

LEGISLATIVE COUNCIL BRIEF

Legal Tender Notes Issue Ordinance (Chapter 65)

LEGAL TENDER NOTES ISSUE (AMENDMENT OF SCHEDULE) NOTICE 2001

INTRODUCTION

At the meeting of the Executive Council on 18 September 2001, the Council ADVISED and the Chief Executive ORDERED that approval should be given to the Financial Secretary to –

- (a) authorise the Po Sang Bank Limited [to be renamed the Bank of China (Hong Kong) Limited] to issue banknotes pursuant to section 3(2) of the Legal Tender Notes Issue Ordinance (Cap. 65);
- (b) withdraw the authorisation for the Bank of China to issue banknotes; and
- (c) make the Legal Tender Notes Issue Ordinance (Amendment of Schedule) Notice 2001, at the Annex, under section 6 of that Legal Tender Notes Issue Ordinance,

all with effect from 1 October 2001.

BACKGROUND AND ARGUMENT

2. The Bank of China (BoC) Hong Kong Branch and its nine sister banks in Hong Kong are undergoing a re-structuring which will involve, inter alia, the merger of the Hong Kong and Shenzhen businesses of ten BoC Group banks into a single entity (the Merger). The Merger

will involve the transfer to and vesting in the Po Sang Bank Limited (a locally incorporated licensed bank) (Po Sang) of the business, property and liabilities of -

- (a) BoC Hong Kong Branch;
- (b) the Hong Kong branches of The Kwangtung Provincial Bank, Sin Hua Bank Limited, The China and South Sea Bank Limited, Kincheng Banking Corporation, The China State Bank Limited, The National Commercial Bank Limited and The Yien Yieh Commercial Bank Limited;
- (c) the Shenzhen branches of The Kwangtung Provincial Bank and Sin Hua Bank Limited; and
- (d) Hua Chiao Commercial Bank Limited.

3. On 20 July 2001, the Bank of China (Hong Kong) Limited (Merger) Ordinance (the Merger Ordinance) was enacted¹. Pursuant to section 3 of the Merger Ordinance, Po Sang will give notice in the Gazette specifying the appointed time for the Merger to take effect.

4. Since 1994, BoC has been a note-issuing bank and issued banknotes in Hong Kong together with the other two note-issuing banks (The Hongkong and Shanghai Banking Corporation Limited and Standard Chartered Bank).

5. Section 6 of the Merger Ordinance provides that –

“Subject to the Financial Secretary (with the approval of the Chief Executive in Council) –

- (a) by notice in writing authorising Po Sang to issue banknotes under section 3(2) of the Legal Tender Notes Issue Ordinance (Cap 65) with effect from the appointed time; and
- (b) by notice in the Gazette amending the Schedule to the Legal Tender Notes Issue Ordinance (Cap. 65) in accordance with section 6 of that Ordinance by repealing “1. Bank of China.” from that Schedule and substituting “1. Bank of China (Hong Kong) Limited.” with effect from the appointed time,

¹ The Bank of China (Hong Kong) Limited (Merger) Bill was a Private Member’s Bill sponsored by Hon David LI Kwok-po. It was introduced into the Legislative Council on 13 June 2001.

Bank of China shall cease to be a note-issuing bank and Po Sang shall become a note-issuing bank, in each case with effect from the appointed time.”

6. As the BoC has set 1 October 2001 as the appointed time, the Administration would need to move in tandem in respect of the note-issuing bank status of Po Sang and BoC. Po Sang will be renamed as Bank of China (Hong Kong) Limited (BoCHK) on commencement of the Merger Ordinance at the appointed time.

Requirements of a Note-Issuing Bank

7. Article 111 of the Basic Law provides that the issue of Hong Kong currency must be backed by a 100% reserve. It further provides that the Government of the Hong Kong Special Administrative Region may authorise designated banks to issue or continue to issue Hong Kong currency under statutory authority, after satisfying itself that any issue of currency will be soundly based and that the arrangements for such issue are consistent with the object of maintaining the stability of the currency.

8. Before giving his approval under the Legal Tender Notes Issue Ordinance (the Notes Ordinance), the Financial Secretary must also ensure that Po Sang can conform with all the requirements applicable to existing note-issuing banks including the following requirements under the Basic Law and the Notes Ordinance -

(a) **Memorandum of Association**

A note-issuing bank is required under section 3(3) of the Notes Ordinance to have the issuance of legal tender notes as one of the objects under its constitution.

