$8.0 Billion for 1990-1992. This represents approximately 1.29% and 1.35%, and 1.06% of the Gross Domestic Product for 1990 - 1992, respectively.

Policy implications of these results are discussed at the end of the section.

A monopsonistic market can only be maintained if there are effective barriers to entry and if there are no close substitutes. The market of interest here is the market for deposits. In this market, interest rates for most deposits below 15 months maturity are determined by the HKAB. (The only deposits that are not governed by the HKAB are deposits that non-bank deposit-taking institutions are allowed to take.) The effective barrier to entry is guaranteed by the Banking Ordinance.

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[1]We use the term monopsony, as opposed to monopoly, because banks are perceived as buyers in the deposits market. A monopolist refers to a single seller in the market.

Legal barriers to entry are discussed in detail in the first sub-section. The second sub-section discusses why there appear to be no close substitutes in the financial markets for the IRA-covered deposits. The third sub-section explains the procedures used to measure the size of the monopsonistic rents. The fourth sub-section describes the data used. The fifth sub-section approximates the size of the monopsonistic rents extracted from the economy. The sixth section explores both the related public policy issue with regard to the imposition of the monopsonistic rent and how the current system affects the market structure. Appendix II-1 responds to the "apparently" contradictory evidence provided by HKAB on interest rate spreads.

II.1. Legal Barriers to Entry

The regulatory framework in Hong Kong effectively creates an oligopsony for deposits below HK$100,000 or for deposits below HK$500,000 that have less than three months' maturity, including demand deposits. This oligopsony derives from three regulations that define the deposit-taking environment in Hong Kong. Most particularly, only three types of institutions are allowed to collect deposits: (1) Licensed Banks (LBs); (2) Restricted Licensed Banks (RLBs); and (3) Deposit-Taking Companies (DTCs). Subject to items (a) and (b) of Section 14(1) of the Banking Ordinance, RLBs and DTCs are only allowed to take deposits with values higher than HK$500,000 and HK$100,000, respectively.[2] Moreover, item (3) of Section 12 in the Banking Ordinance prohibits DTCs from taking deposits with less than three months maturity. It follows that any deposit that does not meet the requirements of either the RLBs or DTCs can only be made at a LB.

The deposit rates in LBs, however, are determined by the de facto interest rate cartel, the HKAB, which was made a statutory body in 1981. HKAB's control of the deposit rates is guaranteed by sections 7(1), 7(2), 12(1)(a), and 21(1) of the Hong Kong Association of Banks Ordinance, 1992. Sections 7(1) and 7(2) specify that all licensed banks are members of the HKAB and vice versa, with the former stating that, "Every licensed bank which is required by a condition attached to its license shall become a member of the Association and shall, subject to this section, remain a member of the Association unless expelled under 21(1)(d); and membership of the Association shall be restricted to licensed banks."

[2]The minimum amount that a DTC can accept was raised from HK$50,000 to HK$100,000 in 1990.

Section 12(1)(a) gives the HKAB the legal right to set interest-rate caps on Hong Kong dollar-denominated accounts. This is done by stating that the Committee of the Association "may, after such consultation with the Financial Secretary as he shall consider appropriate, from time to time...., makes rules-- (a) as to the maximum rates of interest, return, discount or other benefit which may be paid or granted by members, or by any specified categories of members, in respect of --

(i) Hong Kong dollar deposits of their customers;

(ii) specified instruments;...."

Finally, Section 21(1) empowers the HKAB to discipline any of its members to the point of expulsion from the HKAB for "breach of any rule made pursuant to section 12(1)" which includes the aforementioned interest-rate caps. The restrictions are summarized in Table II.1 below.

Table II.1: Restrictions on Deposits Imposed By the Banking and HKAB Ordinances
The Banking Ordinance, 1992, permits only three types of institutions to collect deposits in Hong Kong: Licensed Banks (LBs), Restricted Licensed Banks (RLBs), and Deposit-Taking Companies (DTCs). The following are the restrictions on the types of deposits that they are permitted to accept under the Banking Ordinance, 1992. The current restrictions have been in place since 1990, whereby the minimum deposit size of DTCs were increased from HK$50,000 to HK$100,000.

Type of institution	Minimum Deposit Size	Minimum Maturity	Restrictions
Licensed Bank (LB)	None	None	HKAB
Restricted Licensed Bank (RLB)	HK$500,000	None	None
Deposit-Taking Company (DTC)	HK$100,000	3 months	None

II.2. Substitutes to Bank Deposits

In theory, LBs can only collect monopsonistic rents on deposits that are not in direct competition with the DTCs and the RLBs.[3] This implies that the monopsonistic rents extracted from the financial markets by the LBs would be from small and demand depositors., where "small depositors" are defined to be depositors with insufficient wealth to lend to the RLBs or DTCs. This categorization includes investors with wealth of more than HK$100,000 or HK$500,000 for whom it is not optimal to deposit such a substantial amount of their wealth in a deposit-taking institution.

Kane's (1977; 1981) theory of regulatory dialectic suggests that the banks will find ways and means of circumventing regulations. Taking a chapter out of U.S. banking history, the interest-rate caps for deposits set by Regulation Q could not hold back the onslaught of innovations that led to the demise of the regulation itself. Innovations such as the negotiable Certificates of Deposits (CDs) and the development of the federal funds market were created by banks to evade the Reg Q interest-rate caps; see Eisenbeis (1985) for more details.

One might be tempted to apply this lesson from U.S. banking history and argue that the banking industry in Hong Kong is competitive and thus will create financial instruments that allow banks to get around the HKAB rules. Falling to the temptation, however, one loses the significance of the difference between Regulation Q and the HKAB interest-rate caps. In the case of Regulation Q, the interest rates were pre-determined by law. In Hong Kong, the interest-rate caps are reviewed and determined intermittently by the banks themselves. Thus, there is much less incentive for the banks to innovate towards newer instruments that circumvent the caps.

II.2.1 Historical Attempts to Offer Substitutes

Nonetheless there have been several historic attempts by the market agents to offer substitutes. DTCs, for instance, could offer much higher interest rates for deposits until regulations were introduced in the 1980s that restricted the types of deposits DTCs were permitted to accept; see Table II.1. Consequently, the DTC's market share of total HK$-

[3] There might be some concern about the relatively large market share of the RLBs and DTCs that are owned by the HKAB members.

denominated deposits has dropped significantly from its peak in the early 1980s. Kroszner (1990), in particular, notes that the DTC's market share of HK$ deposits (excluding current accounts) has dropped from a peak of 40% in 1981 to less than 10% in 1990.

Another innovation is the creation of swap deposits. A swap is equivalent to buying both a foreign currency-based fixed maturity deposit and a forward contract to sell the foreign currency at maturity. The forward contract insulates the depositor from any foreign exchange fluctuations. Thus this account should have the same interest rate as HK$ deposits. The absence of any interest-rate ceilings by HKAB, however, enables the banks to offer higher rates for time deposits. The only problem with swap deposits is that banks do not have any incentives to offer market rates on such deposits, as doing so would diminish the monopsonistic rent extracted from HK$ deposits. Moreover a minimum deposit is typically imposed by the banks.[4]

II.2.2 Lack of Substitutes

(a) No Close Substitutes

As we will see in section II.5.4, the main contributors of the estimated monopsonistic rent come from the savings and demand deposits. There appear to be no good substitutes for savings deposits for at least two reasons: liquidity and minimum deposits imposed on the substitutes. Suggestions that the US$ deposits and savings plans, swap deposits, US$ deposits and money market accounts are substitutes do not appear reasonable. It is because US$ deposits, swap deposits, and money market funds have minimum deposits requirements whereas the savings plans require investments at regular time intervals. Even the HKAB admitted the different functions of the HK & US savings accounts.[5] HKAB points out that the US$ and savings deposit accounts serves two different purposes: "HK$ savings accounts are used as transaction accounts, whereas US$ savings accounts are used for capital accumulation" (para.1, pp.6). Thus it would appear that the US$ deposits and for that matter, savings plans, swap deposits, and money market funds are not reasonable substitutes for savings deposits.

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[4]It has also been noted that the liquidity of these accounts are not comparable to the deposits covered by the HKAB agreement.

[5]HKAB's letter to Consumer Council dated January 14, 1994

(b) HKAB Imposes Regulations to Restrict New Substitutes

Demand deposits probably have the most significant interest-rate cap imposed on them; HKAB has ruled that its members are not allowed to pay interest on demand deposits. To get around this regulation, some banks offered to automatically transfer funds from a customer's savings account to the customer's checking account whenever checks are drawn on the checking account; see Ho, et. al. (1991). This, however, came to HKAB's attention and the automatic transfer of funds from the savings to checking account is now no longer allowed. Instead, a milder form is now in existence; customers are allowed to phone in to transfer the funds from savings to checking accounts.

(c) No Access to Clearing House Facilities Impedes Development of Close Substitutes

The other major sources of substitutes are non-"deposit taking" financial institutions. In the U.S., the "disintermediation" process was partially driven by the creation of money-market mutual funds. These money-market funds offered close substitutes to deposits because (1) they were invested in short-term fixed-rate instruments and did not have any fixed maturity or withdrawal penalties, (2) the rates were market driven, and, (3) some funds permitted drafts, effectively checks, to be written for "transactional purposes" (Eisenbeis, 1985).

Kroszner (1990), writing under the supervision of John Greenwood and for the Asian Monetary Monitor of G.T. Management(Asia) Ltd., argues that there are significant barriers to establishing a money-market funds market in Hong Kong. The two major obstacles faced by the money-market mutual fund managers are the HK$50,000 minimum investment requirement on HK$-denominated accounts imposed by the Securities and Futures Commission (SFC) and the lack of access to the HKAB's Clearing House. The former inhibits the entry of less-endowed depositors into this market, a role commensurate with the regulations governing the deposit-taking abilities of the various forms of deposit-receiving entities, as described in the previous section. The latter reduces the substitutability of mutual funds for demand deposits as it inhibits the liquidity that a money-market mutual fund can offer. Kroszner argues that the HKAB Clearing

rules "enforces practices in conformity" with HKAB's rules. To belabour the point, the HKAB rules of particular significance here are the HKAB interest-rate caps. Relaxation of these impediments to entry will enable money-market mutual funds to become much closer substitutes to deposits. Other points are the restraint on the use of terms like "deposit" and "cash" in advertisements which reduces potential investors' ability to make educated comparisons of money-market mutual funds to their meaningful substitutes.

In sum, the current regulations and market structure impose strong impedance on the market discipline of the HKAB in setting their deposit rates. Moreover, the relatively high management fees currently imposed by the fund management houses in Hong Kong make it unlikely that the money-market funds market will compete with HKAB for funds in the near future.

II.3 Measuring the Monopsonistic Rent

Empirical evidence to support the assertion that there is a significant monopsonistic rent extracted from the economy by the LBs is not readily available. One way of gauging monopsonistic rent is to compare the profitability or accounting rates of return of the buyers, in this case the LBS, with other "appropriate" industries/companies. There are two reasons for not following this approach. The most important reason is that the banks' financial statements are disclosed only when each bank's inner reserves entry is updated. As the amount in the inner reserves is not publicly available, no measure of the bank's profit margin or accounting rates of return on equity in Hong Kong is possible. There are only two Hong Kong-based banks have chosen to voluntarily reveal their inner reserves: Hong Kong Bank and its subsidiary, Hang Seng Bank. Second, Fisher and McGowan (1983), show that it is generally very difficult to infer monopoly (or monopsony) profits from accounting rates of return. Horowitz (1984), in a comment on their paper, highlights how this paper has made it very difficult to prove the existence of monopsonistic power of a firm/industry by looking at its balance sheets. The profitability of banks is also well known to be dependent on the interest-rate environment. In low interest-rate environments, i.e. when the cost of funds is low, the lending (long term) rates tend not decrease as much as the short-term interest rates. This tendency increases the profitability of banks. The point is that any meaningful analysis of bank profits has to look at a relatively long history of earnings. For instance, although the most profitable bank in the

world in 1992 was Hongkong & Shanghai Holdings PLC, the next four banks are American banks that are not amongst the top twenty largest banks in the world.[6] Any conclusion about the presence of monopsonistic rents in the banking industry in the U.S. contributing to this result would have no basis.

We would therefore propose a different measure. A readily-observed measure of the profitability of a bank is the interest-rate spreads between its cost of funds and its lending rates. Comparisons of interest-rate spreads of Hong Kong with other countries that are important financial centres, e.g. U.S., Japan, and U.K., provide us with a glimpse of the size of the monopsonistic rents, if any. For instance, the interest-rate spread between Hong Kong's Best Lending Rate and the savings/time deposit rates should be comparable to the prime-savings/time-deposit-rate spreads in other countries. If we find that the spreads in Hong Kong are larger on average than other countries, we will then proceed to compare the prime and deposit rates between Hong Kong and U.S. Such a comparison is meaningful because of the peg of HK$ to the US$; that is, any deviations in the interest rates would create arbitrage opportunities if the markets are perfect. The monopsonistic component of the spread is indicated by the U.S.-H.K. deposit spreads.

[6] See the Asian Wall Street Journal, March 18, 1993, pp.2.

II.4 Data Description

The following table describes the sources and sample period of the data:

Table II.2: Description of Data
This table lists the sources and the sample period of the data used in this report. Whenever possible, interest rate spreads are calculated from the same sources to maintain consistency.

Country	Savings	Prime	Inter-bank	C.D.(months) 1	3	6	12
U.S.		CITI (55-91) IFS (57-91)	CITI (55-91) IFS (57-91)	CITI (78-92)	CITI (78-91)	CITI (78-91)	
Japan	IFS (78-91)	IFS (78-91) PACAP (78-91)	IFS (78-91) PACAP (78-91)	PACAP (85-91)	PACAP (85-91)	PACAP (86-91)	
U.K.	IFS (57-91)	IFS (66-91)	IFS (72-91)				
Australia	IFS (73-91)	IFS (76-91)	IFS (69-91)				
Asian NICs							
Singapore	IFS (77-91) MAS (85-91)	IFS (78-91) MAS (85-91)	IFS (72-91) MAS (85-91)	MAS (85-91)	MAS (85-91)		
Hong Kong	PACAP (78-91)	PACAP (78-91)	HKMD (80-91)	PACAP (82-91)	PACAP (78-91)	PACAP (78-91)	PACAP (78-91)
Other Pacific-Basin countries							
Malaysia	PACAP (79-91) IFS (76-91)	PACAP (82-91) IFS (76-91)	PACAP (75-91) IFS (76-91)	PACAP (79-91)	PACAP (79-91)	PACAP (79-91)	PACAP (79-91)

Key: IFS = International Financial Statistics File, International Monetary Fund, CITI = Citibase, HKMD = Hong Kong Monthly Digest of Statistics, MAS = Monetary Authority of Singapore, PACAP = Pacific-Basin Capital Markets Research Centre Database, Univ. of Rhode Island.

Not described in the table are the annualized interest rates for the HK$-denominated and US$-denominated savings accounts as provided by the American Express Bank on the Sunday Morning Post (SCMP) from June 1987-May 1993. We have also used the US$-HK$ foreign exchange rates from 1975-1991 as provided in the PACAP database. We have only used data from 1978-1991 as there are no readily available data beyond these dates for most of the countries we investigate here.

II.5 Results

Four types of spreads are investigated and reported here. All four attempt to compare the profit margins of the Hong Kong-based operations with those of other countries. They are the prime rate-interbank offer rate spread, the prime rate-fixed deposit/savings spreads, the difference between U.S. and Hong Kong fixed deposit rates for similar maturities, and the difference between a U.S.-denominated and HK$-denominated savings account within the same bank in Hong Kong.

II.5.1 Prime-Interbank Offer Rates (HIBOR) Spreads

The prime rate-interbank-offer-rate (HIBOR) spread, measures the profit margin where the cost of funds is not determined by the HKAB and is closer to the market cost of funds. To be consistent, we use the available data from IMF for all the countries reported here. In the case of Hong Kong, we use the PACAP database for the prime rates and the end of the month one-month HIBOR rate published by the Hong Kong Monthly Digest of Statistics. As mentioned earlier in the section, we use the period of 1/1978-12/1991.[7] Table II.3 provides the prime-HIBOR spread for various countries.

[7]Note that for some countries, the data starts later than 1978.

Table II.3: International Comparisons of Prime rate-Inter Bank Offer Rate Spread

A survey of the spread of the prime rate above the inter-bank offer rate (HIBOR) from various countries for 1/1978-12/1991. This spread gives us a measure of the relative minimum profit margins for banks across the globe. The data is from the International Financial Statistics tapes /IMF for all countries except Hong Kong. We use the PACAP database for Hong Kong.

	Prime-Inter Bank Offer Rate	
Countries	Mean	Standard deviation
Australia	3.55	2.48
Malaysia	2.77	1.77
U.S.A.	1.87	0.73
Singapore	1.70	1.26
Hong Kong	**1.55**	**1.41**
U.K.	1.32	2.62
Japan	0.49	1.20

There is no evidence from this table that suggests that Hong Kong banks require a relatively higher spread to pay for higher operating costs. Hong Kong's spread exceeds only those of the Japan and United Kingdom.

II.5.2 Prime-Fixed Deposits and Prime-Savings interest spreads

This spread uses deposits of fixed maturity of one-, three-, six-, and twelve-months. Due to the great variation in terms used for fixed maturity deposits in the various countries investigated, we refer to the fixed maturity deposits as fixed deposits (FDs). In this case, if the deposited amount is lower than $500,000 for the case of one-month maturity, and lower than $100,000 for the three-, six-, and twelve-month maturities, the HKAB rules will prevail. Hence these spreads in Hong Kong incorporate the monopsonistic rent that HKAB can extract from its depositors. A comparison of these spreads with those of the prime-FD and prime-Savings spreads in the various countries yields a sense of the size of the monopsonistic rent that HKAB is able to collect from its depositors because of its legalized cartel structure. Table II.4 presents the spreads, ordered in decreasing spreads for the Prime-Fixed Deposit spread, for various

countries. Except for U.S. and Singapore, all these spreads are calculated from the PACAP database, as listed in Table II.2. For the U.S., we use CITIBASE and the figures published by the Monetary Authority of Singapore.

Table II.4: International Comparison of Prime-Fixed Deposit
Comparison of prime rate-fixed deposit (FD) rate spread for the one, three, six, and twelve month deposits for 1/1978-12/1991. The average of Hong Kong's spreads above other countries for the all the maturities and countries is 1.65% per annum.

	Prime - Fixed term Deposit			
	1 mth	3 mth	6 mth	12 mth
Hong Kong	3.99	3.78	3.50	2.90
Malaysia	3.13	2.73	2.54	2.19
Singapore		3.01	2.70	
U.S.A.	1.99	1.88	1.76	
Japan	0.73	0.71	0.82	
Summary statistics of the size of Hong Kong's interest rate spread above the other countries				
Average	2.04	1.70	1.54	0.71
Maximum	3.26	3.08	2.68	na
Minimum	0.86	0.77	0.79	na

The prime-FD interest-rate spreads for Hong Kong are consistently higher than those in the other countries. The average prime-FD interest-rate spreads of other countries, below that of Hong Kong's, range from 0.71% to 2.04% per annum. The average of the Hong Kong spread above the spread for all countries across all the maturities is 1.65% per annum. Figure II.1 is a histogram of the prime-FD spread for the maturities: one month, three months, six months, and twelve months, for the various countries for 1/1978-12/1991.

Figure II.1:Plot of Prime-Fixed Deposit Spreads
A plot of the (prime - Fixed deposit) rate spreads of Hong Kong, U.S., Singapore, Malaysia, and Japan for 1/1978-12/1991. The maturities are 1-, 3-, 6-, and 12-months.

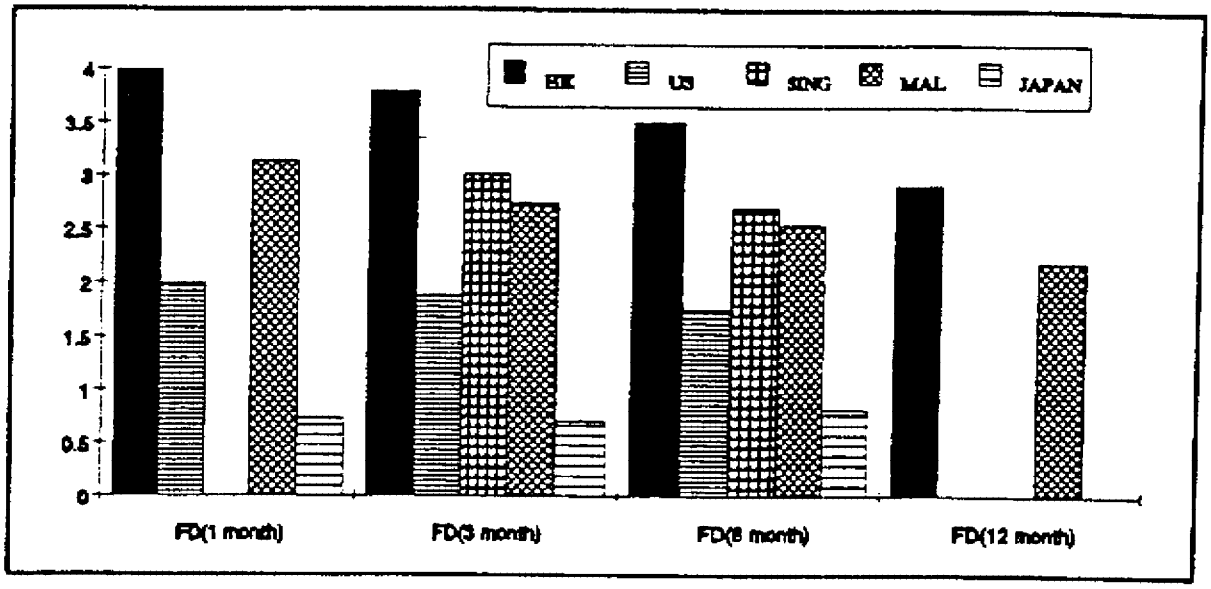


Table II.5 shows a similar trend for the prime-savings spread for 1/1978-12/1991 as well. On average, it is 1.79% per annum higher than the other countries. The difference in spreads of Hong Kong above other countries range from 0.26% (Germany) to 3.07% (Malaysia).

Table II.5 International Comparison of Prime-Savings Spreads
The average prime-savings spreads for the different countries from 1/1978-12/1991. We used the data from IFS/IMF for all countries except Hong Kong. (Hong Kong's data is not reported by the IMF.) We use the PACAP database for Hong Kong's case.

	Prime - Savings		Hong Kong
	Mean	Std Dev	- others
Hong Kong	5.07	0.69	
Germany	4.81	0.67	0.26
Australia	4.37	1.99	0.70
Japan	3.37	0.32	1.70
Singapore	2.76	0.83	2.30
United Kingdom	2.38	3.23	2.69
Malaysia	2.00	1.78	3.07

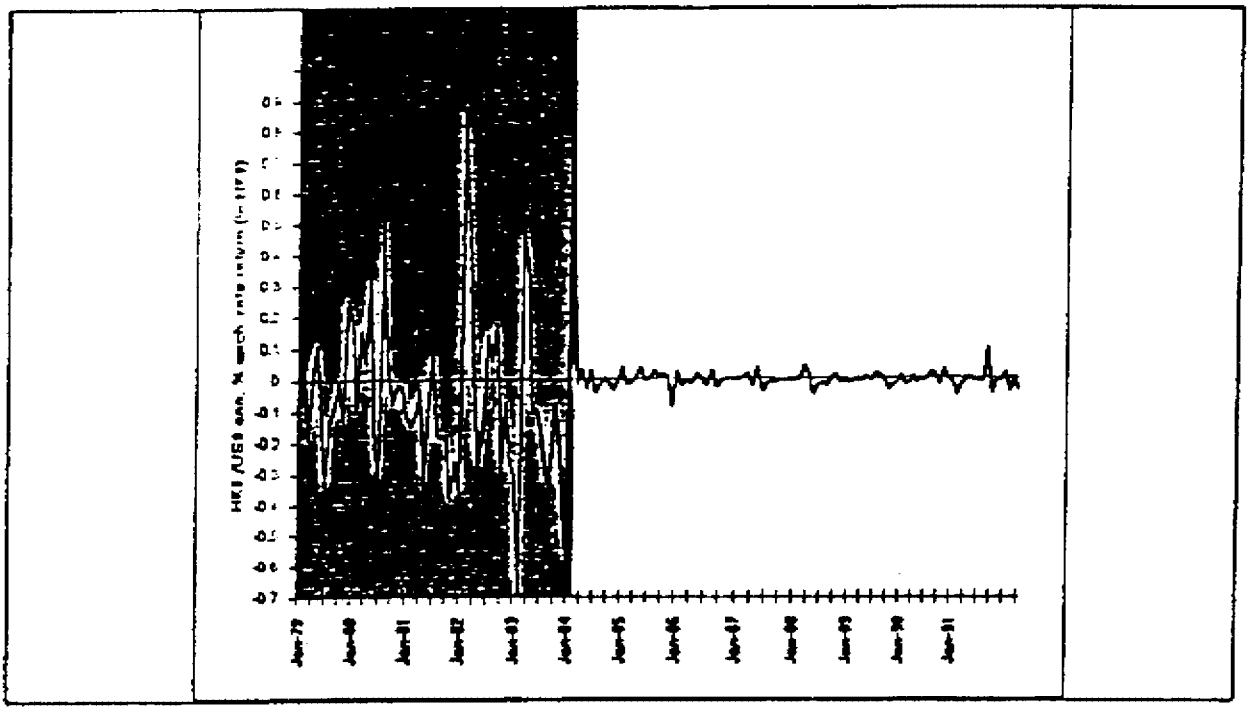
The relatively large size of the Hong Kong prime-(one-month FD) spread, and to a lesser extent the prime-savings spread, when compared to the other countries provides a glimpse of how large a monopsonistic rent the HKAB is able to extract from the deposits that are not in direct competition with other types of deposit-taking institutions, i.e. HK$-denominated deposits that are less than HK$500,000.

II.5.3. Comparison of US$-denominated versus HK$-denominated Deposit rates after the Exchange Rate Link

Two types of comparisons are performed after the Exchange Rate Link to the U.S. was installed: inter-country and intra-country comparisons. What these spreads tell us is how much more or how much less depositors placing their money in the US$-denominated account would have earned from depositing their money in a HK$-denominated account. Taking the pegging to the US$ as given, the main difference between the two saving accounts is that HKAB interest-rate ceilings only apply to HK$-denominated deposits. The inter-country comparison is between the US-based and US$-denominated short-term FD interest rates versus Hong Kong-based and HK$-denominated accounts. The intra-country comparison is between the HK$-denominated savings account versus a US$-denominated savings account within the same bank in Hong Kong. The rationale is similar to that for the first spread, the only difference being that there is no difference in operating costs for the two accounts.

In an unregulated, free and frictionless market where the US$/HK$ foreign exchange rate fluctuation is zero, deviations from zero of the US$-denominated deposit rates from the comparable HK$-denominated deposit rates creates arbitrage profits and thus cannot persist. To elaborate, if US interest rates are higher than Hong Kong rates, then all the deposits from Hong Kong would flock to the U.S. deposit markets. Although fluctuations in the foreign exchange rate between Hong Kong the and U.S. are not zero, these have been relatively small since March 1984. This is largely because the HK$ was officially linked to the US$ after October 1983. As Figure II.2 shows, however, the peg stabilized only after February 1984. For instance, the average annualized return (in HK$) from buying US$ at the end of the previous month and then selling the US$ at the end of the month for the period 3/1984-12/1991 is 0.10% +/- 2.27%. Thus, a large spread between the US$- and HK$-denominated accounts relative to the foreign exchange return could not be easily explained by the existence of a foreign exchange premium due to foreign-exchange-rate fluctuations. Instead it is likely that such a large spread is explained by the monopsonistic rent that the banks are extracting.

