BYU Law Review

Volume 1986 | Issue 3 Article 15

9-1-1986

Survey of Banking Laws and Policies in Hong Kong and Singapore

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A Survey of Banking Laws and Policies in Hong Kong and Singapore

Historically, the decision where to establish banking facilities in East Asia was relatively simple. Of the four newly industrialized East Asian countries—Hong Kong, Singapore, Taiwan, and South Korea[1]—only Hong Kong and Singapore have had the economic growth to emerge with Japan as financial centers with the most sophisticated banking systems.[2] And banks generally preferred Hong Kong because of its laissez-faire economic policies.

However, in the last decade the choice has become more difficult as Singapore has emerged as a financial center and Hong Kong's political destiny has become uncertain. Today, both countries are the banking capitals of their respective regions, each offering profits to the international banker. Although the choice is difficult, an analysis of comparative political situations, financial center characteristics, banking regulations, and tax structures demonstrates that Hong Kong remains the better choice for a multinational bank contemplating an East Asian branch.

I. Singapore as a Banking Center

Singapore became a country in 1819 and was ruled by the British until its independence in 1959. Malaysia had also been ruled by the British and received its independence in 1956. In 1963, Malaysia and Singapore decided to become a single country as the rulers felt that both countries could benefit from each other's resources. The country was to be ruled by Lee Kuan Yew and Tunku Abdul Rahman. However, disagreement arose be-

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1. During the 1960s and 1970s Hong Kong, Singapore, Taiwan, and South Korea "were characterized by relative political stability, complex combinations of quasi-authoritarian politics and capitalist economics, very high-speed economic growth, equitable distributions of income, and high levels of education." Johnson, *The Mousetrapping of Hong Kong: A Game in Which Nobody Wins*, 24 Asian Surv. 887, 887 (1984). In the past two decades, these countries have realized the highest per capita incomes in East Asia, with the exception of Japan. *Id.* In 1984, Singapore's GNP was second only to Japan. *The Singaporeans*, Asiaweek, Sept. 7, 1984, at 24, 31.

2. Coudert, *The Regulation Of Foreign Banking In Japan, Singapore, And Hong Kong*, 91 Banking L.J. 822, 822 (1974).

tween the leaders and in 1965 Singapore decided to separate from Malaysia and once more rule itself as an independent nation.[3] Lee Kuan Yew became the prime minister of a country that had been used mainly as a military base and trading port by the British and was hardly an ideal place for an international bank. However, "by encouraging expatriate enterprise, Singapore has avoided mistakes of other countries that [have] tried to industrialize by themselves" and has become a viable international banking center.[4]

A. *Political Situation*

Singapore is politically stable. Lee Kuan Yew has been at the head of Singapore's majority party, the People's Action Party (PAP), for the past twenty-five years.[5] Educated at Cambridge and Harvard, Lee adheres to the Confucian philosophy that a state must be governed by exemplary men to survive. He has a stable and experienced cabinet.

In part, Singapore's political stability stems from Lee's sometimes ruthless suppression of political, racial, and industrial turmoil.[6] Whatever the reasons, however, Singapore's stability and growth is remarkable in a region of the world still developing modern political systems. Singapore has earned its status as one of the more developed Southeast Asian countries and is constantly trying to improve its image. As one official indicates, "We're always looking for bigger sticks and bigger carrots to get things done."[7]

B. *Financial Center Characteristics*

In evaluating Singapore as an international banking location, one must examine its location, economy, and other incidentals necessary for banking operations.

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3. Ishihara & Kim, *Financial System of Singapore,* in EMERGING FINANCIAL CENTERS: LEGAL AND INSTITUTIONAL FRAMEWORK 913 (R. Effros ed. 1982).

4. Kaylor, *Singapore Proves Asian Work Ethic Pays Rich Rewards,* U.S. NEWS & WORLD REP., Aug. 20, 1984, at 49, 50.

5. *The Singaporeans, supra* note 1, at 34.

6. *What Raffles began,* ECONOMIST, Aug. 4, 1984, at 28, 28. As Lee Kuan Yew told his people last year, "When anyone tries to start anything to make this orderly and rational society irrational or emotional, I stop it. Without hesitation." Kaylor, *supra* note 4, at 49.

7. Kaylor, *supra* note 4, at 50.

1. *Location*

Singapore's location has been a major factor in its growth in international financial activity. Singapore's business hours overlap those of Sydney and Tokyo to the east and Frankfurt and London to the west. Singapore's major advantage in foreign currency transactions results from closing one-half hour later than Hong Kong, making it the last major Asian market to close.

2. *Economy*

When Singapore became an independent country, its economic viability was greatly doubted. However, contrary to predictions and "[a]s a result of its long-standing role as an entrepôt,[8] [Singapore] . . . has become a major financial center" in Southeast Asia.[9] Economic characteristics confirming Singapore as an attractive financial center include a steady growth rate, a financial futures market, the Asian Currency Market, and a stable currency.

Singapore's economy has grown more than 8% per year since 1960[10] and its growth rate in the first half of 1984 was up 9.7%.[11] Inflation has been kept at half the rate of growth.[12] However, the country had a growth rate of only 2% in 1985. Some economists have blamed the recent poor growth rate on Singapore's earlier overly rapid growth and too much government intervention.[13] Singapore's balance of payments has also been favorable, mainly because of capital inflows. The balance of payments has shown a surplus from 1978 to 1982.[14] Foreign exchange reserves exceeded seventeen million Singapore dollars (S$) in 1982.[15] Thus, the country has maintained relative stability during oil crises and associated world recessions.

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8. An entrepôt is a storage and distributing center, whether a seaport or an inland town. THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 437 (1973). It is especially a port where goods are stored until reexported or until duties are paid. Singapore has commonly been known as the entrepôt to Southeast Asia, and Hong Kong as the entrepôt to China.

9. Ishihara & Kim, *supra* note 3, at 913. "About 700 American companies have invested more than 4 billion dollars [in Singapore]. Last year, the U.S. was the island's biggest trading partner at about 6.7 billion dollars." Kaylor, *supra* note 4, at 49-50.

10. *What Raffles began*, *supra* note 6, at 28.

11. *The Singaporeans*, *supra* note 1, at 33.

12. *What Raffles began*, *supra* note 6, at 28.

13. *Lee Kuan Yew and Son*, ECONOMIST, Aug. 3, 1985, at 16, 16.

14. PRICE WATERHOUSE, DOING BUSINESS IN SINGAPORE 8 (1984).

15. *Id.* References to dollars in this comment are to United States dollars unless

Another factor that has strengthened the economy is the introduction of a financial futures exchange patterned after the Chicago Mercantile Exchange (CME).[16] Singapore is now able to annex the Asia-Pacific time zones, thus providing a market to Americans wishing to respond to developments breaking after United States exchanges close.[17]

Singapore has also become the center for a new funding resource, the Asian Currency Market.[18] The Asian Currency Market, popularly known as the Asian Dollar Market, began operations in October 1968. In that year, Bank of America, Singapore, received permission to create a currency unit similar to its London Eurocurrency Unit.[19] The bank's objective was to use

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stated otherwise.

16. The CME backs up the Singapore International Monetary Exchange (Simex). Simex's contracts are interchangeable with those of the CME through a mutual offset system linking the two markets. Normally, "[t]he first exchange to establish a convincingly liquid market in a new futures contract most often captures all the liquidity in that instrument." Kaye, *It's an early bird . . .*, FAR E. ECON. REV., Sept. 6, 1984, at 128, 128. This means that Singapore will have an advantage over Hong Kong in this area as it is the first financial futures market in Southeast Asia and therefore may capture the liquidity in the region.

