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**Paper for the House Committee Meeting
on 27 October 2017**

**Legal Service Division Report on
Banking (Amendment) Bill 2017**

I. SUMMARY

- 1. The Bill**

The Bill seeks to implement the latest international standards on banking regulation issued by the Financial Stability Board and the Basel Committee on Banking Supervision. It seeks to amend the Banking Ordinance (Cap. 155) to provide for recovery planning by authorized institutions ("AIs") (i.e. banks, restricted licence banks or deposit-taking companies); to change the limitations on AIs' exposures and empower the Monetary Authority ("MA") to make rules for such limitations; and to repeal two items of subsidiary legislation made under Cap. 155.
- 2. Public Consultation**

According to the Legislative Council ("LegCo") Brief, MA consulted the banking industry on the proposals for the implementation of the new exposure framework and recovery planning requirements in March and September 2016 respectively. The feedback received was generally supportive. A second round of industry consultation on the detailed provisions of the Bill was conducted in July 2017 and the industry was broadly in support of the proposed amendments.
- 3. Consultation with LegCo Panel**

As advised by the Clerk to the Panel on Financial Affairs, the Panel was consulted on 16 March 2017 and members had no objection to the introduction of the Bill into LegCo.
- 4. Conclusion**

The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. In view of the implications of the Bill on the banking industry of Hong Kong, Members may wish to form a Bills Committee to study the Bill in detail.

II. REPORT

The date of First Reading of the Bill is 25 October 2017. Members may refer to the Legislative Council ("LegCo") Brief (File Ref: B&M/4/1/43C) issued by the Financial Services and the Treasury Bureau and the Hong Kong Monetary Authority on 11 October 2017 for further details.

Object of the Bill

2. The Bill seeks to implement the latest international standards on banking regulation issued by the Financial Stability Board ("FSB") and the Basel Committee on Banking Supervision ("BCBS"). It seeks to amend the Banking Ordinance (Cap. 155) to provide for recovery planning by authorized institutions ("AIs") (i.e. banks, restricted licence banks or deposit-taking companies); to change the limitations on AIs' exposures and empower the Monetary Authority ("MA") to make rules for such limitations; and to repeal two items of subsidiary legislation made under Cap. 155.

Background

3. To address the inadequacy of financial institutions ("FIs") in preparing for severe stress events revealed in the financial crisis, FSB, of which Hong Kong is a member jurisdiction, issued in 2014 a set of standards in its "Key Attributes of Effective Resolution Regimes for Financial Institutions" which require that recovery and resolution plans be put in place for any FIs that could be systemically important or critical if they fail. Supervisory authorities should ensure that FIs maintain a recovery plan that identifies options to restore financial strength and viability when they come under severe stress and the relevant authorities should also have the requisite powers to mandate the implementation of recovery measures. Currently, there are no explicit provisions under Cap. 155 relating to recovery planning by FIs. The Administration proposes to prescribe such explicit planning requirements in Cap. 155 by introducing the Bill into LegCo.

4. Under Cap. 155, AIs are subject to limits and restrictions on exposures stipulated in Part XV of Cap. 155. These limits and restrictions implement the international standards promulgated by BCBS¹, of which Hong Kong is a member, in 1991. Following BCBS's release of a new supervisory framework for measuring and controlling large exposures in April 2014, the existing requirements need to be updated. According to paragraph 8 of the LegCo Brief, in view of the technical nature of the new framework and the need to update the regulatory requirements from time to time to reflect changes in international standards, the Administration considers it more effective to empower MA to make rules to prescribe limits on exposures by way of subsidiary legislation as proposed in the Bill.

¹ BCBS is the international body that sets standards on banking regulation with a view to enhancing financial stability.

Provisions of the Bill

5. The major amendments proposed by the Bill are set out in the ensuing paragraphs.

Proposed amendments relating to recovery planning

Empowering MA to prescribe recovery planning requirements

6. The Bill seeks to add a new Part XIA (new sections 68A to 68I) to Cap. 155 to provide for recovery planning applicable to an AI incorporated in Hong Kong and an AI incorporated outside Hong Kong which operates in Hong Kong through a branch (new section 68B). Under the Bill, MA would be empowered to require, by notice in writing, an AI to prepare, maintain and submit a recovery plan setting out the measures that the AI can take to stabilize and restore its financial resources and viability when the AI comes under severe stress (new section 68C(1)). MA may specify the form of, standards applicable to, and elements to be included in, the recovery plan (new section 68C(2)), including a framework of recovery triggers designed to support the timely implementation of the measures in the plan (new section 68C(3)).

Other powers of MA

7. The Bill also seeks to confer other powers on MA in relation to recovery planning. Such powers include (a) imposing requirements on an AI if MA considers the imposition necessary or expedient to ensure that the AI's recovery plan is fit for the purpose of stabilizing and restoring its financial resources and viability when it comes under severe stress (new section 68D); (b) requiring an AI to revise its recovery plan to address any deficiency or impediment identified by MA (new section 68E); (c) requiring an AI to implement one or more of the measures in its recovery plan if MA considers that the AI is delaying the implementation of the measure(s) (new section 68F); and (d) imposing similar requirements in relation to a recovery plan on an AI's holding company which is incorporated in Hong Kong (new section 68H).

Notification requirements by AIs

8. The new section 68G seeks to provide for notification requirements whereby an AI must, as soon as practicable, notify MA of the occurrence (or likely occurrence) of an event that requires the AI to implement a measure in its recovery plan or the decision of the AI to implement a measure in its recovery plan, and provide MA with any particulars of the matter required by MA. Similar notification requirements are proposed to be imposed on a holding company of an AI under the new section 68H(3) and (4).

