LEGISLATIVE COUNCIL BRIEF

The Secretary for Financial Services submits the following note for Members' information:

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Introduction of the Euro Bill	29.9.98	9.10.98

30 September 1998

Financial Services Bureau

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LEGISLATIVE COUNCIL BRIEF
INTRODUCTION OF THE EURO BILL

INTRODUCTION

At the meeting of the Executive Council on 29 September 1998, the Council ADVISED and the Chief Executive ORDERED that the Introduction of the Euro Bill should be introduced into the Legislative Council.

BACKGROUND AND ARGUMENT

2. In the Maastricht Treaty ratified by the Member States of the European Union (EU) in February 1992, the EU decided to achieve economic and monetary union in phases. The EU further agreed at the Madrid Summit in December 1995 that the single currency would be named Euro.

3. The Euro will be introduced on 1 January 1999 to replace the national currencies of the eleven participating countries[1] in European Monetary Union (EMU)[2]. There is doubt as to whether contracts or instruments containing obligations in European Currency Unit (ECU) and the legacy currencies of EMU will be frustrated by the introduction of the Euro.

4. There are already European Council (EC) Regulations which confirm that the Euro will replace the existing national currencies of the eleven participating Member States from 1 January 1999 and provide certainty for continuity of legal obligations denominated in ECU and the participating national currencies in EU countries. EC Regulation No. 1103/97 provides that the introduction of the Euro shall not have the effect of altering any term of a legal

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[1] The eleven countries are France, Germany, Italy, Spain, Belgium, the Netherlands, Luxembourg, Portugal, Austria, Finland and Ireland.

[2] EMU is meant to have two major dimensions. Economic union refers to the creation of a single market without barriers to trade, a union-wide competition policy, a common regional policy, and co-ordination of macroeconomic policy making. By 1993, following the formation of a single market, economic union has been largely completed. Regarding the monetary union, currency union will be a key step forward, from the existing exchange rate alignment under the Exchange Rate Mechanism (ERM).

instrument[3] or of discharging or excusing performance under any legal instrument, nor give a party the right unilaterally to alter or terminate a legal instrument. The Regulation also provides that as from 1 January 1999 every reference in a legal instrument to ECU is replaced by a reference to the Euro at a rate of one Euro to one ECU.

The need for legislation

5. The EC Regulations take direct effect as part of the law of all Member States of the EU. In Hong Kong, as in other common law jurisdictions, the law of currency or the lex monetae principle applies which means that the definition of a contractual obligation governed by Hong Kong law, expressed in a foreign currency, is determined by the law of the relevant foreign country. Applying this principle, performance of a legal obligation governed by Hong Kong law which provides for payment in a currency replaced by the Euro should continue to be possible as payment must be made in the Euro at the conversion rate between the replaced currency and the Euro determined by the EC. However we believe that it would still be desirable to enact specific legislation to remove any concern that parties to contracts might be able to argue that the advent of the Euro is a fundamental change of circumstances bringing a given legal obligation to an end. The EU has also seen fit to introduce legislation to deal with this problem notwithstanding that the lex monetae principle is applied in a number of its jurisdictions. Given the status of Hong Kong as an international financial centre and the fifth largest foreign exchange trading centre in the world, it is desirable not to leave any doubt, even if we are reasonably confident that problems should not arise in respect of such legal obligations.

6. In addition, there will be uncertainty with respect to legal obligations providing for payment in ECU. The ECU is not a currency as such. It is a basket expressed as particular quantities of the individual currencies of twelve Member States of the EU, originally designed as an official accounting unit for EU budgetary purposes which has subsequently also been adopted as a unit of account for private sector obligations. Within the EU, Article 2 of EC Regulation 1103/97 provides for a direct substitution of the ECU with the Euro at a 1:1 conversion rate. However, there is no equivalent legislation in Hong Kong and therefore such a substitution will not automatically take place as would be the case if ECU were a currency.