17. *Id.*

18. The beginnings of the Asian Currency Market are examined in Thio, *Singapore as a Financial Centre: Some Legal Problems*, 19 MALAYA L. REV. 233, 233 (1977):

> Around 1968, the idea of establishing an Asian Dollar Market based in Singapore was . . . favourably received by the Government and the banking community, the idea being to arrest and divert the stream of "U.S. Dollars" pumped into non-Communist Asia by U.S. military, commercial and foreign ventures which flowed out again mostly to London or Zurich and retain them in Asia to be re-cycled for development projects in [Southeast Asia] . . . . The Asian Dollar Market was officially launched in 1968 and started functioning in 1969 through the Asian Currency Units of those banks which are licensed by the Monetary Authority of Singapore. Basically, these units take Asian Dollar deposits, namely U.S. Dollars or other selected hard currencies (such as the Deutsch Mark, Swiss Franc and Japanese Yen) from off-shore and make loans to off-shore borrowers though such loans may be made to export-oriented hard currency earning corporations in Singapore.

19. J. BAKER, INTERNATIONAL BANK REGULATION 31 (1978) describes Eurocurrency as follows:

> The Eurocurrency market . . . is comprised of currencies held in deposits that are available for reinvestment outside the country in which they are denominated. Thus, a Eurodollar is a dollar deposited anywhere outside the United States; a Euromark is a mark deposited outside West Germany. The market also is comprised of Eurosterling, Euroyen, Eurofrancs—both French and Swiss, and so forth . . . .
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> The market is generally short term in nature . . . . It is a wholesale market, with a high degree of interbank activity, centered primarily around London; thus, the so-called London Interbank Rate, or LIBOR, as the interest rate governing Eurocurrency transactions is known. A typical transaction [can

the Asian Currency Market to attract Asian nonresident deposits to fund the bank's Asian lending activities. The pool of resources in the market has expanded steadily from a base of $130 million in 1968 to $100 billion in 1983.[20]

Three factors have enhanced the growth of Singapore's Asian Currency Market. First, the economic growth of Southeast Asia necessitated a financial center to service the region. Second, Singapore's prominent position as an entrepôt to Southeast Asia made it superior to other Southeast Asian financial centers. Third, the government encouraged the progress of the Asian Currency Market by removing taxation on earned financial deposits and lowering taxes on offshore loans.[21] The government

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> take up] to one year to maturity for $1 to $5 million in amount. Transfers are by telephone or teletype, with a letter of confirmation as the only customary documentation. No withholding tax is levied on interest; the market is highly impersonal; and no government controls of any consequence are present to hamper market trading. Banks dealing in Eurocurrencies hold reserves but are generally exempt from mandatory reserves. This factor is highly advantageous from the standpoint of both profitability and flexibility.

See also Soe, *The Establishment and Conduct of Banks, Merchant Banks and Finance Companies—Legal Requirements,* 19 MALAYA L. REV. 249, 270 (1977).

20. Clark, *Tax Planning for Investment in Singapore,* 9 INT'L TAX J. 339, 341 (1983). Ishihara & Kim, *supra* note 3, at 927, give the 1968 figure as $31 million.

21. Ishihara & Kim, *supra* note 3, at 927. Brown, *Who uses offshore centres?,* BANKER, April 1977, at 100, 100-01, explains the importance of lower taxes for offshore banks as follows:

> A bank performs three main functions: it collects money from depositors, it lends to borrowers, and it engages in fiduciary services . . . .
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> . . . If [a person] deposits funds in one of [the onshore financial] centres, he may well be subject to capital taxes in the event of his death, and on large sums such taxes can be penal in their effects. Apart from tax liabilities the international investor is frequently averse to any unnecessary disclosure of his assets or operations to foreign governments and third parties. As a result he places his money with a bank located in an offshore centre and leaves the bank to channel his funds into the 'onshore' centre interbank market. In this way he avoids disclosure and potential tax liability.
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> In addition, to divest deposits, banks may recycle funds to an 'offshore' location where they can be lent to an international borrower, on the basis that a gross rate of interest is chargeable by the bank. If the borrower is unable to pay interest to the bank without deduction of withholding tax he must, as a rule, pay interest at a rate which provides net interest at the rate required by the bank. For example, if the desired rate of interest is 10 ½ per cent and a 25 per cent withholding tax is applicable, the rate to the borrower will be 14 per cent. In this case it is the *borrower* who has to bear the cost, which could be tax-deductible in his accounts, and in the end his government may add very little to its tax revenues from the transaction.
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> . . . .
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> International banks endeavour to maintain a presence in tax havens be-

also abolished stamp duties on negotiable certificates of deposit, bills of exchange, and bond certificates issued in the Asian Currency Market.[22]

Today, the Asian Currency Market is one of the major functions of the Singapore banking industry.[23] In fact, many international banks operating in Singapore regard their Asian Currency Market activities as the central function of their Singapore branch.

Singapore's stable currency has aided its growth as a financial center. Since 1973 the Singapore dollar has floated freely against other currencies[24] and has generally maintained a stable value against most other currencies.[25] Its stability derives from Singapore's relatively strong foreign currency position. The foreign exchange deals primarily in three currencies: the Singapore dollar, the United States dollar, and a "third currency" consisting of the German mark, the Japanese yen, the Swiss franc, and the British sterling.[26] However, Singapore and United States dollars are used in most dealings.[27]

Singapore suffers from its dollar not being a major world currency. A forward exchange market exists, but it is generally

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> cause these locations form vital links in the chain of international representation. If a link is missing, business may go to competitors. For this reason the major banks have offices in all the better-known offshore centres.

22. Ishihara & Kim, *supra* note 3, at 927.

23. *Id.* at 929-30.

> The Asian Currency Market has benefited the Singaporean economy directly by providing employment, tax, and other revenues, as well as indirectly by upgrading skills and expertise in offshore banking operations. Rough estimates indicate that income and profits derived from the market amounted to about 3 per cent of national income in 1975.

Id.; see also Law of International Transactions: Some Aspects of Transnational Enterprise Investment in Singapore, 19 MALAYA L. REV. 209 (1977).

24. PRICE WATERHOUSE, *supra* note 14, at 2-3. Singapore dollars are convertible at par with the currency of the country of Brunei. *Id.* at 3. The rate of exchange on Sept. 7, 1985, was US$1 = S$2.263. Asian Wall St. J., Sept. 7, 1985, at 10, col. 5.

25. *The Singaporeans, supra* note 1, at 33.

26. Ishihara & Kim, *supra* note 3, at 925-26.

27. *Id.* at 925.

limited to commercial transactions.[28] The market usually quotes currencies for six-month periods.[29]

3. *Incidentals*

Other considerations incidental to establishing banking operations are communications systems, personnel, office rent, and employee housing and maintenance of the area. Singapore's telecommunications system is one of the best not only in Southeast Asia but in the world. Singapore has installed high technology electronic telephone switching equipment to provide better service to its citizens and industries. It is a member of INTELSAT.[30]

Singapore has a vast pool of educated, English-speaking individuals available for clerical and other positions with foreign companies.[31] However, rapid growth in Singapore's banking industry has resulted in a shortage of trained banking personnel.

Singapore's office space rents are competitive with rents in other developed countries and are lower than those in Hong Kong. Space is readily available and conditions will further improve when several buildings now in the construction or planning stage are completed. Financial district rentals generally vary from S$9.00 to S$15.00 per square foot. Tenants must bear maintenance charges. Costs of utilities are comparatively moderate.

