

A faint, light green world map is visible in the background of the slide, centered behind the text.

# **Joint HKSS-HKIMR Workshop on Financial and Economic Statistics (15<sup>th</sup> February 2003)**



# **Financial Soundness Indicators and their Potential Uses**

**Frederick HO Wing-huen**  
**Commissioner for Census and Statistics**  
**HKSAR Government**

# Introduction

**Increasing demand for better financial statistics**

- ✧ **to monitor financial risks and vulnerabilities**
- ✧ **to assess the soundness and stability of financial systems**

**Objective measures of financial system soundness:**

- ⇒ **Financial Soundness Indicators (FSIs)**
- ⇒ **Macroprudential Analysis (MPA)**

# What are FSIs?

✧ No universally accepted definition

*Narrower definitions adopted by IMF:*

Aggregated microeconomic indicators on the health of

- (i) financial institutions, both banks and non-banks
- (ii) major clients of the financial institutions, namely corporations and households

# FSIs proposed by IMF

*Two sets of FSIs are proposed by IMF:*

- (i) **Core set** ⇒ assessing the financial risks of the banking sector of an economy
- (ii) **Encouraged set** ⇒ assessing the health of other sectors that are also relevant in assessing financial sector vulnerability

# What is CAMELS?

*“Core set” of FSIs*

- ✓ **comprises 15 indicators for banking sector**
- ✓ **is organized using the CAMELS framework:**
  - ✧ Capital adequacy
  - ✧ Asset quality
  - ✧ Management soundness ⇒ a qualitative exercise
  - ✧ Earnings
  - ✧ Liquidity
  - ✧ Sensitivity to market risk

# Detailed descriptions on C of CAMELS

**Capital adequacy:**  $\Rightarrow$  **determines the robustness of financial institutions to shocks affecting their balance sheets**

- ✧ **Regulatory capital to risk-weighted assets**
- ✧ **Regulatory Tier 1 capital to risk-weighted assets**

# Detailed descriptions on A of CAMELS

**Asset quality:** ⇒ reflects the repayment performance and loan diversification of the credit portfolios of banks

- ✧ Nonperforming loans to total gross loans
- ✧ Nonperforming loans net of provisions to capital
- ✧ Sectoral distribution of loans to total loans
- ✧ Large exposures to capital



# Detailed descriptions on E of CAMELS

**Earnings:**  $\Rightarrow$  given weak profit performance can ultimately threaten a bank's solvency, it is important to monitor bank performance

- ✧ Return on assets (net income to average total assets)
- ✧ Return on equity (net income to average equity)
- ✧ Interest margin to gross income
- ✧ Non-interest expenses to gross income

# Detailed descriptions on L of CAMELS

**Liquidity:**  $\Rightarrow$  level of liquidity influences the ability of a banking system to withstand shocks

- ✧ Liquid assets to total assets (liquid asset ratio)
- ✧ Liquid assets to short-term liabilities

# Detailed descriptions on S of CAMELS

**Sensitivity to market risk:** ⇒ **Diversified operations of banks involving various aspects of market risk, including interest rate and exchange rate risks**

✧ **Duration of assets**

✧ **Duration of liabilities**

✧ **Net open position in foreign exchange to capital**

# Encouraged set of FSIs

Encouraged set of FSIs includes additional indicators for

- (i) deposit-taking institutions
- (ii) other institutions (e.g. non-bank financial intermediaries, corporate sector, households)
- (iii) markets (e.g. securities market, real estate market)

