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By e-mail: mjylee@legco.gov.hk

Bills Committee on Competition Bill
 Legislative Council
 Legislative Council Complex
 1 Legislative Council Road
 Hong Kong

Attn: Ms Sarah Yuen, Clerk to Bills Committee

Dear Sirs

**FURTHER SUBMISSION ON THE COMPETITION BILL (BILL) BY THE
 HONG KONG ASSOCIATION OF BANKS (HKAB)**

We refer to our previous submissions to the Bills Committee (the "Committee"), being:

- A first submission dated 23 November 2010, which communicated HKAB's views on the Bill and included 11 recommendations for its improvement ("First Submission", attached for reference as Annexure A);
- A second submission dated 11 July 2011, which touched on the draft "illustrative" guidelines relating to the Bill and prepared by the Commerce & Economic Development Bureau, and also reiterated many of the points made in the First Submission;
- A third submission dated 9 November 2011, which urged the Administration to give priority regard to one of the issues raised in the First Submission (namely, that the Bill be amended to exclude from challenge conduct that is undertaken in accordance with certain "regulating provisions" applicable to the banking sector which, whilst not technically imposing "legal requirements", are nonetheless appropriate to treat as such); and
- A fourth submission dated 24 February 2012, which articulated HKAB's concerns about the proposal to apply the Bill's exemption for statutory bodies to the Hong Kong Export Credit Insurance Corporation, and also requested confirmation that the proposed law will apply to Hong Kong Exchanges and Clearing Ltd and Hong Kong Mortgage Corporation.

Chairman The Hongkong and Shanghai Banking Corporation Ltd
Vice Chairmen Bank of China (Hong Kong) Ltd
 Standard Chartered Bank (Hong Kong) Ltd
Secretary Ronie Mak

主席 香港上海匯豐銀行有限公司
 副主席 中國銀行（香港）有限公司
 渣打銀行（香港）有限公司
 秘書 麥依敏



HKAB recognises the progress made by the Committee in securing significant refinements to the Bill by balancing appropriately the objectives of safeguarding competition in Hong Kong with the benefits of facilitating the free play of market forces and continuing to promote a business-friendly environment in the region. In particular, HKAB welcomes many of the amendments tabled before the Legislative Council in October 2011 - several of which addressed concerns that HKAB had communicated to the Committee in its submissions. However, HKAB notes that the Administration's responses have not addressed fully or in some cases, satisfactorily many important issues raised in its submissions. These include outstanding issues of particular importance for the banking sector as well as issues of more general application to the business community.

In the context mentioned above, this submission is structured as follows:

- Part A sets out recommended amendments to the Bill that are intended to deal with issues specific to the banking sector. Each of these issues was raised in our First Submission, but does not appear to have been adequately addressed by the Administration. Where HKAB is aware of the views provided by the Administration to justify its position, HKAB's comments on the suitability of the Administration's response to date are also provided.
- Part B summarises further recommended amendments to the Bill that would have a cross-sector impact. Where these amendment proposals have already been explained in detail in the First Submission, they are only briefly recapped in this Part B. Three new and further refinements to the Bill that are being raised for the first time are outlined here in more detail.

As stated in Part A of this submission, the Administration's response to many of the concerns raised by HKAB and other stakeholders in relation to the Bill has been to suggest that such matters be more appropriately left to the discretion of the Competition Commission or Competition Tribunal once established. Two prime examples include whether vertical agreements will be exempted from the First Conduct Rule, and what 'threshold' of competitive harm (i.e. appreciable restrictions on competition; substantial restrictions on competition and any restrictions on competition) will be considered actionable.

Although HKAB understands that the scope of the proposed law and the need for some flexibility within the regime for it to adapt to changing circumstances mean that it is impractical to try and codify all administrative, enforcement and other key aspects of the regime at the present time, it considers nonetheless that there are some unresolved issues that carry sufficient significance and they should be "locked down" now in order for the business sector and wider community to fully appreciate how the proposed law will operate in practice.

Accordingly, HKAB calls upon the Committee to request the Administration to articulate clearly its position on all such issues, and to codify necessary clarifications and adjustments to the scope of the proposed law by amending the Bill, so as to



provide greater certainty for effective enforcement by the Competition Commission and compliance by the business sector.

HKAB again expresses its gratitude to the Committee for considering the recommendations it has already provided and is now continuing to provide. HKAB would be pleased to provide any further assistance the Committee may need to facilitate action on these recommendations.

Yours faithfully

A handwritten signature in black ink, appearing to be "Ronie Mak", written over a horizontal line.