Figure II.2: Time series of US$-HK$ Exchange rate
This figure plots the foreign exchange return in HK$ from monthly investment in the US$ for the period of 1975-1991. The shaded area represents the period prior to March 1984.



(a) Inter-Country Comparison

The HK prime-deposit rate spreads are significantly different from those of the US. For convenience, we have chosen to define the HK$-US$ prime spread as the spread of the HK$ best lending rate above the US$ prime rate; whereas, the US$-HK$ FD spreads are the differences of the US$ rates above the HK$ accounts. These definitions allow us to see how the prime-FD spread is distributed between the depositors and the borrowers of the bank, as one might expect the spread to be shouldered more by the depositors. This is because the lenders, especially corporate lenders, typically have better access to other financial markets. This is borne out by Table II.6.

Table II.6: Comparison of FD and Prime Rates in US and HK
This table shows how the prime rate-fixed maturity deposit (FD) rate is distributed amongst the depositors and borrowers of the banks. This is accomplished by documenting the average size of the difference of the US$-denominated FD above the alike HK$-denominated deposits and analogously the average differences of the HK$-denominated above the US$-denominated prime rates.

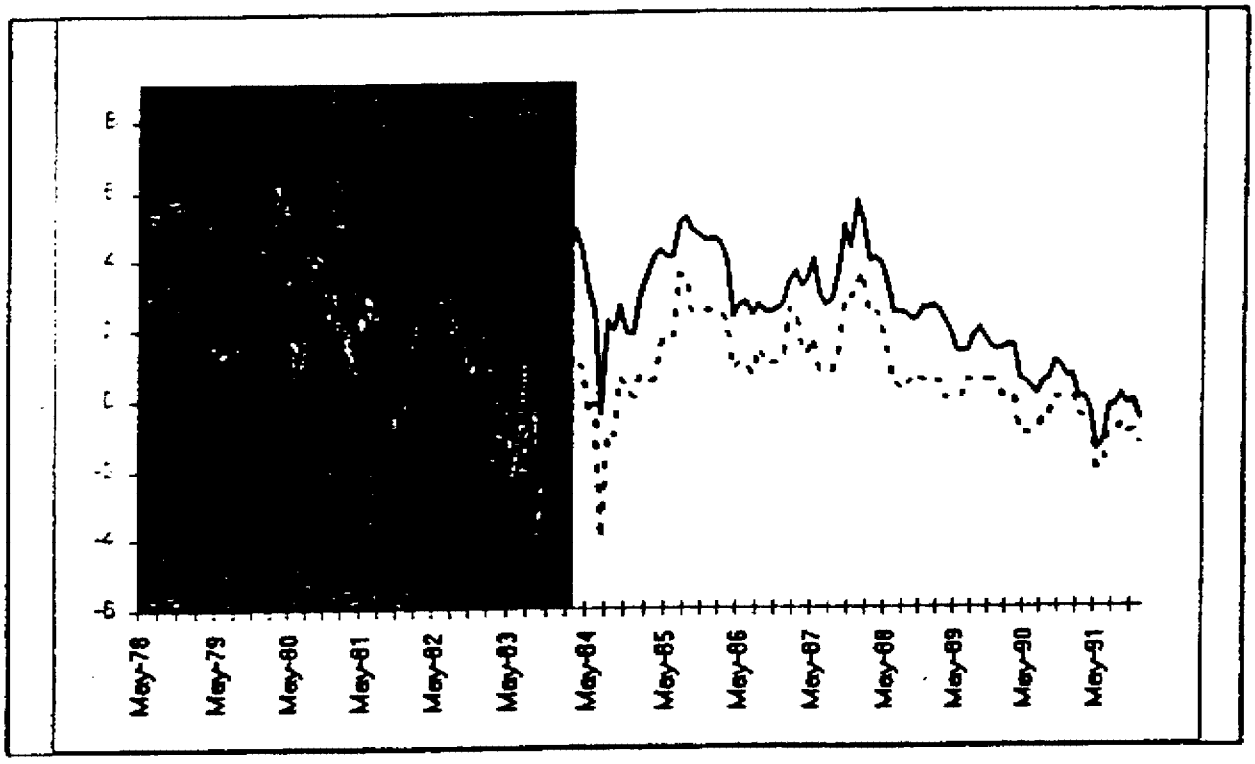
	Fixed Deposits		Prime
	1 month	6 months	
Full Sample			
average	2.454	2.378	0.626
standard deviation	1.652	1.854	1.621
min	-2.221	-3.611	-5.000
max	6.609	7.239	3.769
Sample: 5/1978-9/83 (Before Exchange Rate Link)			
average	0.832+	2.467	0.783
standard deviation	1.328	2.131	1.840
min	-2.221	-3.611	-5.000
max	2.379	7.239	3.769
Sample: 10/83 - 12/91 (After Exchange Rate Link)			
average	2.700	2.320	0.523
standard deviation	1.560	1.657	1.461
min	-1.141	-1.471	-4.000
max	6.609	5.669	3.500

+ There are only 15 months data for this category

There is also no evidence that the linking of the two currencies has led to any major changes in the US$-HK$ 6-month FD or the HK$-US$ prime rate spreads across time. This can be seen from Figure II.3. Although the average one-month spread appears to have changed significantly after the linking, there are not enough data points in the one-month maturity FD to make any strong conclusions. Overall, the average rate spreads are approximately 2.4% per annum for the FDs and 0.6 for the prime rate. Moreover, after the exchange rate link was stabilized and after taking into account foreign exchange fluctuations (0.10% p.a.), depositors in Hong Kong tend to get paid approximately 2.2-2.6% p.a. lower than if they had invested their money in the U.S.

Figure II.3: Plot of US$-HK$ FD spreads from 5/78-12/91

A plot of the time-series of the US$-HK$ six-month time deposit and the HK$-US$ prime rate. The dotted line represents the prime rate spread.

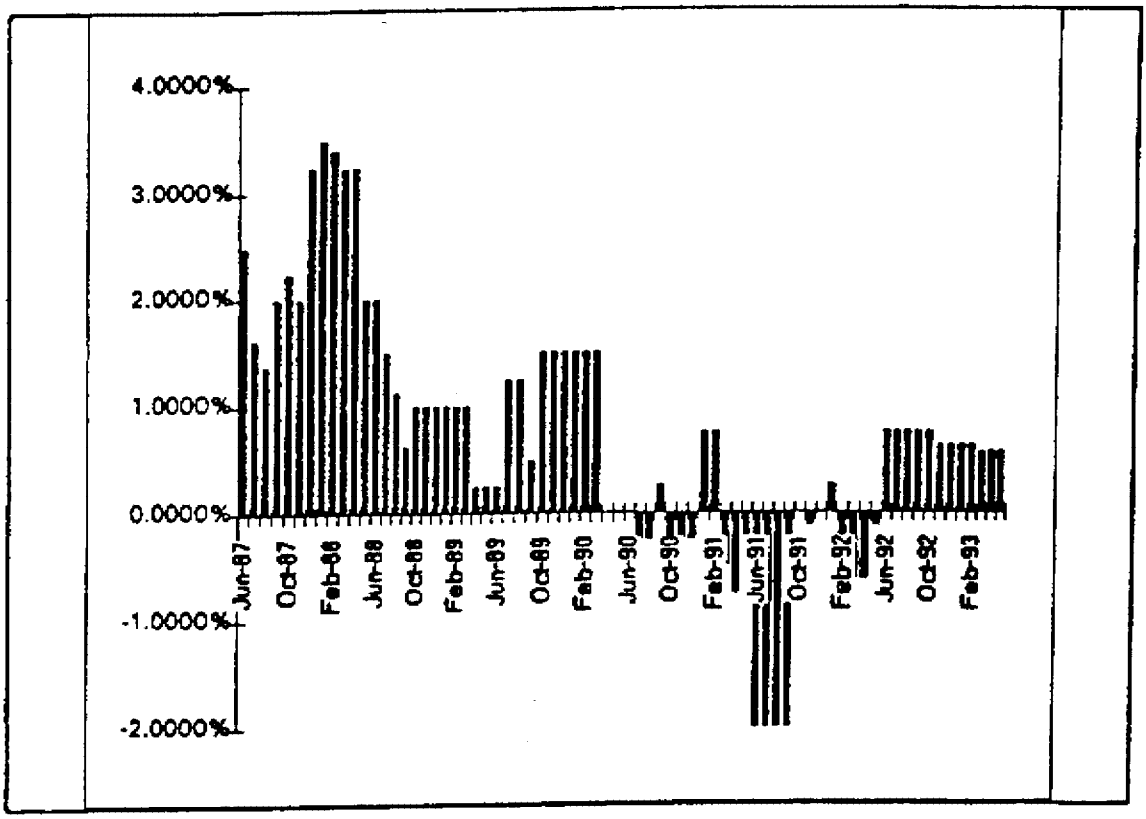


(b) Intra-Country Comparison

Based on the quotes given by the American Express Bank, we find that the US$- and HK$-savings deposit rate spread is on average 0.71% over the last six years. (These rates are indicative of the rates for other banks in Hong Kong as well.) 55 out of 72 months observed had positive spreads. Only eight months had negative spreads lower than 0.25%. Although the evidence on the underpayment of the HK$ savings account is only true in general, and not all the time, the 0.71% spread is indicative of the monopsonistic rent that the banks extracted from their customers who are bound by the interest rate cartel. Adjusting this spread in saving rates for the average foreign exchange return (i.e. 0.10% p.a. for investing in the US$ for the period of 3/1984-4/1992) we see that the average foregone interest by the depositor who deposits her money into the HK$ account instead of the US$ account lost approximately 0.6% per annum. Figure II.4 plots the time-series of the spread.

Figure II.4: Difference of US$- and HK$-savings deposit rate for American Express Bank

A plot of the difference of the annual interest rate of a US$-denominated savings deposit above xHK$-denominated savings deposit for June 1987-May 1993, as quoted by the American Express Bank.



II.5.4. Estimating the Size of the Monopsonistic Rent Extracted

Before proceeding to estimate the size of the monopsonistic rent extracted by the HKAB interest-rate cartel, we would have to deduce what proportion of the interest-rate spreads, if any, could be attributed to the monopsonistic rent. There is, however, no definitive way of estimating the size of the rent. The existence of a monopsonistic rent, however, is supported by the fact that Hong Kong has higher prime-FD and prime-savings spreads then do the other countries investigated for corresponding spreads.

(a) Saving Deposits

Three types of deposits are subject to the HKAB restrictions. The first is savings deposits. A lower bound on the interest-rate spread on savings deposits extracted by the HKAB interest-rate cartel is suggested by the average spread of the US$ savings account in excess of the HK$ savings account within the same bank operating in Hong Kong, i.e. 0.7% per annum. The reason why the US$-HK$ deposit rate is a lower is the same as the reason for why swap rates are not set their perfect competition level. (This was discussed in section II.2.) An estimate of the monopsonistic rent collected, as opposed to a lower bound, is the average prime-savings-rate spread that Hong Kong has above other countries as an indication of foregone interest to the savings account depositors, i.e. 1.79% per annum. (See Table II.4.) The latter (1.79% per annum) represents a more reasonable estimate and is the rate we use in the following calculations. (Kroszner argues for 2% per annum as the cost of the monopsonistic rent, by using Hong Kong's [three-month time deposit]-[three-month HIBOR] spread, after subtracting 0.5% as maintenance cost.)

(b) Time Deposits

Time deposits is the second category of deposits that is affected by the HKAB interest-rate cartel. Estimating the size of the time deposits affected by the interest-rate ceilings is difficult, as not all of the time deposits are covered by the HKAB interest-rate ceilings. Kroszner (1990) assumes that a conservative estimate is 10%. Other estimates from casual conversations with regulators have placed it as high as 20% of the total time deposits. Probably the best available estimate was suggested during our meeting with HKAB. It has been suggested that the consultation paper on the deposit protection scheme by then Monetary Affairs Branch of the Government Secretariat provides us with an estimate of the total deposits covered by the HKAB rate ceilings as a percentage of total HK$-denominated deposits for March 31, 1991, i.e. 0.6135. Using the year-end figures published in the Annual Report of the Commissioner of Banking, 1991, we can estimate the ratio of the sum of demand and saving deposits and total deposits, i.e. 0.5293. Thus we inferred that the percentage of time deposits that were governed by HKAB for 1991 is 17.9%. (Please refer to Appendix II.3 for details of this calculation.) As we shall see in Table II.7, time deposits as a category contribute relatively little to the total monopsonistic rent extracted from the depositors. The interest rate representing the monopsonistic rent extracted from HKAB is obtained by comparing the HK$-US$ FD spreads during the post-US$ exchange rate link and yields a spread in excess of 2.70% per annum. (See

Table II.5.) Alternately, we could use the overall average Hong Kong prime-FD spread above the other countries (for like maturities), i.e. 1.65%. (See Table II.4) We choose to use the more conservative estimate of 1.65% per annum.

(c) Checking Account

Third is the demand deposit, or checking account. As mentioned earlier in Hong Kong, checking accounts are not permitted by the HKAB to earn any interest. Taking the U.S. as an example, it is reasonable to assume that the interest forgone by the depositor is approximately that of the competitive savings deposit rate. To be conservative, we used the estimated savings rate less 1% as a conservative measure of forgone interest rate to the depositors and thus the monopsonistic rents extracted. This estimate is also justifiable as this would effectively be the interest earned if HKAB had allowed for bank-initiated automatic transfers from savings to checking accounts.[8] that are charged elsewhere, if they exist, are not included in this calculation. In the U.S. these rates are typically well within the 1% spread of the savings deposit rate; Kroszner uses 5% per annum, but does not appear to offer any justification for this estimate. Moreover a comparison of bank charges in Appendix II.2 do not support the contention that Hong Kong banks charge less.

Table II.7 calculates the total HK$ amount of monopsonistic rents that HKAB is able to extract from the depositors under the above assumptions. The total deposits are based on year-end figures provided by the 1992 Annual Report of the Commissioner of Banking. We find that the average monopsonistic rents accounts for 1.22% of the gross domestic product (GDP). As a comparison, we note that our figures for 1990 is about HK$1.9 billion higher than that of Kroszner's (1990) estimates, i.e. HK$7.35B as opposed to HK$5.46B.[9] This is due to the lower estimates of deposits that he used and also the lower percentage of time deposits that are

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[8]It is arguable that 1% of the demand deposit might not be enough to cover the checking costs. However it is also plausible that this is a very conservative estimate. From a conversation with a prominent banker, there is reason to believe that the liquidity needs of the bank might drive the demand deposit rates significantly higher if the rates are set competitively. This is supported by the relatively higher CD rates not covered by HKAB agreement.

[9]It is interesting to note that if we use a five-year estimate of the interest rate spreads then the estimate of the 1990 monopsonistic rent is very close to Kroszner's, i.e. HK$5.3 Billion. The main difference here is that the estimated monopsonistic savings and time deposit spreads are 0.87% and 1.53%, respectively. However the average monopsonistic rent as a percentage of GDP is still relatively high, i.e. 0.84%.

affected by the interest-rate ceilings he used. FDs are relatively small contributors to the total monopsonistic rents. The accompanying figure of the size of the monopsonistic rents collected from the different deposits shows that the time deposits adds the least to the total amount of the monopsonistic rents collected by HKAB. Notwithstanding the difference in estimates, we remind the reader that the methodology utilizes statistical averages and thus the magnitude and not the exact figures is more important. In this light our figures are of the same order of magnitude as that of GT Management's.[10]

[10]We also calculated a lower bound for the estimated monopsonistic rent by using the lowest estimates for the prime-savings and prime-FD monopsonistic spreads. For the former we use the HK$-US$ savings spread in Hong Kong, i.e 0.6% after subtracting average foreign exchange losses. For the latter we use the lowest prime-FD spread in Table II.4, i.e.0.7%. Using these figures we still find that the average monopsonistic rent is about 0.6% of the GDP. This is still a highly significant cost to the depositors. Not that even if there was no monopsonistic spread for both savings and fixed deposits, the monopsonistic rents from demand deposits would still be estimated to be 0.35% of the GDP.

Table II.7: Estimated Monopsonistic Rents

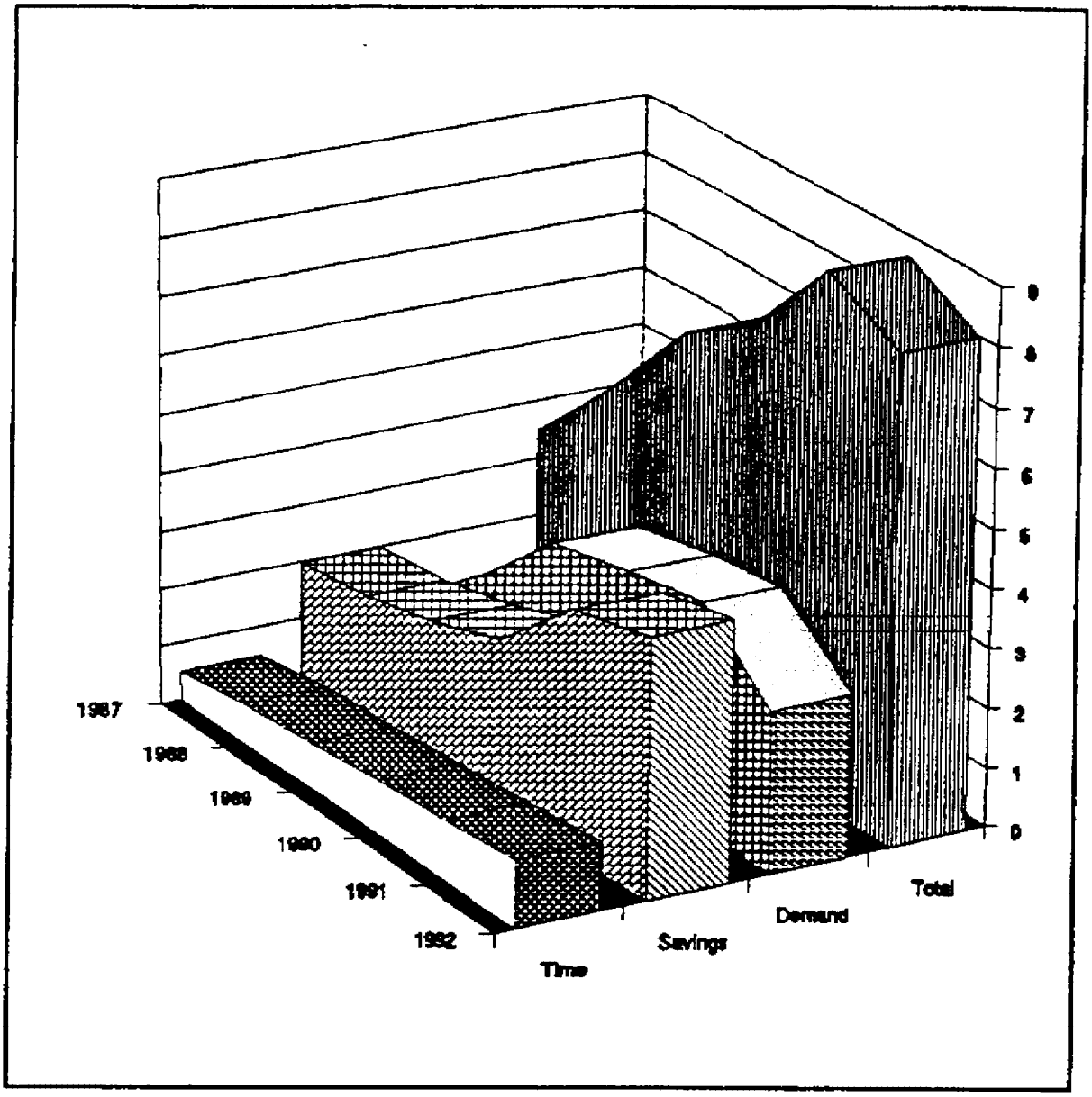
The total estimated monopsonistic rents are calculated based on the 1.79% of total savings, 0.3% of total time deposits, and (0.79% +average historical annual savings deposit rate)*(total demand deposits). The year end total savings, total deposits, and total demand deposits estimates for 1988-1992 are taken from Table A.1 of the 1992 Annual Report of the Commissioner of Banking. The average monthly figures for 1987 are obtained from the 1991 Annual Report.

(in Billion HK$)

Year	Estimated Monopsonistic Rents from			Total Monopsonistic Rents Extracted from HKAB Depositors	
	Demand Deposits	Savings Deposits	Time Deposits	Total Amount	As a % of GDP
1987	1.03	1.96	0.38	3.37	0.92
1988	2.07	2.13	0.53	4.72	1.09
1989	3.35	2.41	0.59	6.35	1.27
1990	3.60	2.84	0.71	7.14	1.29
1991	3.79	4.09	0.78	8.66	1.35
1992	2.71	4.38	0.87	7.95	1.06

Figure II.5: Plot of Estimated Monopsonistic Rents By Categories

The time chart of the different components of the estimated monopolistic rents that HKAB, as a whole, is able to extract from the depositors because of the combination of the Banking and HKAB Ordinances. The vertical axis is in Billions of HK$.



II.6 Summary of results

The aim of section II.5 is to estimate the legally created monopsony for short-maturity and small deposits described by Table II.1. It is pointed out that we cannot use accounting estimates such as return on assets (ROA) or return on equity (ROE) because the banks' earnings are reported only after adjustments to inner reserves. Moreover, there is empirical support that accounting figures are not very useful in estimating monopsonistic rents. Instead, we used interest rate spreads to estimate the profitability of the banks in Hong Kong. As the prime rate is indicative of the rates the banks lend at, we used the prime and the cost of funds spreads as estimates of the bank's profitability. We compare these spreads from Hong Kong with that of other developed and regional developing countries to estimate the interest forgone by Hong Kong depositors as a result of the HKAB interest rate rules. In order to control for the differences in spreads that might be attributable to different costs across countries, etc., we use a cost of funds that was competitive in Hong Kong - the inter-bank-offer rate. We find that the average prime - (inter-bank-offer-rate) in Hong Kong is one of the lower average spreads. This is not the case when we turned our attention to deposits that are regulated by the HKAB. Demand deposits, for instance, cannot be paid interest according to the HKAB interest rate rules. The average prime-savings and prime - (fixed-deposit) spread in Hong Kong were consistently higher in Hong Kong than that of any country in the sample. These results were robust to using different methods of estimation. For the period of 1978-1991, we find that the prime-savings was on average 1.79% lower in Hong Kong compared to other countries; the average prime - (fixed deposit) spread was on average 1.65% lower in Hong Kong compared to other countries. These results were further supported by the relatively larger spreads of HK$ deposits compared to US$ deposits even with the existence of the US$-HK$ peg. Finally, we use these interest spreads to estimate the monopsonistic rents extracted by the banks. We find that the estimated monopsonistic rents extracted from the economy by the HKAB are economically significant and in excess of 1% of the GDP over the last six years. The magnitude of this estimate is robust to different methods used. The component of the monopsonistic rent most robust to the methodology comes from the demand deposits, amounting to at least 0.35% of the GDP. In general, the various methods of estimating the monopsonistic rents from interest rate spreads do not yield an amount lower than 6% of the GDP.

II.7 Public Policy Implications

In understanding the current regulatory setting, it is instructive to understand the rationale behind the current regulations. The current regulation governing the interest-rate caps for short-maturity financial instruments has its roots in the Interest Rate Agreement (July 1964) that was introduced by the Exchange Banks' Association, the predecessor of HKAB. An important factor leading to the signing of the agreement was the view that the "cut throat" interest-rate competition was unhealthy for the banking system. This was voiced in the Tomkins Report for 1962. The current framework was finally set in place when the HKAB was made a statutory body by the HKAB Ordinance in 1980.

Maintaining the Status Quo

There appears to be four main arguments for maintaining the status quo:

(a) The cut-throat competition in the banking industry might pose a threat to the system;

(b) Restriction of market entry in the market for small deposits is required because of the presumed lack of sophistication of the depositors or the high cost of monitoring by the depositors to assess the credit worthiness of the institutions; and

(c) There is no evidence that Hong Kong banks are extracting a monopolistic rent from their customers. Evidence of unusually large interest-rate spreads is misleading, because the various spreads do not take into account the fact that the costs of operating in Hong Kong are inherently higher and there are certain free services that are usually charged in other countries, in these accounts.

(d) The interest rate caps are necessary to maintain the Exchange rate link.

Counter Agruments

These arguments raises four counter-arguments:

(a) Cut-throat Competition in the Banking Industry

Cut-throat competition in any industry by itself does not appear to cause any problems in a highly competitive and open economy like Hong Kong. It must then be the argument that the Tomkins report put forth. i.e. competition will drive the profit margins down to such a level that the banks are "too risky". Shocks to the industry could quickly destabilize the system. With the absence of monopsonistic rents, it is plausible that banks will take higher levels of risks as has been suggested by option pricing-based models of banks, e.g. Merton (1977) and Pyle (1986). The study by the International Monetary Fund entitled, "Deterioration of Bank Balance Sheets," in their report, "Recent Banking Problems in Some Industrial Countries," asserts as much, i.e. "..many banks responded to this new, less hospitable environment by increasing the riskiness of their portfolios.." (para. 3, page 3). However in the next paragraph the study notes that, "In most cases, the increased riskiness of bank portfolios did not translate into an increase in banks' net operating profit (when scaled by their size of their balance sheets."

The next line in the IMF report identifies the risks associated with deregulation as "a significant shift in economic conditions." In other words, it appears that the main problem of deregulation lies in the transition of the banking sector to that of a competitive environment. HKMA quotes Llewelyn (1986 Gilbart Lectures on Banking) as saying that the instability caused by the deregulation suggests that "it might have been preferable not to have had the restrictions in the first place."

Two problems of increased risk-taking due to deregulation that were identified by the IMF report were, (1) the presence of explicit or implicit guarantees of deposit insurance by the government, and (2) the inability of the regulators to keep up with the developments. There is no explicit deposit insurance in Hong Kong; the implicit deposit insurance policy is highly doubtful in light of the occurrence of the BCCI bank failure. We have full confidence that the HKMA is able to handle the deregulation we have proposed. One should note that the proposals made in this report have also sought to lessen the impact of the transition on the banking industry by suggesting a gradual deregulation.

Moreover it should be noted that bank runs occur even under the current environment, as evidenced by the bank run apparently sparked by the BCCI failure. Research in banking have indicated that two major causes of bank runs are liquidity and lack of information, see Diamond and Dybvig (1983) and Chari and Jaganathan (1988) for instance. This would imply that proposed increased disclosure of bank information would then decrease the occurrence of bank runs. (The IMF study also supports the increased disclosure of banks as an improvement, see para. 3, page 22.) With better information and supervision, it is reasonable to expect that individual bank failures do not translate to systemic runs. Moreover one of the "significant shifts in economic conditions" cited by the IMF study is "a tightening of monetary policy" is at least partly determined by the HKMA.