(b) **US Dollar Funding**

Under the linked exchange rate system, a note-issuing bank is required to place US dollars with the Exchange Fund in exchange for non-interest bearing Certificates of Indebtedness issued by the Financial Secretary under the Exchange Fund Ordinance as backing for the Hong Kong dollar banknotes it issues. Consequently, a note-issuing bank should have the necessary US dollar funding readily available to meet its US dollar cash flow requirements.

(c) **Obligations**

A note-issuing bank must accept the obligation to supply banknotes on demand without restriction against Hong Kong dollar balances held with it. It should also readily accept such banknotes without restriction.

(d) **Distribution network**

A note-issuing bank must have an adequate distribution network throughout Hong Kong in order that its banknotes may be distributed and collected efficiently.

(e) **Responsibilities**

Given its special status as a note-issuing bank, to the extent that its commercial interests are not put at unacceptable risk, a note-issuing bank is expected to co-operate with the authorities in monetary operations when called upon to do so.

(f) **Costs**

The Exchange Fund meets the costs of the printing and delivery of printed notes but the note-issuing bank is required to meet all distribution, storage, sorting and destruction costs.

(g) **Operational Arrangements**

A note-issuing bank should put in place the appropriate equipment, resources, tight security and audit control at all levels and stages in relation to the storage, handling, issue and destruction of banknotes.

(h) **Other Conditions**

A note-issuing bank is required to meet other terms and conditions which the Financial Secretary may specify in writing.

9. The Hong Kong Monetary Authority (“HKMA”) has advised the Financial Secretary that the BoC Group has made the necessary efforts to ensure a smooth transition for the Merger to be effected at the appointed time. The HKMA is satisfied that BoCHK will continue to meet the prudential requirements specified under the Banking Ordinance at and after the appointed time, in particular it will have fit and proper controllers, effective organisation structure, satisfactory non-performing loans, liquidity and capital adequacy ratios, and controls over large exposures and connected lending. The HKMA is also satisfied that BoC

(the parent bank) will continue to stand behind its Hong Kong subsidiary, and that Po Sang is prepared and able to meet the requirements as set out in paragraph 8 above to become a note-issuing bank from the appointed time. For the foregoing reasons, the Administration is satisfied that the requirements as stipulated under Article 111 of the Basic Law will be met and that the authorisation of Po Sang as a note-issuing bank under the Notes Ordinance and the issue of banknotes by Po Sang will be soundly based and consistent with the object of maintaining the stability of the currency.

THE NOTICE

10. The Notice at the Annex amends the Schedule to the Notes Ordinance to specify BoCHK as a note-issuing bank within the meaning of that Ordinance in place of BoC. The Notice shall commence operation on 1 October 2001.

PUBLIC CONSULTATION

11. The LegCo Panel on Financial Affairs (the Panel) considered at its special meeting on 19 June 2001 the Bank of China (Hong Kong) Limited (Merger) Bill (the Merger Bill). At that meeting, the Administration briefed the Panel that Po Sang would be appointed as a note-issuing bank in place of BoC at the appointed time under clause 6 of the Merger Bill. The Administration's policy is to ensure that any succession of a note-issuing bank should be smooth and conducive to maintaining public confidence in the legal tender notes issued by the bank.

BASIC LAW IMPLICATIONS

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

HUMAN RIGHTS IMPLICATIONS

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

FINANCIAL AND STAFFING IMPLICATIONS

14. The proposal has no financial or staffing implications for the Government.

BINDING EFFECT OF THE LEGISLATION

15. The Notice would not affect the current binding effect of the Notes Ordinance.

LEGISLATIVE TIMETABLE

16. The legislative timetable for the Notice will be -

Publication in the Gazette	21 September 2001
Tabling at the LegCo	10 October 2001
Commencement of operation	1 October 2001

PUBLICITY

17. A press release will be issued on 21 September 2001. A Government spokesman will be available to handle media enquiries.

OTHERS

18. For enquiry on the content of this brief, please contact Ms Kinnie Wong, Assistant Secretary (Banking and Monetary) of the Financial Services Bureau, at 2527 3974.

Financial Services Bureau
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[sections 2 & 6]

BANKS SPECIFIED FOR THE PURPOSES OF
DEFINITION OF “NOTE-ISSUING BANK”

1. Bank of China.
 2. Standard Chartered Bank.
 3. The Hongkong and Shanghai Banking Corporation Limited.
(Added 98 of 1995 s. 5)
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