

# BANKING (AMENDMENT) ORDINANCE 2001

*The Banking (Amendment) Ordinance 2001 was enacted by the Legislative Council on 19 December 2001 and published in the Hong Kong Government Gazette on 28 December 2001. It seeks to amend the Banking Ordinance so as to keep the banking supervisory regime abreast of recent developments. The major provisions contained therein aim to update and strengthen the supervisory regime in relation to authorized institutions' place of business, advertisements for deposits through the internet and appointment of senior management. This article sets out the rationale behind the legislative changes and the major amendments introduced.*

## Introduction

The Banking (Amendment) Ordinance 2001 (BAO) was enacted by the Legislative Council on 19 December and published in the Hong Kong Government Gazette on 28 December 2001. The main objective of the amendments is to keep the Hong Kong Monetary Authority's (HKMA) supervisory regime abreast of recent developments. In particular, the BAO seeks to update and strengthen the supervisory regime in relation to authorized institutions' (AIs) place of business, advertisements for deposits through the internet and appointment of senior management. A number of amendments have also been made to improve the operation of the Banking Ordinance (BO) in the light of experience.

## Control over Authorized Institutions' Places of Business

At present, AIs are required to seek the Monetary Authority's (MA) approval for establishment of local branches. "Local branch" is defined under section 2 of the BO as a place of business in Hong Kong at which a bank carries on banking business or a restricted licence bank or deposit-taking company carries on the business of taking deposits. The BO empowers the MA to approve or refuse AIs' establishment or maintenance of a local branch, attach conditions to approval, or revoke an approval.

The existing definition, however, only encompasses those places of business at which an

AI enters into commitments on the liabilities side of the balance sheet (i.e. the taking of deposits). In recent years, some AIs have adopted alternative or complementary outlets in addition to full service branches. These outlets, which may not fall under the definition of "local branch", can be categorised into two main types:

- (a) those at which an AI enters into commitments on the assets side of the balance sheet, for example, "lending offices" at which loans are made but no deposits are taken; and
- (b) those at which an AI does not enter into commitments on either side of the balance sheet but which function predominantly as sales and service outlets, for example, personal banking centres at which financial advice is provided.

As type (a) outlets can commit an AI to significant financial risks, it is considered that the MA should be given powers of control over these outlets. Thus the definition of "local branch" is extended under the BAO to cover any place of business in Hong Kong at which an AI carries on banking business or any other business which involves the incurring of financial exposure as defined under section 81(2) of the BO. As a result of the amendments, establishment of outlets to conduct activities such as granting of loans or credit facilities will require prior approval of the MA under section 44 of the BO.

As type (b) outlets subject AIs to a relatively lower level of risk, it is considered sufficient for the MA to have a limited degree of control over them. A new term of “local office” is introduced to capture such outlets. A “local office” is defined under the BAO as a place of business in Hong Kong from which any business of an AI is promoted or assisted and to which members of the public ordinarily have physical access for this purpose (predominantly sales and service centres). In order not to stifle innovation regarding new delivery channels, AIs are only required to notify the MA of the establishment of a local office under a new section 45A. In addition, no annual fee is required for maintenance of such an office.

### Internet Advertisements for Deposits

It has become increasingly popular for financial institutions to promote services through the internet. In response, the HKMA has reviewed the regulatory framework regarding advertisements for deposits placed on the internet, with a view to ensuring that the interests of depositors remain well protected.

#### *The “target at” approach to regulation*

Under section 92 of the BO, with certain exceptions, no person is permitted to issue advertisements that contain an invitation to members of the public to make any deposit in Hong Kong other than with an AI. Since the section was drafted primarily with physical forms of advertisements in mind, some uncertainties may arise about its application to advertisements issued via the internet.

The term “advertisement”, “document” and “issue” as defined under section 2 do not explicitly include the internet or similar electronic channels. The definitions of the three terms are therefore amended under the BAO and a new definition of “invitation” is introduced to cover

advertisements issued through new technological means, in particular the internet.

