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Panel on Financial Affairs
Meeting on 2 April 2007

Background Brief
on the impact of banks' branch closure and fee-charging on the public

Purpose

This paper sets out the background of banks' closure of branches and charging of fees on low-balance and/or inactive accounts, as well as the impact of such measures on the public. It also summarizes the major views and concerns expressed by Members at meetings of the Legislative Council and the Panel on Financial Affairs (FA Panel).

Background

2. In February 1994, the Consumer Council recommended in its report "Are Hong Kong Depositors Fairly Treated?" that the interest rate caps on time, savings and demand deposits be removed. Following the partial deregulation of the interest rate rules (IRRs) undertaken in 1994 and 1995, the interest rates of more than 99% of all Hong Kong (HK) dollar fixed time deposits or around 70% of total HK dollar deposits were free to fluctuate in accordance with competitive market forces. The remaining IRRs covered time deposits with a maturity below seven days, current accounts and savings accounts deposits.

3. In early 1998, the Hong Kong Monetary Authority (HKMA) commissioned the Hong Kong Banking Sector Consultancy Study (the Consultancy Study) and the deregulation of the remaining IRRs was one of the regulatory issues examined in the Consultancy Study. The consultant pointed out that full deregulation of the IRRs could have a significant financial impact on the interest expenses of banks, particularly local banks. While full deregulation would enhance competition and provide consumers with greater choice, it was likely that banks would act to pass on or mitigate these costs in the form of reduction in branch networks, higher fees and/or higher lending rates to customers. Given the difficult operating conditions expected for banks for 1999, no further deregulation was recommended for that year. A possible option was to adopt a phased programme for the deregulation of the remaining IRRs.

4. In July 1999, HKMA published the Policy Response to the Consultancy Study (the Policy Response). HKMA was of the view that competitive pressure was likely to increase with deregulation and consequently, there would be demands on banks to preserve their profit margins by other means. As revealed in the experience of deregulation overseas, banks would try to generate additional revenue through charging fees and introducing tiering of interest rates. They would also review their existing cost structures and streamline unprofitable services and branches. Taking into account the view of the consultant and the public, HKMA accepted that there was a need to proceed with the deregulation of the remaining IRRs. HKMA has therefore adopted a two-phase programme to deregulate the remaining IRRs, with Phase 1 to take effect on 3 July 2000 and Phase 2 on 3 July 2001.

5. In recent years, the growing use of electronic banking services, and the rationalization of branch networks by banks for maintaining their competitiveness following full deregulation of IRRs since July 2001 have led to the closure of quite a number of bank branches. Another development is the charging of fees on bank accounts which are inactive or with a low balance.

Major views and concerns expressed by Members

6. When the FA Panel was briefed on the major findings and recommendations of the Consultancy Study in February 1999 regarding the further deregulation of IRRs, some members considered that the deregulation programme should be expedited so as to realize the benefits associated with deregulation and to enable Hong Kong to meet international standards in this area. Nevertheless, Members have all along attached great importance to the need to minimize the adverse impact, if any, of the measures to streamline business operations and to cut costs, notably the closure of bank branches and the charging of fees on inactive or low balance accounts. During the period January 2001 to end-2006, Members have raised their concerns through the moving of a motion and raising questions at Council meetings, as well as discussion at FA Panel meetings with the Administration, HKMA, the Hong Kong Association of Banks (HKAB) and the Consumer Council. Members' major concerns/suggestions and the response of the Administration and related parties are summarized in the ensuing paragraphs.

Provision of basic banking services through post offices

7. There was concern that the reduction in the number of bank branches had caused great inconvenience to some customers, in particular the less privileged groups such as the elderly, disabled persons and recipients of Comprehensive Social Security Assistance (CSSA). The Administration was requested to consider adopting the practice of some overseas countries to provide basic banking services through other channels such as post offices, and whether the Social Welfare Department (SWD) could consider providing recipients of CSSA, Old Age Allowance and Disability Allowance with the option of collecting payments at post offices instead of through banks.

