

**立法會**  
**Legislative Council**

LC Paper No. LS44/04-05

**Paper for the House Committee Meeting  
on 8 April 2005**

**Legal Service Division Report on  
Banking (Amendment) Bill 2005**

**I. SUMMARY**

- 1. Objects of the Bill** To provide a framework for the introduction of revised banking supervising standards published by the Basel Committee on Banking Supervision in June 2004 (Basel II) and to make other miscellaneous amendments.
- 2. Comments** (a) The Bill does not contain any substantive rules of Basel II. The proposal is that Basel II would be implemented through subsidiary legislation to be made by the Monetary Authority (MA), i.e. the statutory office. (b) Amendments would be made to limit the liability of managers in relation to some offences under BO and providing a defence of “reasonable excuse” to mitigate some harsh effects of the relevant provisions of BO. (c) Other amendments allowing MA to publish details of disciplinary decisions, raising the maximum capital adequacy ratio and dispensing with the need to consult FS are technical in nature.
- 3. Public Consultation** According to the Administration, HKMA, i.e. the government authority, has undertaken extensive public consultation on an ongoing basis in developing the implementation plan for Basel II. A detailed consultation package was issued in August 2004. The draft Bill was circulated in December 2004 to members of the Basel II Consultation Group, the industry associations, the statutory advisory committees, the Consumer Council, the Office of Privacy Commissioner for Personal Data and other interested parties. There was no objection to the Bill.
- 4. Consultation with LegCo Panel** The Financial Affairs Panel was briefed on 5 July and 6 December 2004 on the major features of Basel II, the HKMA’s implementation plan, the legislative approach and the key provisions of the Bill. There was general support for the implementation of Basel II in Hong Kong.
- 5. Conclusion** Although the Bill does not directly make provisions for the implementation of Basel II, Members may find it necessary to know about the details of the new regime of banking authorization and supervision, the planned subsidiary legislation, the implementation schedule and risks control measures and to consider the policy implications of the passage of the necessary framework. It is therefore recommended that a Bills Committee be set up to study the Bill.

## II. REPORT

### Objects of the Bill

- (a) To amend the Banking Ordinance (Cap. 155) (BO) to provide a framework for the introduction of revised banking supervising standards published by the Basel Committee on Banking Supervision in June 2004 (Basel II); and
- (b) To make other miscellaneous amendments to BO, including -
  - (i) limiting the liability of managers of companies, for some offences under BO, to instances that are results of an act or omission on the part of the manager personally or of a person under his control;
  - (ii) allowing a defence of “reasonable excuse” to some offences under BO;
  - (iii) allowing the Monetary Authority (MA), i.e. the statutory office, to publish details of disciplinary decisions in respect of securities business of Authorized Institutions (i.e. banks and deposit-taking companies authorized under BO) (AIs); and
  - (iv) allowing MA to vary the capital adequacy ratio of licensed banks to a maximum of 16%.

### LegCo Brief Reference

- 2. G4/16/36C issued by the Financial Services and the Treasury Bureau on 2 March 2005.

### Date of First Reading

- 3. 6 April 2005.

### Background

#### *Basel II*

- 4. The international standards in banking supervision are set by the Basel Committee on Banking Supervision (BCBS). (Further information is available at [www.bis.org/bcbs/aboutbcbs.htm](http://www.bis.org/bcbs/aboutbcbs.htm).) In July 1988, BCBS made public the “International Convergence of Capital Measures and Capital Standards”, which set down the agreement among the G-10<sup>1</sup> central banks to apply common minimum capital standards to their industries, to be achieved by the end of 1992. It was known as the “Basel Capital Accord” and is now commonly referred to as “Basel I”. According to the Administration, Basel I and its subsequent amendments have been

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<sup>1</sup> Comprising Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, United Kingdom and the United States.

adopted in Hong Kong through legislation in the form of the Third Schedule to BO.

