

立法會
Legislative Council

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**Subcommittee on Banking (Capital) (Amendment) Rules 2017,
Banking (Liquidity) (Amendment) Rules 2017 and Banking (Specification
of Multilateral Development Bank) (Amendment) Notice 2017**

**Minutes of the first meeting on
Monday, 13 November 2017, at 4:30 pm
in Conference Room 2A of the Legislative Council Complex**

Members present : Hon CHAN Chun-ying (Chairman)
Hon James TO Kun-sun
Hon WONG Ting-kwong, GBS, JP
Hon CHAN Kin-por, GBS, JP
Hon YIU Si-wing, BBS
Hon Kenneth LEUNG
Hon Alvin YEUNG
Hon Jimmy NG Wing-ka, JP

Member absent : Hon Christopher CHEUNG Wah-fung, SBS, JP

Public officers attending : Ms Eureka CHEUNG
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services)5

Mr Daryl HO
Executive Director (Banking Policy)
Hong Kong Monetary Authority

Mr Richard CHU
Head (Banking Policy)B
Hong Kong Monetary Authority

Ms Gillian HUI
Head (Banking Policy)A
Hong Kong Monetary Authority

Mr Thomas WONG
Senior Manager (Banking Policy)A2
Hong Kong Monetary Authority

Miss Samantha YAU
Senior Manager (Banking Policy)B1
Hong Kong Monetary Authority

Miss Theresa KWAN
Senior Manager (Banking Policy)B2
Hong Kong Monetary Authority

Miss Selina LAU
Senior Government Counsel
Department of Justice

Ms Mandy NG
Senior Government Counsel
Department of Justice

Mr Vincent FUNG
Government Counsel
Department of Justice

Clerk in attendance : Ms Connie SZETO
Chief Council Secretary (1)4

Staff in attendance : Mr Bonny LOO
Assistant Legal Adviser 4

Mr Hugo CHIU
Senior Council Secretary (1)4

Ms Sharon CHAN
Legislative Assistant (1)4

Ms Vivian CHAN
Clerical Assistant (1)4

Admin

I Election of Chairman

Election of Chairman

Mr James TO, the member with the highest precedence among those who were present at the meeting, presided over the election of the Chairman of the Subcommittee. He invited nominations for the chairmanship of the Subcommittee.

2. Mr CHAN Chun-ying was nominated by Mr WONG Ting-kwong and the nomination was seconded by Mr YIU Si-wing. Mr CHAN accepted the nomination. Mr James TO called for other nominations. There being no other nomination, Mr TO declared that Mr CHAN Chun-ying was elected the Chairman of the Subcommittee. Mr CHAN then took the chair.

3. Members agreed that there was no need to elect a Deputy Chairman.

II Meeting with the Administration

(L.N.175 of 2017	— Banking (Capital) (Amendment) Rules 2017
L.N.176 of 2017	— Banking (Liquidity) (Amendment) Rules 2017
L.N.177 of 2017	— Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2017

Action

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|---------------------------------|--|
| File Ref: B&M2/1/63C | — Legislative Council Brief on Banking (Capital) (Amendment) Rules 2017, Banking (Liquidity) (Amendment) Rules 2017 and Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2017 |
| LC Paper No. LS8/17-18 | — Legal Service Division Report |
| LC Paper No. CB(1)203/17-18(01) | — Marked-up copy of Banking (Capital) (Amendment) Rules 2017 prepared by the Legal Service Division (Restricted to members only) |
| LC Paper No. CB(1)203/17-18(02) | — Marked-up copy of Banking (Liquidity) (Amendment) Rules 2017 prepared by the Legal Service Division (Restricted to members only) |
| LC Paper No. CB(1)203/17-18(03) | — Marked-up copy of Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2017 prepared by the Legal Service Division (Restricted to members only)) |

Discussion

4. The Chairman declared that he was working in the banking sector and was returned by the finance functional constituency. Mr CHAN Kin-por declared that he was an independent non-executive director of the Bank of East Asia, Limited.
5. The Subcommittee deliberated (Index of proceedings attached at **Appendix**).

Action

III Any other business

Invitation of views

6. Members considered it not necessary for the Subcommittee to invite views and meet with deputations to receive views on the three items of subsidiary legislation.

Legislative timetable

7. The Chairman concluded that the Subcommittee had completed the scrutiny of the three items of subsidiary legislation.

8. Members noted that the Chairman would move at the Council meeting of 22 November 2017 a proposed resolution to extend the scrutiny period of the three items of subsidiary legislation to the Council meeting of 13 December 2017. Members further noted that if the scrutiny period of the three items of subsidiary legislation was extended, the deadline for giving notice of motion to amend them was 6 December 2017, and the Chairman would report the deliberations of the Subcommittee at the House Committee meeting on 1 December 2017.