It should be noted that section 92 does not prohibit advertisements for deposits to be placed outside Hong Kong so long as they comply with the disclosure requirements specified in the Fifth Schedule of the BO. Like regulators in other major financial centres, it is also the HKMA’s policy to regulate only those internet advertisements for offshore deposits which are targeted at members of the public in Hong Kong. The relevant provisions are therefore amended to make this policy intention clear.

In accordance with the new section 92(6), the MA will issue a guideline to set out, for example, factors in considering whether an advertisement is targeted at members of the public in Hong Kong. To enhance the deterrent effect, a higher level of fine and a new penalty of imprisonment of up to two years is introduced under section 92(3). This is in line with the penalty in section 95 for AIs failing or refusing to comply with MA’s request for withdrawal of advertisements which are false, misleading or deceptive.

#### *Telecommunication operators, ISPs and ICPs*

The BAO also addresses the role of telecommunication operators, internet service providers (ISPs<sup>1</sup>) and internet content providers (ICPs<sup>2</sup>) which facilitate dissemination of promotion materials via the internet. Telecommunication operators and ISPs are exempted from the requirements of the new section 92 provided that they only act as a mere conduit of information, in the same way, for example, as newspaper vendors act in the distribution of physical publications<sup>3</sup>.

On the other hand, ICPs and those ISPs which do not act simply as a mere conduit of information will be required to satisfy a more stringent test similar to that currently applied to

1 ISPs are companies that provide access to the internet.

2 ICPs are companies that provide news, reference, audio or video content for web sites.

3 Newspaper vendors are exempted under subsection (4) of the existing section 92.

physical publishers<sup>4</sup>. They will only be exempted if they can prove, among other things, that they did not select, modify or otherwise exercise control over the content of the unlawful advertisement and they did not know and had no reason to believe that the issue of the advertisement would constitute an offence.

### **Definition of and Fitness and Properness of Managers\***

At present, the chief executive (and any alternate chief executive) of all AIs and directors of locally-incorporated AIs require the MA's approval. There is neither approval nor notification requirement in relation to AIs' other senior executives, notwithstanding the fact that such persons may play a significant role within the AI, and that significant legal responsibilities are placed on such persons by the BO<sup>5</sup>.

#### *Definition of manager*

The BO refers to senior executives as "manager". The term "manager" is defined to include the chief executive of an AI and any other person employed by the institution who, under the immediate authority of a director or the chief executive, exercises managerial functions or is responsible for maintaining accounts or other records of the institution. Given the rapid developments in the banking industry, AIs have adopted various organisation structures to facilitate business development. A survey conducted by the HKMA shows that the existing definition of manager based on "reporting line" is no longer effective. The term may not be able to capture persons who exercise important managerial functions. On the other hand, it can bring in persons whose functions are not central to the safety and soundness of AIs.

Under the BAO, "manager" has been redefined as any person, other than a director or the chief executive, who is appointed by an AI, or by a person acting for or on behalf of or by an arrangement with the AI<sup>6</sup>, to be principally responsible for the conduct of the key businesses or affairs specified in a new Fourteenth Schedule. Under the revised definition, only those senior executives who are in charge of key businesses or affairs, such as retail banking, corporate banking, internal audit, risk management, compliance and information technology will be regarded as "managers".

#### *Fitness and properness of managers*

As a result of globalisation of financial markets, deregulation and technological advancements, the banking environment has become increasingly sophisticated. It is not just directors and the chief executive of an AI, but also its managers, who can exercise significant influence on the conduct and well-being of the AI. Therefore, apart from clarifying who should fall within the definition of "manager", it is also important to ensure that the person who is, or is to be, a "manager" of the AI is fit and proper. In order to achieve this objective, the Seventh Schedule has been amended by making it a continuing authorization criterion for AIs to maintain adequate systems of control to ensure the fitness and properness of their managers.

The new authorization criterion makes it clear that the onus of ensuring the fitness and properness of managers falls squarely upon the directors and the chief executive of AIs. The MA's role will be to ensure that AIs have in place systems of control to check on managers' fitness and properness and that these systems operate effectively. The MA will issue a guideline to set

<sup>4</sup> Physical publishers are given a defence under subsection (4A) of the existing section 92.

