LEGISLATIVE COUNCIL BRIEF

BANKING ORDINANCE (CHAPTER 155)

BANKING ORDINANCE
(AMENDMENT OF SEVENTH SCHEDULE) NOTICE 2012

INTRODUCTION

At the meeting of the Executive Council on 8 May 2012, the Council **ADVISED** and the Chief Executive **ORDERED** that, the Banking Ordinance (Amendment of Seventh Schedule) Notice 2012, at **Annex A**, should be made under section 135(1) of the Banking Ordinance to revise the market entry criteria in the banking sector as set out in paragraph 12 below.

JUSTIFICATIONS

Existing Market Entry Criteria for Banks

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

(a) an applicant 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"); and

(b) for an applicant which is a company incorporated in Hong Kong, it 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").

3. 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. Foreign banks must first establish a branch in Hong Kong and operate banking business through the branch for at least three continuous years before applying for its banking business to be carried out through a subsidiary incorporated in Hong Kong.

Review of the Market Entry Criteria

(a) International Practice

4. The Hong Kong Monetary Authority (HKMA) has reviewed the licensing conditions in the UK, USA, Germany, Switzerland, 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 their having the capacity and commitment to conduct business with integrity, prudence and competence, and adequate financial resources. However, these jurisdictions do not impose requirements on the size criteria similar to those that are applicable in Hong Kong. In addition, foreign banks wishing to establish a presence are free to enter these markets by either establishing a branch or a locally incorporated subsidiary, subject to their meeting all applicable requirements. There is no requirement, as in Hong Kong, to operate as a branch for a certain period before establishing a locally incorporated subsidiary.

5. In view of the above findings, it is possible that the size criteria and the three-year requirement may put Hong Kong at a disadvantage when compared with other IFCs in attracting international banks to establish a presence here as there are no similar market entry criteria in other IFCs covered in the HKMA's review.

(b) The Size Criteria

6. The requirement to have customer deposits (excluding certain types of deposit) 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 part of their normal business. This would include some well-run international financial institutions.

7. The size criteria have become less relevant as measures of the financial soundness of a bank. Since the HKMA's last review of the market entry criteria in 2002, tier-one capital and capital adequacy ratio measured according to the Basel standards have become the fundamental measures of a bank's financial soundness. These capital requirements are already included in the HKMA's minimum authorization criteria. Where relevant, the HKMA also seeks comments from foreign supervisors to ensure that their banks are sufficiently well-equipped to set up banking operations in Hong Kong.

8. In the light of the above, we consider that the size criteria no longer serve a useful purpose and propose that the Seventh Schedule to the BO be revised to remove them.

(c) The Three-Year Requirement

9. 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, since it has closer supervisory control over locally incorporated institutions than over local branches of those incorporated overseas[1]. There would therefore 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.

10. In light of the above, we propose 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.

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1 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.

OTHER OPTIONS

11. The size criteria and the three-year requirement are stipulated in paragraph 13 of the Seventh Schedule to the BO. Their removal therefore will entail amendments to the Seventh Schedule, which 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 (LegCo). This is the only means for effecting the removal of the size criteria and the three-year requirement, and thereby levelling the playing field for Hong Kong vis-à-vis other major IFCs.

BANKING ORDINANCE (AMENDMENT OF SEVENTH SCHEDULE) NOTICE 2012 (THE NOTICE)

12. Pursuant to section 135(1) of the BO, the Chief Executive in Council may, by notice in the Gazette, amend the Seventh Schedule. The Notice, at **Annex A**, seeks to amend paragraph 13 of the Seventh Schedule to –

(a) remove the requirement that an applicant, whether incorporated in or outside Hong Kong, in seeking an authorization to carry on banking business in Hong Kong, must have total customer deposits (excluding certain deposits) of not less than HK$3 billion (or an equivalent amount in any other approved currency) and total assets (less contra items) of not less than HK$4 billion (or an equivalent amount in any other approved currency) under the existing paragraph 13(a) of the Seventh Schedule;

(b) remove the requirement that a locally incorporated applicant must have been a DTC or RLB (or any combination thereof) for not less than three continuous years under the existing paragraph 13(b)(ii)(A) of the Seventh Schedule; and

(c) remove the requirement that a foreign bank seeking to establish a locally incorporated banking subsidiary in Hong Kong must have been authorized to carry on banking business in Hong Kong for not less than three continuous years and make any necessary transfer of deposits and assets under the existing paragraph 13(b)(ii)(B) of the Seventh Schedule.

LEGISLATIVE TIMETABLE

13. The legislative timetable is as follows –

Publication in the Gazette	18 May 2012
Tabling at LegCo	23 May 2012

IMPLICATIONS OF THE PROPOSAL

14. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. It has no financial, civil service, productivity, environmental or sustainability implications. The Notice will not affect the current binding effect of the BO.

15. The economic implications are set out at **Annex B**.

PUBLIC CONSULTATION

16. The HKMA has consulted the Banking Advisory Committee, the DTC Advisory Committee, the Hong Kong Association of Banks and the DTC Association. All of them have indicated support for the proposed amendments to the Seventh Schedule in paragraph 12 above and have not made any major comments.