9. There being no other business, the meeting ended at 6:00 pm.

Council Business Division 1
Legislative Council Secretariat
6 December 2017

**Proceedings of the first meeting of the Subcommittee on Banking (Capital)
(Amendment) Rules 2017, Banking (Liquidity) (Amendment) Rules 2017 and Banking
(Specification of Multilateral Development Bank) (Amendment) Notice 2017
on Monday, 13 November 2017, at 4:30 pm
in Conference Room 2A of the Legislative Council Complex**

Time Marker	Speaker	Subject(s)	Action Required
Agenda item I — Election of Chairman			
000408 – 000519	Mr James TO Mr WONG Ting-kwong Mr YIU Si-wing Mr CHAN Chun-ying	Election of Chairman	
Agenda item II — Meeting with the Administration			
000520 – 000947	Chairman Administration	Briefing by the Administration on the Banking (Capital) (Amendment) Rules 2017 ("BCAR 2017"), the Banking (Liquidity) (Amendment) Rules 2017 ("BLAR 2017") and the Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2017.	
000948 – 011614	Chairman Mr James TO Mr CHAN Kin-por Mr Kenneth LEUNG Mr YIU Si-wing Administration	<p><u>Implementation of the revised securitization framework under the Banking (Capital) (Amendment) Rules 2017</u></p> <p>Mr TO enquired about how BCAR 2017 would change the capital treatment of authorized institutions' ("AIs") securitization exposures.</p> <p>The Chairman enquired if an AI could decide under BCAR 2017 to adopt the internal ratings-based ("IRB") approach (i.e. the use of credit ratings compiled internally by the AI concerned) or the standardized approach (i.e. the use of external credit ratings) in calculating the risk-weighted capital ("RWC") requirement for its securitization exposures if both internal and external ratings were available.</p> <p>The Government responded as follows:</p> <p>(a) BCAR 2017 introduced new calculation methodologies designed to reduce mechanistic reliance by AIs on external</p>	

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		<p>credit ratings when they calculate RWC requirement for their securitization exposures. In addition, it increased the risk sensitivity of the securitization framework by putting more focus on the risk characteristics of the underlying exposures of a securitization transaction and taking into account more risk drivers, such as the seniority and maturity of a securitization tranche, for calculating RWC; and</p> <p>(b) under the existing Banking (Capital) Rules, AIs adopting IRB approach had to use external crediting ratings (if such ratings were available) in calculating RWC requirement. After the commencement of BCAR 2017, AIs adopting IRB approach had to use the ratings they compiled internally even though the relevant external credit ratings were available.</p> <p>Mr TO pointed out that the Lehman Brothers Minibonds Incident had revealed the complexity of some innovative financial products that even AIs were unable to accurately assess their risks. Hence, an AI adopting IRB approach in calculating RWC requirement for an innovative financial product might arrive at a credit rating higher than those given by external credit rating agencies. However, under the revised securitization framework, the AI was required to use its internal rating to calculate RWC. He asked if an AI adopting IRB approach had to take the ratings of external credit rating agencies into account in calculating its RWC.</p> <p>The Chairman said that an AI had to seek the Hong Kong Monetary Authority's ("HKMA") approval for adopting IRB approach, and establish a model for assessing the risk of its securitization exposures, recruit experts to audit the model and submit the reports to HKMA. HKMA would only grant approval if the model met the stringent Basel III standards promulgated by the Basel Committee on Banking Supervision ("BCBS"). He asked whether the revised securitization framework</p>	

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		<p>under BCAR 2017 sought to prevent banks from using credit enhancement tools to affect the risks of their underlying exposures, and whether there would be a mechanism for AIs to review the internal ratings compiled under IRB approach as necessary.</p> <p>The Government responded as follows:</p> <ul style="list-style-type: none"> (a) Basel III sought to address the weaknesses in banking regulation revealed by the global financial crisis in 2008. The revised securitization framework under BCAR 2017 allowed AIs to take into account a host of factors as specified by BCBS in calculating RWC required for their securitization exposures instead of solely relying on external credit ratings. It could also prevent the abuse of credit enhancement tools; (b) there would be stringent requirements for models used in IRB approach. Ratings compiled under IRB approach were not directly comparable to external credit ratings as the former method had taken into account a host of factors; (c) complex financial products might involve re-securitization. Under the revised securitization framework, AIs were required to use more conservative approaches in calculating RWC of re-securitized exposures, and might be required to use a risk weighting of 1,250% in some extreme cases; (d) HKMA required AIs to take prudent risk management measures. They were expected to closely monitor, among other things, the external credit ratings of relevant financial products and respond to changes in such ratings as appropriate; and (e) Basel III capital requirements were intended to prevent systemic risks; they were unrelated to the risks of individual investment products. 	

