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**Paper for the House Committee**

**Report of the Subcommittee on  
Banking (Disclosure) (Amendment) Rules 2018 and Banking (Specification  
of Multilateral Development Bank) (Amendment) Notice 2018**

**Purpose**

This paper reports on the deliberations of the Subcommittee on Banking (Disclosure) (Amendment) Rules 2018 ("BDAR 2018") and Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2018 ("the Amendment Notice").

**Background**

Basel Committee on Banking Supervision and the Basel framework

2. The Basel Committee on Banking Supervision ("BCBS") is the international body that sets standards on banking regulation with a view to enhancing financial stability. The existing Basel framework comprises three mutually reinforcing "pillars" designed to address the risks faced by banks. Pillars 1 and 2 prescribe the minimum capital and liquidity requirements for banks and a corresponding supervisory process respectively, whereas Pillar 3 requires public disclosure of key information on the capital, liquidity, and risk exposures of banks.<sup>1</sup> To address lessons learned from the global financial crisis, the Pillar 3 requirements have been revised twice, in January 2015 and March 2017, to reflect the outcome of the two reviews to enhance the requirements in terms of transparency, comparability and user-relevance of bank disclosures.

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<sup>1</sup> BCBS has previously issued regulatory frameworks commonly known as Basel I, Basel II and Basel 2.5. Basel III is the latest package of regulatory capital and liquidity standards designed to further enhance the resilience of banks and banking systems and address weaknesses observed in the global financial crisis. BDAR 2018 is part of the legislative initiatives for implementation of on-going enhancements of the regulatory framework in Hong Kong leading on from the Basel III reforms.

3. In Hong Kong, authorized institutions ("AIs") are subject to the revised Pillar 3 disclosure requirements published by BCBS in January 2015 as reflected under the Banking (Disclosure) Rules (Cap. 155M) ("BDR").<sup>2</sup> For the purpose of implementing the disclosure requirements set out in the *Pillar 3 disclosure requirements – consolidated and enhanced framework* issued by BCBS in March 2017 ("March 2017 Standard"), corresponding amendments have to be made to BDR.

#### Specification of multilateral development bank

4. Under section 2(19) of the Banking Ordinance (Cap. 155) ("BO"), the Monetary Authority ("MA") may by notice published in the Gazette specify to be a multilateral development bank ("MDB") for the purposes of the Ordinance 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. AIs' exposures to MDBs specified in the Banking (Specification of Multilateral Development Bank) Notice (Cap. 155 sub. leg. N) ("Notice") are deemed to carry lesser risks and hence accorded preferential treatment in certain areas under BO such as the calculation of the regulatory capital and liquidity requirements.

#### **Banking (Disclosure) (Amendment) Rules 2018 and Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2018**

5. The Amendment Notice and BDAR 2018 were published in the Gazette on 4 May 2018 and tabled before the Legislative Council at the Council meeting of 9 May 2018. The Amendment Notice seeks to specify the Asian Infrastructure Investment Bank ("AIIB") as an MDB for the purposes of BO whereas BDAR 2018 seeks to:

- (a) implement certain disclosure requirements for AIs as set out in the March 2017 Standard;
- (b) update certain existing disclosure requirements having regard to industry and international disclosure practices;
- (c) empower MA to permit an AI to publish the relevant disclosure statement at a time later than the publication of its financial statement where justified, thereby allowing flexibility to the current requirement of concurrent publication;

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<sup>2</sup> BDR is made by the Monetary Authority under section 60A of the Banking Ordinance (Cap. 155) ("BO") after consultation with the Financial Secretary and the persons specified in section 60A(2) of BO.

- (d) remove the existing requirements for an AI to issue a press release concurrently with the publication of a disclosure statement and to keep copies of disclosure statements in each local branch; and
- (e) introduce technical amendments to align certain terminologies used in BDR with amendments made by the Banking (Capital) (Amendment) Rules 2017 for implementation of Basel's revised securitization framework.

6. The Amendment Notice and BDAR 2018 come into operation on 30 June 2018.

### **The Subcommittee**

7. At the House Committee meeting on 11 May 2018, Members agreed to form a subcommittee to study BDAR 2018 and the Amendment Notice. The membership list of the Subcommittee is in the **Appendix**. Under the chairmanship of Hon CHAN Chun-ying, the Subcommittee held one meeting on 21 May 2018 with the Administration to scrutinize the two pieces of subsidiary legislation.

