

**LEGISLATIVE COUNCIL BRIEF**

Banking Ordinance  
(Chapter 155)

**BANKING (AMENDMENT) BILL 2001**

**INTRODUCTION**

At the meeting of the Executive Council on 20 March 2001, the Council ADVISED and the Acting Chief Executive ORDERED that the Banking (Amendment) Bill 2001 (the Bill) should be introduced into the Legislative Council, to improve the operation of the Banking Ordinance (the Ordinance).

**BACKGROUND AND ARGUMENT**

**Control over Authorized Institutions' Places of Business**

2. At present, authorized institutions (AIs) are required to seek the Monetary Authority's (MA's) approval for establishment of local branches. "Local branch" is defined under section 2 of the Ordinance 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 Ordinance empowers the MA to approve or refuse AIs' establishment or maintenance of a local branch, attach conditions to approval, or revoke an approval.

3. 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 established 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 function predominantly as sales and service outlets, for example, personal banking centres at which financial advice is provided.

4. As outlets mentioned in paragraph 3(a) above can commit an AI to significant financial risks, we recommend that the MA be given powers of control over these outlets. We propose to extend the definition of “local branch” 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 exposures as specified under section 81(2) of the Ordinance. 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 Ordinance.

5. As outlets mentioned in paragraph 3(b) above subject AIs to a relatively lower level of risk, we consider it desirable for the MA to have a limited degree of control over them. We propose a concept of “local office” to capture such outlets. A “local office” is defined 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, we suggest that AIs be only required to notify the MA before the opening of a local office. We do not propose any annual fee for maintenance of such an office.

### **Internet Advertisements for Deposits**

6. It has become increasingly popular for financial institutions to promote services through the internet. In response, we have 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***

7. Under section 92 of the Ordinance, 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 when it is applied to the internet.

8. The terms “advertisement”, “document” and “issue” as defined under section 2 do not explicitly include the internet or similar electronic channels. We therefore propose to amend the definitions of the three terms and introduce a new definition of “invitation” to cover advertisements issued through new technological means, in particular the internet.

9. Our policy is to regulate only those internet advertisements, wherever

they originate, for deposits which are targeted at members of the public in Hong Kong. This “target at” approach has been adopted by many financial regulators worldwide (including the Financial Services Authority of the UK, the Securities Exchange Commission of the US, and the Securities and Futures Commission of Hong Kong) and is endorsed by the International Organisation of Securities Commissions.

10. We therefore recommend a new section 92 providing that only advertisement, invitation or document which is targeted at members of the public in Hong Kong will be caught under the section. The MA will be empowered to issue guidelines on, for example, factors in considering whether an advertisement is targeted at members of the public in Hong Kong. To enhance the deterrent effect, we propose a higher level of fine and a new penalty of imprisonment of up to two years. This is in line with the penalty in section 95 on AIs for failing or refusing to comply with MA’s request for withdrawal of advertisements considered false, misleading or deceptive.

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

11. The Bill 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 on the internet. We propose to exempt telecommunication operators and ISPs from the requirements of the new section 92 provided that they only act as a mere conduit of information as do newspaper vendors in the distribution of physical publications<sup>3</sup>.

12. On the other hand, ICPs and those ISPs which do not act as a mere conduit of information will be required to satisfy a more stringent test similar to that currently applied to 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 for believing that the issue of the advertisement would constitute an offence.

13. The above proposals are consistent with the practice in the European Community.

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<sup>1</sup> ISPs are companies that provide access to the internet.

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

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

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

### **Definition of and fitness and properness of managers**

14. 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<sup>5</sup>, 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 Ordinance<sup>6</sup>.

#### ***Definition of manager***

15. The Ordinance 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. Our recent survey also 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.

16. The Bill proposes to re-define "manager" as any person, other than a director or the chief executive, who is appointed by an AI 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 etc. will be regarded as "managers". We have tested the new definition on a sample of large and small AIs and are satisfied with its effectiveness and workability.

