

LEGISLATIVE COUNCIL BRIEF

Banking Ordinance
(Chapter 155)

BANKING (AMENDMENT) BILL 2005

INTRODUCTION

At the meeting of the Executive Council on 22 February 2005, the Council ADVISED and the Chief Executive ORDERED that the Banking (Amendment) Bill 2005, at the Annex, should be introduced into the Legislative Council to provide for the implementation of the revised international capital adequacy framework promulgated by the Basel Committee on Banking Supervision⁽¹⁾ (BCBS) in June 2004, commonly known as “Basel II”⁽²⁾, in Hong Kong and other miscellaneous matters.

Annex

JUSTIFICATIONS

Implementation of Basel II

2. Hong Kong has implemented Basel I and its subsequent amendments. The details are embodied in the Third Schedule to the Banking Ordinance (BO). As a major international financial centre that prides itself on adopting best practices that command wide international acceptance, it is important that Hong Kong commits to adopting Basel II, which is, in effect, an enhanced version of an international standard to which we already subscribe. Other major non-G10 countries, such as Australia and Singapore, have decided to adopt Basel II in full.

3. The three-pillar structure of Basel II represents a major step forward in terms of the identification, quantification and management of risk and public disclosure. Pillar 1 incorporates a much more detailed

⁽¹⁾ The Basel Committee on Banking Supervision was established by the central bank governors of the Group of Ten (G10) countries. It formulates broad supervisory standards, provides guidance and recommends best practice in the area of banking supervision.

⁽²⁾ Basel II substantially amends the Capital Accord of 1988 known as “Basel I”. A key element of Basel I as well as Basel II is the requirement of banks to maintain a minimum capital adequacy ratio of 8%. This underscores the importance of capital held by a bank to absorb losses and thus protect its creditors (primarily depositors) in the event of the bank being wound up. Compared with Basel I, Basel II is more risk-sensitive and covers a wider range of banking risks.

measurement framework for credit risk⁽³⁾ than Basel I, maintains the current measurement framework for market risk⁽⁴⁾, and introduces for the first time a capital charge for operational risk⁽⁵⁾. Pillar 2 requires banks to assess the full range of “other risks” (e.g. reputational risk, business cycle risk and interest rate risk in the banking book) they run and determine how much capital to hold against them. Pillar 3 aims to bolster market discipline through increased disclosure by banks of their risk profiles, capital adequacy and aspects of their internal risk management. The greater risk sensitivity of Basel II and the inclusion of a wider range of risks will further enhance the safety and stability of the banking sector.

4. A key feature of Basel II is to provide incentives to banks to adopt the latest advances in the field of risk management. Banks which adopt best practices in the management of risk will be “rewarded” with lower capital requirements. Enhanced risk management will improve banks’ ability to offer to customers, and use internally, more sophisticated products such as derivatives. It will also enhance banks’ ability to assess lending to sectors such as small and medium enterprises, and allow for better risk-adjusted pricing, and this could allow for lower rates for better customers. Therefore, banks recognise the business need to implement Basel II and the benefits of upgrading their risk management systems.

5. Major international banking groups are expected to implement Basel II globally with effect from 1 January 2007⁽⁶⁾, in accordance with the timetable set by the BCBS. Those banks with a presence in Hong Kong will naturally expect to be able to use the Basel II approaches in their operations in Hong Kong. It is therefore important that Hong Kong implements Basel II at the same time as the BCBS members.

6. The calculation method for the capital adequacy ratio (CAR) under Basel II is considerably more complex than that currently embodied in the Third Schedule to the BO. Hence, putting the revised regime into legislation through the existing approach, i.e. by incorporating all the detailed calculations in the Third Schedule, is considered to be neither practical nor effective. Moreover, there will be a continuing need to revise

⁽³⁾ This is the risk of loss to an institution arising from a counterparty’s failure to perform on an obligation.

⁽⁴⁾ This is the risk of loss to an institution resulting from adverse movements in market rates or prices of its investments.

⁽⁵⁾ This is the risk of loss to an institution resulting from inadequate or failed internal processes, people and systems or from external events.

