

立法會
Legislative Council

LC Paper No. CB(1)2513/03-04

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by the Administration)

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Panel on Financial Affairs

**Minutes of meeting
held on Monday, 5 July 2004 at 10:00 am
in the Chamber of the Legislative Council Building**

Members present : Hon Ambrose LAU Hon-chuen, GBS, JP (Chairman)
Hon Henry WU King-cheong, BBS, JP (Deputy Chairman)
Hon Kenneth TING Woo-shou, SBS, JP
Hon James TIEN Pei-chun, GBS, JP
Dr Hon David CHU Yu-lin, JP
Hon Albert HO Chun-yan
Hon LEE Cheuk-yan
Dr Hon Eric LI Ka-cheung, GBS, JP
Hon NG Leung-sing, SBS, JP
Hon James TO Kun-sun
Hon CHAN Kam-lam, JP
Hon SIN Chung-kai, JP
Dr Hon Philip WONG Yu-hong, GBS
Hon Jasper TSANG Yok-sing, GBS, JP
Hon Emily LAU Wai-hing, JP
Hon Abraham SHEK Lai-him, JP

Members absent : Dr Hon David LI Kwok-po, GBS, JP
Hon Bernard CHAN, JP

Public officers attending : Agenda Item III

Mr Simon TOPPING, JP
Executive Director
Banking Policy Department
Hong Kong Monetary Authority

Mr Danny LEUNG
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services)

Agenda Item IV

Mr Arthur YUEN
Executive Director
Banking Development Department
Hong Kong Monetary Authority

Mr Raymond CHAN
Division Head
Banking Development Department
Hong Kong Monetary Authority

Mr Danny LEUNG
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services)

Agenda Item V

Mr Frederick MA, JP
Secretary for Financial Services and the Treasury

Mrs Clarie LO, JP
Deputy Secretary for Financial Services and the Treasury
(Financial Services)

Mr G W E JONES, JP
Registrar of Companies

Clerk in attendance : Miss Salumi CHAN
Chief Council Secretary (1)5

Staff in attendance : Ms Pauline NG
Assistant Secretary General 1

Ms Connie SZETO
Senior Council Secretary (1)4

Ms May LEUNG
Legislative Assistant

Action

I. Confirmation of minutes of meeting

(LC Paper No. CB(1)2255/03-04 — Minutes of meeting on 3 May 2004

LC Paper No. CB(1)2254/03-04(01) — List of outstanding items for discussion

LC Paper No. CB(1)2254/03-04(02) — List of follow-up actions)

Confirmation of minutes of meeting

The minutes of the meeting held on 3 May 2004 were confirmed.

Operating expenses of Exchange Fund and Hong Kong Monetary Authority in 2003

2. Referring to the Hong Kong Monetary Authority (HKMA)'s written response to her request for information on the operating expenses of the Exchange Fund (EF) and HKMA in 2003 (item 5 of the Panel's list of follow-up actions), Ms Emily LAU suggested that HKMA be invited to consider her views, as follows:

- (a) To invite the Governance Subcommittee of the Exchange Fund Advisory Committee (EFAC) to consider her request for disclosure of information on the operating expenses of EF and HKMA (stated in the letter dated 30 April 2004 from the Clerk to Panel (the Clerk) to HKMA) when conducting the review of disclosure of information in the context of HKMA Annual Report 2004; and
- (b) To incorporate into HKMA's annual report in future the information in respect of the breakdown of the establishment and strength by department of HKMA by the categories of senior staff and other staff, salaries and other staff costs by department, and other departmental expenses.

Briefing by Hong Kong Monetary Authority for Legislative Council Members

3. While appreciating HKMA's effort in keeping Members abreast of latest developments in monetary affairs and issues through closed door briefings, Ms Emily LAU pointed out that such briefings were often given at short notice, such as the briefing on progress in monetary issues to be held in the afternoon of 5 July 2004. Ms LAU suggested that HKMA be invited to consider briefing Members at meetings of the Panel as far as practicable and providing sufficient prior notice to facilitate the attendance of Members.

4. The Chairman directed the Clerk to convey Ms Emily LAU's views in paragraphs 2 and 3 above to HKMA.

(Post-meeting note: The letters from the Clerk to HKMA and HKMA's replies were circulated to members vide LC Paper Nos. CB(1)2387/03-04(01), (02), (03) & (04) on 13 July 2004.)

