

For information

Legislative Council Panel on Financial Affairs

**Review of Market Entry Criteria - Proposed Amendments
to the Seventh Schedule to the Banking Ordinance (Cap. 155)**

Supplementary Information

Purpose

Having regard to the relevant discussion at the meeting of the Panel on Financial Affairs on 2 March 2012 and in response to the letter dated 5 March 2012 from the Panel, this paper provides the following supplementary information regarding the proposed amendments to the Seventh Schedule to the Banking Ordinance (“BO”) (Cap.155) –

- (a) what existing measures are in place and/or what additional measures will be introduced to regulate the incorporation of banks in Hong Kong in order to ensure the stability of the banking sector, if the “deposit size” and the “three-year” requirements are to be removed;
- (b) comparison of the market entry criteria for the banking industry in Hong Kong and those adopted by other international financial centres (“IFCs”) including the United Kingdom, the United States, Australia and Singapore; and
- (c) relevant legislative amendments.

Measures to Ensure Stability of the Banking Sector

2. According to the assessment of the Hong Kong Monetary Authority (“HKMA”), even with the removal of requirements relating to assets as well as deposits and the requirement that an overseas bank wishing to incorporate in Hong Kong must first have operated as a branch or a restricted-licence bank or deposit-taking company (or any combination thereof) for three continuous years, the stability of the banking sector would not be undermined. After the removal of the aforementioned criteria, banks seeking authorization in Hong Kong will continue to be required to meet the remaining licensing criteria set out in the

Seventh Schedule to the BO. These include, among other things, the fitness and propriety of controllers, directors and chief executives, the adequacy of financial resources (e.g. minimum paid-up capital of HK\$300 million for licensed banks) and liquidity, and the adequacy of systems and controls. These criteria apply to institutions not only at the time of authorization but on a continuing basis. They are part of the Basel Core Principles for Effective Banking Supervision, which provide globally agreed minimum standards for banking regulation and supervision. The deposit and asset-size criteria and the three-year rule, however, do not form part of the Basel Core Principles. Therefore, their removal would not result in any departure from internationally agreed minimum standards. The HKMA considers that the remaining licensing criteria set out in the Seventh Schedule to the BO, together with the HKMA's continuing supervision of authorized institutions, would suffice to ensure that institutions establishing branches or subsidiaries in Hong Kong are well-managed and financially sound.

3. The asset and deposit-size requirements have become less relevant as measures of the financial soundness of a bank. Since the HKMA's last review of market entry criteria in 2002, tier-one capital and capital adequacy ratio measured according to the Basel standards have become the fundamental measures of a bank's financial soundness. These capital requirements are included in the HKMA's minimum authorization criteria. Where relevant, the HKMA also seeks comments from foreign supervisors to ensure that their banks are sufficiently well-equipped to set up banking operations in Hong Kong.

4. Regarding the proposed removal of the three-year rule, the HKMA has closer supervisory control over locally incorporated institutions than over local branches of those incorporated overseas. For example, the HKMA must be satisfied that locally incorporated institutions maintain a capital adequacy ratio calculated according to the Banking (Capital) Rules under the BO. However, in the case of an institution incorporated outside Hong Kong, the HKMA will generally accept calculations of the capital ratios based on the methodology of the home supervisor provided that the methodology is in line with the Basel Capital Accord. Hence, there would be benefits, in terms of supervisory control, where overseas banks choose to enter the Hong Kong market by local incorporation rather than by establishing branches. This is particularly relevant when the overseas banks intend to conduct retail business in Hong Kong.

5. The HKMA will monitor market developments closely upon the introduction of the above amendments. It will also keep the market entry criteria under regular review so as to ensure that they are in line with international practices and support the stability of the banking sector in Hong

Kong.

Comparison of Market Entry Criteria of Other IFCs

6. A table comparing the market entry criteria for the locally incorporated banks in Hong Kong with those of other IFCs is at **Annex A**. It should be noted that the information in the table is high-level and based on published sources, including legislation. The criteria are generally minimum standards and relevant regulators often have powers to impose higher standards in individual cases or across the sector. All of the jurisdictions shown have been assessed by the International Monetary Fund as meeting the Basel Core Principles.