Living standards in Singapore are second only to Japan's in the Far East and are higher than those in some European countries.[32] Rents are high for apartments and houses available to foreign individuals. A centrally located unfurnished apartment

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28.
> [A forward exchange market is a] market in which currencies are bought and sold at rates of exchange fixed now, for delivery at specified dates in the future. A transactor expecting to acquire a currency, or to have to make a payment in it, at a future time, may sell or buy the currency forward, thus covering himself against any changes in its exchange value in the intervening period. Others may operate in the market as pure speculators; this is facilitated by the fact that no payment is due on a forward contract until it matures.

D. PEARCE, THE MACMILLAN DICTIONARY OF MODERN ECONOMICS 164 (1981). The forward exchange market is similar to a financial futures market.

29. PRICE WATERHOUSE, *supra* note 14, at 3.

30. *Id.* at 7.

31. Clerical personnel earn between S$700 and S$1,500 per month. The author is originally from Malaysia and has lived and worked in Singapore. These figures are based on personal experience.

32. Kaylor, *supra* note 4, at 49.

costs S$3,000 per month. Rents for unfurnished houses start at S$4,000 per month.

Owning an automobile in Singapore is also very expensive. There are substantial road taxes for all automobiles and special monthly permit charges for automobiles entering the central business district during rush hours. Singapore's other costs of living are relatively low.

C. *Banking Regulations*

Banking regulations are best examined by looking at banking legislation, permissible types of banking institutions, and regulatory authority.

1. *Banking Act of 1971*

The Banking Act of 1971[33] brought Singapore's banking legislation together into one comprehensive statute. The act specifies the minimum capital required for all banks operating in Singapore. Banks centered in Singapore with principal offices in the republic must have capital of S$3 million. A bank with its principal office outside Singapore must have capital of S$6 million and must maintain at least S$3 million of head office funds in Singapore. The Monetary Authority of Singapore (MAS) must approve the type of assets held for the minimum capital account.[34]

In addition, MAS may require banks to maintain a minimum cash balance. MAS may vary the percentage balance to implement its current policy regarding bank liquidity. The percentage required cannot surpass thirty percent of the bank's indebtedness.[35]

A bank may also be required to maintain a minimum amount of liquid assets.[36] Every licensed bank must keep a reserve fund, but if MAS finds that the total reserve fund of a licensed bank whose principal office is located abroad is sufficient for its transactions, it may exempt the bank from maintaining the reserve fund in Singapore.[37]

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33. Banking Act of 1971, *reprinted in* EMERGING FINANCIAL CENTERS: LEGAL AND INSTITUTIONAL FRAMEWORK 962 (R. Effros ed. 1982) [hereinafter cited as Banking Act].

34. *Id.* § 9(b)(ii).

35. *Id.* § 35(1).

36. *Id.* § 34(1).

37. *Id.* § 18(2).

The act prohibits or restricts Singapore banks from engaging in certain activities. For example, a bank may not grant loans, advances, credit, or guarantees to any single borrower in excess of sixty percent of its capital funds. MAS may approve a greater percentage up to one hundred percent if conditions warrant.[38]

The act limits activities of Singapore banks to essentially banking activities. No bank is allowed to deal in wholesale or retail trade except to settle debts becoming due in the course of regular banking transactions.[39] Banks cannot invest in any financial, commercial, agricultural, industrial, or other project in excess of forty percent of capital funds.[40]

Regulations under the act require Singapore banks to provide operational information to the public and MAS.[41] Banks are also required to report on a monthly basis loans and advances made to directors or related entities.[42] Authorized banks and Asian Currency Units must report foreign exchange positions in accordance with the Exchange Control Act.

2. *Banking institutions*

Commercial banks in Singapore fall into the following categories: full license banks, restricted license banks, and offshore license banks.[43] These three are regulated by the Banking Act of

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38. *Id.* § 25(a). This limitation does not apply to transactions with the Singapore government or other banks; purchase of telegraphic transfers; or any facilities granted against letters of credit, bills, guarantees, or documents relating to import/export trade in Singapore.

39. *Id.* § 26(1).

40. *Id.* § 27(1).

41. *Id.* § 21. The act provides that banks must publish the following information once a year in local newspapers: (1) an audited annual balance sheet and profit and loss account and notes thereon, (2) a copy of the report of auditors compiled in accordance with laws of the jurisdiction of incorporation, (3) the names of all directors of the bank, and (4) the names of all subsidiaries of the bank. MAS must approve copies of the foregoing documents prior to publication, and the copies must be submitted to MAS following publication. *Id.*

Banks must submit additional information to MAS on a confidential basis. MAS provides the following forms for all Singapore banks to complete: (1) a schedule of the assets and liabilities of the bank "at the close of business on the last business day of the preceding month" to be submitted within 15 days of the end of the month; (2) "an analysis of loans and advances" of the bank to be submitted quarterly within one month after the end of the quarter; and (3) a schedule of the income and expenditures of the bank to be submitted within six months after the end of the financial year. *Id.* § 22.

42. *Id.* § 23.

43. Soe, *supra* note 19, at 251. The number of commercial banks increased from 37 in 1970 to 100 at the end of March 1981:

1971.[44] Banks may also do business through representative offices or as merchant banks. Merchant banks are regulated by the Companies Act.[45]

a. Full license banks. Banks with full license for commercial banking are authorized to transact all banking activity in Singapore, both domestic and foreign. Thus, they are authorized to operate current accounts, savings and fixed deposit accounts, commercial letters of credit, and trust receipts. In addition, they may finance exports and imports, transfer funds, and purchase and sell traveler's checks and currencies. Full license banks may give advice on trade, investment, and foreign exchange regulations, and may furnish credit reports. Many of the full license banks have also been granted Asian Currency Unit licenses to participate in the Asian Currency Market.[46]

Thirteen domestically incorporated full license banks and twenty-four foreign full license banks existed in 1982.[47] The consensus is that MAS will not grant additional full licenses in the foreseeable future absent exceptional circumstances.[48]

b. Restricted license banks. Prior to 1971, the only bank license available in Singapore was the full license. To attract more licensed banks to Singapore, the restricted license was developed and implemented in 1971. Thirteen banks had been granted restricted licenses as of 1982.[49]

These banks may engage in the entire range of banking business except they are not permitted to accept time deposits[50] of

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> Of these, 13 were domestically owned and 87 were foreign owned, primarily by banks in the United States, Japan, Hong Kong, the United Kingdom, and other European countries. This rapid increase in the number of foreign banks reflected the growing realization on the part of foreign banking interests that Singapore would attract business from international companies and could serve as a base for their regional operations, particularly through the Asian Dollar Market. The existence of a large number of foreign banks has also contributed to a high degree of competition among banks and to banking efficiency in general.

Ishihara & Kim, *supra* note 3, at 920.

44. Banking Act, *supra* note 33.

45. Singapore Companies Act, 1967, *cited in* Soe, *supra* note 19, at 254.

46. Ishihara & Kim, *supra* note 3, at 921.

47. *Id.*

48. The Monetary Authority of Singapore is not granting licenses at the current time in an effort to keep business within domestic banks.