II. Information paper issued since last meeting

5. Members noted the following information paper issued since the last regular meeting held on 14 June 2004:

- (a) Report and information note on "Hong Kong Population Projections 2004-2033" (LC Paper No. CB(1)2288/03-04).

III. Briefing on the implementation of the Basel New Capital Accord in Hong Kong

(LC Paper No. CB(1)2254/03-04(03) — Paper provided by the Administration)

Briefing by Hong Kong Monetary Authority

6. At the Chairman's invitation, the Executive Director, Banking Policy Department, Hong Kong Monetary Authority (ED(BPD)/HKMA) gave a power-point presentation on the new capital adequacy standards for banks to be issued by the Basel Committee on Banking Supervision (Basel II) and HKMA's plans to implement the new standards in Hong Kong. The salient points were summarized as follows:

- (a) The international standards in the field of banking supervision were set by the Basel Committee on Banking Supervision. A key element of the Basel supervisory approach was the capital adequacy ratio (CAR) set out in the Basel Capital Accord adopted in 1988 (Basel I). Basel I and its subsequent amendments had been adopted in Hong Kong through

legislation under the Third Schedule to the Banking Ordinance (BO) (Cap. 155).

- (b) The capital held by a bank helped to absorb losses and thus protect its creditors (primarily depositors) in the event that a bank was wound up. CAR was calculated by dividing a bank's capital base by its risk-weighted assets. The minimum CAR under Basel I was 8%. While the authorized institutions (AIs) in Hong Kong were required to maintain a minimum CAR at 10%, most AIs were maintaining an average ratio of 15% - 16%.
- (c) Basel I had become outdated as the financial world had evolved significantly. The current capital framework had become too broad-bush and insufficiently "risk-sensitive" and failed to capture many other risks that banks faced. Moreover, it did not provide the proper incentives for banks to apply risk mitigation techniques. Hence, the Basel Committee had proposed Basel II to replace Basel I. Basel II aimed to provide an impetus to, and incentive for, banks to enhance risk measurement and management, and to promote market discipline by means of improved disclosure.
- (d) Basel II was built on three pillars. Pillar 1 set out the minimum capital requirements. It maintained the minimum CAR requirement of 8% but the calculation would be extended to cover a bank's exposure to operational risk, in addition to credit risk and market risk. Different approaches for each type of risks were available for adoption by individual banks. For instance, in calculating credit risk, a bank could use the Standardized Approach, which was based on ratings assigned to bank exposures by external agencies, or the Internal Ratings Based (IRB) Approach, which used internal rating models to quantify risks. Depending on the level of sophistication of the bank's internal rating systems, it might choose either the Foundation IRB Approach or Advanced IRB Approach.
- (e) It was envisaged that large international banks would adopt the IRB Approach while small banks would use the Standardized Approach. The operation of the Standardized Approach was similar to the current system, but with the important difference that the risk weights would be linked to external ratings and various risk mitigation techniques. There would be preferential weightings for residential mortgage loans and retail lending, as well as lending to small and medium-sized enterprises (SMEs). Similarly, methods of varying sophistication would be available in respect of operational risk.
- (f) Pillar 2 covered the supervisory review process of a bank. It required a bank to put in place sound internal processes to assess the adequacy of

its capital, based on a thorough evaluation of its risks, including those risks not covered under Pillar 1, such as interest rate risk in the banking book and reputational risk. Banks were expected to hold capital above the regulatory minimum and supervisors must intervene at an early stage if capital levels became insufficient.

