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Paper for the House Committee meeting on 29 June 2012

**Report of the Subcommittee on
Banking Ordinance (Amendment of Seventh Schedule) Notice 2012**

Purpose

This paper reports on the deliberations of the Subcommittee on Banking Ordinance (Amendment of Seventh Schedule) Notice 2012 ("the Notice").

Background

2. Under section 16(1) of the Banking Ordinance (Cap. 155) ("BO"), the Monetary Authority has a general discretion to grant or refuse an application for authorization to carry on (a) banking business; (b) a business of taking deposits as a deposit-taking company ("DTC"); or (c) a business of taking deposits as a restricted licence bank ("RLB") in Hong Kong. Under section 16(2), the Monetary Authority is required to refuse such an application if any one or more of the criteria specified in the Seventh Schedule to the BO applicable to or in relation to the applicant are not fulfilled with respect to the applicant.

3. According to the Administration, most of the authorization criteria in the Seventh Schedule to the BO are aimed at ensuring that only institutions which are managed in a prudent and competent manner can gain access to the local market. They are consistent with the generally accepted features of a prudent licensing system as set out in the Basel Committee's Core Principles for Effective Banking Supervision. Apart from the general prudential criteria, an applicant seeking authorization must also satisfy various market entry criteria specified in paragraph 13 of the Seventh Schedule.

4. The market entry criteria were last reviewed in 2002 when the Administration introduced the Banking Ordinance (Amendment of Seventh Schedule) Notice 2002 into the Legislative Council ("Council") on 15 May 2002

to implement various proposed changes to market entry criteria. The House Committee decided on 17 May 2002 that there was no need to form a subcommittee to study the subsidiary legislation. According to the Administration, the market entry criteria were introduced at different times and the banking environment has changed substantially over time. Improvements have been made to remove certain unnecessary restrictions and distinctions between local and foreign incorporated applicants in the authorization system.

The Notice

5. The Notice amends the minimum criteria for authorization under paragraph 13 of the Seventh Schedule to the BO so as to remove the following requirements for a company seeking authorization to carry on banking business in Hong Kong:

- (a) the requirement to have total customer deposits of not less than \$3 billion and total assets of not less than \$4 billion, as stipulated under the existing paragraph 13(a) of the Seventh Schedule ("the size criteria"); and
- (b) (in the case of a company incorporated in Hong Kong) the requirement to have been a DTC or a RLB (or any combination thereof) for not less than three continuous years, or to be a subsidiary of a bank incorporated outside Hong Kong or a holding company of such a bank that has been authorized to carry on banking business in Hong Kong for not less than three continuous years, as stipulated under the existing paragraph 13(b)(ii) of the Seventh Schedule ("the three-year requirement").

6. The Notice was published in the Gazette on 18 May 2012 and tabled at the Council meeting on 23 May 2012. The Notice will come into operation on 12 July 2012.

The Subcommittee

7. At the House Committee meeting held on 25 May 2012, Members agreed to form a Subcommittee to study the Notice. Under the chairmanship of Hon James TO, the Subcommittee has held a meeting on 12 June 2012. The membership list of the Subcommittee is in **Appendix**.

8. To allow more time for scrutiny of the Notice, the Subcommittee agreed that the Chairman should move a motion at the Council meeting of 20 June 2012

to extend the period for amending the Notice to the Council meeting of 11 July 2012. However, the motion was not dealt with at the Council meeting of 20 June 2012 owing to the heavy agenda for, and the adjournment of, the meeting and as such, the 28-day period for amendment under the negative vetting procedure as specified in section 34(2) of the Interpretation and General Clauses Ordinance (Cap. 1) expired without being extended.

Deliberations of the Subcommittee

9. The Subcommittee has expressed concern about the removal of the size criteria from the Seventh Schedule to the BO under the Notice. The Subcommittee's deliberations are summarized in the ensuing paragraphs.

10. The Subcommittee members have noted the observation of the Administration that there has been some turnover in authorized institutions in Hong Kong in recent years, partly due to the withdrawal of foreign banks after the Asian financial crisis and partly due to the ongoing trend of consolidation, and that the proposed relaxation of the market entry criteria would help enhance the breadth and depth of the financial markets in Hong Kong without compromising banking stability.

11. The Chairman considers that the removal of the size criteria would make it easier for overseas institutions to obtain authorization to conduct deposit-taking business in Hong Kong. This might encourage those overseas institutions that would otherwise be screened out in the application process to seek the opportunity to start a deposit-taking business in Hong Kong. Institutions which are not sufficiently experienced in operating deposit-taking business in their home countries, or those which are not sufficiently sound in their financial status, might be allowed entry into the Hong Kong market. In this sense, the removal of the size criteria would expose local depositors and those from the Mainland to greater risks. The Chairman thus considers that the potential risks arising from the removal of the size criteria could probably outweigh the benefits which the Administration has suggested it would bring about.