49. Ishihara & Kim, *supra* note 3, at 921.

50. A time deposit is "[a]nother term for a savings account in a commercial bank. It is so called because in theory (though no longer in practice) a person must wait a certain amount of time after notice of desire to withdraw part or all of his or her savings." BLACK'S LAW DICTIONARY 1330 (5th ed. 1979).

less than S$250,000, nor have savings accounts. They are also restricted to one location in Singapore. They may be authorized in the foreign exchange market and may be licensed as Asian Currency Units.[51]

Restricted license banks have been very active in the Singapore market. Most are oriented toward wholesale corporate banking, rather than personal banking.[52]

c. Offshore license banks. In 1974, MAS introduced the offshore license to the Singapore market. When first introduced, offshore license banks were restricted to business outside Singapore. They were authorized to deal in foreign exchange and operate Asian Currency Units, but could not offer account facilities.[53]

In 1978 the restrictions on offshore banks were relaxed and offshore banks can now offer credit and other facilities to Singapore residents. The only limit is the maximum amount of S$30 million on credit to any Singapore resident without MAS approval. Offshore banks can now effectively compete in the domestic banking market including current account, overdraft trust receipt, and letters of credit facilities. Fifty offshore banks existed in Singapore in 1982.[54]

d. Representative offices. Foreign banks may also do business in Singapore through representative offices. These offices are limited to promoting foreign bank business and providing the foreign bank with Singapore market information. Many banks open representative offices and intend to apply for an offshore license if business warrants.

e. Merchant banks. Merchant banks engage in finance, investment, assets, mergers of corporations, and other related transactions. They are allowed to accept deposits only from banks and finance companies, and are not allowed to deal in foreign exchange or Asian Currency Units without MAS approval.[55] Most merchant banks in Singapore operate as joint ventures between local and foreign banks.[56]

The Companies Act of 1967 and MAS regulate the activities

51. Ishihara & Kim, *supra* note 3, at 921.
52. *Id.*
53. Soe, *supra* note 19, at 251-52.
54. Ishihara & Kim, *supra* note 3, at 921.
55. *Id.* at 921-22.
56. Soe, *supra* note 19, at 254.

of the merchant banks. Merchant banks grew in Singapore in response to the rising need for industrial financing.[57]

3. *Monetary Authority of Singapore*

The Ministry of Finance of Singapore is the ultimate government regulatory authority over the banking sector. The ministry controls and administers the banking industry through a wholly owned government corporation, the Monetary Authority of Singapore (MAS). Established in 1971, MAS performs all the functions of a central bank except issuing currency, which has continued to be under the authority of the Currency Board.[58]

MAS objectives are to act as a government banker, encourage exchange conditions that will aid the country's economic growth, and combine the monetary and banking functions of the commissioner of banking, the commissioner for finance companies, the accountant-general, and the controller of foreign exchange.[59] MAS is governed by the Monetary Authority of Singapore Act of 1970, which was amended in 1972. The amendment allowed MAS greater powers.[60]

MAS policies are determined by a board of directors chaired by the minister of finance.[61] As part of its regulatory function, MAS grants licenses to financial institutions, controls renewal of licenses, and approves operations for other types of financial institutions.[62] Licenses and approvals are usually granted to any institution with an international network wishing to expand in Singapore. An institution seeking to open in Singapore may be encouraged to join local institutions in a joint venture operation. This is particularly true of merchant banks, finance companies, and Asian Currency Units; it is less true of banks.[63]

MAS also formulates and implements Singapore's monetary

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57. Ishihara & Kim, *supra* note 3, at 921.

58. "Although currency issue is a normal function of a central bank, the authorities had concluded . . . that an autonomous Currency Board would be better suited to the task of maintaining public confidence in the Singapore dollar." *Id.* at 916.

59. Monetary Authority of Singapore Act of 1970, §§ 4, 21, *reprinted in* EMERGING FINANCIAL CENTERS: LEGAL AND INSTITUTIONAL FRAMEWORK 948 (R. Effros ed. 1982) [hereinafter cited as MAS Act].

60. Ishihara & Kim, *supra* note 3, at 917.

61. MAS Act, *supra* note 59, § 7. MAS administers the Banking Act, Finance Companies Act, Exchange Control Act, Development Loans Act, Local Treasury Bills Act, and the Insurance Act.

62. Soe, *supra* note 19, at 253.

63. *Id.* at 254.

policy. As may be expected, MAS works closely with the Ministry of Finance on policy matters. MAS regulates the monetary base through monetary instruments such as the minimum cash balance requirements with which banks and finance companies must comply.[64]

In carrying out its supervisory function, MAS requires all financial institutions to furnish statutory returns, reports, and other information.[65] Routine checks are carried out on books, accounts, transaction records, management practices, and bank policies.[66]

In 1980, Goh Keng Swee was appointed MAS chairman and First Deputy Prime Minister. Since then, MAS's main task had been to more strictly control financial markets.[67] In January 1985, Mr. Richard Hu was appointed chairman of MAS, and in April 1985 he was appointed finance minister. His aim is to make Singapore attractive for foreign investment by making the Singapore dollar an international currency. He wants Singapore to become known as the "Switzerland of Asia."[68]

In December 1982, several banks were disciplined by MAS for placing Singapore dollars in banks abroad that paid greater interest, and then transferring the moneys back to Singapore. Citibank's actions in this regard resulted in fines of S$1.2 million. Managers of two foreign banks were sent back to their head offices. After this incident, bankers were more cautious and asked MAS to explain its policies in greater detail. On November 1, 1983, MAS published a further set of rules to clarify its regulations, but banks are apparently still uncertain about the rules.[69] Since the new rules were published, one merchant bank, Jardine Fleming, has been expelled for giving an unsecured loan of S$200,000 to its local director.[70]

D. *Taxation*

Taxes in the republic are assessed on income, property, and payroll of corporations and individuals. Singapore does not have

64. Banking Act, *supra* note 33, § 35.

65. *Id.* § 22.

66. *Id.* §§ 39, 40. During periods of high demand and resulting tight liquidity, MAS provides commercial banks with swap facilities. Ishihara & Kim, *supra* note 3, at 932.

67. *Critical MAS*, ECONOMIST, Aug. 11, 1984, at 76, 76.

68. *What Hu's up to*, ECONOMIST, Apr. 27, 1985, at 98, 98.

69. *Letting Hongkong off the hook*, ECONOMIST, Jan. 7, 1984, at 69, 70.

70. Asian Wall St. J., Oct. 19-20, 1984, at 1.

a capital gains tax, and the tax year is the normal calendar year, unless the corporation decides to use its financial year as the tax year. Income taxes are levied on profits accumulated or received in the republic. Both local and foreign corporations are taxed similarly. The rate of taxation is forty percent.[71] Offshore income derived from Asian Currency Unit (ACU) operations is taxed at ten percent rather than the normal forty percent.[72]

In September 1983 Singapore introduced two other tax incentives to attract three types of international businesses: fund management, loan syndications, and financial futures.[73] The two tax incentives were an extension of the five-year holiday tax scheme for offshore syndicated loans and an exemption for offshore income earned by nonresident investors from ACU-managed loans. The five-year holiday tax scheme waived taxes for five years and was extended to cover other credit facilities such as syndication of guarantees, performance bonds, and certain underwriting facilities.[74] The offshore income exception became effective on May 1, 1983, and exempts offshore income earned by investors from ACU-managed loans if investors or benefi-

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71. Clark, *supra* note 20, at 339.