- (g) Pillar 3 was to complement Pillar 1 and Pillar 2 by encouraging market discipline through public disclosure of key information on capital, risk exposures and risk assessment of a bank.
- (h) The Basel Committee had finalized and published Basel II by the end of June 2004. The new framework would be implemented globally by the end of 2006, while the more advanced approaches for credit risk and operational risk would be implemented by the end of 2007.
- (i) Greater risk sensitivity of Basel II and inclusion of wide range of risks would further enhance safety and stability of the banking sector in Hong Kong. Moreover, implementation of Basel II in Hong Kong would also enhance Hong Kong's reputation and position as an international banking centre. Although the new capital regime carried significant implementation costs, the investment was fully justified on a cost/benefit basis.
- (j) HKMA had engaged in extensive consultation with the industry over the past few years in developing the implementation plan on Basel II. The industry was supportive of the proposed approach for implementation. HKMA planned to implement the new capital adequacy regime in Hong Kong by the end of 2006 to tie in with the timetable of the Basel Committee. HKMA would adopt a menu approach to incorporate the various approaches for capital measurement under Pillar 1. The choice of options would be left to individual AIs subject to HKMA being satisfied that the choices were appropriate given the nature and scale of their activities.
- (k) Since the method of calculating CAR under Basel II would be considerably more complex, substantive legislative amendments to BO were expected. The Administration was considering the possible legislative approaches. One of the possible options was to provide HKMA with the power to make rules on the details for calculating capital requirements. While the rule-making power would be set out in the principal ordinance, the rules would be subsidiary legislation subject to negative vetting by the Legislative Council (LegCo). The Administration aimed at introducing a banking amendment bill into LegCo in early 2005. It would update the Panel on the subject when there were more concrete proposals on legislative changes.

(*Post-meeting note:* The presentation material was circulated to members vide CB(1)2322/03-04(01) on 6 July 2004.)

Discussion

Implementation of Basel II in Hong Kong

7. Ms Emily LAU indicated her support for the implementation of Basel II in Hong Kong with a view to improving risk management of banks. She noted that the new capital adequacy regime would bring significant benefits to Hong Kong by enhancing the safety and stability of the banking sector, increasing the ability of banks to assess and lend to sectors such as SMEs, and reducing banks' reliance on collateral in granting loans. Ms LAU urged HKMA to expedite its work for the early implementation of Basel II.

8. Mr SIN Chung-kai expressed support of Members of the Democratic Party for the implementation of Basel II in Hong Kong. He urged HKMA to conduct extensive consultation with the industry to work out the implementation plan and to brief Members on further details after commencement of the new LegCo term in October 2004.

Admin

9. Mr Kenneth TING welcomed the implementation of Basel II in Hong Kong. He enquired whether HKMA would stipulate a deadline for AIs to comply with the new capital requirements and whether it would provide incentives to encourage AIs in meeting the new standards.

10. ED(BPD)/HKMA advised that HKMA expected that AIs would make gradual improvement in their risk management systems from end of 2006 onwards and that most of them would fully comply with the new requirements by 2009. However, the implementation timetable could be adjusted in the light of developments in the market. ED(BPD)/HKMA re-iterated that the implementation process would be market driven. Market competition would exert pressure on banks to expedite improvement in their risk management systems.

Approaches for managing credit risks

11. Mr Henry WU enquired about the mechanism for determining AIs' risk management approaches. ED(BPD)/HKMA advised that HKMA would not determine the approaches to be adopted by individual AIs. AIs were expected to choose their own approach having regard to their perception of the market, their position in the market and their own aspirations. HKMA would offer advice to individual AIs and ensure that the approaches chosen by them were suitable for their types of businesses. Moreover, enhancement of public disclosure would allow customers to get to know individual AIs' choices in their risk management approaches. Consultation with the industry indicated that the largest banks and most of the medium-sized banks had aspired to adopt the IRB approach. However, given

the sizeable investments for the implementation of Basel II, the small-sized banks would adopt a simplified approach, which would be a variant of the Basel I regime. The simplified approach for credit risk management would only be an option for the small-sized banks (including deposit-taking companies and restricted licensed banks) with assets not more than \$10 billion.

12. As large banks in Hong Kong were expected to adopt sophisticated approaches in managing their credit risks whereas the medium and small-sized banks might adopt the standardized or a more simplified approach, Ms Emily LAU was concerned that medium and small-sized banks would not fully benefit from the new capital regime and might become less competitive in the market. Mr Henry WU shared her concern.

13. ED(BPD)/HKMA envisaged that AIs would adopt different approaches in managing their credit risks with due regard to their respective needs and circumstances. It was believed that individual AIs would make improvement in their risk management system to catch up with the market development. Notwithstanding that implementation of Basel II could increase market competition and might therefore accelerate the consolidation of the banking industry, medium and small-sized banks would still have their own niche if they developed appropriate business strategies and risk management systems.

Cost for implementing Basel II

14. While expressing the banking industry's support for the implementation of Basel II in Hong Kong, Mr NG Leung-sing remarked that the industry was concerned about the cost implication of the proposal. In this connection, Mr Henry WU enquired about the estimated costs for banks to improve their risk management systems.

