

**Bills Committee on  
Company (Amendment) Bill 2004**

**Follow-up Actions Arising from  
the Discussion at the Meeting on 7 April 2005**

**Purpose**

At the meeting held on 7 April 2005, Members requested the Administration to provide further information about the possible impact of the Bill on the asset-securitization industry in Hong Kong. This note sets out the information sought in the ensuing paragraphs<sup>1</sup>.

**Market Statistics – Hong Kong and Overseas**

2. In respect of the statistics of market sizes, we have consulted Hong Kong Monetary Authority (HKMA) which has provided us with the information (at **Table A**) compiled by the Hong Kong Mortgage Corporation Limited (HKMC) from various market sources.

<b>Markets</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
<b>Hong Kong</b>	\$0.32B	\$0.08B	\$0.33B	\$0.84B	\$1.27B <sup>2</sup>
<b>UK</b>	\$29.6B	\$43.5B	\$52.8B	\$85.7B	\$136.1B
<b>Australia</b>	N/A	N/A	\$19B	\$28B	\$39.8B
<b>Singapore</b>	N/A	N/A	N/A	N/A	N/A
<b>Japan</b>	\$23.5B	\$26.4B	\$36.7B	\$34B	\$46.1B
<b>Korea</b>	N/A	N/A	N/A	\$1.9B	N/A
<b>USA</b>	N/A	N/A	\$2,240B	\$3,060B	\$2,304B

**Table A:** All amounts are in US dollars. NA: Not available.

<sup>1</sup> Members may also wish to refer to our earlier papers entitled “Follow-up Actions Arising from the Discussion at the Meeting on 16 December 2004” (LC paper No. CB(1) 668/04-05(03)), “Impact of the Bill on the Asset-Securitization Market in Hong Kong” (LC Paper No. CB(1) 938/04-05(09)) and “Follow-up Actions Arising from the Discussion at the Meeting on 24 February 2005” (LC Paper No. CB(1)1207/04-05(02)).

<sup>2</sup> In May 2004, the Government of Hong Kong SAR has successfully launched a HK\$6 billion (US\$769 million) bond programme that securitized the revenues of Government-owned toll tunnels and bridge.

(I) Hong Kong

3. The Administration's observations are set out below –

- (a) As regards the existing role and contribution of the asset-securitization industry, we would like to reiterate that the Government attaches great importance to the development of securitization market, which forms part of our continuing effort to reinforce Hong Kong's position as an international financial centre. Government's specific initiatives in recent years include the securitization of revenues from government toll tunnels and bridge, the streamlining of the company prospectuses requirements and investor education.
- (b) Quality and reliable financial reporting is a key to the underpinning of investors' confidence. As regards its expected growth of the market and the impact of the Bill thereon, the Government Economist is of the view that the Bill will have a positive impact on the asset-securitization industry, as it would enhance the quality of corporate governance and hence the status of Hong Kong as an international financial centre.<sup>3</sup> The Bill is also supported by the Securities and Futures Commission and the Stock Exchange of Hong Kong Limited.

(II) Overseas Experience

4. We have endeavoured to check through Hong Kong's Economic and Trade Offices the relevant overseas experience in relation to the adoption of IAS 27. Further to the Administration's paper entitled "Impact of the Bill on the Asset-Securitization Market in Hong Kong" (LC Paper No. CB(1)938/04-05(09)), the information set out below represents the available information received during the enquiry processes.

- (a) According to the Australian Accounting Standards Board (AASB), Australia had adopted the "control-based" definition under IAS 27 in its accounting standards since the last decade. Our enquiry with the Board did not reveal any adverse impact of the adoption of the definition on the asset-securitization

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<sup>3</sup> We have consulted the Government Economist. The Administration has no information for the projection of future growth of the securitization industry.

market in Australia. Indeed, the market statistics at **Table A** show that the Australian market doubled in the past few years. This suggests that there are a host of factors affecting the development of the asset-securitization industry, and that the “off-balance sheet” treatment should not be simply equated to the “oxygen” for the asset-securitization market.

- (b) According to our enquiry with the Accounting and Corporate Regulatory Authority of Singapore through Hong Kong’s Economic and Trade Office there, Singapore adopted the “control-based definition” in IAS 27 since the last decade as well. There are no market statistics available and we are advised that there have not been any comments in the market suggesting that the definition in IAS 27 has had a negative impact on the securitization market in Singapore.
- (c) Finally, all European Union members require all listed companies to prepare group accounts based on IAS 27 from 1 January 2005. So far, we have not received any information suggesting any adverse impact on the securitization markets there.