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		<p data-bbox="564 304 1185 371"><u>Progress of Hong Kong and other jurisdictions in implementing Basel III</u></p> <p data-bbox="564 412 1134 445">Mr TO's and Mr YIU's enquiries as follows:</p> <p data-bbox="564 486 1185 667">(a) whether AIs in Hong Kong would face competitive disadvantage as some jurisdictions might adopt different implementation timetable or even did not fully comply with Basel III standards; and</p> <p data-bbox="564 707 1185 889">(b) whether HKMA had required AIs to carry out additional risk management measures for transactions involving banks from jurisdictions not meeting Basel III standards.</p> <p data-bbox="564 929 1185 1144">The Chairman enquired about the possible impact on Hong Kong if it did not implement Basel III standards in accordance with the timetable of BCBS including whether Hong Kong's credit ratings would be adversely affected.</p> <p data-bbox="564 1184 1074 1218">The Government responded as follows:</p> <p data-bbox="564 1258 1185 1509">(a) all BCBS members had to implement Basel III standard, particularly jurisdictions with internationally active banks present. As observed, major peer jurisdictions were implementing Basel III requirements in accordance with the timetable of BCBS in general;</p> <p data-bbox="564 1550 1185 1800">(b) Basel III standards sought to enhance the resilience of banks and banking systems and address weaknesses observed in the global financial crisis in recent years. There would be strong incentives for other jurisdictions, especially major economies, to implement Basel III standards; and</p> <p data-bbox="564 1841 1185 2058">(c) Hong Kong would from time to time be subject to the review by important international organizations such as the International Monetary Fund and the Financial Stability Board in respect of the robustness of its regulatory regime.</p>	

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		<p>Compliance with international standards, such as Basel III requirements, was among the major yardsticks adopted in such evaluations.</p> <p><u>Impacts of the new Basel III requirements on Hong Kong</u></p> <p>Mr CHAN's enquiries as follows:</p> <p>(a) whether the Administration had, in consulting the Hong Kong Association of Banks ("HKAB") on the three items of subsidiary legislation, taken into account all suggestions made by HKAB; and</p> <p>(b) whether a transitional period would be provided to facilitate the banking sector to prepare for the implementation of the subsidiary legislation.</p> <p>Mr YIU's enquiries as follows:</p> <p>(a) whether BLAR 2017 might pose difficulties (i) for overseas banks to set up branches in Hong Kong; and (ii) for local companies to become AIs; and</p> <p>(b) whether branches of overseas banks in Hong Kong had to meet Basel III requirements.</p> <p>Mr LEUNG conveyed the banking sector's concern if banks listed in the Banking (Specification of Multilateral Development Bank) Notice (Cap. 155N) ("MDB Notice") would continue to be regarded as AIs and be entitled to interests deduction in taxation.</p> <p>The Government responded as follows:</p> <p>(a) it had conducted two rounds of consultation with the banking industry on the subsidiary legislation. While the industry had offered views on the implementation timetable and sought clarifications on the interpretation of certain provisions in the legislation, it supported the implementation of new Basel III requirements. The</p>	

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		<p>Government had already taken into account the industry's views when finalizing the subsidiary legislation;</p> <p>(b) BCBS had adopted a phased-in approach to implement Basel III since 2013. The banking sector had sufficient time to prepare for the implementation. It was envisaged that the implementation of BCAR 2017 would only have slight and manageable impacts on the capital requirements and risk appetite of AIs. No difficulties were anticipated for the banking sector in meeting the liquidity requirements stipulated under BLAR 2017;</p> <p>(c) BCAR 2017 and BLAR 2017 sought to implement relevant capital and liquidity requirements of Basel III, which would be implemented in all major financial centres and economies. The two sets of rules would not pose difficulties for overseas banks to set up branches in Hong Kong;</p> <p>(d) HKMA adopted a two-tier approach in implementing the relevant liquidity requirements of BCBS. The net stable funding ratio ("NSFR") requirements would only apply to AIs which were more sizable or internationally active (i.e. category 1 institutions). For non-category 1 institutions, only those with considerable business sizes or material liquidity risk profile (i.e. category 2A institutions) would be subject to the core funding ratio ("CFR") requirements, which were NSFR requirements in a simplified form. Based on quantitative impact studies conducted by HKMA, it was not envisaged that the AIs concerned would have difficulties in meeting such requirements;</p> <p>(e) branches of overseas banks in Hong Kong were subject to the relevant requirements set out in BLAR 2017; and</p> <p>(f) MDB Notice would only include multilateral development banks ("MDBs") within the meaning of section 2(19) of the</p>	