Offences and penalties

9. Under the new section 68I, if an AI (or its holding company) without reasonable excuse, fails to comply with the notification requirements under the new section 68G (or new section 68H(3) or (4) in the case of a holding company), or a requirement of a notice served by MA under the new section 68C(1), 68D(1), 68E(3) or 68F(4) (or new section 68H(1) in the case of a holding company), the AI (or its holding company) would commit an offence and be liable (a) on conviction on indictment – to a fine at tier 9 (i.e. \$2,000,000) and in the case of a continuing offence, to a further daily fine at tier 5 (i.e. \$100,000); or (b) on summary conviction – to a fine at tier 5 (i.e. \$100,000) and, in the case of a continuing offence, to a further daily fine at tier 2 (i.e. \$10,000). Every director, chief executive and manager of the AI (or every officer in the case of the holding company of the AI) would also commit an offence and be liable to the above levels of fine and imprisonment for five years on conviction on indictment and imprisonment for two years on summary conviction.

Proposed amendments relating to exposure limitation rules

Empowering MA to make rules to prescribe exposure limits

10. Under Part XV (sections 79 to 91) of Cap. 155, AIs are subject to a set of limits and restrictions on financial exposures that they may incur which seek to prevent their exposures from becoming overly concentrated in certain aspects. Clause 9 seeks to add new sections 81A to 81C to Cap. 155 for the purpose of implementing the new BCBS's large exposures framework. Under the new section 81A, MA would be empowered, 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, to make rules prescribing limits and restrictions in respect of exposures incurred by AIs. Such rules would be subsidiary legislation, subject to scrutiny by LegCo under section 34 of the Interpretation and General Clauses Ordinance (Cap. 1).

11. Under the new section 81B, MA would be empowered to require an AI to take remedial action, if the AI fails to comply with any provision of the rules to be made under the new section 81A, after holding discussions with the AI for determining what remedial action should be taken.

Repealing certain provisions under Part XV of Cap. 155

12. Clauses 7, 8 and 10 to 15 seek to repeal certain sections under Part XV of Cap. 155 in relation to restrictions on exposures incurred by an AI. According to paragraph 18 of the LegCo Brief, these provisions would become obsolete and would be repealed upon the commencement of the rules to be made by MA in relation to new exposure limits prescribed under the new section 81A.

Offences and penalties

13. Under the new section 81C, if an AI fails to comply with a notification requirement prescribed in the rules to be made under the new section 81A(1) or a requirement imposed in a notice in relation to remedial action served by MA under the new section 81B(2), the AI would commit an offence and be liable (a) on conviction on indictment – to a fine at tier 8 (i.e. \$1,000,000) and, in the case of a continuing offence, to a further daily fine at tier 3 (i.e. \$20,000); or (b) on summary conviction – to a fine at tier 5 (i.e. \$100,000) and, in the case of a continuing offence, to a further daily fine at tier 2 (i.e. \$10,000). Every director, chief executive and manager of the AI would also commit an offence and be liable to the above levels of fine and imprisonment for five years on conviction on indictment and imprisonment for two years on summary conviction.

Consequential amendments

14. The Bill contains other proposed amendments to Cap. 155 and its subsidiary legislation consequential upon the making of the new exposure limitation rules. These amendments include the repeal of the Specification of Factors (Financial Exposure of Authorized Institution) Notice 2007 (Cap. 155P) (clause 30) and a definition of “capital base” would be added to section 2(1) of the Banking (Capital) Rules (Cap. 155L) (clause 28).

Review mechanism in relation to recovery planning and exposure limitation rules

15. Any AI which is aggrieved by a decision of MA in relation to imposing requirements to implement measure(s) in the recovery plan under the new section 68F(4) or the making of rules relating to exposure limits under the new section 81A(4) could apply to the Banking Review Tribunal ("Tribunal") for a review of the decision under section 101B(1) of Cap. 155 (clause 19).

Other amendments

16. Other proposed amendments under the Bill include providing for separate definitions of "holding company" and "subsidiary" in section 2(1) of Cap. 155 (clause 3(3) and (5)) and the proposed repeal of the Banking (Specification of Public Sector Entity in Hong Kong) Notice (Cap. 155O) (under clause 29) which has become obsolete.

Commencement

17. Except for the provisions relating to the definitions of "holding company" and "subsidiary" (clauses 2 and 3(3) and (5)), recovery planning under Part XIIA (clause 4), application to the Tribunal for review of the decision of MA in relation to recovery plan (clause 19(1)) and repeal of Cap. 155O (Division I of Part 4) which

would come into operation on the day on which the enacted Ordinance is published in the Gazette, the Bill, if passed, would come into operation on a day to be appointed by the Secretary for Financial Services and the Treasury by notice published in the Gazette.

Public Consultation

18. According to paragraphs 25 and 26 of the LegCo Brief, MA consulted the banking industry on its proposals for the implementation of the new exposure limits framework and recovery planning requirements in March and September 2016 respectively. The feedback received was generally supportive. A second round of industry consultation on the detailed provisions of the Bill was conducted in July 2017 and the industry was broadly in support of the proposed amendments.

Consultation with LegCo Panel

19. As advised by the Clerk to the Panel on Financial Affairs, on 16 March 2017, the Panel was briefed on the legislative proposal for implementing the latest international standards on banking regulation issued by BCBS and FSB. Members called on the Administration to take into account views of the banking industry in drafting the relevant legislation and make reference to the approach and time frame of other jurisdictions in implementing the new BCBS framework.

Conclusion

20. The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. In view of the implications of the Bill on the banking industry of Hong Kong, Members may wish to form a Bills Committee to study the Bill in detail.

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