Ronie Mak
Secretary

Enc.

c.c. Dr. the Hon David K.P. Li, GBM, GBS, JP, Member of the Legislative Council

FURTHER SUBMISSION BY HONG KONG ASSOCIATION OF BANKS IN RELATION TO THE COMPETITION BILL

PART A - RECOMMENDED AMENDMENTS TO THE BILL INTENDED TO DEAL WITH ISSUES SPECIFIC TO THE BANKING SECTOR

As noted in the cover letter to this submission, each of the recommendations set out below was raised in one or more of our previous submissions, but does not appear to have been acted upon by the Administration. Where HKAB is aware of the Administration providing a response on the issue in purported justification of its position, HKAB's views on the suitability of the Administration's response are also provided here:-

Recommendation 1: Ensuring immunity for conduct undertaken in accordance with relevant codes of practice, circulars, guidelines, etc

- **What is HKAB advocating?**

HKAB recommends that the Bill be amended to exclude from challenge under the Conduct Rules any conduct that is undertaken in accordance with certain “regulating provisions” applicable to the banking sector which, whilst not technically imposing “legal requirements”, are nonetheless appropriate to treat as such.

- **What is the rationale for HKAB's position?**

Section 2 of Schedule 1 of the Bill effectively provides that agreements or conduct entered into or undertaken for the purpose of complying with a legal requirement will not be subject to challenge under the Bill's so-called “Conduct Rules”. As noted in the First Submission, HKAB is concerned this exclusion will not extend to agreements made or conduct engaged in for the purposes of complying with all of the important codes of practice, circulars and regulatory guidance or directives issued or endorsed by a government-approved regulatory or supervisory authority in Hong Kong and applicable to the banking sector in Hong Kong (hereafter referred to for convenience as “**Regulating Provisions for Banking**”)¹.

The pertinent example raised in HKAB's First Submission is the Code of Banking Practice (the “**Code**”), which sets out minimum service standards that HKAB member banks and authorized institutions should meet when providing services to personal customers. As explained in detail in the First Submission, although

¹ This would include relevant directives (etc) issued by supranational bodies such as the Basel Committee on Banking Supervision concerning matters aimed at ensuring best banking practice and the stability of the banking sector.

the Code is issued on a voluntary basis by HKAB and The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies, all HKAB member banks and other relevant authorized institutions are expected to conduct their business in accordance with the Code.

A further example is the circulars issued from time to time by the Hong Kong Monetary Authority ("HKMA"), which outline required expected standards for various aspects of banking practice. While these standards do not usually have the force of law, adherence is closely monitored by the HKMA and deviations from the standards can lead to regulatory action.

A recent example is the circular issued by the HKMA to all authorised institutions dated 8 November 2011 (a copy of which is provided in Annexure B), which sets out the HKMA's requirements on position squaring with the RMB Clearing Bank. Notwithstanding that the circular lacks binding legal force, the requirements for relevant banking practice specified in the circular are expressed as being mandatory², and the circular clearly provides for significant penalties to be imposed on non-compliant banks (such as suspension of any future position squaring with the RMB Clearing Bank and unwinding of relevant previous arrangements).

Notably, the requirements imposed by the HKMA under this circular include behaviour such as exchange of information with other banks to substantiate that transactions proposed to be subject to position squaring are genuine cross border trade transactions qualifying for such arrangements. While HKAB would not necessarily anticipate that such arrangements would be in conflict with competition law obligations, HKAB is aware that information exchange between competitors is a practice that can commonly give rise to competition law concerns and thus requires careful management and (commonly) legal advice if subject to the proposed Hong Kong law.

Accordingly, HKAB is concerned that if conduct in compliance with such circulars (and other Regulatory Provisions for Banking) was not exempt from challenge under the proposed law, banks would face great uncertainty. To begin with, the legality of such arrangements could not be verified with precision until the scope of application of the Conduct Rules is more fully explained by regulations and guidance documents (which are not in place yet, and once in place may be amended from time to time). Further, even when such documents were in place, it would be incumbent upon both the banks and the HKAB to seek legal advice in relation to all such arrangements, to ensure there was no risk of those arrangements being viewed as inconsistent with the proposed law. HKAB

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In setting out the required standards and practices, the circular expresses these in language that underlines the expectation of compliance by HKMA. The types of expressions used include "Participating AIs [Authorised Institutions] must be able to demonstrate that...", "HKMA expects...", "Participating AIs should...", and "Participating AIs are expected to adhere strictly to the above requirements".

believes this would be an unfair burden on banks (and the HKMA), and could only lead to confusion and conflict in the event that different views were taken on the legitimacy of mandated arrangements.

