

**立法會**  
**Legislative Council**

LC Paper No. LS39/12-13

**Paper for the House Committee Meeting  
on 19 April 2013**

**Legal Service Division Report on  
Subsidiary Legislation Gazetted on 12 April 2013**

**Date of tabling in LegCo** : 17 April 2013

**Amendment to be made by** : 15 May 2013 (or 5 June 2013 if  
extended by resolution)

**PART I    SUBSIDIARY    LEGISLATION    ON    BANKING  
ORDINANCE**

**Banking Ordinance (Cap. 155)**

**Banking (Capital) Rules (Cap. 155 sub. leg. L)**

**Banking (Capital) (Amendment) Rules 2013    (L.N. 51)**

**Banking (Disclosure) Rules (Cap. 155 sub. leg. M)**

**Banking (Disclosure) (Amendment) Rules 2013    (L.N. 52)**

**Background**

The Banking (Amendment) Bill 2011 was passed by the Legislative Council on 29 February 2012 and gazetted as the Banking (Amendment) Ordinance 2012 (3 of 2012) (BAO) on 9 March 2012. It amends the Banking Ordinance (Cap. 155) (BO) to provide for the framework for implementing in Hong Kong the revised regulatory capital, disclosure and liquidity standards promulgated by the Basel Committee on Banking Supervision (BCBS) (known as "Basel III").

2. The relevant sections of the BAO which amend the powers of the Monetary Authority (MA) to make rules to prescribe capital and disclosure requirements for authorized institutions (AIs) in Hong Kong came into operation on 1 January 2013 (L.N. 158 of 2012). On the same day, the Banking (Capital) (Amendment) Rules 2012 (L.N. 156 of 2012) (BCAR 2012), which amended the Banking (Capital) Rules (Cap. 155

sub. leg. L) (BCR), also came into operation to implement in Hong Kong the first phase of the new Basel III capital framework. According to paragraph 3 of the LegCo Brief (File Ref: G4/16/44C) issued by the Financial Services and the Treasury Bureau and the Hong Kong Monetary Authority on 10 April 2013, the BCAR 2012 have revised the minimum capital ratio requirements applicable to AIs, tightened the criteria for instruments to be recognized as regulatory capital, and extended the risk coverage of the capital framework in relation to counterparty credit risk (CCR) to capture potential loss due to credit valuation adjustment (CVA) risk and exposures to central counterparties (CCPs). Members may refer to the LegCo Brief for further details.

L.N. 51

3. L.N. 51 is made by MA under section 97C of the BO after consultation with the Financial Secretary (FS), the Banking Advisory Committee (BAC), the Deposit-taking Companies Advisory Committee (DTCAC), The Hong Kong Association of Banks (HKAB) and The DTC Association (DTCA) to further amend the BCR by incorporating the requirements of the latest technical guidance documents released by BCBS in November and December 2012 to clarify certain capital treatments for CCR and exposures to CCPs. According to the Explanatory Note to L.N. 51, the further amendments include those which reflect the requirements set out in the documents entitled "Basel III counterparty credit risk and exposures to central counterparties – Frequently asked questions" published by BCBS in December 2012, and "International Convergence of Capital Measurement and Capital Standards – A Revised Framework (Comprehensive Version)" published by BCBS in June 2006 (ICCMCS 2006). The major amendments to the BCR include:

- (a) amendments to clarify that an AI may, in its regulatory capital calculation, substitute the risk-weight of a CCP for the risk-weight that would otherwise apply to a loan exposure where the AI hedges that exposure with a recognized credit default swap (CDS) cleared through that CCP (sections 100, 101, 134, 135, 215 to 217, 265 and 278);
- (b) amendments on the use of option contracts on CDS and short positions in bonds to hedge CVA risk, and the clarification of how AIs may recognize the credit risk mitigating effect of collateral under the standardized CVA method of calculating capital charges (sections 203, 226P and 226S);

- (c) amendments to clarify the conditions for hedging instruments to be regarded as eligible hedges of CVA risk and the requirements to be complied with by an AI that has over-hedged the CVA risk for a counterparty with an eligible CVA hedge (section 226T);
- (d) amendments to clarify how the effect of credit risk mitigation is taken into account in the calculation of capital charges for exposures arising from transactions cleared by CCPs, and the capital treatment for collateral posted by AIs with CCPs (sections 226V, 226X, 226Z, 226ZD and 226ZE);
- (e) amendments to clarify the provisions on the use of a credit derivative contract booked in an AI's trading book to offset the market risk capital charge for specific risk calculated for the AI's trading book position in the underlying exposure or in another credit derivative contract (sections 308 to 311); and
- (f) the transitional arrangements for the treatment of certain capital deductions and capital instruments.

