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on 3 November 2006**

**Legal Service Division Report on
Subsidiary Legislation Gazetted on 27 October 2006**

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Amendment to be made by : 29 November 2006 (or 20 December 2006 if extended by resolution)

PART I BANKING - IMPLEMENTATION OF BASEL II

Banking Ordinance (Cap. 155)

Banking (Capital) Rules (L.N. 228)

Banking (Disclosure) Rules (L.N. 229)

Banking (Specification of Multilateral Development Bank) Notice (L.N. 230)

Banking (Specification of Public Sector Entity in Hong Kong) Notice (L.N. 231)

Banking (Amendment) Ordinance 2005 (Commencement) Notice 2006 (L.N. 232)

Background

The Administration has, after consultation with the banking industry and other interested parties, decided to introduce the revised capital adequacy and disclosure framework known as Basel II in January 2007 (for details please see the “International Convergence of Capital Measurement and Capital Standards: A Revised Framework” at <http://www.bis.org/publ/bcbs107.htm>). The Hong Kong Monetary Authority (HKMA) has chosen the rule making approach to implement the new regime. The Banking (Amendment) Ordinance 2005 (19 of 2005) (the Amendment Ordinance) was enacted in July 2005 to provide the legal framework and to empower the Monetary Authority (MA) to make the necessary subsidiary legislation. L.N. 228 and L.N. 229 are made by MA after consultation with the Financial Secretary (FS), the Banking Advisory Committee (BAC), the Deposit-taking Companies Advisory Committee (DTCAC), the Hong Kong Association of Banks (HKAB) and The DTC Association (DTCA) pursuant to sections 98A and 60A of the Banking Ordinance (Cap. 155) (BO) as amended by the Amendment Ordinance. L.N. 230 and L.N. 231 are made by MA respectively under section 2(19) of, and

paragraph 1A of the Fourth Schedule to, BO as amended by the Amendment Ordinance. L.N. 232 is made by the Secretary for Financial Services and the Treasury under section 1(2) of the Amendment Ordinance.

2. Basel II comprises three “pillars”. Pillar I provides for the minimum capital adequacy ratio (CAR) and its calculation. A capital charge for operational risk is introduced in addition to that for market and credit risk as required under Basel I. Pillar II stipulates 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. Pillar III complements Pillar I and II through enhancing market transparency and market discipline by requiring 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. Corresponding to the structure of Basel II, the Capital Rules seeks to implement Pillar I and the Disclosure Rules Pillar III. Members may wish to refer to the LegCo Brief (Ref.: B9/1/1/1C) issued by HKMA in October 2006 for further and background information.

Consultation

3. According to the LegCo Brief, MA has, in accordance with sections 60A and 98A of BO, consulted FS, BAC, DTCAC, HKAB and DTCA on the Rules. HKMA has also specifically sought comments from a broad spectrum of society, including members of the Panel on Financial Affairs (FA Panel), the Consumer Council, the business community (through trade associations and chambers of commerce), the accounting and legal professions and academics. For the Disclosure Rules, HKMA has further consulted interested parties such as credit rating agencies, financial analysts and members of the Joint Technical Working Group on Financial Disclosure (which members include representatives of both the Hong Kong Stock Exchange and the Securities and Futures Commission). All respondents are supportive of the objective of the rule-making. HKMA has addressed all the comments and its responses are set out in the Annex to the LegCo Brief for Members’ reference.

4. At its meeting on 4 May 2006, FA Panel was briefed on the development of the Capital Rules and Disclosure Rules for the implementation of Basel II in Hong Kong. The Panel was subsequently updated in writing on the progress of preparation of the two sets of Rules in June and October 2006 respectively. Members’ major concerns expressed at the meeting were as follows:

- (a) Some Authorized Institutions (AIs) had queried whether the implementation timetable was too aggressive. In order to ensure that AIs were able to comply with the requirements of Basel II, HKMA should fully address AIs’ concerns in developing the implementation plan; and

- (b) In order to expedite the legislative process and facilitate the timely implementation of the new requirements, HKMA should fully address the concerns of the banking industry on the two sets of Rules before tabling the Rules before LegCo for negative vetting.

Members may wish to refer to the minutes of the FA Panel meeting on 4 May 2006 (LC Paper No. CB(1)2165/05-06) and the two progress updates provided by HKMA in writing (LC Paper Nos. CB(1)1887/05-06(01) and CB(1)2328/05-06(01)) for detailed information.