8. The Administration advised that SWD had no plan to distribute CSSA and Social Security Allowance (including Old Age Allowance and Disability Allowance) through post offices. While the existing setup of individual post offices are geared to providing postal services, Hongkong Post (HKP) might consider the feasibility of providing deposit and withdrawal services on condition that the quality of postal services would not be affected and subject to the views of the banking industry. However, as the service scope of HKP is governed by the Post Office Ordinance (Cap. 98) and the Trading Funds Ordinance (Cap. 430), legislative amendments would be required in this regard.

Measures to encourage banks to provide services in public housing estates

9. Members observed that elderly and disabled persons might have difficulty in using Automatic Teller Machines (ATMs) or electronic banking services on the Internet. As many of them resided in public housing estates, the closure of bank branches in their vicinity would mean that they would have to travel a long way for banking services or collecting welfare payments disbursed by SWD. Members therefore urged for measures to encourage banks to provide services in public housing estates, such as providing rental waiver to banks and facilitating the provision of ATMs.

10. As advised by the Administration, the Housing Authority had, where appropriate, made downward adjustments to the rental assessments of many bank premises in public housing estates. It had also taken a number of measures to facilitate banking institutions to set up banks or ATMs in public housing estates, such as a package letting strategy by which a number of premises would be let to interested banking institutions in a lot. The Panel was informed that The Link Management Limited was working closely with banks and pursuing a flexible leasing strategy to bring in more banking outlets in the premises managed by it. The Administration had undertaken to liaise with HKAB to identify suitable locations for ATM installation and provide necessary assistance and facilitation to HKAB in the process.

Alleviating the impact of fees charged by banks on the public

11. On 14 February 2001, the Council passed a motion on "protecting the interest of small depositors of banks" moved by Hon LAU Chin-shek as amended by Hon CHAN Kam-lam, as follows:

"That this Council is concerned about the substantial increase in charges by some banks on their small depositors, and its impact on the elderly and the disadvantaged groups in the community; to enhance the transparency of the charging policies of banks and protect the interests of depositors, this Council urges the Government and the Hong Kong Monetary Authority to review the relevant provisions in the Code of Banking Practice, so as to enhance the transparency of fee revisions by banks, and examine at the same

time the empowerment of the Hong Kong Monetary Authority to protect consumers of banking services."

12. In its progress report to follow up the motion, the Administration has highlighted that the setting of fees and charges is a commercial decision for individual banks. Both between banks and within the same bank, customers appeared to have a choice as to how they access banking services and at what cost. HKMA would work with the banking sector to improve the Code of Banking Practice by enhancing the transparency and clarity in the setting and revision of fees and charges by banks. The Administration also indicated that it would review HKMA's role in consumer protection and the legal mandate, if any, for it to function as a consumer watchdog.

13. One major concern raised by Members was that the charging and adjustment of fees might deter small depositors and disadvantaged groups from accessing basic banking services. As such, consideration should be given to mandating or encouraging banks to grant fee concessions or waivers to accounts used for payments of welfare assistance and salaries. To better enforce banks' compliance with the Code of Banking Practice, there is a view that the Administration should consider giving statutory backing to the Code. Nevertheless, there is also the contrary view that fee exemption for CSSA recipients and disadvantaged groups should be offered by banks voluntarily as a matter of social responsibility and should not be mandated by legislation.

14. In the view of the Administration, market competition would ensure that banks set their fees and charges at a reasonable level. It also advised that exemption from deposit account charges was already provided by individual banks to senior citizens and social welfare recipients. Given the effective functioning of the present self-regulatory regime and the ever-changing business practices of banks, the Administration does not consider it appropriate to make the Code of Banking Practice statutory. Nonetheless, it assured Members that HKMA would work closely with the industry associations and keep in view the latest developments in other jurisdictions.