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[3] As defined in Article 1 of EC Regulation No. 1103/97, “legal instruments” shall mean legislative and statutory provisions, acts of administration, judicial decisions, contracts, unilateral legal acts, payment instruments other than banknotes and coins, and other instruments with legal effect.

7. The issue of continuity of legal obligations in relation to the Euro has also been of particular concern to other financial centres such as New York whose law is widely used as the governing law for cross-border agreements. To remove any uncertainty as to whether contracts containing obligations denominated in ECU and the legacy currencies will be frustrated by the introduction of the Euro, the State of New York enacted legislation on 29 July 1997. The New York legislation contains provisions dealing with ECU/Euro conversion as well as continuity of contracts and other instruments in terms similar to those set out in the relevant EC Regulations.

8. We have consulted the banking industry on this issue in order to assess the need for introducing specific legislation. The banks that have been consulted are all concerned about the continuity issue, particularly in relation to the sizeable amount of transactions in ECU deposits and lending (both customer and interbank) e.g. whether the borrower will use the frustration of contract as an excuse to refuse repayment. They also indicated support for the introduction of specific legislation in Hong Kong to provide for the general continuity of legal obligations in relation to the introduction of the Euro. Apart from saving much of their time and resources in seeking counterparties' consent to the amendments of legal obligations, this would provide them with certainty on continuity of legal obligations denominated in ECU or other participating national currencies.

The proposal

9. Like the legislation in New York and EU, we propose that the specific legislation in Hong Kong should not only deal with the ECU/Euro conversion, but also remove any doubt about the general continuity of legal obligations arising from the introduction of the Euro. The new legislation should also respect the freedom of contracts to provide scope for contracting parties to review the underlying purpose of the legal obligation to see whether a direct substitution by the Euro is appropriate.

THE BILL

10. The main provisions are -

(i) Clause 3 provides for references in any legal obligation to the ECU (as officially defined in the relevant EC Regulation) to be replaced by references to the Euro at the rate of one Euro to one ECU. The official definition of the ECU should be presumed to apply unless it is otherwise expressly agreed or provided;

(ii) Clause 4 provides for continuity of legal obligations, i.e. subject to any express agreement or provision to the contrary, the introduction of the Euro and the changes consequential upon its introduction should not discharge or excuse any performance under a legal obligation nor give the obligor or obligee to the obligation the right to unilaterally alter or terminate the obligation. This formulation has taken into account the consideration of respecting the freedom of contracts; and

(iii) Clause 5 puts it beyond doubt that the new legislation should not be taken to affect the operation of the law relating to the validity or enforceability of a legal obligation, e.g. the application of the lex monetae principle, in future cases of currency alteration.

PUBLIC CONSULTATION

11. The local banking community, the Hong Kong Capital Markets Association and the Law Society of Hong Kong have been consulted and they strongly support the proposal.

HUMAN RIGHTS IMPLICATIONS

12. The Department of Justice advises that the legislation has no human rights implications.

BINDING EFFECT

13. All individuals and organisations in Hong Kong, inlcuding the SAR Government and State organs, will have to abide by the proposed legislation as it covers all relevant legal obligations.

FINANCIAL AND STAFFING IMPLICATIONS

14. There are no financial or staffing implications.

ECONOMIC IMPLICATIONS

15. It will be difficult to quantify the exact impact or economic consequence arising from the legal uncertainty in relation to the introduction of the Euro. However, as Hong Kong is an international financial centre, it is highly desirable to introduce specific legislation to remove any doubt in this respect.

LEGISLATION TIMETABLE

16. Subject to Members' approval of the introduction of the Bill into the Legislative Council, the legislative timetable will be -

Publication in the Gazette	9 October 1998
First Reading and commencement of Second Reading Debate	4 November 1998
Resumption of Second Reading Debate, Committee Stage and Third Reading	to be notified

PUBLICITY

17. A press release will be issued on the day when the Bill is published in the Gazette on 9 October 1998.

ENQUIRIES

18. Enquiries on this brief can be directed to Eddie Cheung, Assistant Secretary for Financial Affairs at 2528 9076.

30 September 1998
Financial Services Bureau