Banking (Capital) Rules (L.N. 228)

5. L.N. 228 has nine Parts and 15 Schedules. Section 3 states that CAR is the ratio of the capital base of an Authorized Institution (AI) to the sum of its respective risk weighted amount for credit risk, market risk and operational risk. Part 2 prescribes the approaches and basis in accordance with which the weighted amounts for different risks are to be calculated. An AI shall only use the standardized (credit risk) approach in calculating its credit risk for non-securitization exposures, but an AI may apply to HKMA for approval to use the basic (credit risk) approach or the internal ratings-based approach to calculate such exposure. For the calculation of credit risk for securitization exposures, an AI shall use only the standardized (securitization) approach or the internal ratings-based (securitization) approach depending on the approach adopted for calculating the non-securitization exposures. For market risk, an AI shall use the standardized (market risk) approach unless HKMA has granted approval to use the internal models approach or the approach used by its parent bank. For operational risk, the prescribed approach is the basic indicator approach unless approval has been obtained for using the standardized (operational risk) approach or the alternative standardized approach. Each AI shall calculate its CAR on a solo and consolidated basis unless it has approval to do otherwise. Part 4 to Part 9 set out the detailed rules for calculation under the respective approaches. Part 3 prescribes the rules for the determination of an AI's capital base. Capital base comprises core capital and supplementary capital.

6. The Legal Service Division is continuing scrutiny of the Capital Rules and will seek clarification from the Administration on a number of drafting points. A further report will be made, if necessary.

Banking (Disclosure) Rules (L.N. 229)

7. The purpose of L.N. 229 is to prescribe the information to be disclosed to the general public by AIs relating to their state of affairs, profit and loss and CAR. It also prescribes the manner in which, times at which and periods during which such information shall be disclosed.

8. L.N. 229 consists of eight parts. Part 2 specifies the general disclosure requirements applicable to AIs incorporated in Hong Kong, including the requirement for a clearly documented disclosure policy approved by the relevant AI's board of directors and the requirement for an AI to publish a disclosure statement. This Part also specifies the period for which the disclosures should be made, the places at which the disclosure statement should be exhibited, and the hours during which the disclosure statement should be made available to the general public for inspection.

9. Part 3 specifies the disclosures an AI incorporated in Hong Kong is required to make in respect of every six-month period immediately after the close of its financial year. The required disclosures relate to the capital structure and adequacy of AIs, their liquidity and risk exposures.

10. Part 4 specifies the disclosures an AI incorporated in Hong Kong is required to make in respect of the AI's every financial year. Some of the disclosures required under this Part are the same as those required under Part 3. In addition, an AI is required under Part 4 to disclose matters such as the principal accounting policies it uses in preparing its financial statements, its cash flow hedges, the fair value of each class of its financial assets and financial liabilities, the AI's cash flow statement, its secured liabilities and information relating to its corporate governance.

11. Parts 5, 6 and 7 respectively specify the additional disclosures an AI incorporated in Hong Kong is required to make in respect of its financial year if it uses the standardized (credit risk) approach, basic approach and internal ratings-based approach to calculate its credit risk for non-securitization exposures.

12. Part 8 specifies the disclosures an AI incorporated outside Hong Kong is required to make in respect of every financial year and in respect of every six-month period immediately after the close of the AI's financial year. Similar to AIs incorporated in Hong Kong, an AI incorporated outside Hong Kong is required to prepare and publish a disclosure statement. Some of the disclosure requirements prescribed under this Part are similar to those prescribed for AIs incorporated in Hong Kong under Part 3.

13. The Legal Service Division has given its comments in September 2006 on the English text of the draft Banking (Disclosure) Rules which HKMA released for statutory consultation referred to in paragraph 3 above. It is noted that L.N. 229 is substantially the same as the draft Rules in content, although some changes have been made to take into account our views and comments received from the consultation.

14. The Legal Service Division is continuing its scrutiny of L.N. 229 and will seek clarification from the Administration on some drafting points. A further report will be made, if necessary.

Banking (Specification of Multilateral Development Bank) Notice (L.N. 230)

15. Under section 2(19) of BO, as amended by the Amendment Ordinance, MA may by notice published in the Gazette specify to be multilateral development bank for the purposes of BO any bank or lending or development body established by agreement between, or guaranteed by, two or more countries, territories or international organizations other than for purely commercial purposes.

16. L.N. 230 specifies 10 banks or bodies as multilateral development banks.

Banking (Specification of Public Sector Entity in Hong Kong) Notice (L.N. 231)

17. Under paragraph 1A of the Fourth Schedule to BO, as amended by the Amendment Ordinance, MA may by notice published in the Gazette specify to be a public sector entity in Hong Kong for the purposes of that Schedule any entity established by or on behalf of the Government. The Fourth Schedule sets out the method of calculating an AI's liquidity ratio.