Progress update provided by HKAB

15. Noting from the latest discussion on 3 July 2006 that the Task Force on Financial Services Delivery Channel established under HKAB has put up a number of recommendations to improve access to basic banking services, the FA Panel considers that the progress of these improvement measures should be further examined. Members have also noted the Consumer Council's concern about the impact of bank charges on small depositors. In November 2006, HKAB provided a paper (circulated to members vide LC Paper No. CB(1)390/06-07) to update the FA Panel on the following :

- (a) measures to improve access to basic banking services, such as measures to facilitate the provision and use of ATMs;

- (b) follow-up actions taken by HKAB in collaboration with the Administration and parties concerned to ensure that basic banking need of the public, especially those of the elderly and the disabled, is catered for; and
- (c) information on banks charging fees on inactive accounts/low-balance accounts and applying fee waivers.

16. The Panel has considered it necessary to follow up the subject with a view to ascertaining the latest situation and the effectiveness or otherwise of the recommended improvement measures. The Administration, HKMA, HKAB and the Consumer Council have been invited to attend the Panel meeting to be held on 2 April 2007 for discussion of the subject.

References

17. A list of relevant papers is in **Appendix**.

Council Business Division 1
Legislative Council Secretariat
26 March 2007

| Committee | Paper | LC Paper No. |
|--|--|---|
| | Progress report on the motion on "Protecting the Interests of Small Depositors of Banks" | <i>Issued</i> |
| FA Panel special meeting on 3 May 2001 | Minutes of special meeting of FA Panel on 3 May 2001 (<i>paragraphs 15 to 24</i>) http://www.legco.gov.hk/yr00-01/english/panels/fa/minutes/fa030501.pdf | CB(1)1949/00-01 |
| FA Panel special meeting on 26 February 2002 | Paper on "Consumer Protection in the Banking Sector" provided by the Administration http://www.legco.gov.hk/yr01-02/english/panels/fa/papers/fa0226cb1-1114-1e.pdf Report on "Comparative Study on Banking Consumer Protection and Competition Arrangements in the United Kingdom, Australia and Hong Kong" provided by HKMA http://www.legco.gov.hk/yr00-01/english/panels/fa/papers/a1112e02.pdf Paper on "Reference Materials for Deliberation on the Protection for Consumers in the Banking Sector" prepared by the Legislative Council Secretariat http://www.legco.gov.hk/yr01-02/english/panels/fa/papers/facb1-626-2e.pdf Minutes of special meeting of FA Panel on 26 February 2002 (<i>paragraphs 10 to 19</i>) http://www.legco.gov.hk/yr01-02/english/panels/fa/minutes/fa020226.pdf | CB(1)1114/01-02(01) CB(1)1112/00-01(02) CB(1)626/01-02(02) CB(1)1853/01-02 |
| FA Panel special meeting on 13 June 2002 | Paper on "Consumer Protection in the Banking Sector" provided by the Administration http://www.legco.gov.hk/yr01-02/english/panels/fa/papers/fa0613cb1-1942-1e.pdf | CB(1)1942/01-02(01) |

