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Report of the Bills Committee on Banking (Amendment) Bill 2001

Purpose

This paper reports on the deliberations of the Bills Committee on Banking (Amendment) Bill 2001.

Background

2. The Banking Ordinance (Cap. 155) (the Ordinance) provides for the regulation of banking business and the business of taking deposits; supervision of authorized institutions (AIs) so as to provide a measure of protection to depositors; promotion of general stability and effective working of the banking system as well as supervision of money brokers. The Monetary Authority (MA) is responsible for promoting the general stability and effective working of the banking system.

The Bill

3. The Banking (Amendment) Bill 2001 seeks to improve the operation of the Ordinance by -

- (a) enhancing MA's supervision of AIs' places of business;
- (b) regulating advertisements for deposits issued through new technological means, in particular the internet;
- (c) making it a continuing authorization requirement for AIs to maintain adequate systems of control to ensure the fitness and properness of their managers;
- (d) allowing for the establishment of local representative offices by foreign banks which do not take deposits from customers in their home country;

- (e) rationalizing the availability of the general defence under section 126 of the Ordinance;
- (f) requiring MA to notify a company in writing the reasons for refusing its application to use the name “bank”;
- (g) requiring a controller of AI, to whom MA has served a notice of objection, to transfer his relevant shares to a nominee of MA;
- (h) redrafting section 71 to require MA to specify the reason for refusing to give consent to an individual seeking to become the chief executive or a director of an AI.

The Bills Committee

4. At the House Committee meeting on 19 January 2001, members agreed to form a Bills Committee to study the Bill. Under the chairmanship of Hon Jasper TSANG Yok-sing, the Bills Committee has held four meetings. The membership list of the Bills Committee is at **Appendix I**.

Deliberations of the Bills Committee

Control over AI’s places of business

5. The Bill proposes to extend the existing definition of “local branch” under section 2 of the Ordinance to cover outlets at which AIs carry on banking business or any other business which incur financial exposures under section 81(2) of the Ordinance, so that the establishment of these outlets will require prior approval by MA. For outlets at which AIs promote sales and service which incur a relatively lower level of risk, the Bill proposes a concept of “local office” to capture such outlets, so that AIs are only required to notify MA before the opening of local offices.

6. The Bills Committee notes that local offices include kiosks set up by AIs in outlets such as supermarkets, and that no sales transactions nor deposit will be made at these kiosks. Customers who decide to accept any offer of the services will have to approach a branch where actual transactions will take place. Given the limited number of such kiosks in Hong Kong, doubt has been cast on the need for the notification requirement. According to the Administration, it is quite likely that this type of kiosk arrangement will proceed in a larger scale as in other jurisdictions such as the United States. The notification requirement will enable MA to know the locations of local offices to ensure that business is conducted in a proper manner as the public may be led to enter into transactions as a result of having contact with these offices. On members’ concern that the term “office” may have given the public an impression that it is a place for business rather than promoting sales and service, the Administration’s explanation is that MA has already used the term “local representative office” in the Ordinance to describe the representative offices of foreign

banks in Hong Kong which are not actually carrying on banking business but representing the banks in gathering intelligence and marketing services. Similar approach has been adopted in defining “local office”. The term as drafted is considered reasonable since it precisely describes a place of business from which any business of an AI is promoted or assisted and at which the public interface with the staff of the AI. It does not include the principal place of business of an AI in Hong Kong nor its local branches at which banking business as defined under the Ordinance is carried on. Besides, flexibility has been provided under the definition to exclude certain types of offices as local offices.

Strengthening control over appointment of managers

7. In the light of the review of the level of corporate governance in the banking industry, which has shown that it is not just the directors and the chief executive but also other senior executives of an AI who can exercise significant influence on the conduct and well-being of the AI, the Bill proposes to revise the definition of “manager” to cover 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 the new Fourteenth Schedule. The revised definition will ensure that 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 caught as “managers”.

8. Concerns have been raised on the revised definition that it will capture a broader spectrum of bank officials than the current definition, and that more persons, including some lower level executives, can be caught by the strict liability offences in the Ordinance. According to the Administration, the enhanced definition is based on a functional approach and will capture those individuals who perform key functions in the AIs. Although these individuals may be at a lower level in the reporting hierarchy, they are the ones whose fitness and properness is central to the safety and soundness of the AIs. Besides, the revised definition does not necessarily capture a broader spectrum of managers than the current definition. Based on the results of an earlier survey on seven selected AIs, the number of managers captured under the new definition is 66 compared with 105 under the existing definition, representing a reduction of 37%. To ensure that a person is aware that he has been designated as a manager under the Ordinance, members requested and the Administration agreed to introduce a Committee Stage amendment (CSA) to require AIs to give notice in writing to the person within 14 days of his appointment as a manager.

