

立法會
Legislative Council

LC Paper No. CB(1)937/12-13(03)

Ref : CB1/SS/9/12

**Subcommittee on Banking (Capital) (Amendment) Rules 2013 and
Banking (Disclosure) (Amendment) Rules 2013**

**Background brief on the implementation of Basel III
(as at 22 April 2013)**

Purpose

This paper provides background information on the Banking (Capital) (Amendment) Rules 2013 and the Banking (Disclosure) (Amendment) Rules 2013 which were gazetted on 12 April 2013 for the first phase implementation of Basel III in Hong Kong. The paper also summarizes the discussions of relevant issues by committees of the Legislative Council ("LegCo") in 2012.

Basel III

2. The international standards in the field of banking supervision are set by the Basel Committee on Banking Supervision ("the Basel Committee"). Hong Kong joined the Basel Committee as a member in June 2009. The Basel Committee has previously proposed regulatory frameworks commonly known as Basel I¹, Basel II² and Basel 2.5³. While Basel I and its subsequent amendments were implemented in Hong Kong through legislation under Part XVII of and the Third Schedule to the Banking Ordinance ("BO") (Cap. 155), requirements under Basel II and Basel 2.5 frameworks were introduced in 2007 and 2012 respectively through the Banking (Capital) Rules (Cap. 155 sub. leg. L) and the Banking (Disclosure) Rules (Cap. 155

¹ Basel I refers to the supervisory approach stipulated in the Basel Capital Accord adopted in 1988. A key element is the introduction of the capital adequacy ratio.

² Basel II refers to the supervisory approach stipulated in the New Basel Capital Accord published in 2004 to replace Basel I.

³ Basel 2.5 refers to a set of enhancements to the Basel II framework issued by the Basel Committee in 2009.

sub. leg. M) made by the Monetary Authority ("MA"). The two sets of rules are subsidiary legislation subject to the negative vetting procedures of LegCo.

3. Building upon Basel 2.5, Basel III is a package of regulatory capital and liquidity standards designed to further enhance the resilience of banks and banking systems and address weaknesses observed in the recent global financial crisis. Basel III seeks to improve the banking sector's ability to absorb shocks arising from financial and economic stress, and to reduce the risks of any spillover from the banking sector to the real economy. It increases the level, quality and transparency of banks' capital base, as well as the risk coverage of the capital framework. It sets three minimum risk-weighted capital ratios, two new capital buffers to reduce the procyclicality of the capital framework, a non risk-weighted leverage ratio, and two minimum standards for banks' liquidity. It also strengthens the capital requirements for certain counterparty credit risk exposures of banks.

4. Basel III was endorsed by the G20 Leaders in November 2010, and they are committed to implementing Basel III fully in line with the Basel Committee's transitional timeline with the implementation beginning in January 2013 and phasing in the standards over the subsequent six years to achieve full implementation by 1 January 2019.

Banking (Amendment) Ordinance 2012 and the relevant subsidiary legislation

5. The Administration introduced the Banking (Amendment) Bill 2011 into LegCo on 21 December 2011 to provide for a framework for implementation of Basel III in Hong Kong. No Bills Committee had been formed for scrutiny of the Bill which was passed by LegCo on 29 February 2012 and gazetted as the Banking (Amendment) Ordinance 2012 ("BAO") on 9 March 2012. The major elements of BAO include the following:

- (a) to remove the minimum capital and liquidity ratios from the main body of BO and use subsidiary legislation to introduce the Basel III requirements into Hong Kong;
- (b) to introduce new provisions in BO to empower MA to make rules to prescribe capital requirements for authorized institutions ("AIs")⁴ incorporated in Hong Kong and liquidity requirements for all AIs, subject to the statutory duty imposed on MA to consult the Financial Secretary, the Banking Advisory Committee, the

⁴ Authorized institutions refer to licensed banks, restricted licence banks, and deposit-taking companies authorized under the BO.

Deposit-taking Companies Advisory Committee, the Hong Kong Association of Banks and the Deposit-taking Companies Association;

- (c) to empower MA to approve codes of practice for the purpose of providing guidance in respect of the rules prescribing capital requirements and liquidity requirements for AIs, and the rules prescribing the information to be disclosed to the general public by AIs relating to their financial affairs;
- (d) to broaden the scope of the Capital Adequacy Review Tribunal and designate it as the forum to hear appeals against decisions by MA to vary capital or liquidity requirements or require remedial actions by AIs when they have failed to comply with the capital or liquidity requirements applicable to them; and
- (e) to rename the Capital Adequacy Review Tribunal as the "Banking Review Tribunal" to reflect its broadened scope of functions.

