

**Summary Note on Major Changes to
the Guide to Applicants for Authorization under the Banking Ordinance**

INTRODUCTION

1. The Guide to Applicants was issued by the Hong Kong Monetary Authority (HKMA) in 1995 to provide guidance to institutions seeking authorization under the Banking Ordinance. Since the Guide was last updated in December 1997, there have been a number of changes introduced to the authorization regime of the HKMA. The purpose of this note is to inform interested parties of these latest developments while a comprehensive review of the Guide is being undertaken. It is expected that an updated Guide to Applicants will be available in the third quarter of 2002.

CHANGES TO AUTHORIZATION REGIME

RELAXATION OF MARKET ENTRY CRITERIA

2. In December 2001, the HKMA completed a review of the balance sheet size and other criteria for a banking licence set out in paragraphs 6 and 13 of the Seventh Schedule to the Banking Ordinance. In view of the ongoing consolidation in the industry and the fact that the banking supervisory system has been further strengthened, the HKMA believes that some of these criteria can be relaxed without compromising banking stability. These changes are described below:
 - (i) The review indicated that the US\$16 billion asset size criterion applicable to overseas-incorporated bank applicants was unduly restrictive and was inconsistent with the practices of other major international financial centres. For the sake of policy consistency, this criterion has now been replaced by the much lower size criteria applicable to locally incorporated bank applicants, which are currently set at HK\$3 billion for customer deposits and HK\$4 billion for total assets. These balance sheet size criteria will apply to the applicant as a whole;
 - (ii) Most of the market entry criteria applicable to locally incorporated bank applicants were introduced to avoid circumvention of the then one-building condition imposed on overseas-incorporated banks. Since all branching restrictions on foreign banks have been abolished (see below), the HKMA considers that these criteria can be appropriately relaxed. Against this background, the requirement that a locally incorporated bank applicant must have been a restricted licence bank (RLB) or deposit-taking company (DTC) in Hong Kong for at least 10 continuous years has been reduced to three

years, which should provide sufficient time for the HKMA to assess the performance of an applicant for upgrading. In addition, the requirement that the applicant must in the opinion of the HKMA be “closely associated and identified with Hong Kong” has been dispensed with entirely; and

- (iii) The minimum capital¹ requirement for locally incorporated bank applicants has been increased from HK\$150 million to HK\$300 million. The adjustment aims to strike a balance between making it easier for institutions to enter the market as a full licensed bank and avoiding a multiplicity of small banks. For the sake of policy consistency, this requirement has also been extended to overseas-incorporated bank applicants (in respect of the applicant as a whole).
3. In addition to the above changes to the Seventh Schedule, the HKMA has also lifted the general requirement for banks incorporated outside Hong Kong to have maintained a local representative office for a period of 1-2 years before its authorization request will be considered. Overseas-incorporated banks can now apply to become an authorized institution (AI) directly.
4. The above changes to the authorization regime will allow a broader range of domestic and international institutions to participate in Hong Kong’s banking sector. This would be conducive to maintaining Hong Kong’s status as an international financial centre.

FITNESS AND PROPRIETY OF SENIOR EXECUTIVES OF AIs

5. As the banking environment becomes increasingly sophisticated, it is not just directors and the chief executive of an AI, but also its senior executives, who can affect the safety and soundness of the AI. In view of this development, a new authorization criterion, which requires AIs to maintain adequate systems of control to ensure the fitness and propriety of their senior executives (which are referred to as “managers” in the Banking Ordinance), has been introduced under the Banking (Amendment) Ordinance 2001. In addition, AIs are required under section 72B of the Ordinance to notify the Monetary Authority (MA) of the appointment of managers and any subsequent changes associated with such appointments.
6. The Amendment Ordinance also seeks to update the existing definition of “manager” which has become outdated and less effective as a result of the rapid changes in the banking industry. The enhanced definition, which is based on a functional approach instead of a reporting hierarchy approach, captures those senior executives who are

¹ “Capital” in this context has been expanded since June 2001 to cover both paid-up share capital and balance of share premium account.

principally responsible for the key business or affairs specified in a new Fourteenth Schedule. These include:-

- (a) the carrying on of retail banking, private banking, corporate banking, international banking, institutional banking, treasury or any other business which is material to the AI;
- (b) the maintenance of the accounts or the accounting systems of an AI;
- (c) the maintenance of systems of control of an AI, including those systems intended to manage the risks of the AI;
- (d) the maintenance of systems of control of an AI to protect it against involvement in money laundering;
- (e) the development, operation and maintenance of computer systems for an AI;
- (f) the conduct of internal audits or inspections of the AI's affairs or business; and
- (g) the function of ensuring that an AI complies with laws, regulations or guidelines that are applicable to it (i.e. the compliance function).

USE OF BANKING NAMES AND DESCRIPTIONS BY LOCALLY INCORPORATED RLBs

7. To provide locally incorporated RLBs with greater flexibility in doing business, the HKMA has amended the general consent issued under section 97(1). The revised general consent allows a locally incorporated RLB to use the name of its banking parent in the name or description under which it is carrying on business in Hong Kong provided that:

- (i) such name is used in immediate conjunction with, and is not more prominent than, the term "restricted licence bank" in the same language; and
- (ii) such description is used solely for the purpose of indicating the relationship between the RLB and its parent bank.

Thus, for example, a RLB subsidiary of ABC bank may describe itself as "ABC Bank (Asia) Ltd, a restricted licence bank", "ABC (Asia) Ltd, a subsidiary of ABC Bank" or "ABC Bank (Asia) Ltd, a restricted licence bank wholly owned by ABC Bank".

REMOVAL OF THE ONE-BUILDING CONDITION

8. Overseas-incorporated banks licensed since 1978 and overseas-incorporated RLBs licensed since 1990 were previously subject to the one-building condition. Given such factors as advances in technology and the increasing importance of electronic delivery channels, the HKMA considers that this twenty-year-old policy has outlived its usefulness and is not consistent with Hong Kong's reputation as an open international financial centre. The condition was first partially relaxed to three buildings in September 1999 and was subsequently completely removed in November 2001. Overseas incorporated banks and RLBs previously subject to this condition can now establish as many branches as they wish to.

THREE-TIER AUTHORIZATION SYSTEM

9. In conjunction with the review of the existing market entry criteria mentioned above, the HKMA has also evaluated the need to simplify the present three-tier authorization system into a two-tier system.
10. Moving to a two-tier structure is not itself a simple process since it would involve reconciling the different deposit-taking restrictions that currently apply to RLBs and DTCs. On the other hand, it is believed that the relaxations of the market entry criteria would enable more RLBs to upgrade to full licensed bank status and eventually lead to a natural simplification of the three-tier system. In view of this probable development, the HKMA considers it inappropriate to introduce any change to the three-tier system at this stage. This issue can be revisited when the relaxations of the market entry criteria have bedded down and worked their way through the system.

WHERE TO OBTAIN MORE INFORMATION

11. More details about these latest developments can be found on the HKMA's public website (www.hkma.gov.hk). Any questions about this note or the Guide to Applicants should be directed to Banking Development Division B of the HKMA through any of the following channels:

By mail: Banking Development Division B
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