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**THE HONG KONG
BANKING ORDINANCE**

Butterworths

The Hong Kong Banking Ordinance

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FOREWORD

The progress of banking supervision in Hong Kong, as in so many other countries, might be caricatured as too little, too late. Events post the first Banking Ordinance, 1948, would suggest that this caricature might not be too far from the truth — at least, that is, until 1986. The first Ordinance only required banks to register with the Government. “Banks” were narrowly defined, and no supervisory body was established.

Difficulties in the banking system in the early 1960s were followed by an expert enquiry into the need for better control. The result was the Banking Ordinance 1964, and the creation of the post of the Commissioner of Banking.

These changes unfortunately did not go far enough and in some important respects fell short of the report’s recommendations. Moreover, the definition of banking remained narrow, and there was nothing to prevent companies from taking deposits outside the ambit of the control. Many non-bank deposit-taking companies grew up. Furthermore, the statutory tests of liquidity and capital to be met by licensed banks on a continuing basis were inadequately constructed.

Pressures to make further changes to the regulatory regime therefore increased during the 1970s and early 1980s. There were initially problems with some of the smaller banks, and a moratorium was imposed on new banking licences. These were followed by difficulties in a few of the unregulated deposit-taking companies. Unrelated to these difficulties was the swelling number of overseas banks attracted to Hong Kong by its growing status as an international banking centre.

In 1976 an additional Ordinance was enacted requiring non-bank deposit-taking companies to be registered; in ensuing years, mere registration gave way to proper supervision of their businesses. Some technical changes were made to the Ordinances to recognise the fact that the supervision of banking companies incorporated in Hong Kong had to extend world-wide, to follow the activities of the institutions themselves.

Unfortunately, all this was still insufficient. In 1983 the Hang Lung Bank had to be rescued by the Government. This was followed by the rescue of the Overseas Trust Bank, and its subsidiaries, in 1985. There were difficulties in other banks. It was clear that the Government had to rethink its approach to supervision once again. In this it was aided by a report from outside experts, as in 1964, from the Bank of England. The report recommended that the application of supervision had to be

stiffened and that fresh legislation was needed.

The Government acted swiftly. In addition to a strengthening of the Office of the Banking Commissioner, the Banking Ordinance 1986, the subject of this book, was introduced. It provided for the first time in Hong Kong a comprehensive framework for the authorization, supervision and, if necessary, the despatch of all banks and other deposit-taking companies. Coupling the new approach to the administration of banking supervision to the new legislation, it can be said that though these might have been too late, they should certainly not be too little.

The 1986 Ordinance is complex and affects a great deal of the business being undertaken by the institutions authorized under it. A good deal of interpretation of its provisions is therefore required of them. This book should, I hope, make their task that much the easier. In saying this I do not guarantee that my Office, or, more importantly, the courts will necessarily agree with everything written here. This is not to detract from the authors' work, which is of a high standard throughout. Rather it reflects the simple fact that this area of the law is far from straightforward, and more than one interpretation is frequently possible.

Looking forward, there is little doubt that the 1986 Ordinance cannot itself be the last word. Before the Governor's formal assent to it was barely dry, work had started on a short amending Ordinance. This was enacted last year and has been incorporated in the coverage of this book. But we are already conscious that more will need to be done.

Some changes will be technical. For example, the present legislation has introduced a number of discretions for the Commissioner to enable particular prohibitions to be relaxed, or tightened, as is deemed sensible in individual cases, but without detracting from their general application. We can expect to see some further elaboration on these lines, to reflect the difficulty of trying to lay down in statute universal rules for the boundary of banks' business conduct. Moreover, banking business is itself ever changing. Banking supervision too must adapt and evolve, and with it so must the legislation.

The present structure of deposit-taking authorizations, the three-tier system, described in this book is currently under review. The outcome of that review may well lead to legislative change. If so it is to be hoped that there will be time to tidy up the present Ordinance; its current complexity owes something to the fact that it is an amalgamation of its two predecessor Ordinances, inevitable given the haste with which it had to be drafted.

I can say, with some confidence, therefore, that this should not be the last edition of this book.

A W Nicolle
Commissioner of Banking, Hong Kong
February 1988

PREFACE

The new Banking Ordinance which was enacted in 1986 and amended in 1987 was the first attempt to regulate comprehensively and consistently all banking and deposit-taking companies operating in Hong Kong.

This book considers the new legislation in two parts. The first part, the introduction, which was written by Christopher Bates, described the historical background to the legislation, the objectives of the new Ordinance and its structure, the privileges accorded to authorized institutions, the industry today and proposals for the future. The second part of the book, which was written by us jointly (as well as severally), contains a detailed commentary upon each section of the Ordinance. Where appropriate, reference has been made to relevant Hong Kong case law and other Hong Kong legislation but reference is also made to English and other Commonwealth case law, in view of its persuasive force in Hong Kong. The Appendices to the book set out the two "guidelines" issued by the Commissioner of Banking. While the Ordinance is expressed to be a new Ordinance, many of its provisions are derived from the former Banking Ordinance and Deposit-taking Companies Ordinance and derivations and cross-references are provided accordingly.

The new Ordinance was an important step in the development of the regulation of banking and deposit-taking in Hong Kong but it is certainly not the last step. In May 1987 the Commissioner of Banking prepared five papers upon the Hong Kong banking industry and suggested certain options for reform. In December 1987 the Basle Committee on Banking Regulations and Supervisory Practices ("the Cooke Committee") published proposals for a common framework for the measurement of a bank's capital and for the establishment of a minimum international standard. These proposals may, at least in part, be extended to apply to institutions incorporated in Hong Kong.

