

BANKING (AMENDMENT) ORDINANCE 1999 - GUIDELINES ON SECTIONS 87A AND 121(3)

Since the Banking (Amendment) Ordinance 1999 was passed in July 1999, the majority of the provisions except those in relation to sections 60A, 87A and 121(3) have commenced operation. The commencement of sections 87A and 121(3) is scheduled to take place in February 2000. This paper introduces the new guidelines on sections 87A and 121(3) of the Banking Ordinance which respectively regulates major acquisitions by authorised institutions and empowers the Monetary Authority to disclose information about individual customers of authorised institutions to overseas supervisory authorities.

Introduction

Since the Banking (Amendment) Ordinance (BAO) 1999 was passed in July 1999, the majority of its provisions except those in relation to sections 60A, 87A and 121(3) have commenced operation. The commencement of sections 87A and 121(3) is scheduled to take place in February 2000 while section 60A will commence operation later after the subsidiary legislation on publication of information relating to financial affairs of authorised institutions ("institutions") is finalised.

This paper introduces the new guidelines on sections 87A and 121(3) of the Banking Ordinance ("Ordinance") which respectively regulates major acquisitions by institutions and empowers the Monetary Authority (MA) to disclose information about individual customers of institutions to overseas supervisory authorities. The issuance of these two guidelines enables the two relevant provisions mentioned above to take effect, thus bringing Hong Kong's banking supervisory framework more fully in line with the Basel Committee's Core Principles for Effective Banking Supervision ("Core Principles").

Major Acquisitions by Authorised Institutions

Principle 5 of the Core Principles states that banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision. While section 64 of the Ordinance enables the MA to obtain details of any company in which an

institution holds 20% or more of the shares, there were previously no formal requirements for institutions to notify the MA before making major acquisitions or investments (other than in relation to overseas banking subsidiaries). In order to fully comply with the relevant Core Principle, section 87A was introduced in the BAO 1999.

The new section 87A imposes a requirement on a locally incorporated authorised institution to seek the MA's prior approval for any major acquisition in a company (including establishment of a company) which amounts to 5% or more of the institution's capital base except in certain specific cases. The specific cases are where an institution acquires the shares of a company in the course of satisfaction of debts due to the institution, or under an underwriting or sub-underwriting contract for a period not exceeding 7 days.

In accordance with section 79A of the Ordinance, the MA may apply the provisions of section 87A to institutions on both an unconsolidated basis and a consolidated basis, thus covering acquisitions by institutions' subsidiaries as well.

The guideline on section 87A is enclosed at Annex A. It sets out the manner in which the MA will exercise his powers of approval under the new section 87A. This includes, among other things, the application procedures, considerations for the refusal of approval or revocation of consent and the associated appeal mechanism. In addition to the statutory requirements, the guideline specifies the circumstances under which the MA would normally expect institutions to notify him of acquisitions below the 5% threshold.

Disclosure of Information about Individual Customers

Principle 25 of the Core Principles states that banking supervisors must have powers to share information needed by the home country supervisors for the purpose of carrying out consolidated supervision. Under section 121 of the Ordinance, the MA may disclose information to an overseas supervisory authority, where in the opinion of the MA:

- (a) the relevant overseas authority is subject to adequate secrecy provisions; and
- (b) it is desirable or expedient that information should be disclosed in the interests of depositors or the public interest; or
- (c) such disclosure will enable or assist the recipient of the information to exercise his functions and it is not contrary to the interests of depositors or potential depositors or the public interest that the information should be so disclosed.

However, the MA was previously not legally permitted to disclose information to an overseas supervisory authority about the affairs of individual customers. In view of this constraint, section 121(3) has been amended to enable the MA to disclose individual customers' information to an overseas supervisory authority.

To address concern about lack of control on the onward disclosure of information by the receiving authority, the new provisions also empower the MA to attach a condition to any disclosure made under section 121 to require the MA's consent for any onward transmission of such information. Such a condition is mandatory in the case of disclosure of individual customers' information.

