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Legal Service Division Report on
Subsidiary Legislation and Non-Legislative Instrument
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Amendment to be made by : 21 November 2012 (or 12 December 2012 if extended by resolution)

PART I BANKING - FIRST PHASE IMPLEMENTATION OF BASEL III

Banking Ordinance (Cap. 155)
Banking (Capital) (Amendment) Rules 2012 (L.N. 156)
Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2012 (L.N. 157)
Banking (Amendment) Ordinance 2012 (Commencement) Notice 2012 (L.N. 158)

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 and liquidity standards promulgated by the Basel Committee on Banking Supervision (BCBS)[1] (Basel III). Under section 1(2) of BAO, BAO comes into operation on a day to be appointed by the Secretary for Financial Services and the Treasury (SFST) by notice published in the Gazette.

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[1] BCBS is an international standard-setting body which promotes sound standards of banking supervision globally. Its members come from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.

2. Basel III is designed to further enhance the resilience of banks and banking systems and address weaknesses observed in the recent global financial crisis. It was endorsed by the G20 Leaders in November 2010. The Administration considers that it is incumbent upon Hong Kong, a major international financial centre and a member of BCBS, to adopt the internationally agreed timeline. Implementation should begin in January 2013, with the standards being phased-in over the subsequent six years to achieve full implementation by 1 January 2019.

Banking (Amendment) Ordinance 2012 (Commencement) Notice 2012 (L.N. 158)

3. By L.N. 158 made under section 1(2) of BAO, SFST has appointed 1 January 2013 as the day on which the following provisions of BAO come into operation -

(a) sections 1, 2, 3(1), (2) and (3), 4, 5(1), 6, 7, 9, 10, 11, 18(1), (2) and (4), 19, 20, 21 and 22;

(b) section 3(5) (except in so far as it relates to the addition of the new definition of liquidity requirement rule);

(c) section 8 (except in so far as it relates to the addition of the new Part XVIB and to the new section 97H(1) in the new Part XVIC);

(d) section 12 (except in so far as it relates to the new sections 97H(5), 97J(3) and 97K(7));

(e) section 15(2) (except in so far as it relates to section 104(2) of BO); and

(f) section 15(3) (except in so far as it relates to liquidity ratio and section 105(1) of BO).

4. The above BAO provisions amend the powers of the Monetary Authority (MA) to make rules to prescribe capital requirements for authorized institutions (AIs) in Hong Kong and disclosure requirements[2] for AI, and confer powers on MA to approve codes of practice to provide guidance in respect of those rules. Further, these BAO provisions prescribe the procedure for remedial action to be taken by an AI which has contravened these requirements, and provide for the Banking Review Tribunal to review certain decisions made by MA in this connection.

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[2] According to the Administration, MA intends to make the Banking (Disclosure) (Amendment) Rules 2013, in the form of subsidiary legislation, in the first quarter of 2013 to prescribe the disclosure requirements associated with the new capital requirements. The relevant disclosure requirements will take effect from 30 June 2013 in order to align with the latest implementation timetable promulgated by BCBS.

Banking (Capital) (Amendment) Rules 2012 (L.N. 156)

5. The Banking (Capital) Rules (Cap. 155 sub. leg. L) (BCR) currently prescribe the manner in which the capital adequacy ratio of an AI incorporated in Hong Kong is to be calculated.

6. L.N. 156, which has been made by MA under section 97C of BO as amended by BAO after consultation with the Financial Secretary, the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, The Hong Kong Association of Banks and The DTC Association, amends BCR for implementation of Basel III capital requirements and the major amendments include -

(a) Amendments to the minimum capital ratio requirements and the definition of regulatory capital

(i) new Part 1A is added to redefine the term "capital adequacy ratio" to mean, in relation to an AI, the AI's Common Equity Tier 1 capital ratio, Tier 1 capital ratio and Total capital ratio and to prescribe these three new minimum capital adequacy ratios applicable to AI from year 2013 onwards;

(ii) with respect to the determination of capital base of an AI, new sections 38, 39 and 40 and Schedules 4A, 4B and 4C are added to tighten the qualifying criteria for Common Equity Tier 1, Additional Tier 1 and Tier 2 capital;

(iii) new sections 43 to 48 and Schedules 4E, 4F and 4G are added to prescribe the regulatory deductions to be made in determining an AI's capital base; deductions can broadly be categorized into two groups, namely, items that ultimately may not provide a bank with loss absorbent capital to the extent of their accounting value (such as goodwill and other intangibles) and items that inflate regulatory capital within the financial system by virtue of their double-gearing effect (such as investments in own capital instruments and reciprocal cross-holdings in the capital of financial institutions);

