

LEGISLATIVE COUNCIL BRIEF

Banking Ordinance
(Cap.155)

SPECIFICATION OF FACTORS (FINANCIAL EXPOSURE OF AUTHORIZED INSTITUTION) NOTICE 2007

INTRODUCTION

The Monetary Authority (MA) has published the *Specification of Factors (Financial Exposure of Authorized Institution) Notice 2007*, at **Annex**, in the Gazette to specify the factors to be applied to nine types of off-balance sheet items of an authorized institution (AI) pursuant to section 81(2)(c) of the Banking Ordinance (“the Ordinance”) for the purpose of calculating the financial exposure of the institution.

BACKGROUND

2. The Banking (Amendment) Ordinance 2005 (“BAO 2005”) enacted on 6 July 2005 provided for, among other things, the implementation of a revised international capital adequacy framework in Hong Kong, based upon the “International Convergence of Capital Measurement and Capital Standards: A Revised Framework” issued by the Basel Committee on Banking Supervision (commonly known as “Basel II”).

3. When the BAO 2005 came into operation on 1 January 2007, the Third Schedule to the Ordinance was repealed and the Banking (Capital) Rules (Cap. 155 Sub. Leg. L) (“the Rules”) were made by the MA pursuant to section 98A of the Ordinance to replace the provisions of the Third Schedule. The way in which a locally-incorporated AI calculates its capital adequacy ratio, which was previously set out in the Third Schedule, is now prescribed in the Rules. The BAO 2005 also made necessary consequential amendments to the Ordinance, such as the repeal of section 81(2)(c) which contained a reference to “Table B of the Third Schedule”, the inclusion of a revised section 81(2)(c) which now contains a reference to the Rules, and the repeal of the *Specification of Factors (Financial Exposure of Authorized Institution) Notice* (Cap. 155 Sub. Leg. C) issued pursuant to section 81(3) of the Ordinance.

JUSTIFICATIONS

4. Section 81(1) of the Ordinance imposes a statutory limit on a Hong Kong-incorporated AI's financial exposure to any one person or a group of connected parties as defined in that section. The financial exposure of an institution is defined under section 81(2) to include, among other items, loans and advances, holdings of shares and debt securities, and off-balance sheet items referred to in the rules made by the MA for the purposes of section 98A(1). For calculating the financial exposure arising from an AI's off-balance sheet item, section 81(2)(c) provides that it should be "the product of (i) the principal amount of any item that, in relation to the institution, is an off-balance sheet item for the purpose of rules made under section 98A(1); and (ii) the factor specified by the Monetary Authority pursuant to subsection (3) for that item."

5. Consequent upon the repeal of the *Specification of Factors (Financial Exposure of Authorized Institution) Notice* (Cap. 155 Sub. Leg. C) on 1 January 2007, it would be necessary for the MA to prepare a new notice to specify the factors for the purposes of section 81(2)(c) of the Ordinance. The new notice, the *Specification of Factors (Financial Exposure Authorized Institution) Notice 2007* which was published in the Gazette on 18 May 2007, is therefore intended to replace the repealed notice.

6. The off-balance sheet items covered in the new notice are the same as those set out in the Rules and substantially similar to those in the repealed notice. The factors specified for these off-balance sheet items in the new notice are also the same as those specified in the repealed notice.

THE NOTICE

7. The *Specification of Factors (Financial Exposure of Authorized Institution) Notice 2007* specifies the factors to be applied to nine types of off-balance sheet items for the purposes of section 81(2)(c) under section 81(3) of the Ordinance.

LEGISLATIVE TIMETABLE

8. The notice was published in the Gazette on 18 May 2007 and will be tabled at the Legislative Council on 23 May 2007 for negative vetting. Subject to the completion of the negative vetting process, it is intended that the notice shall come into operation on 13 July 2007.

IMPLICATIONS OF THE PROPOSAL

9. The notice is in conformity with the Basic Law, including the provisions concerning human rights. It has no financial or civil service, productivity, environmental or sustainability implications.

PUBLIC CONSULTATION

10. The Hong Kong Monetary Authority (HKMA) has informed the banking industry of the proposed factors applicable to the nine types of off-balance sheet items to be specified in the new Gazette notice. No specific comments have been received.