12. In short, the Subcommittee is concerned that, if the size criteria are removed, overseas banks with no history of taking deposits could do so in Hong Kong, possibly increasing risks to local depositors and those from the Mainland. Members therefore asked the Hong Kong Monetary Authority ("HKMA") to consider whether it could impose conditions on authorization in such cases to address this risk.

13. In response to the Subcommittee members' concern, the Administration has explained that there are better, and more widely accepted international measures of the financial soundness of banks, including tier-1 capital and capital adequacy ratios. These are already included in the Seventh Schedule to the BO and the Basel framework, which does not include minimum-deposit requirements. The Hong Kong banking sector currently has an aggregate capital adequacy ratio well in excess of the statutory minimum. Moreover, the BO also contains stringent criteria to be applied in assessing licensing applications, including tests of the fitness and propriety of shareholder controllers, directors and senior executives, and requirements to have adequate systems of control, adequate financial resources, adequate liquidity, provisions and accounting systems.

14. In respect of protection for depositors, the Administration has advised that deposits in Hong Kong are covered by the Deposit Protection Scheme up to the level of \$500,000 per depositor per institution. (This generally covers 90% of all depositors.)

15. According to the Administration, it would be unusual for an overseas applicant that did not take deposits as part of its normal business to apply to do so in Hong Kong. If such an application were received, the HKMA would examine the applicant's proposed business model, including its management, internal controls and systems, very carefully before deciding whether to grant authorization. The Administration has further advised that in its normal supervision of banks, the HKMA imposes measures, including limits on intra-group exposures and requirements on holding of liquid assets, designed in part to control banks' ability to funnel deposits taken in Hong Kong to parents or affiliates outside Hong Kong.

16. After the meeting, the Administration has circulated a proposal of the HKMA to the Subcommittee members with a view to addressing their concern. In gist, the HKMA has proposed to include the following paragraph in its Guideline on Minimum Criteria for Authorization (Guideline), issued under section 16(10) of the BO –

"Where an overseas applicant proposes to undertake deposit-taking business in Hong Kong, but is unable to demonstrate that it has sufficient experience of operating such business in its home jurisdiction, the Monetary Authority (MA) will require the applicant to explain in detail its business case for the proposed deposit-taking business. In the event that the MA is minded to approve the application, the MA may impose conditions in the interest of depositors limiting the scope of or the way in which the applicant may conduct its deposit-taking business in Hong Kong."

17. According to the Administration, the Guideline is issued to assist prospective applicants for authorization to conduct banking business in Hong Kong. It contains the HKMA's requirements and policies in respect of applications for authorization. The Guideline will be amended to reflect the changes contained in the Notice. The above paragraph will be included at the same time and the amended Guideline published in the Gazette. The Subcommittee members have expressed no particular views about the HKMA's proposal.

18. A Subcommittee member considers that while the removal of size criteria and the three-year requirement would facilitate the entry of foreign banks into Hong Kong, there was no urgent need to make the change in this legislative session and given the concern expressed by the Subcommittee, the Administration could withdraw the Notice so that the matter could be revisited and considered more thoroughly in the Fifth Legislative Council. However, the Administration has indicated that, given the benefits of encouraging well-managed and reputable financial institutions to gain access to the local market, it has no intention to defer the planned timing for the removal of the criteria.

19. Hon James TO separately gave notice on 13 June 2012 to move a motion to repeal the Notice at the Legislative Council meeting of 20 June 2012. As mentioned in paragraph 8 above, the 28-day period for amending the Notice expired at the Council meeting of 20 June 2012 without being extended. As such, members noted that it is technically not feasible for the Subcommittee or any Member to amend or repeal the Notice. Consequently, the Notice will come into operation without amendment on 12 July 2012 as stated in paragraph 6 above.

Advice sought

20. Members are invited to note the deliberations of the Subcommittee as set out above.

Council Business Division 1
Legislative Council Secretariat
28 June 2012

**Subcommittee on
Banking Ordinance (Amendment of Seventh Schedule) Notice 2012**

Membership List

Chairman Hon James TO Kun-sun

Members Hon CHIM Pui-chung

 Hon KAM Nai-wai, MH

(Total : 3 members)

Clerk Mr Derek LO

Legal Adviser Mr Bonny LOO