For information
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Legislative Council Panel on Financial Affairs

Review of Market Entry Criteria - Proposed Amendments to the Seventh Schedule to the Banking Ordinance (Cap. 155)

PURPOSE

The Hong Kong Monetary Authority ("HKMA") has recently reviewed the market entry criteria specified in the Seventh Schedule to the Banking Ordinance ("BO") (Cap. 155) to ascertain whether they remain appropriate. This paper seeks to brief Members on the results of the review and the proposed amendments to the Seventh Schedule to the BO.

BACKGROUND

2. Paragraph 13 of the Seventh Schedule to the existing BO imposes, among other things, the following authorization criteria applicable to banks -

(a) applicants must have total customer deposits of not less than HK$3 billion and total assets of not less than HK$4 billion (known as the size criteria);

(b) for companies incorporated in Hong Kong, the applicant must either:

(i) have been a deposit-taking company ("DTC") or restricted licence bank ("RLB") (or any combination thereof) for at least three consecutive years; or

(ii) be a subsidiary of a bank or bank holding company incorporated outside Hong Kong, which has been authorized to carry on banking business in Hong Kong for at least three consecutive years (known as "the three-year requirement").

The effect of the three-year requirement is that foreign banks cannot enter the Hong Kong market through the establishment of a locally incorporated subsidiary straight away. They must first establish a branch and operate it for three continuous years before applying to incorporate locally.

3. These market entry criteria were introduced at different times against different backgrounds. They were intended to ensure that locally incorporated applicants had sufficient critical mass to be upgraded to full licensed status.

4. Following the recent review, the HKMA has come to the view that these criteria may be unnecessarily restrictive and put Hong Kong at a disadvantage when compared with other international financial centres (“IFCs”).

INTERNATIONAL PRACTICE

5. The HKMA has reviewed the licensing conditions in the UK, USA, Australia and Singapore. In general, the requirements for full licensed banks in these jurisdictions are similar to those of the HKMA in that applicants are required to meet a set of criteria aimed at ensuring they have the capacity and commitment to conduct business with integrity, prudence and competence, and adequate financial resources. However, these jurisdictions do not impose requirements similar to the size criteria applicable in Hong Kong. In addition, foreign banks wishing to establish a presence are free to enter the market by either establishing a branch or a locally incorporated subsidiary, subject to meeting all applicable requirements. There is no requirement, as in Hong Kong, to operate as a branch for a period before establishing a locally incorporated subsidiary.

6. It is therefore possible that the size criteria and the three-year requirement put Hong Kong at a disadvantage in comparison with other IFCs in attracting international banks to establish a presence here as there are no similar market entry criteria in other IFCs. Retaining these criteria may therefore put Hong Kong at a disadvantageous position.

MARKET ENTRY CRITERIA

The Size Criteria

7. The requirement to have customer deposits (excluding certain deposits) of at least HK$3 billion (or an equivalent amount in any other approved currency) effectively excludes some financial institutions from obtaining banking licences in Hong Kong because they do not take deposits as a part of their normal business. This would include well-run institutions such as major international investment banks.

8. The HKMA advises that the size criteria are not the best way to determine the financial strength of a bank. There are other, more widely accepted, measures of financial soundness (e.g. Tier-one capital and capital adequacy ratio measured according to the standards of the Basel Committee on Banking Supervision). Since all these factors are already included in the minimum authorization criteria in the Seventh Schedule, the HKMA believes that it is unlikely that removal of the size criteria would undermine the stability and effective working of the banking system in Hong Kong.

9. In the light of the above, the HKMA considers that the size criteria no longer serves a useful purpose as authorization criteria and proposes that the Seventh Schedule to the BO be revised to remove the size criteria.

The Three-Year Requirement

10. Like the size criteria, there is no equivalent to the three-year requirement in the other IFCs reviewed. Also, as noted above, for overseas banks which wish to establish a locally incorporated banking subsidiary in Hong Kong, the requirement effectively means that they must operate as branches for three continuous years before setting up the subsidiary (or operate DTCs/RLBs for three continuous years before such DTCs/RLBs can apply for full banking licences). The HKMA questions whether this restriction is necessary or desirable. It has closer supervisory control over locally incorporated institutions than over local branches of those incorporated overseas. For example, the HKMA must be satisfied that locally incorporated institutions maintain a capital adequacy ratio calculated according to the Banking (Capital) Rules under the BO. However, in the case of an institution incorporated outside Hong Kong, the HKMA will generally accept calculations of the capital ratios based on the methodology of the home supervisory provided that the methodology is in line with the Basel Capital Accord. There would be benefits, in terms of supervisory control, where overseas banks choose to enter the Hong Kong market by local incorporation rather than by establishing branches. This is particularly relevant when the overseas banks intend to conduct retail business in Hong Kong. In terms of assessing the soundness and capacity of a proposed locally incorporated subsidiary of an overseas bank, the HKMA does not find it difficult to base its assessment on the position of the parent and the resources and support the parent is prepared to make available to the subsidiary.

11. In light of the above, the HKMA proposes that the Seventh Schedule to the BO be amended to remove the three-year requirement. With this amendment, overseas banks will be free to enter the market by either establishing a branch or a locally incorporated subsidiary. This will put Hong

Kong on a par with other major IFCs.

INDUSTRY CONSULTATION

12. The HKMA has recently consulted the Banking Advisory Committee, the DTC Advisory Committee, the Hong Kong Association of Banks and the DTC Association on the proposal to remove the size criteria and the three-year requirement. They are supportive of the proposal.

WAY FORWARD

13. The proposed removal of the size criteria and three-year requirement from the Seventh Schedule will require approval of the Chief Executive in Council pursuant to section 135(1) of the BO and be subject to negative vetting by the Legislative Council. We have set in train the necessary preparatory work for the legislative amendments with a view to tabling them at the Legislative Council for negative vetting within the current legislative session.

14. We believe the above changes will help to rationalize the authorization and market entry criteria in Hong Kong and assist reputable and sound financial institutions to establish their business here. This in turn will increase the breadth and depth of the banking sector and enhance the position of Hong Kong as an IFC.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
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