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# Hong Kong Contingent Bank Capital Facility (CBCF)

David Tam
*Yale Program on Financial Stability*

Steven Kelly
*Yale Program on Financial Stability*

# Hong Kong Contingent Bank Capital Facility (CBCF)[1]

*David C. Tam[2] and Steven Kelly[3,4]*

Yale Program on Financial Stability Case Study
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**Abstract**

On October 14, 2008, Hong Kong's financial secretary announced the Hong Kong Monetary Authority (HKMA) would use Hong Kong's Exchange Fund to provide standby capital to banks if needed. The Contingent Bank Capital Facility (CBCF) was available until the end of 2010 to shore up depositor and investor confidence in the local banking sector and commenced in parallel with a broader set of announced measures including a consumer bank deposit guarantee. Twenty-three locally incorporated "Authorized Institutions" were eligible to access CBCF capital upon request. The provisioning of CBCF capital would be accompanied by enhanced oversight from the HKMA. The Hong Kong government did not formalize the structure or terms of CBCF capital, nor did it expressly define any limits for individual banks or in aggregate. The CBCF never injected any capital and expired as initially scheduled, at the end of 2010.

**Keywords:** broad-based, capital injections, broad-based capital injections, Contingent Bank Capital Facility, Exchange Fund, Hong Kong, Hong Kong Monetary Authority

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[1] This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering broad-based capital injection programs. Cases are available from the *Journal of Financial Crises* at https://elischolar.library.yale.edu/journal-of-financial-crises/.

[2] Research Associate, YPFS, Yale School of Management.

[3] Research Associate, YPFS, Yale School of Management.

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# Hong Kong Contingent Bank Capital Facility (CBCF)

## At a Glance

Around the peak of the Global Financial Crisis (GFC) in October 2008, Hong Kong's domestic banking sector remained in relatively strong shape. Hong Kong's local banks collectively had a regulatory capital ratio of 14%, which was well over the 8% of risk-weighted assets that the Basel II international standards prescribed (HKMA 2008a, 2). However, in keeping with its international counterparts and responding to growing domestic financial disturbance, the Hong Kong Monetary Authority (HKMA) implemented a capital injection facility. In addition to a temporary expansion of deposit insurance and several previously announced liquidity provisions, the financial secretary announced on October 14, 2008 that the HKMA would use the Exchange Fund (the Fund) to provide standby capital to banks. Under a program known as the Contingent Bank Capital Facility (CBCF), locally incorporated "Authorized Institutions" could request capital on an as-needed basis. The HKMA did not formalize the structure or terms of CBCF capital injections, nor did it make explicit any maximum investment figure—either on a per-bank basis or in aggregate. As the HKMA predicted, the CBCF was never accessed. The program was allowed to expire as planned at the end of 2010.

| Summary of Key Terms | |
|---|---|
| Purpose: To support stability and confidence in the Hong Kong banking system by "making available additional capital to locally incorporated licensed banks, on request and subject to supervisory scrutiny should this become necessary" (FS 2008) | |
| Launch Dates | Announcement: October 14, 2008<br><br>Operational: October 14, 2008 |
| Wind-Down Dates | December 31, 2010 (HKMA 2010) |
| Program Size | Not specified. The limit was the total size of the Exchange Fund, inclusive of its borrowing limit |
| Usage | None (HKMA 2010) |
| Outcomes | No uptake |
| Ownership Structure | Government-owned |
| Notable Features | The design of the capital injections was not broadly established; instead, investment terms were to be set on a bank-by-bank basis (HKMA 2008a, 3) |

## Summary Evaluation

Because no CBCF capital was ever deployed, there are no specific instances of execution from which to draw an evaluation. However, the HKMA consistently described the CBCF as preemptory and intended to ward off the risk of the Hong Kong banking system becoming undercapitalized, even if the odds of such risk were remote (HKMA 2008a, 3; Wong and Tang 2008). In this respect, the lack of usage is consistent with success. In December 2008, the International Monetary Fund executive board stated it considered the CBCF to be "timely and warranted" (IMF 2008). However, the effects that CBCF may have had cannot be clearly separated from those of the other contemporaneous local and global responses.

| **Hong Kong Context: 2007–2008** | |
|---|---|
| **GDP (SAAR, nominal GDP in LCU converted to USD)** | \$211.6 billion in 2007<br>\$219.1 billion in 2008 |
| **GDP per capita (SAAR, nominal GDP in LCU converted to USD)** | \$30,594 in 2007<br>\$31,516 in 2008 |
| **Sovereign credit rating (five-year senior debt)** | As of Q4 2007:<br>Moody's: Aa2<br>S&P: AA<br>Fitch: AA+<br><br>As of Q4 2008:<br>Moody's: Aa2<br>S&P: AA+<br>Fitch: AA+ |
| **Size of banking system** | \$305.3 billion in total assets in 2007<br>\$330.3 billion in total assets in 2008 |
| **Size of banking system as a percentage of GDP** | 144.3% in 2007<br>150.6% in 2008 |
| **Size of banking system as a percentage of financial system** | Data not available for Hong Kong |
| **Five-bank concentration of banking system** | 77.7% of total banking assets in 2007<br>79.5% of total banking assets in 2008 |
| **Foreign involvement in banking system** | 91% of total banking assets in 2007<br>91% of total banking assets in 2008 |
| **Government ownership of banking system** | 0% of banks owned by the state in 2007<br>0% of banks owned by the state in 2008 |
| **Existence of deposit insurance** | 100% insurance on deposits up to \$64,500 in 2007<br>100% insurance on deposits up to \$64,500 in 2008 |
| *Source: Bloomberg, World Bank Deposit Insurance Dataset, World Bank Global Financial Development Database, World Bank Regulation and Supervision Survey* | |

# Key Design Decisions

**1. Part of a Package: Hong Kong's financial secretary announced the Contingent Bank Capital Facility alongside a broad deposit guarantee scheme.**

The Contingent Bank Capital Facility shared a press release with the new expansion of deposit guarantees (FS 2008), and its establishment also followed several weeks of newly implemented HKMA liquidity measures (HKMA 2009b). The purpose of the CBCF was to provide standby capital to banks during the Global Financial Crisis. Moreover, the CBCF came in the middle of a spate of capital injection programs across other developed markets (COP 2009, 12).