(iv) new Schedule 4H provides for the transitional arrangements for the phasing-in of the above requirements;

(b) Enhancements to the counterparty credit risk (CCR) framework

new Part 6A is added to provide for the rules on the calculation of CCR and the key elements include -

(i) introduction of an approach which allows the use of internal models to calculate CCR exposures (new sections 10A to 10D and 226C to 226M and Schedule 2A);

(ii) strengthening of the collateral management standards (amendments to sections 77, 79, 80, 124, 125 and 139);

(iii) a revised capital framework for exposures to central counterparties (including lower risk weights for certain exposures to central counterparties that satisfy specified eligibility criteria) (new sections 16A and 226U to 226ZE);

(c) Other technical amendments

(i) the capital treatment for securities financing transactions is refined in order to clarify the requirements in respect of the CCR exposures arising from margin lending, securities lending and repurchase transactions (amendments to sections 75, 76, 122, 123 and 202 and new sections 76A and 123A); and

(ii) further clarifications of the policy intent of certain provisions are made, ambiguity in the existing rules are addressed and alignment with the banking supervisory standards relating to capital issued by BCBS are effected (amendments to sections 77, 88, 89, 100, 124, 134, 149, 216, 217, 225, 226, 272, 273 and 318).

7. L.N. 156 will come into operation on 1 January 2013.

Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2012 (L.N. 157)

8. Under section 2(19) of BO, MA may by notice published in the Gazette specify to be a multilateral development bank for the purposes of BO any bank or lending or development body established by agreement between, or guaranteed by, two or more countries, territories or international organizations other than for purely commercial purposes.

9. There are currently 13 multilateral development banks and the list is contained in the Banking (Specification of Multilateral Development Bank) Notice (Cap. 155 sub. leg. N) (Principal Notice). Exposures to multilateral development banks will be treated more favourably for the purposes of calculating the capital adequacy ratio and liquidity ratio of an AI under BO and BCR.

10. According to paragraphs 11 and 22 of the LegCo Brief (File Ref: G4/16/44C) dated 17 October 2012 issued by the Financial Services and the Treasury Bureau and the Hong Kong Monetary Authority, BCBS made a decision in May 2010 to include the Multilateral Investment Guarantee Agency (MIGA), which is a member of the World Bank Group, in the list of multilateral development banks for the purposes of the Basel capital framework.

11. To implement the decision of BCBS, L.N. 157, which has been made by MA, amends the Principal Notice to specify MIGA as a multilateral development bank for the purposes of BO.

12. L.N. 157 will come into operation on 1 January 2013.

Other points

13. Members may refer to the LegCo Brief for further information in relation to Basel III and its implementation in Hong Kong.

14. According to paragraph 27 of the LegCo Brief, the Hong Kong Monetary Authority has engaged in a series of discussions, meetings and exchanges of correspondence with the industry as part of the consultative process to formulate L.N. 156. MA also issued a draft of the provisions of L.N. 156 to consult the persons as specified in section 97C of BO in August and September 2012. It is reported that responses have indicated support for the direction of the amendments and that MA has addressed relevant technical or drafting comments in the finalized rules as appropriate and clarified the intent of certain provisions.

15. The Panel on Financial Affairs was briefed on the legislative proposals for implementation in Hong Kong of Basel III at its meeting on 4 June 2012. At the meeting, some members expressed concern about whether additional costs would be incurred by AI, in particular small and medium-sized AI, in complying with Basel III.

16. The Legal Service Division is still scrutinizing the legal and drafting aspects of L.N. 156 and will make a further report if necessary. No difficulties have been identified in relation to the legal or drafting aspects of L.N. 157 and 158.

PART II DOUBLE TAXATION RELIEF

Inland Revenue Ordinance (Cap. 112)
Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with respect to Taxes on Income) (Malaysia) Order (L.N. 159)
Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with respect to Taxes on Income) (United Mexican States) Order (L.N. 160)

17. L.N. 159 and L.N. 160 are made by the Chief Executive (CE) in Council under section 49(1A) of the Inland Revenue Ordinance (Cap. 112) to give effect to the following comprehensive agreements for avoidance of double taxation (CDTA) respectively -

(a) the Agreement between the Government of the Hong Kong Special Administrative Region of the People's Republic of China (HKSAR) and the Government of Malaysia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income signed on 25 April 2012 (the Malaysian Agreement); and

(b) the Agreement between the Government of HKSAR and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income signed on 18 June 2012 (the Mexican Agreement).