The banking practices mandated by the HKMA are formulated in accordance with the organisation's statutory obligation to ensure that banks operate with integrity and the appropriate degree of professional prudence, and in a manner that is not detrimental to the interests of depositors. Overlaying additional regulations that may at best create uncertainties and at worst may result in inconsistencies in the regulatory framework applicable to banks could only have adverse impacts on the efficiency and stability of Hong Kong's banking industry,

In this context, HKAB reiterates the recommendation set out in its First Submission- that the Bills Committee shall seek an amendment to the definition of the term "legal requirements" in section 2 of Schedule 1 of the Bill, so that conduct engaged in or agreements made in compliance with any requirements applying under Regulating Provisions for Banking are excluded from challenge under the Conduct Rules.

- **What has the Administration's response been, and is this response satisfactory?**

HKAB notes that several documents entitled *Summary of views expressed by deputations on major prohibitions, exclusion and exemption of the Bill and the Administration's response* (hereafter, "**Summary of Views & Administration's Response**") have been tabled at Bills Committee meetings and made public on the website of the Legislative Council³. These documents summarise the views of the Administration on key issues, including several of the issues raised by HKAB in its various submissions on the Competition Bill. The Summary of Views & Administration's Response document of 18 May 2011 notes that the Administration considers that:

- (a) broadening the definition of "legal requirement" might cast the net too wide, rendering the exclusion a norm rather than an exception; and
- (b) introducing such an exemption would be inconsistent with the position in other jurisdictions, where relevant exemptions only apply if behaviour is mandated by law (rather than if the behaviour is discretionary by reference to guidance or circulars of no particular legal effect).

HKAB does not agree with these views of the Administration, for the reasons set out below.

³ http://legco.gov.hk/yr09-10/english/bc/bc12/papers/bc12_d.htm

Firstly, HKAB is not suggesting that any and all conduct subject to Regulating Provisions on Banking should be exempt from the Conduct Rules. Rather, it is recommending that an exemption apply to the extent that application of the Conduct Rules would prohibit conduct that is otherwise in accordance with Regulating Provisions on Banking. In this context, HKAB considers that broadening the definition of “legal requirement” would not “case the net too wide”, but rather would have only a very limited, but prudent and logical, impact.

Secondly, it is noted that this is an issue which has been addressed in other jurisdictions. For example, section 164 of the Financial Services and Markets Act 2000 excludes conduct that is subject to the regulating provisions of the Financial Services Authority (FSA) from key prohibitions in the UK's Competition Act, to the extent that such conduct is encouraged by any of the FSA's regulating provisions. This represents a recognition by the UK authorities that the general provisions within the UK's Competition Act exempting conduct that is undertaken to comply with a legal requirement from challenge are too narrow to address all relevant circumstances, and that conduct that is “encouraged” by the UK-equivalent to Regulating Provisions on Banking is suitable for exclusion from relevant competition law. HKAB considers that it is appropriate for an analogous approach to be adopted in Hong Kong.

Accordingly, HKAB respectfully repeats its request for the Bills Committee to raise this matter with the Administration as a priority, to seek an appropriate amendment to the definition of the term “legal requirements” in section 2 of Schedule 1 of the Bill or implementation of some other exemption to deal with this issue.

Recommendation 2: Priority issuing of guidelines on banking practices after due consultation

- **What is HKAB advocating?**

HKAB recommends that section 35 of the Bill (Guidelines) be amended to require the Commission to consult with the banking sector on, and issue before commencement of the Conduct Rules, guidelines on its interpretation and enforcement approach to such rules in the context of relevant banking practices.

- **What is the rationale for HKAB's position?**

According to section 35 of the Bill, the Commission is required to issue guidelines explaining, amongst other things, the manner in which it intends to interpret and give effect to the Conduct Rules. HKAB believes it will be appropriate for the Commission to also issue guidelines specifically applicable to industry sectors whose structure or regulatory environment may raise particularly complex or challenging competition issues in respect of which additional clarity

regarding the Commission's interpretation and enforcement approach will be appropriate.

In particular, it is considered that the banking sector should be amongst the industry sectors that are the subject of such guidelines - as there are relatively unique structural and regulatory features in this sector that lead to business arrangements and activities in respect of which guidance is especially warranted⁴. As explained in detail in the First Submission, there is international precedent for such approach.