#### ***Fitness and properness of managers***

17. 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 as discussed in paragraph 16, who can exercise significant

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<sup>5</sup> Banking (Amendment) Bill 2000, now being considered by the Legislative Council, introduces a requirement for MA's approval of not less than two executive officers responsible for supervising the regulated activities, including securities business, conducted by an exempt AI. This is aimed at bringing the supervision of AIs' securities business more in line with that of securities brokers and the approval requirement applies only to senior executives in charge of securities business.

<sup>6</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)).

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.

18. The initial thinking was to introduce an approval requirement for appointment of managers. This would allow the MA to carry out the necessary vetting process to verify the fitness and properness of the individuals seeking to become a manager. However, during consultation with the banking industry, some banks queried the need for this new power. They argued that it was the primary responsibility of the directors and the chief executive of AIs to ensure the competence and integrity of their management teams. They were concerned that the proposal might impinge upon AIs’ autonomy in recruitment of staff.

19. We have considered different options to address these concerns, without compromising the policy objective of ensuring the fitness and properness of AIs’ managers. A viable alternative to the approval requirement, which is the current proposal in the Bill, is to make it an authorization criterion for AIs to maintain adequate systems of control to ensure the fitness and properness of their managers<sup>7</sup>.

20. Under the current proposal, 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 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 manager positions.

21. 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 Ordinance 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.

22. Ancillary to the new authorization criterion, we propose to introduce a requirement on AIs to notify the MA of the appointment of managers under a new provision. Although the MA may use his existing power under section 63(2) of the Ordinance to obtain the information, a specific provision for this purpose will be more transparent. The notification requirement should enable the MA to monitor and assess whether an AI is maintaining adequate systems

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<sup>7</sup> Like other authorization criteria in the Banking Ordinance, this proposed new criterion is continuing in nature i.e. it applies to the institution not only at the time of authorization but also thereafter.

of control to ensure the fitness and properness of its managers.

23. We believe that the current approach should be an effective means to achieving the original policy objective, while at the same time addressing some AIs' concern about impingement upon AIs' autonomy to appoint their management teams.

### **Other Amendments**

24. The other amendments seek to apply the general defence provision in the Ordinance in a more consistent manner and to improve the working of individual provisions of the Ordinance in the light of experience. A summary of these amendments is at Annex.

### **THE BILL**

25. The main provisions of the Bill are: -

- (a) clause 2(a)(v) expands the definition of "local branch" to include any place of business in Hong Kong at which an AI carries on any business (not being banking business) whereby it may incur financial exposure mentioned in section 81(2);
- (b) clause 2(a)(vii) introduces a definition of "local office" and clause 7 introduces a new section 45A to require an AI to notify the MA at least seven days before commencing business at a local office;
- (c) clause 19 substitutes the existing section 92 by a new section 92 which has been enhanced to cover the situation where advertisements for deposits are provided by new technological means, in particular the internet;
- (d) clause 2(a)(vi) amends the existing definition of "manager", clause 27 makes it a continuing authorization requirement for AIs to maintain adequate systems of control to ensure the fitness and properness of their managers, and clause 17 introduces the new section 72B to require an AI to notify the MA when a person becomes or ceases to be a manager of the AI; and
- (e) clause 21 amends section 126 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).

## **PUBLIC CONSULTATION**

26. The Legislative Council Panel on Financial Affairs (LegCo FA Panel), the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, the Hong Kong Association of Banks (HKAB), the DTC Association and the Hong Kong Internet Service Providers Association (in respect of the part relating to internet advertisements for deposits) have been consulted.

27. As mentioned in paragraph 18 above, the banking industry expressed reservations on the original proposal of introducing an approval requirement for managers. Some Legislative Council Members also expressed concerns on the increase in MA's power and administrative burden on AIs. Having considered these feedbacks, the MA now proposes an authorization requirement that AIs should maintain adequate systems of control to ensure the fitness and properness of their managers. This alternative approach should be able to address the above concerns. HKAB has confirmed that it has no objection to the present proposal.