18. Under section 49(1A) of Cap. 112, CE in Council may, by order, declare that arrangements have been made with the government of any territory outside Hong Kong with a view to affording relief from double taxation in relation to income tax and any similar tax imposed by the laws of that territory.

19. According to the LegCo Briefs (file ref: TsyB R 183/800-1-1/50/0 (C) and TsyB R 183/800-1-1/38/0 (C)) issued by the Financial Services and the Treasury Bureau (FSTB) on 17 October 2012, while a local resident's income derived from sources outside Hong Kong would not be taxed in Hong Kong and hence would not be subject to double taxation, double taxation may occur where a foreign jurisdiction taxes its own residents' income derived from Hong Kong. Although many jurisdictions provide their residents with unilateral tax relief for the Hong Kong tax they paid on income derived from Hong Kong, the existence of a CDTA will provide enhanced certainty and stability for the elimination of double taxation. Besides, the tax relief provided under a CDTA may exceed the level provided unilaterally by a tax jurisdiction.

20. For the purposes of section 49(1A) of Cap. 112, it is respectively declared in L.N. 159 and L.N. 160 that the following arrangements have been made with a view to affording relief from double taxation in relation to income tax and any similar tax, and that it is expedient that those arrangements should have effect -

(a) the arrangements specified in Articles 1 to 29 of the Malaysian Agreement and Paragraphs 1 to 4 of the protocol thereto; and

(b) the arrangements specified in Articles 1 to 29 of the Mexican Agreement and Paragraphs 1 to 13 of the protocol thereto.

21. Upon such declaration, the arrangements have effect in relation to tax under Cap. 112 despite anything in any enactment and, for the purposes of any provision of those arrangements that requires disclosure of information concerning tax of the relevant jurisdictions, have effect in relation to any tax of those jurisdictions that is the subject of that provision.

22. The provisions in the Malaysian Agreement and the Mexican Agreement set out the allocation of taxing rights between HKSAR and the respective jurisdictions and the relief on tax rates on different types of income. Each Agreement contains provisions based on the model text of the Organisation for Economic Cooperation and Development 2004 version of the Exchange of Information Article (sample EoI Article) annexed to LC Paper No. CB(1)106/09-10(02) which was presented to the Bills Committee on Inland Revenue (Amendment) (No. 3) Bill 2009. According to the LegCo Briefs, the Malaysian Agreement and the Mexican Agreement have adopted all the safeguards in the sample EoI Article. It is noted that each Agreement (or its protocol) provides that information should only be exchanged upon request (i.e. no automatic or spontaneous exchange), that the requested information must be foreseeably relevant, and that the information must be disclosed only to the tax authorities and not their oversight bodies nor any third jurisdiction.

23. The Malaysian Agreement and the Mexican Agreement are respectively the twenty-fourth and twenty-fifth CDTA concluded by Hong Kong with other jurisdictions.

24. L.N. 159 and 160 will come into operation on 14 December 2012.

25. The Panel on Financial Affairs has not been consulted on the above subsidiary legislation.

PART III DESIGNATION OF FREQUENCY BANDS AND DETERMINATION OF SPECTRUM UTILIZATION FEES

Telecommunications Ordinance (Cap. 106)
Telecommunications (Determining Spectrum Utilization Fees by Auction) (Amendment) Regulation 2012 (L.N. 161)
Telecommunications (Designation of Frequency Bands subject to Payment of Spectrum Utilization Fee) (Amendment) Order 2012 (L.N. 162)

26. Under section 32I(1) of the Telecommunications Ordinance (Cap. 106), subject to the consultation requirement under section 32G(2), the Communications Authority may by order designate the frequency bands within which the use of spectrum is subject to the payment of spectrum utilization fee by the users of the

spectrum. Under section 32I(2) of Cap. 106, the Secretary may by regulation prescribe the level of spectrum utilization fees or the method for determining the spectrum utilization fees, which may be by auction or tender or such method as the Secretary thinks fit.

