

**Bills Committee on
Securities and Futures Bill and Banking (Amendment) Bill 2000**

**Proposed amendments to the Banking Ordinance
concerning the functions of the Monetary Authority**

Purpose

At the Bills Committee meeting on 10 December 2001, Members expressed concern over the amendment to the functions of the Monetary Authority (“MA”) as proposed in the Banking (Amendment) Bill 2000 (“BAB”). This paper explains the proposed amendment.

The Definition and Scope of “Banking Business”

2. Fully licensed banks in Hong Kong are authorized under the Banking Ordinance (“BO”) to carry on “banking business”. Other authorized institutions (“AIs”), consisting of restricted licence banks and deposit-taking companies, are subject to a more limited form of authorization which allows them to carry on “the business of taking deposits”.

3. “Banking business” is defined in the BO as “the business of either or both of the following –

- (a) receiving from the general public money on current, deposit, savings or other similar account repayable on demand or within less than the period specified in item 1 of the First Schedule or with a period of call or notice of less than that period;
- (b) paying or collecting cheques drawn by or paid in by customers.”

4. Despite the fact that their authorization under the BO relates specifically to banking business or the business of taking deposits, AIs obviously carry out a wide range of other business activities. Such business activities may have an impact, for good or ill, on the liabilities side of AIs’ balance sheets and are thus of direct interest to the banking supervisor. It is for this reason that section 7 of and the Seventh Schedule to the BO seek to provide a legal basis for the MA to supervise all business activities conducted by AIs generally, not only their banking or deposit-taking business.

Section 7 of Banking Ordinance

5. Section 7(1) of the BO currently stipulates that the principal function of the MA under that Ordinance shall be to promote the general stability and effective working of the banking system. Section 7(2) further provides that the MA, among other things, shall take all reasonable steps to ensure that all AIs and local representative offices are operated in a responsible, honest and business-like manner. Furthermore, the MA shall suppress or aid in suppressing illegal, dishonourable or improper practices in relation to the business practices of AIs (see Annex for the existing section 7 of the BO).

6. The wording of section 7 is general in nature and does not restrict the functions of the MA to the supervision of only the banking business or deposit-taking business of AIs. Similarly, a number of the authorization criteria stipulated in the Seventh Schedule to the BO are related to the business of AIs generally instead of confining to their banking business or their business of taking deposits. For example, an applicant for authorization must have adequate financial resources to meet all its obligations – not simply those relating to its banking business or the business of taking deposits. The applicant must disclose adequate information about the state of its affairs generally. The MA must also be satisfied that the business of an applicant is presently, and will if it is authorized continue to be, carried on with integrity, prudence, etc. Such criteria have to be met by the applicant not only at the point of authorization but also on an on-going basis.

7. In the light of the foregoing, the framework promulgated by the BO is intended to allow the MA to exercise supervisory oversight over all the business conducted by AIs instead of confining such oversight simply to their banking business or their business of taking deposits. This approach is in line with the “Core Principles for Effective Banking Supervision” published by the Basle Committee in 1997 – Principle 20 stipulates that an essential element of banking supervision is the ability of the supervisors to supervise the banking group on a consolidated basis. In particular, it is considered essential by the Basle Committee that –

- “ • the supervisor has a supervisory framework that evaluates the risks that non-banking activities conducted by a bank or banking group may pose to the bank or banking group; and
- the supervisor has the legal authority to review the overall activities of a bank, whether the activities are conducted directly (including those conducted at overseas offices) or indirectly, through subsidiaries or affiliates of the bank. ”

8. In other words, the supervisory processes of banking supervisors should extend beyond banking business and embrace all businesses conducted by a bank, including those conducted through its subsidiaries. This is clearly necessary in order to ensure that the various businesses conducted by AIs (including, for example, their business of lending) does not adversely impact upon their financial position and/or reputation – which could in turn damage the interests of depositors and other customers and the stability of the banking system as a whole.

