BANKING (AMENDMENT) ORDINANCE 1999

The Banking (Amendment) Ordinance 1999 was passed by the Legislative Council on 7 July and gazetted on 16 July 1999 to bring Hong Kong's banking supervision framework fully in line with the Basle Committee's Core Principles for Effective Banking Supervision. This paper sets out the rationale behind the legislative changes and the major amendments resulted from this exercise.

Introduction

The Banking (Amendment) Ordinance (BAO) 1999 was passed by the Legislative Council on 7 July and gazetted on 16 July 1999. The main purpose of the amendments is to bring the existing banking supervision framework in Hong Kong fully in line with the Basle Committee's Core Principles for Effective Banking Supervision (Core Principles) which are accepted as international standards of banking supervision. A number of amendments to the Banking Ordinance (the Ordinance) have also been made to improve the operation of the Ordinance in light of market developments.

Compliance with The Core Principles

In September 1997, the Basle Committee on Banking Supervision published the Core Principles which were endorsed by the central banks of the G10[1] countries. The Core Principles serve as a basic reference for supervisory authorities around the world to review their existing supervisory arrangements and to initiate a programme designed to address any deficiencies as quickly as practicable within their legal authority.

Hong Kong's banking supervision framework substantially complies with the Core Principles except in the following areas:

(a) there are no formal requirements for authorised institutions (AIs)[2] to notify or seek the approval of the Hong Kong Monetary Authority (MA) before making major acquisitions or investments, except in the case of the acquisition or establishment of overseas banking subsidiaries;

(b) the MA is not legally permitted to disclose information of individual customers to an overseas supervisory authority;

(c) the MA's supervisory power to bring about timely corrective actions on a problem AI may be disrupted by a winding-up petition against the AI presented by creditors; and

(d) there are a few cases of existing AIs in Hong Kong which are part of parallel banking structures (a holding company holding subsidiary banks in different jurisdictions) over which there is no consolidated supervision.

It is the Government's policy that the supervisory framework in Hong Kong should conform as much as possible to international supervisory standards. The deficiencies mentioned in point (a), (b) and (c) above can be addressed by making appropriate amendments to the Ordinance, while the issue of parallel banking structure in (d) is more complicated and requires the co-operation of the respective overseas banking supervisors. This is being addressed through ring-fencing the institutions concerned in Hong Kong and appropriate discussions with the relevant supervisors.

1 The G10 countries are Canada, Belgium, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom and the United States.

2 Licensed banks, restricted licence banks and deposit-taking companies are collectively known as authorised institutions.

Major Amendments

Major acquisitions or investments by AIs

Core Principle 5 provides that banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments made by an AI and ensuring that corporate affiliations or structures do not expose the AI to undue risks or hinder effective supervision. In these instances, the banking supervisor will determine if the institution has both the financial and managerial resources to make the acquisition. The supervisor must clearly define what types and amounts of investments need prior approval and notification.

In determining what constitutes a major acquisition or investment in a company by an AI, the main supervisory concern is how the proposed acquisition or investment would affect the financial position of the institution, such as its capital base or profitability. It is generally considered that a 5% effect on profits, capital or assets would be material.

In view of the above and the fact that section 87 of the Ordinance already limits an AI's acquisition or holding of shares in any other companies in aggregate to 25% of its capital base, it is appropriate to require a locally incorporated AI to seek the MA's prior approval for any major acquisition or investment in a company (including establishment of a company) which is 5% or more of the capital base of the AI except in certain specific cases.[3] Thus, a new section 87A is added to this effect. By putting the new section 87A under Part XV of the Ordinance, the MA can also apply the 5% restriction to AIs on an unconsolidated basis, a consolidated basis or both by way of section 79A, thus covering any acquisitions or investments by AIs' subsidiaries as well. The MA will issue a guideline to set out the general principles and the manner he will like to exercise his powers under the new section 87A.

Disclosure of information about individual customers

Section 121(3) of the Ordinance prohibits the sharing of information about individual customers of a bank with an overseas supervisory authority.

Core Principle 25 provides that host banking supervisors of the local operations of foreign banks must have powers to share information needed by the home country supervisors of those banks for the purposes of carrying out consolidated supervision. In the view of the Basle Committee, this would include information about individual customers. Thus the current restriction under section 121(3) on disclosure of individual customers' information to overseas supervisors needs to be removed in order to enable the MA to comply with this principle.

To address concern about lack of control on the onward disclosure of information by the receiving authority, new provisions are added to enable the MA to attach a condition to any disclosure made under section 121 to require the MA's consent for any onward transmission of such information. Such a condition will be mandatory in the case of proposed disclosure of individual customers' information.

Provisions relating to winding-up petitions of AIs

Core Principle 22 provides that banking supervisors must have adequate supervisory measures to bring about timely corrective actions when banks fail to meet prudential requirements, when there are regulatory violations, or where the interests of depositors are threatened in any other way.