It is also important that such guidelines are developed in consultation with banking sector representatives, and published well prior to commencement of the Conduct Rules.

- **What has the Administration's response been, and is this response satisfactory?**

In the Summary of Views & Administration's Response document of 18 May 2011, it is noted that the Administration's response to this issue has been to state that it considers the Commission should be left to determine to whom, and in what form, compliance guidance is provided.

HKAB understands the need to ensure the Commission is given some flexibility in this area, especially as it will have many tasks to complete upon establishment and a number of business sectors to liaise with and (it would be expected) provide guidance to. However, HKAB also considers that the Administration needs to recognise that in the absence of specific guidance being issued for the banking sector, the proposed law will give rise to uncertainties that could have implications well beyond this sector and thus warrant priority attention.

The importance of the banking sector to (and its interrelationship with) the broader Hong Kong economy has long been recognised by the Administration. Any new field of regulation that creates uncertainties about significant banking-related issues, such as the extent to which banks can collaborate on back-end networks and systems, therefore risks adversely impacting not only the banks, but the wider business sector and community that relies upon them to ensure a sound and stable financial system.

In this context, it is not surprising that the justification for prioritising production of sector-specific competition law guidelines for the banking sector has been recognised in many jurisdictions around the world, as described in detail in the

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As explained in detail in the First Submission, examples include the common requirement under regulation or business necessity for banks to enter into co-operative arrangements with other banks, for reasons such as to ensure the efficient and secure operation of inter-bank networks and systems (such as automatic teller machines, international credit card or national debit transfer systems, payments clearing systems, and credit history databases).

First Submission. As a proposed “late adopter” of cross-sector competition law, Hong Kong has the advantage of being in a position to learn from the experience and approach of those jurisdictions on issues such as this.

Accordingly, HKAB reiterates its view to the Bills Committee that it is imperative that competition-orientated guidelines relating to relevant banking practices be developed by the Commission as a priority in consultation with banking sector representatives, and published well before commencement of the Conduct Rules. Amending section 35 of the Bill to reflect this requirement will assist to ensure certainty on this matter.

Recommendation 3: Requiring the Commission to consult relevant industry authorities before conducting investigations and enforcement actions

- **What is HKAB advocating?**

HKAB considers that section 129 of the Bill (Functions of Commission) should be amended to require the Commission to consult with any body or association in Hong Kong that, under a Hong Kong Ordinance, is provided with regulatory, supervisory or representative functions or responsibilities in relation to an industry sector before commencing any investigation or enforcement action relating to that sector in fulfilment of the Commission's function under paragraph (a) of that section (“to investigate conduct that may contravene the competition rules and enforce the provisions of this Ordinance”).

- **What is the rationale for HKAB's position?**

Under the Bill, the existing role of the Telecommunications Authority and Broadcasting Authority⁵ as the primary competition regulator in relation to their respective sectors is retained. According to paragraph 7 of Chapter VI of the May 2008 *Detailed Proposals for a Competition Law* consultation paper, this is for reasons that include the merit of retaining this “specialist knowledge” of the sector.

As noted in the First Submission, HKAB supports this approach, and also believes that it is appropriate to ensure the expertise of existing banking regulators and other key banking sector representatives is appropriately utilised by the competition regulator.

For example, it is clear that the functions and duties provide the HKMA with special knowledge of Hong Kong's banking industry and the optimum competition environment for the sector, which special knowledge will be

⁵ Or, effective 1 April 2012, the unified regulator, the Communications Authority, that will take the place of the Telecommunications Authority and Broadcasting Authority.

appropriate for the Commission to call on and take into account before proceeding with investigations and enforcement actions specifically relating to the banking sector. This will ensure the Commission has all pertinent information relevant to assessment of issues such as market definition, the market effect and public policy benefits of common industry practices, and the broader impact on the industry and its prudent operation that may arise from proposed remedies that may be contemplated by the Commission where suspected infringements are identified.

As also noted in the First Submission, open dialogue between competition regulators and sectoral regulators for the purposes of ensuring informed decision is common in many mature competition law jurisdictions, and has been formalised in some areas. There are also analogous domestic examples of regulatory bodies being required by law to consult with appropriate persons and institutions before engaging in key activities (refer the example outlined in detail in the First Submission regarding the HKMA being required to consult with other industry bodies when fulfilling key functions). Accordingly, there are both international and domestic precedents for this recommended approach.