**2. Legal Authority: The legal authority for the financial secretary to establish the CBCF stemmed from the Exchange Fund Ordinance.**

The Exchange Fund Ordinance, originally of 1935, established an Exchange Fund to be under the discretion of the financial secretary in consultation with an Exchange Fund Advisory Committee. During the Global Financial Crisis, the ordinance's outlined authorities provided the secretary the power to use the Fund's resources to affect the exchange value of the Hong Kong currency and, secondarily, to engage in stabilizing transactions that aim to maintain "Hong Kong as an international financial centre" (HKMA 2008a; LegCo n.d.). In addition to the established funds, the Exchange Fund Ordinance also granted the secretary the legal authority to borrow for the Fund up to HKD 50 billion (approximately USD 6.5 billion) via sovereign debt issuance, without securing any additional authorization (LegCo n.d.).

**3. Communication: The HKMA created the CBCF to provide standby capital to banks upon their request, but Chief Executive of the HKMA Joseph Yam described it as a precautionary measure and did not expect to use it.**

Chief Executive of the HKMA Joseph Yam generally referred to the CBCF as a precautionary measure, enacted in response to adverse foreign developments (FS 2008; Yam 2008b, 12). Contemporary media coverage, however, noted that Hong Kong's Bank of East Asia had started to experience a run in the weeks preceding the announcement of the CBCF (Wan 2008).

Yam consistently reiterated that the HKMA did not expect banks to use the CBCF, due to the perceived strength of the Hong Kong banking sector (FS 2008; HKMA 2008a, 4; Panel 2008, 11).

**4. Governance/Administration: The HKMA operated the CBCF, and the Exchange Fund would have held any CBCF investments, under the discretion of the financial secretary.**

Given the limited outlines of the program itself as well as its lack of uptake, there does not seem to have been any material discussion of governance.

Had any banks utilized the CBCF, requesting banks would have been subject to additional monitoring by the HKMA. Borrowing institutions would have been subject to enhanced supervisory scrutiny with respect to material deviations in risk, balance sheet structure, or business strategy. The HKMA would have required borrowing institutions to notify it before beginning or materially expanding a line of business (HKMA 2008b).

**5. Size, Timing, and Source of Injections: The CBCF was available until the end of 2010 and was backed by the resources of the Exchange Fund.**

The Exchange Fund was the source of funds for the CBCF. While policymakers did not offer an explicit monetary figure, the Fund contained approximately HKD 1.4 trillion (approximately USD 180 billion) in October 2008 (Wong and Tang 2008; HKMA 2008c). As noted in Key Design Decision No. 2 above, the financial secretary could also supplement the Fund's resources with up to HKD 50 billion (about USD 6.5 billion) of sovereign borrowing. However, the financial secretary also committed the Fund's resources to the expanded deposit guarantee scheme announced alongside the CBCF (FS 2008).

**6. Eligible Institutions: Only locally incorporated licensed banks were eligible to participate in the CBCF.**

This list included 23 Hong Kong banks (HKMA 2009a, 197). Licensed banks were the only type of bank allowed to accept consumer deposits less than HKD 100,000 (approximately USD 13,000) (HKMA n.d.). Notably, the deposit guarantee scheme announced alongside the CBCF expanded deposit insurance to banks outside this "licensed" classification (FS 2008; HKDPB n.d.).

**7. Individual Participation Limits: There does not appear to have been any stated limit on individual institutions' participation, given the lack of broadly applied terms.**

The only apparent limit on the amount of funding available to an institution seemed to be the available amount in the Exchange Fund.

**8. Capital Characteristics: There seems to have been no specifics with regard to the terms of the capital investments under the CBCF.**

HKMA would have designed the structure of CBCF investments with consideration for each requesting bank's individual circumstances (HKMA 2008a, 3). Without a stated structure design or any ultimate usage of the program, it is not clear what kind of structure the HKMA injections would have assumed.

**9. Other Conditions: The HKMA signaled that CBCF capital would come with conditions.**

It appears any injections would have come with conditions that encouraged banks to replace the Exchange Fund's investment with private capital (HKMA 2008b). HKMA Chief Executive Yam noted that banks would prefer private capital to the CBCF due to the enhanced restrictions and supervisory measures that would be attached to that latter (Yam 2008a).

**10. Exit Strategy: The CBCF closed on December 31, 2010, as originally announced.**

Had the financial secretary made investments under the CBCF, it is not clear how long the Exchange Fund would have held onto any shares.

**11. Regulatory Changes: The creation of the CBCF did not include any regulatory changes.**

HKMA Chief Executive Yam stated that, alongside the CBCF, the HKMA would adopt a "flexible approach to adjusting the 'premium' over the statutory capital adequacy ratio" for individual banks, but it is not clear how this flexibility would have interacted with capital injections pursuant to the CBCF (Yam 2009, 8).

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