15. ED(BPD)/HKMA advised that the additional cost would be negligible for small-sized AIs adopting the simplified approach, as few changes would be required for their existing risk management systems. For AIs adopting the Standardized Approach, some changes in their information technology (IT) systems would be required. But it was expected that the cost involved would be absorbed in the budgets for on-going improvements in the systems. As regards AIs adopting the IRB approach, the cost would vary among institutions depending on the current state of their risk management and IT systems. For large international banks already equipped with advanced risk management systems, they would only be required to fine-tune their systems and the cost involved would not be significant.

Regulatory regime for compliance of requirements under Basel II

16. Mr NG Leung-sing noted that Pillar 2 under Basel II required regulators to intervene at an early stage if the capital level of a bank became insufficient. He expressed concern about providing HKMA with such power of intervention, which might adversely effect the operation of the banks concerned.

17. ED(BPD)/HKMA advised that under Basel II, banks would be required to assess their own risks in running businesses and to decide the capital levels to be maintained subject to verification by HKMA that the levels were sufficient to guard against the risks faced by the banks. This approach would be different from the existing regime where the capital levels were determined by HKMA. As such, it would be necessary to provide HKMA with the power of intervention to require banks to increase their capital levels should such a need arise. ED(BPD)/HKMA stressed that HKMA was aware of the importance of striking a proper balance between the need to provide banks with operational flexibility and the need to maintain a regulatory power to step in when there were problems. As regards sanctions on banks for failure to comply with the new capital level, ED(BPD)/HKMA advised that a range of supervisory tools were available for HKMA to rectify problems relating to capital adequacy requirements. However, he believed that HKMA would not invoke the power of intervention unless under very exceptional circumstances.

Proposal of issuing a White Bill on Basel II

18. Given the complexity of the subject and the technical issues involved, Mr SIN Chung-kai considered it advisable for the Administration to publish a White Bill on the legislative proposal to facilitate consultation with the public and the industry, and scrutiny of the banking amendment bill by LegCo. However, Mr Kenneth TING opined that it might not be appropriate to publish a White Bill on very technical legislative proposals.

19. ED(BPD)/HKMA said that HKMA was mindful of the need to engage full consultation with the industry in developing the appropriate legislative approach for implementing Basel II. It planned to issue a consultation paper on the general approach of the new capital regime, which would outline the technical issues involved. He assured members that the Administration would work out a draft bill for wide consultation.

IV. Progress of the establishment of a commercial credit reference agency in Hong Kong

(LC Paper No. CB(1)2254/03-04(04) — Paper provided by the Administration)

Briefing by Hong Kong Monetary Authority

20. At the invitation of the Chairman, the Executive Director, Banking Development Department, Hong Kong Monetary Authority (ED(BDD)/HKMA) gave a power-point presentation on the latest developments on the establishment of a commercial credit reference agency (CCRA) in Hong Kong. He highlighted the following points:

- (a) CCRA, which gathered and collated information about the indebtedness and credit history of commercial enterprises and made available the information to lending institutions, would help strengthen credit risk management of AIs, improve the credit transparency of the corporate sector, and facilitate SMEs to seek bank finance.
- (b) The Industry Working Party, which was jointly formed by the Hong Kong Association of Banks (HKAB) and the Hong Kong Association of Restricted Licence Banks and Deposit-Taking Companies (DTCA) in 2002, and with participation from HKMA, had developed and published in June 2003 a set of recommendations on the arrangements of the CCRA scheme. The recommendations included the following items -
 - To establish a non-statutory scheme which would be easier and less costly to implement than a statutory scheme as well as more flexible and responsive to the changing needs of the banking sector;
 - All AIs involved in SME lending were expected to participate in the CCRA scheme. Subsidiaries of AIs involved in SME lending could join the scheme on a voluntary basis;
 - The CCRA scheme would cover initially only the SME customers of AIs. For the purposes of the scheme, an SME was currently defined as a non-listed commercial enterprise with an annual turnover not exceeding \$50 million. Enterprises with an annual turnover exceeding this limit were allowed to join the scheme on a voluntary basis. Sole proprietors and partnerships would not be covered at the initial stage of the scheme;
 - CCRA would collect both positive and negative information of SMEs, including the limits of the credit facilities granted by AIs to SMEs and the extent of which the facilities were supported by collateral, the amount of facilities that were overdue for more than