27. The Telecommunications (Designation of Frequency Bands Subject to Payment of Spectrum Utilization Fee) Order (Cap. 106 sub. leg. Y) provides that the frequency bands set out in the Schedule thereto are designated as the frequency bands within which the use of spectrum is subject to the payment of spectrum utilization fee by the users of the spectrum. L.N. 162 adds a new Part 4A to Cap. 106Y in order to designate an additional frequency band, namely, MHz 2635-2660, within which the use of spectrum is subject to the payment of spectrum utilization fee. L.N. 161 includes the new Part 4A (as provided by L.N. 162) in the Telecommunications (Determining Spectrum Utilization Fees by Auction) Regulation (Cap. 106 sub. leg. AC) for the purpose of providing auction as the method for determining the spectrum utilization fee.

28. Members may refer to the LegCo Brief (ref: CTB(CR)7/10/7) issued by the Commerce and Economic Development Bureau dated 17 October 2012 for background of L.N. 161 and L.N. 162. At the meeting of the Information, Technology and Broadcasting Panel on 9 January 2012, the Administration briefed members on the consultation exercise concerning the assignment of the available radio spectrum in the 2.5/2.6 GHz band for wireless broadband services. Panel members raised no objection to the Administration's proposals to designate the concerned spectrum for use subject to the payment of the spectrum utilization fee and to let the spectrum utilization fee be set by auction.

29. L.N. 161 and L.N. 162 will come into operation on 14 December 2012.

PART IV LIFTS AND ESCALATORS ORDINANCE - COMMENCEMENT NOTICES

Lifts and Escalators (General) Regulation (L.N. 75 of 2012)
Lifts and Escalators (General) Regulation (Commencement) Notice (L.N. 163)

Lifts and Escalators (Fees) Regulation (L.N. 76 of 2012)
Lifts and Escalators (Fees) Regulation (Commencement) Notice (L.N. 164)

Lifts and Escalators Ordinance (8 of 2012)
Lifts and Escalators Ordinance (Commencement) (No. 2) Notice 2012 (L.N. 165)
Lifts and Escalators Ordinance (Commencement) (No. 3) Notice 2012 (L.N. 166)

30. The Lifts and Escalators Ordinance (8 of 2012) (Cap. 618) was enacted

in April 2012 to provide for the safety of lifts and escalators, including the registration of contractors, engineers and workers for the purposes of carrying out lift works and escalator works and to provide for consequential, incidental and related matters.

31. The preliminary provisions for the implementation of Cap. 618 have already been brought into operation in May 2012 by L.N. 85 of 2012. On 4 May 2012, the Lifts and Escalators (General) Regulation (L.N. 75 of 2012) and the Lifts and Escalators (Fees) Regulation (L.N. 76 of 2012), which were made for the implementation of Cap. 618, were gazatted. By L.N. 163 and L.N. 164, the Secretary for Development appoints 17 December 2012 as the day on which L.N. 75 and L.N. 76 will come into operation.

32. By L.N. 165, the Secretary for Development appoints 17 December 2012 as the day on which the uncommenced provisions of Cap. 618, other than the following, will come into operation -

(a) section 9(4) (in so far as it relates to the contravention of section 9(2)) (a person must not use or operate a lift if there is no use permit in force in respect of the lift);

(b) section 13(4) (in so far as it relates to the contravention of section 13(2)) (the responsible person for a lift must ensure that the lift is not used or operated if there is no use permit in force in respect of the lift);

(c) section 39(3) (contravention of the requirements for display of use permits in respect of lifts);

(d) section 43(4) (in so far as it relates to the contravention of section 43(2)) (a person must not use or operate an escalator if there is no use permit in force in respect of the escalator);

(e) section 45(4) (in so far as it relates to the contravention of section 45(2)) (the responsible person for an escalator must ensure that the escalator is not used or operated if there is no use permit in force in respect of the escalator);

(f) section 69(2) (contravention of the requirements for display of use permits in respect of escalators); and

(g) sections 8(2), 9(2) and 11 to 26 of Schedule 16 (consequential amendments with respect to construction workers).

33. By L.N. 166, the uncommenced provisions of Cap. 618 as set out in subparagraphs (a) to (f) above will come into operation on 2 April 2013. There remains uncommenced provisions set out in subparagraph (g).