The guideline on section 121(3) is enclosed at Annex B. It illustrates the manner in which the MA will exercise his discretion to disclose customers' information and the types of conditions he will impose on the recipient authority.

The guiding principle to be followed by the MA is that he will not routinely disclose information relating to individual customers to an overseas supervisory authority. This means, among other things, that the MA will continue to delete the names of individual customers in Hong Kong Monetary Authority examination reports sent to an overseas supervisory authority. Disclosure of information about individual customers will be made only on a case-by-case and "need to know" basis, following either a specific request from the overseas authority concerned or on occasions at the initiative of the MA. Normally, the MA would be more forthcoming in providing information to an overseas regulator relating to the credit or other financial exposure of the institution concerned and will take particular care regarding disclosure of information about individual depositors. 

- Prepared by the Banking Development Division

MAJOR ACQUISITIONS BY AUTHORISED INSTITUTIONS OF SHARE CAPITAL IN COMPANIES - SECTION 87A OF THE BANKING ORDINANCE

A guideline issued by the Monetary Authority under section 7(3) of the Banking Ordinance

Introduction

1. Section 11 of the Banking (Amendment) Ordinance (“BAO”) 1999 introduces a new section 87A in the Banking Ordinance (“the Ordinance”) which requires an authorised institution incorporated in Hong Kong (“institution”) to obtain the prior approval of the Monetary Authority (“MA”) if it proposes to acquire (whether by one acquisition or a series of acquisitions) all or part of the share capital of a company to a value of 5% or more of the capital base of the institution. Acquisition includes the establishment of the company by the institution concerned. The day of commencement of section 11 of the BAO 1999 (“the relevant day”) was 18 February 2000.

2. This guideline sets out the manner in which the MA will exercise his powers of approval under section 87A of the Ordinance.

General Principles

Capital base

3. For the purposes of section 87A, the capital base of an institution is defined in accordance with section 79 (2). The relevant capital base is that which applies at the time of the acquisition of shares which would take the institution’s holdings to 5% or more of its capital base. In normal circumstances, the capital base figure which stood at the end of the previous quarter will be used as the basis for assessing an institution’s relevant capital base. However, the MA may require an institution to use its latest capital base figure for this purpose, if there has been a significant fall in its capital base compared with that shown at the end of the previous quarter.

4. For the purpose of calculating the 5% threshold, the value of the shares will be determined by the value at which they would be shown in the books of the institution at the time of the acquisition (together with the amount for the time being remaining unpaid on the

shares, if any). Normally, this value will be determined by the cost of acquisition. The definition of “share capital” for the purposes of section 87A excludes shares acquired in the course of the satisfaction of debts due to the institution or under an underwriting or sub-underwriting contract for a period not exceeding 7 working days (or such further period as the MA approves in writing).

5. Where an institution acquires the share capital of a company to a value less than 5% of its capital base at the time of the acquisition, it is not required to seek the prior approval of the MA if a subsequent fall in its capital base would cause its percentage holding in the company to rise to 5% or more of its capital base. Similarly, prior approval is not required if a rise in the market value of an institution’s existing holding of shares causes its current book value to rise to 5% or more of its capital base.

Consolidated supervision

6. To ensure the effectiveness of the MA’s supervisory regime, the 5% threshold will be applied to institutions on both an unconsolidated and a consolidated basis in accordance with section 79A. This means that an acquisition of shares in a company by a subsidiary¹ which is consolidated for the purposes of Part XV of the Ordinance will require the MA’s prior approval if the value of the acquisition is 5% or more of the capital base of the institution on a consolidated basis. The application of section 79A to institutions will be based on the MA’s Guideline 5.2.1A concerning consolidated supervision of concentration risks under Part XV of the Ordinance. For ease of administration and in view of the similar nature of sections 87 and 87A, subsidiaries to be included for consolidated supervision for the purposes of section 87A shall be the same as those included for the purposes of section 87, unless otherwise advised by the MA. In the latter case, the MA will discuss with individual institutions and notify them in writing as to which subsidiaries will be included for consolidation.