- 60 days and the amount of loans that had been written off. CCRA would collect data only from its start-up date onwards;
- The information contained in CCRA would be updated by AIs on a monthly basis. The credit information relating to each facility would be retained for five years from the date of full repayment of that particular facility;
 - AIs had to seek SME customers' consent before disclosing their credit data to CCRA. An SME could revoke its consent by giving the AI 90 days' prior notice in writing;
 - AIs would be required to observe the data protection rules issued by HKMA in the form of a statutory guideline under BO. AIs were required to put in place adequate systems of control to properly protect the data of their SME customers by maintaining records of access to CCRA database and performing audit checks in this regard on a regular basis;
 - The CCRA operator was required to take proper measures to safeguard the security and accuracy of the data, and to keep proper records and conduct regular audit checks on the systems. SME customers could access their information and make correction requests;
 - SME customers who would like to complain against AIs and the CCRA operator might forward the complaints to HKMA. HKMA would ensure that the complaints were properly handled in accordance with the relevant data protection guidelines.

(Post-meeting note: The presentation material was circulated to members vide CB(1)2322/03-04(02) on 6 July 2004.)

21. ED(BDD)/HKMA added that in August 2003, the Industry Working Party had appointed Dun & Bradstreet (HK) Ltd to operate the CCRA. At present, both parties had largely finalized the operational details of the scheme. Most AIs had started amending their systems to meet the requirements of the scheme. With reference to the Code of Practice on Consumer Credit Data issued by the Privacy Commissioner for Personal Data, HKMA had developed the statutory guideline governing the sharing and use of credit data through CCRA and issued it to all AIs in June 2004. HKMA and the Industry Working Party would continue to promote the SME sector's understanding and acceptance of the scheme by attending the meetings of relevant SME bodies and providing briefings to SMEs. AIs were expected to complete seeking customers' consent for disclosure of data to CCRA by the end of August 2004. Based on the present schedule, AIs could start uploading credit data to CCRA in September 2004 and the scheme was envisaged to be fully operational by the end of 2004.

Discussion

Benefits of the CCRA scheme

22. Mr Kenneth TING, Mr CHAN Kam-lam and Mr NG Leung-sing welcomed the establishment of the CCRA scheme in Hong Kong, which would facilitate SMEs in seeking bank finance and reduce banks' reliance on collateral for granting loans. However, noting that information such as the company's assets and business plans would not be covered by the scheme, Mr TING and Mr CHAN were concerned that banks would not have sufficient information to assess the credit worthiness of SMEs. In this connection, Mr NG asked whether financial information of SMEs would be included in the database on the request of the customers.

23. In reply, ED(BDD)/HKMA advised that the purpose of the CCRA scheme was to provide information relating to companies' credit facilities and overdue facilities, which were presently not shared among AIs. The CCRA operator would not include financial information of an SME, such as business records and accounts, in the database. In general, AIs would require SME customers to provide financial information relating to the enterprises to facilitate the assessment of credit applications. As AIs had no difficulty in obtaining such information from borrowers, it was considered not necessary to include the information in the CCRA database.

24. Noting that CCRA would collect data only from its start-up date onwards and that default data of past facilities or overdue payments of current facilities which had been settled would not be reported, Mr NG Leung-sing enquired about the rationale behind the proposal. ED(BDD)/HKMA pointed out that information on default of past facilities and overdue payments of current facilities which had been settled would have limited value in assisting AIs in conducting credit checks on customers. The proposal would strike a balance between ensuring comprehensiveness of the CCRA database and benefits to SMEs.

25. Dr Philip WONG expressed reservation over the benefits of the CCRA scheme. He pointed out that for those SMEs which had already obtained numerous credit facilities from AIs, or those with negative credit data, it would be even more difficult for them to seek bank finance. Moreover, AIs would be less willing to lend to those SMEs which were not participating in the scheme.

26. While agreeing that some SMEs with excessive lending might not benefit from the CCRA scheme, ED(BDD)/HKMA stressed that the scheme would help the majority of SMEs in seeking credits. There was a need to provide these SMEs with greater access to credits and the scheme would provide AIs with a fuller picture of the credit worthiness of these customers to facilitate credit assessment. ED(BDD)/HKMA also pointed out that similar schemes operating in the United States (US), the United Kingdom (UK) and Asian countries had successfully

improved credit accessibility of the corporate sector and strengthened lending institutions' credit risk management.

