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Information Note for LegCo Panel on Financial Affairs

Transfer of Banking Business in Hong Kong

PURPOSE

This paper informs Members of the current framework of transferring banking business in Hong Kong and findings in relation to the overseas practice in this regard.

BACKGROUND

2. To implement a bank merger or acquisition (collectively referred to as "mergers" in this paper) in Hong Kong, the institutions concerned must first obtain the relevant supervisory approvals of the Monetary Authority (MA) under the Banking Ordinance[1]. In addition, they should find a legally effective way to transfer the existing assets and liabilities to a new entity or to the institution which remains after the merger (i.e., the surviving institution).

3. Banks in Hong Kong may consider three possible ways[2] to give legal effect to a transfer of assets and liabilities involved in a bank merger :

(a) **Universal succession** is a legal concept under civil law systems. It provides for the artificial continuance of a person by another, and all

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[1] For example, section 69 of the Banking Ordinance provides that amalgamation, etc of the business of a locally incorporated AI requires the MA's approval. Also, a bank merger would usually involve the transfer or revocation of authorisation, which requires the approval of the MA under sections 29 and 22 of the Ordinance respectively. A bank merger may also result in a change of shareholders, which should be approved by the MA under section 70 of the Ordinance.

[2] Another method is by way of a scheme of arrangement pursuant to section 166 of the Companies Ordinance. However, this method is primarily used in a corporate distress situation. It is rarely used to effect a bank merger.

the rights and liabilities of the former person are automatically transferred to and vested in the latter. Though the common law system followed by Hong Kong does not have a concept of universal succession, Hong Kong laws do recognise and accept mergers effected by way of universal succession if the merger is allowed under the law of the domicile of the merging entities. Therefore, if two overseas incorporated banks are approved to merge by the process of universal succession in their home jurisdiction and it is part of that process that the assets and liabilities of one will become the assets and liabilities of the other, Hong Kong laws will accept that those assets and liabilities have been so transferred. According to the HKMA, there have been 11 such merger cases since 2002.

(b) **Novation.** A bank merger may be implemented by transferring the assets and liabilities of the merging institutions item by item to the new or surviving entity by novation. Depending on the size of the merging institutions, this method is usually very costly and administratively intensive since the institutions have to seek the explicit consent of each and every counterparty towards the transfer of the relevant assets and liabilities. According to the HKMA, there has been 1 such case in Hong Kong since 2002.

(c) **Private legislation.** The transfer of banking business may also be effected by private legislation with the approval of the Legislative Council (LegCo).

4. Mergers in Hong Kong involving locally incorporated banks are normally effected by private legislation. Since 1997, 11 Private Member's Bills (PMBs) in relation to bank mergers have been passed by the LegCo.

PRESENT FRAMEWORK FOR EFFECTING BANK MERGERS BY PMBs

5. Under the present arrangements of effecting transfer of banking business by means of PMBs, the LegCo is the approving authority for effecting such proposals. Under Article 74 of the Basic Law, the written consent of the

Chief Executive is required before PMBs relating to Government policies (e.g. bank merger, taxation, tenancy arrangements, etc) are introduced.

6. It has been the Administration's policy to support consolidation of the banking sector in Hong Kong, which should improve its competitiveness and contribute to systemic stability in the longer term. As part of this policy, the Administration would facilitate mergers of financial institutions where draft PMBs for consolidation are submitted for consideration. This is, however, always subject to the overriding aim to promote the stability of the banking system and to provide an appropriate degree of protection to depositors in the merged institutions and to depositors generally.

7. The Financial Services and the Treasury Bureau (FSTB) would consult the HKMA and other relevant government bureaux/departments and public bodies on the draft PMB received. The HKMA looks into, among other things, the financial soundness of the institutions and possible impact on depositor interest. The Treasury Branch, Companies Registry, Department of Justice, Housing, Planning and Lands Bureau, Economic Development and Labour Bureau, Home Affairs Bureau, the Privacy Commission and the Mandatory Provident Fund Schemes Authority are also consulted given the PMB's possible implications on areas such as taxation, company titles and accounts, property rights, personal privacy, employment and pension funds, land interests, etc. The Administration requires the institutions applying for merger to consider and satisfactorily address all comments received from these agencies, as well as to conduct in-depth due diligence to ascertain that the contractual parties' interests as governed by Hong Kong law are not affected by the transfer of banking business.

8. With reference to the 11 cases of bank mergers effected by PMBs since 1997, on average, it took 7.5 months [ranged from about 4 months to 14.5 months] for a PMB to be enacted since submission of the draft bill to the Administration. Prior to this, it took about 2 months, depending on the complexity of each case, for HKMA to conduct initial review of the bank merger proposal before the institutions approached FSTB with the draft bill.

OVERSEAS PRACTICES

9. The Administration has studied the framework for facilitating the

transfer of banking business in six common law jurisdictions, namely Singapore, Malaysia, the U.K., the U.S.[3], Australia and New Zealand. The banking laws in the first five jurisdictions provide for a legal arrangement whereby the assets and liabilities of a bank can be transferred to another company *en bloc* upon the sanction of a specified authority. New Zealand does not have any generic legislation to deal with the transfer of banking business.

10. Of the above five jurisdictions which have legislation concerning the transfer of banking business, the power to give effect to the transfer rests with the bank regulator in the U.S. and Australia. In Singapore, the power is given to the Minister-in-charge of the Monetary Authority of Singapore (MAS)[4]. In the U.K. and Malaysia, the authority is vested with the court.