9. The regulatory framework proposed in the Securities and Futures Bill provides that the MA shall remain the front-line regulator for the securities business conducted by AIs. Under this framework, the MA will be responsible for the day-to-day supervision of the conduct of securities business by AIs in a manner and according to standards that are in line with those applied by the Securities and Futures Commission to its licensees. This may involve the MA exercising his powers under the BO, e.g. section 16(9) for imposing conditions on authorization, or section 52 for intervention by the MA, in cases involving the securities business of AIs.

10. The functions of the MA, as currently provided for under the BO, appear to be able to embrace the above situations. However, on reflection and on the advice of our legal advisors, we consider it desirable to remove any uncertainty about the scope of the MA's functions for the effective performance of its front-line regulatory role. We propose to achieve this by making it explicit in the BO that the MA's function is to ensure that the overall business of AIs is properly conducted. This will help reflect the policy that the MA has an overall supervisory responsibility for the business of AIs, regardless of whether such business is related to banking or deposit-taking.

Proposed Amendments

11. Clause 3 of the BAB proposes to add a new paragraph to section 7(2) of the BO. The new paragraph is intended to clarify that the MA has a responsibility to take all reasonable steps to ensure that any business of AIs (and not simply their banking or deposit-taking business) is conducted with “integrity, prudence and the appropriate degree of professional competence”. This reflects the fact that AIs are involved in other areas of business in addition to taking deposits and extending loans (such as issuance of credit cards, purchase and sale of foreign currencies, equities trading for customers, marketing of investment products, insurance agency activities and MPF-related services). The MA has to be satisfied that all these businesses are conducted properly to safeguard the

overall safety and integrity of individual AIs. This does not preclude the possibility that other regulators may also have their own particular responsibilities in relation to certain parts of an AI's business. This in turn requires arrangements for supervisory co-operation, such as those embodied in the Memoranda of Understanding between the HKMA and other regulators.

12. We have considered the alternative of confining the scope of the proposed amendment to the "securities business" of AIs. As explained above, the MA already has an overall supervisory responsibility for all the business conducted by AIs, and the proposed amendment is merely intended to clarify the situation. To limit the scope of the proposed amendment to "securities business" will have the undesirable effect of calling into question whether it is within the MA's powers under the BO to supervise the business activities of AIs other than banking and securities businesses, such as credit cards, mortgages, trade financing, insurance products etc. We have therefore concluded that this alternative is inappropriate as it will not be able to reflect the supervisory philosophy outlined above.

Hong Kong Monetary Authority
Financial Services Bureau
31 December 2001

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Section of Enactment



Chapter:	155	Title:	BANKING ORDINANCE	Gazette Number:	
Section:	7	Heading:	Functions of Monetary Authority	Version Date:	30/06/1997

(1) The principal function of the Monetary Authority under this Ordinance shall be to promote the general stability and effective working of the banking system. (Amended 82 of 1992 s. 15)

(2) Without limiting the generality of subsection (1), the Monetary Authority shall- (Amended 82 of 1992 s. 25)

(a) be responsible for supervising compliance with the provisions of this Ordinance;

(b) take all reasonable steps to ensure that the principal places of business, local branches, overseas branches and overseas representative offices of all authorized institutions and local representative offices are operated in a responsible, honest and business-like manner;

(c) promote and encourage proper standards of conduct and sound and prudent business practices amongst authorized institutions and money brokers; (Amended 4 of 1997 s. 4)

(d) suppress or aid in suppressing illegal, dishonourable or improper practices in relation to the business practices of authorized institutions;

(e) co-operate with and assist recognized financial services supervisory authorities of Hong Kong or of any place outside Hong Kong, whenever appropriate, to the extent permitted by this or any other Ordinance; and (Amended 95 of 1991 s. 4)

(f) consider and propose reforms of the law relating to banking business and the business of taking deposits.

(3) The Monetary Authority may from time to time cause to be prepared and published by notice in the Gazette, for the guidance of authorized institutions, guidelines not inconsistent with this Ordinance, indicating the manner in which he proposes to exercise functions conferred or imposed by this Ordinance upon him. (Amended 82 of 1992 s. 25)

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