Customer consent

HKMA

27. Mr CHAN Kam-lam considered the proposed 90-day notice period for SMEs to revoke their consent of disclosing credit data to CCRA too long and suggested that the period be shortened. Mr CHAN further suggested that the Industry Working Party should consider putting in place a more flexible mechanism to facilitate SMEs to give and withdraw their consent. ED(BDD)/HKMA undertook to reflect Mr CHAN's views to the Industry Working Party.

28. Mr NG Leung-sing enquired whether AIs were required to inform CCRA of customers' revocation of consent. ED(BDD)/HKMA said that AIs were required to report the revocation to CCRA as soon as practicable upon receipt of notice from the SME concerned and to stop reporting the credit data of that SME to CCRA after the 90-day period. Failure to comply with the requirement would result in supervisory actions by HKMA. He also pointed out that SMEs which had revoked their consent could re-join the scheme by notifying their AIs.

29. Referring to paragraph 7 of the paper provided by HKMA, Mr Henry WU noted that by the end of March 2004, AIs had on average sought consent from 55% of SME customers to disclose their credit data to CCRA, but only about 60% of these customers had responded to AIs' requests. Mr WU expressed concern about the low response rate, which might indicate a lack of support by SMEs for the scheme. He considered that AIs should explain the details including the purposes, benefits and costs of the scheme to SMEs.

HKMA

30. ED(BDD)/HKMA emphasized that the SME sector had recognized the benefits of the scheme and given its support. With a view to building up a comprehensive database and avoiding AIs from approaching SME customers on a selective basis, AIs were required to seek the consent of all SME customers which had met the definition of SME under the scheme. Most AIs would seek their customers' consent when they conducted annual review of their credit facilities. Given that AIs had only started to seek SME's consent in October 2003, the progress by the end of March 2004 was considered reasonable. Moreover, about 96% of those SMEs which had responded gave their consent. The result was encouraging. It was expected that AIs would further step up their consent seeking efforts in light of the upcoming launch of the scheme. ED(BDD)/HKMA undertook to provide results of the survey as at end of June 2004 on AIs' consent seeking efforts for members' reference when the information was available.

31. As regards the work to promote SME sector's understanding and acceptance of the CCRA scheme, ED(BDD)/HKMA said that HKMA and the Industry Working Party, in collaboration with various SME bodies, had organized briefings for SMEs. HKAB and DTCA had also issued a leaflet to explain the details of the scheme to

SMEs. He assured members that both HKMA and the industry would continue to promote the scheme to SMEs.

Cost implication on banks

32. Mr CHAN Kam-lam expressed concern about the cost implication of the CCRA scheme on SME customers. In response, ED(BDD)/HKMA advised that AIs would be charged for access to the credit data. As regards whether such cost would be transferred to SME customers, it would be a matter for AIs and the customers to decide.

Access to the CCRA database

33. Mr SIN Chung-kai was concerned about which parties had the right of access to the CCRA database and whether government departments, law enforcement agencies and the media had such right of access. As CCRA would not be regulated by HKMA, Mr SIN urged that the Administration should issue rules/guidelines setting out clearly the parties which had the right of access to the database and the circumstances under which access could be made. In this connection, Mr James TIEN pointed out that it was the understanding of the business sector that only AIs and SMEs participating in the scheme had the right of access to the database.

34. ED(BDD)/HKMA advised that in general, AIs and their subsidiaries could access the CCRA database for conducting credit checks in relation to the grant, review or renewal of SMEs' credit facilities. SMEs would have the right of access to their credit data, but media did not have such right. As regards enforcement agencies, ED(BDD)/HKMA undertook to provide information on the circumstances under which enforcement agencies might access the CCRA database and the enforcement agencies involved.

35. Mr SIN Chung-kai considered it essential for the Administration to issue rules/guidelines on the circumstances under which enforcement agencies might access the CCRA database. The Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) agreed to provide the Administration's response after the meeting.

(Post-meeting note: The Administration's replies on paragraphs 34 and 35 were circulated to members vide LC Paper No. CB(1)2450/03-04(01) on 27 July 2004.)