L.N. 52

4. L.N. 52 is made by MA under section 60A of the BO after consultation with FS, BAC, DTCAC, HKAB and DTCA to amend the Banking (Disclosure) Rules (Cap. 155 sub. leg. M) (BDR). The BDR prescribe the information to be disclosed to the general public by AIs relating to their state of affairs, profit and loss or capital adequacy ratio, and the manner in which and periods during which such information shall be disclosed.

5. According to the Explanatory Note to L.N. 52, the amendments to the BDR include those which reflect the disclosure requirements set out in Table 8 in ICCMCS 2006 and a document entitled "Composition of capital disclosure requirements – Rules text" published by BCBS in June 2012. The amendments to the BDR include:

- (a) amendments to reflect the wider scope of disclosure requirements prescribed in section 60A(1) of the BO (as amended by the BAO) to cover capital and liquidity resources under the Basel III framework (sections 5 and 11);

- (b) amendments to implement the enhanced disclosure requirements under Basel III in respect of an AI's capital base set out in the returns relating to capital adequacy submitted to MA in respect of the interim and annual reporting periods (sections 6, 14, 18, 24, 33 and 45);
- (c) amendments to incorporate recent BCBS disclosure standards for calculating the market risk capital charge of AIs for the purpose of promoting sound risk management practices in AIs (sections 52, 61, 70 and 83);
- (d) amendments to incorporate disclosure requirements relating to capital charges under the internal models (counterparty credit risk) (IMM(CCR)) approach introduced under the BCAR 2012 for the calculation of an AI's capital requirement for its default risk exposures under the Basel III enhanced CCR framework (sections 58 and 80); and
- (e) various consequential amendments to reflect changes made under the BCAR 2012.

6. L.N. 51 and L.N. 52 will come into operation on 30 June 2013. According to the LegCo Brief, jurisdictions should give effect to the new disclosure requirements by this date to align with the BCBS timetable.

7. According to paragraph 14 of the LegCo Brief, MA has closely engaged the industry in a consultative process in formulating L.N. 51 and L.N. 52. In accordance with sections 60A and 97C of the BO, MA issued a draft of the provisions of the two sets of rules to consult FS, BAC, DTCAC, HKAB and DTCA in November 2012 and March 2013 before finalizing the amendments. According to the Administration, responses indicated support for the amendments.

8. As advised by the Clerk to the Panel on Financial Affairs, at the meeting of the Panel on 4 June 2012, some members expressed concern about whether banks, in particular small and medium-sized institutions, would incur additional costs in complying with the Basel III standards.

## **PART II COMMENCEMENT NOTICE**

### **Residential Care Homes (Persons with Disabilities) Ordinance (Cap. 613)**

### **Residential Care Homes (Persons with Disabilities) Ordinance (Commencement) Notice 2013 (L.N. 53)**

9. By L.N. 53, the Secretary for Labour and Welfare (SLW) appoints 10 June 2013 as the day on which Part 2 (i.e. sections 4 to 6) of the Residential Care Homes (Persons with Disabilities) Ordinance (Cap. 613) (the Ordinance) comes into operation.

10. The Residential Care Homes (Persons with Disabilities) Bill (enacted as the Ordinance) was passed by the Legislative Council on 16 June 2011 and the enacted Ordinance was published in the Gazette on 24 June 2011. The Ordinance provides for the control of residential care homes for persons with disabilities (RCHDs) through a licensing scheme administered by the Director of Social Welfare (DSW). The Ordinance (except Part 2), together with the Residential Care Homes (Persons with Disabilities) Regulation (L.N. 111 of 2011) made by SLW under section 24 of the Ordinance to stipulate the requirements for the operation, management and supervision of RCHDs, came into operation on 18 November 2011 (L.N. 112 of 2011). Part 2 of the Ordinance, which is to come into operation on 10 June 2013, makes it an offence for anyone to operate, keep, manage or control a RCHD without a licence or certificate of exemption (CoE). The maximum penalty is a fine at level 6 (i.e. \$100,000) and imprisonment for 2 years, and a further fine of \$10,000 per day in the case of a continuing offence.

11. According to paragraph 3 of the LegCo Brief (File Ref. LWB 9/3939/97) issued by the Labour and Welfare Bureau on 10 April 2013, the commencement of Part 2 of the Ordinance has been delayed to provide for a grace period of 18 months after the commencement of the other parts of the Ordinance to allow sufficient time for individual RCHDs to put in place suitable arrangements for application for a new licence or CoE and for DSW to process the applications.