11. The banking laws in the U.S. and Australia provide detailed specification on the factors that the bank regulator should take into account in sanctioning a transfer of banking business. In the U.S., these factors include the possible impact of the proposed merger on competition, the adequacy of the financial resources of the new or surviving institution, the needs of the community to be served, as well as other supervisory matters such as money laundering issues. In Australia, the bank regulator should have regard to the interests of the depositors of the banks concerned, the interests of the financial sector as a whole and any other matters that it considers relevant in deciding whether to approve the transfer. In addition, the bank regulator must consult the relevant authorities to ensure that the transfer will not breach the competition law, company law, takeover law and tax law. It may also consult any other persons that it considers necessary.

12. The Banking Act in Singapore provides the Minister-in-charge of the MAS with a general power to call for any information which he considers relevant in assessing an application for a transfer of banking business.

13. In the U.K., the Financial Services and Market Act (FSMA) states that, in considering a petition for the transfer of banking business, the court must consider all the circumstances of the case and hear representations from the regulator and any person (e.g., an employee or a customer of the merging

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[3] In the U.S., each state may have its own banking and company laws. The discussion in this paper is based on the laws of the New York State.

[4] The Senior Minister is currently the Minister-in-charge of the MAS.

institutions) who alleges that he would be adversely affected by the transfer. It is worth noting that the regime in the U.K. originally applied only to insurance business. It was extended to banking business when the relevant provisions in the FSMA came into effect on 1 December 2001. In the case of Malaysia, though the banking law does not specify the factors to be considered by the court, it is expected that the court would take into account all the circumstances of the case in considering any proposed transfer of banking business. In both the U.K. and Malaysia, the court must be satisfied that the bank regulator (as well as the Finance Minister in the case of Malaysia) has consented to the transfer before granting its approval.

14. New Zealand does not have legislation that deals with a bank's assets and liabilities to be transferred to another bank en bloc with the sanction of a designated authority. Banking entities which seek to transfer assets and liabilities must do so by novation or private legislation.

15. According to information obtained from these overseas jurisdictions, each bank merger application is evaluated on a case-by-case basis and the time taken to process each application depends on the circumstances, including the completeness of information submitted and the complexity of the case.

FRAMEWORK FOR TRANSFER OF INSURANCE BUSINESS IN HONG KONG

16. We have also studied the relevant Hong Kong laws and found that the Insurance Companies Ordinance (ICO) is the only piece of legislation which provides for a framework for transferring financial business. Under the ICO, there are separate arrangements for effecting a transfer of long term and general insurance business. The framework in respect of long term insurance business is similar to the regime in the U.K. A proposal for the transfer of long term insurance business can be effected by an order of the court. According to the Insurance Authority (IA), a total of eight such cases were sanctioned by the court during the period between 1 January 1995 and 30 November 2005. On average, it took about 10 to 12 months for the entire process to be completed, depending on the complexity of the business to be transferred. On the other hand, a transfer of general insurance business only requires the approval of the IA. Irrespective of which type of insurance business is to be transferred, the court or the IA, as the

case may be, is required to take into account all the circumstances of the case and any representation made by any person who alleges to be aggrieved by the transfer.

ASSESSMENT

17. Our study of overseas practices have revealed that there is no common international practice in effecting transfer of banking business. Of the five jurisdictions which have legislative framework for the purpose, the sanctioning authority differs: two by the court, two by the bank regulator, and one by the Minister-in-charge of the monetary authority. New Zealand does not have a legislative framework for the purpose, and the transfers are effected by novation or private legislation. The example of the transfer of long term insurance business in Hong Kong, which can be effected by the court, provides an alternative arrangement for reference.

18. The FSTB has sought the views of relevant government bureaux and departments on the desirability of introducing a legislative framework for effecting transfer of banking business in Hong Kong and the sanctioning authority. The HKMA has also collected the initial views of the industry advisory bodies, namely the Banking Advisory Committee and the Deposit-taking Companies Advisory Committee.

19. The views received indicate that, if a legislative framework is to be contemplated for Hong Kong, the court is generally regarded as a suitable sanctioning authority having regard to the overseas practices. It is believed that the court would be in a better position to take into account all the circumstances of the case and hear representations from interested parties including those of the regulator, other relevant government departments as well as the creditors and employees of the merging institutions. There are also views that the current arrangements of transfer by private legislation have worked well and there does not appear to have very strong justifications to introduce any fundamental changes to the system. Besides, imposing a requirement of seeking approval from the court may make the process more lengthy and costly, and is thus not conducive to encouraging the consolidation of the banking sector in Hong Kong.

20. In light of the views received, the FSTB sought the views of the

Judiciary on the option of designating the court as the sanctioning authority, if a legislative framework is introduced in Hong Kong to facilitate the transfer of banking business. Noting (i) the different overseas practices with different sanctioning authorities in the Administration's study, and (ii) that existing alternative means through PMBs is already available for effecting a transfer of banking business, the Judiciary considers that it is not necessary as a matter of principle to designate the court as the sanctioning authority. More importantly, as the transfer of banking business involves a wide range of public policy issues (including for example, the financial soundness of the surviving institution, depositor protection, competition in the banking sector, etc.), and given that public policy issues do not fall under the purview of the Judiciary, it is inappropriate for the court to be designated as the sanctioning authority.

21. In considering the desirability and feasibility of introducing new generic legislation in Hong Kong for effecting transfer of banking business, it should be noted that the existing arrangements of transfer by private legislation, which have been in place all along, have been operating smoothly and also well-received by the banking industry. The number of PMBs has been small, and these cases were dealt with effectively and efficiently, taking on average several months to complete. Any departure from the existing regime would require full consultation with the banking industry and other concerned stakeholders to ensure that the future development of the banking sector as well as the stability of the banking system would not be adversely affected.

Financial Services Branch
Financial Services and the Treasury Bureau
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