There is also a major problem with not gradually deregulating the monopsonistic banking system. As recognized by the IMF report, most of the deregulation in the banking sector are driven by the markets' innovations to circumvent regulation, see for example Kane's (1981) regulatory dialectic theory and Eisenbeis (1985) for the case of US. Though the deregulation caused instability it is unclear whether the banking sector could have avoided (or afforded) not to deregulate in the first place. As recognized by the IMF study, the "forces that propelled the financial liberalization in the Nordic countries were similar to those in other industrial countries.....Chief among these was the emergence of new markets and non-bank financial institutions that escaped existing regulations and strains.." (para. 8, page 5). Rather than wait for the sudden and forced transition of the banking industry that are caused by innovations by the financial sector, it would be judicious for Hong Kong to anticipate this problem and work towards removing these anti-competitive restriction. Additional regulatory and supervisory measures can be implemented by the HKMA to anticipate future problems, if the HKMA believes they are necessary. The quote from Llewelyn can then be seen from a different light -- that if we remove the restrictions gradually now, we do not have to have to go through the pain of removing them dramatically. As noted in the IMF study, the "reality is that major banking systems are in a structural transition to a changing competitive environment, and current problems are to some extent a reflection of that transition. That transition will not be completed overnight -- especially in countries where financial innovation is still accelerating" (concluding para., page 22). It would certainly appear that Hong Kong fits the description of the last sentence.

Finally, it is difficult to justify that about 1% of the country's annual GDP is a worthwhile premium to safeguard the economy from such a threat, if it exists.

(b) Restriction of Market Entry for Small Deposits is Required

The basic assumption here is that the LBs are "safer" and thus this regulation safeguards the welfare of the smaller investor. Moreover, Merton (1986) shows that the presence of monopolistic (or monopsonistic) rents effectively removes any incentive for LBs to take on too much risk because they would also be risking their monopoly (or monopsonistic) rent. The monopsonistic rent might also induce the LBs to self-regulate amongst themselves in order to maintain the status quo in the industry. To this extent, imposing the tax on the smaller depositors might be warranted, as they are arguably the main beneficiaries of such a regulation.

The presence of such a regulation, however, creates two major problems:

First, there is no limit to the monopsonistic rent that is extracted from the small depositors. Alternate methods that can be introduced to safeguard the interests of the small depositors are discussed later.

Second, the regulation might create inflationary pressures within the economy and reduce business investment. Analogous to the argument by Kane (1981, pp. 365), if the monopsonistic costs are too high, "Besides distorting institutional balance sheets and production processes and politicizing citizens, deposit rate ceilings changed longstanding household patterns of allocating accumulated wealth. For traditional savings instruments, all but the wealthiest U.S. households substituted food inventories and leveraged purchases of housing, investment real estate, and consumer durables. Small savers' efforts to protect their real wealth from being eaten away by unfairly low deposit rates simultaneously reduced the proportion of aggregate personal income flowing through deposit institutions, increased total household debt, and fed a speculative boom in housing. By increasing household demands on productive resources, this pattern of saving tended to crowd out business investment and to increase the rate of inflation." Thus small savers, by attempting to hedge against inflation, invest disproportionately in real estate rather than investing through bank deposits. As banks redirect part of these deposits to fund business investments, the loss of deposits results in redirecting the economy's resources towards the housing industry from other productive processes. Moreover further "crowding out" of business investment is exacerbated by the use of mortgages. The increased demand for housing leads to increased inflation as there would be increased amounts of money chasing a

fixed amount of land. Kane asserts that this increased demand led to a "speculative boom in housing."

(c) Can the Monopsonistic Rent be Justified?

It has been suggested that the operating costs in Hong Kong might be higher than the other countries to which it has been compared. To allay those criticisms, we compared the prime-IBOR spread across the countries to obtain a sense of whether the spreads are larger in Hong Kong. The belief that a higher spread is required in Hong Kong compared to the other countries is not supported. Moreover, the average 0.7% per annum spread of a US$ above a HK$ savings account offered by the same bank in Hong Kong, within a linked-rate system, cannot be justified by the differences in operating costs. On the second point, one would respond that the allocation of costs amongst the depositors is effectively a tax on the not-so-frequent users of the services to subsidize the more frequent users.[11] The decision of redistributing wealth should, however, generally be left to state policy makers rather than private institutions. There is no evidence to suggest that the cost of operating is higher in Hong Kong. For instance, in a study by the Consumer Council on the exemption clauses imposed on customers by the HKAB members, the Consumer Council concluded that the clauses imposed were not reasonable and leave the banks with less responsibility than their counterparts in other parts of the world. Since this "responsibility" of a bank is part of the implicit cost of doing business, these exemption clauses make the cost of doing business relatively lower in Hong Kong. (See Appendix II.4 for details) Finally, there is no evidence to suggest that Hong Kong banks offer more free services or charge less than their counterparts elsewhere. Appendix II.B surveys itemizes the charges imposed by banks on their depositors in Hong Kong, Singapore, and United Kingdom. We find no evidence that Hong Kong banks charge less for their services.

Justifications for Maintaining the Status Quo

There are at least two arguments to be made against maintaining the status quo. The current banking environment is much akin to the situation described by Kane (1980) where the banking regulation, by imposing restrictions on the less interest-sensitive depositors, taxes the less interest-sensitive depositors. The reason is that the more interest-sensitive depositors can always switch to other market instruments, e.g. money-market funds. Kane (1980) argues that these investors are the young, the old, and the

[11] Moreover, it could be that the more frequent users of these services are more affluent than the less affluent users, thus creating a subsidy that flows from the poor to the rich.

poor. The argument applies here as well and raises a very important public policy issue of whether the government intends to tax these segments of the public to maintain the monopsony.

The second relates to the current structure of the banking industry in Hong Kong. An implication of the interest-rate caps on all LBs is that the competition for deposits on the basis of interest rates is transformed to one that is based on non-monetary benefits. This arguably is to the advantage of the major banks today[12]. The larger the size of the banks, the higher accessibility (more branches) and less risky the banks. The inverse relation of size to the riskiness of banks is supported by the small-firm effect observed in the investments literature, e.g. Banz [1981] and more recently by Fama and French [1992]. As there is no tradeoff of higher interest rates for higher risk and lower accessibility, there is a tendency for the depositors to choose the larger and more established banks. Moreover, three of the major banks in Hong Kong, i.e. Hong Kong and Shanghai Banking Corp., Standard Chartered Bank, and Bank of China, are permanent members of the HKAB Committee, the first two holding the rotating chairmanship of the Committee. Having established that the banking industry is extracting a monopsonistic rent from depositors, it stands to reason that any regulatory framework that helps maintain the current market structure implicitly maintains the distribution of such monopsonistic rents amongst the banks.

(d) Interest-Rate Caps are necessary to maintaining the Exchange Rate Link

This point draws two critical counterpoints. First, as argued in (c), the interest rate caps taxes the young, the old, and the poor more heavily than others in order to maintain the exchange rate link. This is a policy issue that is to be determined by the Hong Kong government and not HKAB. Second, the Hong Kong Monetary Authority has now implemented a new accounting system for the banks and thus is no longer dependent on the interest rate agreement to maintain the exchange rate link. Moreover, if the HKMA believes it is necessary, a new clause in the amended Banking Ordinance can be made to give the HKMA or Financial Secretary some control on the HK$ deposits rates under certain special circumstances.

[12]Smaller banks might still be resistant against the dismantling of the interest rate caps for two reasons: (1) they are less efficient than the other banks, and/or (2) they are not willing to lose their monopsonistic rents.

III. THE BANKING STRUCTURE IN HONG KONG

III.1 Background

The banking structure in Hong Kong is characterized by a three-tier system which comprises (1) Licensed Banks (LBs), (2) Restricted Licensed Banks (RLBs), and (3) Deposit-taking Companies (DTCs). Licensed banks provide normal banking services. They must comply with the interest rate rule set by the Hong Kong Association of Banks; the RLBs and DTCs do not have to comply with the interest rate rule. The RLBs are investment banks or merchant banks. The RLBs can only accept deposits of not less than HK$500,000 per account. The DTCs are finance companies. They are restricted to accept deposits of not less than HK$100,000 per account and with a maturity of not less than three months.[13]

Our objectives in this section are twofold:

1. We examine the extent of bank concentration in markets for loans and deposits in Hong Kong. It is not possible for us to pinpoint banks that have the sizeable market shares as individual bank data on market share is confidential. We could obtain, however, measures of the banking industry concentrations using the Herfindahl indices.

2. We also examine the industry concentration in these markets over time.

III.2 Data and Methodology

The data for this part of study come from the Hong Kong Monetary Authority (HKMA). We employ the Herfindahl Index as a measure of bank concentration. We requested the HKMA to calculate the Herfindahl indices for the following balance sheet items[14]:

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[13]For more details on the banking structure in Hong Kong, see Ho, et al. (eds) (1991).

[14] We appreciate the kind cooperation and assistance of the HKMA in carrying out the calculations for the H-Index, as most of the individual bank data is neither for release nor available to the public.

Assets

(i) Mortgage loans;

(ii) Other loans for use in Hong Kong;

Liability Items

(i) Customer deposits divided into savings, demand and time deposits,

We requested the above values in the following currencies:

i. HK dollar;

ii. foreign currency; and,

iii. the combination of HK dollar and foreign currency translated into HK$.

The data covers the time period from January 1 1988 through December 31 1992, as the HKMA does not have data on those items prior to January 1 1988.

III.2.1. The Herfindahl Index for the Calculation of Bank Market Concentration

The Herfindahl index is calculated as: $H = \Sigma_i s_i^2$,

where s_i is the share of institution i in a particular asset or liability item.
s_i is defined as:

$$s_i = \frac{\text{Value in dollar amount of the item in institution i}}{\text{Sum of the values for the particular item for all the banking institutions in the industry.}} \quad (1)$$

The minimum value of the Herfindahl index is 1/n, if there are n firms of equal size The maximum value is 1, which would indicate a monopoly. Examples of the calculation of the Herfindahl indices are given in Appendix III.1. Considerable insight can also be gained by calculating the numbers equivalent, which is defined as 1/H [15]. If H equals 0.2, the reciprocal of H, 1/H is 5. It is as if in that market, there were 5 firms with equal market share.

Herfindahl indices (H indices) are used by U.S regulatory bodies to challenge mergers. The Antitrust Division of the US Department of Justice, in a guideline issued in 1982, is very likely to challenge mergers if the H index in the industry is above a certain number. For example, challenge is very likely for horizontal mergers if the H index exceeds 0.2, and merger will raise the H index by 0.01. Challenge is possible if the H index is between 0.1 and 0.18 and entry is difficult, or the market has been collusive. In this study, we say that a market is concentrated if the H index is 0.1 or greater. The value of H index of 0.1 corresponds to 10 banks with equal market share; higher values indicate fewer number of banks with equal market shares.

As information on the market share of individual banks is not available, we requested the HKMA to calculate the Herfindahl indices for the above-listed asset and liability items by the following categories:

Category 1: Include only the Licensed Banks (LBs);

Category 2: Include only the Restricted Licensed Banks (RLBs);

Category 3: Include only the Deposit-Taking Companies (DTCs);

Category 4: Include all the banking institutions, i.e., those in Categories 1, 2 and 3 as individual banking units, but include four major banking groups as four individual units[16]:

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[15]For more details on the use of Herfindahl index, see for example Stigler (1968, p. 31-36), Shepherd (1985, p. 227) and McGee (1988, p. 251-252).

[16] We should note that there are more than four major bank groups besides those listed. We settle for this relatively small number of groups as it would take the HKMA more time and resources if they were to comply with the ideal request that, under this category, all RLBs and DTCs whose equity is 50% or at least 50% owned by licensed banks, are grouped.

(i) The Hongkong and Shanghai Banking Group;

(ii) Bank of China Group;

(iii) Bank of East Asia Group; and

(iv) The Standard Chartered Bank Group.

All other institutions, including foreign institutions, are treated as individual banking units.

Category 5: Include the four banking groups listed above (i.e., Hong Kong Bank Group, Standard Chartered Group, Bank of China Group and the Bank of East Asia Group). The banks that are foreign incorporated are divided into the following groups:

(i) Japanese Institutions;

(ii) U.S. Institutions;

(iii) European Institutions.

Hence, the number of 'firms' (in Category 5) for the purpose of calculation of the Herfindahl Index is 7. We would sum the values for the particular item of the 7 banking groups when calculating the denominator of eq. (1). The rationale for this category is to appraise the industry concentrations of these 7 major bank groups; we like to know the relative market shares of the 4 major bank groups vis-a-vis the three major groups by foreign ownership.

III.3 Results

The results for the calculations of the Herfindahl indices are shown in Table III.1A; the results for the numbers equivalent, or 1/H, are shown in Table III.1B. The numbers equivalent should be read together with the number of banking units existing in the industry. For example,

even though the number of existing banking units is 300, and the numbers equivalent for a particular market is 3, it implies that the industry is oligopolistic in nature, or a market with a few dominant sellers.

As shown, some banks have a relatively larger share (larger than the average market share) in certain markets than do the other banks. For all markets, at least one bank has a higher than average market share, which is defined here, as the market share if all banks have equal market share. This can be seen when one computes '1/n', where n is the number of firms in a certain category. We describe below the results by markets for particular items for the various categories of authorized institutions. For Category 5, we would like to note at the outset that the market concentrations among these seven groupings are high for all markets; H indices are at least 0.18.

III.3.1 The Market for Demand Deposits

The H index for the market for HK$ demand deposits in the licensed banks category is about 0.1 in 1992. The H indices range from 0.1 to 0.12, within the period 1988-1992.

Table III.1A

Herfindahl Indices for some banking markets in Hong Kong (1988-92)

Year	No. of banking units	Demand deposits HKD	Demand deposits FCY	Demand deposits TOT	Savings deposits HKD	Savings deposits FCY	Savings deposits TOT	Time deposits HKD	Time deposits FCY	Time deposits TOT	Total deposits HKD	Total deposits FCY	Total deposits TOT	Private residential mortgage loans HKD	Private residential mortgage loans FCY	Private residential mortgage loans TOT	Other loans for use in Hong Kong HKD	Other loans for use in Hong Kong FCY	Other loans for use in Hong Kong TOT	Total loans for use in Hong Kong # HKD	Total loans for use in Hong Kong # FCY	Total loans for use in Hong Kong # TOT
(1) Category 1 : all licensed banks																						
88	155	0.11	0.06	0.10	0.16	0.08	0.12	0.07	0.03	0.03	0.11	0.03	0.05	0.07	0.31	0.07	0.04	0.06	0.04	0.04	0.05	0.04
89	165	0.11	0.07	0.10	0.17	0.09	0.14	0.07	0.04	0.04	0.11	0.04	0.06	0.09	0.39	0.09	0.05	0.04	0.04	0.05	0.04	0.04
90	166	0.12	0.07	0.09	0.16	0.09	0.14	0.07	0.04	0.04	0.10	0.04	0.05	0.09	0.53	0.09	0.04	0.04	0.03	0.04	0.03	0.03
91	160	0.12	0.10	0.10	0.16	0.10	0.14	0.08	0.04	0.04	0.12	0.04	0.06	0.09	0.77	0.09	0.05	0.04	0.04	0.04	0.03	0.04
92	161	0.10	0.11	0.09	0.16	0.10	0.14	0.07	0.03	0.04	0.11	0.04	0.06	0.10	0.61	0.10	0.05	0.03	0.04	0.05	0.03	0.04
(2) Category 2 : all restricted licensed banks																						
88	35	0.48	0.33	0.28	N.A.	N.A.	N.A.	0.23	0.11	0.11	0.23	0.11	0.11	0.67	0.51	0.66	0.17	0.11	0.15	0.17	0.13	0.14
89	36	0.57	0.26	0.24	N.A.	N.A.	N.A.	0.22	0.13	0.10	0.21	0.12	0.10	0.67	0.79	0.66	0.39	0.19	0.31	0.38	0.17	0.30
90	44	0.30	0.24	0.20	N.A.	N.A.	N.A.	0.22	0.09	0.08	0.21	0.09	0.08	0.76	0.73	0.75	0.42	0.23	0.35	0.41	0.20	0.34
91	52	0.30	0.49	0.39	N.A.	N.A.	N.A.	0.23	0.07	0.07	0.20	0.07	0.07	0.77	0.64	0.76	0.43	0.23	0.37	0.43	0.17	0.33
92	55	0.33	0.39	0.36	N.A.	N.A.	N.A.	0.26	0.08	0.08	0.24	0.07	0.07	0.80	0.33	0.79	0.43	0.19	0.37	0.42	0.14	0.36
(3) Category 3 : all deposit-taking companies																						
88	216	0.28	0.34	0.28	N.A.	N.A.	N.A.	0.09	0.08	0.05	0.08	0.08	0.05	0.25	0.37	0.25	0.14	0.08	0.09	0.13	0.07	0.09
89	200	0.09	0.31	0.16	N.A.	N.A.	N.A.	0.11	0.05	0.05	0.11	0.05	0.05	0.28	0.51	0.28	0.10	0.11	0.08	0.09	0.06	0.06
90	190	0.06	0.40	0.20	N.A.	N.A.	N.A.	0.10	0.05	0.05	0.10	0.06	0.05	0.30	0.51	0.30	0.11	0.14	0.08	0.10	0.08	0.07
91	157	0.09	0.65	0.19	N.A.	N.A.	N.A.	0.10	0.05	0.04	0.10	0.05	0.04	0.33	1.00	0.33	0.12	0.29	0.09	0.11	0.17	0.08
92	146	0.08	0.30	0.07	N.A.	N.A.	N.A.	0.10	0.05	0.04	0.10	0.05	0.04	0.32	N.A.	0.32	0.11	0.19	0.09	0.10	0.13	0.08
(4) Category 4 : all authorized institutions (4 major bank groups singled out *)																						
88	369	0.22	0.10	0.19	0.34	0.26	0.30	0.16	0.07	0.09	0.22	0.08	0.13	0.17	0.22	0.17	0.05	0.14	0.05	0.04	0.10	0.04
89	364	0.23	0.11	0.20	0.36	0.24	0.32	0.16	0.08	0.09	0.23	0.09	0.13	0.18	0.30	0.18	0.11	0.04	0.08	0.10	0.03	0.08
90	363	0.23	0.14	0.20	0.35	0.26	0.31	0.16	0.08	0.10	0.23	0.09	0.13	0.20	0.47	0.20	0.10	0.04	0.08	0.10	0.03	0.07
91	332	0.23	0.14	0.20	0.35	0.27	0.33	0.19	0.08	0.11	0.25	0.10	0.15	0.20	0.82	0.20	0.11	0.04	0.09	0.11	0.03	0.08
92	325	0.21	0.15	0.19	0.35	0.28	0.32	0.18	0.08	0.10	0.24	0.10	0.15	0.21	0.91	0.21	0.11	0.03	0.09	0.11	0.03	0.09
(5) Category 5 : 4 major bank groups * plus 3 bank groups by country of beneficial ownership @																						
88	7	0.31	0.19	0.27	0.40	0.31	0.35	0.24	0.18	0.18	0.29	0.18	0.21	0.25	0.38	0.25	0.38	0.43	0.33	0.37	0.35	0.32
89	7	0.31	0.20	0.28	0.42	0.29	0.37	0.23	0.18	0.19	0.30	0.19	0.21	0.26	0.43	0.26	0.19	0.44	0.20	0.19	0.37	0.19
90	7	0.31	0.22	0.27	0.40	0.31	0.37	0.24	0.18	0.19	0.30	0.19	0.21	0.27	0.49	0.27	0.19	0.44	0.20	0.19	0.38	0.20
91	7	0.31	0.23	0.28	0.40	0.32	0.38	0.26	0.19	0.19	0.32	0.19	0.23	0.27	0.83	0.26	0.20	0.39	0.20	0.19	0.34	0.19
92	7	0.29	0.25	0.27	0.40	0.33	0.37	0.26	0.19	0.19	0.31	0.19	0.22	0.28	0.94	0.28	0.20	0.33	0.19	0.19	0.29	0.19

Notes : * Include
i. Hongkong and Shanghai Bank group (including Hang Seng Bank group)
ii. Bank of China group
iii. Bank of East Asia group
iv. Standard Chartered Bank group
@ include
i. Japanese authorized institutions
ii. US authorized institutions
iii. European authorized institutions
include trade financing loans + loans for use in HK.
N.A. restricted license banks or deposit-taking companies did not have such item.

Table III.1B

Numbers Equivalent from Herfindahl Indices (1988-92)

Year	No. of banking units	Demand deposits HKD	Demand deposits FCY	Demand deposits TOT	Savings deposits HKD	Savings deposits FCY	Savings deposits TOT	Time deposits HKD	Time deposits FCY	Time deposits TOT	Total deposits HKD	Total deposits FCY	Total deposits TOT	Private residential mortgage loans HKD	Private residential mortgage loans FCY	Private residential mortgage loans TOT	Other loans for use in Hong Kon HKD	Other loans for use in Hong Kon FCY	Other loans for use in Hong Kon TOT	Total loans for use in Hong Kong # HKD	Total loans for use in Hong Kong # FCY	Total loans for use in Hong Kong # TOT
(1) Category 1 : all licensed banks																						
88	155	9.09	16.67	10.00	6.25	12.50	8.33	14.29	33.33	33.33	9.09	33.33	20.00	14.29	3.23	14.29	25.00	16.67	25.00	25.00	20.00	25.00
89	165	9.09	14.29	10.00	5.88	11.11	7.14	14.29	25.00	25.00	9.09	25.00	16.67	11.11	2.56	11.11	20.00	25.00	25.00	20.00	25.00	25.00
90	166	8.33	14.29	11.11	6.25	11.11	7.14	14.29	25.00	25.00	10.00	25.00	20.00	11.11	1.89	11.11	25.00	25.00	33.33	25.00	33.33	33.33
91	160	8.33	10.00	10.00	6.25	10.00	7.14	12.50	25.00	25.00	8.33	25.00	16.67	11.11	1.30	11.11	20.00	25.00	25.00	25.00	33.33	25.00
92	161	10.00	9.09	11.11	6.25	10.00	7.14	14.29	33.33	25.00	9.09	25.00	16.67	10.00	1.64	10.00	20.00	33.33	25.00	20.00	33.33	25.00
(2) Category 2 : all restricted licensed banks																						
88	35	2.08	3.03	3.57	N.A.	N.A.	N.A.	4.35	9.09	9.09	4.35	9.09	9.09	1.49	1.96	1.52	5.88	9.09	6.67	5.88	7.69	7.14
89	36	1.75	3.85	4.17	N.A.	N.A.	N.A.	4.55	7.69	10.00	4.76	8.33	10.00	1.49	1.27	1.52	2.56	5.26	3.23	2.63	5.88	3.33
90	44	3.33	4.17	5.00	N.A.	N.A.	N.A.	4.55	11.11	12.50	4.76	11.11	12.50	1.32	1.37	1.33	2.38	4.35	2.86	2.44	5.00	2.94
91	52	3.33	2.04	2.56	N.A.	N.A.	N.A.	4.35	14.29	14.29	5.00	14.29	14.29	1.30	1.56	1.32	2.33	4.35	2.70	2.33	5.88	2.86
92	55	3.03	2.56	2.78	N.A.	N.A.	N.A.	3.85	12.50	12.50	4.17	14.29	14.29	1.25	3.03	1.27	2.33	5.26	2.70	2.38	7.14	2.78
(3) Category 3 : all deposit-taking companies																						
88	216	3.57	2.94	3.57	N.A.	N.A.	N.A.	11.11	12.50	20.00	12.50	12.50	20.00	4.00	2.70	4.00	7.14	12.50	11.11	7.69	14.29	11.11
89	200	11.11	3.23	6.25	N.A.	N.A.	N.A.	9.09	20.00	20.00	9.09	20.00	20.00	3.57	1.96	3.57	10.00	9.09	12.50	11.11	16.67	16.67
90	190	16.67	2.50	5.00	N.A.	N.A.	N.A.	10.00	20.00	20.00	10.00	16.67	20.00	3.33	1.96	3.33	9.09	7.14	12.50	10.00	12.50	14.29
91	157	11.11	1.54	5.26	N.A.	N.A.	N.A.	10.00	20.00	25.00	10.00	20.00	25.00	3.03	1.00	3.03	8.33	3.45	11.11	9.09	5.88	12.50
92	146	12.50	3.33	14.29	N.A.	N.A.	N.A.	10.00	20.00	25.00	10.00	20.00	25.00	3.13	N.A.	3.13	9.09	5.26	11.11	10.00	7.69	12.50
(4) Category 4 : all authorized institutions (4 major bank groups singled out *)																						
88	369	4.55	10.00	5.26	2.94	3.85	3.33	6.25	14.29	11.11	4.55	12.50	7.69	5.88	4.55	5.88	20.00	7.14	20.00	25.00	10.00	25.00
89	364	4.35	9.09	5.00	2.78	4.17	3.13	6.25	12.50	11.11	4.35	11.11	7.69	5.56	3.33	5.56	9.09	25.00	12.50	10.00	33.33	12.50
90	363	4.35	7.14	5.00	2.86	3.85	3.23	6.25	12.50	10.00	4.35	11.11	7.69	5.00	2.13	5.00	10.00	25.00	12.50	10.00	33.33	14.29
91	332	4.35	7.14	5.00	2.86	3.70	3.03	5.26	12.50	9.09	4.00	10.00	6.67	5.00	1.22	5.00	9.09	25.00	11.11	9.09	33.33	12.50
92	325	4.76	6.67	5.26	2.86	3.57	3.13	5.56	12.50	10.00	4.17	10.00	6.67	4.76	1.10	4.76	9.09	33.33	11.11	9.09	33.33	11.11
(5) Category 5 : 4 major bank groups * plus 3 bank groups by country of beneficial ownership @																						
88	7	3.23	5.26	3.70	2.50	3.23	2.86	4.17	5.56	5.56	3.45	5.56	4.76	4.00	2.63	4.00	2.63	2.33	3.03	2.70	2.86	3.13
89	7	3.23	5.00	3.57	2.38	3.45	2.70	4.35	5.56	5.26	3.33	5.26	4.76	3.85	2.33	3.85	5.26	2.27	5.00	5.26	2.70	5.26
90	7	3.23	4.55	3.70	2.50	3.23	2.70	4.17	5.56	5.26	3.33	5.26	4.76	3.70	2.04	3.70	5.26	2.27	5.00	5.26	2.63	5.00
91	7	3.23	4.35	3.57	2.50	3.13	2.63	3.85	5.26	5.26	3.13	5.26	4.35	3.70	1.20	3.85	5.00	2.56	5.00	5.26	2.94	5.26
92	7	3.45	4.00	3.70	2.50	3.03	2.70	3.85	5.26	5.26	3.23	5.26	4.55	3.57	1.06	3.57	5.00	3.03	5.26	5.26	3.45	5.26

Notes : * Include
i. Hongkong and Shanghai Bank group (including Hang Seng Bank group)
ii. Bank of China group
iii. Bank of East Asia group
iv. Standard Chartered Bank group
@ include
i. Japanese authorized institutions
ii. US authorized institutions
iii. European authorized institutions
include trade financing loans + loans for use in HK.
N.A. restricted license banks or deposit-taking companies did not have such item.

Transformed into numbers equivalent, it is as if there were 10 LBs with equal market share in this category. Although the number of licensed banks between 1988 and 1992 range from 155 to 161, the number of banks actively involved in retail banking is considerably fewer. We estimate that about one third of the licensed banks are involved actively in taking demand deposits. Considering there were about 50 licensed banks actively involved in taking large amounts of demand deposits in the period 1988-1992, and given the US Department of Justice merger guidelines, the market here could be considered concentrated. The H index for foreign currency deposits in this category is 0.11 in 1992, and the H index for total demand deposits is 0.09 in 1992.