Implementation of this recommendation will also assist the Commission to adopt the exemption discussed in Recommendation 1 in this submission. Specifically, since such adoption would exempt any conduct engaged in or agreements made in compliance with requirements of Regulating Provisions for Banking from challenge, it follows that consultation by the Commission with banking sector regulators prior to commencement of any investigation or enforcement action will make the Commission be aware, in a timely manner, that compliance of any Regulating Provisions for Banking may have necessitated the conduct or agreements in question.

- **What has the Administration's response been, and is the response satisfactory?**

In the Summary of Views & Administration's Response of 22 February 2011, it is noted that the Administration responded on this issue by suggesting that as an independent body, the Commission should be able to perform its functions objectively and free from influence from parties whose interests might be affected by its investigations.

This response suggests that implementing HKAB's recommendation would risk compromising the impartiality of the Commission. We disagree given that HKAB's recommendation is simply intended to ensure the Commission will be fully informed in its decision making. It has not been suggested that the Commission's decision making power should in any way be subject to direction or influence from external bodies, and there is no obvious reason to suspect this would be the result of the Commission engaging in appropriate consultation when undertaking key functions.

The Administration has already suggested that a representative of the small-to-medium sized business sector should be included on the board of the Commission. This indicates that the Administration considers it appropriate for the Commission to have the benefit of access to parties with detailed knowledge and experience of this business segment when dealing with matters relating to it. HKAB's recommendation will simply ensure an analogous benefit when the Commission is considering investigative or enforcement action relating to participants in an industry sector that is relevantly regulated or supervised in Hong Kong.

In this context, HKAB reiterates it would be appropriate for the Administration to implement the recommendation.

Recommendation 4: Excluding the banking sector from the scope of permitted “market studies”
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- **What is HKAB advocating?**

HKAB recommends that section 129 of the Bill (Functions of Commission) be amended to exclude the possibility of market studies being undertaken by the Commission in relation to industry sectors which are already supervised by a sectoral regulator that is in a position to review and if necessary respond to relevant instances of market failure, such as the banking sector.

- **What is the rationale for HKAB's position?**

Section 129 of the Bill empowers the Commission to conduct market studies into matters affecting competition in markets in Hong Kong. No further details are provided in the Bill regarding the nature of such market studies, and their implications. However, in the First Submission HKAB noted that it was understood the Administration intends for the market study powers of the Commission to be exercised in a similar manner to the market investigation powers that the Office of Fair Trading has in the United Kingdom under that jurisdiction's Enterprise Act 2002, which may extend to calling for changes to be made to how an industry sector is regulated and structured. This understanding appears to have been confirmed by subsequent communications from the Administration⁶.

⁶ In the Summary of Views & Administration's Response of 22 February 2011, it is stated that the market study power “is a common function of the competition authorities in other overseas jurisdictions” and is intended to enable the Commission “to identify, and advise the sector on, the needs and ways to improve matters that affect competition in a particular segment of the economy.”

In this context, HKAB believes it is appropriate to ensure that mechanisms are built into the Bill to avoid unnecessary overlap in the functions of the Commission and existing sectoral regulators, particularly in the context of examining instances of market failure and how these may be best addressed.

With regard to the banking sector, HKAB notes that there is already significant regulatory oversight of banking markets in Hong Kong through bodies such as the HKMA, whose supervisory role extends beyond mere prudential supervision of the sector to include reviewing and addressing a broad range of issues relating to malpractice and market failure. This was explained in detail in HKAB's First Submission.

HKAB therefore believes the HKMA's legislative responsibilities and the scope of its supervisory role is sufficient to ensure appropriate ongoing review of banking markets, and the HKMA's special knowledge of the banking sector also positions it as the most appropriate body to conduct any intensive assessment of specific banking structures or practices whenever this may be necessary. Accordingly, HKAB believes that it is appropriate for the scope of the Commission's market study powers to exclude review of the banking sector.

- **What has the Administration's response been, and is this response satisfactory?**

In the Summary of Views & Administration's Response as at 22 February 2011, it is noted that the Administration has responded on this issue by stating that sectoral regulators other than the Telecommunications Authority and Broadcasting Authority do not have the necessary expertise on competition and cannot replace the Commission in the performance of this function.

HKAB is concerned that this response misses the point of its recommendation on this issue.

HKAB agrees that when it comes to matters such as investigation and prosecution of unlawful anti-competitive conduct, the Commission (and the two aforementioned sectoral regulators / their forthcoming unified successor, the Communications Authority) will likely be alone in having the expertise appropriate to conduct this work.