⁽⁶⁾ This refers to the implementation date for the less advanced approaches to the calculation of capital charges for credit and operational risks. For the most advanced approaches, the BCBS has set the implementation date at 1 January 2008.

the CAR regime in Hong Kong to keep pace with both industry developments that impact on the CAR calculations and international practices, which will evolve over time. It is therefore proposed that a rule-making approach be adopted, under which the BO will provide for the revised capital framework to be operated in accordance with rules to be promulgated by the Monetary Authority (MA). The MA's rule-making powers will be confined to those strictly necessary to ensure the methodology for calculating the CAR and the requirements for disclosure of financial information continue to reflect international best practices. It is proposed that the rules made under the BO will have the status of subsidiary legislation and hence will be subject to negative vetting by the Legislative Council. Before issuing the rules, the MA shall be obliged to consult the relevant parties and the Financial Secretary.

Miscellaneous Amendments to the BO

7. In order to improve the working of the BO in light of experience, we propose a small number of miscellaneous amendments under the Bill, including –

- (a) confining the liability of a manager of an authorized institution (AI) for certain contraventions under the BO to the case where the contravention results from an act or omission of the manager himself or a person under his control. This amendment is proposed to address concerns expressed by the banking industry on the present strict liability offences in the BO which extend liability to every manager of an AI in contravention; and
- (b) expressly providing that the MA may publish details of his disciplinary decisions in respect of AIs' securities business. This amendment is proposed to allow the MA to publish his disciplinary decisions in a manner similar to that followed by the Securities and Futures Commission (SFC)⁽⁷⁾, thereby maintaining a level playing field between AIs and SFC regulated persons.

8. In addition, the Bill proposes that section 101 of the BO be amended to allow the MA, after consultation with an AI, to vary the CAR of that AI by increasing the ratio to not more than 16%. Currently, the MA is empowered to set the minimum CAR for individual banks in the range of 8-12%, and for individual restricted licence banks (RLBs) and deposit-

⁽⁷⁾ The MA has been empowered under the Banking (Amendment) Ordinance 2002 to use the same standards and approaches adopted by the SFC in the MA's front-line supervision of AIs' securities business. Currently, the SFC publishes its disciplinary action as well as the relevant facts and findings surrounding a case. There is, however, doubt as to whether the MA can publish his disciplinary actions in a similar manner in view of the confidentiality obligations imposed on him by section 120 of the BO.

taking companies (DTCs) in the range of 8-16%. In practice, the minimum CAR for individual banks has been set in the range of 10-12%. This is a very narrow range, and means that the MA's ability to set higher minimums if the circumstances should so require (for example, if there were to be a major upward shift in the risk profile of individual banks, or of the industry as a whole) is limited. The amendment is therefore to extend the upper end of the range for banks to 16%, which is currently the figure applicable to RLBs and DTCs.

OTHER OPTIONS

9. The Hong Kong Monetary Authority (HKMA) has consulted the industry and other interested parties extensively throughout the long process of development of Basel II and the detailed implementation proposals for Hong Kong. There is general support from the parties consulted and their comments have been taken into account where appropriate. Given the considerable benefits of implementing Basel II for banks, their customers and Hong Kong's status as an international financial centre, the HKMA considers it highly desirable to adopt the revised capital adequacy regime, and putting it into legislation through amending the BO is the only means of achieving these policy objectives for the reasons explained in paragraph 6 above.

10. The HKMA will adopt a menu-based approach in implementing Basel II, providing AIs with a choice of options of capital charge calculation methodologies depending on their size of operations and sophistication in risk management. In addition to the approaches of varying degree of sophistication offered by Basel II, the HKMA has developed for use in Hong Kong a "Basic Approach" for credit risk which is a modified version of Basel I with slight definitional changes and incorporation of an operational risk capital charge. This is primarily intended for AIs with small, simple and straightforward operations (e.g. RLBs and DTCs), thus addressing smaller AIs' concerns over the complexity and cost of implementation of Basel II. As reflected in the consultations conducted, the industry endorses the implementation proposals as a pragmatic means of implementing the Basel II framework in Hong Kong.

THE BILL

11. The proposed amendments to the BO under the Bill for implementing Basel II, in general terms, provide for –

- (a) the CAR of AIs to be calculated in a manner to be prescribed by rules made by the MA (instead of being calculated according to the Third Schedule to the BO). Such rules are hereafter referred to as "Capital Rules"; and

- (b) the expansion of the power conferred on the MA to require AIs to publicly disclose information relating to their financial affairs, to include the power to require disclosure of information relating to an AI's CAR. These powers are proposed to be exercised by the MA by making rules under the BO, which are hereafter referred to as "Disclosure Rules".