9. As regards the interplay between the revised definition and the penal provisions in the Ordinance, the Administration proposes a two-stage approach to address the issue. Firstly, CSA will be introduced to make it clear that prosecution for a strict liability offence will not necessarily be instituted against every director, chief executive or manager of an AI, and that the defendant merely needs to show that he has exercised reasonable precautions and due diligence to avoid the commission of the offence. Secondly, the Administration will undertake a comprehensive review of all penal provisions in the Ordinance. The primary purpose of the exercise is to review the application of strict liability offences, including whether any such offences

should be changed into ordinary offences and whether the AI concerned will be made the “primary criminal” for any such offence under the Ordinance. Any radical changes as a result of the review will be subject to extensive consultation.

10. The Bills Committee notes that apart from updating the definition of manager, the Bill also proposes to introduce a requirement for AIs to notify MA of the appointment of managers, termination of existing appointments and any changes in the responsibilities of existing managers. Some members express concern that the notification requirement may not be effective in ensuring the fitness and properness of managers. According to the Administration, MA has considered three different options to achieve the objective of ensuring the fitness and properness of managers of AIs. These include -

- (a) introducing an approval requirement for appointment of managers so that MA can formally assess the fitness and properness of the individuals seeking to become a manager. The proposal has been dropped after consultation with the banking industry and the LegCo Panel on Financial Affairs in the light of concern about over-regulation and intrusion on the autonomy of an AI in the appointment of senior staff;
- (b) empowering MA to object to the appointment of an existing manager if he is not satisfied that the latter is fit and proper to discharge his responsibilities. The proposal has not been pursued as this will be a more intrusive and disruptive arrangement since the AI concerned will be required to remove the manager from his position after the formal contract of employment has been entered into between the AI and the individual concerned; and
- (c) making it an authorization criterion for AIs to maintain adequate systems of control to ensure the fitness and properness of their managers. Under this proposal, the onus of ensuring the fitness and properness of managers will rest with the directors and the chief executives of AIs. The regulator’s role will be to verify whether AIs have in place systems of control to ensure the fitness and properness of managers. In the event that a manager of an AI is found to be not fit and proper for his position as a result of ineffective systems for the selection of managers, MA may exercise his power to take remedial actions such as issuing directions to enforce the removal of the manager whose conduct threatens the safety and soundness of the AI and/or prejudicial to the interests of depositors. The proposal is considered workable as it is consistent with other parts of the Ordinance which highlight specific aspects of the general requirement on AIs to behave prudently.

After the enactment of the Bill, MA will issue a guideline setting out the key elements which AIs should include in their systems of control for recruitment of senior executives such as details of what constitute “fit and proper” in the context of

managerial positions. MA will also carry out regular examination to verify AIs' compliance with the new authorization criterion.

11. As regards the liability of the directors and the chief executives in the event of frauds committed by their managers, members note the Administration's view that this would depend on the circumstances of each case. If the appointment of an unfit manager has resulted from a serious failure of the relevant control systems within an AI or from disregard of the guideline issued by MA or otherwise indicates a serious lack of judgement by the directors and/or the chief executive, MA may have to decide to withdraw his approval of one or more of the individuals from their positions. However, if all the proper appointment procedures have been adopted, it will be difficult to put the blame on the directors and the chief executive.

Internet advertisement for deposits

12. As the terms "advertisement", "document" and "issue" as defined under section 2 of the Ordinance do not explicitly include the internet or similar electronic channels, the Bill proposes to update the existing definitions of the terms and to introduce a new definition of "invitation" to cover advertisements issued through new technological means, in particular the internet. It also proposes a new section to regulate those advertisements, wherever they originate, for deposits targeting at members of the public in Hong Kong. This "target approach" has been adopted by many financial regulators worldwide and is endorsed by the International Organization of Securities Commissions.

13. Doubt has been cast on how to determine the "targeting" intention. According to the Administration, the Basel Committee on Banking Supervision is exploring the practicality of developing a convergent approach to regulate online provision of cross-border banking services. In particular, the Basel Committee has suggested that considerations of targeting or organizational intentions be taken into account in determining whether e-banking services are being offered to a certain host country. Possible indicators which may suggest "targeting" intention include -

- (a) the service provider's website is presented in the language and/or the currency of the host country;
- (b) the provider's website can be accessed through portals or search engines located in the host country;
- (c) the provider's website uses a domain name of a type reserved to or identified with the host country;
- (d) the provider's website has inserted banners with hyperlinks with sites in the host country; and
- (e) the provider has used other means to advertise its services in the host country.