6. The relevant sections of BAO which amend the powers of MA to make rules to prescribe capital and disclosure requirements for AIs, and the Banking (Capital) (Amendment) Rules 2012 were commenced on 1 January 2013 to implement the first phase of the new Basel III capital framework in Hong Kong⁵. In essence, the Banking (Capital) (Amendment) Rules 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 to capture (a) potential loss due to changes in the credit quality of a counterparty; and (b) exposures to central counterparties.

⁵ The Subcommittee on Banking (Capital) (Amendment) Rules 2012, Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2012 and Banking (Amendment) Ordinance 2012 (Commencement) Notice 2012 was formed at the meeting of the House Committee on 26 October 2012 to scrutiny the three pieces of subsidiary legislation. The Banking (Amendment) Ordinance 2012 (Commencement) Notice 2012 appoints 1 January 2013 as the day on which the amended powers of MA to make rules to prescribe capital and disclosure requirements for AIs for implementation of Basel III will come into operation. The Banking (Capital) (Amendment) Rules 2012 amends the Banking (Capital) Rules to revise the minimum capital ratio requirements and the definition of regulatory capital, and to enhance the counterparty credit risk framework. The Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2012 is to reflect the Basel Committee's decision in May 2010 to include the Multilateral Investment Guarantee Agency in the list of "multilateral development banks" for the purpose of the Basel capital framework. No amendments were moved to the three pieces of subsidiary legislation which were commenced on 1 January 2013.

The legislative proposals

The Banking (Capital) (Amendment) Rules 2013

7. The Banking (Capital) (Amendment) Rules 2013 are made by MA under section 97C of the BO to further amend the Banking (Capital) Rules by incorporating the requirements of the latest technical guidance documents released by the Basel Committee in November and December 2012 to clarify certain capital treatments for counterparty credit risk and exposures to central counterparties. According to the Administration, 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 the Basel Committee in December 2012, and "International Convergence of Capital Measurement and Capital Standards – A Revised Framework (Comprehensive Version)" published by the Basel Committee in June 2006 ("ICCMCS 2006"). The major amendments are set out in paragraph 9 of the LegCo Brief (File Ref: G4/16/44C) dated 10 April 2013 issued by the Administration, and paragraph 3 of the report (LC Paper No. LS39/12-13) dated 17 April 2013 issued by the Legal Service Division of the LegCo Secretariat.

The Banking (Disclosure) (Amendment) Rules 2013

8. The Banking (Disclosure) (Amendment) Rules 2013 are made by MA under section 60A of the BO to amend the Banking (Disclosure) Rules to prescribe revised requirements regarding disclosure by AIs of their capital adequacy and associated relevant financial information for the first phase implementation of Basel III capital standards. The amendments are to enhance the consistency and comparability of banks' disclosure in respect of their capital base, and to specify disclosure requirements relating to the internal models approach to the calculation of capital requirements for counterparty credit risk which were introduced by the Banking (Capital) (Amendment) Rules 2012. According to the Administration, the amendments 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 the Basel Committee in June 2012. Details of the amendments are set out in paragraph 8 of the LegCo Brief (File Ref: G4/16/44C) dated 10 April 2013 issued by the Administration, and paragraphs 4 and 5 of the report (LC Paper No. LS39/12-13) dated 17 April 2013 issued by the Legal Service Division of the LegCo Secretariat.

9. The Banking (Capital) (Amendment) Rules 2013 and the Banking (Disclosure) (Amendment) Rules 2013 will come into operation on 30 June 2013.

Discussions by the Panel on Financial Affairs

10. Issues related to the implementation of Basel III capital standards in Hong Kong were discussed at meetings of the Panel on Financial Affairs held on 21 May and 4 June 2012. Members expressed concerns that implementation of Basel III requirements might result in over-regulation of the banking sector and additional costs on AIs, and small and medium-sized AIs might encounter difficulties in complying with Basel III standards.

11. The Hong Kong Monetary Authority ("HKMA") advised that it would consult the industry on the implementation of Basel III requirements and the Basel Committee would conduct comprehensive evaluations of the implementation of Basel requirements by its members to ensure a level playing field among them. On the cost impact on AIs, HKMA explained that since the capital adequacy ratio for banks in Hong Kong had been maintained at a very high level (standing at 15.8% at the end of 2011 which well exceeded the statutory requirement of 8%), banks in Hong Kong should have no difficulty in complying with the new requirements. On the other hand, strong capital adequacy might help reduce banks' cost for raising additional capital. HKMA added that as revealed by the findings of the bi-annual Quantitative Impact Studies conducted by HKMA on banks, the small and medium-sized banks in Hong Kong had no difficulty in complying with Basel III requirements.