The H index for HK$ demand deposits in Category 4 (all authorized institutions with 4 groups singled out) shows a substantial increase from the H indices in Category 1 (all licensed banks category). The H index is about 0.2, and transformed into numbers equivalent, it is as if there were 5 banking groups with equal market share in this category. This shows that the bulk of the demand deposits is in the hands of a relatively few groups of banks. The H indices for foreign currency deposits and total demand deposits are also high, 0.15 and 0.19, respectively, in 1992. We wish to note that a large number of licensed banks, RLBs and DTCs are not involved in retail banking. We note that RLBs are not allowed to operate current accounts. Their holdings of "demand deposits" represent mainly time deposits that have expired but are not withdrawn or renewed by customers. This means that even though Category 4 groups all authorized institutions together, Category 4 should effectively contain licensed banks which are actively involved in this market. Even so, the H indices are high, implying that the markets are highly concentrated.

III.3.2 The Market for Savings Deposits

The H indices for HK$ savings deposits in Category 1 (all licensed banks) range from 0.16 to 0.17 within the period 1988-92. Transformed into numbers equivalent, it is as if there were about 6.25 (or 1/0.16) LBs with equal market shares in this category. This shows that the market in this category is highly concentrated. The H indices are not calculated for Categories 2 and 3, because RLBs and DTCs do not carry such an item. The H indices for savings deposits for Category 4 are high; it is as if there were about 3.3 banking groups with equal market shares in this market (the number of authorized institutions should not read as in the column, "No. of

banking units", because legally, RLBs and DTCs do not carry such an item. The exact numbers could not be ascertained because the HKMA does not have sufficient time and resources to come up with these figures).

III.3.3 The Market for HK$ Time Deposits

The H indices for HK$ time deposits in Category 1 range from 0.07 to 0.08 within the period 1988-92, indicating the market for time deposits among the LBs is not highly concentrated. For Category 2, the H indices are higher, on the order of 0.22 (or 4.5 banks with equivalent market shares) for HK$ time deposits. The H index for HK$ time deposits in DTCs (Category 3) is 0.1. Transformed into numbers equivalent, it is as if there were 10 DTCs of equal size in the market.

The H indices for HK$ time deposits in Category 4 (all authorized institutions with four major bank groups singled out) are high, ranging from 0.16 to 0.19 within the period 1988-92. Transformed into numbers equivalent, it is as if there were about 5 bank groups with equal market share of time deposits, indicating that this market is highly concentrated.

III.3.4 The Market for Total Deposits (HK$ and Foreign currency deposits)

The H index for HK$ total deposits for Category 1 is 0.11 for 1992, and values before 1992 do not show much difference. The H index for HK$ deposits for RLBs (Category 2) is 0.24 for 1992, indicating that for RLBs, the concentration for total HK$ deposits is high.

The H index for Category 4 institutions for HK$ deposits is 0.24; in numbers equivalent form, it is as if there were about 4 bank groups of equal size in this market. This shows that the bulk of total HK$ deposits is in the hands of a relatively few banks. The H indices for foreign currency deposits and total deposits (FC and HK$) are 0.1 and 0.15, respectively in 1992, and the values do indicate these markets are concentrated.

III.3.5 The Market for Private Residential Mortgage Loans

For all licensed banks (Category 1), the H index for HK$ residential mortgage loans is 0.1 in 1992; the H indices range from 0.07 to 0.10 for the period 1988-92. The H indices for HK$ private residential mortgage loans for RLBs (Category 2) are high, and appear to increase over time. The H indices for foreign currency and total private residential mortgage loans in 1992 are respectively 0.33 and 0.79. This shows that a few RLBs control the major market share for private residential mortgage loans produced by RLBs. The H index for HK$ private residential mortgage loans for DTCs is 0.32 in 1992, indicating that the concentration of this market is high among the DTCs.

When all authorized institutions, with 4 major bank groups singled out, are considered, the H index for the HK$ private residential mortgage loans is 0.21. This shows that the market is highly concentrated; it is as if there were, in numbers equivalent form, 5 bank groups with equal market share in this market. .

III.3.6 The Markets for "Other loans for use in Hong Kong" and "Total Loans for Use in Hong Kong"

The H indices for other loans for use in Hong Kong and total loans for use in Hong Kong, are quite similar. This section discusses these two markets together. The H indices are lower than 0.1 for these markets for all licensed banks (Category 1). The H indices are higher than 0.1 for these markets for RLBs (Category 2), with H indices of about 0.4 recorded for HK$-denominated loans. These results show that these markets are highly concentrated among the RLBs.

The H indices for the markets for HK$-denominated total loans for use in Hong Kong among all authorized institutions (Category 4) are about 0.1. Considering there are 325 banking units, the market in 1992 for total loans for use in Hong Kong can be considered to be concentrated; in numbers equivalent form, it is as if there were 10 banking groups with equal market share.

III.4 Summary

Among licensed banks (Category 1), the markets for HK$-denominated demand deposits, savings deposits and private residential mortgage loans could be considered to be concentrated. Among all authorized institutions (Category 4), the markets for HK$ denominated demand deposits, savings deposits, time deposits, and private residential mortgage loans could be considered to be highly concentrated (H indices are about 0.2 or greater).

This section does not intend to use the high concentrations in the HK$ deposit market to imply the existence of monopsonistic rents. Instead we leave that for section II where we argue that the existence of monopsonistic rents is created by the Banking and Hong Kong Association of Banks Ordinance. The existence of high concentrations in HK$ deposits does point to the severity of the outcome of the legally created monopsonistic rents in HK$ deposits. Detractors of this contention might argue that banking research performed on American banks has only weak evidence that a relationship exists between monopsonistic rents and concentration/market structure, see Gilbert (1986) for a summary of the literature. But one should bear in mind that these studies compare segmented bank markets within U.S.. However, it is questionable that such a study can be used to infer anything about monopsonies across international segmentation where the segmentation are more restrictive legally and geographically. Another important difference between Hong Kong and U.S. is that Hong Kong's legal structure legalizes a cartel.

IV. ANALYSIS OF INFORMATION DISCLOSURE PRACTICES BY BANKS IN HONG KONG

IV.1 Introduction

This section of the Consumer Council study on bank competitiveness analyses the information disclosure practices by banks in Hong Kong.

Banks in Hong Kong currently do not have to report true profits and losses; the creation of inner reserves hence follows. They are allowed to transfer certain amounts from their yearly profits to an account called the inner reserves, if permitted by the Hong Kong Monetary Authority. The consent of the HKMA is not required for a transfer from inner reserves. The HKMA , however, expects to be consulted in advance and they expect strong justification for such a transfer. Banks in some other countries are also allowed to keep inner reserves. Inner reserves are allowed in Germany, Switzerland and Singapore.

Banks in Hong Kong also reveal less information compared to those in the United States. For example, in the United States, banks have to itemise the sources of their revenues and report their corresponding profits and losses. They also have to report, among other items, the credit risk amount of financial instruments with off-balance sheet risk.

This study examines two aspects of information disclosure:

a. the disclosure of inner reserves; and

b. the disclosure of more detailed items, such as those currently disclosed by banks in the United States to the public, such as profits and losses from foreign exchange trading and investment securities, maturities of loans, etc.

IV.2 Objective

The objective of this study is to examine if banks in Hong Kong should reveal more information than they currently do. There are pros and cons to revealing more information. This study is designed to be a source of information to the general public on the issues involved on information disclosure practices by banks in Hong Kong. We will document the merits of

more information disclosure, and ask if the general public will be better off given more information of a bank's activities.

We provide recommendations on several areas in information disclosure where the government, the legislature and the public may want to look into, and perhaps improve. This study is commissioned by the Consumer Council of Hong Kong which acts in the interests of consumers, namely the depositors and the shareholders. The recommendations we provide are motivated by similar interests.

The remainder of this section is organized as follows. Subsection IV.3 describes the methodology. Subsection IV.4 analyzes the interviews with bankers, financial analysts, and the Hong Kong Monetary Authority. We compare the information disclosure practices by banks in Hong Kong with those in the United States, Japan, United Kingdom and Singapore in subsection IV.5.

IV.3 Methodology

The methodology to carry out the study is as follows:

1. To document the current information disclosure practices by banks in Hong Kong;

2. To seek the views of the Hong Kong Monetary Authority, bankers and bank financial analysts on information disclosure;

3. To compare the information disclosure practices in Hong Kong with those in United States of America, United Kingdom, Japan and Singapore;

4. To provide economic analysis of the merits and demerits of disclosing more information;

5. To attempt to establish a quantitative relationship between the stability in the banking system and the degree of information disclosure.

We believe a balanced view on the issue of the disclosure of inner reserves and other more detailed information by banks can be attained if we meet with the Hong Kong Monetary Authority (HKMA), bankers and financial analysts, and solicit their views. Mere summary of the views of the HKMA, bankers and financial analysts alone in this study will not be helpful to the general public. Hence, we also analyze their views, and provide economic ramifications and interpretations of these views. The general public, particularly bank depositors and shareholders, having been exposed to the views and economic analysis given, can then decide for themselves whether they wish to press for more information disclosure by banks. We also provide views and positions of our own on this issue (we acknowledge not all financial economists will concur with us on the issues discussed here).

We tried to solicit interviews from locally-incorporated as well as foreign-incorporated banks. However, out of twelve requests for meetings with bankers from different banks, we managed to obtain interviews with four bankers. Interviews with officials from the Hong Kong Monetary Authority, five financial analysts who come from well-established brokerage and financial research centres were also conducted. After these interviews, we sent to each of the interviewees a copy of unedited notes written by us for their final approval. We analyze below their views based on the notes edited by the interviewees themselves.

Appendix IV.1 provides the views from the HKMA. A summary of the views of the financial analysts and the bankers in tabulated form are given in Appendix IV.2. Unless otherwise stated, 'the bankers' and 'the financial analysts' in this study refers to the bankers and financial analysts we interviewed, respectively. Also 'banks' can refer to either licensed banks, restricted licensed banks or licensed deposit-taking companies. To avoid any inconvenience to the bankers and financial analysts we interviewed, we decide not to quote the sources of the various views analyzed in this section.

We send questionnaires to the central bank authorities or supervisory bodies of United States, United Kingdom, Japan, and Singapore to compare the disclosure practices by banks in those countries and in Hong Kong. We analyze the merits of disclosing more items based on various publications by the Securities and Exchange Commission, USA. As for establishing whether there is a relationship between the stability in a banking system and the degree of information disclosure, please see Appendix IV.3.

IV.4 Analysis of Interviews with Bankers, Financial Analysts and the Hong Kong Monetary Authority on the Issue of the Disclosure of Inner Reserves and other more detailed information

All the bankers maintain that inner reserves do not have to be disclosed presently given the present institutional structure. A banker is personally for disclosure of inner reserves if some present institutional features (discussed later on), which appear unfair to banks other than the Hong Kong and Shanghai Bank, are removed. Another banker indicates this bank is prepared to disclose its inner reserves if all other banks follow suit. The HKMA's position currently is in favour of more disclosure by banks in Hong Kong. However, the HKMA has not decided on what other information banks should disclose. It has set up a working group to examine this issue. Please see Appendix IV.1 for the HKMA's current attitude towards financial disclosure (as of January 1994). We categorize the main points of the bankers, the HKMA and the financial analysts below, and provide economic analysis of these points.

IV.4.1 Principle on which information disclosure is based

In this section, we ask, "What motivates information disclosure"? Should investors rely on the regulatory banking authority in a country for the safety of their deposits or should they rely on reliable information disseminated by banks? In designing disclosure regulations, the legislature and the government should ask whether current information disclosure laws are adequate in protecting depositors and shareholders of banks.

We cite the basis for the Securities and Exchange Commission of the United States in adopting disclosure regulations, "The materiality of information to investors is the principal consideration of the Commission in adopting disclosure regulations. Materiality, as construed by the Supreme Court of the United States, is determined by reference to the information a reasonable investor would wish to know in the evaluation of a securities investment." We should realize that bank deposit is a form of securities investment and depositors are "investors".

The SEC's (US) regulatory brief, as expressed in the Securities Act (US) of 1933, is to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce. Throughout the laws administered by the Commission, the protection of investors is achieved not through substantive regulation of business decisions but through the medium of disclosure, which permits the public securities markets to make informed investment judgments. The Commission's disclosure regulations thus require comprehensive information on all aspects

of an issuer material to an evaluation of its prospects, including its business, management, and financial statements.

With minimal information disclosure to the public, the regulatory authority appears to be the ultimate guardian of safety of deposits. With more disclosure of relevant financial items important to depositors' and shareholders' decision-making, the responsibility of the regulatory authority as the ultimate guardian of depositors' money becomes less. We recommend that the basis for information disclosure requirements in Hong Kong be motivated by the protection of investors achieved through the medium of disclosure, rather than through the regulation of business decisions.

IV.4.2 Can inner reserves act as a buffer when times are bad?

Some bankers have maintained that inner reserves act as a buffer when banks report less than average performance. They argue that if true profits are reported, depositors may overreact in response to poor results by withdrawing their deposits, thus causing a bank run. What is more worrying is the prospect of a contagious bank run. The recent example, which bankers quote, was the failure of Bank of Credit and Commerce International in 1991, which caused bank runs on Standard Chartered and Citibank, two banks which, report "true profits" on a consolidated basis. We feel however, that if depositors do not know the whole truth, they may feel that matters are actually worse than what they really are. In short, the practice of maintaining inner reserves may backfire.

IV.4.3 Estimating inner reserves and the value of bank stocks

The value of any stocks cannot be determined accurately due to the uncertainty of estimating expected future cash flows owing to a myriad of company-specific and macroeconomic factors. The question in this study is whether inner reserves makes that process more difficult. Financial analysts, we talk to, state that the task of estimating the value of a bank is made more difficult when banks do not disclose their inner reserves. Also, they state that it is difficult to estimate the inner reserves of banks even if they analyze its financial statements and operations since its inception date. We were provided some estimates of inner reserves by some financial analysts. We quote some estimates of inner reserves of banks provided by these analysts, and to protect confidentiality, we do not name the sources for those

estimates[17]. The motivation for presenting these estimates is to let the public judge whether inner reserves of banks can be easily estimated. The inner reserves estimated as at 31 Dec 1992 are in Table IV.1, given below:

Table IV.1 Estimates of inner reserves of some banks in Hong Kong by some financial analysts

	Financial Analyst		
	I	II	III
	HK $million		
Bank			
Bank of East Asia	2530	3,269	920
Dah Sing Financial Holdings	185	560	
Wing Lung Bank	550	922	
Dao Heng Bank	273	657	

Particularly interesting is the estimate of inner reserves for Bank of East Asia. The inner reserves estimated by the financial analysts range from 920 HK$million to 3,269 HK$million - a difference of 2,349 HK$million.

Hong Kong Bank and Hang Seng Bank (a subsidiary of Hong Kong and Shanghai Bank) disclosed its inner reserves on 14 April 1992. The disclosure of Hang Seng Bank's inner reserves surprised the investor community by being significantly higher than was originally believed. According to a financial analyst, it leads to a re-rating of most bank stocks in the territory and was believed to be one of the main reasons behind a 1992 share price increase of 50% or more for many of the smaller banks. This price increase was obviously not fair to the investors who had sold before the re-rating and was a windfall for those who bought before it. This shows that shareholders can be hurt by non-disclosure of inner reserves and true profits.

[17] These financial analysts provide services of estimating inner reserves for clients or for their own portfolio decisions. Hence, some feel strongly against letting the public know where these estimates come from or how they are calculated.

IV.4.4 More detailed information

Some bankers are also not in favour of disclosure of more detailed information, such as the breakdown of the income statement into profits and losses from foreign exchange trading, investment securities, interest income, and other activities. Financial analysts' views are different from the bankers' views. Financial analysts maintain that more information on the breakdown of the profits and losses will benefit shareholders and depositors, as this will enable the financial analysts and shareholders to better gauge the risk-return performance of banks.

There are merits in such breakdown of the income statement. For example, if a bank were to report heavy losses from foreign exchange trading, it does suggest a bank is involved in unhealthy speculation in the foreign exchange markets. Shareholders, given this information, may wish to rebalance their portfolios. Another item of importance that has been brought up by financial analysts is the need for banks in Hong Kong to report their level of non-performing loans and the amount of bad debt provisions. We believe that such disclosure would enable shareholders and financial analysts to gauge the trend in the quality of a bank's assets. The benefits of disclosing other items are described in Section IV.5.

IV.4.5 Reporting of unrealized profits and losses

The market values of fixed assets, such as properties and investment securities holdings, fluctuates from time to time. An important issue is whether banks should revalue their assets to reflect the fair values of their assets. Banks do revalue their assets, but it is not done frequently. Revaluation is a costly exercise. However, we feel that revaluations of assets would lead to a better representation of the value of a bank.

IV.4.6 The unavailability of deposit insurance in Hong Kong and information disclosure

There are two sides to the argument on the non-existence of deposit insurance in Hong Kong and disclosure of more information to the public. There is the argument that as there is no deposit insurance, the case is stronger for not releasing true profits as inner reserves can be used as a buffer when banks report poor profits or heavy losses. Depositors may overreact by withdrawing their deposits in response to the news of poor profits or heavy losses. The other side is that, there is a need for more detailed information disclosure so that depositors can assess for themselves where to place their deposits as their deposits are not insured. Which side is right? Financial analysts we talk to emphasize that depositors should have access to more

detailed information so that they could decide for themselves where to place their deposits as they ultimately shoulder the risk of not getting their deposits back.

IV.4.7 The impact of more information disclosure on smaller banks

Some bankers are of the opinion that smaller banks would be at a greater disadvantage if inner reserves and other more detailed information are disclosed. According to them, smaller banks might be viewed as less financially stable, and the disclosure of inner reserves, if below shareholders' and depositors' expectations, might hit smaller banks most. Depositors may rush to withdraw their money and in the short-term there may be transfers of deposits from financially weak smaller banks to well-established bigger banks.

While it may be true that smaller banks are sometimes perceived as being less financially stable, it is possible that reporting of information that does not depict their true picture may backfire.

IV.4.8 Guidelines on the transfer to and fro inner reserves and supervision by the HKMA

The bankers we talk to state that the level of supervision by the HKMA is adequate. They maintain that the HKMA has been doing a good job in regulating banks. Hence, according to them, information on inner reserves and other more detailed information need not be disclosed to the public. The most recent major bank failure is the failure of the Bank of Credit and Commerce International, which bankers attribute to foreign factors, not originated from Hong Kong.

The public cannot expect the HKMA to supervise every minute details of a bank's operations as that would be too costly. However, we feel that the public can together shoulder the responsibility in monitoring banks. The government should realize that the public can also act as a means to discipline banks. This can be done only if adequate information is available; information such as disclosed inner reserves, true profits and losses of a bank, and other more detailed information (examples of which are described in Section IV.5). Increased disclosure of information can also protect consumers against the possibility that a regulating body may be incompetent.

It is likely that accurate disclosure of risk would tend to discourage risk-taking. If, for example, a bank prefers a riskier portfolio, uninsured depositors would have to be offered higher expected returns to compensate them for bearing more risk. The excess returns promised to the uninsured depositors would absorb the excess returns expected from the normal-than-riskier portfolio. Hence, there would be little incentive for banks to engage in excessive risk-taking. This may in turn lead to fewer number of bank failures. However, as emphasized before, market discipline can work effectively only if adequate information is given. Studies by Hannan and Hanweck (1988) and Baer and Brewer (1986) show that the market for uninsured Certificates of Deposits (deposits larger than US$100,000) in the U.S. does demand higher premium on the uninsured CDs as bank risk taking becomes higher. Baer and Brewer (1986) further argue that the impact of disclosures on stock price and deposit flows should not be as disruptive as one may expect. The disclosures should help the market assess bank risk taking.

The HKMA sets strict guidelines on transfers to and out of inner reserves. A bank must declare its general policy about transfers to inner reserves. It appears that banks cannot wantonly abuse the present system on transfers to and out of the inner reserves given present guidelines set by the HKMA. However two uncertainties remain; the public does not know whether a bank in a particular year has transferred amounts out of inner reserves to add to the yearly profits or losses, and the difficulties that financial analysts, shareholders and depositors face in valuing stocks and estimating inner reserves remain.

IV.4.9 'Unfair' Bank Institutional Structure

A particularly interesting point on the present banking structure is brought up by a banker. He states that the existing institutional structure provides an unfair advantage to Hong Kong and Shanghai Bank (HSBC) if inner reserves and other more detailed information are disclosed.

HSBC currently enjoys certain privileges not available to other banks; it is the management bank of the Hong Kong clearing system as well as the principal banker to the Government. As the management bank of the Hong Kong clearing system of the Hong Kong Association of Banks, HSBC charges banks interest rate of about prime + 3% on any credit balance above a certain credit line. The amount of the credit line is determined by the HSBC at its discretion. As the principal banker to the Government, the HSBC has almost all the

deposits of the Government. The banker is of the opinion that more information disclosure by banks in Hong Kong would add on to the advantages now presently enjoyed by HSBC.[11]

IV.4.10 The costs of acquiring information

It is not realistic to expect all depositors to be as well versed as financial analysts in interpreting financial statements of banks or other corporations. A financial analyst states that it is not likely that the average depositor would understand the details of a financial statements, beyond the reporting of the profits and losses of a bank. Even so, a relevant issue is whether depositors would overreact even more swiftly and severely to published information that does not depict the true picture or performance of a bank.

It is not uncommon for financial analysts' opinion to appear in newspapers, which are available at a small cost to the public. However, it is unlikely that more detailed information can be obtained from these analysts free of charge; otherwise, no one would pay for their services. He states that common depositors are not expected to have as much information as those possessed by shareholders who have lines of communication with their financial analysts or brokers. He believes that it is unlikely that information will be available to the common depositors costlessly; shareholders have the financial advice because they pay these brokers or financial analysts.

Granted that it is so that shareholders are better informed than the common depositors, we come next to the issue as to whether knowing true information in the form of disclosed inner reserves or true profits or losses would hurt the depositors. It is possible that if depositors know that they are not fed the true information about the financial condition of a bank, they may overreact unduly even more swiftly or severely. Depositors may be concerned that things may be worse than what is reported by banks - a worse scenario. Non-disclosure of true performance might backfire.

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[11] Although the cheque-clearing system and placement of Government deposits do not fall under the scope of our study, we suggest that the Government look into the cheque-clearing system and its deposit placements with other banks in Hong Kong.

IV.4.11 Locally-incorporated versus foreign-incorporated banking institutions: different disclosure regulations

A banker brings up an important point that locally-incorporated banks could be disadvantaged as against the foreign-incorporated banks, if inner reserves are disclosed. This is because foreign-incorporated banks which consolidate their figures do not have to report locally, unless there is a separately incorporated Hong Kong subsidiary. The general public in Hong Kong could therefore know less about the local operations of a foreign-incorporated company than a locally-incorporated bank. We recommend that if inner reserves were to be disclosed, it is fair then for foreign-incorporated branches to report on the same basis as locally-incorporated banks. We understand that if the foreign bank of which the branch is a part does maintain inner reserves, it would do so at the Head Office. The first step towards parity of disclosure by foreign-incorporated and locally-incorporated banks
would be for the foreign branches to disclose its true earnings in Hong Kong, its repatriation of earnings to the Head Office, and the capital contributed by the Head Office.

IV.4.12 Position of Hong Kong as a leading international financial centre with minimal information disclosure

A number of bankers and the HKMA have brought up the issue that regulatory bodies in leading international financial centres such as Switzerland, Germany and Singapore also allow inner reserves to be maintained by banks. They state that the disclosure of inner reserves is not a prerequisite for Hong Kong to continue to be a leading international financial centre. We believe that while it is true that Hong Kong presently enjoys the role of a international financial centre, disclosure of more information by banks in Hong Kong, particularly the release of inner reserves and other more relevant information, would even enhance that position.

International markets compete for investment funds. Flow of funds to the territory very much depends on whether investors have the relevant information about the assets they invest in. Funds from the territory may even flow to foreign markets if local investors do not have adequate information about their assets. The minimum information that investors use to gauge the value of their investments is the true cash flow of a firm. The relevant question is whether investors in banks would want more information, such as the true profitability and inner reserves of banks? Would more information disclosure hurt the value of the stocks? It is likely, the answer is 'yes' to the first question and 'no' to the second. It is unlikely that the discreetness

of bank reporting can enhance the value of a bank's stock. Investors cannot gauge the fair value of a stock, without at least knowing the true profits and losses of a bank. In fact, according to some financial analysts, the value of a certain bank stock in Hong Kong is currently overpriced.

IV.4.13 Summary

This subsection compares and contrasts the views of bankers and financial analysts with regards to information disclosure. Bankers argue that banks do not have to disclose more information given that there is adequate supervision by the Hong Kong Monetary Authority. Financial analysts believe that more disclosure would lead to better valuations of banks and bank stocks, and provide information vital to the depositors on their deposit placements.

IV.5 Comparisons between Information Disclosure by banks in Hong Kong with those in United States, Japan, United Kingdom and Singapore: An Economic Analysis

It is quite well known that banks in Hong Kong do not disclose as much information as banks in the US, UK, and Japan. In this subsection, we first provide a breakdown of the items that are disclosed by banks in the United States, and provide economic rationale for disclosure of such information. We provide the economic rationale for disclosure of such information as merely documenting the differences in information disclosure would not be informative to the public.

IV.5.1 The Income Statement

IV.5.1.1 Breakdown of Revenue and Expenses

Banks in the U.S. provide a breakdown of the sources of their revenues. We single out below the important items that are of use to investors and depositors in determining the risk-return performance of banks, and that are not required by law to be reported by banks in Hong Kong. Banks in the U.S. report their interest income on loans, foreign exchange trading revenue and gains or losses from investment securities. It is helpful to shareholders, analysts and depositors if banks provide the interest income on loans, and gains and losses from foreign exchange trading and investment securities as they provide information of how well the banks are doing in these trading activities. Obviously if banks were to derive their revenues in the form of fees and commissions from trading for other parties, the foreign exchange trading

activities does not deserve scrutiny. However, gains and losses from open or uncovered positions in foreign exchange trading activities and holdings in investment securities would be helpful to depositors, shareholders and financial analysts, as it provides information on a bank's exposure to these risky trading activities.

Breakdown of operating expenses is not as important. However, breakdown of expenses into salaries and employee benefits, travel, etc. does give shareholders some idea of a bank's operating expenses.

IV.5.1.2 Inner Reserves

Banks in Hong Kong do not have to report their "true" profits. This makes it difficult for investors, and depositors to know the true financial strength and the value of banks. If banks do disclose their inner reserves later on due to some regulatory requirements, such as Hong Kong Bank having to disclose its inner reserves in its bid for Midland Bank, shareholders may be hurt. If inner reserves are higher than expected, those who sell their shares before the disclosure of inner reserves will see their wealth go down and those who buy the shares before disclosure reap excess profits. Conversely, when inner reserves are lower than expected, those who sell before disclosure gain, and those who buy loses. Hence, inner reserves adds more uncertainty to the valuation of shares and values of banks.

