

**For discussion  
on 7 October 2024**

## **Legislative Council Panel on Financial Affairs**

### **Review of the Banking Ordinance**

#### **PURPOSE**

This paper briefs Members on -

- (a) the Government's plan to amend the Banking Ordinance (Cap. 155) (BO); and
- (b) two of the proposed legislative amendments to the BO, namely (i) simplifying the three-tier banking system into two-tier; and (ii) allowing sharing of information among Authorized Institutions (AIs) on customers, accounts and transactions for the purpose of preventing and detecting financial crime.

#### **BACKGROUND**

2. The Monetary Authority (MA)<sup>1</sup> is charged with the principal function of promoting the general stability and effective working of the banking system under the BO. As part of his statutory functions under the BO, the MA is responsible for considering and proposing reforms of the law relating to banking business and the business of taking deposits.

3. In recent years, a number of legislative amendments to the BO (and the relevant rules) were effected to ensure the regulatory framework in Hong Kong remains in line with international standards, particularly those

<sup>1</sup> Legally, the MA is an individual appointed by the Financial Secretary under the Exchange Fund Ordinance. The powers under the Banking Ordinance are personally vested in the MA. In practice, the MA heads an Office known as the "Hong Kong Monetary Authority" (HKMA) of which he is the Chief Executive.

issued by the Basel Committee on Banking Supervision<sup>2</sup>.

4. While the Hong Kong banking system remains robust, resilient and well regulated, it is important to review and assess regularly the framework so that the MA could effectively discharge his functions under the BO, especially in promoting the general stability and effective working of the banking system. This is particularly important in the face of rapid developments in the banking sector and the evolving domestic and international regulatory and supervisory landscape.

5. Against this backdrop, the MA has recently conducted a review of the BO with the following purposes:

- (a) reflect developments in banking industry practices, and regulatory and supervisory approaches, both globally and domestically;
- (b) address specific issues identified from the Hong Kong's supervisory experience over recent years; and
- (c) continue the process of aligning the system of regulation in Hong Kong with that of other major financial centres.

6. The BO review focuses specifically on a number of priority areas where amendments and enhancements to the BO are considered timely and necessary. The aim is to ensure that the MA is equipped with a set of tools and powers to maintain banking stability that is fit for purpose, and to better enable the MA and the Hong Kong banking industry to face new risks and challenges going forward.

## **THE PROPOSALS**

7. The Government, in collaboration with the MA, will put forward enhancement proposals in the following priority areas:

- (a) simplification of the three-tier banking system into two-tier;
- (b) allowing sharing of information among AIs on customers,

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<sup>2</sup> Hong Kong has been a member of the Basel Committee on Banking Supervision since June 2009.

accounts and transactions for the purpose of preventing and detecting financial crime;

- (c) establishing a statutory regime for the MA to exercise direct regulatory and supervisory powers over designated locally incorporated holding companies of locally incorporated AIs;
- (d) extending the MA's enforcement powers, for better enabling the MA to deal with a range of potential "misconduct" and "fitness and propriety" issues, in a more tailored and proportionate manner;
- (e) allowing flexibility for the MA to engage skilled persons on a case-by-case basis, where appropriate, for assisting the MA in the performance of his functions under the BO; and
- (f) introducing a number of technical amendments for addressing operational issues, streamlining the regulatory and supervisory processes, reducing compliance burdens faced by AIs, continuing the process of aligning the system of regulation in Hong Kong with that of other major financial centres, and further enhancing legal and regulatory clarity.

8. In view of the complexity and volume of the proposed enhancements for BO, the proposals in (a) and (b) above will be introduced in this paper, while the other proposals will be introduced in a future Panel meeting.

*(A) Simplification of the Three-tier Banking System*

9. The current three-tier structure of the banking system (comprising licensed banks (LBs), restricted licence banks (RLBs) and deposit-taking companies (DTCs)) had a history of four decades and aimed to strike a balance between flexibility of entry into the banking system and protection of small depositors. In gist, the system allows:

- (a) LBs to engage in banking and deposit-taking business without any restrictions;
- (b) RLBs to take deposits in amounts of HK\$500,000 and above without restriction on maturity; and

- (c) DTCs to take deposits but restricted to those of HK\$100,000 or above with an original term to maturity of at least three months.

10. Over the years, refinements had been made to the three-tier banking system to ensure that it remained fit for purpose, including making it easier to become an LB by relaxing the market entry criteria<sup>3</sup>.