18. L.N. 231 specifies 10 entities to be public sector entities in Hong Kong.

Commencement

19. L.N. 228 and L.N. 229 will come into operation on the day appointed for the commencement of sections 4 and 2 of the Amendment Ordinance respectively. Sections 2 and 4 of the Amendment Ordinance respectively empower MA to make rules requiring the public disclosure by AIs of information relating to their financial affairs and prescribing the manner of calculating the CAR of an AI. By L.N. 232, these two sections will come into operation on 1 January 2007.

20. L.N. 230 and L.N. 231 will come into operation on 1 January 2007.

Banking (Amendment) Ordinance 2005 (Commencement) Notice 2006 (L.N. 232)

21. L.N. 232 appoints 1 January 2007 as the day on which sections 2, 3, 4, 6 and 7 of and the Schedule to the Amendment Ordinance will come into operation. These provisions provide for various matters necessary for the implementation of the Basel II framework, including MA's power to require AIs to disclose information relating to their financial affairs and to prescribe the manner of calculating their CAR. The other provisions of the Amendment Ordinance had come into operation on 2 December 2005.

PART II AVOIDANCE OF DOUBLE TAXATION

Inland Revenue Ordinance (Cap. 112)

Specification of Arrangements (The Mainland of China) (Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income) Order (L.N. 234)

22. On 21 August 2006, the Mainland and the HKSAR Government entered into an arrangement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (Arrangement) together with a protocol to the Arrangement (Protocol). The Arrangement will cover the following aspects -

- (a) in respect of the Mainland - individual income tax, foreign investment enterprises income tax and foreign enterprises income tax; and
- (b) in respect of Hong Kong - profits tax, salaries tax and property tax.

23. This Order specifies the arrangements in Articles 1 to 27 of the Arrangement and Paragraphs 1 to 3 of the Protocol as double taxation relief arrangements under section 49 of the Inland Revenue Ordinance (Cap. 112) (IRO) and declares that it is expedient that those arrangements should have effect. The effect of such a declaration is that the arrangements have effect in relation to tax under IRO notwithstanding anything in any enactment.

24. Paragraph 1 of Article 24 of the Arrangement provides that “[t]he competent authorities of both Sides shall exchange such information as is necessary for carrying out the provisions of this Arrangement or of the domestic laws of both Sides concerning taxes covered by this Arrangement insofar as the taxation thereunder is not contrary to this Arrangement and, in particular, information for the prevention of fiscal evasion”. Comprehensive Agreements for Avoidance of Double Taxation with Belgium (2003) and Thailand which were signed in 2003 and 2005 respectively also contain an exchange of information provision (Cap. 112 sub. leg. AJ and AX).

25. Members may refer to the LegCo Brief (Ref: FIN CR 17/10/2041/46) issued by the Financial Services and the Treasury Bureau on 25 October 2006 for background information. Annex B to the LegCo Brief gives background information about the Exchange of Information Article (Article 24) contained in the Arrangement.

26. The Order has not been referred to any LegCo Panel.

27. The Order has come into operation on the date it was published in the gazette, i.e. 27 October 2006.

PART III RELOCATION OF JUVENILES TO TUEN MUN CHILDREN AND JUVENILE HOME

Protection of Children and Juveniles Ordinance (Cap. 213)

Protection of Children and Juveniles (Places of Refuge) (Amendment) Order 2006 (L.N. 237)

Juvenile Offenders Ordinance (Cap. 226)

Places of Detention (Juvenile Offenders) Appointment (Consolidation) (Amendment) Order 2006 (L.N. 238)

Remand Home (Amendment) Rules 2006 (L.N. 242)

Probation of Offenders Ordinance (Cap. 298)

Probation of Offenders (Approved Institution) (Consolidation) (Amendment) Order 2006 (L.N. 239)

Reformatory Schools Ordinance (Cap. 225)

Reformatory School (Establishment) (Consolidation) (Amendment) Order 2006 (L.N. 240)

Immigration Ordinance (Cap. 115)

Immigration (Places of Detention) (Amendment) Order 2006 (L.N. 241)

28. In 2003, the Finance Committee approved a sum of \$330 million to construct a new residential training complex, namely, Tuen Mun Children and Juvenile Home, to provide better rehabilitative service for young offenders and mal-adjusted juveniles under care and supervision. The new complex will co-locate six existing correctional/residential homes (the Ma Tau Wai Girls' Home, the Pui Chi Boys' Home, the Begonia Road Juvenile Home, the Fanling Girls' Home, the Shatin Boys' Home and the O Pui Shan Boys' Home) operated by the Social Welfare Department as places of refuge, places of detention, reformatory schools and/or approved institutions under the relevant subsidiary legislation.