12. The main provisions of the Bill are as follows –

- (a) **Clause 2** amends section 60A to provide for the MA to make rules prescribing public disclosure requirements for AIs on their financial affairs including CAR;
- (b) **Clause 4** adds the proposed section 98A to provide for the MA to make rules prescribing the manner of calculation of the CAR of AIs;
- (c) **Clause 5** amends section 101(1) to increase to 16 per cent the maximum ratio to which the CAR of an AI may be varied by the MA under that subsection;
- (d) **Clause 7** amends section 2 to limit the liability of the managers of an AI for certain contraventions under the BO to cases where the contravention is caused or contributed to by an act or omission on the part of the manager himself or a person under his control;
- (e) **Clauses 10 and 11** introduce a defence of "reasonable excuse" for certain offence provisions in the BO;
- (f) **Clauses 9 and 13** amend sections 58A and 71C respectively to provide that the MA may disclose to the public certain details of his disciplinary action taken against a relevant individual who is engaged in securities business on behalf of an AI or an executive officer who is responsible for directly supervising the securities business of an AI; and
- (g) **Clause 5 of Part 1 to the Schedule** provides for a mechanism that will allow certain decisions of the MA made under the Capital Rules to be subject to an appeal to the Chief Executive in Council.

13. The HKMA intends to implement Basel II as from 1 January 2007 to tie in with the BCBS' implementation timetable. In order to allow sufficient time for AIs' preparation for conforming to the revised requirements, the HKMA intends to table the Capital Rules and Disclosure Rules, after consultation with the relevant parties specified under the Bill, at the Legislative Council for negative vetting by the second quarter of

2006. These rules will set out the detailed calculation methodology of the CAR and the financial disclosure requirements.

LEGISLATIVE TIMETABLE

14. The legislative timetable will be –

Publication in the Gazette	4 March 2005
First Reading and commencement of Second Reading debate	6 April 2005
Resumption of Second Reading debate, committee stage and Third Reading	to be notified

IMPLICATIONS OF THE PROPOSAL

15. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. It has no financial or civil service implications. The proposal has no significant sustainability implications. The amendments proposed in the Bill will not affect the current binding effect of the BO.

Economic Implications

16. Basel II provides incentives for AIs to improve their risk management systems, which will enable them to better distinguish the credit quality of borrowers and form better pricing policies. This could result in lower cost of funding for certain borrowers and could in turn help boost the local economy. As regards additional regulatory or compliance costs for Basel II, this is difficult to quantify, as banks would be making many of these improvements in risk management standards irrespective of the introduction of these regulatory requirements.

PUBLIC CONSULTATION

17. As noted above, the HKMA has undertaken extensive public consultation on an ongoing basis in developing the implementation plan on Basel II. A detailed consultation package on implementing Basel II in Hong Kong was issued in August 2004. Responses received have been supportive of the proposals to implement Basel II from 1 January 2007. The comments received have been mostly to seek clarification on a number of technical issues. These comments are being addressed in finalising the implementation proposals.

18. In December 2004, the HKMA circulated the draft Bill, and a covering note explaining the key provisions of the Bill and inviting

comments, to members of the Basel II Consultation Group⁽⁸⁾, the industry associations⁽⁹⁾, the statutory advisory committees⁽¹⁰⁾, the Consumer Council, the Office of Privacy Commissioner for Personal Data and other interested parties. The respondents have raised no objections to the Bill. Most responses received have been drafting comments or requests for clarification. The HKMA has taken into account their feedback in finalising the Bill, and set out its responses to these comments in a document posted on its website.

19. The framework of Basel II is intended to apply not just to individual banks but also to bank holding companies (BHCs) i.e. parent entities within banking groups, in order to ensure that risks within the entire banking group are considered. To address this, the consultation draft of the Bill incorporated provisions providing for a proposed new regulatory regime for BHCs. However, the responses received indicated that while most respondents raised no objections, there remain a number of questions as to how the proposed regime would be applied in practice. Moreover, there appears to be a general feeling that such a regime is not strictly necessary at this juncture, in particular because no consensus has yet emerged among banking regulators as to how exactly it should be implemented. In light of these comments and the fact that the existing powers of the MA under the BO in respect of controllers of AIs are for the time being broadly adequate to achieve the Basel II objective of ensuring that risks within banking groups can be captured, the HKMA has decided to respond to the industry comments by excluding from the Bill the provisions on BHCs. This will be revisited later when we can see how other key regulators approach the issue.