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		<p>Banking Ordinance (Cap. 155) ("BO"), which were not regarded as AIs under BO.</p> <p>Mr LEUNG's enquiries as follows:</p> <ul style="list-style-type: none"> (a) whether a development bank set up by a single country would be eligible for specification as an MDB and whether the Asian Infrastructure Investment Bank ("AIIB") was included in MDB Notice; (b) whether Hong Kong would specify an MDB on its own initiative; and (c) how HKMA would monitor AIs' compliance with the requirements of BCAR 2017 and BLAR 2017. <p>The Government responded as follows:</p> <ul style="list-style-type: none"> (a) under section 2(19) of BO, HKMA might 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. AIIB had yet to be included in the MDB Notice; (b) normally Hong Kong would only follow BCBS's decision in updating the list of MDBs set out in MDB Notice; and (c) AIs were required to meet the requirements of BCAR 2017 and BLAR 2017 at all times, and submitted quarterly reports to HKMA on their compliance situation in relation to Basel III requirements. Besides, AIs were required under BO to appoint external auditors to audit: (i) their reports submitted to HKMA; and (ii) their internal systems of control. HKMA would also conduct on-site inspections as appropriate. 	

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011615 – 012400	Chairman Mr Kenneth LEUNG Administration	<p>Mr LEUNG's enquiries as follows:</p> <ul style="list-style-type: none"> (a) involvement of retail investors, if any, in securitization transactions; (b) whether the revised securitization framework under BCAR 2017 sought to tackle the imprudent acts of certain credit rating agencies; and (c) how external auditors recruited by AIs could give views on the AI's compliance with Basel III requirements and internal review mechanism. <p>The Government responded as follows:</p> <ul style="list-style-type: none"> (a) securitization transactions were mainly carried out by AIs, institutional investors and professional investors. Securitization packaged as investment products would be subject to the regulation of the Securities and Futures Commission ("SFC"); (b) Basel III standards sought to enhance banks' resilience and thus would enhance protection for depositors at large; (c) the revised securitization framework was targeted at AIs rather than credit rating agencies; (d) in order for their ratings to be eligible for use in capital calculation under the Basel III external ratings based approaches, rating agencies needed to be recognized based on specific criteria; and (e) if an AI's external auditor noticed that the AI failed to fulfill relevant Basel III requirements, the auditor could make an exception report in the AI's report submitted to HKMA. HKMA would arrange a tripartite meeting with the AI and external auditor concerned to follow up the matter if necessary. 	

Time Marker	Speaker	Subject(s)	Action Required
Clause-by-clause examination of the three items of subsidiary legislation			
012401 – 012848	Chairman Administration	The Subcommittee examined the clauses of the three items of subsidiary legislation and members raised no question.	
012849 – 013130	Chairman Assistant Legal Adviser 4 ("ALA4") Administration	<p>ALA4 pointed out that the first page of BCR (in the Looseleaf and online versions) still showed section 98A of BO as its empowering provision, even though that section was repealed by section 9 of the Banking (Amendment) Ordinance 2012 (3 of 2012), and had since been replaced by section 97C of BO under which BCAR 2017 was made.</p> <p>The Government explained that the reference to "section 98A" at the top of page 1 of BCR did not form part of the BCAR 2017. (BCAR 2017 cited "section 97C" of BO as the empowering provision.) It was a piece of information (representing a shorthand version of the enacting provision) placed in the Looseleaf version and online version of BCR editorially for readers' reference. Hence, this piece of information could be updated editorially. The Government was looking into this and would update the information shortly.</p> <p>ALA4 further pointed out that section 47 of BCAR 2017 appeared to contain a grammatical/typographical error: the proposed new section 242(6) of BCR referred to "the securitization exposure are backed by a mixed pool and the risk-weights for the exposures are determined" etc.</p> <p>The Government confirmed that the singular form of the term "securitization exposure" was a typographical error which should read "securitization exposures". The typographical error should not affect the interpretation of the provision in the current context. The Government would amend the provision when the earliest opportunity arose.</p>	

Time Marker	Speaker	Subject(s)	Action Required
Agenda item III — Any other business			
013131 – 013307	Chairman	Legislative timetable and concluding remarks	

Council Business Division 1
Legislative Council Secretariat
6 December 2017