Legislative Amendments

7. To effect the above amendments, paragraphs 13(a) and 13(b)(ii) in the Seventh Schedule to the BO should be deleted. A copy of the existing Seventh Schedule is attached at **Annex B** for easy reference. We are working with the Department of Justice in preparing the proposed amendments to the Schedule, with a view to tabling these amendments for negative vetting by the Legislative Council within the current legislative session.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
19 March 2012

Comparison of market entry criteria for locally incorporated banks in Hong Kong and other international financial centres

	Market entry criteria	Hong Kong	Germany	Switzerland	UK	USA ¹	Australia	Singapore
1.	Minimum share capital	HK\$300 million for licensed banks, HK\$100 million for restricted licence banks and HK\$25 million for deposit-taking companies	€5 million	CHF10 million	€5 million	No mandated minimum dollar level of capital	Tier 1 capital of AUD50 million	SGD1.5 billion
2.	Minimum capital adequacy ratio measured in line with Basel standards	8% ²	12% in the first three years	8%	8%	10% for the first three years of operations	8%	10%
3.	Adequate liquidity	<ul style="list-style-type: none"> ● Statutory liquidity ratio of 25% ● Sound liquidity risk management framework 	<ul style="list-style-type: none"> ● Liquidity regulatory requirements published by Federal Gazette ● Efficient and reliable liquidity risk management systems 	<ul style="list-style-type: none"> ● Statutory liquidity ratio of 33% ● Minimum reserves required 	<ul style="list-style-type: none"> ● Liquidity resources containing an adequate buffer of high quality, unencumbered assets ● Prudent funding profile 	<ul style="list-style-type: none"> ● Sound liquidity risk management 	<ul style="list-style-type: none"> ● Minimum holding of 9% of its liabilities in specified high quality liquid assets at all times ● Appropriate control mechanisms in place 	<ul style="list-style-type: none"> ● Generally, a minimum of 16% of its Qualifying Liabilities in liquid assets

¹ There are two main categories of bank in the US: federally chartered and state-chartered. As the licensing requirements for state-chartered banks vary across the States, only the market entry criteria for federally chartered banks have been reviewed.

² In practice, the Monetary Authority (“MA”) will usually set a trigger ratio, above the minimum capital requirement, to provide both an early warning signal of deterioration in an authorized institution (AI)’s capital position and a cushion to reduce the risk of breaches of the minimum requirement. Under section 101 of the Banking Ordinance, the MA may increase capital adequacy ratio for particular AIs to not more than 16%. As at 30 September 2011, locally incorporated AIs had an aggregate consolidated capital adequacy ratio of 15.7%, which was well above the minimum standard of 8%.

(Added L.N. 120 of 1994)
(Sixth Schedule added 94 of 1993 s. 33)

Schedule:	7	MINIMUM CRITERIA FOR AUTHORIZATION	L.N. 232 of 2006	01/01/2007
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[sections 16(2) & (10),
17, 29(2) & 135(1)
& 8th Schedule]

1. (1) In this Schedule-

"adequate" (足夠), in relation to systems of control, includes operating effectively;

"controller" (控權人) includes a minority shareholder controller;

"net debit balance" (借方淨差額), in relation to a company, means the aggregate of the excess of accumulated losses over accumulated profits disclosed in the profit and loss account, and other reserves separately disclosed in the balance sheet, of the most recent audited accounts of the company;

"system of control" (管控制度) includes procedures.

(2) For the purposes of the calculation of the paid-up share capital of a company required by this Schedule, there shall be deducted from such share capital any net debit balance.

(3) For the avoidance of doubt, it is hereby declared that where pursuant to the provisions of this Schedule the Monetary Authority holds an opinion, or is satisfied, in relation to any matter, his holding that opinion or being so satisfied, as the case may be, shall not of itself bind the Monetary Authority-

(a) to continue to hold that opinion or to be so satisfied, as the case may be, whether before, on or after the authorization, if any, of the company to which the matter directly or indirectly relates (including any case where that company is seeking a different authorization); or

(b) to hold any similar opinion or to be similarly satisfied, as the case may be, in respect of any similar matter which directly or indirectly relates to any other company seeking or having the same or a different authorization from that first-mentioned company.