¹ “Subsidiary” is defined under section 2 of the Banking Ordinance to have the same meaning in the Companies Ordinance.

Deemed approval

7. Section 87A(3) provides that approval shall be deemed to have been granted in respect of any company where:

- (a) the institution held share capital of the company to a value of 5% or more of its capital base immediately prior to the relevant day; or
- (b) the institution comes to hold, not later than 3 months after the relevant day, share capital to a value of 5% or more of its capital base where the acts or circumstances leading to the acquisition occurred substantially before the relevant day.

8. Institutions should notify the MA of all acquisitions to which section 87A(3) is relevant.

Acquisitions which require the MA's prior approval

Procedures

9. An institution should contact the MA at an early stage to discuss their intention to acquire the share capital of a company amounting to a value of 5% or more of the institution's capital base. A formal notice in writing in advance of the acquisition should be submitted to the MA seeking his approval under section 87A. The notice should be accompanied by information on the proposed acquisition, including the following where relevant²:

- (a) the name of the company being acquired;
- (b) its place of incorporation or establishment;
- (c) the value of the acquisition in absolute terms and as a percentage of the institution's capital base;
- (d) the impact of the acquisition on the institution's solo and consolidated capital adequacy ratios;

² The relevance of some of the items will depend on whether the acquisition will represent a portfolio or a direct investment by the institution concerned.

- (e) the percentage of the company's shares that will be held by the institution and whether the company will become an associate or subsidiary of the institution as a result of the acquisition;
- (f) how the acquisition will fit into the institution's group structure;
- (g) how the acquisition will be funded;
- (h) the nature of the business of the company and its internal control systems;
- (i) financial information about the company (balance sheet, profitability, capital ratios, etc.) for 3 consecutive years;
- (j) the management structure and corporate affiliations of the company;
- (k) the proposed degree of involvement by the institution in the direction and management of the company's affairs, including representation on the board of directors;
- (l) proposed business plan for the company;
- (m) the manner in which the investment will be managed and controlled by the institution, including reporting lines from the company to the institution and any limits established over the company's activities;
- (n) whether the company is subject to any formal regulation or supervision in its place of incorporation or establishment, e.g., by stock exchanges or financial regulators, and if so the names of the regulators or supervisors concerned; and
- (o) details of any secrecy constraints on disclosure of information to the institution by the company being acquired.

10. After receiving a formal notice, the MA will, as soon as practicable, issue either a consent of approval

or a refusal of approval to the institution. Before the acquisition actually takes place, the institution should inform the MA of any major changes to the above information after it has submitted the application for approval to the MA.

Refusal of Approval

11. The MA may refuse to grant approval when he is of the opinion that the interests of depositors or potential depositors of the relevant institution would be threatened by the acquisition of shares in the company concerned. In forming this view, the following factors will be taken into consideration:

- (a) the financial capacity and ability of the institution to make the acquisition. The impact on the capital adequacy of the institution and its ability to fund the acquisition will be assessed. The present financial condition and the possible future requirements of the company in terms of possible injections of capital and liquidity will also be considered to ensure that there will not be a drain on the financial resources of the institution;
- (b) the managerial capacity of the institution, if applicable, to ensure that the activities of the company are conducted in a prudent and reputable manner;
- (c) any undue risks to which the institution may be exposed arising from the acquisition. Factors to be taken into account would include:
 - the size and nature of the business of the company;
 - the reputation and standing of the company;
 - the present or proposed management structure of the company and the quality of its management;
 - the present or proposed nature of the internal control systems within the company;
 - the reporting lines to the institution and its monitoring arrangements (including the type and frequency of information to be provided);

- the arrangements within the institution to monitor the company and the amount of time to be devoted to such monitoring;
- the past experience and skills of the institution in managing its investments or acquisitions; and

- (d) the place of incorporation or establishment of the company, in particular whether the relevant corporate laws are inconsistent with the laws of Hong Kong, and whether there are any secrecy constraints which would inhibit effective consolidated supervision by the MA.