34. The Administration's plan to implement the provisions of Cap. 618 by phases has been explained in its letter to the Legal Service Division dated 8 May 2012 (attachment to LC Paper LS60/11-12). As for the reasons for the deferred commencement of the provisions as set out in subparagraph (g) above, the Legal Service Division and Clerk to the Development Panel have enquired with the Administration. According to the Administration, the relevant provisions are for terminating the transitional arrangements in respect of the qualification requirements for registration as a registered lift/escalator engineer or a registered lift/escalator worker under Cap. 618 and they will come into operation on a further date to be appointed by the Secretary for Development. The transitional arrangements are provided so that the enactment of Cap. 618 would not affect the livelihood of the existing engineers/workers and the industry would have sufficient human resources to provide services. The Administration has not yet fixed the schedule for terminating the transitional arrangements because of the need to take into account the above impacts after the main provisions of Cap. 618 are brought into operation. The transitional arrangements have been discussed at the Bills Committee meetings of the Lifts and Escalators Bill (please see paragraphs 22 to 24 and 39 to 44 of the Report of the Bills Committee (LC Paper No. CB(1)1117/11-12).

35. The Development Panel has not been consulted on the proposals contained in L.N. 163, 164, 165 and 166.

PART V MEDIATION ORDINANCE - COMMENCEMENT NOTICE

Mediation Ordinance (15 of 2012)
Mediation Ordinance (Commencement) Notice (L.N. 167)

36. The Mediation Ordinance (15 of 2012), which was enacted in June 2012, provides a regulatory framework in respect of certain aspects of the conduct of mediation and to make consequential and related amendments.

37. L.N. 167 appoints 1 January 2013 as the day on which the Mediation Ordinance will come into operation.

38. The Panel of the Administration of Justice and Legal Services has not been consulted on L.N. 167.

PART VI NON-LEGISLATIVE INSTRUMENT

Air Pollution Control Ordinance (Cap. 311)
Third Technical Memorandum for Allocation of Emission Allowances in Respect of Specified Licences (S.S. No. 5 to Gazette No. 42/2012)

39. The Third Technical Memorandum for Allocation of Emission Allowances in Respect of Specified Licences is issued by the Secretary for the Environment under section 26G of the Air Pollution Control Ordinance (Cap. 311).

40. This Technical Memorandum seeks to allocate from the emission year of 2017 the quantities of emission allowances for the three specified pollutants, namely sulphur dioxide (SO_2), nitrogen oxides (NO_x) and respirable suspended particulates (RSP) for each of the power plants in Hong Kong. The allowances are reduced from those allowed under the Second Technical Memorandum issued in 2010. This Technical Memorandum further requires the emission allowances to be reviewed not less than once every two years.

41. By virtue of section 37B of Cap. 311, where a technical memorandum has been laid on the table of LegCo, LegCo may, by resolution passed at its sitting held before the expiration of a period of 28 days after the sitting at which it was so laid, amend the technical memorandum in any manner consistent with the power to issue the technical memorandum. Before expiry of the 28-day period, LegCo may by resolution extend that period to the first LegCo sitting held not earlier than the twenty-first day after the day of its expiry.

42. Under section 37C of Cap. 311, the technical memorandum shall commence to have effect upon the expiry of the above amendment period or the period as extended if LegCo does not pass a resolution to amend it. In the case where LegCo passes a resolution amending the technical memorandum, it shall come into effect on the day of the publication in the Gazette of such resolution.

43. According to the LegCo Brief (with no reference number) issued by the Environmental Protection Department in October 2012, the proposed reduction of emission allowances is the result of a recent review of the Second Technical Memorandum issued in 2010. The proposal, when compared with the emission allowances allocated under the Second Technical Memorandum, will see a reduction of 17% for SO_2, 6% for NO_x and 10% for RSP. The two local power companies, namely the CLP Power Hong Kong Limited and the Hongkong Electric Co. Ltd, have been consulted on the proposal and support the reduction. Members may refer to paragraph 17 of the LegCo Brief for further background information.

44. On 4 July 2012, the review of the Second Technical Memorandum and the proposed Third Technical Memorandum were discussed at the meeting of the Panel on Environmental Affairs. At the meeting, members expressed concerns about the cost implications of the Third Technical Memorandum on electricity tariff since the increased use of cleaner fuels (such as natural gas and low-emission coal) and renewable energy by the two power companies would come with a cost. They also urged the power companies to strive to enhance their emission performance through acquisition of more emission reduction facilities in order to further improve the air quality. According to the Administration, the proposal contained in the Third TM will not increase the use of natural gas for power generation as compared with the Second Technical Memorandum and in any case, the actual fuel cost would be subject to international market prices and the power companies would present their tariff assessment to the Administration in accordance with the prevailing regulatory mechanism under the Scheme of Control Agreement (paragraph 18 of the LegCo Brief).

45. No difficulties have been identified in the legal and drafting aspects of the above subsidiary legislation and the Technical Memorandum.

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