(4) Without prejudice to the generality of subparagraph (3), the Monetary Authority may regard himself as being satisfied in relation to any matter in respect of which he may be satisfied pursuant to the provisions of this Schedule where-

(a) the matter directly or indirectly relates to a company incorporated outside Hong Kong;

(b) the relevant banking supervisory authority informs the Monetary Authority that it is satisfied in relation to that matter; and

(c) the Monetary Authority is satisfied as to the scope and nature of the supervision exercised by that authority.

(5) For the avoidance of doubt, it is hereby declared that subparagraph (4) shall operate before, on and after the authorization, if any, of the company to which any matter referred to in that subparagraph directly or indirectly relates.

(6) For the purposes of paragraph 13(a)(i)(F) and (G), a company is an associated company of any other company where that second-mentioned company may- (Amended L.N. 63 of 2002)

(a) by means of the holding of shares or the possession of voting power in or in relation to that first-mentioned company or any other body corporate; or

(b) by virtue of any powers conferred by the memorandum or articles of association or other document regulating that first-mentioned company or any other body corporate,

significantly influence the conduct of the affairs of that first-mentioned company.

(Amended 19 of 2005 s. 7)

2. If the company is incorporated outside Hong Kong, it is a bank-

(a) as defined in section 46(9); and

(b) in respect of which the Monetary Authority is satisfied that it is adequately supervised by the relevant banking supervisory authority.

3. The Monetary Authority is satisfied that he knows the identity of each controller of the company.

4. If the company is incorporated in Hong Kong, the Monetary Authority is satisfied that each person who is, or is to be, a director, controller, chief executive or executive officer of the company is a fit and proper person to hold the particular position which he holds or is to hold.

(Amended 6 of 2002 s. 14)

5. If the company is incorporated outside Hong Kong, the Monetary Authority is satisfied that each person who is, or is to be-

- (a) a chief executive, or executive officer, of the business in Hong Kong of the company; (Amended 6 of 2002 s. 14)
- (b) a director, controller or chief executive of the business of the company in the place where it is incorporated,

is a fit and proper person to hold the particular position which he holds or is to hold.

5A. The Monetary Authority is satisfied that the company has, and will if it is authorized continue to have, adequate systems of control to ensure that each person who is, or is to be, a manager of the company is a fit and proper person to hold the particular position which he holds or is to hold.

(Added 32 of 2001 s. 27)

6. The Monetary Authority is satisfied that the company presently has, and will if it is authorized continue to have, adequate financial resources (whether actual or contingent) for the nature and scale of its operations and, without prejudice to the generality of the foregoing-

- *(a) in the case of a company seeking authorization to carry on banking business in Hong Kong, the aggregate amount of its paid-up share capital and the balance of its share premium account is not less than \$300000000 or an equivalent amount in any other approved currency; (Amended L.N. 130 of 2001; L.N. 63 of 2002)
- (b) in the case of a company seeking authorization to carry on a deposit-taking business as a deposit-taking company, the aggregate amount of its paid-up share capital and the balance of its share premium account is not less than \$250000000 or an equivalent amount in any other approved currency; (Amended L.N. 130 of 2001)
- (c) in the case of a company seeking authorization to carry on a deposit-taking business as a restricted licence bank, the aggregate amount of its paid-up share capital and the balance of its share premium account is not less than \$100000000 or an equivalent amount in any other approved currency; (Amended L.N. 130 of 2001)
- (d) in the case of a company incorporated in Hong Kong, the company, if it is authorized, will on and after authorization have and maintain a capital adequacy ratio which complies with the provisions of Part XVII applicable to it. (Amended L.N. 431 of 1997; 19 of 2005 s. 7)
- (e) (Repealed 19 of 2005 s. 7)

7. The Monetary Authority is satisfied that the company-

- (a) presently maintains, and will if it is authorized continue to maintain, adequate liquidity to meet its obligations as they will or may fall due; and
- (b) without prejudice to the generality of subparagraph (a), if it is authorized, will on and after authorization have and maintain a liquidity ratio which complies with the provisions of Part XVIII applicable to it.

8. The Monetary Authority is satisfied that the company, if it is authorized, will on and after authorization comply with the provisions of Part XV applicable to it.

