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3 October 2006

Ms Salumi Chan
Clerk to Financial Affairs Panel
LegCo Financial Affairs Panel
3/F Citibank Tower
3 Garden Road
Hong Kong Monetary Authority

Dear Ms Chan

Consultation on Draft Banking (Capital) Rules

Further to my letters of 4 August and 1 September 2006 on the public consultation of the draft Banking (Capital) Rules and Banking (Disclosure) Rules respectively, I am writing to update the members of the Financial Affairs Panel (FAP) on the progress in our preparation of the Rules for the implementation of Basel II in Hong Kong.

Banking (Capital) Rules

The HKMA released draft Banking (Capital) Rules, which are being made pursuant to section 98A of the Banking Ordinance as amended by the Banking (Amendment) Ordinance 2005, for public consultation on 3 August 2006. The purpose of the Rules is to prescribe how the capital adequacy ratio (CAR) of locally incorporated authorized institutions (AIs) shall be calculated. As required under section 98A of the Ordinance, the Monetary Authority has consulted the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, Hong Kong Association of Banks, the DTC Association and the Financial Secretary on the Rules. Apart from these parties specified in the legislation, the HKMA has also specifically sought comments from a broad spectrum of society, including members of the FAP, the Consumer Council, the business community (through the trade associations and chambers of Commerce), the accounting and legal professions, and academics. The wide scope of the consultation parties is to ensure broad support and to identify issues of relevance to industry players and the general public so that they could be properly considered before the Rules are finalised. The consultation closed on 3 September 2006. In the course of the consultation, the HKMA has also conducted briefing sessions on the Rules to parties interested in the subject.

We have received around 30 sets of responses to the draft Rules, including the responses from the two industry associations and personal comments from the Assistant Legal Adviser of the Legislative Council. All the respondents were supportive to the objectives of the rule-making. The comments received have been mostly drafting comments or requests for clarification on a number of technical points. These comments are being addressed in finalising the Rules.

Banking (Disclosure) Rules

On 1 September 2006, the HKMA issued the draft Banking (Disclosure) Rules for public consultation. The purpose of the Rules, which are being made pursuant to section 60A of the Banking Ordinance as amended by the Banking (Amendment) Ordinance 2005, is to set out the minimum standards for public disclosure which AIs must make in respect of their profit and loss, state of affairs or capital adequacy. The consultation covered a wide range of parties, including many of those who were also consulted on the Banking (Capital) Rules with the addition of other interested parties such as credit rating agencies and financial analysts, and members of the Joint Technical Working Group on Financial Disclosure (which includes representatives of both the Hong Kong Stock Exchange and the Securities and Futures Commission). The consultation period ended on 23 September 2006.

We have received 20 sets of responses to the draft Rules. The respondents were supportive to the proposed Rules, recognising that they represent a pragmatic approach to the adoption of Pillar 3 while ensuring that public disclosure standards in Hong Kong continue to remain at the forefront of the region and in line with other leading international financial centres. There were no major comments on the draft Rules, other than a few requests for clarification on various specific disclosure requirements. The HKMA will address these comments in finalizing the Rules.

Legislative and Implementation Timetable

The Banking (Capital) Rules and Banking (Disclosure) Rules are subsidiary legislation and hence subject to negative vetting by the Legislative Council (LegCo). As the consultation does not reveal any substantial issues, it remains the Administration's aim to publish both sets of Rules in the Gazette in late October and table them in LegCo in early November 2006. The HKMA will set out its responses to the comments received from the public consultation in a Feedback Statement, which will be posted on the HKMA website before the Rules are published in gazette. As the Administration has decided to implement the

requirements of Basel II in Hong Kong on 1 January 2007, the Rules are intended to come into effect on 1 January 2007.

Yours sincerely

(Simon Topping)
Executive Director (Banking Policy)

c.c. FSTB (Attn: Mrs Millie Ng / Mr Clement Chan)
DoJ (Attn: Ms. Mayanna To / Mr Michael Lam / Ms. Mabel Cheung)