17. In addition, we briefed the LegCo Panel on Financial Affairs on the proposal on 2 March 2012. Members did not raise any adverse comments. However, a Member raised questions regarding the existing measures and/or additional measures that would be introduced to regulate the incorporation of banks in Hong Kong, in order to ensure the stability of the banking sector following the removal of the size criteria and the three-year requirement. In response, we explained that such removal would not undermine the stability of the banking sector since banks seeking authorization in Hong Kong would continue to be required to meet the other licensing criteria[2] set out in the Seventh Schedule to the Ordinance. These criteria apply to institutions not only at the time of authorization but on a continuing basis. They are part of the Basel Core Principles for Effective Banking Supervision, which provide

[2] These licensing criteria include, among other things, the fitness and propriety of controllers, directors and chief executives, the adequacy of financial resources and liquidity, and the adequacy of systems and controls.

globally agreed minimum standards for banking regulation and supervision. The size criteria and the three-year requirement, however, do not form part of the Basel Core Principles. Therefore, their removal would not result in any departure from the internationally agreed minimum standards. The other licensing criteria in the Seventh Schedule to the BO, together with the HKMA's continuing supervision of authorized institutions, would ensure that institutions establishing branches or subsidiaries in Hong Kong are well-managed and financially sound. The HKMA will monitor market developments closely upon the introduction of the proposed amendments. It will also keep the market entry criteria under regular review so as to ensure that they are in line with international practices and support the stability of the banking sector in Hong Kong, without unnecessarily stifling our development as an IFC.

PUBLICITY

18. We will issue a press release upon the issuance of the LegCo Brief. HKMA will also issue a circular letter to keep the banking industry informed.

BACKGROUND

19. Under section 16(1) of the BO, the Monetary Authority (MA) has a general discretion to grant or refuse an application for authorization to carry on (a) banking business; (b) a business of taking deposits as a DTC; or (c) a business of taking deposits as an RLB in Hong Kong. Under section 16(2), the MA is required to refuse to authorize if any one or more of the criteria applicable to or in relation to the applicant specified in the Seventh Schedule to the BO are not fulfilled with respect to the applicant.

20. Most of the authorization criteria in the Seventh Schedule to the BO are aimed at ensuring that only institutions which are managed in a prudent and competent manner can gain access to the local market. They are consistent with the generally accepted features of a prudent licensing system as set out in the Basel Committee's Core Principles for Effective Banking Supervision. Apart from the general prudential criteria, an applicant seeking authorization must also satisfy various market entry criteria specified in the Seventh Schedule.

21. The market entry criteria were last reviewed in 2002. Some modifications were made following that review, which included replacing the US$16 billion asset size criterion for foreign bank applicants by the size criteria

for local banks applicants (which were HK$3 billion for total customer deposits and $4 billion for total assets); increasing 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); reducing the period of operation as an RLB or DTC from ten to three years and dispensing with the "association with Hong Kong" requirement for locally incorporated applicants seeking to upgrade to licensed bank status; and allowing foreign banks to subsidiarize their Hong Kong operations if such banks had been established in Hong Kong for at least three years and their Hong Kong operations met the deposit and asset criteria.

22. The 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, and avoid a proliferation of very small local banks. The HKMA has recently completed a review of these criteria in the light of present-day circumstances and international practices, and come to the view that some of these criteria may be unnecessarily restrictive and put Hong Kong at a disadvantage when compared with other IFCs. The removal of the size criteria and the three-year requirement is therefore proposed.

ENQUIRIES

23. For any enquiries relating to the Brief, please contact Mr Jackie Liu, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) at 2810 2067, or Mr Raymond Lam, Senior Manager (Licensing), Hong Kong Monetary Authority, at 2878 1509.

Financial Services Branch
Financial Services and the Treasury Bureau
16 May 2012

Annex A

Banking Ordinance (Amendment of Seventh Schedule) Notice 2012

(Made by the Chief Executive in Council under section 135(1) of the Banking Ordinance (Cap. 155))

1. Commencement

This Notice comes into operation on 12 July 2012.

2. Banking Ordinance amended

The Banking Ordinance (Cap. 155) is amended as set out in section 3.

3. Seventh Schedule amended (minimum criteria for authorization)

(1) Seventh Schedule, paragraph 1—

Repeal subparagraph (6).

(2) Seventh Schedule—

Repeal paragraph 13

Substitute

"13. If the company seeking authorization to carry on banking business in Hong Kong is a company incorporated in a place outside Hong Kong, either—

(a) there is, in the opinion of the Monetary Authority, an acceptable degree of reciprocity in respect of banks incorporated in Hong Kong seeking to carry on banking business in that place; or

(b) that place is, or is part of the territory of, a member of the World Trade Organization.".

Clerk to the Executive Council

COUNCIL CHAMBER

2012

Explanatory Note

The main purpose of this Notice is to amend the Seventh Schedule (***Schedule***) to the Banking Ordinance (Cap. 155) to remove—

(a) the requirement of a company seeking authorization to carry on banking business in Hong Kong to have total customer deposits (excluding certain types of deposit) of not less than $3,000,000,000 and total assets (less contra items) of not less than $4,000,000,000 under the existing paragraph 13(a) of the Schedule;

(b) the requirement of a locally incorporated company seeking authorization to carry on banking business in Hong Kong to have been a deposit-taking company or a restricted licence bank (or any combination of the two) for not less than 3 continuous years under the existing paragraph 13(b)(ii)(A) of the Schedule; and

(c) the requirement of a foreign bank seeking to establish a locally incorporated subsidiary to carry on banking business in Hong Kong to have been authorized to carry on banking business in Hong Kong for not less than 3 continuous years and make any necessary transfer of deposits and assets under the existing paragraph 13(b)(ii)(B) of the Schedule.

Annex B

Economic Implications

The proposed changes to the market entry criteria would make it easier for domestic and international institutions to participate in the Hong Kong financial markets as full licensed banks. It would be conducive to enhancing the status of Hong Kong as an international financial centre.