3 The specific cases are where an AI acquires the shares of a company in the course of satisfaction of debts due to the AI, or under an underwriting or sub-underwriting contract for shorter than a specified period.

At present, the MA possesses a range of powers to accomplish the goals set out in Core Principle 22. For example, under section 52(1)(C), the MA may appoint a Manager to take control of the affairs, business and property of an AI when, for example, the MA is of the opinion that the AI is carrying on its business in a manner detrimental to the interests of its depositors or creditors. The appointment of the Manager seeks to enable a troubled institution to be nursed back to health, or alternatively to enable the MA to take quick action to safeguard the assets of the AI until a liquidator is appointed. These measures are ultimately aimed to protect the interests of depositors and maintain the stability of the banking sector.

However, the Ordinance does not prevent any unsatisfied creditor from petitioning to wind-up an AI or from taking legal proceedings against the assets of the AI during the period of the Manager's appointment. Moreover, there are no procedural safeguards to ensure that the regulator's views are heard when a winding-up petition of an AI is presented by a person other than the Financial Secretary. This is not a satisfactory situation as the Manager's efforts to effectively discharge his responsibilities might be disrupted.

It has therefore been decided that the MA should be given the right to be heard in respect of a winding-up petition against an AI and to support or oppose such a petition under section 122(7) of the Ordinance. This will enable the court to take the regulator's view into account before it decides on whether to wind up a regulated institution. A similar provision can be found in the Insurance Companies Ordinance.

Publication and submission of annual audited accounts

Section 60(1) and (2)

Under section 60(1) of the Ordinance, every AI incorporated in Hong Kong is required to publish its audited annual accounts and the auditors' report (in accordance with the Tenth Schedule) in one English and one Chinese language newspaper not later than 4 months after the close of each financial year. Section 60(2) requires a copy of such newspaper notice to be lodged with the MA seven days before publication.

The introduction of the Best Practice Guide on Financial Disclosure by AIs in 1994 and further subsequent disclosure requirements have resulted in a significant increase in the amount and quality of disclosure by AIs in their annual accounts. The length of the financial statements and hence the cost of publishing them in newspapers have significantly increased. During previous discussions on the financial disclosure requirements of AIs, the banking industry has requested a review of this particular requirement.

It is considered that the requirements of section 60(1) can be removed for the following reasons -

(a) the main focus of the majority of the public seems to be on the broad financial indicators which give them a flavour of the overall financial performance and the strength of AIs. Such information is generally widely reported by the media well before the publication of the annual accounts under section 60(1);

(b) although listed companies are required to publish limited financial information relating to the profit and loss account in newspapers, there are no corresponding requirements to publish full accounts and other detailed financial information in the Companies Ordinance (Cap 32) nor are there such requirements in other major financial centres such as New York and London. Moreover, section 60(1) of the Ordinance creates an inequality of treatment between local and foreign AIs as the requirement applies only to the former; and

(c) the improvement in financial disclosure by AIs in recent years has already contributed to greater transparency of the performance and financial strength of AIs and as a result, better informed analysis can now be made and disseminated in different ways to the public.

The current provisions under section 60(1) have therefore been replaced by a more general provision, namely section 60A, giving the MA a discretionary power to require all AIs to publish or disclose information relating to their financial affairs. The MA will specify in a legal notice the requirements regarding the amount of information to be disclosed and the manner and timing in which this should be published. It is intended that other less costly ways of disclosure, e.g., publication in the form of a press notice containing the relevant financial information, would be required. This approach will ensure that adequate transparency on the accounts of AIs is maintained and address the AIs' concern about the cost of publishing their accounts in newspapers. As a result of the amendment, the MA's Best Practice Guide on Financial Disclosure will be formalised under the new section 60A.

Section 60(5)

Under section 60(5) of the Ordinance, every AI incorporated outside Hong Kong is required to lodge with the MA, not later than 6 months after each financial year end, a copy of its audited annual balance sheet and profit and loss account.

A number of AIs incorporated outside Hong Kong (such as the US) do not normally prepare audited accounts because their home countries' regulations require only the publication and submission of the holding company's consolidated accounts.

The MA considers that the consolidated accounts should be acceptable for the purpose of assessing the financial position of the AIs concerned and, from a practical point of view, it would be unnecessary to require these AIs to prepare a separate set of accounts for the purpose of complying with section 60(5) of the Ordinance. It is therefore legitimate that foreign AIs be allowed to lodge either a copy of their audited annual accounts or, with the MA's prior approval in writing, a copy of the consolidated accounts of their holding company.

The Way Forward

The majority of the provisions of the BAO 1999 are expected to commence as soon as practicable. Sections 87A and 121(3) are scheduled to commence later subject to the issue of guidelines to AIs. Further, sections 60 and 60A are expected to take effect in the 4th quarter of 1999 as separate legal notices would need to be prepared and gazetted covering the financial disclosure requirements of both foreign and local AIs under section 60A before the year end. The amendments to section 60 would not take effect until the new requirements have been formalised under section 60A.

- Prepared by the Banking Development Division