28. The banking industry and the LegCo FA Panel have no objection to the other major proposals in the Bill.

## **BASIC LAW IMPLICATIONS**

29. The Department of Justice advises that the Bill does not conflict with those provisions of the Basic Law not carrying human rights implications.

## **HUMAN RIGHTS IMPLICATIONS**

30. The Department of Justice advises that the Bill is consistent with the human rights provisions of the Basic Law.

## **BINDING EFFECT OF THE LEGISLATION**

31. The Bill does not affect the current binding effect of the existing provisions of the Ordinance.

## **FINANCIAL AND STAFFING IMPLICATIONS**

32. There will be additional workload to the Hong Kong Monetary Authority (HKMA) as a result of the proposed tightening of the supervisory regime relating to the fitness and properness of AIs' senior management. This will be absorbed by the HKMA through redeployment of existing resources. There are no financial and staffing implications for the Government.

## **ECONOMIC IMPLICATIONS**

33. Measures to keep the regulatory framework abreast of rapid market developments are conducive to promoting the stability of the banking system and maintaining Hong Kong's status as an international financial centre.

## **LEGISLATIVE TIMETABLE**

34. The legislative timetable will be as follows:-

Publication in the Gazette	23 March 2001
First Reading and Commencement of Second Reading debate	4 April 2001
Resumption of Second Reading debate, committee stage and Third Reading	To be notified

## **PUBLICITY**

35. A press release will be issued on 23 March 2001.

## **ENQUIRIES**

36. Enquiries may be directed to Mr Edward Mak, Assistant Secretary for Financial Services at 2527 3974.

**Financial Services Bureau**  
**23 March 2001**

**Summary of Other Amendments**

**Divestment of Shares**

Under section 70A of the Ordinance, the MA is empowered to serve a notice of objection on a controller of a locally incorporated AI if the controller is no longer considered fit and proper or if his being a controller may threaten the interests of depositors or potential depositors. Upon serving a notice of objection, the MA can seek a Court order to direct the controller concerned to sell his relevant shares under section 70B(7).

2. The former Commissioner of Banking encountered in one case problems in implementing the sale order of the Court given by virtue of section 70B(7). Although the controller concerned did not object to the Court order, he could not identify a suitable buyer within the period specified by the Court. This divestment problem causing a technical breach of the Court's sale order could have been avoided if the relevant shares of the controller had been required to be transferred to a nominee of the MA. The effect of this transfer would be to deprive the controller of his voting rights in the AI but not his beneficiary interests of the shares. After the transfer, the controller would still be expected to dispose of his relevant shares.

3. At present, section 70B(10) of the Ordinance provides that where an 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, it is proposed that this provision be amended to make 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. Minor technical amendments to clarify the operation of section 70D are also necessary.

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

4. Under section 97(1) of the Ordinance, it is an offence for any person, other than a licensed bank or a central bank (recognized as such in the place in which it is incorporated), without the written consent of the MA to use the name "bank".

5. The policy is that the MA will not give consent to the use of a banking name or description where its use could mislead the public into believing that the company in question is or may be a bank or that it is under the direct supervision of a banking supervisor. The MA will as a matter of course inform a company of the reasons for refusing it to use the name “bank”. For the avoidance of doubt, the Bill proposes to state explicitly under section 97 that the MA must notify the company concerned in writing of the approval or refusal of its application, and in the latter case the reasons for the refusal. It is further proposed that any person who feels aggrieved by the MA’s decision should be given the right to appeal to the Chief Executive in Council. This is in line with the existing channel of appeal against MA’s decisions provided in section 132A of the Ordinance.