| Committee | Paper | LC Paper No. |
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| | <p>List of issues raised at the meeting on 26 February 2002</p> <p>http://www.legco.gov.hk/yr01-02/english/panels/fa/papers/fa0613cb1-1942-2e.pdf</p> <p>Minutes of special meeting of FA Panel on 13 June 2002 (<i>paragraphs 43 to 44</i>)</p> <p>http://www.legco.gov.hk/yr01-02/english/panels/fa/minutes/fa020613.pdf</p> | <p>CB(1)1942/01-02(02)</p> <p>CB(1)2567/01-02</p> |
| LegCo meeting on 9 April 2003 | <p>Hansard of the LegCo meeting on 9 April 2003 (written question no. 7)</p> <p>http://www.legco.gov.hk/yr02-03/english/counmtg/hansard/cm0409ti-translate-e.pdf</p> | <i>Issued</i> |
| LegCo meeting on 9 July 2003 | <p>Hansard of the LegCo meeting on 9 July 2003 (written question no. 18)</p> <p>http://www.legco.gov.hk/yr02-03/english/counmtg/hansard/cm0709ti-translate-e.pdf</p> | <i>Issued</i> |
| LegCo meeting on 9 November 2005 | <p>Hansard of the LegCo meeting on 9 November 2005 (oral question no. 2)</p> <p>http://www.legco.gov.hk/yr05-06/english/counmtg/hansard/cm1109ti-translate-e.pdf</p> | <i>Issued</i> |
| FA Panel meeting on 6 February 2006 | <p>Minutes of the FA Panel meeting on 6 February 2006 (<i>paragraphs 23 to 28</i>)</p> <p>http://www.legco.gov.hk/yr05-06/english/panels/fa/minutes/fa060206.pdf</p> | CB(1)1178/05-06 |
| LegCo meeting on 17 May 2006 | <p>Hansard of the LegCo meeting on 17 May 2006 (written question no. 8)</p> <p>http://www.legco.gov.hk/yr05-06/english/counmtg/hansard/cm0517ti-translate-e.pdf</p> | <i>Issued</i> |

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| LegCo meeting on 14 June 2006 | <p>Hansard of the LegCo meeting on 14 June 2006 (written question no. 13)</p> <p>http://www.legco.gov.hk/yr05-06/english/counmtg/hansard/cm0614-translate-e.pdf</p> | <i>Issued</i> |
| FA Panel meeting on 3 July 2006 | <p>Paper on "Impact of Branch Closure of Banks on the Public" provided by the Hong Kong Association of Banks (HKAB)</p> <p>http://www.legco.gov.hk/yr05-06/english/panels/fa/papers/fa0703cb1-1848-3e.pdf</p> <p>Submission from the Consumer Council on "Impact of Branch Closure of Banks on the Public"</p> <p>http://www.legco.gov.hk/yr05-06/english/panels/fa/papers/fa0703cb1-1848-4e.pdf</p> <p>The Administration's response to the Panel on issues relating to "Impact of Branch Closure of Banks on the public"</p> <p>http://www.legco.gov.hk/yr05-06/english/panels/fa/papers/fa0703cb1-1848-5e.pdf</p> <p>Background brief on "Impact of Branch Closure of Banks on the Public" prepared by the LegCo Secretariat</p> <p>http://www.legco.gov.hk/yr05-06/english/panels/fa/papers/fa0703cb1-1848-6e.pdf</p> <p>Minutes of FA Panel meeting on 3 July 2006 (<i>paragraphs 18 to 35</i>)</p> <p>http://www.legco.gov.hk/yr05-06/english/panels/fa/minutes/fa060703.pdf</p> <p>Reply dated 24 November 2006 from HKAB (Follow-up paper)</p> <p>http://www.legco.gov.hk/yr05-06/chinese/panels/fa/papers/fa0703cb1-390-1-ec.pdf</p> | <p>CB(1) 1848/05-06(03)</p> <p>CB(1)1848/05-06(04)</p> <p>CB(1)1848/05-06(05)</p> <p>CB(1)1848/05-06(06)</p> <p>CB(1)176/06-07</p> <p>CB(1)390/06-07(01)</p> |

| Committee | Paper | LC Paper No. |
|-----------------------------------|---|---------------------|
| | <p>The Administration's response dated 24 November 2006 to members' comments and suggestions on measures for provision of basic banking services to the public (Follow-up paper)</p> <p>http://www.legco.gov.hk/yr05-06/english/panels/fa/papers/fa0703cb1-381-1-e.pdf</p> | CB(1)381/06-07(01) |
| LegCo meeting on 13 December 2006 | <p>Hansard of the LegCo meeting on 13 December 2006 (written question no. 16)</p> <p>http://www.legco.gov.hk/yr06-07/chinese/counmtg/floor/cm1213-confirm-ec.pdf</p> | <i>Issued</i> |