5. In June 2004, BCBS published the “International Convergence of Capital Measures and Capital Standards: a revised framework” (full text at [www.bis.org/publ/bsbc107.htm](http://www.bis.org/publ/bsbc107.htm)), which set out the new capital adequacy framework commonly known as “Basel II”. Whilst Basel I recommended a minimum capital adequacy ratio (CAR) of 8% to cover credit and market risks, Basel II improves the capital framework’s risk-sensitivity and is more comprehensive. It has three main components (i.e. 3 Pillars). The first (Pillar 1) is the minimum CAR. Although it remains at the same 8%, the calculation now includes a new capital charge for bank’s operational risks and is more closely aligned to each bank’s actual risk of economic loss. A bank may choose out of the three available options an approach to credit risk that seems most appropriate for the sophistication of its activities and internal controls. The Standardized Approach would utilize the ratings assigned to the bank by external agencies and the Internal Rating Based (IRB) Approach would use internal rating model to quantify risks. A bank having adopted the IRB Approach could choose between the Foundation IRB Approach and Advanced IRB Approach depending on the level of sophistication of its rating systems. The second (Pillar 2) is the supervisory review process. Each bank is required to establish internal processes to assess its own capital adequacy on the basis of a thorough evaluation of the risks to which it is exposed. The third (Pillar 3) is market discipline through public disclosure. Each bank would be required to disclose publicly key information on its capital, risk exposures and risk assessment. This allows market participants to be the judge and inadequate banks would suffer loss in reputation, business and customers.

6. BCBS is discussing implementation issues with member jurisdictions. It is intended that Basel II could be implemented globally by the end of 2006 and the most advanced approaches to risk measurement by the end of 2007.

#### *Implementation of Basel II in Hong Kong*

7. The Hong Kong Monetary Authority (HKMA), i.e. the government authority, has planned to implement Basel II in Hong Kong by the end of 2006. A new Basic Approach (being essentially a modified version of Basel I with some changes in definitions and the incorporation of an operational risk capital charge, and Pillars 2 and 3 of Basel II) would be made available to AIs whose operations are small, simple and straight forward. The individual AI could choose its own approach so long as HKMA is satisfied that the choices are appropriate having regard to the nature and scale of the AI’s activities.

8. The proposed implementation of Basel II in Hong Kong would involve a significantly more sophisticated approach to the calculation of CAR and extend the requirements to cover holding companies of AIs. That necessitates the amendment of BO. Due to the complexity of the new requirements and the ongoing need to update the regime in keeping with industry developments and international practices, HKMA has proposed to adopt a rule making approach to the implementation of the new regime. It would limit the amendments to BO to the

provision for the power to make the necessary subsidiary legislation by MA and other incidental and consequential amendments.

### *Criminal liabilities of Managers*

9. Under the existing provisions of BO (e.g. sections 11(2), 12(6), 14(5), 65(2), 66(2), 80(3), 81(9), 83(7), 85(3), 90(3), 95(3), 99(3), 103(3) and 106(4)), a manager of an AI would be personally guilty of an offence when the AI has contravened a provision of BO. The liability is strict.

## **Comments**

### *Implementation of Basel II*

10. Since HKMA has adopted the rule making approach to its implementation in Hong Kong, the Bill does not contain any substantive provisions of Basel II. Indeed not even Basel II is anywhere referred to in the Bill. The proposed new section 60A (clause 2) would give MA the power to make rules requiring disclosure of financial affairs of AIs to the public (i.e. Pillar 3) and the proposed new section 98A (clause 4) would empower it to make rules for the calculation of CAR (i.e. Pillar 1). The power to make rules is subject to the statutory duty to consult the Financial Secretary (FS) and the Banking Advisory Committee (BAC), the Deposit-taking Companies Advisory Committee (DTCAC), the Hong Kong Association of Banks (HKAB) and the DTC Association. The requirement to maintain CAR has been already provided for under the existing section 98, which would be amended to delete the reference to the Third Schedule and substituting reference to rules made under section 98A. No specific provisions have been proposed for Pillar 2 as the review process could be covered by the existing powers enjoyed by HKMA.

11. The proposed amendments set the framework for a new regime of banking authorization and supervision. Consequential amendments are therefore required to make BO in tune with the new regime. They are contained in the Schedule to the Bill. Apart from the new definition of “capital adequacy ratio”, the consequential amendments are mostly textual and technical. A new provision is clause 5 of Part I of the Schedule. It amends section 132A(1) of BO to provide for appeal to the Chief Executive in Council from a decision of MA made in the exercise of a power conferred by rules made under section 98A(1). However, such appeal would only be available when MA has declared in the rules made that the appeal provision should apply to the particular decision. It is the intention of the Administration that such appeal provision would only apply when the decision made by MA is a fundamental decision on the approach to the calculation of CAR that an AI may adopt and may have a material impact on an AI’s capital requirements.