11. In 2023, the HKMA conducted a review of the three-tier banking system, with a view to simplifying the structure of Hong Kong's banking system, enhancing its vital role in strengthening Hong Kong's status as an international financial centre, and revitalising institutions in the category of DTCs to enhance their flexibility and efficiency in conducting business and meeting customers' needs.

#### *Enhancement Proposal*

12. According to the result of the review, the total number of DTCs has dropped significantly over the past four decades. As of end-June 2024, DTCs only accounted for 0.07% and 0.03% of the Hong Kong banking sector in terms of total assets and customer deposits respectively. Therefore, it is proposed to simplify the three-tier system into two tiers by merging DTCs into the RLB sector, thereby forming a new second-tier of our banking system. The key parameters of the proposal are:

- (a) maintain LBs as the first-tier institutions and merge DTCs into the second-tier, which will continue to be called RLBs;
- (b) discontinue the authorisation of new DTCs, and invite and encourage existing DTCs to upgrade themselves to the second-tier (i.e. RLBs) or LBs, within a transition period of five years; and
- (c) keep the nomenclature of and requirements on the second-tier unchanged, including the minimum capital requirement (HK\$100 million) and the minimum deposit size requirement

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<sup>3</sup> For example, a number of outdated authorization criteria for LBs were removed in 2012 following a review conducted by the HKMA.

(HK\$500,000), and the arrangement for optional application for access to the real-time gross settlement systems.

13. To facilitate the transition of existing DTCs into the new framework, it is further proposed that an existing DTC that wishes to upgrade as an RLB during the five-year transition period will be converted as an RLB when it can demonstrate to the HKMA's satisfaction its ability to meet the minimum capital requirement of HK\$100 million, without the need to submit fresh applications for licence.<sup>4</sup> DTCs that do not upgrade to become an RLB or LB before the end of the five-year transition period will be deemed to have requested the MA to revoke its authorisation as a DTC. The HKMA will provide guidance to the DTCs in their transitions.

14. To minimise potential impact on existing depositors<sup>5</sup> of DTCs, upon conversion to an RLB, DTCs can continue to hold/renew deposits between HK\$100,000 and HK\$500,000 taken before conversion, subject to three-month maturity restriction but up to the end of the transition period. Any new deposits taken on or after the conversion will be subject to the deposit size requirement of HK\$500,000 while no maturity restrictions will apply. Dormant account balances will be transferred to a suspense account, with no size or maturity requirements.

*(B) Information Sharing among Authorized Institutions for Crime Prevention and Detection*

15. In recent years, a sharp increase in financial crime, especially digital fraud, has been observed globally including Hong Kong. This has led to increasing concern about harm to victims, damage to consumer confidence in digital financial services and possible wider impacts on the stability and integrity of the banking system.

16. Experience shows that information sharing among banks and law enforcement agencies (LEAs) is key to combatting financial crime and

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<sup>4</sup> Re-appointment of controllers, directors or senior management are also not necessary. Any conditions previously attached by the MA to DTC's authorization; any existing approvals for establishment of branches, overseas representative offices / banking corporations; and any acts, consents, approvals, dispensations, exemptions etc. given by the MA pursuant to BO and its subsidiary legislations shall continue in force and effect.

<sup>5</sup> As at end June 2024, there were 11 DTCs and about 2 500 DTC depositors in Hong Kong.

related money laundering (ML). In this regard, the HKMA, the banking sector and the Hong Kong Police Force (HKPF) have responded with a number of public-private initiatives, including the Fraud and ML Intelligence Taskforce and Anti-Deception Coordination Centre.

17. While these public-private initiatives have achieved considerable success, they are not, by themselves, sufficient to fully address the issue of fraud and ML via networks of accounts maintained by criminals. This is due to the fact that such arrangements generally only apply in cases where LEA investigations are already active, and may not support the sharing of information quickly where there is no existing investigation. Criminals are therefore able to exploit information gaps between AIs. For example, by the time one AI has taken action against illicit activities, those fraudsters may be able to move their activities to other AIs, which the first AI is unable to alert.

18. In view of the above, there is a growing trend internationally towards cooperation between private-sector financial institutions by sharing information to combat crime and related ML. In Hong Kong, the Financial Intelligence Evaluation Sharing Tool (FINEST) was introduced in June 2023<sup>6</sup> to facilitate information sharing among AIs. However, FINEST currently only covers information on corporate accounts. If personal account information is included in the scope of FINEST, its ability to prevent and detect crime will be greatly enhanced, since an estimated 90% of accounts used in ML-related fraud are held by individuals.