Additionally, HKAB recognises that - even where no relevant competition law infringements are identified - the Commission may have a legitimate role to play in scrutinizing some markets where competition does not appear to be optimised.

However, this should not be the case for those heavily supervised markets where public policy goals other than "maximisation of competition" shape the manner in which the market is regulated and organised. The banking industry in Hong Kong is a prime example.

It is well recognised that one of the primary goals of regulation of the banking industry in Hong Kong (and around the world) is to ensure the stability and integrity of the system, which has been the pillar of confidence to the community of Hong Kong whether as depositors and / or customers. For this reason, market entry is subject to strict licensing standards, and the conduct of market participants is regulated to a degree that far outweighs what exists for most industry sectors.

In this context, HKAB is concerned that if the Commission sought to undertake any study of such a sector, which according to the wording of section 129 of the Bill would only focus on (and rightly so under its remit) competition issues, it would not be in a position to give due regard to all of the policy aims that may necessarily rank alongside, if not above, the aim of maximising competition.

In contrast, a body with special knowledge of the banking sector (such as the HKMA) remains the most appropriate body to conduct any intensive assessment of specific banking structures, practices or market failures whenever this may be necessary.

Accordingly, HKAB reiterates that it is appropriate for the scope of the Commission's market study powers to exclude review of the banking sector. This will avoid what at best may be unnecessary overlap in the functions of the Commission and existing sectoral regulators, and at worst unsuitable analysis and reporting by the Commission due to its much narrower focus compared with the wider public policy goals pursued by bodies such as the HKMA as explained above.

Recommendation 5: Exemptions and exclusions to be granted to banks

- **What is HKAB advocating?**

HKAB recommends that the Bills Committee highlight to the government the importance of ensuring that the Commission introduces Block Exemption Orders or other exemptions and exclusions covering relevant aspects of banking and financial sector practice, and for the Commission to consult foreign competition regimes and liaise with Hong Kong's banking sector representatives in order to achieve this end.

- **What is the rationale for HKAB's position?**

HKAB believes it will be appropriate for the Administration to ensure that, once established, the Commission makes it a priority to:

- (a) identify areas of banking activity that are properly excluded from, or specially dealt with under, the Conduct Rules; and

- (b) more generally liaise with representatives of the banking sector to determine where existing industry arrangements are already subject to appropriate regulation and control or should otherwise properly fall outside of the proper ambit of competition review.

Many countries around the world have introduced competition law exemptions or other forms of sector-specific treatment for banks and/or other types of financial institutions, most commonly granted so as to reduce risk and uncertainty and ensure systemic stability, and numerous examples are referenced in HKAB's First Submission.

- **What has the Administration's response been, and is this response satisfactory?**

In the Summary of Views & Administration's Response as at 18 May 2011, it is noted the Administration's response to this issue has simply been to note that the Commission will be empowered to implement relevant exemptions (and to consult on and issue related guidelines relating to these) once established. As far as HKAB is aware, the Administration is yet to indicate that it recognises a need to ensure the banking sector is treated as a priority in this regard.

HKAB is not calling for amendments to the Bill to "hardwire" priority treatment on this issue. This is because HKAB recognises that there are existing mechanisms in the Bill that provide for the Commission to consider and introduce Block Exemption Orders in due course - and it may be impractical to include a specific reference in the Bill to all of the industry sectors which should be covered in this regard (given that there may be a number of these and/or some relevant exemptions may have a cross-sector impact).

However, HKAB does believe it is important for the Administration to expressly acknowledge the need for the Commission to move quickly in this area, once established, and to make consideration of issues relating to the banking sector one of its priorities. The justifications for this largely reflect those stated in the section of this document explaining HKAB's view that the Commission should prioritise the issuing of guidelines on banking practices. Namely:

- A failure to address uncertainties in this area risks significant adverse consequences - not only for the banks, but for the business sector and wider community that relies on the banks to ensure a sound and stable financial system in Hong Kong; and
- Many countries around the world have introduced competition law exemptions or other forms of sector-specific treatment for banks and/or other types of financial institutions, most commonly granted so as to reduce risk and uncertainty and ensure systemic stability, and Hong Kong has the advantage of being in a position to learn from and mirror the approach of these jurisdictions.

Accordingly, at this stage HKAB recommends that the Bills Committee focuses on highlighting to the Administration the importance of ensuring that the Commission shall introduce Block Exemption Orders or other exemptions and exclusions covering relevant aspects of banking and financial sector practice, and for the Commission to consult foreign competition regimes and liaise with Hong Kong's banking sector representatives in order to achieve this end.