IV.5.2 The Balance Sheet

IV.5.2.1 Loan Loss Reserves and Non-performing loans

Except for HSBC, banks in Hong Kong do not have to report their loan loss reserve figures or the level of non-performing loans. Banks, do however, take general provisions (which is some percentage of total loans) and, most maintain that non-performing loans are less than a certain percentage of total loans. Banks in the U.S. report their level of non-performing loans and loan loss reserve figures. Loan loss reserve figures and the level of non-performing loans provide important information about a bank's trend in asset qualities. These figures provide information as to whether the bank is expected to generate, in the future, good income from its assets, or whether a bank's loan portfolio is expected to degenerate or go sour. This

information, if available, would help financial analysts and shareholders value a bank and assess its soundness. Several financial analysts we talk to emphasize that there is a need for such figures.

IV.5.2.2 Debt Maturities and Interest Rate Sensitivity Gap

Banks in the U.S. provide a breakdown of their outstanding debt balance and their maturities. This is important as it would enable financial analysts, shareholders, and depositors know the extent of a bank's short-term and long-term credit risk. Banks in the United States report these values on a more detailed basis. Besides reporting the details of a bank's rate-sensitive liabilities (RSL) and their balance, banks in the US also report the maturities of their rate-sensitive assets (RSA) and their values. This reveals a bank's interest rate sensitive gap, or (gap = RSA-RSL). Knowing the gap values, a bank's sensitivity to interest rate changes can be appraised.[19]

IV.5.2.3 Detailed Breakdown of Loan portfolios

Banks in the US report their loan portfolios on a more detailed basis. They are classified into:

loans for commercial real estate;,

loans to financial institutions;

commercial and industrial loans;

loans for purchasing or carrying securities;

consumer loans (such as loans secured by residential properties, credit card

[19]For example, if RSA is greater than RSL, a decline in interest rates would result in a decline in net interest revenue. If RSL is greater than RSA, decline in the interest rate would result in an increase in net interest revenue. It is damaging for the bank when interest rate rise as net interest rate revenue would decline. The thrift institutions in the United States experienced this problem in the late 70's and early 80's when interest rates were high. For further details, see, for eg., Sinkey (1986).

loans);

lease financing;

loans to governments and official institutions (including details of credit exposure in certain Latin American countries);

Reporting the breakdown of loan portfolios is important, as it will be easier for shareholders, depositors and financial analysts to know the extent of a bank's loan concentrations. This information provides information on a bank's asset qualities. For example, undue concentration in loans to governments and official institutions, especially to governments with debt-servicing difficulties, will reveal the extent of a bank's exposure to such credit risk.

IV.5.2.4 Fair Values of Financial Instruments

Banks in the United States are required to report the fair values of their financial assets and financial liabilities. Reporting the fair values of their assets is important as the values of these assets change with changes in interest rates as well as changes in credit risk of the borrowers, resulting in changes in the expected interest and principal payments.

IV.5.3 Off-Balance Sheet Items.

Banks engage in a number of off-balance sheet activities, which are not captured as assets or liabilities under conventional accounting procedure. For example, loans enter as assets in a bank's balance sheet, whereas a promise to make a loan is a contingent liability. Once the promise is fulfilled, should the contingency be realized, the liability is then recorded in the balance sheet. Statement of Financial Accounting Standards (SFAS) No. 105 issued by the Financial Accounting Standards Board (FASB) of the United States requires disclosures about financial instruments with off-balance sheet risk and credit risk concentrations for all financial instruments.

Off-balance sheet activities do expose the firm to credit and interest-rate risk. Presently in Hong Kong, off-balance sheet activities do not have to be reported to the public. This is in contrast to the practice in the United States, where banks have to report their exposure to credit risk from their off-balance sheet activities.[20]

IV.5.4 Foreseeable changes in financial condition should be reported

Item 303 of Securities and Exchange Commission (US) Regulation S-K requires corporations and bank holding companies to report foreseeable changes in its financial condition. There are merits in requiring companies to do so. For example, if just before closing of the balance sheet at year's-end, the bank already has decided to take on more debt in the next year, it should be reported. This provides shareholders and debt-holders information on the riskiness of their securities. Banks are recommended to report any known trends, or any known demands, commitments, events that may materially affect a bank's liquidity, capital resources (for example, debt/equity ratios) and revenues. The disclosure of this information is not required in Hong Kong.

IV.5.5 Cross-country Comparisons of information disclosure practices between Hong Kong and some other countries.

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[20]Off-balance sheet activities are grouped into several categories:

a. Commitments

These are commitments by banks to advance funds to borrowers in the future. Commitments expose banks to acquiring a credit exposure or risk at some time in the future. Examples of commitments are unused overdrafts and credit lines, revolving lines of credit and note issuance facilities.

b. Guarantees

These are guarantees by a bank to fulfil obligations of a third party. Should a counter-party on whose behalf a guarantee has been written default, the bank incurs an immediate loss. Examples are banker's acceptances, standby letters of credit and commercial letters of credit.

c. Foreign-exchange and interest-rate related transactions

These are interest-rate and exchange-rate agreements. Whether the transaction is hedged or unhedged, the bank is subject to the creditworthiness of the counter-party. Examples of transactions are forward foreign exchange rate agreements and interest rate and currency swaps.

d. Other activities, such as securities underwriting.

Some banks engage in investment banking and merchant banking, which earn fees. Banks which underwrite securities are subject to risks arising from fluctuations in the prices of securities they are underwriting.

We present in Tables IV.2 and IV.3 summaries of the items of importance that may be disclosed by banks in Hong Kong, United States, United Kingdom, Japan, and Singapore to the public and to their respective central banks (or regulating authorities).[21]

As shown in Tables IV.2, banks in Hong Kong are not required to report to the public as much information as banks in the US, UK and Japan. However, all the information that are not required to be disclosed to the public is disclosed to regulatory body - the Hong Kong Monetary Authority.

IV.5.6 Summary

This subsection provides the economic rationale for disclosure of inner reserves, breakdown of revenues and expenses, loan loss reserves and non-performing loans, maturity mismatching, detailed breakdown of loan portfolios, off-balance sheet items and foreseeable changes in financial conditions of banks. We note that banks in Hong Kong do not report the aforementioned items. Banks in Hong Kong report less than banks in the US, UK and Japan. Hong Kong's position as an international financial centre would be further enhanced if banks disclose more information. We provide recommendations on the items that should be disclosed in the near future in Section VI.[22]

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[21] For documenting information disclosure in the U.S., we use the SEC as the regulatory authority. We would like to note that not all banks come under the SEC's jurisdiction; U.S bank holding companies are subject to SEC's regulations. The supervisory agencies in the U.S include the Federal Reserve, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency.

[22] We briefly compare the recommendations by the Working Group on Financial Disclosure and those of this study. The Working Group on Financial Disclosure (WGFD), whose members come from the Securities and Futures Commission (SFC), Stock Exchange of Hong Kong (SEHK) and the Hong Kong Society of Accountants (HKSA), issued a report dated August 1993, providing recommendations on furthering information disclosure by companies listed on the Stock Exchange of Hong Kong. The WGFD points out that a major area of deficiency is the exclusion of banking, insurance and shipping companies from certain disclosure requirements of the Companies Ordinance. The WGFD proposes, "that consideration should be given to the possibility of the issue being dealt with through the Listing Rules in advance of a change in the law." (see #41, p. 13). Of course, if banks whose shares are listed on the SEHK, were to comply with the Companies Ordinance, they would not be permitted to maintain inner reserves, and they would have to report true profits, which are consistent with our recommendations for authorized (banking) institutions. The WFGD proposes certain other disclosure requirements that are recommended for review by the SEHK and HKSA. For further details, please see their report. The WFGD targets listed companies in their report. This report differs from the WFGD in that we target authorized institutions (including the LBs, RLBs and DTCs) in general.

Table IV.2 Cross-Country Comparisons of Information Disclosure Practices by Banks in Hong Kong, United States (US), United Kingdom (UK), Japan (Jap), and Singapore (SNG).

	US[1]	UK[2]	Jap[3]	HK[4]	SNG[5]
Is the following information disclosed to the public?					
1. Deposit balance 1.1 Are individual banks required to disclose their deposit balance by the maturities of the deposits (this is to determine the extent of banks' exposure to maturity mismatching and interest-rate risk)?	Y	Y	Y	N	N
2. Loan Concentrations 2.1 Are individual banks required to disclose loan concentrations by single borrower: single individual; group of firms; or LDC (lesser developed countries)?	Y Y Y	N N N	N N Y	N N N	N N N
3. Loan Portfolios 3.1 Are individual banks required to disclose their loan portfolios by: a. the maturities of the loans; b. the uses of the loans (such as LBO (leveraged buyouts), loans itemised into the property, commercial or industrial sectors) and report their corresponding outstanding principal amounts; c. by geographical locations (loans by regions)?	Y N[6]/Y N[6]/Y	Y N N	Y Y N	N N N	N N N
3.2 Are individual banks required to disclose the: a. principal amount of nonperforming loans; b. bad debt provisions?	Y Y	N Y	Y Y	N N	N N
4. Foreign exchange activities 4.1 Are banks required to disclose their profits and losses from foreign exchange trading?	Y	N	Y	N	N
4.2 Are they required to disclose the amount of their uncovered (exposed or open) position in foreign exchange?	Y	N	N	N	N
5. Others 5.1 Are banks required to provide a fair assessment of the foreseeable changes in the financial condition of a bank in the coming year?	Y	N	N	N	N
5.2 Are individual banks required to disclose information such as: a. holdings of investment securities; b. and their gains and losses; c. off-balance sheet activities (those amounts subject to credit and market risk, such as interest rate and exchange rate fluctuations)?	Y Y Y	Y N Y	Y Y N	Y N N	Y N N
6. Are inner (hidden) reserves disallowed?	Y	Y	Y	N	N

Note: Y - Yes; N - No

Table IV.3 Cross-Country Comparisons of Information Disclosure Practices by Banks in Hong Kong, United States (US), United Kingdom (UK), Japan (Jap), and Singapore (SNG)

	US[1]	UK[2]	Jap[3]	HK[4]	SNG[5]
Is the following information disclosed to the Central Bank?					
1. Deposit balance 1.1 Are individual banks required to disclose their deposit balance by the maturities of the deposits (this is to determine the extent of banks' exposure to maturity mismatching and interest-rate risk)?	Y	Y	Y	Y	Y
2. Loan Concentrations 2.1 Are individual banks required to disclose loan concentrations by single borrower: single individual; group of firms; or LDC (lesser developed countries)?	 Y Y Y	 Y Y Y	 Y Y Y	 Y Y Y	 Y Y Y
3. Loan Portfolios 3.1 Are individual banks required to disclose their loan portfolios by: a. the maturities of the loans; b. the uses of the loans (such as LBO (leveraged buyouts), loans itemised into the property, commercial or industrial sectors) and report their corresponding outstanding principal amounts; c. by geographical locations (loans by regions)?	 Y N[6]/Y N[6]/Y	 Y Y N	 Y Y N	 Y Y Y	 Y Y Y
3.2 Are individual banks required to disclose the: a. principal amount of nonperforming loans; b. bad debt provisions?	 Y Y	 N Y	 Y Y	 Y Y	 Y Y
4. Foreign exchange activities 4.1 Are banks required to disclose their profits and losses from foreign exchange trading?	Y	N	Y	Y	Y
4.2 Are they required to disclose the amount of their uncovered (exposed or open) position in foreign exchange?	Y	Y	Y	Y	Y
5. Others 5.1 Are banks required to provide a fair assessment of the foreseeable changes in the financial condition of a bank in the coming year?	Y	N	N	Y	Y
5.2 Are individual banks required to disclose information such as: a. holdings of investment securities; b. and their gains and losses; c. off-balance sheet activities (those amounts subject to credit and market risk, such as interest rate and exchange rate fluctuations)?	 Y Y Y	 Y N Y	 Y Y N	 Y Y Y	 Y Y Y

Note: Y - Yes; N - No

Notes - continued

[1] The questionnaire for the case in the US is completed by the Securities and Exchange Commission (SEC).

[2] The questionnaire for the case in the UK is completed by the Bank of England.

[3] The questionnaire for the case in Japan is completed by the Federation of Bankers Associations of Japan.

[4] The questionnaire for the case in Hong Kong is completed by a banker in Hong Kong.

[5] The questionnaire for the case in Singapore is completed by looking at the annual reports of banks in Singapore and blank returns banks in Singapore must submit to the Monetary Authority of Singapore (MAS) , as we could not obtain the completed questionnaires from the MAS. Any errors are regretted.

[6] Although bank holding companies (BHCs) in the US are not required to disclose such items, a survey of annual reports of BHCs shows that most, if not all, BHCs disclose this information.

V. Tying of Mortgage and Fire Insurance

V.1. Introduction to Tie-In Sales

A tie-in sale occurs when the sale of one good is made contingent upon the sale of other goods. The "good" can be anything from a physical good to a service, and to a financial product.

Tying contracts create an artificial connection between the availability of two distinct products. Tie-in sales exist for many reasons:

(1). **Efficiency.** For example, laced shoes are sold with laces and are sold in pairs. Coats are sold with buttons on. Such practices are more efficient to sellers and most consumers. After all, most products can be regarded as consisting of many small products that can be sold separately. These small pieces are tied together to meet consumers' demand for the assembled products. By practising tie-ins, sellers can lower the costs and facilitate the distribution of their products.

(2). **Quality Assurance.** The sales of goods might be tied together to guarantee the best quality of the products. For example, plane company might tie its planes to certain parts for quality and safety considerations. However, tying is not the only way, nor the best way, to serve this purpose. Methods like instructions, suggestions, warnings can be more adequate.

(3). **Evading Regulation and Agreement.** When there are price ceilings, products subject to the ceilings might evade such controls by tying to other uncontrolled products, which would be sold at a higher price. A firm engaged in a Cartel agreement might also give a secret price discount by tie-ins and charge the tied product a lower price.

(4). **Monopolistic Profit Seeking.** By tying a monopolised product to a product not under its control, a monopolist could undertake price discrimination, and create a second monopoly by extending its monopolistic power into other markets. It can also raise barriers to entry and protect its monopolistic status.

V.2. The Tying of Mortgage Loan and Fire Insurance in Hong Kong

Some banks are known to be tying their mortgage loans to fire insurance in Hong Kong; i.e., a designated insurance company has to be accepted when a customer applies for mortgage loans. According to a survey undertaken by the Hong Kong Consumer Council in August 1989, out of the 37 banks studied, there were 24 banks (65%) requiring customers to take fire insurance from a designated insurance company for mortgage loans to be granted.

Only 4 banks allowed customers to choose their own insurance companies, subject to these banks' consent. The other 9 banks allowed customers to choose insurance companies from an approved list.

To find out whether there is still tying of mortgage loans to fire insurance in Hong Kong, we used a sample of banks from the following different banking groups (see also Table V.1): (1) the Hong Kong Bank group, including Hong Kong Bank and Hang Seng Bank; (2) the Bank of China group, including all the 13 member banks; (3) some major foreign banks, including Citibank, Chase Manhattan Bank, Belgian Bank, and Standard Chartered Bank; and (4) some local banks, like Bank of East Asia and Dah Sing Bank. We believe that such a choice is representative, as banks included have a major share in the mortgage loan market, and they are the main banks from different banking groups operating in Hong Kong.

From Table V.1, member banks of the BOC group seem to be generally practising tie-ins. Among the 13 member banks studied, nine of them designate a single insurance company to their customers. The other 4 banks allow some choice, but only from a list of at most 3 companies. Besides, all of the designated insurance companies are held by the BOC group.

In contrast, the Hong Kong Bank and Hang Seng Bank are no longer tying their mortgage loans to fire insurance of a list of designated companies. Consumers can take insurance from any company, subject to the banks' consent with regard to items like the scope and amount of the cover.

The cases of the local banks and foreign banks are both rather mixed. Some of them, like Bank of East Asia, Wing Lung Bank, Chase Manhattan Bank, and Belgian Bank, accept insurance from only one designated company. While some other banks, including Dah Sing Bank, Standard Chartered Bank, and Citibank, have given up their tying requirements since the last study undertaken by the Consumer Council in 1989.

Overall, there is a mixed case. Some banks in Hong Kong are tying their mortgage loans to fire insurance, while some banks are not. If we look at the banks by groups, banks of one of the two dominant banking groups are generally practising tie-ins. Some of the major local banks and foreign banks are also practising tie-ins.

V.3. Possible Effects on Consumers

We measure the possible effects of the tying of mortgage loans and fire insurance by considering the costs of the loans and insurance. We used all the other banks and 4 out of the 13 BOC member banks (chosen randomly) listed in Table V.1 for our following calculation.

V.3.1. The Costs of Mortgage Loans.

The banks studied are all charging the same interest rate on their mortgage loans (8.25%, or prime rate + 1.75%, see Table V.2). Therefore, the interest rate alone will give the impression that the costs of mortgage of all banks are the same.

However, in many cases the consumers have to pay service and evaluation charges when they apply for mortgage loans[23]. There will also be penalty charges if they want to pay back their mortgage early or if they lag behind the due payment of their mortgage. Such costs differ very much across the studied banks (see Table V.2).

(1) The Service Charge and Evaluation Fee. These are lump-sum charges paid to the banks by applicants when they start to receive mortgage loans. Because banks use different methods to calculate the charges, for comparison purpose, we assume three cases when a customer borrows 1 million, 2 millions, and 3 millions mortgage loans, respectively, from the banks. The costs of the three cases for each bank are listed in Table V.3.

No systematically higher lump-sum charges are found for banks practising tie-ins. Some of the BOC member banks have rather high charges, but some other banks, like Bank of China, Chase Manhattan Bank, and Belgian Bank are charging the average level, while

[23] We do not consider the government stamp duty, as the rate is the same for all purchases falling in the same category. Nor do we consider solicitors' fees, which are determined by the Law Society of Hong Kong and should apply to all solicitors.

Bank of East Asia and Wing Lung Bank are not even charging the applicants.

(2) **The Early Payback.** Charges on early paybacks are a measure used by banks to punish the speculators in the real estate market and to protect themselves. Banks usually charge a penalty fee on borrowers who wish to pay back their mortgages within 1-year or half-a-year's time. In some cases the charges are negotiable, depending on the reasons the borrowers give.

Because early payback charges are sometimes used as a leverage to reduce speculation in the real estate market (especially by the leading banks), the level of such charges might not reflect the costs of tie-ins.

Since different methods are used by banks in calculating the charges, we again used examples of 1, 2, and 3 millions loans. From Table V.4, no systematic higher charges are collected by the tying banks.

(3) **The Lagged Payment.** A higher penalty rate is charged in most cases when the borrowers fail to pay the due instalments. The cases, again, seem to be very mixed across banks.

V.3.2 Insurance costs.

Fire insurance costs can have significant variations, depending mainly on the location and year of the building. For comparison purposes, we have chosen a newly completed building in Kwai Chung, the New Territory. The average flat in that building has a constructional size of 750 square feet, and is currently worth 3.3 million HK dollars. Features of the building, like being a new building and having the common size, make this choice representative, easy for the studied banks to quote insurance premiums of their designated or recommended companies, and easy for insurance companies to quote their premiums on untied insurance.

The base of insurance is important for comparing the insurance costs. Except for Shanghai Commercial Bank, which bases the insurance on reinstatement costs, all other banks are still quoting the insurance on loan amounts when approached in this study (Table V.5). As the Consumer Council reported in 1990, basing fire insurance on loan amounts might over-insure or under-insure the property, and both cases are unfair to the consumers. In this study, however, we concentrate on the differences in the costs of insurance of banks

practising tie-ins and banks not practising tie-ins. Since almost all of the banks studied are using loans as the insurance base, the base problem will not give rise to differences in actual insurance costs of different banks. We, therefore, have chosen to ignore this factor.

The terms and conditions in the fire insurance policies of different companies are set according to guidelines of the Fire Insurance Association of Hong Kong. The policies studied cover only damage to the building caused by fire.

For the group of banks that are not practising tie-ins, the insurance costs of their customers depend on the insurance companies the customers choose. Nevertheless, these banks also recommend insurance companies to their customers. The insurance premiums of these recommended companies are listed in Table V.5, along with the premiums of companies designated by other banks.

From Table V.5, we cannot detect significant and systematic differences in the premiums charged by insurance companies designated by the banks with other companies not recommended. The tying of mortgage and fire insurance does not seem to give rise to generally higher premiums for the tied insurance.

There are marketing strategies which both the banks practising tying and banks not practising tying are using. One is to offer negotiable premiums (like 20-30 per cent off) to the customers. Another is to give away the first-year insurance, free of charge. The insurance premiums in the following years fall largely in the same range for both tied and untied deals.

Table V.6 listed the fire insurance charges of some insurance companies on clients not taking mortgage from their associated banks. The quoted premiums are for the same building which we have chosen. The base of the insurance is up to the customers to decide, and is actually determined by the banks from whom the customers are applying for mortgage loans. The premium rates are even slightly higher than the cases when the clients are designated or recommended by the banks as mortgagors. The bargain of first-year free insurance is gone, and the 30 per cent discount is more difficult to obtain.

V.3.3. The Total Costs.

To obtain an idea of the total costs of mortgage loans from different banks, we calculated the 3-year costs of loans of 1, 2, and 3 million HK dollars from different banks (Table V.7). We did not consider early payback and lagged payment problems in these calculations. Because there are many factors we did not consider (including other possible

charges and different repayment schemes), these examples only serve to illustrate the variations in the costs we have studied so far.

Although some banks obviously charge more than others, we obtained no evidence indicating that banks practising tie-ins are generally charging more.

V.4. Some Preliminary Economic Analysis

Tie-in sales undoubtedly restrict the choice of consumers. When a consumer is forced to purchase another good from a specified seller in buying one good, the consumer is deprived of the freedom of choice in purchasing the other good. In our case, when the consumers have to buy fire insurance from a designated company, they are sacrificing their freedom of choice of insurance companies.

Theoretically, when there is sufficient competition in the markets for the tying and tied products, tie-ins cannot harm consumers interests. The reason is, the consumers can always leave the sellers who attempt tying, and go to their competitors that are not practising tying. In order to keep their customers, sellers practising tying must compensate them in some way, like offering lower prices, assured quality, guaranteed supply, etc. When information is hard or costly to obtain, the convenience implied by tying also offer some attraction.

When there is monopoly or collusion among the cartel members, the situation is different. Through tying, the monopolies can extend their monopolistic power from the tying product to the tied product, and charge high prices on both products. For consumers who have to buy the monopolized goods, there is no way to refuse purchasing the tied product. The consumers' interests will be harmed.

For the case of Hong Kong, we find that some banks, including the Hong Kong Bank and some other big banks, are not tying mortgage loans to fire insurance. Although we do not know the exact market share of each bank in Hong Kong, we know the HSBC provides a substantial part of mortgage loans, and the mortgage market is competitive. Therefore, generally speaking, if borrowers find that the banks practising tie-ins are attaching unfavourable conditions, they can go to the banks that do not have tying requirements. Because of this potential competition pressure, it is easy to understand why the tying banks cannot charge more on their borrowers, and why the tied or recommended insurance is even slightly cheaper than the untied insurance.

In short, because banks practising tying do not have sufficient market power in the

tying product (mortgage) market, they can hardly pass such power on to the tied product (fire insurance) market; and they can not derive significant monopolistic rent by such tying practice. In such a case, tying becomes more or less a sales instrument.

There are special situations under which consumers' interests might be harmed. They include:

(1) Consumers are reluctant to change from one bank to another, because it takes time to gain knowledge, experience, and confidence of a bank's services and products. Information might not be readily available to them either. So consumers might not change their banks even if they are not satisfied with their banks' practices. However, when the conditions become too unfavourable, they will eventually leave.

(2) Lots of new residential projects have associated banks that provide mortgage loans, and these banks own de facto monopoly over mortgage for these projects. If these banks are tying banks and make use of their position, they might be able to pass their monopolistic power over to the insurance business, and harm consumers' interests.

V.5. Conclusions

(1) The tying of mortgage and fire insurance is still common in Hong Kong, but many banks, including some leading banks, no longer have tying requirements. Banks practising tying do not have overall dominant market power in Hong Kong.

(2) We conclude that the tying of mortgage and fire insurance does not seem to give rise to generally higher premiums for the tied insurance.

Table V.1. Tying of Mortgage Loan and Fire Insurance[1]

Practising Banks	Holding an account	Insurance policy subscription		
		A single designated company	One from a list (number of companies)[2]	Any one but needs approval
Hong Kong Bank	y	n	n	y
Hang Seng Bank	y	n	n	y
Standard Chartered Bank	y	n	n	y
First Pacific Bank	y	n	n	y
Dah Sing Bank	y	n	n	y
Citibank	y	n	n	y
Bank of China	y	n	y (2)	n
Chiyu Banking Corporation	y	n	y (3)	n
Po Sang Bank Ltd[3]	y	n	y (3)	n
Bank of Communication	y	n	y (2)	n
Nanyang Commercial Bank	y	y	n	n
Kincheng Banking Corporation	y	y	n	n
Kwangtung Provincial Bank	y	y	n	n
Hua Chiao Commercial Bank Ltd.[3]	y	y	n	n
National Commercial Bank	y	y	n	n
China & South Sea Bank Ltd.	y	y	n	n
Sin Hua Bank Ltd.	y	y	n	n
Yien Yieh Commercial	y	y	n	n
China State Bank	y	y	n	n
Bank of East Asia	y	y	n	n
Wing Lung Bank	y	y	n	n
Shanghai Commercial Bank	y	y	n	n
Chase Manhattan Bank	y	y	n	n
Belgian Bank	y	y	n	n

Notes:

1. y – yes; n – no.
2. All the insurance companies on the list are owned by the BOC Group.
3. These two banks are not accepting new applications for mortgage loans.
4. Information was collected between June - September 1993

Table V.2. Mortgage Interest Rates and Some Other Related Costs.

Practising banks	Mortgage rates and related Costs				
	Int. rate	Service charge	Evaluation fee	Early payback	Lagged payment
Hong Kong Bank	8.25%	$1,000	Included in service charge	1.5% of outstanding balance (max.$10,000)	Prime rate + 4.75%
Hang Seng Bank	8.25%	$1000	Included in service charge	50,000 or 3% of outstanding balance	Prime rate + 1.75%
Standard Chartered Bank	8.25%	$1000	Included in service charge	2-mth int. within 1 yr	3% of monthly repayment
First Pacific Bank	8.25%	$2000	Depends on size and location (payable to the evaluation company)	3% of loan within 1 yr	3% of monthly repayment
Dah Sing Bank	8.25%	no	$1,000	3-mth int. within 1 yr	Same rate ($50 min.)
Citibank	8.25%	no	$1,500 min	3-mth int. within 1 yr	Same rate
Bank of China	8.25%	$1,000	Included in service charge	3% of loan within 1 yr	Prime rate + 4.75
Chiyu Banking Corporation	8.25%	$150	$1000-1500	1-mth int. within 1 yr	Prime rate x 15 days interest
Nanyang Commercial Bank	8.25%	0.25% of loan	Included in service charge	3% of loan within 1 yr	Prime rate + 5.5%
Kincheng Banking Corporation	8.25%	0.5% of loan	$200	3- & 2-mth int. within 1/2 & 1 yr	Prime rate + 3.75%
Kwangtung Provincial Bank	8.25%	0.5-1% of loan (negotiable)	$150-200, (max $1000)	3-mth int.	Prime rate + 9%
Bank of East Asia	8.25%	no	no	1.5% of loan (min. 10,000)	Prime rate + 3%
Wing Lung Bank	8.25%	no	no	1-mth int. within 1/2 yr	Prime rate + 1.75%
Shanghai Commercial Bank	8.25%	0.25% of loan max. (negotiable)	no	1% of loan within 1-yr	Prime rate + 1.75%
Chase Manhattan Bank	8.25%	no	$1,000-1,500	2% of loan within 1 yr	1% of monthly payment
Belgian Bank	8.25%	$1,000 (only if turn down)	$500 (all inclusive)		Prime rate + 7%

*based on survey conducted in June - December 1993

Table V.3. Minimum Initial Lump-Sum Charges by Banks[1].