72. PRICE WATERHOUSE, *supra* note 14, at 69; Ishihara & Kim, *supra* note 3, at 927.

73. *Letting Hongkong off the hook*, *supra* note 69, at 70. A financial futures market is a market in which the future delivery of financial instruments (e.g., dollars, treasury bonds, stocks, exchange markets) is bought and sold. The syndicated loan is described by Bee:

> [T]he syndicated loan . . . has become the single most important financing vehicle in the world today.
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> A syndication differs from a direct commercial loan in that a number of banks participate at the outset. Consequently, the loan must be structured and packaged so that it satisfies both the demands of the individual participating banks (lenders) and the needs of the borrower . . . .
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> . . . .
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> Although there are many types of syndicated loans, the lending form . . . has the following characteristics:
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> 1. It is medium term (now generously defined as 3 to 15 years).
> 2. The interest rate is normally quoted as a spread over the London interbank offered rate (LIBOR) and adjusted at predetermined intervals (normally 3 to 6 months).
> 3. There is a lead bank or syndicate manager (or group of managers), which negotiates the terms of the loan with the borrower (maturity, amortization, interest rates, covenants, etc.) and incorporates them into a loan agreement and sells participations in the loan to a number of other banks.

Bee, *Syndication*, in OFFSHORE LENDING BY U.S. COMMERCIAL BANKS 177-78 (F. Mathis ed. 1981).

74. PRICE WATERHOUSE, *supra* note 14, at 69. A five year holiday tax scheme means that the government reduces or excuses taxes for five years.

ciaries of the funds are nonresidents and the funds are invested in offshore markets and non-Singapore assets.[75]

As a result of these recent tax changes, a representative office properly limiting its activities should not be liable for Singapore income tax on income generated offshore. However, the Inland Revenue Department takes the position that because the regional office in Singapore provides a service to its head office, the head office has a source of income in Singapore. For tax purposes, a profit margin of five percent of the Singapore office's expenses is imputed and taxed at the normal rate of forty percent. The harshness of this tax ruling is softened somewhat by tax treaties Singapore currently has with twenty-three countries. When profits are taxed in the foreign country, a credit is given against the Singapore tax.[76]

Companies operating in Singapore also must pay several indirect taxes. These include a payroll tax of two percent on wages, including bonuses and commissions. A property tax is imposed on real estate as a percentage of value. A primary factor in determining taxable value is annual rental value. Other taxes include motor vehicle taxes, stamp duties, customs duties, and public utilities tax.[77]

Personal taxation in Singapore is relatively high. Gross income includes all remuneration, benefits, allowances, rents, and dividends.[78] Personal allowances (exemptions) are limited to S$2,000 per individual, and S$1,000 is deductible as a wife allowance. The allowance for children starts at S$750 for the first

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75. *Id.*

76. *Id.* at 63-64. For a discussion of tax treaties, see P. POSTLEWAITE, INTERNATIONAL CORPORATE TAXATION 60-62 (1980):

> When a corporation enters the international arena, many nations may claim a right to tax all or part of its income. Thus, the specter of double taxation of corporate income becomes a distinct possibility . . . .
>
> . . . Consequently, many nations have entered into bilateral agreements or conventions with other trading nations in order to limit double taxation effects . . . .
>
> . . . .
>
> . . . [A] tax treaty embodies a pact under which each nation agrees to extend significant tax benefits to the *residents* or *enterprises* of the other. This may be accomplished by providing reduced rates, or by exempting specified classes of income.

77. PRICE WATERHOUSE, *supra* note 14, at 83-85.

78. *Id.* at 44.

child and decreases for additional children.[79] Nonresidents are taxed at forty percent.[80]

II. Hong Kong as a Banking Center

Hong Kong became a British colony in 1842 and was leased for ninety-nine years in 1898 from the Chinese. Hong Kong was to be primarily an entrepôt for China. Its principal activity has been in economic enterprises.[81] Hong Kong entered a crisis period in 1949 when the China market closed. It was forced to make a difficult adjustment from a simple harbor to one of the world's greatest free ports. Since that time it has become a major industrial and economic power and an attractive location for international banks.

A. *Political Situation*

Politically, Hong Kong is in transition. Hong Kong's uncertainty as a borrowed place living on borrowed time[82] was resolved in September 1984. Beginning July 1, 1997, Hong Kong will be a "special administrative region" of China but will retain its independence for an additional fifty years. Though under Chinese rule, Hong Kong will continue its role as a free port on the principle of "one country, two systems."[83]

The fear of losing valuable property when China assumes control has led many regionally located banks and businesses to transfer assets outside Hong Kong. In March 1984, Jardine, Matheson & Co., which has been trading in Hong Kong since 1906, moved its headquarters to Bermuda. Other companies that might relocate include Swire Pacific, Wheelock Marden, Hongkong Land, and Hutchison Whampoa.[84] Hongkong & Shanghai Banking Corporation has transferred seventy percent

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79. *Id.* at 93.

80. *Id.* at 73.

81. McCarthy, *Financial System of Hong Kong,* in Emerging Financial Centers: Legal and Institutional Framework 95 (R. Effros ed. 1982).

82. R. Hughes, Borrowed Place, Borrowed Time: Hong Kong and its Many Faces (1976).

83. *Hong Kong Buys Some Time,* Newsweek, Oct. 1, 1984, at 40, 40. The agreement between the British and Chinese also "guarantees Hong Kong residents freedom of travel; . . . free exchange of currencies and . . . preservation of the local legal system." *Id.*

84. *Will Other Companies Follow Jardine Out of Town?,* Bus. Wk., Apr. 16, 1984, at 62, 62.

of its assets overseas.[85] Approximately thirty thousand individuals have started relocating businesses and finances outside Hong Kong or are transferring Hong Kong currency into United States dollars and other foreign currencies.[86]

However, some observers are optimistic that Hong Kong will continue to be an attractive international business location. The Chinese "admit that their record of sticking to policies at home is appalling, but they pride themselves on their adherence to international bargains."[87] China benefits from Western knowledge gained by Hong Kong and from Hong Kong money that is being invested in China.[88] Perhaps the principal reason for China to keep its promises to Hong Kong is the example that it will be setting for its future attempts to negotiate reincorporation with Taiwan.[89]

Ronald Silin, a former employee of the Bank of America, voiced an attitude shared by some:

> People in charge of China now are from the older generation, and political considerations lead them to require certain conditions, even in Hong Kong. . . . As that generation passes and China develops, younger officials will adjust to practical realities. There's a risk in what I'm doing [business in Hong Kong], but it's worth the potential reward.[90]

Lord Lawrence Kadoorie, Hong Kong's only English Lord, is also optimistic. Referring to China's banking in Hong Kong, engaging in joint commercial ventures, and marketing Chinese-made goods to Hong Kong's residents and tourists, Lord Kadoorie stated that the mainland government needs a place where it can "do things which it cannot allow its people to do."[91]

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85. *The Rising Tide of 'Red Capitalism,'* BUS. WK., Mar. 5, 1984, at 53, 53.

86. Taylor, *As Hong Kong Braces For Takeover by Peking,* U.S. NEWS & WORLD REP., Sept. 24, 1984, at 54, 55.

87. *Hongkong: Our turn next,* ECONOMIST, May 5, 1984, at 33, 34.

88. *Red sky over Hongkong,* ECONOMIST, Jan. 28, 1984, at 13, 14.

89.
> China has already offered Taiwan even more extensive autonomy than Hongkong, including the right to maintain its own armed forces. But the present generation of Taiwan leaders, all exiles from the mainland, will not be seduced. Neither will their heirs, not unless they see Chinese promises being kept in Hongkong, and not just for a token honeymoon period.

Id.

90. Kraar, *Confidence is Building in Hong Kong,* FORTUNE, June 11, 1984, at 140, 146.

91. Jones, *A businessman philosopher,* FORBES, Dec. 19, 1983, at 116, 117.

Kadoorie also believes the Chinese are dependent on Hong Kong's free gold market.[92]

B. Financial Center Characteristics

A bank considering locating an office in Hong Kong should consider characteristics that will affect its operations, such as Hong Kong's geographic location, economy, and other incidentals necessary for banking operations.