As a final comment for this Part A, HKAB again notes that these recommendations were detailed in full and with comprehensive explanations and supporting arguments in the First Submission, which is attached to this submission for the Bills Committee's ongoing reference.

FURTHER SUBMISSION BY HONG KONG ASSOCIATION OF BANKS IN RELATION TO THE COMPETITION BILL

PART B - FURTHER RECOMMENDED AMENDMENTS TO THE BILL THAT WOULD HAVE A CROSS-SECTOR IMPACT

As noted in the cover letter, HKAB's focus in providing this submission is on re-emphasising the importance of ensuring the Administration addresses several significant banking-specific issues relating to the Bill. Those issues are dealt with in Part A of this submission.

However, HKAB would also like to reiterate its ongoing support of the efforts by many other business organisations in Hong Kong to ensure other prudent amendments to the Bill with cross-sector implications are implemented. In particular, reflecting the contents of its First Submission, HKAB reiterates its views on the following issues:-

- **(Market definition):** HKAB believes the Bill should be amended to introduce a definition of the term “market”, and this definition should expressly reflect the fact that the geographic scope of many product and service markets contested by undertakings in Hong Kong extends beyond the territorial boundaries of the Hong Kong S.A.R. and will commonly encompass mainland China and beyond.
- **(Vertical agreements):** HKAB considers the Bill should be amended to expressly exempt vertical agreements from the scope of the First Conduct Rule.
- **(Statutory bodies):** HKAB remains of the view that the Bill should not provide any exemption for statutory bodies that provide goods or services in competition with private sector entities, such as Hong Kong Export Credit Insurance Corporation.
- **(Applications to the Commission for comfort):** HKAB believes that there should be a relaxation of the restrictions on the process set out in Subdivision 2 of Part 2 of the Bill, pursuant to which undertakings may apply to the Competition Commission for a decision as to whether or not an agreement that they have entered in to (or propose to enter into) would benefit from a relevant exemption or exclusion from the Conduct Rules.
- **(Substantiality requirement):** HKAB considers that a substantiality requirement should be expressly encoded into the Conduct Rules, so as to ensure that conduct which exerts an insignificant or unappreciable effect on a market will not be subject to unnecessary regulatory intervention.

Additionally, since making its previous submissions, HKAB has identified three further areas where it considers refinements to the Bill with cross-sector impact are appropriate. As these issues have not been dealt with in previous HKAB submissions, they are addressed in detail below.

- **(Dominant market position):** HKAB recommends that the Competition Ordinance should refer to the concept of dominant position rather than substantial degree of market power for the purposes of the Second Conduct Rule.

HKAB has serious concerns about the substantial market power threshold, as detailed below.

Firstly, it is noted that most mature competition law regimes (including Canada, the E.U., the U.K., France, Germany and the Netherlands) apply a threshold of dominance rather than substantial market power. In the Asia-Pacific, a majority of countries adopt the same test, including India, South Korea, Malaysia, Taiwan, Singapore and mainland China.

Indeed, only a handful of countries (most notably Australia and New Zealand, which have enacted quite different competition legislation to that proposed to apply in Hong Kong) use a “substantial market power” threshold.

Accordingly, it is clear that applying a threshold of substantial market power in Hong Kong would place Hong Kong at odds with many of the key jurisdictions whose abundant case law the Administration has suggested Hong Kong's courts should draw reference from⁷. In particular, Hong Kong will be denied the opportunity to draw on the clear principles applied in EU case law and the guidance documents the European Commission has published on this area, as well as, the precedents adopted in many other jurisdictions which apply a “dominance” threshold.

It is also clear that the narrow range of jurisdictions to which Hong Kong may be required to turn for guidance on interpretation of the concept of “substantial market power” may not be able to offer much by way of clarity. In Australia, for example, the phrase is not defined in legislation but has been rather unhelpfully interpreted by the courts as a level of market power that is “considerable” or “large” but less than “commanding a market” or a “monopoly”⁸. The ambiguity inherent in this definition has led to a situation where courts have concluded that a market share of just 16% could amount to substantial market power⁹.

⁷ Refer, for example, paragraph 17 (page 7) of the Commerce and Economic Development Bureau's November 2010 paper “Overview of Major Components of the Competition Bill” CB(1)320/10-11(02), where it is stated that “a ‘general prohibitions’ approach... has been widely adopted in overseas competition jurisdictions from which Hong Kong can draw reference from their abundant case law and long history of experiences.”

⁸ Refer section 10 in the Australia chapter of Global Competition Review's *Getting the Deal Through - Dominance* publication 2012.