### **Deliberations of the Subcommittee**

8. The Subcommittee has noted that BDAR 2018 and the Amendment Notice are intended to bring the banking regulatory regime in Hong Kong up-to-date and in line with international standards. This will promote market discipline and banking stability, and ensure competitiveness of the local banking industry, thereby reinforcing Hong Kong's status as an international financial centre.

9. The Subcommittee has no objection to the two pieces of subsidiary legislation. The deliberations are summarized in the ensuing paragraphs.

### **Banking (Disclosure) (Amendment) Rules 2018**

#### *General*

10. Noting that a number of existing provisions of BDR are removed/revised under BDAR 2018, the Subcommittee has sought the reasons for the substantial revisions. The Administration has explained that the amendments to BDR are meant to bring into force certain new requirements mandating disclosure of an

AI's key prudential ratios<sup>3</sup> and prudent evaluation adjustments,<sup>4</sup> which serve to reflect the AI's capital and liquidity positions as well as their compositions; and, secondly, to update the format and frequency of the existing disclosures to accord with the March 2017 Standard. The substantial amendments involve, inter alia, consolidation of certain existing requirements under Parts 2B, 3, 3A and 4 into Part 2A of BDR.

11. The Administration has advised that in line with the established practice for codifying Basel standards on regulatory disclosure in the local legislation (i.e. BDR), standard disclosure templates (or tables if applicable) are to be specified under section 6(1)(ab) of BDR by MA for use by AIs. The Administration has informed the Subcommittee that the new/updated disclosure templates/tables for implementation of BDAR 2018 have been issued to the banking industry in May 2018 for consultation, and the finalized version will be used by AIs for making disclosure of their individual capital and liquidity positions, etc. after commencement of BDAR 2018 on 30 June 2018.

12. In response to the Subcommittee's enquiry, the Administration has also advised that the definitions of the terminologies used in BDAR 2018 basically follow those adopted by BCBS, except those local requirements that are applicable to Hong Kong only (e.g. requirements relating to the liquidity maintenance ratio of AIs).

#### *Verification of information to be disclosed*

13. The Subcommittee has enquired about the verification of information required to be disclosed by AIs under BDR. The Administration has advised that as stipulated in section 8 of BDR, the board of directors and the senior management of an AI shall ensure, among other things, that the information which the institution is required to disclose pursuant to BDR is, before being so disclosed, scrutinized and subjected to an internal review to ensure that the information is not false or misleading in any material respect. The internal review and internal control processes applied to the information disclosed by an AI under BDR must be no less stringent than those applied to the information provided by the institution within the management discussion and analysis part of its financial statements. The Administration has also clarified that it is not a requirement that the information should be verified by an AI's external auditor before disclosure.

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<sup>3</sup> Such as CET1 capital ratio, Tier 1 capital ratio, total capital ratio and leverage ratio which reflect the capital adequacy position of an AI, and liquidity coverage ratio and net stable funding ratio which reflect its liquidity position.

<sup>4</sup> This refers to adjustment required to be made by an AI (for regulatory capital purposes) to the valuation of its exposures to account for factors (such as illiquidity of exposures) that might affect the prudence and reliability of the valuation.

14. The Subcommittee has further noted that if an AI fails to comply with any requirement applicable to it contained in the rules made under 60A(1) (disclosure to the general public of information relating to financial affairs) including BDR, every director, every chief executive and every manager of the AI commit an offence and are liable to a fine.

*Requirements on publication of disclosure statements*

15. Dr Hon KWOK Ka-ki has sought the reasons for removing the existing requirements for an AI to issue a press release concurrently with the publication of a disclosure statement. He is concerned that this will deprive the public of a convenient means of access to the information disclosed.

16. The Administration has advised that under the existing requirements of BDR, an AI is required to issue a press release concurrently with the publication of a disclosure statement and to keep copies of disclosure statements in each local branch. Having regard to web-based disclosures nowadays, the voluminous nature of the disclosure statements and their target readers/users (who are mainly financial professionals and analysts), as well as changes in media practices and coverage, these existing requirements are considered obsolete and hence proposed to be removed. The proposal has taken into account industry and international disclosure practices. The Administration points out that while the requirement for an AI to publish its disclosure statements in the press will be removed, it remains a requirement for the AI to make the relevant disclosure on its internet website (or a section of the internet website).<sup>5</sup> The Administration considers that web-based disclosures will suffice to serve the intended purpose of ensuring transparency of the disclosure for public inspection.

Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2018

17. The Subcommittee has noted that AIs' exposures to AIIB as an MDB specified in the Amendment Notice will be accorded preferential treatment in certain areas under BO, such as the calculation of the regulatory capital and liquidity requirements. In view of AIIB's relatively short history of operation, Dr Hon KWOK Ka-ki is worried that the preferential treatment so accorded to AIIB may in effect increase the credit risks on those AIs which are counterparties to AIIB, in particular if any individuals of AIIB happen to engage in fraudulent,

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<sup>5</sup> Regarding the meaning of "a section of the internet website", the Administration has clarified that it refers to the part of an AI's website which is dedicated for making disclosure of information under BDR and where the AI has established and maintained the archives of its disclosure statements for public inspection in accordance with the BDR requirements.

corruptive or other prohibited practices by mis-using the funds/loans for AIIB-financed projects. He has also asked about the limitations, if any, set on an AI's exposure to the financial instruments issued by AIIB or other MDB.

18. The Administration has advised that as with other banks/bodies specified in the Notice, the specification of AIIB as an MDB for the purposes of BO was made following BCBS's promulgation of AIIB as an MDB eligible for preferential treatment under the capital regime. AIIB's eligibility has been critically assessed by BCBS according to a set of criteria in its framework of capital measurement and capital standards. BCBS will review the eligibility of the promulgated MDBs including AIIB from time to time. If any bank/body is removed from BCBS' list of MDBs because it no longer meets the relevant requirements to be eligible for the preferential treatment, the Administration will introduce amendments to the Notice accordingly. The Administration has emphasized that the preferential treatment in question only applies to AIs' exposures to AIIB in certain areas under BO, which do not cover the acts of any individuals of AIIB. Besides, the rules governing exposure limit by AIs incorporated in Hong Kong (currently set out in section 81 of BO) will soon be amended to generally restrict the financial exposure of an AI to any counterparty (including AIIB) that is not a sovereign to an amount not exceeding 25% of the AI's Tier 1 capital.<sup>6</sup> This will help manage and minimize the AI's risk exposures.

#### Future related legislative amendments

19. The Subcommittee has noted that there are two requirements of the March 2017 Standard which are not dealt with in BDAR 2018, viz. (a) disclosures concerning the constituents of an AI's resources eligible to meet its minimum total loss-absorbing capacity requirement for resolution purposes, which need to tally with the terminology and scope of application of the proposed rules currently being developed by the Hong Kong Monetary Authority to prescribe loss-absorbing capacity requirements for AIs under the Financial Institutions (Resolution) Ordinance (Cap. 628); and (b) disclosures associated with the revised market risk framework, concerning which the international implementation timeline has been postponed by BCBS to 2022, and BCBS has yet to promulgate related guidelines. For the reasons stated above, the Administration will take forward separate legislative exercise(s) to amend the relevant laws when ready.

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<sup>6</sup> According to the Administration, it will introduce this legislative amendment in the second half of 2018.

**Recommendation**

20. Subcommittee members have no objection to BDAR 2018 and the Amendment Notice. The Subcommittee and the Administration will not move any amendment to the two pieces of subsidiary legislation.

**Advice sought**

21. Members are invited to note the deliberations of the Subcommittee.

Council Business Division 1  
Legislative Council Secretariat  
28 May 2018

**Subcommittee on Banking (Disclosure) (Amendment) Rules 2018 and  
Banking (Specification of Multilateral Development Bank) (Amendment)  
Notice 2018**

**Membership list**

**Chairman** Hon CHAN Chun-ying

**Members** Hon James TO Kun-sun  
Hon WONG Ting-kwong, SBS, JP  
Hon YIU Si-wing, BBS  
Hon Kenneth LEUNG  
Dr Hon KWOK Ka-ki  
Hon Christopher CHEUNG Wah-fung, SBS, JP  
Hon Jimmy NG Wing-ka, JP

(Total : 8 members)

**Clerk** Ms Angel SHEK

**Legal Adviser** Miss Rachel DAI