We would like to thank Robert Fell, the former Commissioner of Banking, and Tony Nicolle, the current Commissioner of Banking, and the staff of the Commissioner's Office for their assistance in the preparation of this book. We are also grateful to Pauline Wallace for her comments upon Parts XI and XII of the Ordinance. The views expressed in this book (and any errors) are, however, ours alone and are not necessarily those of the Commissioner of Banking.

We would also like to thank Vicky Yau, Phillis Chan and Cary Lyons for typing, correcting and checking the manuscript and our colleagues at Clifford Chance for their assistance. Finally we would like to thank our wives and families for their support during the preparation of the book.

The law is stated as at 1 January 1988.

A.N. Williams and C.J. Bates

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INTRODUCTION

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Historical background

The history of banking regulation in Hong Kong has been marked by a succession of ordinances gradually extending the degree of supervisory control exercised over the industry.

The original Banking Ordinance of 1948 created a system of regulation and licensing of banks under the control of the Governor, but, in the absence of any official central bank of Hong Kong, the establishment of a separate supervisory authority under the first Commissioner of Banking had to await the Banking Ordinance of 1964 which was enacted "to make better provision for the licensing and control of banks, banking business and matters connected therewith". However, the collapse of two banks in 1965 led to a general moratorium on new banking licences. This was only relaxed in 1972, but even then the terms of the limited embargo that continued until 1975 were such that only one licence was granted during that period, so that by January 1975 there were 75 licences in issue (source: Commissioner of Banking paper, "The 'Three-Tier' System", May 1987, para 2.1).

By this time, it was also apparent that a large "secondary bank" sector had grown up in the form of finance houses who were able to take deposits from the public and to engage in other banking activities because of the restrictive definition of "banking business" contained in the 1964 Banking Ordinance. At the same time, many foreign banks who had been unable to obtain banking licences under the embargo had set up finance companies in Hong Kong as part of this sector.

The pressure on licensed banks, who were subject to competition from unregulated institutions, and concerns as to the possible "chain reaction" from a failure in the finance company sector (as had been seen, for example, in the UK) led to the enactment of the Deposit-taking Companies Ordinance in 1976 under which all non-bank deposit-taking institutions had to be registered. However, registered deposit-taking companies ("DTCs") were restricted to taking deposits of HK\$50,000 or more, the corollary of which was that extensive supervisory controls were not imposed on them. As was stated by the Financial Secretary at the time:

"The government has no duty to protect the larger depositor in a way that might limit his freedom, at his own risk, to seek the best returns or generally to do what he likes with his own money."

(see R Fell, "Recent Developments in Banking Regulation", *Law Lectures for Practitioners 1986*, 166 at 171). Given that DTCs were prohibited access to the small depositor, the regulatory system was not designed to place the new Commissioner for Deposit-taking Companies

“in a position of responsibility for the prudential conduct of business by companies, which it is not intended to accept.”

(statement by the Financial Secretary in the Legislative Council quoted in Commissioner of Banking, “Annual Report for 1986”, para 2).

This system of regulation by registration rapidly came under pressure from a huge increase in the number of registered DTCs. The numbers rose from 179 DTCs at the end of 1976 to 316 by February 1981 (source: Commissioner of Banking paper, “The ‘Three-Tier’ System”, May 1987, para 3.3). This growth had continued notwithstanding the imposition of minimum liquidity requirements on DTCs by the Deposit-taking Companies (Amendment) Ordinance 1978, a measure designed to put licensed banks and DTCs on a more similar competitive footing. The growth was stopped by the enactment of new legislation in 1981 which gave the Governor power to direct the suspension or restriction of further registrations of DTCs (s 2 Deposit-taking Companies (Amendment) Ordinance 1981), a power which was exercised by a direction to the Commissioner only to register a DTC if 50% or more of the DTC was owned by an adequately supervised bank.

The growth in the number of DTCs also led to a review of the DTC sector which showed that while there was a substantial group of finance companies operating as DTCs and engaged in consumer credit, hire purchase, mortgage finance and similar business, there were two other main groups of DTCs. The first group consisted of subsidiaries or associates of licensed banks which were primarily engaged in taking deposits from the public and on-lending the proceeds to the parent bank. Licensed banks then, as now, were subject to the Rules on Interest Rates made by the Hong Kong Association of Banks (the “HKAB”) pursuant to s 12 of the Hong Kong Association of Banks Ordinance, under which the HKAB has power to fix the maximum rates of interest which may be paid by member banks to Hong Kong dollar depositors. This group of DTCs effectively recycled deposits at market rates to their parent banks to enable the parent banks to avoid the restrictions of the HKAB rules. The second main group consisted of DTCs primarily engaged in merchant banking or quasi-banking business and were mostly either subsidiaries or associates of licensed banks (which also played a part in the recycling of deposits) or subsidiaries or associates of foreign banks which were unable to obtain a banking licence under the complete moratorium which was reimposed from 1975 to 1978 and which, after a short period of relaxation, was imposed again from 1979 to 1981. Indeed, some foreign banks had obtained DTC status for a Hong Kong branch without establishing a separate Hong Kong incorporated DTC.

The recycling of deposits by DTCs had caused a substantial erosion of the deposit base of licensed banks and tended to diminish the importance of the HKAB interest rate controls which constituted one of the few instruments available for implementing the government’s monetary policy.

While it was desired to restore the bank’s customer base by restricting the access of DTCs to shorter-term deposits, there was also a concern to maintain the presence of foreign banks in Hong Kong, even though they might have to operate without a full banking licence, and not to restrict