20. The HKMA briefed the Panel on Financial Affairs of the Legislative Council on 5 July and 6 December 2004 on the major features of Basel II, the HKMA's implementation plan, the legislative approach and the key provisions of the Bill. Panel members were generally supportive.

PUBLICITY

21. A press release will be issued on 3 March 2005. Background briefings for the media may be arranged as necessary. A spokesman will be available to answer media and public enquiries.

⁽⁸⁾ The Basel II Consultation Group comprises representatives from the HKMA, the industry, the accounting profession, and other interested parties. One of the major objectives of the Group is to assist the HKMA in developing its approach to implementing Basel II in Hong Kong.

⁽⁹⁾ These include The Hong Kong Association of Banks and The DTC Association.

⁽¹⁰⁾ These include the Banking Advisory Committee and the Deposit-taking Companies Advisory Committee.

ENQUIRIES

22. Enquiries on this brief may be directed to Mrs Millie Ng, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) at 2529 0121, and Ms Rose Luk, Head (Banking Policy), Hong Kong Monetary Authority at 2878 1638.

**Financial Services and the Treasury Bureau
2 March 2005**

BANKING (AMENDMENT) BILL 2005

CONTENTS

Clause Page

PART 1

PRELIMINARY

1. Short title and commencement 1

PART 2

**AMENDMENTS RELATING TO PUBLIC DISCLOSURE OF
INFORMATION AND TO CAPITAL ADEQUACY RATIO**

2. Section substituted

60A. Disclosure to the general public of information
relating to financial affairs 1

3. Capital adequacy ratio 2

4. Section added

98A. Calculation of capital adequacy ratio 3

5. Monetary Authority may increase capital adequacy ratio for
particular authorized institutions 3

6. Amendments consequential to sections 2 to 5 4

PART 3

OTHER AMENDMENTS

7. Interpretation 4

8. Revocation of authorization 4

9. Disciplinary action in respect of relevant individuals 5

10. Audit 5

11.	Returns and information to be submitted to the Monetary Authority	5
12.	Punishment for attempted evasion of restrictions	5
13.	Executive officers of registered institutions require Monetary Authority's consent	5
14.	Revocation of approval	6
Schedule	Amendments consequential to sections 2 to 5 of this Ordinance	6

A BILL

To

Amend the Banking Ordinance.

Enacted by the Legislative Council.

PART 1

PRELIMINARY

1. Short title and commencement

(1) This Ordinance may be cited as the Banking (Amendment) Ordinance 2005.

(2) This Ordinance shall come into operation on a day to be appointed by the Secretary for Financial Services and the Treasury by notice published in the Gazette.

PART 2

AMENDMENTS RELATING TO PUBLIC DISCLOSURE OF
INFORMATION AND TO CAPITAL ADEQUACY RATIO

2. Section substituted

Section 60A of the Banking Ordinance (Cap. 155) (as inserted by section 6 of the Banking (Amendment) Ordinance 1999 (42 of 1999) and further amended by section 24(4) of the Banking (Amendment) Ordinance 2001 (32 of 2001)) is repealed and the following substituted –

**"60A. Disclosure to the general public of
information relating to financial
affairs**

(1) The Monetary Authority may, after consultation with the Financial Secretary and the persons specified in subsection (2), make

rules prescribing the information to be disclosed to the general public by authorized institutions relating to their state of affairs, profit and loss or capital adequacy ratio and prescribing the manner in which, times at which and periods during which such information shall be so disclosed.

(2) The persons specified for the purposes of subsection (1) are –

- (a) the Banking Advisory Committee;
- (b) the Deposit-taking Companies Advisory Committee;
- (c) The Hong Kong Association of Banks; and
- (d) The DTC Association.

(3) Rules made under subsection (1) may make different provision for authorized institutions belonging to different classes of authorized institution.

(4) Where an authorized institution fails to comply with any requirement applicable to it contained in rules made under subsection (1), every director, every chief executive and every manager of the authorized institution commits an offence and is liable –

- (a) on conviction upon indictment to a fine at tier 7; or
- (b) on summary conviction to a fine at tier 5,

and, in the case of a continuing offence, to a further fine at tier 2 for every day during which the offence continues.