19. While safeguarding data privacy and customer confidentiality is crucial to the banking sector, there is an increasing view that such considerations should be balanced against the need for a degree of information sharing to help prevent and detect illicit activities. Several overseas jurisdictions<sup>7</sup> have introduced legal protection for information sharing among financial institutions in cases where fraud, ML, terrorist financing (TF) or proliferation financing (PF) are suspected, subject to appropriate safeguards.

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<sup>6</sup> The initiative is developed by the Hong Kong Association of Banks, with guidance from the HKMA, and support from the HKPF.

<sup>7</sup> For example, the United States, the United Kingdom and Singapore.

*Enhancement proposal*

20. The main objectives of the proposal are:
- (a) supporting the expansion of the FINEST platform to include information on personal accounts, which comprise the great majority of suspicious or “mule” accounts;
  - (b) assisting AIs in deciding whether to file suspicious transaction reports (STRs) by allowing them to share information on customers or activities which raise red flags. This will enhance the overall quality of STRs by combining information from different AIs, while also reducing false positives, as information from one AI may help explain activities that another AI has identified as suspicious. It also helps reduce information requests and related inconvenience to customers; and
  - (c) allowing prompt sharing of information to support interception or freezing of illicit funds by LEAs with a view to eventual confiscation and return to victims.
21. In light of the above, it is proposed that:
- (a) AIs be permitted to share information, as requested by another AI or at an AI’s own initiative, where:
    - (i) a disclosing/requesting AI has observed activity that it has reasonable grounds to believe that such activity may indicate possible involvement in ML/TF/PF;
    - (ii) a disclosing AI has reasonable grounds to believe that the information will assist receiving AI(s) in detecting or preventing ML/TF/PF; and
    - (iii) a requesting AI has reasonable grounds to believe that AI(s) to which the request is sent has information likely to assist in detecting and preventing ML/TF/PF;

- (b) legal protection be provided to AIs sharing information (i.e. sharing will not be considered a breach of confidentiality requirements under laws, rule of conduct or in contracts). AIs will be required to act with reasonable care and in good faith;
- (c) empowering the MA to designate platforms to be used for sharing, permit AIs to access, and maintain a database; and
- (d) AIs be obliged to protect confidentiality of information received, except for necessary onward disclosure, and maintain adequate systems and controls.

## **CONSULTATION**

22. The HKMA has conducted public consultation on the two BO enhancement proposals above which are detailed in paragraphs 23 to 26 below.

### *Simplification of the Three-tier Banking System*

23. The HKMA conducted a three-month public consultation on 26 June 2023 to collect views from the banking industry (including RLBs and DTCs) and the public on the proposal. The respondents were supportive of the proposal, including the minimum capital requirement of HK\$100 million and keeping the current nomenclature of RLB for the new second-tier. Specific comments are mainly on the transitional arrangements, minimum deposit size requirement, and impact on banking stability.

24. Taking into account the feedback during the public consultation, the HKMA issued a consultation conclusions paper<sup>8</sup> on 5 August 2024, addressing the comments raised in the consultation and setting out details of the proposal.

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<sup>8</sup> The consultation conclusions paper is available at [https://www.hkma.gov.hk/media/eng/regulatory-resources/consultations/ConsultationConclusions3TierBankingSystem\(ENG\)\\_05082024.pdf](https://www.hkma.gov.hk/media/eng/regulatory-resources/consultations/ConsultationConclusions3TierBankingSystem(ENG)_05082024.pdf).



*Information Sharing among Authorized Institutions for Crime Prevention and Detection*

25. The HKMA issued a consultation document on 23 January 2024 to seek views from the banking sector and the public. The consultation closed on 29 March 2024. 18 responses were received, including the Office of the Privacy Commissioner for Personal Data (PCPD).

26. The proposal received general support from respondents. 11 respondents explicitly supported the proposal and none opposed it, while others offered comments and suggestions on implementation, which were generally supportive or neutral. For PCPD, they provided general observations from the perspective of protection of personal data privacy under the Personal Data (Privacy) Ordinance (Cap. 486) (PDPO), which are reflected in the consultation conclusions. The HKMA welcomes PCPD's comments and will maintain communication with PCPD on the interaction between the proposed legislative amendments and the operation of the provisions of the PDPO.

27. The HKMA plans to launch a public consultation on the remaining BO enhancement proposals soon. We will introduce the relevant amendment bill into the Legislative Council subject to the progress and results of further consultation.

**ADVICE SOUGHT**

28. Members are invited to note the plan to amend the BO and comment on the two legislative proposals set out in the paper.

**Financial Services and the Treasury Bureau  
Hong Kong Monetary Authority  
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