12. Where the MA intends to refuse to grant approval, his proposed reasons will be advised to the institution, in order to allow the institution to make representations, prior to his final decision. The formal notice of refusal of approval will specify the particular grounds on which the MA refuses to grant his approval for the institution's proposed acquisition.

Conditions

13. The MA has the power, under section 87A(4) of the Ordinance, to attach conditions to an approval. Such conditions may be attached when the initial consent to acquire a company is given or at a subsequent date. Conditions may be attached when the MA is of the view that such conditions are necessary to safeguard the interests of depositors or potential depositors of the relevant institution. In deciding whether to attach conditions, the MA will take into account the same factors as those set out in paragraph 11 above.

14. Before the MA attaches conditions to any approval, he will discuss with the institution concerned the proposed conditions and the reasons for attachment in order to give the institution an opportunity to make representations. The conditions will be set out in a written notice specifying the reasons of attachment.

Revocation of approval

15. Under section 87A(5) of the Ordinance, the MA may revoke an approval that has been given, or is deemed to have been given under section 87A(3), for the acquisition of a company to a value of 5% or more of the institution's capital base. In such a case, the

institution will be required to reduce its holding in the company concerned to less than 5% of its capital base on or before the revocation comes into effect. The MA may decide to take such action when he is of the opinion that the interests of depositors or potential depositors of the relevant institution are threatened in some manner. The factors that will cause the MA to form this view are the same as those set out in paragraph 11 above.

16. Where the MA intends to revoke an approval, he will advise the institution of his proposed reasons, in order to allow the institution to make representations, prior to issuing the formal notice. The notice will state the particular grounds on which he has revoked the approval and specify a period within which the institution should make the necessary reduction in its shareholding in the company. Such period will be discussed with the institution and will be reasonable, taking into account the particular circumstances of each case.

17. The MA will be prepared to consider an extension of the deadline for the institution concerned to effect the reduction in its shareholding if he believes that the institution has made genuine attempts to achieve the disposal but has been unable to find a buyer for the shares within the original deadline.

Rights of appeal

18. An institution which is aggrieved by the MA's refusal to grant approval under section 87A, or by the MA's decision to attach conditions or to revoke his approval may appeal to the Chief Executive in Council under section 132A, but that refusal, those conditions or that revocation shall take effect immediately, notwithstanding that an appeal has been made.

Other acquisitions where institutions are expected to serve advance notification on the MA

19. In addition to the statutory requirement to seek the MA's prior approval for acquisitions amounting to a value of 5% or more of an institution's capital base, the MA would normally expect institutions to notify him in advance of acquisitions which may have a significant impact on the financial position, business strategy, managerial resources or reputation of the institution. Examples of such acquisitions would include the following:

- (a) those where the institution would become a significant shareholder in another financial institution, in Hong Kong or overseas, and in particular where consent would be required from another regulator for such acquisitions;
- (b) those which would result in the company concerned becoming a subsidiary of the institution and subject to consolidation for the purposes of Parts XV, XVII or XVIII of the Ordinance;
- (c) those which would have a material adverse impact on the capital adequacy ratio of the institution (say 0.5% or more); and
- (d) those which would represent a significant diversification by the institution into a new line of business or into non-financial activities (including, for example, investment in a property company).