Practising banks	For loans of HK$1 million	For loans of HK$2 million	For loans of HK$3 million
Hong Kong Bank	1,000	1,000	1,000
Hang Seng Bank	1,000	1,000	1,000
Standard Chartered Bank	1,000	1,000	1,000
First Pacific Bank	2,000 (min.)	2,000 (min.)	2,000 (min.)
Dah Sing Bank	1,000	1,000	1,000
Citibank	1,500 (min.)	1,500 (min.)	1,500 (min.)
Bank of China	1,000	1,000	1,000
Chiyu Banking Corporation	1,150	1,150	1,150
Nanyang Commercial Bank	2,500	5,000	7,500
Kincheng Banking Corporation	5,000 + 200	10,000 + 200	15,000 + 200
Kwangtung Provincial Bank	5,000 + 150	10,000 + 150	15,000 + 150
Bank of East Asia	0	0	0
Wing Lung Bank	0	0	0
Shanghai Commercial Bank[2]	2,500 (max.)	5,000 (max.)	7,500 (max.)
Chase Manhattan Bank	1,000 (min.)	1,000 (min.)	1,000 (min.)
Belgian Bank	500	500	500

Note:
1. Including service charges and evaluation fees only.
2. Based on survey conducted in June - September 1993

Table V.4. Penalty on Early Payback of Mortgage Loans Within 1 Year[1].

Practising banks	For outstanding loans of HK$1 million	For outstanding loans of HK$2 million	For outstanding loans of HK$3 million
Hong Kong Bank	15,000	30,000	45,000
Hang Seng Bank	30,000	50,000 (max.)	50,000 (max.)
Standard Chartered Bank	13,750	27,500	41,250
First Pacific Bank	30,000	60,000	90,000
Dah Sing Bank	20,650	41,250	61,950
Citibank	20,650	41,250	61,950
Bank of China	30,000	60,000	90,000
Chiyu Banking Corporation	6,875	13,750	20,625
Nanyang Commercial Bank	30,000	60,000	90,000
Kincheng Banking Corporation	13,750 (20,650)	27,500 (41,250)	41,250 (61,950)
Kwangtung Provincial Bank	20,650	41,250	61,950
Bank of East Asia	15,000	30,000	45,000
Wing Lung Bank	0 (6875)	0 (13,750)	0 (20,625)
Shanghai Commercial Bank[2]	10,000	20,000	30,000
Chase Manhattan Bank	20,000	46,000	60,000
Belgian Bank			

Note:
1. Figures in Brackets are penalty on early paybacks within half a year.
2. Based on survey conducted in June - September 1993

Table V.5. Insurance Premium of Companies Designated or Recommended by Banks[1].

Practising Banks	Insured amount	Insurance premium (%)	Bargains
Hong Kong Bank	Loan	0.11	1st half yr. free
Hang Seng Bank	Loan	0.15	Yr.1 free
Standard Chartered Bank	Loan	0.11	
First Pacific Bank	Loan	0.135	
Dah Sing Bank	Loan	0.08	
Citibank	Loan	Discretion of the insurance company	
Bank of China	Loan	0.15	
Chiyu Banking Corporation	Loan	0.18	30% off
Nanyang Commercial Bank	Loan	0.15	Yr.1 free, then 30% off
Kincheng Banking Corporation	Loan	0.15	30% off
Kwangtung Provincial Bank	Loan	0.15	
Bank of East Asia	Loan	0.15	Yr.1 free, then 20% off
Wing Lung Bank	Loan (negotiable)	0.15	30% off
Shanghai Commercial Bank	Reinstatement cost	0.15	40% off
Chase Manhattan Bank	Loan	0.165 (yr.2) & 0.15 (yr.3)	Yr.1 free
Belgian Bank	Loan	0.15	Yr.1 free (no payback in 3 yrs.)

Note:

1. The insurance premium is paid to the insurance companies. Where banks allow their customers to choose their own insurance companies, the data given are those of the companies these banks recommend.
2. Based on survey conducted in June - September 1993

Table V.6. Insurance Premium of Some Insurance Companies for Individual Mortgage Clients.

Insurance companies	Insured amount	Insurance premium (%)	Bargains
China Life Insurance Co. Ltd	Any	0.165	
The Ming An Insurance Co. (HK) Ltd.	Any	0.15 - 0.20	
BOC Group Insurance Co. Ltd	Any	0.15	
Hang Seng Bank Limited	Any	0.15	
Wing Lung Limited	Any	0.15 - 0.2	30% off for own mortgage clients 20% off for others
Bank of East Asia (Insurance Dept.)	Any	0.15	30% off Max.
Citibank (Insurance Dept.)	Any	0.11	
Hong Kong Bank	Any	0.11	

* Based on survey conducted in June - September 1993

Table V.7. The Minimum 3-Year Costs for Mortgage Borrowers of Selected Amounts[1].

Practising banks	For loan of HK$1 million	For loan of HK$2 million	For loan of HK$3 million
Hong Kong Bank	251,250	501,500	751,750
Hang Seng Bank	251,500	502,000	752,500
Standard Chartered Bank	251,800	502,600	753,400
First Pacific Bank	253,550	505,100	756,650
Dah Sing Bank	250,900	500,800	750,700
Citibank	No information	No information	No information
Bank of China	253,000	505,000	757,000
Chiyu Banking Corporation	252,430	503,710	754,990
Nanyang Commercial Bank	252,100	504,200	756,300
Kincheng Banking Corporation	255,850	511,500	767,150
Kwangtung Provincial Bank	257,150	514,150	771,150
Bank of East Asia	249,900	499,800	749,700
Wing Lung Bank	[illegible]50	501,300	751,950
Shanghai Commercial Bank[2]	252,700	505,400	758,100
Chase Manhattan Bank	251,650	502,300	752,950
Belgian Bank	251,000	501,500	752,000

Notes:

1. The costs we calculated include the interest, service and evaluation charges, and insurance premium. For simplicity, we did not consider repayment of loans in these first 3 years.
2. For this bank, the service and evaluation charges are the maximum, and the insurance premium is calculated on reinstatement cost basis.
3. Based on survey conducted in June - September 1993

VI. POLICY RECOMMENDATIONS

VI.1 Pricing Policy

We find that the current banking regulatory framework extracts too high a "tax" (monopsonistic rent) from the small savers. The following are the recommendations that we would like to put forth with regard to the pricing policy:

VI.1.1 Amend Section 12(1)(a) of the HKAB Ordinance to prohibit HKAB to set interest-rate caps for its members. If Section 12(1)(a) is amended, the government should initially monitor the HKAB to ensure that they do not collude.

The current provisions give HKAB with the legal right to set interest-rate caps. Theoretically, the removal of HKAB's legal right to set interest-rate caps by amending Section 12(1)(a) would reduce the monopsonistic rent significantly, if not all of it. However, bearing in mind that the HKAB is already well-organized, it is unclear that the removal of the legal right to set interest-rate caps would necessarily either remove the incentive or the ability to collude amongst themselves. Some preliminary monitoring by the government might be necessary to ensure that the legal disbanding of the HKAB interest rate carte is a de facto one as well. Past experience has shown however that the problem of ensuring a competitive environment amongst banks might not be a severe one.

VI.1.2 Failing to legislate such an amendment, a counter-proposal would be that the HKAB be disallowed from imposing restrictions on demand and on savings deposits.

As shown in Table II.7, these two components constitute the lion's share of the monopsonistic rent extracted from HKAB.

VI.1.3 The Schedule

In view of the difficulties faced by the banking sector when the interest rate rule is abolished immediately, we are proposing a gradual process of liberalising the interest rate rule according to the following schedule (summarised in Table V.1):

1. Starting 1995:
abolish the interest rate rule on time deposits.

2. Starting 1996:
allow banks to offer interest payment on demand deposit.

3. Starting 1997:
abolish the interest rate rule on savings deposit and demand deposit.

VI.2 Information Disclosure Policy

Better information disclosures will allow the depositors, financial analysts, and other market participants to distinguish between good and bad banks. This will reduce the problem of systemic bank runs as the ability to analyze the state of the bank's financial health will reduce the possibility of a bank run on a financially shaky bank to spread to financially healthy banks. Although it has been argued by some that there are occasions in Hong Kong where bank runs have spread to healthy banks and are "rumour-driven", these systemic bank runs could plausibly be explained by the lack of public information on the banks involved.

We recommend the following policies for information disclosure:

VI.2.1 Disclose inner reserves

Banks in Hong Kong do not have to report their "true" profits. This makes it difficult for investors, and depositors to know the true financial strength and the value of banks. If banks do disclose their inner reserves later on due to some regulatory requirements, such as Hongkong and Shanghai Banking Corporation having to disclose its inner reserves in its bid for Midland Bank, shareholders may be hurt. If inner reserves are higher than expected, those who sell their shares before the disclosure of inner reserves will see their wealth go down and those who buy the shares before disclosure reap excess profits. Conversely, when inner reserves are lower than expected, those who sell before disclosure gain, and those who

buy loses. Hence, inner reserves adds more uncertainty to the valuation of shares and values of banks. As shown in Table IV.1, the estimates of inner reserves by financial analysts are very much different from each other; the estimates for Bank of East Asia as at 31 December 1992 range from 920 HK$million to 3,269 HK$million - a difference of 2,349 HK$million. Disclosure of inner reserves now would protect future shareholders and present shareholders.

If inner reserves are to be disclosed, it should be done concurrently with or after the disclosure of true earnings. This would provide depositors with better information on what to do with their deposits.

VI.2.2 Disclose detailed profits and expenses items

It is helpful to shareholders, analysts and depositors if banks itemize their profits or losses by their various sources. The total profits (or losses) are recommended to be broken down into gains and losses from foreign exchange trading revenue, from investment securities and from interest income as they provide information on how well banks are doing in these risky activities.

VI.2.3 Disclose loan loss reserves and non-performing loans

It is important that banks in Hong Kong report their loan loss reserve figures and the level of non-performing loans as this provides important information about a bank's trend in asset qualities.

VI.2.4 Disclose maturities mismatching level

The reporting of the balance and maturities of a bank's rate-sensitive liabilities (RSL) and the values and maturities of its rate-sensitive assets (RSA) reveals a bank's interest rate sensitive gap (gap = RSA-RSL). Knowing the gap values, a bank's sensitivity to interest rate changes can be appraised. Incidentally, the reporting of outstanding debt balance and their maturities also provide information about a bank's short-term and long-term credit risk.

VI.2.5 Disclose detailed loan portfolios

We recommend that the detail of individual bank loan portfolio should be disclosed to the general public. They should be classified into:

* loans for commercial real estate;

* loans to financial institutions;

* commercial and industrial loans;

* loans for purchasing or carrying securities;

* consumer loans (such as loans secured by residential properties, credit card loans);

* loans to governments and official institutions (including details of credit exposure in certain Latin American countries);

* loans by geographical regions, Hong Kong operations revealed separately from those of other regions.

Reporting the breakdown of loan portfolios is important, as it will be easier for shareholders, depositors and financial analysts to know the extent of a bank's loan concentrations in different sectors of financing. The figures for the above uses of loans are available on an aggregate basis (but not for individual banks), and are published by the Hong Kong Monetary Authority.

VI.3 Tying Practice Policy

We do not suggest any legal action here as we do not find any consistently harmful tying of mortgage and fire insurance resulting from the monopsonistic structure. For banks that practice tying, we do not find any evidence suggesting that their packages of mortgage and fire insurance are systematically more expensive than banks that do not practice tying. However, it is only fair to let consumers have more freedom of choice if banks drop their tying or expand their list of insurance companies. Banks, anyway, can always recommend their most favourable packages to consumers.

Table VI.1 Proposed Schedule for the Implementation of Policies

Policies Recommendations	1994	1995	1996	1997
Pricing				
Demand Deposits			✓	
Savings Deposit				✓
Time Deposits		✓		
Information Disclosure				
Earnings		D		
Inner Reserves			D	
Detailed Loan Portfolios	D			
Detailed Profit & Loss Items		D		
Loan Loss Reserves & Non-Performing Loans	D			
Maturity Mismatching		D		

Notes: ✓ = Abolish interest rate rule.
D = Disclosure

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APPENDIX II.1: Response to HKAB's Initial Observations

To respond to the observation by HKAB that the interest-rate spreads in Hong Kong are competitive, if not smaller, when compared to most countries, we argue that the spreads are misleading because they are current spreads and not time averages. In other words, the spreads presented by HKAB represents only one point in time. In statistics, it is well known that we should not draw inferences from a small sample. For instance, referring to Figure Appendix II.1.1, we see that Hong Kong's average spread is higher than Australia, Germany, and Japan for most of 1979-1984. Furthermore Table Appendix II.1.1 shows that Hong Kong's average prime-savings spread is higher than the average of other countries for all years. Hong Kong's spread, however, is lower than all of them for the brief period of 1/1987-2/1987. It would incorrect to infer that Hong Kong has lower spreads than the others by using data from 2/1987, especially since Hong Kong has on average higher spreads than all these countries. Mr. Martin, the Secretary of HKAB, agrees as much and stated that a better sample to look at would be from a longer time span. In the analysis carried out here, the sample size typically exceeds ten years of data.

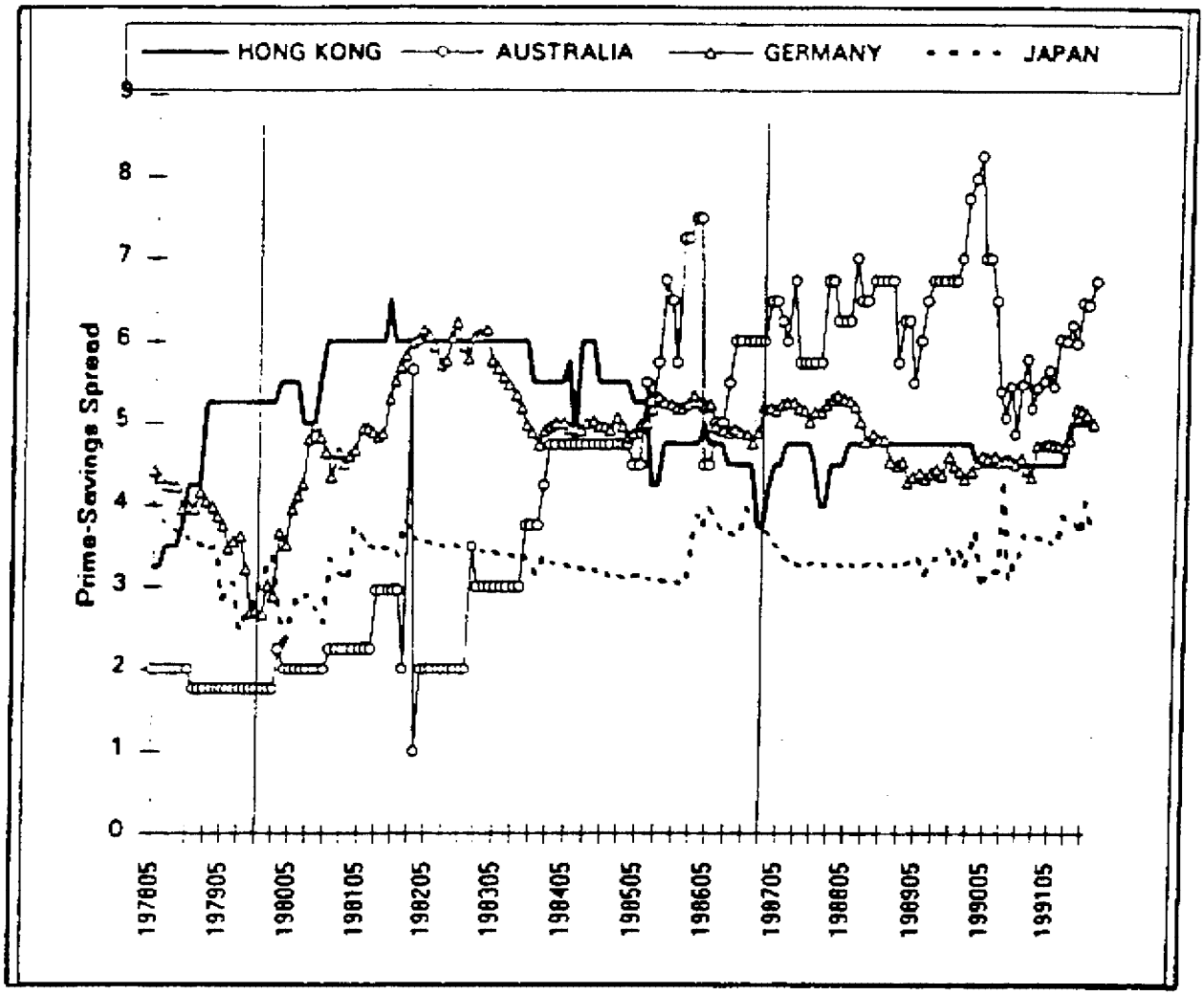
Moreover from Table II.1.1, the prime-savings spread in Hong Kong is consistently higher than Japan and Singapore for 1978-1991 and it is only lower or equal to Malaysia in 1987. In U.K.'s case, the UK spread was only larger than that of Hong Kong for 1989-1991.

Table Appendix II.1.1: Table of average monthly prime-savings spread for each year, 1978-1991

The data for all countries except Hong Kong is obtained from the IMF database. For Hong Kong, we use the PACAP database. Abbreviations used: Aus = Australia, Mal = Malaysia, and Sing = Singapore

Year	Hong Kong	U.K.	Germany	Japan	Aus.	Mal.	Sing.	H.K. Average in excess of countries
1978	4.10	3.17	4.27	3.73	1.94	2.38	2.42	1.12
1979	5.29	2.21	3.49	3.06	1.75	2.00	2.30	2.82
1980	5.63	2.04	4.09	2.85	2.00	1.52	2.35	3.15
1981	6.04	2.58	4.95	3.43	2.54	-1.17	2.94	3.50
1982	6.00	-0.58	5.96	3.56	2.22	-0.96	3.01	3.80
1983	5.75	-1.35	5.49	3.38	3.23	3.06	2.74	2.99
1984	5.56	-1.55	4.96	3.25	4.71	1.81	1.99	3.03
1985	4.77	1.20	5.09	3.10	5.50	2.40	2.94	1.40
1986	4.42	0.82	5.04	3.70	5.90	3.63	2.93	0.75
1987	4.52	0.28	5.16	3.45	6.06	5.19	3.21	0.63
1988	4.75	1.80	5.04	3.27	6.60	3.93	3.23	0.77
1989	4.71	7.84	4.44	3.32	6.42	2.40	3.00	0.14
1990	4.50	8.53	4.52	3.39	6.38	1.26	2.69	0.04
1991	4.81	6.17	4.84	3.70	5.93	0.94	2.95	0.71
Average '78 - 91	5.07	2.38	4.81	3.37	4.37	2.00	2.76	1.79

Figure Appendix II.1.1: Plot of Prime-savings spread for selected countries



APPENDIX II.2 Survey of Bank Charges in Hong Kong, Singapore, and U.K.

The main purpose of this appendix is to provide some evidence that bank charges in Hong Kong are not any lower than that of other countries, as is frequently asserted. Table APPENDIX II.2.1 provides a list of bank charges for 1991 and 1993. Note that most of the studied banks started charging an annual fee on their ATM cards and for coin changing after 1991. Referring to Table APPENDIX II.2.2, the following list itemizes that Hong Kong banks charge for that .U.K. banks generally do not charge for: (1) the ATM card and its replacement; (2) closing a savings account within three months; (3) issuing a balance certificate; and (4) coin changing. Overall, the UK banks appear to charge less than the Hong Kong banks.

The data for all countries except Hong Kong is obtained from the IMF database. For Hong Kong, we use the PACAP database. Abbreviations used: Aus=Australia, Mal=Malaysia, and Sing = Singapore

From Table APPENDIX II.2.2, we also see that Hong Kong and Singapore impose charges on almost all of the items listed. The only exception is Singapore banks do not charge an annual fee on their ATM cards. Some of them also do not charge items like a balance certificate and a banker's letter, which all Hong Kong banks charge.

There are several other charges and requirements of the Hong Kong banks that this survey did not study in further detail. These include: (1) the charge on large cash deposits. The typical practice is the banks will charge 0.5% over cash deposits exceeding HK$20,000; (2) the requirement that a minimum balance be maintained with the savings account by some banks; (3) the charges on purchasing or depositing a bank draft.

Table APPENDIX II.2.1. Some banks' service charges (in HK$) in Hong Kong[1].

Banks	Savings A/C	Current A/C				ATM card		Other services					
	Closure within 3 months	Cheque returned (HK$/cheque)		Cheque cancellation (HK$/cheque)	Copying a cashed cheque (HK$/cheque)	Annual fee (HK$/card)	Replacing a lost card (HK$/card)	Copying a past bank statement (within 12 months) (HK$/page)	Issuing a balance certificate (HK$ per A/C)	Issuing a banker's letter (HK$/copy)	Replacing a lost savings passbook (HK$ per A/C)	Purchasing a gift coupon (HK$/cheque)	Changing for coins (HK$/cheque)
		Technical reason	Insufficient fund										
Hong Kong Bank	50 (20 min.)	Free (free)	70 (70)	50 (50)	30 (25)	50 (50)	30 (20)	30 (25)	50 (30)	100 (100)	30 (20)	5 (3)	1 (free)
Hang Seng Bank*	Free (10)	Free (free)	50 (50)	20 (25)	25 (25)	50 (50)	20 (20)	25 (25)	50 (30)	100 (50)	30 (20)	5 (5)	1 (free)
Bank of China*	20 (20)	20 (20)	20 (50)	20 (30)	10 (10)	50 (free)	20 (20)	10 (10-20)	30 (20)	30, Customer prepared (50)	Free (20)	3 (2)	1/roll (1/roll)
Nanyang Commercial Bank*	20 (20)	20 (20)	20 (50)	20 (20)	10 (10)	50 (free)	20 (20)	10 (10)	30 (20)	30, Customer prepared (50)	Free (20)	3 (2)	1/roll (1/roll)
Kincheng Banking Corp.*	20 (20)	20 (20)	20 (50)	20 (30)	10 (10)	50 (free)	20 (20)	10 (10)	30 (20)	30, Customer prepared (50)	Free (20)	3 (2)	1/roll (1/roll)
Standard Chartered Bank	75 (N/A)	Free (N/A)	80 (N/A)	40 (N/A)	Free in 60 days; 25 after 60 days (N/A)	50 (N/A)	30 (N/A)	Free in 60 days; 25 after 60 days (N/A)	100 (N/A)	200 (N/A)	30 (N/A)	10 (N/A)	1 (N/A)
Bank of East Asia*	20 (10)	Free (free)	70 (50)	20 (30)	10 (5)	50 (free)	20 (free)	10 (5)	50 (30)	N/A (50)	20 (10)	5 (3)	1 (1/roll)
Dah Sing Bank	30 (20)	Free (free)	85 (30)	50 (20)	20 (10)	Free (free)	20 (free)	20 (10)	50 (20)	100 (50)	30 (20)	5 (2)	1 (free)
Wing Lung Bank*	20 (10)	50 (free)	50 (50)	20 (20)	10 (5)	50 (free)	Free (20)	10 (5)	20 (20)	50 (free)	20 (10)	3 (2)	Free for own customers (free)
Citibank*	100 (N/A)	80 (N/A)	80 (N/A)	50 (N/A)	20 in 2 yrs; 50 after 2 yrs (N/A)	Free (N/A)	30 (N/A)	20 within 2 yrs; 50 after 2 yrs (N/A)	50 (N/A)	50 (N/A)	Free (N/A)	5 (N/A)	N/A (N/A)
Chase Manhattan Bank*	50 (25)	25 (25)	50 (50)	25 (25)	25 (25)	Free (free)	25 (25)	25 (25)	100, with 2 extra copies (100)	100, with 2 extra copies (100)	25 (25)	5 (5)	N/A (N/A)
Belgian Bank*	20 (20)	Free (free	50 (50)	20 (20)	20 (10)	Free (free)	Free (free)	20 (10)	50 (30)	100 (50)	Free (20)	5 (2)	1 (1/pack)

Notes: 1. Numbers in brackets are data of February, 1991, obtained from HK Consumer Council "Studies on Selected Topics", June 1991 (176).

2. Numbers for November 1993 were collected by the HK Consumer Council, and are subject to further confirmation by respective banks.

3. Banks with a "*" mark do not have pre-printed or completed materials/brochures on their service charges.

4. N/A means information for the item is not available.

Table APPENDIX II.2.2. A comparison of banks' service charges in Hong Kong, Singapore, and the U.K.[1]

	Savings A/C	Current A/C				ATM card		Other services					
	Closure within 3 months	Cheque returned		Cheque cancellation	Copying a cashed cheque	Annual fee	Replacing a lost card	Copying a past bank statement (within 12 months)	Issuing a balance certificate	Issuing a banker's letter	Replacing a lost savings passbook	Purchasing a gift coupon	Changing for coins
		Technical reason	Insufficient fund										
Hong Kong	0-100	0-80	20-85	20-50	0-30	0-50	0-30	0-30	20-100	30-200	0-30	3-10	0-1/roll
Singapore[2]	0-240	0-72	53-144	0-96	0-48	0	0-24	4.8-48	0-192	0-96	0-96	0-24	0-24/pack
The U.K.[3]	0	171-228		N/A	Discretion of branch	0	0	34-57	0	N/A	0	N/A	0

Notes:

1. Data for Singapore and the U.K. were provided to the Hong Kong Consumer Council by the Consumers' Association of Singapore (Sept. 1993) and the U.K. Consumers' Association (Aug. 1993), respectively.
2. The Singapore dollar was converted into the HK dollar at a rate of S$1 = HK$4.8.
3. The U.K. pound was converted into the HK dollar at a rate of GBP1 = HK$ 11.40.
4. N/A means information for the item is not available.

APPENDIX II.3 Calculation of the HKAB-covered time deposits as a proportion of total HK$ time deposits

The following are the numbers we used to calculate the ratio of the (HKAB-covered time deposits) over the total HK$-time deposits.

From the deposit insurance report, we are given:

Total HKAB Deposits (HKAB Tot) = HK$300.334
Total HK$ Deposits (HK$ Tot) = HK$489.548
Then the (HKAB Tot)/(HK$ Tot) = 0.6135.

From the Commissioner's report for the year end, the total HK$-denominated demand, savings, and time deposits are HK$69, HK$229, and HK$265. It follows that the ratio of the (HKAB Time)/(HK$ Tot)= X = 0.5293.

Thus the ratio of (HKAB Time)/(HK$ Tot) = Y = 0.6135 - 0.5293 = 0.0842

Thus the ratio of (HKAB Time)/(HK$ Time)= Y/X = 0.0842/0.5293 = 0.1788.

Appendix II.4 : Unfair Contract Terms

At the end of 1992, the Consumer Council received several complaints concerning the change on general terms and conditions of current accounts by their banks.