PUBLICITY

11. The HKMA will issue a letter to all AIs and the industry associations informing them of the notice.

ENQUIRIES

12. Enquiries on this brief may be directed to Ms Rose Luk, Head (Banking Policy) of the HKMA at 2878 1638.

**Hong Kong Monetary Authority
Financial Services and the Treasury Bureau
18 May 2007**

L.N. 89 of 2007**SPECIFICATION OF FACTORS (FINANCIAL
EXPOSURE OF AUTHORIZED
INSTITUTION) NOTICE 2007**

(Made by the Monetary Authority under section 81(3) of the
Banking Ordinance (Cap. 155))

1. Commencement

This Notice shall come into operation on 13 July 2007.

2. Interpretation

In this Notice—

“asset sale with recourse” (有追索權的資產出售) has the meaning assigned to it by section 2(1) of the Capital Rules;

“Capital Rules” (《資本規則》) means the Banking (Capital) Rules (L.N. 228 of 2006);

“direct credit substitute” (直接信貸替代項目) has the meaning assigned to it by section 2(1) of the Capital Rules;

“forward asset purchase” (遠期資產購買) has the meaning assigned to it by section 2(1) of the Capital Rules;

“forward deposits placed” (遠期有期存款) has the meaning assigned to it by section 2(1) of the Capital Rules;

“note issuance and revolving underwriting facilities” (票據發行及循環式包銷融通) has the meaning assigned to it by section 2(1) of the Capital Rules;

“original maturity” (原訂到期期限), in relation to a relevant off-balance sheet item of an authorized institution, means the period between the date on which the item is entered into by the institution and the earliest date on which the institution can, at its option, unconditionally cancel the item;

“partly paid-up shares and securities” (部分付款股份及證券) has the meaning assigned to it by section 2(1) of the Capital Rules;

“relevant off-balance sheet item” (有關資產負債表外項目) means an off-balance sheet item for the purpose of rules made under section 98A(1) of the Ordinance;

“trade-related contingency” (貿易關聯或有項目) has the meaning assigned to it by section 2(1) of the Capital Rules;

“transaction-related contingency” (交易關聯或有項目) has the meaning assigned to it by section 2(1) of the Capital Rules.

3. Specified factors

For the purposes of section 81(2)(c) of the Ordinance, the factor for a relevant off-balance sheet item set out in the second column of the Schedule is specified in the third column of that Schedule opposite to that item.

SCHEDULE

[s. 3]

FACTORS FOR RELEVANT OFF-BALANCE SHEET ITEMS

Item	Relevant off-balance sheet item	Factor
1.	Direct credit substitutes	100%
2.	Transaction-related contingencies	100%
3.	Trade-related contingencies	100%
4.	Asset sales with recourse	100%
5.	Forward asset purchases	100%
6.	Partly paid-up shares and securities	100%
7.	Forward deposits placed	100%
8.	Note issuance and revolving underwriting facilities	100%
9.	Commitments which do not fall within any of items 1, 2, 3, 4, 5, 6, 7 and 8 and—	
	(a) which have an original maturity of any duration;	100%
	(b) which may be cancelled at any time unconditionally by the authorized institution or which provide for automatic cancellation due to a deterioration in the creditworthiness of the persons to whom the institution has made the commitments;	100%
	(c) the drawdown of which will give rise to a relevant off-balance sheet item falling within any of items 1, 2, 3, 4, 5, 6, 7 and 8 or any item specified in section 120 of the Capital Rules.	100%

Joseph C. K. YAM
Monetary Authority

14 May 2007

Explanatory Note

Section 81 of the Banking Ordinance (Cap. 155) provides that the financial exposure of an authorized institution to any person, company or combination thereof shall not exceed a certain amount and specifies how such financial exposure is to be calculated. The purpose of this Notice is to specify, in relation to the calculation of such financial exposure, the factors for certain off-balance sheet items that are off-balance sheet exposures specified in Table 14 under section 118 of the Banking (Capital) Rules (L.N. 228 of 2006) for the purpose of calculating an authorized institution's capital adequacy ratio.