(5) For the avoidance of doubt, it is hereby declared that any requirement under subsection (1) for the Monetary Authority to consult with any person shall not operate to prevent the Monetary Authority from consulting with such other person as the Monetary Authority thinks fit."

3. Capital adequacy ratio

Section 98(1) is amended by repealing everything after "with" and substituting "subsection (2) and rules made under section 98A(1)".

4. Section added

The following is added –

"98A. Calculation of capital adequacy ratio

(1) The Monetary Authority may, after consultation with the Financial Secretary and the persons specified in subsection (2), make rules prescribing the manner in which the capital adequacy ratio of authorized institutions shall be calculated.

(2) The persons specified for the purposes of subsection (1) are –

- (a) the Banking Advisory Committee;
- (b) the Deposit-taking Companies Advisory Committee;
- (c) The Hong Kong Association of Banks; and
- (d) The DTC Association.

(3) Rules made under subsection (1) may provide for the Monetary Authority, on application made to him by any person aggrieved by a decision made by the Monetary Authority under those rules, to review his decision.

(4) For the avoidance of doubt, it is hereby declared that any requirement under subsection (1) for the Monetary Authority to consult with any person shall not operate to prevent the Monetary Authority from consulting with such other person as the Monetary Authority thinks fit."

5. Monetary Authority may increase capital adequacy ratio for particular authorized institutions

Section 101(1) is repealed and the following substituted –

"(1) The Monetary Authority may, after consultation with an authorized institution, by notice in writing served on it vary the capital adequacy ratio specified in section 98(1) in relation to that institution by increasing the ratio to not more than 16 per cent and, where the ratio is so

varied, the other provisions of this Part shall, in relation to that institution, apply as if the ratio specified in section 98(1) were the ratio as so varied."

6. Amendments consequential to sections 2 to 5

The amendments set out in the Schedule shall have effect.

**PART 3
OTHER AMENDMENTS**

7. Interpretation

(1) Section 2(8) is amended by adding ", other than section 14," after "Ordinance".

(2) Section 2 is amended by adding –

"(18) Any provision of this Ordinance that purports to impose criminal liability on every manager of an authorized institution or other company in the event of a contravention of this Ordinance shall be construed as imposing criminal liability on a manager of an authorized institution or other company only to the extent that the contravention was caused or contributed to by an act or omission on the part of the manager himself or a person under his control."

8. Revocation of authorization

(1) Section 22(1) is amended by repealing "subsection (3)" and substituting "subsections (1A) and (3)".

(2) Section 22 is amended by adding –

"(1A) The requirement in subsection (1) to consult the Financial Secretary before proposing to revoke the authorization of an authorized institution shall not apply where the ground for the revocation of the authorization of the authorized institution is a request in writing by the institution to the Monetary Authority to revoke its authorization."

9. Disciplinary action in respect of relevant individuals

Section 58A is amended by adding –

"(4A) Where the Monetary Authority has exercised his power under subsection (1) against a relevant individual, the Monetary Authority may disclose to the public details of the decision he has made under that subsection, the reasons for which the decision was made, and any material facts relating to the case."

10. Audit

Section 59(5) is amended by repealing "or (2)" and substituting ", and every director, every chief executive and every manager of an authorized institution which, without reasonable excuse, contravenes subsection (2)".

11. Returns and information to be submitted to the Monetary Authority

Section 63(5) is amended by repealing "contravenes subsection (1), or fails to comply with any requirement under subsection (3) or (3A)," and substituting ", without reasonable excuse, contravenes subsection (1) or fails to comply with any requirement under subsection (3) or (3A)".

12. Punishment for attempted evasion of restrictions

Section 70D(2) is amended by repealing "every director, every chief executive and every manager" and substituting "any director, chief executive or manager".

13. Executive officers of registered institutions require Monetary Authority's consent

Section 71C is amended by adding –

"(7A) Where the Monetary Authority has exercised his power under subsection (4) against an executive officer, the Monetary Authority may disclose to the public details of the decision he has made under that

subsection, the reasons for which the decision was made, and any material facts relating to the case.".

14. Revocation of approval

(1) Section 118D(1) is amended by repealing "subsection (2)" and substituting "subsections (1A) and (2)".