1. Location

Hong Kong's Asian location has aided its growth as a financial center. Hong Kong banks can deal on the Tokyo market in the morning and the London and Frankfurt markets in the afternoon. Hong Kong closes before Singapore, thus losing its position as the Asian "sunset money market." However, other advantages outweigh this disadvantage. Hong Kong's central Asian location permits a Hong Kong office to conveniently service Japan and Korea, as well as Southeast Asia. The recent increase in Western interaction with China and Hong Kong's proximity to China have led to new growth in Hong Kong's business and banking sectors. "About one million pounds sterling flow from Hong Kong to mainland China each day."[93] In addition, China has invested $15 to $20 billion in Hong Kong.[94]

2. Economy

Hong Kong's economic program is founded on "classical liberalism." The Hong Kong government expects its laissez-faire policy to encourage businesses to use their assets to the greatest advantage.[95] Hong Kong's considerable self-confidence has created a self-fulfilling prophecy of reinvestment and growth in the colony.

Hong Kong's economy has flourished over the last thirty-six years. Per capita income has risen from $200 per year in 1948 to $5,000 per year in 1984. Even now, despite the uncertainty of the end of British control, Hong Kong continues to thrive.

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92. *Id.*

93. Comment, *The Legal Implications of the Sino-British Treaties Regarding Hong Kong*, 4 LOY. L.A. INT'L & COMP. L.J. 111, 116 (1981).

94. *Communist management for Hong Kong conglomerate*, INT'L MGMT., Apr. 1984, at 7.

95. Comment, *supra* note 93, at 115.

Though dipping slightly in 1985 to a predicted level of 4.5% to 5%,[96] the economy grew 5.9% in 1983 and 8.5% in 1984.[97]

Hong Kong's stable currency has aided its economic growth. The unit of currency in Hong Kong is the Hong Kong dollar, divided into one hundred cents.[98] Following the 1967 devaluation of the British sterling and the 1973 devaluation of the United States dollar, Hong Kong's currency has floated free of the dollar and sterling,[99] although it sometimes follows the dollar in exchange fluctuations. The Hong Kong dollar has had its share of fluctuations on the international money market. However, it is generally considered a stable currency in the region and thus provides a basis for an extensive foreign exchange market.[100]

3. *Incidentals*

Hong Kong has an excellent communications system, particularly for the large loan syndications commonly done there. Two satellite stations provide around-the-world coverage, and telephone service rates are among the lowest in the world.[101]

Hong Kong also has available a large pool of local clerical, accounting, and banking personnel. The level of spoken English is acceptable, and individual candidates with previous experience can be located easily. New York and London legal counsel are also available in the colony, a noted advantage over all other Asian centers except Singapore.

Hong Kong's real estate market collapsed in 1982 from overbuilding and rising fears over its political future. Office rents, which were the most expensive in the world, are now fourth highest after New York, London, and Tokyo.[102] Rentals normally exclude annual rates and management charges. Commercial space in the financial area is still in huge demand and rents are estimated at HK$19 per square foot per month.[103]

Residential rents have kept up with commercial rents. Lux-

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96. *Cold wind from the west,* ECONOMIST, Sept. 28, 1985, at 69, 69.

97. Alexander, *Jumping for Joy in the Pacific,* TIME, Nov. 12, 1984, at 78, 79; Taylor, *supra* note 86, at 54.

98. In this paper, HK$ refers to Hong Kong dollars. US$1 = HK$7.814. Asian Wall St. J., Sept. 7, 1985, at 10, col. 4.

99. PRICE WATERHOUSE, DOING BUSINESS IN HONG KONG 3 (1983).

100. Smith, *Incorporation in Hong Kong,* 133 NEW L.J. 591, 591-92 (1983).

101. PRICE WATERHOUSE, *supra* note 99, at 10.

102. *Hongkong's Future,* ECONOMIST, Mar. 12, 1983, at 52, 53.

103. Asian Wall St. J., Oct. 16, 1984, at 4.

ury flats in desirable locations cost $2,000 to $5,000 per month. Unfurnished moderate housing cost $1,500 a month.[104] Utility rates are moderately high, due primarily to the need for air conditioning. Other costs of maintaining personnel in Hong Kong are moderate, particularly when compared with rental costs. Automobiles are not subject to excess tax. The cost of food, servants, and entertainment is moderate.

C. *Banking Regulations*

Other important factors for a bank considering opening an office in Hong Kong include statutes regulating banks, types of banking institutions available in Hong Kong, and the nature of the regulatory authority over banking.

1. *Banking statutes*

The Banking Ordinance of 1964 restricts banking practices and requires every bank incorporated in Hong Kong to maintain a minimum capital balance of HK$100 million.[105] The ordinance imposes no minimum reserve requirements, but requires banks to keep a minimum holding of liquid assets equal to at least twenty-five percent of deposit liabilities. Certain types of liquid assets, namely call money, and demand deposits may not fall below fifteen percent of deposit liabilities.[106] In addition to the required minimum liquid holdings, banks must maintain a published reserve. Banks must also maintain sufficient reserves for "bad and doubtful debt."[107]

Under the ordinance, a bank may not loan more than twenty-five percent of its paid-up capital and reserves to any one person, firm, corporation, or any group of companies. However, exceptions exist for transactions between banks, certain guaranteed transactions, telegraphic transfer purchases, and purchases of certain trade bills of exchange or documents of title.[108] Banks are also prohibited from loaning more than ten per-

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104. *Paycheck Power—From Houston to Hong Kong,* U.S. NEWS & WORLD REP., Oct. 28, 1985, at 62, 63.

105. Banking Ordinance, 1964, § 20 (*Laws of Hong Kong,* Cap. 155, 1981), *reprinted in* EMERGING FINANCIAL CENTERS: LEGAL AND INSTITUTIONAL FRAMEWORK 140 (R. Effros ed. 1982) [hereinafter Banking Ordinance].

106. *Id.* § 18.

107. *Id.* § 19A.

108. *Id.* § 23.

cent of paid-up capital and reserves to directors and officers, their relatives, and companies in which they have an interest.[109]

Banks are also restricted in their commercial activities and ownership of real property. A bank may not undertake any wholesale, retail, import, or export trade. The ordinance prevents banks from acquiring any prolonged direct benefit in any agricultural, commercial, industrial, or similar endeavor.[110] Hong Kong banks are permitted to hold land of an aggregate value not exceeding twenty-five percent of paid-up capital and reserves. This limitation excludes property used by the bank in the course of its banking business.[111] Banks may acquire the share capital of other companies, but the acquired capital may not exceed, in aggregate, twenty-five percent of the bank's paid-up capital and reserves. However, an exception is made for an affiliate engaged in a business related to banking.[112]

The banking ordinance requires Hong Kong banks to provide operational information to the public and the commissioner.[113] The ordinance also provides that a foreign bank may submit accounts and reports prepared in accordance with laws of the jurisdiction of its incorporation rather than those required by the ordinance.[114]

Deposit-taking companies are regulated by the Deposit-Taking Companies Ordinance of 1976.[115] The restrictions and requirements of the deposit-taking companies ordinance are similar to, but less detailed than, those of the banking ordinance.

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109. *Id.* § 24.

110. *Id.* § 26.

111. *Id.* § 28.

112. *Id.* § 27.