12. According to the Clerk to the Panel on Welfare Services, when the Panel was updated on the latest progress of the implementation of the licensing scheme for RCHDs at its meeting on 16 April 2013, the Administration informed members that L.N. 53 would be tabled in Council on 17 April 2013 and that 10 June 2013 would be the day for the full implementation of the licensing scheme. Members expressed

concern about the difficulties of private RCHDs in complying with the licensing requirements. They urged the Administration to provide more support to private RCHDs such as increasing the percentage of purchased places under the Pilot Bought Place Scheme. The Administration was also requested to ensure a proper displacement of residents of RCHDs which had not applied for licences/CoEs or had indicated their intention to cease operation.

### **PART III LEGAL NOTICE NOT REQUIRED TO BE TABLED**

#### **United Nations Sanctions Ordinance (Cap. 537)**

#### **United Nations Sanctions (Democratic People's Republic of Korea) Regulation (Cap. 537 sub. leg. AE)**

#### **United Nations Sanctions (Democratic People's Republic of Korea) (Amendment) Regulation 2013 (L.N. 54)**

13. L.N. 54 is made by the Chief Executive under section 3 of the United Nations Sanctions Ordinance (Cap. 537) (UNSO) on the instruction of the Ministry of Foreign Affairs of the People's Republic of China and after consultation with the Executive Council. It amends the United Nations Sanctions (Democratic People's Republic of Korea) Regulation (Cap. 537 sub. leg. AE) (the principal Regulation) to give effect to Resolution 2087 (2013) as adopted by the Security Council of the United Nations (UNSC) on 22 January 2013 in view of the launch using ballistic missile technology by the Democratic People's Republic of Korea (DPRK) on 12 December 2012.

14. The principal Regulation, which was previously amended in 2010 and 2012, prohibits, among other matters, the direct or indirect supply, sale or transfer of specified items and luxury goods to DPRK, the procurement of specified items from DPRK, and the provision of technical training, service, assistance or advice related to the provision, manufacture, maintenance or use of specified items to a person connected with DPRK. L.N. 54 amends the definition of "specified item" in section 1 of the principal Regulation to cover any item, material, equipment, goods or technology set out in the following documents:

- (a) the International Atomic Energy Agency document INFCIRC/254/Rev. 11/Part 1<sup>1</sup>;

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<sup>1</sup> Available at <http://www.iaea.org/Publications/Documents/Infcircs/2012/infcirc254r11p1.pdf> (accessed on 12 April 2013).

- (b) the International Atomic Energy Agency document INFCIRC/254/Rev. 8/Part 2<sup>2</sup>; and
- (c) the Security Council document S/2012/947<sup>3</sup>.

Section 32 of the principal Regulation is also amended to require these documents to be made available at the office of the Director-General of Trade and Industry for inspection by the public. L.N. 54 further makes textual amendments to the principal Regulation to simplify its language.

15. L.N. 54 came into operation upon gazettal on 12 April 2013. Members may refer to the LegCo Brief (no reference provided) issued by the Commerce and Economic Development Bureau in April 2013 for further information.

16. Under section 3(5) of UNSO, sections 34 and 35 of the Interpretation and General Clauses Ordinance (Cap. 1) shall not apply to regulations made under UNSO. Accordingly, L.N. 54 is not subject to amendment by the Legislative Council. However, it comes within the terms of reference of the Subcommittee to Examine the Implementation in Hong Kong of Resolutions of the United Nations Security Council in relation to Sanctions (the Subcommittee). An information paper prepared by the Administration on L.N. 54 was circulated to members of the Subcommittee and all other Members vide LC Paper No. CB(1)848/12-13(01) on 15 April 2013. As advised by the Clerk to the Subcommittee, the Subcommittee will study L.N. 54 at its meeting to be held on 30 April 2013.

### **Concluding observations**

17. The Legal Service Division is scrutinizing L.N. 51 and L.N. 52 and will make a further report, if necessary. No difficulties have been identified in the legal or drafting aspects of L.N. 53 and L.N. 54.

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17 April 2013

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<sup>2</sup> Available at <http://www.iaea.org/Publications/Documents/Infcircs/2010/infcirc254r8p2.pdf> (accessed on 12 April 2013).

<sup>3</sup> Available at <http://www.un.org/sc/committees/1737/pdf/S2012947.pdf> (accessed on 12 April 2013)