V. Progress of review of the Companies Ordinance

(LC Paper No. CB(1)2254/03-04(05) — Paper provided by the Administration)

Briefing by the Administration

36. At the Chairman's invitation, the Secretary for Financial Services and the Treasury (SFST) briefed members on the progress of the overall review of the Companies Ordinance (CO) (Cap. 32). The salient points were summarized as follows:

- (a) The CO was one of the largest and most complex pieces of legislation in Hong Kong. It was derived from the UK Companies Act, which was first enacted in 1865. Regular updates of the CO were necessary to ensure that Hong Kong's company law met the needs of modern day users and continued to provide the legal infrastructure commensurate with Hong Kong's status as a major international business and financial centre. The Standing Committee on Company Law Reform (SCCLR) had been formed in 1984 to advise on the necessary amendments to the CO on a continuous basis. Although there had been regular amendments to the CO over the past two decades, it had come to a stage where piecemeal amendments were no longer desirable. A complete rewrite and restructuring of the CO was considered appropriate to take account of the latest international practices, to upgrade Hong Kong's corporate governance regime, and to harmonize the new and old provisions.
- (b) The Administration, in consultation with the SCCLR, considered it desirable to make reference to the developments in the UK company law review embarked on a few years before as the basis of the rewrite exercise of the CO. To take forward the exercise, a Companies Bill Team (CBT) would be established in the Companies Registry (CR) to prepare a White Bill for public consultation with a view to leading to the preparation of a new Companies Bill. Working Groups (WGs) would be formed under the CBT comprising representatives nominated by the relevant professional bodies and company law academics for considering and endorsing the White Bill.
- (c) Assuming that the UK White Bill would be available in early 2005, the Administration envisaged that preparation for the White Bill in Hong Kong would take about 24 months from May 2005 to April 2007. The White Bill would then be released for public consultation from May to October 2007. After revising the White Bill from November 2007 to April 2008, the new Companies Bill would be introduced into LegCo by

October 2008. Given the complexity of the bill, it was expected that the scrutiny period would take about 18 months up to March 2010.

- (d) The Administration had formed a working group to map out the terms of reference and the detailed work schedule for the rewrite exercise. The Administration planned to submit the necessary funding proposal for undertaking the exercise to LegCo before the end of 2004.

Discussion

Timeframe for the rewrite exercise

37. Ms Emily LAU indicated support for the proposal to rewrite the CO. She however expressed concern that under the proposed timeframe, it would take five years to complete the rewrite exercise. She urged that the exercise be expedited so that Hong Kong's company regulatory regime could keep pace with international developments.

38. In response, SFST assured members that the Administration would endeavour to complete the rewrite exercise as early as practicable. Given that it would be a very complex task involving extensive legal research and numerous parties, it was prudent to adopt a conservative timetable. He stressed that the proposed timeframe was indicative only and would hinge on a number of factors. The Registrar of Companies (RC) supplemented that the Administration planned to seek LegCo's approval for the resource requirements for the exercise before the end of 2004. Subject to provision of resources and suitable staff, the rewrite exercise would commence in mid 2005.

Company law reforms in other jurisdictions

39. Whilst supporting that reference should be made to the UK White Bill, Ms Emily LAU was concerned that if the UK White Bill was not available in early 2005, the rewrite exercise in Hong Kong might be delayed. She enquired how far the UK White Bill would affect the rewrite exercise.

40. In reply, RC re-iterated that both the Administration and the SCCLR agreed that, in taking forward the rewrite exercise, due regard should be given to the results of the UK company law review, as Hong Kong's company law was essentially derived from the UK model. However, the rewrite exercise was not necessarily bound by the results of the UK review given the cultural, social, economic and regulatory differences between the two jurisdictions. While the rewrite exercise would go in parallel with the UK company law reform, it would not be constrained by the UK legislative timetable for enactment of the new UK Companies Act.

41. Mr Henry WU enquired whether the Administration would make reference to company laws of jurisdictions of the European Union (EU) in rewriting the CO. RC said that the SCCLR had not studied EU legislation, as EU countries were civil law

jurisdictions whereas Hong Kong was a common law jurisdiction. He added that the SCCLR had focused its study on company laws of US, UK, Australia and Singapore etc, in conducting previous reviews on the CO.

Structure of the rewrite exercise

42. To enhance the efficiency of the rewrite exercise, Ms Emily LAU considered it important for the Administration to put in place an appropriate administrative structure delineating the roles and duties of the various parties involved in the process. In this connection, she enquired about the roles of the SCCLR and SFST in the exercise.