(2) Section 118D is amended by adding –

"(1A) The requirement in subsection (1) to consult the Financial Secretary before proposing to revoke the approval of an approved money broker shall not apply where the ground for the revocation of the approval of an approved money broker is a request in writing by the money broker to the Monetary Authority to revoke its approval.".

SCHEDULE

[s. 6]

AMENDMENTS CONSEQUENTIAL TO SECTIONS 2 TO 5 OF THIS ORDINANCE

PART 1

AMENDMENTS TO THE BANKING ORDINANCE AND ITS SUBSIDIARY LEGISLATION

Banking Ordinance

1. Interpretation

(1) The Banking Ordinance (Cap. 155) is amended, in section 2(1), by repealing the definition of "capital adequacy ratio" and substituting –

""capital adequacy ratio" (資本充足比率), in relation to an authorized institution, means the ratio of the institution's capital base to a value representing the degree of risk of the following kinds to which the institution is exposed –

(a) credit risk, that is to say, the risk of loss from –

- (i) default by counterparties in on-balance sheet and off-balance sheet items of the institution; or
 - (ii) diminution in the value of such on-balance sheet items of the institution as may for the purposes of this paragraph be prescribed by the Monetary Authority in rules made under section 98A(1);
 - (b) market risk, that is to say, the potential losses arising from fluctuations in the value of positions held by the institution –
 - (i) for trading purposes in debt securities, interest rate-related contracts, equities and equity-related contracts; and
 - (ii) in foreign exchange, exchange rate-related contracts, commodities and commodity-related contracts; and
 - (c) operational risk, that is to say, the risk of direct or indirect losses resulting from –
 - (i) inadequacies or failings in the processes or systems, or of personnel, of the institution; or
 - (ii) external events;".
- (2) Section 2(1) is amended by adding –
- ""capital base" (資本基礎), in relation to an institution, means the sum of –
- (a) the following amounts, but in each case only to the extent prescribed by the Monetary Authority in rules made under section 98A(1), namely –
 - (i) the paid-up capital of the institution;
 - (ii) the amount standing to the credit of the share premium account of the institution;

- (iii) the audited retained earnings of the institution;
and
- (iv) the published reserves of the institution; and
- (b) the amounts of such other resources of the institution as may for the purposes of this paragraph be prescribed by the Monetary Authority in rules made under section 98A(1);

"multilateral development bank" (多邊發展銀行) means any bank or lending or development body specified by the Monetary Authority under subsection (19);

"share premium account" (股份溢價帳) –

- (a) in relation to a company incorporated in Hong Kong, means a share premium account referred to in section 48B(1) of the Companies Ordinance (Cap. 32) maintained in respect of the company;
- (b) in relation to a company incorporated outside Hong Kong, means an account having the same characteristics as a share premium account referred to in section 48B(1) of the Companies Ordinance (Cap. 32) irrespective of its name;

"The DTC Association" (DTC 公會) means The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies incorporated under the Companies Ordinance (Cap. 32);

"The Hong Kong Association of Banks" (香港銀行公會) means the body corporate of that name incorporated by section 3 of The Hong Kong Association of Banks Ordinance (Cap. 364);

"Tier 1 country" (第 1 級國家) means Hong Kong and any country or place other than Hong Kong which –

- (a) is a member of the Organization for Economic Co-operation and Development; or
- (b) has concluded a special lending arrangement with the International Monetary Fund associated with the International Monetary Fund's General Arrangements to Borrow,

but excludes any such country or place which –

- (c) has rescheduled its external sovereign debt, whether to central government or non-central government creditors, within the previous 5 years; or
- (d) is specified by the Monetary Authority by notice published in the Gazette as being a country or place that is not to be regarded as a Tier 1 country for the purposes of this definition;".

(3) Section 2 is amended by adding –

"(19) The Monetary Authority may by notice published in the Gazette specify to be a multilateral development bank for the purposes of this Ordinance any bank or lending or development body established by agreement between, or guaranteed by, 2 or more countries, territories or international organizations other than for purely commercial purposes."

2. **Functions of the Monetary Authority**

Section 7(3) is amended by repealing everything after "Gazette" and substituting "guidelines indicating the manner in which he proposes to exercise functions conferred or imposed by or under this Ordinance upon him."

3. **Interpretation and application**

Section 79(2) is amended by repealing everything after "with" and substituting "rules made under section 98A(1)".