### **Specific Arguments Raised by the Securitization Industry**

5. We note that the HKMC, Professor Kalok Chan and the Hong Kong Capital Markets Association<sup>4</sup> had submitted to the Bills Committee their views about the possible impact of the Bill. In short, some members of the securitization industry raised the arguments that –

- (a) consolidation of the accounts of special purpose entities (SPE) might affect the financial ratios of the group company thus making the issuance of the securities less attractive; and
- (b) the continued growth and expansion of the asset-securitization market requires the support of an off-balance sheet treatment.

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<sup>4</sup> Members may wish to refer to HKMC’s submission dated 11 March 2005 (LC Paper No. CB(1)1113/04-05(01)), Professor Kalok Chan’s submission dated 16 March 2005 (LC Paper No. CB(1)1130/04-05(01)), the Hong Kong Capital Markets Association’s submission dated 31 December 2004 (LC Paper No. CB(1) 647/04-05(01)), and the Administration’s detailed responses thereto in our earlier papers mentioned in footnote 1.

6. Regarding paragraph 5(a), we have difficulties in appreciating the argument that the consolidation of the accounts of an SPE subjected to the “control” of a parent company would adversely affect the interpretation of the group’s financial ratios. This argument is built on the assumption that the present off-balance sheet note disclosure is completely ignored by analysts and investors. In our view, financial ratios should not be, and are not, viewed in isolation; and indeed sophisticated analysts and investors are able to see through off-balance sheet disclosures for interpretational purposes. Compared to notes disclosure, consolidation will present a clearer picture to all users of the statements (including ordinary investors) as regards the company’s leverage hence facilitating interpretation of financial information pertinent to an informed investment decision. From the overseas experience of adopting IAS 27, we are unable to see how such a clearer presentation of the group’s financial information would make the issue of securities under a securitization transaction less attractive.

7. Regarding paragraph 5(b), we wish to reiterate that the “off-balance sheet” treatment should not be simply equated to the “oxygen” for the asset-securitization market. The primary purpose of financial reporting is to give a true and fair view of the state of affairs and results of the company.

### **True and Fair View**

8. The Administration is invited to clarify –

- (a) whether off-balance sheet treatment for securitization SPE may result in a “distortion of financial statements of the group as a whole to the extent that they do not show a true and fair view”; and
- (b) whether the current off-balance sheet treatment for securitization SPE has failed to give a “true and fair view” of the company’s group accounts.

9. On the two questions in paragraphs 8(a) and (b), we have consulted the HKICPA as the auditing and accounting profession is vested with the statutory duty under the Companies Ordinance (CO, Cap. 32)<sup>5</sup> to give its independent and professional opinion on whether a

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<sup>5</sup> Auditors have a statutory duty under s. 141(1) and (3) to state whether in the auditor’s opinion group accounts are prepared in accordance with the CO and give a “true and fair view”.

true and fair view is given in group accounts.

10. According to HKICPA, off-balance sheet treatment for securitization SPE by **the group company that has control over them**<sup>6</sup> would result in the financial statements of that group not giving a true and fair view. This is because the financial statements so presented fail to take account of all assets and liabilities controlled by the group. Currently, however, financial statements of Hong Kong companies are not qualified by their auditors for non-consolidation of SPE, because HKAS 27 includes certain specific provisions for companies incorporated under the CO. In short, these provisions require Hong Kong companies to use the definition of “subsidiary” as set out in the existing section 2(4) of the CO in preparing consolidated financial statements and to disclose information of SPE in notes to accounts. The HKICPA considers the specific provisions an interim measure, and that the definition of “subsidiary” in the CO should be amended. For non-Hong Kong incorporated companies primarily listed in Hong Kong, they are already required under the Listing Rules to prepare group accounts according to IAS 27 or HKAS 27, thus the obligation to consolidate securitization SPE already exists.

## **Financial Regulation and Financial Reporting**

11. Finally, we wish to point out again that financial regulation and financial reporting aim at serving different purposes. Financial reporting is fundamentally presenting financial performance based on generally accepted accounting principles, whereas financial regulators may request financial information to be presented under certain separate rules specifically for prudential purposes.

12. To illustrate, despite the adoption of HKAS 27 and IAS 27 for financial reporting, HKMA requests authorized institutions to continue to apply its own consolidation rules for prudential purposes in relation to capital adequacy. Furthermore, according to HKMC, the Australian Prudential Regulatory Authority has also implemented a separate regulatory requirement for banks.

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<sup>6</sup> It should be noted that this refers to control over the *SPE itself*. Even though the parent company may have transferred the title, ownership and risks of the particular *securitized assets* to the SPE, the parent company may still retain the control over the operating and financial policies of the SPE, hence the need for consolidation of the SPE as part of the group.

13. Finally, we understand that the HKICPA would separately write to the Bills Committee to provide further information in relation to the matters (including the experience in Germany) arising from the meeting on 7 April 2005.

**Financial Services and the Treasury Bureau  
May 2005**