9. The Monetary Authority is satisfied that the company presently maintains, and will if it is authorized continue to maintain, adequate provision for depreciation or diminution in the value of its assets (including provision for bad and doubtful debts), for liabilities which will or may fall to be discharged by it and for losses which will or may occur.

10. The Monetary Authority is satisfied that the company presently has, and will if it is authorized continue to have, adequate accounting systems and adequate systems of control.

11. If the company is incorporated in Hong Kong, the Monetary Authority is satisfied that it presently discloses, and will if it is authorized continue to disclose, adequate information-

- (a) in relation to the state of its affairs, its profit and loss and its capital adequacy ratio; and (Amended 19 of 2005 s. 7)
- (b) in-
 - (i) its audited annual accounts within the meaning of section 60(11);
 - (ii) any supplementary information to those audited annual accounts;
 - (iii) the report of the directors under section 129D(1) of the Companies Ordinance (Cap 32); and
 - (iv) the institution's cash flow statement, together with any notes thereon, where the statement does not already form part of those audited annual accounts.

12. The Monetary Authority is satisfied that the business (including any business which is not banking business or the business of taking deposits) of the company is presently, and will if it is authorized continue to be, carried on-

(Amended 6 of 2002 s. 14)

- (a) with integrity, prudence and the appropriate degree of professional competence; and
- (b) in a manner which is not detrimental, or likely to be detrimental, to the interests of depositors or potential depositors.

13. Where the company is seeking authorization to carry on banking business in Hong Kong-

- (a) it has (or, where subparagraph (b)(ii)(B) is applicable, will have)-
 - (i) total customer deposits of not less than \$3000000000, or an equivalent amount in any other approved currency, excluding any deposits by-
 - (A) any authorized institution;
 - (B) any bank incorporated outside Hong Kong which is not an authorized institution;
 - (C) any controller or director of the company;
 - (D) any relative, within the meaning of section 79, of any such controller or director;
 - (E) any firm, partnership or body corporate in which the company, any controller or director of the company or any relative, within the meaning of section 79, of any such controller or director, is interested as director, partner, manager or agent;
 - (F) any holding company, subsidiary or associated company of the company;
 - (G) any subsidiary or associated company of any such holding company; and
 - (ii) total assets (less contra items) of not less than \$4000000000 or an equivalent amount in any other approved currency; and
- (b) in the case of-
 - (i) a company incorporated outside Hong Kong, either-
 - (A) there is, in the opinion of the Monetary Authority, an acceptable degree of reciprocity in respect of banks incorporated in Hong Kong seeking to carry on banking business in the place where that company is incorporated; or
 - (B) the place where that company is incorporated is, or is part of the territory of, a member of the World Trade Organization;
 - (ii) a company incorporated in Hong Kong, either-
 - (A) it has been a deposit-taking company or a restricted licence bank (or any combination thereof) for not less than 3 continuous years; or
 - (B) it is a subsidiary of a bank incorporated outside Hong Kong or a subsidiary of a holding company of such bank and that-
 - (I) the bank has been authorized to carry on banking business in Hong Kong for not less than 3 continuous years; and
 - (II) the Monetary Authority is satisfied that the bank will transfer, and is capable of transferring, as soon as reasonably practicable after the company is authorized, from its principal place of business in Hong Kong or any local branch or local office (within the meaning of this Ordinance as amended by the Banking (Amendment) Ordinance 2001 (32 of 2001)), to the company amounts of customer deposits and assets not less than the respective amounts specified in subparagraph (a)(i) and (ii). (Replaced L.N. 63 of 2002)

(Seventh Schedule added 49 of 1995 s. 52)

Note:

* For the transitional provision relating to the amendments made by the Banking Ordinance (Amendment of Seventh Schedule) Notice 2002 (L.N. 63 of 2002), see section 2 of that Notice.

Schedule:	8	GROUNDS FOR REVOCATION OF AUTHORIZATION	L.N. 219 of 2004	25/02/2005
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[sections 22(1) & 135(1)]

1. In this Schedule, "controller" (控權人) includes a minority shareholder controller.

*2. The Monetary Authority is satisfied that, if the authorized institution were not authorized and were to make an application under section 15 for authorization in respect of the business referred to in that section presently being carried on by it, section 16(2) would prohibit him from so authorizing it (but excluding the criteria specified in