### **General Defence Provisions**

6. Section 126(1) of the Ordinance provides that, in proceedings for an offence under the Ordinance, it shall be a defence for the person charged to prove that he took all reasonable precautions and exercised all due diligence to avoid the commission of such an offence by himself or any person under his control. Subsection (2) sets out the 13 sections in the Ordinance to which the general defence under section 126 shall not apply. It is noted that availability of the general defence to the offences in the Ordinance has not been applied consistently and there is a need to rectify the situation.

7. In considering whether the general defence under section 126 shall be available to the offences in the Ordinance, the following factors have been taken into account:

- (a) the nature of the offence concerned and whether it is in the interests of the public not to make available the general defence to such offence;
- (b) whether there is an explicit requirement on the prosecution to prove the guilty state of mind of the person charged; and
- (c) the consistency of treatment of similar offences.

8. We propose that the general defence should not be available to the following offences:

- (a) Sections 18(11), 22(12), 24(12), 25(10), 53C(14) and 63(7) – these offences involve a person signing a document which he knows or

reasonably ought to know to be false in a material particular. Given that the prosecution will have to prove the person's knowledge or constructive knowledge that the document is false in a material particular, it is considered that the general defence should not be available to these offences;

- (b) Sections 53H and 93(1) – there are explicit requirements on the prosecution to prove the guilty state of mind of the person charged (i.e. “wilfully” or “reckless representation”). The onus of proof is already on the prosecution. It is therefore unnecessary to make available the general defence to these offences; and
- (c) Section 125(4) – this offence involves a person obstructing a police officer who holds a search warrant. We consider that the general defence (took reasonable precautions and exercised all due diligence) is inappropriate for such an offence.

9. On the contrary, it is proposed that the general defence should be available to the following offences which are currently excluded under section 126(2):

- (a) Section 46(8) – this provision imposes a strict liability on the chief representative of a local representative office (“LRO”) which was established without the MA’s approval. A possibility is that the offence is not detected until the first chief representative, who committed the offence, has been replaced by a new one. It appears reasonable that the general defence should be available to the new chief representative if he can prove that he has exercised all due diligence to avoid the commission of this offence (e.g. he has no reason to believe that his predecessor has not obtained the necessary approval from the MA); and
- (b) Section 47(2) – this provision is similar to section 53C(13) in the sense that both sections impose a requirement on certain persons to provide information, but is currently excluded from the general defence. We consider that a consistent treatment should be applied here and the general defence should be applicable to this section.

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

10. Under section 46(1) of the Ordinance, a bank shall not establish or

maintain any local representative office (LRO) without the MA's approval. Subsection (9) further provides that "In this section, "bank" means a company incorporated outside Hong Kong which -

- (a) is neither an AI nor recognized as the central bank of the place in which it is incorporated; and
- (b) may, whether or not in or outside the place where it is incorporated, lawfully take deposits from the general public, whether or not on current account."

11. In accordance with section 46(9), the MA should not approve an overseas bank to establish an LRO if the bank cannot take deposits from the general public in its country of incorporation or elsewhere. However, it is noted that some overseas governments may set up policy banks to pursue specific economic objectives (e.g. to support import and export). While these institutions are commonly referred to as "banks", they may not be allowed to engage in certain banking business such as taking deposits from the general public.

12. From the perspective of maintaining Hong Kong as an international financial centre, it is desirable to allow these banks to maintain a representative office in Hong Kong. We therefore propose that the definition of "bank" under section 46(9)(b) be amended to allow the MA to approve policy banks which cannot take deposits to establish an LRO in Hong Kong. These policy banks will be required to satisfy the MA that they are adequately supervised by their relevant banking supervisory authority.

### **Enhancement of Section 71**

13. Section 71 of the Ordinance 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. We propose to redraft the section 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 proposed provision also makes clear that the MA should specify his reasons when refusing to give consent under section 71. The proposed new section 71 does not introduce new powers for the MA.