

## INFORMATION NOTE

### THE LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS

#### BANKING (AMENDMENT) (No. 2) BILL

#### INTRODUCTION

This paper outlines the proposed amendments to the Banking Ordinance (“the Ordinance”) in the Banking Amendment (No.2) Bill. The main purposes of the amendments are:

- (a) to raise the level of corporate governance in the banking industry;
- (b) to keep the banking supervisory regime abreast with the rapid developments in the banking industry in particular e-banking;
- (c) to enhance the Monetary Authority’s supervisory powers over the places of business of authorized institutions (AIs); and
- (d) to improve the working of individual provisions of the Ordinance in the light of experience.

#### DETAILS

##### *Corporate Governance*

2. As a result of globalisation, deregulation and technological advancements, the financial markets have become increasingly competitive, and the level of risks that financial institutions are exposed to has been escalating. As a bank regulator, the Hong Kong Monetary Authority (HKMA) has a responsibility to ensure that each AI is being managed by able individuals who possess the necessary knowledge and skills to identify, monitor and control the risks that their institutions are taking.

3. Currently, the Ordinance only requires persons wishing to become directors (in relation to locally incorporated AIs only) or chief executives of AIs to obtain the HKMA’s consent for their appointments. There are no similar requirements for appointments of senior management. This is a significant gap because it is not just the directors and chief executive of an AI, but also its senior management, who shape the organisation and determine how well it performs.

Consequently, it is proposed that section 71 of the Ordinance be amended to enable the HKMA to approve the appointments of senior management as well. In addition, fitness and propriety of the senior management of an institution should be one of the minimum criteria for authorisation. The proposed approval requirement is in line with the practice adopted by the Financial Services Authority in the U.K., and consistent with the “Guideline on Enhancing Corporate Governance in Banking Organisations” issued by the Basel Committee on Banking Supervision in September 1999.

4. The current definition of “manager” (the term used in the Ordinance to refer to senior management) in section 2 of the Ordinance has become outdated. At present, a “manager” is a person employed by an AI “who, under the immediate authority of a director or of the chief executive, exercises managerial functions or is responsible for maintaining accounts or other record of the institution”. However, with the changes in the management structure of banks to facilitate business development, this definition no longer catches certain individuals who exercise important managerial functions. Equally, it can bring in other individuals whose functions are not central to the safety and soundness of AIs. Therefore, the definition of manager needs to be amended in order to be used as a yardstick for determining which level of senior management should be subject to approval.

5. It is proposed that the new definition of “manager” should capture those persons below the level of director or chief executive who are “principally responsible” for the conduct of key business activities or functions of AIs. The precise titles of such persons will vary from institution to institution, but the sort of persons whom the regime is intended to capture are heads of key functions or business activities such as retail banking, corporate banking, treasury, internal audit, risk management etc.

6. To minimise the administrative burden on AIs, a provisional approval mechanism will be introduced for the appointment of managers by AIs. A new section 71A is proposed to be added under which a person appointed in writing by an AI to be a manager will be deemed to have been given the provisional consent of the HKMA until such time that his appointment is formally approved or rejected by the HKMA. The AI will be required to notify the HKMA of such appointments in writing within a short period of time.

7. In order to avoid excessive administrative workload for both the HKMA and the AIs, there will be an arrangement under section 71B to grandfather<sup>1</sup> existing managers of AIs. However, the HKMA will be empowered

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<sup>1</sup> To grandfather means that a person who is a manager of an AI immediately prior to the commencement of the relevant section of the Bill shall be deemed to have the consent of the Monetary Authority under section 71 to be such manager.

to revoke the appointment of a person regardless of whether he has been previously grandfathered.

### ***Internet Advertisement for Deposits***

8. It has become increasingly popular for financial institutions to promote their products and services through the world wide web in view of the lower advertising cost and the reach of the internet. Given the pervasive nature of the internet, promotion materials posted on the internet are readily accessible to members of the public in Hong Kong who are connected to the internet. To protect the interests of depositors in Hong Kong, we have reviewed the adequacy of the existing legal framework for regulating advertisements for deposits placed on the internet which are targeted at Hong Kong.

9. In order to ensure that no person, other than those exempted under section 92, can issue advertisements through the internet or other electronic media to solicit deposits from members of the public in Hong Kong, it is proposed that the definition of “advertisement” be amended to cover advertisements published through new technological means, in particular the internet. Definitions of “document”, “invitation” and “issue” under section 2 of the Ordinance will also be amended in a similar light.