MA will take into account these criteria in developing a guideline on the factors that will be considered in determining whether an advertisement is targeting at Hong Kong. Moreover, MA will seek assistance from relevant overseas supervisory authorities in enforcing the provisions in relation to advertisements hosted overseas and targeting at Hong Kong. It is expected that these overseas authorities will be willing to help as they will generally wish their institutions to respect the laws of other jurisdictions. In the event that these overseas authorities are not cooperative or are unable to assist for whatever reasons, MA can consider issuing a press release to clarify that the relevant advertisement is not in compliance with the statutory provisions and to remind members of the public to take extra caution in placing offshore deposits with such institutions. MA can also take the refusal into account in deciding whether to approve any application by such institutions for authorization in the future. It is believed that the current work of the Basel Committee in fostering a greater international cooperation on this issue will be conducive to more effective enforcement of the relevant regulations by banking regulatory authorities.

Committee Stage amendments

14. A copy of the Committee Stage amendments to be moved by the Administration is at **Appendix II**.

Recommendation

15. The Bills Committee supports the resumption of the Second Reading debate on the Bill.

Consultation with the House Committee

16. The House Committee at its meeting on 30 November 2001 supported the recommendation of the Bills Committee to resume the Second Reading debate on the Bill on 19 December 2001.

Prepared by
Council Business Division 1
Legislative Council Secretariat
10 December 2001

Bills Committee on Banking (Amendment) Bill 2001

Membership list

Chairman	Hon Jasper TSANG Yok-sing, JP
Members	Hon Eric LI Ka-cheung, JP Dr Hon David LI Kwok-po, GBS, JP Hon NG Leung-sing, JP Hon Bernard CHAN Hon SIN Chung-kai Hon Ambrose LAU Hon-chuen, GBS, JP Hon Henry WU King-cheong, BBS
	(Total : 8 Members)
Clerk	Miss Becky YU
Legal Adviser	Mr KAU Kin-wah
Date	1 July 2001

COMMITTEE STAGEAmendments to be moved by the Secretary
for Financial Services

<u>Clause</u>	<u>Amendment Proposed</u>
2	<p>(a) In paragraph (a)(vi), in the proposed definition of "manager", by deleting paragraphs (a) and (b) and substituting -</p> <p>"(a) subject to paragraph (c), in relation to an authorized institution incorporated in Hong Kong, means any individual, other than a director or chief executive of the institution, appointed by the institution, or by a person acting for or on behalf of or by an arrangement with the institution, to be principally responsible, either alone or with others, for the conduct of any one or more of the affairs or business of the institution specified in the Fourteenth Schedule;</p>

(b) subject to paragraph (c), in relation to an authorized institution incorporated outside Hong Kong, means any individual, other than a chief executive of the institution, appointed by the institution, or by a person acting for or on behalf of or by an arrangement with the institution, to be principally responsible, either alone or with others, for the conduct of any one or more of the affairs or business in Hong Kong of the institution specified in the Fourteenth Schedule;".

(b) By adding -

"(d) by adding -

"(17) For the avoidance of doubt, it is hereby declared that any reference in this Ordinance to the commission of an offence by every director, every chief executive and every manager of an authorized institution or other company (including any grammatical variations or cognate expressions of such reference) means that one or more than one of any such director, chief executive

and manager may be prosecuted for the offence."."

17

In the proposed section 72B -

(a) in subsection (1) -

(i) by deleting "An" and substituting "Subject to subsections (1A) and (1B), an";

(ii) by adding "and the person" after "to the Monetary Authority";

(iii) in paragraph (iii), by adding "in the case of the notice to the Monetary Authority," before "such";

(b) by adding -

"(1A) Subject to subsection (1B), an authorized institution is not required to comply with subsection (1) in respect of a manager appointed bona fide on a temporary basis.

(1B) Where in respect of the appointment of a manager -

(a) an authorized institution has not complied with subsection (1) by virtue of subsection (1A); and

(b) the appointment subsequently ceases to be on a temporary basis,

then -

(i) subsection (1) shall, on the date on which that cesser occurs, apply in respect of the manager; and

(ii) that date shall be the date mentioned in subsection (1) from which the period mentioned in that subsection shall be calculated within which the institution shall comply with that subsection in respect of the manager.".

21 By deleting "Section 126(2) is repealed and the following substituted -" and substituting -

"Section 126 is amended -

(a) in subsection (1), by repealing "all" where it twice appears;

(b) by repealing subsection (2) and substituting -".

22 (a) In paragraph (a), in the proposed section 132A(1)(f), by adding ", by the Monetary Authority" after "such conditions".

(b) In paragraph (b), in the proposed section 132A(1)(fb), by adding "by the Monetary Authority" after "refusal".

(c) By adding -

"(c) in paragraph (h), by repealing "金" and substituting "產".".

29 In the proposed Fourteenth Schedule, in paragraph 1, in the definition of "財政管理", by deleting "金" and substituting "產".