43. SFST advised that a designated CBT would be established in CR to undertake the relevant research work, to prepare the White Bill and to steer the new Companies Bill through LegCo. While RC would have overall administrative control of the exercise, SFST said that he himself would oversee the exercise. RC advised that in addition to the existing Joint Government/Hong Kong Society of Accountants (HKSA) Working Group, which was responsible for reviewing the accounting and auditing provisions of the CO, two new working groups would be established to undertake reviews of Part II of the CO, involving provisions on share capital and debentures, and the remaining parts of the CO. He stressed that, in view of the complexity and far reaching implications of the rewrite exercise, the Administration was fully aware of the need to involve experts and consult relevant stakeholders in the process. Representatives from professional and commercial organizations including the HKSA, Law Society of Hong Kong, Hong Kong Bar Association and the Hong Kong Chamber of Commerce etc., would be invited to join the working groups so that balanced views from the key sectors would be taken into account.

44. As regards the role of the SCCLR, RC said that although the SCCLR would not be involved in the detailed drafting of the new Companies Bill, it would be consulted on any related policy issues which emerged in the process of the rewrite and would provide guidance on the work of the CBT and WGs.

45. Referring to paragraph 11 of the paper provided by the Administration, Ms Emily LAU agreed that it was important to recruit staff of the right calibre to join the CBT in taking forward the rewrite exercise. She enquired about the details of recruiting these staff and whether the Administration had contingency plan in the event that suitable persons could not be identified.

46. SFST advised that the Administration shared the SCCLR's view that it was crucial to recruit staff of the right calibre to undertake the re-write exercise to make it a success. The Administration's aim was to engage legal experts and relevant professionals in the private sector to participate in the task.

Cost for the rewrite exercise

47. Ms Emily LAU and Mr Henry WU enquired about the estimated cost for undertaking the rewrite exercise. SFST said that, given the complexity of the rewrite exercise, considerable resources would be required. He informed members that the last major review of the CO conducted in mid 1990s costed over \$10 million. It was envisaged that the rewrite exercise would incur higher costs. SFST advised that the Administration would be working on the funding and manpower proposals relating to the exercise and planned to submit the proposals for LegCo's approval before end of 2004. He assured members that the Administration would be mindful of the need to conduct the rewrite exercise in a cost-effective manner.

48. Mr Henry WU remarked that the scale and complexity of the rewrite exercise were comparable to those of the exercise on the enactment of the Securities and Futures Ordinance (SFO) (Cap. 571). He sought information on the costs incurred by the Administration and the Securities and Futures Commission (SFC) in the latter exercise, including the costs involved in the whole process from the preparation and drafting of the White Bill in April 2000 and the enactment of the SFO in March 2002.

49. In respect of the costs incurred by the Administration, the Deputy Secretary for Financial Services and the Treasury (Financial Services) advised that three additional posts namely, one Directorate Staff Grade B post, one Directorate Staff Grade C post and one Senior Administrative Officer post had been created to undertake the exercise on the enactment of the SFO. As for the SFC, in addition to existing staff, it had engaged a number of outside experts to assist in the project. These experts were employed on contract basis and their posts had been deleted after completion of the exercise. SFST undertook to request the SFC to provide the details on the costs involved in the project for members' reference.

(Post-meeting note: The information provided by SFC was circulated to members vide LC Paper No. CB(1)2439/03-04(02) on 21 July 2004.)

Way forward

50. At the suggestion of Ms Emily LAU, members agreed that the Panel should continue to monitor progress of the rewrite exercise in the next legislative term.

(Post-meeting note: The item on "Comprehensive review of the Companies Ordinance" was included in the Panel's list of outstanding items for discussion.)

VI. Any other business

Concluding remarks

51. As the meeting was the last regular meeting of the Panel in the current legislative term, the Chairman took the opportunity to thank members, the Administration, and the LegCo Secretariat for their support and contribution to the work of the Panel throughout the whole term.

52. Ms Emily LAU also thanked the LegCo Secretariat for its services provided to the Panel. To facilitate members to keep track of the issues discussed by the Panel, Ms LAU suggested that the LegCo Secretariat should prepare background briefs on discussion items as far as practicable.

53. There being no other business, the meeting ended at 12:50 pm.

Council Business Division 1
Legislative Council Secretariat
13 September 2004