4. Limitations on advances by authorized institutions

- (1) Section 81(2)(c) is repealed and the following substituted –
 - "(c) the product of –
 - (i) the principal amount of any item that, in relation to the institution, is an off-balance sheet item for the purpose of rules made under section 98A(1); and
 - (ii) the factor specified by the Monetary Authority pursuant to subsection (3) for that item,where, in respect of that institution, the other party is,".
- (2) Section 81(6)(b)(i)(D) is amended by repealing "within the meaning of the Third Schedule".
- (3) Section 81(8)(b) is repealed and the following substituted –
 - "(b) the expression "debt securities" (債務證券) shall mean any securities other than shares, stocks or import or export trade bills;".

5. Appeals

- (1) Section 132A(1) is amended by adding –
 - "(fc) a decision of the Monetary Authority, made in the exercise of a power conferred by rules made under section 98A(1), that is a decision to which this paragraph applies by virtue of a declaration made in accordance with subsection (1A);".
- (2) Section 132A is amended by adding –
 - "(1A) Rules made under section 98A(1) conferring on the Monetary Authority power to make any decision may declare decisions made in the exercise of that power to be decisions to which subsection (1)(fc) applies.".

6. Power to amend Schedules

Section 135(3) is amended by repealing "Third,".

7. Capital adequacy ratio

The Third Schedule is repealed.

8. Liquidity ratio

(1) The Fourth Schedule is amended, in paragraph 1, by repealing the definition of "multilateral development bank".

(2) The Fourth Schedule is amended, in paragraph 1, by repealing the definition of "public sector entity in Hong Kong" and substituting –

""public sector entity in Hong Kong"(香港公營單位) means any entity specified by the Monetary Authority under paragraph 1A;"

(3) The Fourth Schedule is amended by adding –

"1A. The Monetary Authority may by notice published in the Gazette specify to be a public sector entity in Hong Kong for the purposes of this Schedule any entity established by or on behalf of the Government."

9. Minimum criteria for authorization

(1) The Seventh Schedule is amended, in paragraph 1(1), by repealing the definition of "share premium account".

(2) The Seventh Schedule is amended, in paragraph 6(d), by repealing the semicolon and substituting a full stop.

(3) The Seventh Schedule is amended by repealing paragraph 6(e).

(4) The Seventh Schedule is amended, in paragraph 11(a), by repealing "and its profit and loss" and substituting ", its profit and loss and its capital adequacy ratio".

10. Minimum criteria for approval as money broker

The Eleventh Schedule is amended, in paragraph 1(1), by repealing the definition of "share premium account".

**Specification of Factors (Financial Exposure of
Authorized Institution) Notice**

11. Repeal

The Specification of Factors (Financial Exposure of Authorized Institution) Notice (Cap. 155 sub. leg. C) is repealed.

**Banking (Specification of Public Sector Entities in
Hong Kong) Notice**

12. Repeal

The Banking (Specification of Public Sector Entities in Hong Kong) Notice (Cap. 155 sub. leg. E) is repealed.

PART 2

AMENDMENTS TO OTHER ORDINANCES

Companies Ordinance

1. Preferential payments

Section 265(6) of the Companies Ordinance (Cap. 32) (as amended by the Deposit Protection Scheme Ordinance (Cap. 581)) is amended, in the definition of "excluded person", in paragraph (c), by repealing "paragraph 1 of the Third Schedule to" and substituting "section 2(1) of".

Deposit Protection Scheme Ordinance

2. Deposits specified for purposes of definitions of "protected deposit" and "relevant deposit" in section 2(1) of this Ordinance

Schedule 1 to the Deposit Protection Scheme Ordinance (Cap. 581) is amended, in section 3, in paragraph (b) of the definition of "excluded person", by repealing "paragraph 1 of the Third Schedule to" and substituting "section 2(1) of".

Explanatory Memorandum

The main purpose of this Bill is to amend the Banking Ordinance (Cap. 155) ("the Banking Ordinance") to provide for the introduction of revised banking supervision standards following the publication in June 2004 of the report entitled "International Convergence of Capital Measurement and Capital Standards: a Revised Framework" by the Basel Committee on Banking Supervision (a committee, established by the central bank governors of the Group of Ten countries, which formulates broad supervisory standards, provides guidance and recommends best practice in the area of banking supervision). The framework contained in this report is commonly referred to as "Basel II".

