

LEGISLATIVE COUNCIL BRIEF

The Secretary for Financial Services and the Treasury submits the following note for Members' information :

<u>Title of the Note</u>	<u>Date of ExCo</u>	<u>Date of Gazette</u>
Legal Tender Notes Issue Ordinance (Amendment of Schedule) Notice 2004	25 May 2004	28 May 2004

28 May 2004

Financial Services and the Treasury Bureau

LEGISLATIVE COUNCIL BRIEF

Legal Tender Notes Issues Ordinance (Chapter 65)

LEGAL TENDER NOTES ISSUE ORDINANCE (AMENDMENT OF SCHEDULE) NOTICE 2004

INTRODUCTION

At the meeting of the Executive Council on 25 May 2004, the Council ADVISED and the Chief Executive ORDERED that approval be given to the Financial Secretary to –

- (a) authorise Standard Chartered Bank (Hong Kong) Limited (SCBHK) to issue banknotes pursuant to section 3(2) of the Legal Tender Notes Issue Ordinance (Cap. 65) (the Notes Ordinance);
- (b) withdraw the authorisation for Standard Chartered Bank (SCB) to issue banknotes; and
- (c) publish the Legal Tender Notes Issue Ordinance (Amendment of Schedule) Notice 2004 (the Notice), at the Annex, under section 6 of the Notes Ordinance,

all with effect from 1 July 2004.

JUSTIFICATIONS

2. The SCB Hong Kong Branch, Manhattan Card Company Limited (a locally incorporated restricted licence bank), Standard Chartered Finance Limited, Standard Chartered International Trade Products Limited and Chartered Capital Corporation Limited (collectively, the Transferring Entities) are undergoing a re-structuring which will result in, inter alia, the merger of the businesses of the Transferring Entities into a single entity (the Merger). The Merger will involve the transfer to and vesting in SCBHK (a locally incorporated licensed bank) of the business, property and liabilities of the Transferring Entities.

3. On 7 May 2004, the Standard Chartered Bank (Hong Kong) Limited (Merger) Ordinance (the Merger Ordinance) was enacted¹. Pursuant to section 3 of the Merger Ordinance, SCBHK and the Transferring Entities will give joint notice in the Gazette specifying the appointed day for the Merger to take effect.

4. At present, there are three note-issuing banks in Hong Kong. SCB has been authorised to issue banknotes in Hong Kong since 1862. The other two note-issuing banks are The Hongkong and Shanghai Banking Corporation Limited and the Bank of China (Hong Kong) Limited.

5. Section 7 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 authorizing Standard Chartered Bank (Hong Kong) to issue bank notes under section 3(2) of the Legal Tender Notes Issue Ordinance (Cap. 65) with effect from the appointed day; 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 “2. Standard Chartered Bank.” from that Schedule and substituting “2. Standard Chartered Bank (Hong Kong) Limited.” with effect from the appointed day,

Standard Chartered Bank shall cease to be a note-issuing bank and Standard Chartered Bank (Hong Kong) shall become a note-issuing bank, in each case with effect from the appointed day.”

6. As SCBHK has set 1 July 2004 as the appointed day, the Administration would need to move in tandem in respect of the note-issuing bank status of SCBHK and SCB.

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 (the Government) may authorise designated banks to issue or continue to issue

¹ The Standard Chartered Bank (Hong Kong) Limited (Merger) Bill (the Merger Bill) is a Private Member’s Bill sponsored by Dr. the Honourable David LI Kwok-po. It was passed by the Legislative Council (LegCo) on 28 April 2004.

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 Notes Ordinance, the Financial Secretary must also ensure that SCBHK 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, as well as 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 SCB has made the necessary efforts to ensure a smooth transition for the Merger to be effected on the appointed day. The HKMA is satisfied that SCBHK will continue to meet the prudential requirements specified under the Banking Ordinance on and after the appointed day, in particular it will have fit and proper controllers, an effective organization structure, a satisfactory level of non-performing loan, liquidity and capital adequacy ratios, as well as adequate controls over large exposures and connected lending. The HKMA is also satisfied that Standard Chartered PLC (the parent bank) will continue to stand behind its Hong Kong subsidiary, and that SCBHK is prepared and able to meet the requirements as set out in paragraph 8 above to become a note-issuing bank from the appointed day. 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 SCBHK as a note-issuing bank under the Notes Ordinance and the issue of banknotes by SCBHK will be soundly based and consistent with the object of maintaining the stability of the currency.

THE NOTICE

10. The publication of the Notice at the Annex amends the Schedule to the Notes Ordinance to specify SCBHK as a note-issuing bank within the meaning of that Ordinance in place of SCB. The Notice shall commence operation on 1 July 2004.

LEGISLATIVE TIMETABLE

11. The legislative timetable for the Notice will be -

Publication in the Gazette	28 May 2004
Tabling at LegCo	2 June 2004
Commencement	1 July 2004

IMPLICATIONS OF THE PROPOSAL

12. The proposal has no financial implications for the Government. A smooth succession of the note-issuing bank status is expected to take place through this proposal to avoid disruption on the economy. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. It has no productivity, environmental or civil service implications. The proposal has no sustainability implications. The Notice at the Annex will not affect the current binding effect of the Notes Ordinance.

PUBLIC CONSULTATION

13. In considering the Merger Bill on 2 February 2004, the LegCo Panel of Financial Affairs (the “Panel”) noted that SCBHK would be appointed as a note-issuing bank in place of SCB on the appointed day under clause 7 of the Merger Bill. The Administration’s policy is to ensure that any succession to a note-issuing bank should be smooth and conducive to maintaining public confidence in the legal tender notes issued by the bank.

PUBLICITY

14. A press release will be issued on 28 May 2004. A Government spokesman will be available to handle media enquiries.

OTHERS

15. For enquiry on the content of this brief, please contact Mr Danny Leung, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services), at 2529 0121.

Financial Services and the Treasury Bureau
Financial Services Branch
28 May 2004

L.N. 105 of 2004**LEGAL TENDER NOTES ISSUE ORDINANCE (AMENDMENT
OF SCHEDULE) NOTICE 2004**

(Made under section 6 of the Legal Tender Notes Issue
Ordinance (Cap. 65) with the approval of
the Chief Executive in Council)

1. Commencement

This Notice shall come into operation on 1 July 2004.

**2. Banks specified for the purposes of
definition of “note-issuing bank”**

The Schedule to the Legal Tender Notes Issue Ordinance (Cap. 65) is amended by repealing item 2 and substituting—

“2. Standard Chartered Bank (Hong Kong) Limited.”.

Henry TANG
Financial Secretary

25 May 2004

Explanatory Note

This Notice—

- (a) amends the Schedule to the Legal Tender Notes Issue Ordinance (Cap. 65) to specify Standard Chartered Bank (Hong Kong) Limited as a note-issuing bank within the meaning of that Ordinance in place of Standard Chartered Bank;
- (b) implements section 7(1)(b) of the Standard Chartered Bank (Hong Kong) Limited (Merger) Ordinance (6 of 2004).