113. *Id.* § 37. Section 37 of the banking ordinance provides that within six months of the close of its financial year, a bank must publish the following in one English and one Chinese daily newspaper and must exhibit this information at its offices throughout the year: (a) audited annual balance sheet and any notes thereon, profit and loss account, and a copy of the report of the auditor, (b) names of all directors or managers of the bank, and (c) names of all subsidiaries of the bank.

114. *Id.* The banking ordinance also requires banks to provide a monthly report on their assets and liabilities, a quarterly statistical return, and such further information as may be required by the commissioner. *Id.* § 38. In addition, banks may also be subject to audit and investigation by Hong Kong banking authorities without notice or may be required to submit their books and records or other information to the commissioner in the course of an investigation. *Id.* §§ 15, 39.

115. Deposit-Taking Companies Ordinance, 1976 (*Laws of Hong Kong,* Cap. 328, originally No. 3 of 1976), *reprinted in* EMERGING FINANCIAL CENTERS: LEGAL AND INSTITUTIONAL FRAMEWORK 185 (R. Effros ed. 1982) [hereinafter Deposit-Taking Companies Ordinance].

In 1983 Hong Kong suffered a setback as a banking center when several deposit-taking companies failed.[116] Those failures left foreign banks with up to $2 billion in potential bad debts. Bankers have called for more vigorous government involvement in banking, but the Hong Kong government is reluctant to establish a central bank or to introduce deposit insurance. Instead, the government is thinking of imposing stricter rules on loans to directors or individuals.[117]

2. *Banking institutions*

Foreign banks locating in Hong Kong may elect to establish a branch bank, a deposit-taking company, or a representative office.[118]

a. Branch bank. Section 12A of the banking ordinance provides the commissioner of banking with guidelines for approving a branch bank.[119] With the lifting of a moratorium in 1981,[120] foreign banks are again allowed to open full Hong Kong branches subject to three standards. Prospective banks must be licensed in their own countries, they must have more than $3 billion in assets, and Hong Kong must receive reciprocity to open a bank in the country of the bank seeking to establish a branch in Hong Kong.[121]

If these standards are met and a license is given, the prospective bank is restricted to opening a single Hong Kong office.[122] However, banks established prior to the enactment of section 12D of the banking ordinance are allowed to maintain multiple offices. The foreign bank with the most extensive Hong Kong operation is the Chartered Bank.[123] In August 1984 there were 149 licensed banks in Hong Kong with over 1,301 offices. Four licenses were granted by the commissioner in 1984.[124]

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116. *Disciplining Hongkong's banks,* ECONOMIST, July 13, 1985, at 84, 84-85.

117. *Calls For a Banking Crackdown,* BUS. WK., Apr. 4, 1983, at 46, 46.

118. There are at least 123 licensed banks, 350 registered deposit-taking companies, and 121 representative offices of foreign banks. PRICE WATERHOUSE, *supra* note 99, at 15-16.

119. Banking Ordinance, *supra* note 105, § 12A.

120. Entry was closed to banks from 1965 to 1978. McCarthy, *supra* note 81, at 103. Entry was later closed again, but reopened in 1981. PRICE WATERHOUSE, *supra* note 99, at 16.

121. McCarthy, *supra* note 81, at 107.

122. *Id.*

123. *Id.* at 105.

124. TA KUNG PAO, Aug. 9-15, 1984, at 15.

b. Deposit-taking companies. During the period of the first moratorium on banking licenses from 1965 to 1978, many foreign banks established finance companies or deposit-taking companies in Hong Kong. Most banks found establishing a finance company an attractive way to enter the Hong Kong market because the banking ordinance restrictions were inapplicable.[125]

Recent legislation, including the Deposit-Taking Companies (Amendment) Ordinance of 1982, has considerably altered the law concerning banking corporations.[126] Prior to the amendment, registered and licensed deposit-taking companies could not hold short term deposits. However, now a licensed deposit-taking company can accept any short term deposits while a registered deposit-taking company may accept such deposits only from banks and deposit-taking companies.[127]

A registered deposit-taking company can become licensed. The two types of deposit-taking companies have different criteria. Licensed deposit-taking companies are required to have at least HK$100 million share capital and HK$75 million paid-up capital. They also must meet certain size, ownership, and management requirements. Registered deposit-taking companies, on the other hand, are required to have HK$10 million paid up capital.[128] There are currently 33 licensed and 307 registered deposit-taking companies in Hong Kong.[129]

Deposit-taking companies have been extremely successful. From 1978 to 1980, deposit-taking companies' total assets/liabilities grew by 148%.[130] This success is due to the low-interest rates charged on loans. Commercial banks have been subject to stringent interest rates laws.[131]

c. Representative office. Section 12C of the Banking Ordinance of 1964 governs establishment of a representative office by

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125. McCarthy, *supra* note 81, at 104.

126. *Id.* at 107.

127. "A short-term deposit is one with an original maturity (or period of call or notice) of less than three months." *Id.*

128. PRICE WATERHOUSE, *supra* note 99, at 16.

> Since April 1981, a company has only been able to register if it is more than 50 percent owned by a bank in Hong Kong or elsewhere. At the end of 1981, there were 350 registered deposit-taking companies. No company had at that time been granted the status of a licensed deposit-taking company.

Id.

129. *Fell farming*, ECONOMIST, Apr. 27, 1985, at 98, 98.

130. McCarthy, *supra* note 81, at 108.

131. *Id.*

a bank incorporated outside Hong Kong.[132] As the name implies, a representative office is only permitted to act as a liaison office, solicit business for the bank outside Hong Kong, and gather regional information. Permission to create a representative office is easily obtained. The establishment fee is HK$10,000, and the annual maintenance fee is HK$10,000 per year.[133] In 1984, there were 112 representative offices in Hong Kong.[134]

3. *Commissioner of banking*

There is no central monetary authority in Hong Kong. Therefore, the government has assumed some of the responsibilities of a central bank.[135] It does not, however, issue currency. Notes are issued by the Hongkong & Shanghai Banking Corporation and the Chartered Bank.[136] The principal government official in charge of banking is the financial secretary, who is a valued member of the Legislative Council. Hong Kong banking regulation is under his supervision and control. In addition, a banking advisory committee counsels the governor on affairs related to the banking ordinance and banking industry.[137] The banking ordinance established the office of commissioner of banking to help implement its provisions.[138] The commissioner's

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132. Banking Ordinance, *supra* note 105, § 12C.

133. *Id.* § 12E(3)(a), (b).

134. *Profile of a financial centre,* ECONOMIST, July 13, 1985, at 84, 84.

135. McCarthy, *supra* note 81, at 96.

> Ultimate responsibility for financial affairs is vested in the Legislative Council, which consists of the Governor, 4 ex officio members (the Chief Secretary, the Attorney-General, the Secretary for Home Affairs, and the Financial Secretary), 17 official members, and 26 unofficial members. While this Council is responsible for financial affairs in Hong Kong, the U.K. Secretary of State for Foreign and Commonwealth Affairs retains a veto power when major decisions are involved.

Id.

136. *Id.*

> The value of currency issued by the banks is regulated by an Exchange Fund, which receives payment from these banks in exchange for certificates of indebtedness denominated in Hong Kong dollars . . . . These certificates are noninterest bearing and are issued and redeemed at the discretion of the Financial Secretary. The Exchange Fund's resources are held in Hong Kong dollars and certain foreign currencies.

PRICE WATERHOUSE, *supra* note 99, at 15.

137. Banking Ordinance, *supra* note 105, § 3. The committee consists of the financial secretary, as chairman; the secretary for monetary affairs; the commissioner of banking; and between four and twelve other members appointed by the governor. *Id.* § 3(2).

