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Panel on Financial Affairs

Meeting on 1 March 2012

**Background brief on
market entry criteria for the banking industry**

Purpose

This paper provides background information on the market entry criteria for the banking industry, and gives an account of the review of the market entry criteria conducted in 2002.

Background

2. Under section 16(1) of the Banking Ordinance (Cap. 155) ("BO"), the Monetary Authority ("MA") has a general discretion to grant or refuse an application for authorization to carry on a business of banking or taking deposits. Under section 16(2) of BO, MA is required to refuse an application for authorization if any one or more of the criteria specified in the Seventh Schedule to BO are not fulfilled with respect to the applicant. Under section 135(1) of BO, the Chief Executive in Council may, by notice in the Gazette, amend the Seventh Schedule. The present market entry criteria specified in the Seventh Schedule are summarized as follows –

- (a) the minimum capital requirement (including paid-up share capital and balance of share premium account) - HK\$300 million for licensed banks, HK\$100 million for restricted licence banks, and HK\$25 billion for deposit-taking companies;
- (b) the minimum-size criteria – only licensed banks are required to observe these criteria which are HK\$3 million customer deposits and HK\$4 billion total assets;

- (c) in the case of an applicant incorporated outside Hong Kong, whether the applicant is a bank adequately supervised in its home country;
- (d) whether the chief executive, directors, controllers and executive officers of the applicant are “fit and proper”;
- (e) the adequacy of the systems of control for appointment of senior executives, who are referred to as “managers” under BO;
- (f) the financial soundness of the applicant, in respect of capital, liquidity and asset quality;
- (g) the adequacy of internal controls and accounting systems; and
- (h) whether the business of the applicant is, and will continue to be, carried out with integrity, prudence and competence.

Review of the market entry criteria in 2001-2002

3. The Hong Kong Monetary Authority ("HKMA") completed a review of the market entry criteria for the banking industry in December 2001, and proposed the following changes to the criteria –

- (a) to replace the US\$16 billion asset size criterion for foreign bank applicants by the size criteria for local bank applicants, viz. HK\$3 billion for deposits and HK\$4 billion for assets;
- (b) to increase the minimum capital requirement for locally incorporated banks from HK\$150 million to HK\$300 million and extending this requirement to foreign incorporated banks (in respect of the bank as a whole);
- (c) to reduce the period of operation as a restricted license bank or deposit-taking company from 10 to three years and dispensing with the “association with Hong Kong” requirement for locally incorporated applicants seeking to upgrade to licensed bank status; and
- (d) to allow foreign banks to subsidiarize their Hong Kong operations if such banks have been established in Hong Kong for at least three years and their Hong Kong operations meet the deposit and asset

size criteria applicable to local bank applicants as set out in item (a) above.

4. In December 2001, HKMA released a consultation paper on the review of the market entry criteria for the banking industry and the three-tier authorization regime for consultation with the industry associations. The consultation paper was also provided to the Panel on Financial Affairs for information. When HKMA briefed the Panel on its work on 6 May 2002, HKMA mentioned about the review and the proposed changes to the market entry criteria. A member expressed concern that relaxation in the market entry criteria might fuel competition in the market and pose new pressure on the profit margins of banks. In the circumstance, banks might be induced to engage in high-risk businesses. HKMA advised that in its supervisory process, HKMA would ensure that banks managed their risks appropriately and would closely monitor authorized institutions' ("AIs") asset quality, lending policies and business practices.

5. The Administration introduced the Banking Ordinance (Amendment of Seventh Schedule) Notice 2002 into the Legislative Council on 15 May 2002 to implement the proposed changes to the market entry criteria mentioned in paragraph 3 above. The Administration explained that the market entry criteria were introduced at different times and the banking environment had changed substantially over time. In keeping with its status as an international financial centre, Hong Kong had moved on to embrace the world trend of enhanced competition with improved market discipline and transparency, a supervisory framework of international standard, and a safety net to cope with potential problems. At the same time, the number of AIs had been dwindling for some years¹, which was partly due to the withdrawal of foreign banks after the Asian financial crisis and partly due to the ongoing trend of consolidation. In the light of the above developments, the Administration considered that relaxing some of the market entry criteria would help to enhance the breadth and depth of the financial markets in Hong Kong without compromising banking stability. In addition, some improvements could also be made to remove certain unnecessary restrictions and distinctions between local and foreign incorporated applicants in the authorization system. According to the Administration, the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, the Hong Kong Association of Banks and the DTC Association had been consulted on and all of them supported the proposed relaxations of the market entry criteria.

6. The subsidiary legislation was subject to the negative vetting procedure. It was considered by the House Committee on 17 May 2002 and the House

¹ As of December 2001, the total number of AIs in Hong Kong was 245, while the number was 382 in June 1995.

Committee decided that there was no need to form a subcommittee to study the subsidiary legislation.

Latest development

7. The Administration and HKMA will consult the Panel on Financial Affairs on a recent review of the market entry criteria for the banking industry and the proposed amendments to the Seventh Schedule to BO at the Panel meeting on 1 March 2012.

Relevant papers

8. The relevant papers are available at the following links:

Consultation paper on "Review of market entry criteria and the three-tier authorization system" published by HKMA (December 2001)	Press release Consultation paper
Meeting of the Panel on Financial Affairs on 6 May 2002	Presentation material provided by HKMA Minutes (paragraphs 16-17)
Banking Ordinance (Amendment of Seventh Schedule) Notice 2002	Legislative council brief Press release by the Hong Kong Monetary Authority
Background brief on "Banking Supervision in Hong Kong" issued by HKMA	Banking supervision in Hong Kong