

LEGISLATIVE COUNCIL BRIEF

Banking Ordinance (Chapter 155)

BANKING ORDINANCE (AMENDMENT OF THIRD SCHEDULE) NOTICE 2001

INTRODUCTION

The Financial Secretary has made the Banking Ordinance (Amendment of Third Schedule) Notice 2001 (the Notice) which will be gazetted on 6 July 2001.

BACKGROUND AND ARGUMENT

The Third Schedule

2. The Third Schedule to the Banking Ordinance (Cap. 155) provides for the calculation of an authorized institution's (AI's) capital adequacy ratio (CAR). An AI's CAR is the ratio of its Capital Base¹ to its risk weighted exposures.

SSAP 9

3. In January 2001, the Hong Kong Society of Accountants (HKSA) issued a revised Statement of Standard Accounting Practice (SSAP) 9, "*Events after the Balance Sheet Date*", which would be regarded as the accounting standard² in respect of financial statements relating to accounting periods beginning on or after 1 January 2001.

4. According to the revised SSAP 9, enterprises, including AIs that are incorporated in Hong Kong, are required to treat dividends that are proposed or declared³ after the balance sheet date (dividends), as a separate component of

¹ Capital Base includes Core Capital and Supplementary Capital.

² Accounting Standards are applicable to financial statements of a reporting entity that are intended to give a true and fair view of its state of affairs at the balance sheet date and of its profit or loss and cash flows for the financial period ending on that date.

³ Include proposed or declared dividends to holders of equity instruments, including preference shares. According to SSAP 9, an equity instrument is any contract that evidences a residual interest in the assets of an enterprise after deducting all of its liabilities.

an enterprise's equity at the balance sheet date. Although the treatment of interim dividends has not been specifically addressed by SSAP 9, it is stipulated in SSAP 25 – Interim Financial Reporting – that an enterprise should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements. The amendments in the Notice, therefore cover both interim and final dividends.

5. Before SSAP 9 was revised, dividends had been treated as an adjusting post balance sheet event, i.e. they would normally be accounted for in an enterprise's balance sheet as a liability item, even though they were proposed after the balance sheet date. The revised SSAP 9 would change the current accounting practice from treating dividends as part of an enterprise's liabilities to treating them as part of its equity. The revision is to bring the Hong Kong accounting framework in line with the International Accounting Standards.

6. Since the Third Schedule is silent on the treatment of dividends, SSAP 9 would affect their treatment under the capital adequacy framework. Unless the Third Schedule explicitly excludes dividends for the purpose of calculating the CAR, AIs would be able to include them in their Capital Base when calculating the CAR.

Justifications to exclude dividends from the Capital Base

7. While the revised SSAP 9 has changed the accounting standard for the presentation of dividends in the balance sheet of a locally incorporated AI, the economic substance of the AI has not altered. The dividends would still need to be paid out in due course. The CAR would therefore be temporarily inflated if dividends were allowed to be included in the Capital Base.

8. Moreover, the long-term nature of capital is of essential importance under the capital adequacy framework. It may allow AIs to absorb losses on an on-going basis and maintain their financial position. The HKMA considers that dividends are temporary in nature and could not be regarded as capital.

Amendments to the Third Schedule

9. Apart from paragraphs 3(d) and (e) of the Third Schedule, under which dividends would normally be captured for capital adequacy purpose by virtue of the revised SSAP 9, amendments should also be made to paragraphs 3(f) and (o). It is because dividends of an AI's subsidiaries could be included as minority interests on consolidation i.e. as Core Capital under paragraph 3(f) and as Supplementary Capital under paragraph 3(o).

10. The amendments would reinstate the status quo position vis-à-vis the Capital Base of an AI, i.e. the Capital Base would not alter as a result of the revision to SSAP 9.

11. The amendments are in line with the practice of other developed countries, such as Australia and the UK, whose banking supervisors have specifically required that anticipated or expected dividend payments be excluded from a bank's Capital Base in the calculation of CAR.

THE NOTICE

12. Under section 135(3) of the Banking Ordinance (Cap. 155), the Financial Secretary may, by notice in the Gazette, amend the Third Schedule to the Ordinance.

13. This Notice made by the Financial Secretary will amend the Third Schedule to specifically exclude dividends proposed or declared from the Capital Base of a locally incorporated AI for the purpose of calculating its CAR.

PUBLIC CONSULTATION

14. We have consulted the Hong Kong Association of Banks, the DTC Association and have taken into account their comments in preparing the Notice.

BASIC LAW IMPLICATIONS

15. The Department of Justice advises that the Notice is consistent with the Basic Law.

HUMAN RIGHTS IMPLICATIONS

16. The Department of Justice advises that the Notice has no human rights implications.

BINDING EFFECT OF THE LEGISLATION

17. The amendments will not affect the current binding effect of the existing provisions of the Banking Ordinance (Cap. 155).

FINANCIAL AND STAFFING IMPLICATIONS

18. There are no financial or staffing implications for the Government.

LEGISLATIVE TIMETABLE

19. The Notice, being subsidiary legislation, will be tabled at the Legislative Council on 11 July 2001 for negative vetting. The Notice will come into operation on 29 October 2001.

PUBLICITY

20. The HKMA will issue to all locally incorporated AIs a letter on the amendments after the negative vetting period by the Legislative Council expires.

ENQUIRIES

21. Inquiries on this Brief may be directed to Ms Rita Yeung, Head (Banking Policy) of HKMA (telephone number: 2878 1388) or Mr Edward Mak, Assistant Secretary for Financial Services (telephone number: 2527 3974).

**Financial Services Bureau
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