138. *Id.* § 4.

office is charged with licensing[139] and direct supervision of the banking sector.[140] The commissioner also regulates deposit-taking companies.[141]

In recent years the commissioner has followed the government policy of closely controlling entry into the Hong Kong banking market. He effectively closed entry from 1965 to 1978 to prevent Hong Kong from becoming over-banked and to prevent bank failures like the Canton Trust failure of 1965.[142] When the the moratorium was lifted in 1978, twenty-one banks were admitted.[143] From 1979 to 1981 entry was again closed to international banks and local deposit-taking companies.[144]

D. Taxation

The simplicity of Hong Kong's tax structure and its low standard rate of taxation have made Hong Kong an attractive regional banking center. Tax is levied under the Inland Revenue Ordinance. The major tax imposed is the profits tax; Hong Kong also levies an interest tax, salaries tax, and property tax.[145]

Only income and profits earned in Hong Kong are subject to Hong Kong taxation. Income or profits arising outside Hong Kong are not taxed even if remitted to Hong Kong.[146] Thus, residency or nonresidency is not a criterion in the tax structure. A representative office is not normally liable for profits tax since its permitted activity should not generate any Hong Kong income or profits.

The profits tax is payable by all corporations doing business in Hong Kong, including foreign banks and deposit-taking companies that have profits arising from Hong Kong activities. In February 1984 the government raised the corporate income tax rate from 17% to 18.5% following its first budget deficit.[147] Tax is assessed on a current year basis for a tax year running from April 1 to March 31. Taxable profit is determined by deducting

139. *Id.* § 6.

140. McCarthy, *supra* note 81, at 96.

141. Banking Ordinance, *supra* note 105, Part III.

142. Rowley, *Hong Kong Moves Up Market,* BANKER, Dec. 1978, at 55, 56.

143. *Id.* at 57.

144. PRICE WATERHOUSE, *supra* note 99, at 16.

145. Au-Yeung, *Understanding the Hong Kong Tax System,* 8 INT'L TAX J. 337, 337 (1982). Other taxes include an estate duty, stamp duty, entertainments tax, betting duty, business registration fees, and hotel accommodations tax. *Id.* at 338.

146. *Id.*

147. *Will Other Companies Follow Jardine Out of Town?, supra* note 84, at 62.

the costs and expenses incurred in deriving income. Corporations do not have to pay withholding tax on dividends.[148]

Taxes on individuals employed in Hong Kong are favorable when compared with other Southeast Asian regions. The salaries tax is progressive with a bottom rate of five percent and a top rate of twenty-five percent and is imposed on all income. However, the total tax is limited to fifteen percent of the gross income before personal allowances are deducted.[149]

Property taxes are levied on real property located within Hong Kong. The rate is fifteen percent of net rental value of the property. Property owned by corporations doing business in Hong Kong is exempt from property taxation if the property is used for business purposes.[150]

The Hong Kong interest tax is not relevant to the operation of a branch bank or deposit-taking company because it does not apply to foreign currency deposits placed with licensed banks. The interest tax rate is ten percent of interest received and is a withholding tax assessed on Hong Kong currency.[151]

III. Singapore or Hong Kong?

Both Singapore and Hong Kong offer advantages to a foreign bank looking to establish an East Asian presence. However, Hong Kong is the better choice for a bank willing to take a risk on Hong Kong's political future.

A. *Political Situation*

One of Singapore's key advantages is its political and economic stability. During its twenty-five years of independence, Singapore has had but one ruler, Lee Kuan Yew. As long as Lee Kuan Yew continues to rule, the country should be stable and growth-oriented. When Lee Kuan Yew dies or steps down Singapore may not be able to maintain its stability and growth. However, Lee Kuan Yew is working to ensure Singapore's continued stability after he is no longer able to rule. Thus, foreigners can continue to view Singapore as a stable and growth-oriented country and a favorable location for international business.

Hong Kong, on the other hand, has an obscure political fu-

148. Au-Yeung, *supra* note 145, at 337.
149. *Id.* at 337-38.
150. *Id.*
151. *Id.*

ture due to the uncertainty about what will happen when China assumes control in 1997. Whether China will allow Hong Kong to maintain its status quo remains to be seen. Although Hong Kong has been stable, its uncertain future detracts from its attractiveness as an international banking center.

B. Financial Center Characteristics

Both countries are centrally located and each enjoys a unique advantage over the other due to its location. Singapore has the advantage of a later closing time. This allows last-minute financial transactions to be carried out in Singapore after Hong Kong markets have closed. Hong Kong, however, is more centrally located in Asia, thereby permitting service to Japan, Korea, Southeast Asia, and the People's Republic of China. This closeness to China spurred recent growth in Hong Kong's business and banking sectors and should be even more important as interaction between China and the West increases. As a result of this central location, most syndicated deals in Asia are still transacted in Hong Kong.

Although both countries have stable currencies in the region and extensive foreign exchange markets, Singapore offers additional specialized banking functions, such as the Asian Dollar Market, Asian Dollar Bond, and a financial futures market. Both countries have modern facilities and trained personnel, although Hong Kong has a slight advantage in this area. The cost of establishing operations in Singapore is less than in Hong Kong, especially in the area of office rent and employee housing.

Considering all financial center characteristics, Singapore is slightly more attractive. It has recently had stronger economic growth, offers additional financial services, and has a lower initial cost for establishing operations.

C. Government Regulations

Singapore offers an active banking sector to the foreign bank located in East Asia. Singapore's government has set up a licensing and regulatory framework conducive to foreign banking operations. The regulatory climate, however, is tighter in Singapore than in Hong Kong. The Singapore government exercises a paternalistic concern for the economy in general and the banking industry in particular. This high level of regulation and control is a major concern for a foreign bank considering opening a

Singapore branch. This is particularly true given the difficulty of knowing what the regulations permit and the stiff penalties imposed for their violation.[152]

In contrast, Hong Kong is justifiably known as the most laissez-faire of Asian banking centers and has relatively light regulation. It is noted for the absence of government intervention until serious economic dislocations or industry failures occur. Hong Kong's less stringent laws and the manner of administration are primary factors in attracting the banking industry.[153]

D. *Taxation*

A significant disadvantage of Singapore is its relatively high tax burden of forty percent on bank and overseas employees' income. This burden presently can be partially offset by operational cost savings. Singapore also offers additional tax incentives to offshore banks, keeping taxation in offshore lending on par with Hong Kong's.

Hong Kong, however, is the most favorable Asian tax jurisdiction, with no taxation of income derived outside Hong Kong even if remitted to Hong Kong. Its income tax is also low. Hong Kong's low tax rates and liberal exemptions make it very suitable for foreign businesses. This is perhaps the most important factor to a foreign bank considering establishing a bank in one of these countries.

IV. Conclusion

For the careful banker who prefers not to take a risk on Hong Kong's future and who also prefers lower costs for setting up operations, Singapore is the better choice. On the other hand, for the risk-taking banker who is not afraid of Hong Kong's uncertain future as an international financial center, Hong Kong would be the better choice. A more significant return on investment can be obtained in Hong Kong due to lower tax rates. Also, in the foreseeable future Hong Kong banking regulations are expected to remain light and be more predictably administered than those in Singapore. Therefore, the risk of substantial penalties for violations of banking regulations is significantly lower in Hong Kong. These factors have led to Hong Kong having the

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152. *See supra* notes 69-70 and accompanying text.
153. *Letting Hongkong off the hook*, *supra* note 69, at 70.

largest foreign banking operation in Asia, and indicate that it is still the better choice for a multinational bank considering opening a bank in East Asia.

Jagjit Kaur Meetook