20. In the above cases, the MA would reserve the right, following notification, to request the institution concerned to supply him with additional information similar to that specified in paragraph 9 above. ☒

DISCLOSURE OF INFORMATION RELATING TO THE AFFAIRS OF INDIVIDUAL CUSTOMERS UNDER SECTION 121(3) OF THE BANKING ORDINANCE

A guideline issued by the Monetary Authority under section 7(3) of the Banking Ordinance

Introduction

1. The Banking (Amendment) Ordinance 1999 amends, among other things, section 121(3) of the Banking Ordinance (“the Ordinance”) to allow the Monetary Authority (“MA”) to disclose information relating to the affairs of any individual customer of an authorised institution (“institution”) or local representative office to an overseas supervisory authority.

2. The amendment to section 121(3) is necessary in order to bring Hong Kong’s banking supervisory regime in line with the Basel Committee’s Core Principles for Effective Banking Supervision which are accepted as international standards. Principle 25 provides that host banking supervisors of the local operations of foreign banks must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision. In the view of the Basel Committee, this includes the sharing of information about individual customers.

3. This guideline sets out the manner in which the MA will exercise his discretion to disclose information about individual customers and the criteria for such disclosure.

MA’s considerations and criteria for disclosure

4. The guiding principle to be followed by the MA is that he will not routinely disclose information relating to individual customers to an overseas supervisory authority. This means, among other things, that the MA will continue to delete the names of individual customers in HKMA examination reports sent to an overseas supervisory authority. Disclosure of information about individual customers will be made only on a case-by-case and “need to know” basis, following either a specific request from the overseas authority concerned or on occasions at the initiative of the MA. The latter might occur, for example, where the MA wished to share information about a problem loan booked in Hong Kong with the relevant institution’s home supervisor.

5. Normally, there should be no difficulty with the MA providing information upon a specific request of an overseas supervisor relating to the credit exposure or other financial exposure of the institution concerned, provided that the relevant criteria are satisfied. Such information is of the type which would be of direct relevance to the home supervisor in the conduct of its consolidated supervision of the institution concerned.

6. As regards the liability side of the balance sheet, the MA will take particular care regarding the disclosure of information about individual depositors. This is in line with the recommendations of the Basel Committee* which acknowledges that home supervisors do not normally need to know the identity of individual depositors. However, a home supervisor may sometimes wish to know the amount of deposits held by a depositor in Hong Kong in order to verify whether the depositor in question is among the large depositors of an institution. This would enable the home supervisor to monitor deposit concentrations or the funding risk of the deposit being withdrawn. In such cases, where there is a clear and specific supervisory need for the information in question, the MA will consider whether to respond to a request for disclosure from an overseas supervisory authority. In general, however, it is envisaged that the test for whether disclosure about individual depositors should be made will be set at a higher level than in the case of information on credit exposures.

7. Before making any disclosure, whether of credit or deposit information, the MA will wish to satisfy himself that the criteria laid down in section 121(1)(b) of the Ordinance are satisfied, including that the overseas supervisory authority is subject to adequate secrecy provisions in the overseas jurisdiction concerned. In addition, where the proposed disclosure relates to a customer who is an individual, the MA will wish to satisfy himself that the exemption given to financial regulators under section 58 of the Personal Data (Privacy) Ordinance applies to the particular circumstances of the case.

* As set out in the report on The Supervision of Cross-Border Banking produced by the Basel Committee and the Offshore Group of Banking Supervisors in 1996.

8. As required by section 121(3)(b) of the Ordinance, the disclosure of any information about an individual customer to an overseas supervisory authority shall be subject to the condition that the information shall not be disclosed to any other person without the consent of the MA. In addition, the MA will want to lay down the following criteria which are in line with the recommendations of the Basel Committee:

- (a) the purpose for which the information is sought must be specific and supervisory in nature;
- (b) the information will be restricted solely to officials engaged in prudential supervision;
- (c) all possible steps will be taken to preserve the confidentiality of information received by the overseas supervisory authority;
- (d) there is a two-way flow of information between the MA and the supervisory authority concerned (although it will not be possible to insist on perfect reciprocity); and
- (e) the overseas supervisory authority will consult with the MA before taking consequential action based on the information disclosed. 