12. As regards the progress of implementing Basel III standards in Hong Kong vis-à-vis that of overseas jurisdictions, the Administration advised that Hong Kong would follow the timeframe set by the Basel Committee in implementing Basel III requirements, and aimed to enforce the capital standards starting from 1 January 2013. The Administration added that it was a statutory requirement for HKMA to consult the relevant banking and deposit-taking company associations in introducing the subsidiary legislation for implementation of Basel III standards.

Discussion by the Subcommittee for scrutiny of the Banking (Capital) (Amendment) Rules 2012

13. During the scrutiny of the Banking (Capital) (Amendment) Rules 2012, some Subcommittee members expressed concerns about the impacts of implementation of Basel III capital standards on the borrowing costs of the banking sector and the general business, and whether AIs would become more prudent in lending which might cause difficulty for the small and medium enterprises ("SMEs") and members of the public in obtaining credits. HKMA responded that given that AIs' capital adequacy ratio had been maintained at a very high level in general, it was not envisaged that implementation of the new

minimum capital adequacy ratios would increase the cost of borrowing for AIs. Nor there would be large-scale capital-raising activities for AIs to meet the new requirements. HKMA also pointed out that as AIs in Hong Kong had been well-capitalized, implementation of the new minimum capital adequacy ratios should not adversely affect AIs' lending to SMEs, and hence the borrowing cost for the general business, as well as members of the public. On the other hand, implementation of the Basel III requirements would further enhance the resilience of AI and enable them to continue lending during periods of economic downturn.

14. Noting that some major jurisdictions like the European Union ("EU") and the United States ("US") might experience some delay in the Basel III implementation timetable, some Subcommittee members were concerned that possible delay in other jurisdictions in implementing Basel III on 1 January 2013 might cause competitive disadvantage to AIs in Hong Kong, and enquired whether HKMA would consider introducing flexibility in the implementation timetable in Hong Kong. HKMA advised that recognizing the importance of Basel III in strengthening the financial system, a number of jurisdictions were working towards implementation of the Basel III enhanced capital standards. According to a report of the Basel Committee in October 2012, most of Hong Kong's peers in Asia, including Australia, Mainland China, India, Japan and Singapore, had already issued final rules for Basel III implementation. The EU and the US were also working towards the implementation of Basel III. Given the benefits of Basel III in bringing about a better capitalized and more resilient banking system for Hong Kong, the Basel Committee's determination to implement the first phase of Basel III standards on 1 January 2013, and the need for Hong Kong as a major international financial centre to align with the international implementation timetable, the Administration considered that Hong Kong should remain committed to implementing Basel III on 1 January 2013.

Relevant papers

15. A list of relevant papers is in the **Appendix**.

Appendix

List of relevant papers

Date	Event	Papers/Minutes of meeting
21 May 2012	Briefing by the Hong Kong Monetary Authority to the Panel on Financial Affairs on its work	Power-point presentation materials by HKMA (LC Paper No. CB(1)2080/11-12(01)) Minutes of meeting (LC Paper No. CB(1)2267/11-12)
4 June 2012	The Panel on Financial Affairs was briefed on the progress of the implementation of Basel III standards in Hong Kong	Discussion paper (LC Paper No. CB(1)2035/11-12(04)) Background brief prepared by the Legislative Council Secretariat (LC Paper No. CB(1)2034/11-12) Minutes of meeting (LC Paper No. CB(1)2574/11-12)
October 2012 – November 2012	The Legislative Council formed a Subcommittee to scrutinize the Banking (Capital) (Amendment) Rules 2012, Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2012 and Banking (Amendment) Ordinance 2012 (Commencement) Notice 2012	Legislative Council Brief (File Ref: G4/16/44C) Legal Service Division Report (LC Paper No. LS5/12-13) Report of the Subcommittee (LC Paper No. CB(1)230/12-13)
17 April 2013	The Banking (Capital) (Amendment) Rules 2013 and the Banking (Disclosure) (Amendment) Rules 2013 were tabled in the Legislative Council	Legislative Council Brief (File Ref: G4/16/44C) Legal Service Division Report (LC Paper No. LS39/12-13)