The subsequent investigation revealed that HKAB has recommended its members to insert the new terms and conditions, which would require customer to inform banks of unauthorized payments and to act with care in the custody of cheque books, the drawing of cheques and the conduct of the account generally. HKAB suggested the wording of the clause dealing with unauthorized payment to be as follows:

> "Account statements will be sent at monthly intervals, unless otherwise requested. The account-holder agrees to examine each statement of account received from the Bank to see if there are any errors, discrepancies, unauthorised debits or other transactions or entries arising from whatever cause, including, but without limitation, forgery, forged signature, fraud, lack of authority or negligence of the account-holder or any other person (the "Errors"). The account-holder also agrees that the statement of account shall, as between the Bank and the account-holder, be conclusive evidence as to the balance shown therein and that the statement of account shall be binding upon the account-holder, who shall be deemed to have agreed to waive any rights to raise objections or pursue any remedies against the Bank in respect thereof unless the account-holder notifies the Bank in writing of any such Errors within 90 days after personal delivery of such statement of account to the account-holder or, if posted, within the same period after the Bank has posted such statement of account."

This proposal amounts to the introduction of exemption clauses by which customers are accountable for losses if cheques are drawn in such a way that may be altered or may facilitate fraud or forgery. The banks would be free of liability if customers do not report any discrepancies in their bank statements within the specified period. Further, customers have the duty to verify information on their cheque books and inform banks of any irregularities.

Customers are obliged to accept such terms and conditions, for all HKAB members would introduce similar terms, The duration for reporting the discrepancies varies in each bank, which ranges from 7 days to 90 days.

The Consumer Council objected to HKAB's introduction of such sweeping terms on the following grounds:

(1) It drastically restricts the 6-year limitation period;

(2) The customers are deemed to have waived any rights to raise objection;

(3) It is unconscionable for the banks to remove the basic legal right of individuals with a standard term contract;

(4) While bank customers have to be careful and has an implied duty of care, they should not be held responsible for losses arising from alteration of cheques which are not readily detectable;

(5) It is particularly harsh on bank customers if they have to bear the loss in case of fraud due to no negligence or breach of care on their part.

(6) HKAB's advice was based on the 1985 judgement of the Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd which established that a bank which pays away money in compliance with a forged cheque has no right to debit the amount of that payment to the customer. The Council is surprised that HKAB is taking action seven years after the case. We believe that only an alarming increase in loss resulted over the usage of forged cheques would justify the proposed charge of terms and conditions.

(7) HKAB also made reference to the Uniform Commercial Code issued by the State of New York in US. However, the Hong Kong version is more sweeping than in that the Code (S.4-406), which states that a customer who does not within one year from the time the statement made available to him discover and report his unauthorized signature or any alteration on the face or back of the item or does not within three years from that time discover and report any unauthorised endorsement is precluded from asserting against the bank such unauthorized signature or endorsement or such alteration.

The Consumer Council believes that some of the new terms and conditions may have contravened the Control of Exemption Clauses Ordinance. All exemption clauses are subject to the test of reasonableness.

Appendix III.1

Examples on the Calculation of the Herfindahl Index

Example 1

Assume there are 5 banks with the following mortgage loans outstanding (principal value).

	Mortgage loans outstanding (principal value)	share, s_i	s_i^2
Bank A	100,000	0.05	0.0025
Bank B	200,000	0.1	0.01
Bank C	300,000	0.15	0.0225
Bank D	400,000	0.2	0.04
Bank E	1,000,000	0.5	0.25
Total	2,000,000	1.0	0.325

The Herfindahl Index is 0.325 for this example.

Example 2

If 5 banks have equal market share in the particular item, s_i is 0.2 for each bank. The Herfindahl index, $\Sigma_i s_i^2$ is equal to 0.2 or 1/n, where n = 5 for this example.

Example 3

If there is one firm in the industry, the Herfindahl index, $\Sigma_i s_i^2$ is equal to 1, which would indicate a monopoly.

Appendix IV.1 HKMA's Attitude Towards Financial Disclosure

1. The HKMA is in favour of more disclosure by banks in Hong Kong, but considers that this should be done in a manner which is consistent with the need to maintain the stability of the banking system.

2. It is accepted that the general trend in financial reporting is towards greater transparency and accountability, and that the level of disclosure in Hong Kong is lower than in other comparable centres, both in the region and elsewhere. The existing provisions in the Tenth Schedule of the Companies Ordinance mean that banks in Hong Kong need provide only limited information in their annual accounts. This has attracted adverse comment from various quarters, and there is a risk that it could eventually lead to a lower than justified perception of the quality of banks in Hong Kong and inhibit their ability to conduct international business.

3. Equally, there must be a recognition that banks are different from other companies. They are heavily reliant on external funding from customer deposits or interbank borrowing; and their capital and earnings are vulnerable to fluctuations in asset values and to variations in the business cycle and in monetary conditions. This means that banks depend critically on the confidence of their creditors. News of a sharp deterioration in the financial position of a bank due to adverse developments in the economy or in the position of individual borrowers may undermine that confidence, in extreme cases causing a run on the bank and precipitating an immediate crisis. The bank may thus be denied the chance to work its way out of its problems. Moreover, a loss of confidence in one bank can quickly spread to others, threatening the stability of the system as a whole.

4. Thus, the natural desire of individual depositors to protect their funds may have a systemic effect which is disproportionate and unwarranted - particularly if the information which provokes the instability has been misinterpreted by depositors. This is why banks in a number of countries, not only Hong Kong, have been exempted from the full disclosure requirements which apply to other companies. Removal of such exemptions needs to be carefully considered. If more disclosure were to result in greater volatility of the deposit base of banks as depositors reacted to "bad news" the result would be counterproductive.

5. The benefits of more disclosure thus need to be weighed carefully against the costs. It should not be assumed that more disclosure would be a cost-free exercise.

6. The HKMA has recently discussed the question of more disclosure with representatives of the local banks. There was general agreement that more disclosure was desirable. But views differed as to how much disclosure should be made and how quickly. In particular, there is continuing concern among banks about disclosure of inner reserves. It is considered that these can play a useful role in "smoothing" profits, putting away a reserve in good years which can be used, if necessary, to moderate losses in bad years and thus maintain the

confidence of depositors.

7. The HKMA has accepted in the past that this argument has a certain validity in the special circumstances of Hong Kong, where the fortunes of banks are closely linked to that of the local economy and that in China, where market conditions can be volatile and where the political situation is in a state of transition. It cannot be assumed that the favourable conditions in which the banks have operated for the last three years will persist indefinitely.

8. The HKMA believes, however, that the ability to maintain inner reserves is a privilege which should not be abused. In particular, banks should not manipulate the percentage of profits that is transferred to inner reserves simply to produce growth in published profits which is in line with their peers.

9. The HKMA has therefore required banks to produce written statements of their policy towards inner reserves and to agree these with the HKMA. Such a statement should include a range for the percentage of profits that will normally be transferred to inner reserves each year. The HKMA requires banks to consult with it before any transfer to, or from, inner reserves is made and looks for consistency of approach. Generally, any transfers to inner reserves should be within the agreed range; any transfers from inner reserves should be rare and exceptional and should not be made unless the bank can demonstrate that without such a transfer, the confidence of depositors in the bank will be materially affected. In addition, the HKMA would not allow unrealized "capital" reserves to be transferred to the profit and loss account until they had been realized.

10. It should also be noted that inner reserves are only one component of the total capital base of locally incorporated banks. The principal measure of capital adequacy is not inner reserves but the "capital adequacy ratio" which banks are required to maintain under the Banking Ordinance. A minimum ratio of 8% is specified in the Ordinance, but in practice banks maintain ratios which are well in excess of this. As an added precaution banks are allowed to count only 70% of the revaluation surplus on their properties within capital base for the purpose of calculating their ratios.

11. A further point is that disclosure of the "true" profits and reserves of a bank is only meaningful if assets are properly valued in the first place and adequate provision is made for bad and doubtful debts. In some countries which ostensibly practice more disclosure than Hong Kong this is not the case. In Hong Kong, banks are required to maintain adequate provisions under the Banking Ordinance, and the HKMA monitors this through its on-site examinations and off-site reviews. The external auditors also play an important role. The HKMA intends to improve its capability to monitor the quality of banks' assets through the introduction of a new loan classification system.

12. The HKMA believes that such factors mitigate the present low level of disclosure by banks in Hong Kong. But it may nonetheless be argued that depositors, shareholders and counterparties have the right to receive more information so that they can form their own judgements. The HKMA is therefore proposing to hold further discussions with the banks on the scope for more disclosure. It will liaise closely with the Stock Exchange and the Securities and Futures Commission which have an interest in relation to listed banks. It is hoped that a phased programme for greater disclosure can be agreed, beginning with the accounts for 1994. This would not preclude individual banks from taking steps to disclose more information prior to then. The HKMA is aware that some banks are considering this.

13. The HKMA would prefer to proceed by agreement with the banks, particularly in relation to the difficult issue of inner reserves. It believes that this provides the best means of avoiding any adverse impact on the stability of individual banks or of the system as a whole. In view of the importance of the banking sector to the economy and monetary system of Hong Kong, the HKMA considers that this should be the dominant consideration.

Hong Kong Monetary Authority
12 January 1994

Appendix IV.2

Summary of Views of Bankers and Financial Analysts on Financial Disclosure

Issues	Views of some of the bankers	Views of some of the financial analysts
1. Disclosure of Inner reserves and true earnings	a. Inner reserves act as a buffer when banks have less than average performance. b. Misuse of inner reserves is limited given supervision by the HKMA.	a. Depositors should have information on the true earnings and reserves of a bank to assess its true financial strength. b. It is difficult for financial analysts to estimate the riskiness and value of banks. c. Non-disclosure may backfire. Depositors may think that the performance of banks may be worse than what they actually are.
2. Unavailability of deposit insurance		Information disclosure becomes even more important than ever.
3. Position of Hong Kong as a leading international financial centre.	Present level of disclosure does not impair Hong Kong as a leading financial centre.	Better information disclosure enhances Hong Kong's position as an international financial centre.
4. More detailed income statement and balance sheet.	More detailed information is not necessary as supervision by the HKMA is adequate.	More detailed information enables analysts and depositors to better gauge the risk-return performance of banks.
5. Supervision by the HKMA.	Adequate	More information disclosure to the public enables the public to discipline banks (with regards to their portfolio and capital structure decisions).
6. Costs of acquiring information		It is costly to acquire more detailed information from financial analysts and brokers. Nevertheless, more disclosure leads to better valuation of banks.

Appendix IV.3 Relationship Between the Degree of Instability and the Degree of Disclosure.

This appendix investigates if there is a relationship between the degree of instability of banking systems in different countries and the degree of disclosure of information. The methodology here is by no means perfect. Ideally, we would want to come up with a methodology to test the hypothesis whether a higher level of disclosure would lead to greater chance of bank runs occurring in Hong Kong. Such hypothesis is difficult to test. We present below an alternative test.

Data and Methodology

We examine the relationship between the degree of instability and the degree of information disclosure by banks in various countries.

The degree of instability is measured by:

i. Variance of percentage change in the monthly demand deposit rates (the countries included are Spain, United States of America, France, Japan, Thailand, Malaysia, Switzerland, New Zealand, United Kingdom, Germany, Belgium, Finland, Luxembourg, Sweden, Greece, Iceland and Singapore);

ii. Variance of percentage change in the monthly demand deposit balances (the countries included are Spain, United States of America, Japan, Thailand, Malaysia, Norway, Switzerland, New Zealand, United Kingdom, Germany, Finland, Luxembourg, Sweden, Greece, Iceland, Cyprus, Philippines, and Singapore);

iii. Variance of (percentage change in the quarterly demand deposit rates from one quarter to another/percentage change in the quarterly GDP) (The countries included are United States of America, France, Malaysia, Norway, Switzerland, New Zealand, United Kingdom, Germany, Finland, Sweden, Greece, Philippines, and Singapore);

iv. Variance of (percentage change in the quarterly demand deposit balances from one quarter to another/percentage change in the quarterly GDP) (The countries included are the same as above).

Fluctuations in interest rates may be used as a measure of instability as excessive fluctuations in interest rates are not desirable for the smooth running of the economy. The percentage change in the monthly deposit balances may also be

used as a measure of instability as excessive deposit changes in the demand balance suggests that there is excessive withdrawals of deposits from one period to another. We also control for the changes in the economy by employing (iii) and (iv).

Another measure of instability is to relate the number of bank runs to the degree of disclosure. This data is not readily available. However there is no published study so far that suggests empirically that higher level of disclosure would lead to more bank runs.

The time period for this study is from January 1980 through 1990, i.e. only countries in our sample that have data for this period are included, the data for the above are taken from the International Financial Statistics databases.
The degree of disclosure is measured by:

1. Calculating the number of 'Yes' responses in the questionnaire (given in Appendix IV.3A) to the central banks to get the value of YN. Divide that number YN by 13, the total number of questions in the questionnaire. We recognize that laws governing information disclosure change from time to time in most countries, and that this measure of the level of information disclosure may suffer from this problem. However, we believe that the approximate measure used here is adequate.

Results

The plots of degree of instability vs degree of disclosure are given in Appendices IV.3B and IV.3C. The plots show no relationships between the degree of instability (as measured by the variance of the percentage change in demand deposit rates and demand deposit balances) and the degree of disclosure. We repeat our analyses by controlling for the changes in the economy by dividing the percentage change in demand deposit rates (and demand deposit balances) by the percentage changes in the quarterly GDP. Our results (not shown) also do not show any relationship. These results appear to show that information disclosure has no effects on the degree of instability in a banking system.

Summary

Using variance of percentage change in the demand deposit rates and deposit balances as the measures of instability, the results show that there is no relationship between the degree of instability and the degree of disclosure. There is no study so far that suggests empirically that more information disclosure would lead to more bank runs. Rather, more disclosure provides more information on the soundness of banks, such that financially sound banks would not be subject to rumours concerning their well-beings.

Appendix IV.3A

Questionnaire on information disclosure: Please put a tick (/) in the appropriate space

Part I

Please indicate if the following information is required to be disclosed to the general public:

Deposit balance

1 Are individual banks required to disclose their deposit balance by the maturities of the deposits (this is to determine the extent of banks' exposure to maturity mismatching and interest-rate risk)? Yes ____ No ____

Loan Concentrations

2 Are individual banks required to disclose loan concentrations by single borrower?
single individual;
group of firms; or
LDC (lesser developed countries). Yes ____ No ____

Loan Portfolios

Are individual banks required to disclose their loan portfolios by:

3 a. the maturities of the loans; Yes ____ No ____

4 b. the uses of the loans (such as LBO (leveraged buyouts), loans itemised into the property, commercial or industrial sectors) and report their corresponding outstanding principal amounts; Yes ____ No ____

5 c. by geographical locations (loans by regions)? Yes ____ No ____

Are individual banks required to disclose the:

6 a. principal amount of nonperforming loans; Yes ____ No ____

7 b. bad debt provisions? Yes ____ No ____

Foreign exchange activities

8 Are banks required to disclose their profits and losses from foreign exchange trading? Yes ____ No ____

9 Are they required to disclose the amount of their uncovered (exposed or open) position in foreign exchange? Yes ____ No ____

10 Are banks required to provide a fair assessment of the foreseeable changes in the financial condition of a bank in the coming year? Yes ____ No ____

Are individual banks required to disclose information such as:

11 a. their gains and losses from investment securities; Yes ____ No ____

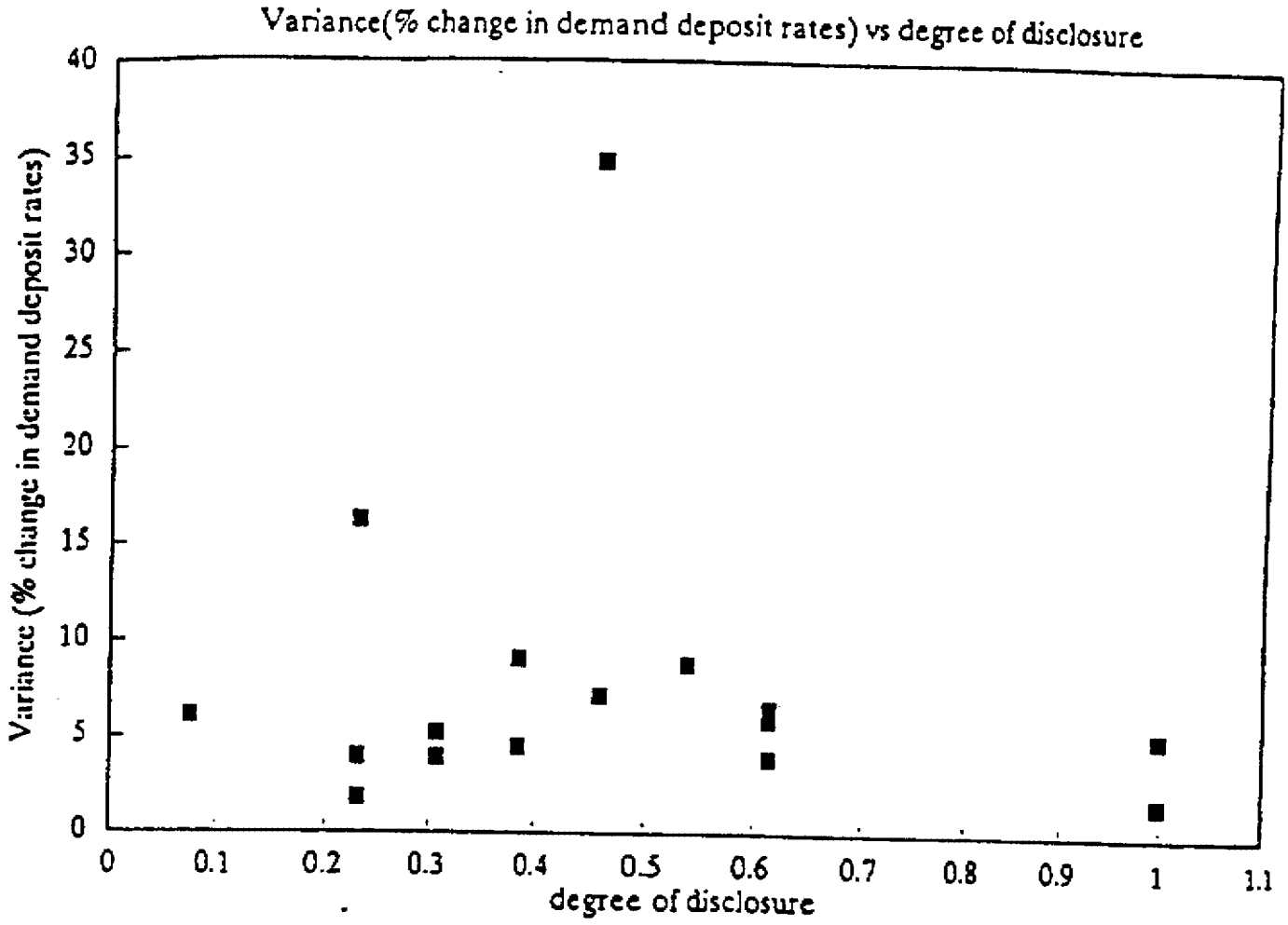
12 b. off-balance sheet activities (those amounts subject to credit and market risk, such as interest rate and exchange rate fluctuations)? Yes ____ No ____

Part II

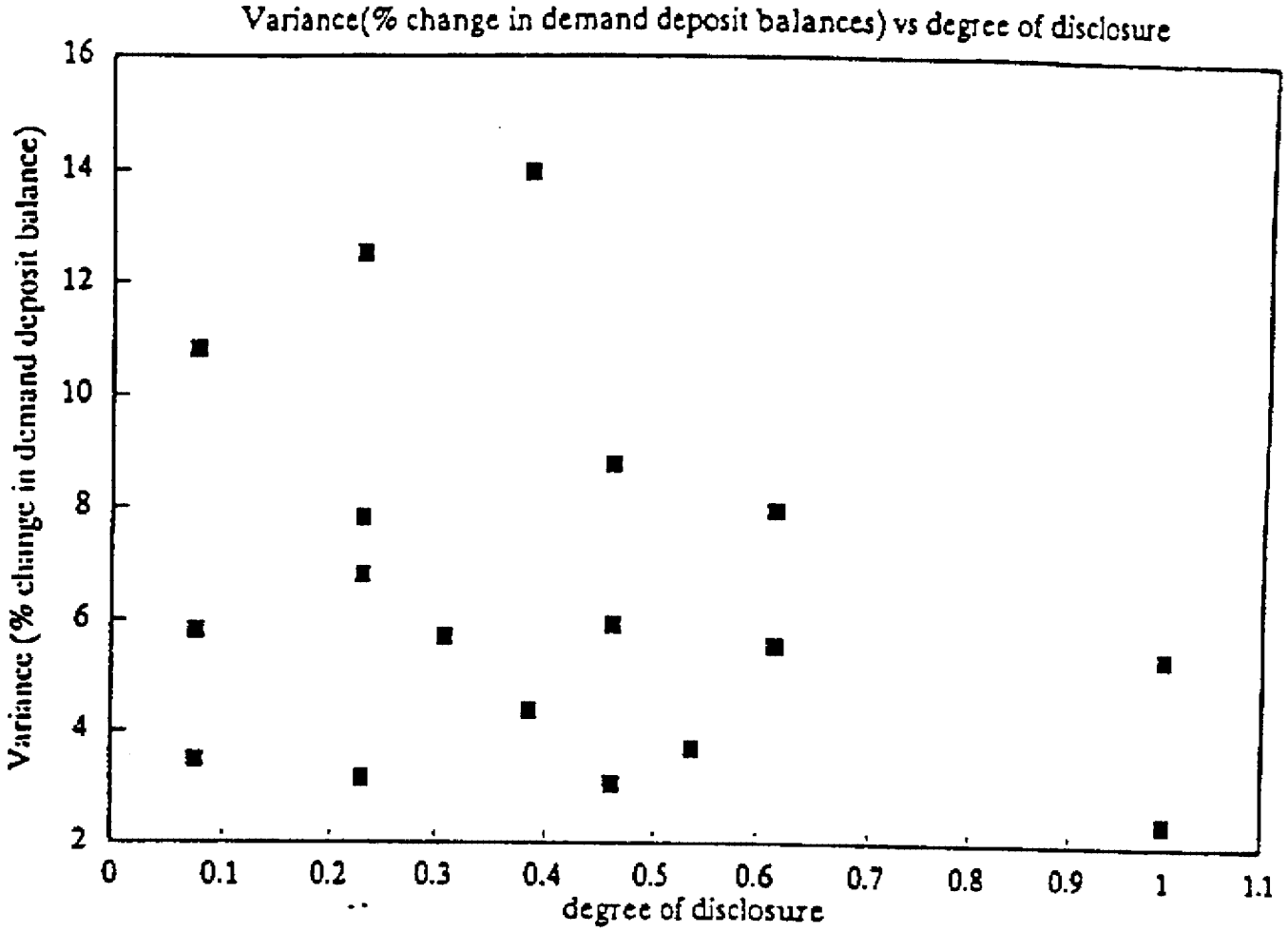
13 Are inner (hidden) reserves disallowed? Yes ____ No ____

Please fax this questionnaire to: Dr. K.C. Lim, Fax #: (852) 788-8806.

Appendix IV.3B



Appendix IV.3C



Appendices V.1

1. Data Sources:

All data used in this chapter were obtained by visits and phone calls to the concerned banks and companies.

2. The UK's Legal Experience.

The UK's experience of treatment of mortgage and fire insurance tying might be interesting for considering Hong Kong's case; however, it does not directly apply, because we are not aware of any industry-wide agreement over tie-ins in the banking sector in Hong Kong, and the biggest mortgage loan maker, the HSBC group, is not practising tying.

In the UK, under Section 101(1) of Law of Property Act 1925, mortgagees have the power to insure and keep insured against loss or damage by fire any buildings, etc., forming part of the mortgaged property. Building societies hence provide for insurance in their rules which are binding on borrowers.

The Building Societies Association (BSA) had, until 1975, recommended to members that insurance be organised by societies through insurers of their choice. The societies thus tied financial services to insurance services. Borrowers were not allowed to arrange own-insurance. Societies would earn commission on introductions to insurers which they did not pass on to borrowers.

Following the receipt of complaints from members of the public in respect of these practices, the Office of Fair Trading (OFT) warned the BSA that the restrictions were significant and inappropriate to sections 21(2) dispensation. The BSA decided to amend their rules so that in 1975, new borrowers would be given the choice of three insurance companies plus the option to nominate companies of their own choice. The society would remain free to reject the nomination where they were unconvinced that: the scope and amount of the cover was equivalent to the societies normal cover; the service was likely to be satisfactory; and that the insurer would keep the society covered should the borrower failed to pay a premium. Moreover, the Society could demand that the policy not be altered without prior notification to the society.

Subsequently, the OFT expressed their concern to the BSA that some societies insisted, as a condition of granting a mortgage, that they should receive some, or all, of the commission payable in respect of linked endowment policies. They indicated that this practice was hard to justify in cases where the society had not arranged the policy. The BSA, in response, recommended that societies stop commission sharing where the borrower arranged its own insurance. As a result of these modifications to existing rules and practices, the BSA rules were not referred to the Restrictive Practices Court (RPC) and, ultimately, were given exemption under section 21(2) RTPA 1976.

Halifax, the biggest building society in UK, also agreed in 1982 that it would no longer insist on its borrowers taking out property insurance through the Society.