### *Variation of capital adequacy ratio*

12. MA is empowered under section 101 of BO to vary, after consultation with FS, the CAR of banks to a maximum of 12% and that of deposit-taking

companies and restricted licence banks to 16%. Clause 5 recasts section 101(1) to empower MA to vary the CAR of all AIs to a maximum of 16%. According to the Administration, such amendment is necessary to enable MA to set a higher CAR if the circumstances so require, e.g. a significant increase in risks to which an individual bank or the industry as a whole is exposed.

#### *Criminal liability of managers*

13. Clause 7 amends section 2 of BO by adding a proposed subsection (18) to limit the criminal liability of managers of an AI or other company in the event of a contravention of BO to the extent that such contravention was caused or contributed to by an act or omission on the part of the manager himself or a person under his control. The criminal liability of a manager under BO would therefore become more clearly defined and to that extent the strictness of the liability is mitigated. Clause 12 amends section 70D(2) to exclude the application of the proposed section 2(18) to it because the nature of the offence requires the presence of a mental element in the first place.

#### *Defence of “reasonable excuse”*

14. Clauses 10 and 11 introduce a defence of “reasonable excuse” to an offence for contravening section 59(2) (report on matters as MA may reasonably require for the exercise of his functions under BO) or section 63(1) (submission of monthly and quarterly return), or failing to comply with any requirement under section 63(3) or (3A) (submission of an auditor’s report as specifically required by MA before a specified date) of BO. The amendments would mitigate the harsh effect of the relevant provisions.

#### *Exceptions to official secrecy*

15. The obligation of MA under section 120 of BO to keep secret all matters relating to the affairs of any person that may come to his knowledge in the exercise of his functions under BO is comprehensive. Clauses 9 and 13 amend sections 58A and 71C respectively to allow MA to disclose to the public the details of the disciplinary decision that he has made, the reasons for which the decision was made and any material facts relating to the case.

#### *Dispensation with the obligation to consult*

16. MA is obliged to consult FS before the revocation of the authorization of an AI and the approval of an approved money broker without any exception. Clauses 8 and 14 amend sections 22 and 118D respectively to dispense with the need to make such consultation when the revocation is made upon a request in writing by the relevant AI or the relevant money broker.

### **Public Consultation**

17. According to the Administration, HKMA has undertaken extensive public consultation on an ongoing basis in developing the implementation plan for

Basel II. A detailed consultation package was issued in August 2004. The draft Bill was circulated in December 2004 to members of the Basel II Consultation Group (comprising representatives from HKMA, the industry, the accounting profession and other interested parties), the industry associations (including HKAB and the DTC Association), the statutory advisory committees (including BAC and DTCAC), the Consumer Council, the Office of Privacy Commissioner for Personal Data and other interested parties. There was no objection to the Bill. HKMA has taken into account the feedbacks of the respondents in finalising the Bill.

18. Basel II is intended to apply, on a fully consolidated basis, to any bank holding companies (BHCs), i.e. holding companies being the parent entity within a bank group. The consultation draft of the Bill included provisions for a new regulatory regime for BHCs. However, whilst most respondents had no objections, views were divided on how the regime would be applied in practice and the general feeling was that such a regime was not strictly necessary at this juncture. Since there is yet no consensus among banking regulators on the implementation and HKMA is satisfied that its existing powers are adequate to capture risks within banking groups, it has decided to exclude the provisions on BHCs from the Bill.

### **Consultation with LegCo Panel**

19. At its meeting on 5 July 2004, the Financial Affairs Panel was briefed on the major features of Basel II, the HKMA's implementation plan and the legislative approach. Then on 6 December 2004 the Panel was briefed on the progress made in HKMA's preparation for the implementation of Basel II in Hong Kong, the legislative proposal and the key provisions of the Bill. There was general support for the implementation of Basel II in Hong Kong, although during both meetings some members had expressed some views and concerns. Members may wish to refer to the minutes of the two Panel meetings (LC Paper Nos. CB(1)2513/03-04 and CB(1)741/04-05) for details.

### **Conclusion**

20. Although the Bill does not directly make provisions for the implementation of Basel II, Members may find it necessary to know about the details of the new regime of banking authorization and supervision, the planned subsidiary legislation, the implementation schedule and risks control measures and to consider the policy implications of the passage of the necessary framework. It is therefore recommended that a Bills Committee be set up to study the Bill.

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