10. The HKMA has considered whether telecommunications companies<sup>2</sup>, internet content providers<sup>3</sup> (ICPs) and internet service providers<sup>4</sup> (ISPs), which facilitate the dissemination of promotion materials on the internet, should be subject to the regulatory framework provided under section 92. In line with the practice in the European Community, it is proposed that telecommunications companies and ISPs which act as a mere conduit of information should not be taken to contravene section 92 by reason that they only issue, or have in their possession for the purposes of issue, an unlawful advertisement in the course of providing a telecommunications service or connection to the internet. It is further proposed that ICPs and ISPs which do not merely act as a carrier of information (e.g. those which provide website hosting

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<sup>2</sup> Under the Telecommunications Ordinance (Cap 106), “telecommunication service” means the provision of facilities for use by members of the public or by any person for the transmission or reception of messages or the provision on loan, lease or hire to members of the public or to any person of apparatus for telecommunication either within Hong Kong or with any place outside Hong Kong. The word “telecommunication company” can be construed accordingly.

<sup>3</sup> Internet content providers are companies that provide news, reference, audio or video content for web sites.

<sup>4</sup> Internet service providers are companies which provide access to the internet.

service to their customers) should also 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.

11. The policy intention of the HKMA is that advertisements placed on the internet, wherever they originate, which are targeted at Hong Kong people should be subject to regulation. The “target at” approach has been adopted by many leading regulators and the Internet Task Force of the International Organization of Securities Commission. It is proposed that the HKMA be empowered to issue guideline to set out the factors which it will take into account in considering whether an advertisement of an overseas financial services provider is targeted at members of the public in Hong Kong.

### ***Control over AI's Places of Business***

12. Traditionally, AIs have operated primarily through a physical network of branch offices. However, over time, they are increasingly adopting alternative or complementary delivery channels, such as ATMs, the telephone and, more recently, the internet. The role of the traditional branch is therefore changing, with institutions experimenting with various alternatives to the full service branch.

13. Under section 2 of the Ordinance, a local branch is defined as a place of business thereof in Hong Kong, other than its principal place of business in Hong Kong, at which a bank carries on banking business or a restricted licence bank (RLB) or deposit-taking company (DTC) carries on the business of taking deposits. The current definition only encompasses those places of business at which the bank enters into commitments on the liabilities side of the balance sheet.

14. AIs may operate a number of different types of outlets which fall outside this definition, but basically these fall into two main types:

- (a) Those at which the AI enters into commitments on the assets side of the balance sheet (e.g. “lending offices” at which loans are made but no deposits taken); and
- (b) Those at which the AI does not enter into commitments on either the liabilities or assets side, but which function predominantly as sales and service outlets.

15. To enhance the HKMA's powers of control over AIs' places of business, it is proposed that the definition of local branch should be expanded to include type (a) outlets. A local branch will cover any place of business in Hong Kong at which it carries on banking business or any business which involves incurring financial exposure as defined in section 81(2) of the Ordinance. The effect of this change will be that activities such as the granting of advances, loans or credit facilities will be brought under the definition. This definition is consistent with the approach adopted by the U.S. regulators.

16. It is also considered necessary to have a limited degree of control over other places of business of AIs which do not fall within the above definition of local branch. The HKMA proposes the introduction of the concept of "local office", which captures type (b) outlets. Local office will be defined as a place of business in Hong Kong from which any business of the AI is promoted or assisted and to which members of the public ordinarily have physical access.

17. It is proposed that AIs should be required to notify the HKMA before the opening of such a local office. In order not to stifle innovation in relation to the use of new delivery channels, the HKMA does not intend to require approval of such offices. Accordingly, no annual fee for maintenance of a local office would be payable.

18. As the HKMA has a duty to oversee the business and the quality of the systems and controls at these local offices, it is necessary to put it beyond doubt that the HKMA's various powers provided under the Ordinance will cover local offices. Relevant sections of the Ordinance will therefore need to be amended.

### ***Other Amendments***

19. The other proposed amendments seek to improve the operations of the Ordinance in the following areas:

- empower the Monetary Authority to direct a controller on whom notice of objection under section 70A has been served to transfer his shares to a nominee of the Monetary Authority within a specified period (the proposed amendment is in line with similar provisions contained in the Exchanges and Clearing Houses (Merger) Ordinance (Cap 555));
- provide that any person who feels aggrieved by the Monetary Authority's refusal to grant consent for the use of the name "bank" can appeal to the Chief Executive in Council against the Monetary

Authority's decision;

- enhance the general defence provision under section 126 of the Ordinance; and
- expand the definition of "banks" in section 46(9) which relates to the control of the establishment of local representative offices in Hong Kong, to include a bank which is authorized or recognised as a bank in the place where it is incorporated notwithstanding that such bank does not take deposits from the general public in its country of incorporation.

## **CONSULTATION**

20. The Banking Advisory Committee and the Deposit-taking Companies Advisory Committee have been consulted on the proposals contained in the Bill and they are largely supportive of the proposed legislative amendments.

## **LEGISLATIVE TIMETABLE**

21. It is expected that the proposed amendments to the Ordinance outlined above will be introduced into the Legislative Council in early 2001.

## **ADVICE SOUGHT**

22. Members are invited to comment on the proposed amendments to the Banking Ordinance.

**Financial Services Bureau**  
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