銀行對存戶是否公平？

消費者委員會
財經服務專責研究小組總結
香港的銀行政策及運作
對消費者的影響報告書

1994年2月

I、背境

港督於1992年10月向立法局提交的施政報告提及政府會致力與消費者委員會及有關團體聯手，為本港制訂一項全面競爭政策。本會隨即成立競爭政策研究小組，就一些行業的經營手法作深入的經濟分析，揭露市場上存在的不公平、具歧視性和違反自由競爭的經營手法，及研究其對消費者的影响。

銀行業發展迅速，提供的服務不斷更新，成為市民日常生活不可或缺的一環。另一方面，消費者委員會接獲有關銀行的投訴有上升的趨勢，值得關注。本會有見及此，隨即成立專家顧問小組，就香港的銀行政策及該行業的競爭情況，提供寶貴意見。小組成員如下：

主席：陳坤耀教授(香港大學亞洲研究中心主任)

成員：何美歡女士(香港大學法律系講師)
林孝信先生(顧問)
羅祥國博士(南華資料研究有限公司董事)
饒餘慶博士(香港大學經濟金融學院教授)

本會委任城市理工學院經濟及財務學系進行深入研究：

統籌：何炘基教授
張仁良博士

成員：黃國波博士
邱武慶博士
林國洲博士

本報告書第一部份闡釋消費者委員會的立場，是本會全人經詳細研究城市理工學院完成的報告書及專家顧問小組意見，綜合而成的。

本會謹向專家顧問小組成員、城市理工學院研究小組，及曾經協助本會研究的機構及個別人士致謝。

Ⅱ、研究目的

研究有關銀行政策、銀行的運作及市場環境對消費者的影响，包括現行的法律及監管架構、市場結構及集中程度、經營手法(市場行為)和資料公開程度。

本研究在一定程度上受到資料不足的限制(足以証明消費者委員會建議公開資料的重要性)，縱雖如此，本會相信本研究將會增加公眾對銀行業的關注，藉此引發建設性的討論和改善建議。

報告內容經已知會香港金融管理局、香港政府財經事務司及香港銀行公會。

Ⅲ、利率協議

一、存款市場具壟斷性

研究結果顯示十萬元以下及五十萬元而在三個月定期以下的存款市場具有壟斷性，原因是現行法律的限制及市場上沒有類同的替代品(Close substitutes)：

(a) 香港銀行公會條例

第12節(1)(a)——銀行公會有全權決定銀行大部份存款的利率，一般人稱之為「利率協議」。

第21節(1)——銀行公會有權對其會員，即持牌銀行(Licensed Banks)採取紀律行動，甚至革除會籍假如會員「違反第12條(1)的任何規定，包括利率協議」。

(b) 銀行法例第12及14節

規定有限制持牌銀行(Restricted Licensed Banks)及接受存款公司(Deposit-taking Companies)只能接受五十萬元以上的大額存款。此外，接受存款公司不能接受低於三個月為期的存款(除非獲金融管理局書面批准)。換句話說，這些機構不能接受「小額」和活期存款。(附件1)

這規定限制了有限制持牌銀行及接受存款公司進入小額存款市場競爭，鞏固了現有持牌銀行的壟斷。

二、市場沒有代替品，消費者別無選擇：

銀行提供的其他投資工具如掉期存款、美元存款，存款儲蓄計劃及貨幣市場基金等，與港元銀行存款性質不同，並非類同的替代品。另一方面，市場的壟斷勢力，亦不容許替代品的出現，令消費者別無選擇，原因如下：

(a) 掉期存款、美元存款、存款儲蓄計劃和貨幣市場基金有固定的儲存期限，不及港元銀行存款靈活，部份工具亦有最低存款額的限制，因此這些投資工具並非真正的替代品。

(b) 過往經驗顯示，市場一旦出現足以與銀行存款競爭的替代品，銀行公會即採取行動抑制，舉例來說，曾有銀行推出儲蓄戶口自動轉賬到支票戶口的服務，以「迴避」銀行公會支票戶不能支付利息的規定，其後銀行公會禁止該銀行繼續此服務。

(c) 銀行公會規定非會員不能利用中央結算 (Clearing House) 服務，進一步扼殺替代品的出現，例如貨幣市場基金及持牌銀行存款一旦沒有「結算」服務的支持難以競爭。

在現行法例的庇蔭下，新競爭者難以進入市場，形成五十萬元以下的儲蓄及支票戶口壟斷的局面，市場上亦缺乏其他類似的選擇，令小額存戶受到不利的影响。

Ⅳ、銀行務業的市場行為——利率差距

利率差距(銀行的資本成本與借貸利率的比較)亦可以反映銀行業壟斷的情況，它還是銀行最主要盈利收入來源之一，因此與外地息差的比較足以反映銀行因壟斷而獲取的額外收益。

研究報告將香港優惠利率與四類存款的息差，比較於世界上其他主要金融中心如美國、日本和英國以及澳洲、馬來西亞及星加坡的息差，為期由1978至1991年，長達十三年(附件2)，闡釋如下：

一、優惠利率比對銀行同業拆息
二、優惠利率比對定期存款利率
三、優惠利率比對儲蓄存款利率
四、-在美國的美金戶口利率與香港港元存款利率比較
　　-本港同一間美資銀行美元存款與港元存款息率比較

一、優惠利率與銀行同業拆息率(HIBOR)比較

銀行同業拆息率是不受利率協議限制的，受到市場需求而升降，與外地息差比較，香港的息差與其他四個國家息差相距不大，僅較美國和日本為高，反映出兩方面的情況：

(a) 在沒有利率協議的人為干預下，息差的走勢最接近市場情況；

(b) 銀行同業拆息是借貸的利率，同業借貸市場存在高度的競爭，因此與外國息差比較不相伯仲，同樣地，本港樓宇按揭貸款市場，因有高度競爭，雖然有「搭賣」保險情況，但「搭賣」與非「搭賣」銀行的收費沒有重大分別，也是競爭力量的明証。

另一方面，其他三類存款的息差都較外地為高，應該是因為受利率協議的限制，分析如下：

二、優惠利率—定期存款息差

香港的優惠利率與1個月、3個月、6個月及12個月定期存款的息差全部高於所比較的國家，平均高出1.65%。

三、優惠利率—儲蓄存款息差

香港的息差高於德國、澳洲、英國、日本、星加坡和馬來西亞，平均高出1.79%，比馬來西亞高3.07%，德國0.26%。

四、自1984年美元與港元掛鈎以後，理論上滙率不會有大幅度的波動，美元存款對港元存款利率亦相對穩定。因此，比較兩地存款的息差，足以反映出港元存款利息是否受利率協議的限制而偏低。研究作了兩項比較，首先是美元在美國定期存款和本港港元定期存款兩者的息差，其次是本港美資銀行給予的美元儲蓄存款與港元儲蓄存款的息差(附件3)，分析數據減除了自84年至今滙率的平均波幅(約0.1%)，結果如下：

(a) 美國銀行美元定期與本港銀行港元定期存款息差

港元定期平均低於美元定期2.2-2.6%，換句話說，香港人在美國開戶口會多收2.2-2.6%的利息。

(b)本港美資銀行港元與美元儲蓄存款息差

息差為0.6%，既然是同一家銀行的戶口，運作成本及其他因素應該沒有分別，但港元存戶平均每年少收0.6%的利息，正好反映出港元存款利息因利率協議的限制而低於應有的水平。

銀行界認為各類風險因素也是香港銀行利息差距大的原因，但銀行通常以優惠利率加若干厘作為貸款利率，而本研究僅以優惠利率來計算利率差距，經已充份考慮風險因素。

V、銀行業因壟斷而取得的利益(Monopsonistic Rents)

一、以每年利率差距計算壟斷利益

銀行業因利率協議所獲取的壟斷利益估計在1991年達五十二億元(51.7億)，即國民生產總值百分之零點八(0.8%)，由 1987年至91年每年所得的額外利潤分列如下：

(以十億港元為單位)

年份	從以下存款方式取得的估計壟斷利益			銀行公會屬下銀行因壟斷而從存戶取得的利益總數	
	支票戶口	儲蓄存款	定期存款	壟斷利益總數	佔全港生產總值 %
1987	$0.37	$0.69	$0.16	$1.23	0.33%
1988	$1.19	$0.92	$0.32	$2.43	0.56%
1989	$2.44	$0.19	$0.58	$3.21	0.64%
1990	$2.63	$0.06	$0.80	$3.50	0.62%
1991	$2.56	$1.63	$0.99	$5.17	0.80%

由於1992及1993年外地銀行的資料不全，尚未能計算出這兩年的壟斷利益。

計算方法：

由於支票戶口，儲蓄存款及部分定期存款均受銀行公會利率協議限制，計算方法是根據每年每類戶口的總存款數目，乘以該年與外國比較的平均利息差距，所得的總數是銀行業當年所獲取的壟斷利益。(支票戶口的利息差距計算方法略有不同) 詳細計算方法在附件4。

二、以平均利率差距計算壟斷利益

以一段較長的時間即由1978至1991年來分析，根據歷年平均利率差距來計算，銀行所得的壟斷利益估計在1991年為$74億，1992年為$64億。這方法的優點是剔除了短期經濟循環的急劇升降因素。

無論用那一個方法去分析，問題的焦點並不是在銀行所獲取壟斷利益的金額大小，而是究竟銀行有沒有壟斷利益，和這利益的大概比例。

公平問題

銀行因市場壟斷而賺取的額外利潤究竟是由那些人負担？答案最明顯不過，就是那些最沒有辦法為資金覓取高回報息率的小存戶。資本雄厚的人士是不會受到銀行限制競爭手法影响的，他們可以利用其他投資工具如貨幣市場基金等。反之，小存戶最受影响，而他們往往就是社會上較貧窮，較年輕和年長人士，由他們去承受銀行壟斷的代價是否符合社會公平的原則？從公共政策的角度來說，這究竟是否是政府堅持利率協議的原意？

VI、維持與反對銀行現行壟斷結構的理由

一、確保銀行體系的穩定性

有意見認為利率協議有助於減少銀行因惡性競爭而進行高風險的投資。

消費者委員會認為以上論據不能成立，利率協議自1964年開始推行至今，銀行業已趨穩定，同時金融管理局的監察機制亦行之有效。維持銀行業穩定，最主要是加強監管，而非鼓勵壟斷。

近年銀行業不時出現的新嘗試，試圖迴避利率協議的限制，正反映出市場對轉變的強烈要求，因此，再沒有充份理由繼續去抑壓市場上的自由競爭。在美國監管制度下，銀行因順應市場的需要而轉變，迴避監管的計劃層出不窮，終於引致監管制度失調。國際貨幣基金會(International Monetary Fund, IMF)的報告亦指出瑞典、挪威、丹麥和冰島也有同一遭遇，相信沒有人敢保証類似情況不會在香港出現。

為確保銀行業的長遠穩定，消費者委員會建議順應時勢，逐步放寬利率管制，消費者委員會相信漸進改革遠比突變為佳。若漠視市場因素，一旦產生突發事件，情況將不容易控制，所以銀行業及監管當局適宜未雨綢繆，逐步撤銷限制競爭的規定。

近年來某些國家銀行體制面臨的困難，成因相當複雜，其中的一個原因是監管制度未能追得上銀行業的轉變。但香港消費者委員會深信金融管理局在放寬利率管制之際，一定會採取有效的措施去配合，有需要的時候，會加強監管，以應付改革過程中出現的小問題。

公平問題

即使利率協議與維持銀行穩定息息相關的論據成立，銀行在短期內不放寬利率的限制，以換取短暫的穩定，仍須考慮公平問題：小存戶因此而要承担的壟斷代價是否太高，以致有失公平？

資源分配問題

有意見認為限制新競爭者進入市場，使銀行維持壟斷利益，是避免銀行高風險投資的好辦法，但在這情況下，壟斷者從小存戶所取得的利益並無止境。再者，在壟斷市場所產生的低存款利率，會吸引大量資金投資轉到樓宇炒賣活動，削減資金在市場作其他有建設性的投資活動，扭曲資源分配，妨碍經濟發展，同時亦會帶來通貨膨脹的壓力。

二、運作成本

研究結果顯示，香港的運作成本不一定高於其他國家，本港優惠利率與銀行同業拆息率的息差，除日本與美國之外，均低于相比較的國家，換句話說，沒有証據香港必須以高息差來負担較高的運作成本。

香港銀行公會警告說「一旦放寬利率管制，銀行將會改變不收費政策，現有相當多免費的項目將會收費」，消費者委員會認為以上說法不合理，原因如下：

首先，研究顯示目前銀行的服務並非全部都是免費，從收費的項目和價錢幅度來看，香港銀行不比其他國家的銀行收費為低。

其次，銀行聲稱目前利息差距雖然高，但由於銀行收費低，實際上已令消費者得益，消費者委員會認為這意見不合情理，因為只有在銀行利率和收費兩方面有完全競爭的情況下，消費者才會真正得益，銀行之間的競爭自然會令收費降到合理低水平，按揭市場是銀行競爭的好例子。雖然銀行按揭有「搭賣」火險的情況，由於按揭利率不受利率協議管制，不受大銀行分行多、資產厚影響，銀行之間有劇烈的競爭，減低了「搭賣」對消費者的不良影響。

公平問題

縱使高運作成本的解釋能夠成立，為什麼要由小存戶——即較貧窮、年輕和年長的人士去負担？又假設銀行以利率協議所取得的利益，補貼應收的各種服務費用，問題是為什麼要由銀行公會代替消費者作出決定？應該由消費者去決定是否願意多收利息而同時付出服務費，或以低息換取低收費？何況這並非並無選擇的絕對性問題。

三、維持聯繫滙率制度

自一九八八年，外滙基金與滙豐銀行達成協議，實行「新會計安排」，現時的金融管理局毋須再依靠利率協議以維持聯繫滙率。

縱使金管局認為有需要在一些情況下，利用存款利率作為維持聯繫滙率的途徑，可賦予財政司權力在必要情況下對港元存款利率作出適當的干預。

公平問題

若要較貧窮、較年輕或年長的小存戶因維持聯繫滙率制度而承担代價，讓銀行享有壟斷性利益，並不公平。

Ⅶ、市場集中

研究從「向氏市場集中指數」(Herfindahl Indices)分析一九八八至九二年間持牌銀行港元銀行存款的市場集中情況，結果顯示高度集中於數間大銀行，而持牌銀行的港元來往戶口和私人住宅樓宇按揭貸款市場亦屬集中。

以上的分析目的並非要証明本港銀行業市場集中和壟斷利益是否存在著因果關系，但研究資料所確實的集中情況，反映出銀行業在法例保護之下，從利率協議取得的利益也不是平均分配。所以有關利益團體大力反對本會廢除利率協議的建議，是可以預計的。

Ⅶ、銀行公開資料

本港銀行向市民公開的資料較英、美和日本為少。一些外國視為公開的銀行資料，香港公眾不能取得到，這包括：銀行內部儲備、詳細收入支出項目、壞賬儲備金、呆賬、存貸期不協調、貸款組合、資產負債表以外項目，以及銀行財務狀況的可見變動等。

銀行公開較詳細資料會令市場更為穩健，理由是：

- 銀行不公開財務狀況引致存戶與金融分析家胡亂猜測，反而會有反效果。

- 銀行公開更多資料，受到存戶、股東、金融分析家以公眾的監察，銀行投入高風險活動的機會減少，大大鼓勵了自律。

- 銀行公開詳細資料對存戶和股東帶來公平，讓存戶和股東有充份資料去考慮銀行的盈利情況，這是十分重要的，尤其是在缺乏存款保險制度的情況下，存戶只能完全信賴監管機構的監察，但一旦有問題發生監管機構却不會承担補償責任。

- 銀行業公開更多資料，會提高香港作為國際金融中心的地位。根據一間國際信貸評估機構按一九九一年度銀行年報資料而進行的普查顯示，在亞洲九個國家中，香港的資料公開程度排行第八。報告指出，香港銀行由於公開的資料有限，妨碍了其在亞洲區的競爭能力。

Ⅸ、搭賣情況

本會有些銀行把樓宇按揭貸款與火險一起安排，當消費者向銀行申請按揭貸款時，銀行規定他們向指定公司購買火險，也有些容許顧客從銀行提供的保險公司名單上選擇。

「搭賣」會損及消費者的經濟利益，並且令一個行業的壟斷勢力影响及另一行業，但今次的研究發現有規定「搭賣」與沒有規定的銀行，在火險安排和收費方面沒有重大分別。原因是樓宇按揭市場不受利率協議限制，因此非但沒有壟斷情況，且競爭非常激烈。另一個例子是94年1月滙豐和恒生銀行宣佈降低按揭成數，但其他銀行沒有跟隨，正好反映市場不受利率協議而可以自由競爭的情況。

消費者委員會認為有需要繼續研究「搭賣」對消費者的影响，例如火險承保的項目與「搭賣」有沒有關係，及銀行用貸款數額而並非以「重建費用」作為保險額對消費者的影响。

X、政策建議

消費者委員會建議撤銷利率協議並促請銀行公開更多資料，建議分階段放寬，使銀行有充份準備時間，以減低可能帶來的影响。

整個過程需時4年，由1994至1997年完成。

利率協議

本會建議銀行業1995年開始逐步放寬「利率協議」至1997年完成：

1995年 - 撤銷定期存款利率上限；

1996年 - 銀行為支票戶口提供利息；

1997年 - 撤銷儲蓄存款利率上限。

公開資料

本會建議以上三年時間完成：

1994年 - 公開銀行資產的資料，讓公眾得知銀行資產的情況，貸款組合、壞賬儲備金及呆賬；

1995年 - 公開銀行收益讓市民得知銀行的風險承担，包括公開有關損益賬項、收支詳情、存貸期不協調及真實收益詳情；

1996年 - 公開內部儲備的資料。

分階段實施的項目：

政策建議	1994	1995	1996	1997
撤銷利率協議				
支票戶口			✓	
儲蓄存款				✓
定期存款		✓		
公開資料方面				
收益		D		
內部儲備			D	
貸款組合	D			
損益明細項目		D		
壞賬儲備金 呆賬	D			
存貸期不協調		D		

註：✓ = 撤銷利率協議規定
D = 公開資料

附件

附件1

表一、接受存款的限制

銀行條例容許三類機構在本港接受存款，包括：持牌銀行，有限制持牌銀行及接受存款公司。以下是這些財務機構接受存款的限制，目前的限制在1990年曾經修訂，接受存款公司的最低接受存款額由$50,000提高到$100,000。

銀行類別	最低存款限制	最低存款期限	所受限制
持牌銀行	無	無	香港銀行公會
有限制持牌銀行	HK$500,000	無	無
接受存款公司	HK$100,000	三個月	無

表二、本港與外地息差比較：優惠利率－同業拆息

以下是香港與外地優惠利率與同業拆息歷年的息差(1978年1月到1991年12月)，外國資料取自國際貨幣基金會，本港資料來自 Pacific-Basin Capital Market Research Centre Database (PACAP)。

國　家	優惠利率－同業拆息(% p.a.)	
	中位數	標準差
澳洲	3.55	2.48
馬來西亞	2.77	1.77
美國	1.87	0.73
新加坡	1.70	1.26
香港	1.55	1.41
英國	1.32	2.62
日本	0.49	1.20

表三、本港與外地息差比較：優惠利率－定期存款利率

以下是1978年1月至1991年12月期間，香港、馬來西亞、新加坡、美國和日本優惠利率與一個月、三個月、六個月及十二個月定期存款利率的差距。本港各定期存款息差與外國比較，年息平均高出1.65% p.a.。

	優惠利率比對定期存款 (% p.a.)			
	一個月	三個月	六個月	十二個月
香港	3.99	3.78	3.50	2.90
馬來西亞	3.13	2.73	2.54	2.19
新加坡	0.86	3.01	2.70	
美國	1.99	1.88	1.76	
日本	0.73	0.71	0.82	
本港年息差距高出其他國家的數目 (% p.a.)				
平均	2.04	1.70	1.54	0.71
最高	3.26	3.08	2.68	-
最低	0.86	0.77	0.79	-

附件2B

表四、1978年至1991年優惠利率與儲蓄存款平均月息差距

外國資料數據取自國際貨幣基金會。香港的數據根據PACAP資料。

(以% p.a.顯示)

年份	香港	英國	德國	日本	澳洲	馬來西亞	新加坡	本港高出外地的平均數
1978	4.10	3.17	4.27	3.73	1.94	2.38	2.42	1.12
1979	5.29	2.21	3.49	3.06	1.75	2.00	2.30	2.82
1980	5.63	2.04	4.09	2.85	2.00	1.52	2.35	3.15
1981	6.04	2.58	4.95	3.43	2.54	-1.17	2.94	3.50
1982	6.00	-0.58	5.96	3.56	2.22	-0.96	3.01	3.80
1983	5.75	-1.35	5.49	3.38	3.23	3.06	2.74	2.99
1984	5.56	-1.55	4.96	3.25	4.71	1.81	1.99	3.03
1985	4.77	1.20	5.09	3.10	5.50	2.40	2.94	1.40
1986	4.42	0.82	5.04	3.70	5.90	3.63	2.93	0.75
1987	4.52	0.28	5.16	3.45	6.06	5.19	3.21	0.63
1988	4.75	1.80	5.04	3.27	6.60	3.93	3.23	0.77
1989	4.71	7.84	4.44	3.32	6.42	2.40	3.00	0.14
1990	4.50	8.53	4.52	3.39	6.38	1.26	2.69	0.04
1991	4.81	6.17	4.84	3.70	5.93	0.94	2.95	0.71
平均數 '78-91	5.07	2.38	4.81	3.37	4.37	2.00	2.76	1.79

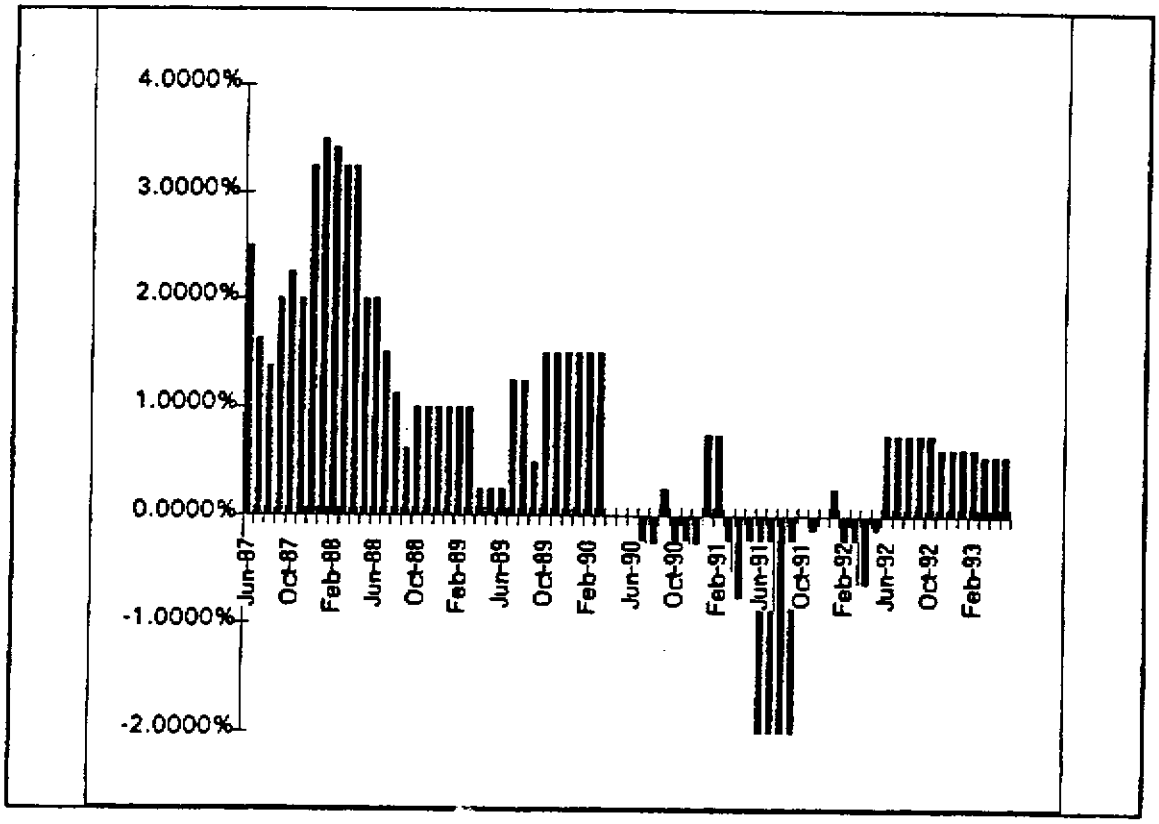
表五、美國與香港定期存款利率比較

下表顯示美國美元定期存款高出本港港元定期存款利率的差距。

83年10月-91年12月（實施聯繫滙率以後）	定期存款利率差距（%p.a.）	
	一個月	六個月
平均	2.700	2.320
標準差	1.560	1.657
最低	-1.141	-1.471
最高	6.609	5.669

圖一、美國運通銀行美元及港元儲蓄存款利率差距

由1987年6月至1993年5月期間，美國運通銀行美元儲蓄存款年息高出港元儲蓄存款年息的差距圖。



銀行業因壟斷所得利益的計算方法

壟斷利益的計算方法有兩種：按每年利率差距及按平均利率差距。由於利率協議的限制，銀行從三類存款：支票戶口、儲蓄存款及定期存款取得壟斷性的利益。

一、按每年利率差距計算：

(a) 支票戶口

支票戶口是沒有利息的，存戶損失的利息，亦即是銀行從這類存款取得的壟斷利益。計算方法如下：

（儲蓄存款利息 - 1%）x 支票戶存款的總額

- 1%是代表支票戶口較儲蓄戶口所多出的營運成本。

- 方程式以本港儲蓄利息計算，沒有加上本港與外國比較的息差，原因是銀行未必會支付利息予支票戶內的小額存款。但由於欠缺小額存款所佔的比率，我們在計算壟斷利益時，採取了較保守的方法，即是採用歷年實際儲蓄存款利率而並沒有加上外國比較的息差來一併計算。

銀行從支票存款所得的壟斷利益

（以港幣10億為單位）

年份	支票戶口總額	損失利率（實際儲蓄存款利率減1%）	從支票戶口取得的壟斷利益
1987	$37	1.00%	$0.37
1988	$49	2.44%	$1.19
1989	$51	4.79%	$2.44
1990	$54	4.88%	$2.63
1991	$69	3.71%	$2.56

(b) 儲蓄存款

銀行從這類存款取得的壟斷利息計算方法是：以每一年的儲蓄存款總額乘以當年本港與外國優惠利率和儲蓄存款利率的息差。

〔(香港息差：優惠利率-儲蓄存款利率) - (外國息差：優惠利率-儲蓄存款利率)〕 x儲蓄存款總額

結果如下：

銀行從儲蓄存款所得的壟斷利益

(以港幣10億為單位)

年份	儲蓄存款總額	本港優惠利率比對儲蓄存款利率差距高出所比較國家之數	從儲蓄存款取得的壟斷利益
1987	$110	0.63%	$0.69
1988	$119	0.77%	$0.92
1989	$135	0.14%	$0.19
1990	$159	0.04%	$0.06
1991	$229	0.71%	$1.63

(c) 定期存款

銀行從定期存款取得的壟斷利益計算方法也是以每一年兩地的息差乘以定期存款的總數，受銀行公會利率協議限制的定期存款，估計只佔銀行存款總額的17.9%(根據銀行業務監察專員辦事處1991年年報資料計算所得)，所以要再乘17.9%。

〔(優惠利率-定期存款)香港息差 − (優惠利率-定期存款)外國息差〕 x定期存款總額x17.9%

結果如下：

銀行從定期存款(受利率協議限制的戶口)所得的壟斷利益

(以港幣10億為單位)

年份	定期存款的17.9%	價惠利率比對定存利率差距與所比較國家之差額	從定期存款取得的壟斷利益
1987	$23	0.72%	$0.16
1988	$32	1.01%	$0.32
1989	$36	1.62%	$0.58
1990	$43	1.87%	$0.80
1991	$47	2.09%	$0.99

二、根據平均利率差距演算

按以下方法估計銀行所得的壟斷利益：

(a) 支票存款取得的壟斷利益：

(1978-91年香港平均儲蓄存款利率 - 1%) x 每年的支票戶口存款總額

(b) 儲蓄存款取得的壟斷利益：

先計算1978至91年本港和外地的優惠利率與儲蓄存款利率差距的平均數1.79% p.a.

1.79% x 每年的儲蓄存款總額

(c) 定期存款取得的壟斷利益：

先計算1978至91年本港和外地的優惠利率與定期存款利率差距的平均差數 = 1.65% p.a.

17.9%是受利率協議限制的定期存款總額的百分比。

1.65% x 17.9% x 每年定期存款總額

按平均利率差距演算的壟斷利益

(以港幣10億為單位)

年份	從以下存款方式取得的估計壟斷利益			壟斷利益總額	
	支票戶口	儲蓄存款	定期存款	總額	佔全港生產總值%
1987	0.37	1.96	0.38	2.71	0.74
1988	1.19	2.13	0.53	3.85	0.89
1989	2.44	2.41	0.59	5.45	1.09
1990	2.63	2.84	0.71	6.18	1.11
1991	2.56	4.09	0.78	7.43	1.16
1992	1.16	4.38	0.87	6.40	0.86