<sup>5</sup> For example, these persons may be held liable for non-compliance with various provisions under the Banking Ordinance (e.g. sections 44(8), 49(8) and 50(4)).

<sup>6</sup> For example, an AI may outsource its internal audit function to an audit firm. The individual appointed by the audit firm to be principally responsible for the internal audit function of the AI would be regarded as a manager of the AI.

\* See also the "Supervisor's Memo" of this issue of *Quarterly Bulletin* on Systems of Control for the Appointment of Managers.

out the key elements that AIs' systems of control for recruitment of senior executives should comprise, including details of what constitutes "fit and proper" in the context of managerial positions.

If a manager of an AI is found to be unfit for his position, this could call into question whether the AI continues to satisfy the authorization criterion. The MA may consider exercising his powers under section 52 of the BO to require the AI to take necessary remedial actions, which might include removing the unfit manager and strengthening its procedures for recruitment of senior executives.

Ancillary to the new authorization criterion, a new section 72B is introduced. It requires AIs to notify the MA and the person who has been appointed as a manager not later than 14 days after the appointment is made.

For the sake of reducing the reporting burden on AIs, the notification requirement is waived if a manager is appointed bona fide on a temporary basis (e.g. a person who is appointed to act on a temporary basis as an alternate to a manager who is precluded by illness, absence from Hong Kong or any other cause from carrying out his functions as manager). However, if a temporary appointment becomes a permanent appointment due to a change in circumstances, the AI is required to notify the MA of the change within 14 days.

### **Other Amendments**

#### *Establishment of a Local Representative Office*

The definition of "bank" under section 46(9), which relates to the control of the establishment of local representative offices (LROs) in Hong Kong, is expanded to include an institution which is authorized or recognised as a bank in the place where it is incorporated notwithstanding that it does not take deposits from the general public. The amendment will enable the MA to approve certain foreign banks (e.g. a foreign policy bank which does not take deposits from the general public) to establish an LRO in Hong Kong.

#### *Divestment of Shares*

At present, section 70B(10) of the BO provides that where a Court order has been made under subsection (7), the Court may, on the application of the MA, make such further order relating to the sale or transfer of the shares as it thinks fit. For the avoidance of doubt, section 70B(10) is amended to make it clear that the Court may, on the application of the MA, require a controller of an AI to transfer specified shares of the controller to a nominee of the MA. In addition, minor technical amendments are also made to clarify the operation of section 70D.

#### *Enhancement of Section 71*

Section 71 of the BO provides that no person may become the chief executive or a director (for locally incorporated AIs only) of an AI without the MA's prior approval. This section is redrafted to clarify that the MA shall refuse to give consent under the section unless he is satisfied that the individual seeking to become the chief executive or a director of the AI concerned is a fit and proper person. The revised section 71 also makes clear that the MA should specify his reasons when refusing to give consent under section 71.

#### *Restriction on Use of the Name "Bank"*

A new section 97(IAA) is added to provide explicitly that the MA must notify the person which seeks to use the name "bank" in writing of the approval or refusal of its application, and in the latter case the reasons for the refusal. Any person who feels aggrieved by the MA's decision is given the right to appeal to the Chief Executive in Council under the new section 132A(1)(fb).

#### *General Defence Provisions*

A new section 2(17) is added to clarify that any reference in the BO to the commission of an offence by every director, every chief executive and every manager of an AI or other company means that one or more than one of any such director, chief executive and manager may be prosecuted for

the offence.

Section 126(1) is amended by deleting the word “all” from the current wording where it applies in relation to “reasonable precautions” and “due diligence” taken by the defendant. This will render the current defence under section 126 more effective.

Section 126(2) is amended to ensure that there is a consistent rationale supporting the basis on which the offence provisions mentioned in the new section are excluded from the benefit of the defence provision in section 126(1).

### **The Way Forward**

In order to allow AIs sufficient time to prepare themselves for compliance with the new requirements, the BAO will commence operation at a later date, probably in early May. Meanwhile, the guidelines on systems of control for appointment of managers and regulation of advertising materials for deposits issued on the internet have largely been finalised. They will be issued upon the commencement of the BAO. 

- Prepared by the Banking Development Department