29. L.N. 237 to L.N. 242 make technical amendments to replace references to the six existing homes by the new complex under the relevant subsidiary legislation. The Administration also takes the opportunity to, by L.N. 241, remove references to two closed homes, namely, the Chuk Yuen Children's Reception Centre and the Pui Yin Juvenile Home, provided in the Immigration (Places of Detention) Order (Cap. 115 sub. leg. B).

30. Members may refer to the LegCo Brief (Ref: HWF/W/27/3 VI) issued by the Health, Welfare and Food Bureau on 25 October 2006 for background information.

31. The commencement date for the provisions for the listing of the new Tuen Mun Children and Juvenile Home under L.N. 237 to L.N. 242 is 30 November 2006, which is its anticipated completion date. In order to allow buffer for any unforeseen incidents resulting in delay in the removal exercise, the Administration has proposed the commencement date for the provisions for the removal of the references to the six existing homes under the relevant subsidiary legislation to be 31 December 2007 (para. 15 of LegCo Brief).

PART IV OTHERS

Prevention of Bribery Ordinance (Cap. 201)

Prevention of Bribery Ordinance (Amendment of Schedule 1) (Hong Kong IEC Limited) Order (L.N. 233)

32. This Order amends Schedule 1 to the Prevention of Bribery Ordinance (Cap. 201) to specify Hong Kong IEC Limited, a joint venture involving the Hong Kong Government, the Hong Kong Airport Authority and a private-sector consortium which was formed to develop and operate Asia World-Expo, as a public body for the purposes of the Ordinance.

33. Members may refer to the LegCo Brief (Ref: CIB CR L/M 22/2006 to CR 135/02/1) issued by the Commerce, Industry and Technology Bureau in October 2006 for background information.

34. The Order shall come into operation on 1 January 2007.

Land Survey Ordinance (Cap. 473)

Land Survey (Fees Revision) Regulation 2006 (L.N. 235)

35. This Regulation amends the Schedule to the Lands Survey (Fees) Regulation (Cap. 473 sub. leg. A) to -

- (a) reduce the fees payable for –
 - (i) the inspection of land boundary record from \$225 to \$53;
 - (ii) the supply of each copy of land boundary or survey record plan from \$325 to \$73;
 - (iii) the renewal of registration as an authorized land surveyor from \$1,150 to \$715; and

- (b) increase the fees payable for –
 - (i) the deposit of land boundary plan and corresponding survey record plan with the Land Survey Authority from \$2,290 to \$2,520;
 - (ii) the registration as an authorized land surveyor from \$1,150 to \$4,080.

36. These fees were first introduced in 1995 and were last revised in December 1996. Members may also refer to the LegCo Brief issued by the Housing, Planning and Lands Bureau in November 2006 for background information. According to the Administration, the fees are revised in accordance with the “user pays” principle and the need to resume revision has been announced in the 2004-05 Budget Speech (para. 4 of the LegCo Brief).

37. The Regulation shall come into operation on 1 January 2007.

Public Health and Municipal Services Ordinance (Cap. 132)
Public Health and Municipal Services (Fees and Charges) (Museums)
(Amendment) Regulation 2006 (L.N. 236)

38. This Regulation provides for the following admission fees for the Dr Sun Yat-sen Museum which is tentatively scheduled for opening in December 2006 -

- (a) a full-time student, disabled person
or a person aged 60 or above \$5
- (b) a group of 20 or more persons \$7 person
- (c) any other person aged 4 or above \$10

39. Members may refer to the LegCo Brief (Ref: 343/2006 to HAB/C 30/23) issued by the Home Affairs Bureau in October 2006 for background information. The above fees for admission is same as those for admission to the Hong Kong Museum of Art, the Hong Kong Museum of History, the Hong Kong Space Museum, the Hong Kong Museum of Coastal Defence and the Hong Kong Heritage Museum.

40. The Regulation shall come into operation on 1 December 2006.

Prepared by
KAU Kin-wah (L.N. 228)
FUNG Sau-kuen, Connie (L.N. 229 to L.N. 232)
Kitty Cheng (L.N. 233 to L.N. 242)
Assistant Legal Advisers
Legislative Council Secretariat
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