**Examples:**

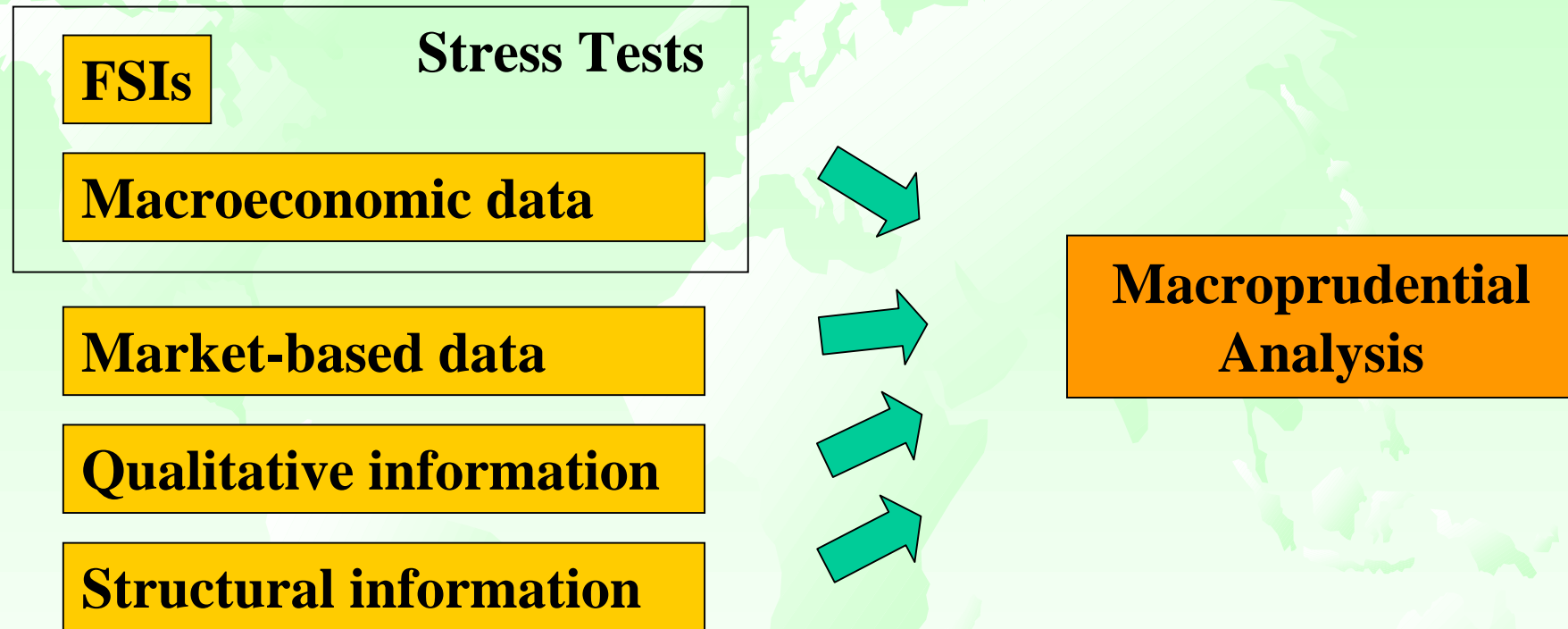
**Corporate Sector:** total debt to equity, return on equity

**Real estate markets:** residential real estate loans to total loans

# What is Macprudential Analysis (MPA)?

- ✧ a methodological tool that helps to quantify and qualify the soundness and vulnerabilities of financial systems
- ✧ focuses on health and stability of financial system
- ✧ complements early warning systems, focussing on vulnerabilities in domestic financial systems

# Components of MPA



## Stress tests:

- ✧ Tests for potential impact of shocks on selected FSIs
- ✧ Identify necessary pre-emptive remedies

# **Important issues on compilation and dissemination of FSIs**

## **IMF Survey on the Uses, Compilation and Dissemination of Macprudential Indicators:**

- ✧ **compilation and dissemination of FSIs is quite limited**
- ✧ **required components of certain core FSIs are widely available**
- ✧ **two important issues should be resolved**
  - **heterogeneity of standards** (concepts, accounting, regulatory, statistical standards)
  - **high resource costs** (substantial data reporting requirements)

# **International Standard on FSIs**

## *Compilation Guide on Financial Soundness Indicators*

- ✧ **being developed by the IMF, in consultation with other international organisations and national authorities**
- ✧ **provide guidance on concepts, definitions, data sources and compilation techniques**
- ✧ **planned to be finalised within 2003**



## Relevance to Hong Kong

- ✧ **strengthen Hong Kong's position as an international financial centre**
- ✧ **facilitate the surveillance of the financial market**
- ✧ **provision of relevant information for Financial Sector Assessment Program (FSAP), Financial System Stability Assessment (FSSA) and Article IV Consultation**
- ✧ **increased efforts will be needed from both data suppliers and indicator compilers if linkage between FSIs and SDDS is established**

# Current Availability of FSIIs for Hong Kong

**Capital Adequacy:** - Capital adequacy ratio

**Asset Quality:** - Non-performing loans to total gross loans

**Earnings:**

- Return on assets
- Net interest margin
- Cost-income ratio

# Way Forward

- ✧ to draw up the work plan for compilation and dissemination of FSIs for Hong Kong, subject to the finalisation of the *Compilation Guide on Financial Soundness Indicators*
- ✧ important issues to be addressed
  - development of benchmarks for level of FSIs
  - cooperation from data suppliers



**End of Presentation**