2. The Bill also makes miscellaneous other amendments to the Banking Ordinance, including –
- (a) limiting the liability of managers of companies, for certain offences under that Ordinance, to cases where the contravention results from an act or omission on the part of the manager himself or of a person under his control;

- (b) introducing a defence of "reasonable excuse" for certain offence provisions under that Ordinance.

Preliminary (Part 1)

- 3. Clause 1 contains the short title and a commencement provision.

Amendments relating to public disclosure of information and to capital adequacy ratio (Part 2)

- 4. Clause 2 amends section 60A of the Banking Ordinance (this section was inserted by an amendment to the Banking Ordinance in 1999 but has not yet been brought in operation). The amendment expands the scope of the power conferred on the Monetary Authority to require the public disclosure by authorized institutions of information relating to their financial affairs, to include information relating to their capital adequacy ratio. The amendment also provides for the power conferred under that section to be exercised by means of rules made under that Ordinance instead of by notice published in the Gazette.
- 5. Clause 3 amends section 98(1) of the Banking Ordinance to provide that the capital adequacy ratio of authorized institutions shall be calculated in accordance with rules made under new section 98A of that Ordinance, instead of in accordance with the Third Schedule to that Ordinance.
- 6. Clause 4 adds new section 98A to the Banking Ordinance to provide for the Monetary Authority to make rules prescribing the manner of calculation of the capital adequacy ratio of authorized institutions.
- 7. Clause 5 amends section 101(1) of the Banking Ordinance to increase to 16 per cent the maximum ratio to which the capital adequacy ratio of an

authorized institution may be varied by the Monetary Authority under that subsection.

8. Clause 6 provides for the consequential amendments set out in the Schedule to have effect.

Other amendments (Part 3)

9. Clause 7(1) disapplies section 2(8) of the Banking Ordinance to section 14 of that Ordinance, to avoid the unintended consequence of a restricted licence bank or deposit-taking company becoming liable for holding a deposit of less than the minimum size allowed under section 14 of that Ordinance by reason only of fluctuation in foreign currency exchange rates.

10. Clause 7(2) adds new section 2(18) to the Banking Ordinance so as to limit the liability of the managers of an authorized institution for certain contraventions under that Ordinance to the case where the contravention is caused or contributed to by an act or omission on the part of the manager himself or a person under his control.

11. Clause 8 amends section 22 of the Banking Ordinance to remove the existing requirement for the Monetary Authority to consult the Financial Secretary before revoking the authorization of an authorized institution in cases where such revocation has been requested by the authorized institution itself.

12. Clause 9 amends section 58A of the Banking Ordinance to provide that the Monetary Authority may disclose to the public certain details of disciplinary action taken under that section.

13. Clause 10 amends section 59(5) of the Banking Ordinance so that a contravention of section 59(2) of that Ordinance is an offence only in the absence of reasonable excuse.
14. Clause 11 amends section 63(5) of the Banking Ordinance so that a contravention of section 63(1), or a failure to comply with a requirement under section 63(3) or (3A), of that Ordinance is an offence only in the absence of reasonable excuse.
15. Clause 12 amends section 70D(2) of the Banking Ordinance to remove it from the ambit of new section 2(18) of that Ordinance.
16. Clause 13 amends section 71C of the Banking Ordinance to provide that the Monetary Authority may disclose to the public certain details of disciplinary action taken under that section.
17. Clause 14 amends section 118D of the Banking Ordinance to remove the existing requirement for the Monetary Authority to consult the Financial Secretary before revoking the approval of an approved money broker in cases where such revocation has been requested by the money broker itself.

**Amendments consequential to sections 2 to 5
of this Ordinance (Schedule)**

18. The Schedule sets out the amendments that are consequential to the amendments effected by clauses 2 to 5 of the Bill. Part 1 of the Schedule contains amendments to the Banking Ordinance, including –
 - (a) the addition of new definitions in section 2(1) of that Ordinance consequent on the repeal of the Third Schedule to that Ordinance;

- (b) the amendment of section 7(3) of that Ordinance to provide that guidelines may be issued by the Monetary Authority in relation to the exercise of powers conferred by subsidiary legislation under the Ordinance.

Part 2 of the Schedule contains consequential amendments to other Ordinances.