⁹ *Australian Competition and Consumer Commission v Universal Music Australia Pty Ltd* [2001] FCA 1800 [Hill J, 14 December 2001]. Note that this decision was overturned on appeal, but the fact that the Federal Court was at first instance able to come to a conclusion

HKAB is therefore concerned that application of the “substantial market power” threshold will lead to great uncertainty for business operators and enforcement agencies alike in Hong Kong. This is perhaps reflected in the fact that when the Administration drafted its indicative “Guidelines on the Second Conduct Rule”¹⁰ (submitted to the Bills Committee in June 2011) most of the discussion in that document on the concept of substantial market power made reference to principles and market share thresholds applied in the EU, U.K, and Singapore - notwithstanding that these jurisdictions use a “dominance” test. It can only be assumed that those involved in drafting the indicative Guidelines recognised that there is a distinct lack of useful principles to borrow from the regimes utilising the concept of “substantial market power”.

There is no doubt this state of uncertainty will increase the complexity and cost of compliance for business operators in Hong Kong, and in particular for multinationals required to ensure their activities satisfy both Hong Kong’s competition law regime and the many other regimes utilising the “dominance” threshold. Worryingly, this could therefore make it more difficult for Hong Kong-based undertakings to compete in markets which have a geographic scope extending beyond the territory of Hong Kong.

Taking into account these concerns, HKAB’s view is that the substantial market power threshold should be replaced with the dominance threshold.

Further, it is important from a certainty and practical perspective to have a clear market share benchmark to enable businesses in Hong Kong to monitor compliance. An analysis of the market share threshold used in other small economies (including Singapore and Taiwan) shows that a vast majority of them use a market share threshold of between 40 and 60 per cent as an indicator of the existence of dominance. Hong Kong itself already uses the dominance test and high market share thresholds in the telecommunications and broadcasting sectors¹¹. We believe an indicative market share threshold of 50% is appropriate.

A low market share threshold would not be a sound economic policy for a small territory where entry barriers are low and could adversely affect consumer interests. If the threshold is set at a low percentage, it is expected that many undertakings in Hong Kong will be caught by the Second Conduct Rule. This

that the relevant business operator with a 16% market share held substantial market power serves as a warning that the threshold may be considered very easily met.

¹⁰ Refer the boxed text on pages 4 and 5 of this document.

¹¹ In the broadcasting sector, a presumption of market dominance only arises if a licensee’s market share is persistently above 50%. In the telecommunications sector, while the new compliance guidelines issued in 2010 do not provide any indication of market shares for the purpose of assessing market power, under the previous guidelines, only a licensee with a greater than 75% market share will be presumed to be dominant.

will be overly burdensome for the business community as well as the Competition Commission, to the detriment of effective competition and ultimately to the detriment of consumers.

- **(Intra-group agreements):** The Competition Ordinance should clarify that the First Conduct Rule does not apply to intra-group relationships.

In most competition law regimes, the prohibition against restrictive agreements does not apply to intra-group dealings. In particular, an agreement between a parent and its subsidiary company, or between two companies which are under the control of a third, will not be considered as agreements between undertakings but will be regarded as an internal allocation of functions and not be subject to competition law. Business operators should be given flexibility in managing their business affairs within the same group.

Legal certainty would be increased if it is expressly provided that the First Conduct Rule does not apply to internal group measures. This proposal is in line with the practice in many jurisdictions, including in Australia where section 45(8) of the Trade Practices Act expressly provides that the prohibition against restrictive agreements does not apply where the parties qualify as “related bodies corporate.” A parent and a subsidiary are considered as such, as long as the parent company owns more than 50% of the equity of the subsidiary.

- **(Sanctions against Individuals/Directors):** The Bill provides for a wide array of possible sanctions against individuals - including pecuniary penalties, far reaching disqualification orders as well as criminal liabilities. Including excessive sanction powers would be inefficient and counterproductive as this may result in over-deterrence by providing incentives to engage in excessive monitoring and compliance expenditures or to refrain from engaging in risky but overall competitive projects. It can also create conflicting interests between individuals and undertakings in the context of leniency or commitment procedures. Finally, it would single out Hong Kong as one of the most severe competition law regimes in the world, which might harm Hong Kong’s broader business interests.

On this basis, HKAB would recommend:

- a) There should not be pecuniary penalties imposed on individuals under Sections 90(1) and 91(1) of the Bill unless they qualify as undertakings. The disqualification orders contemplated in Section 99 of the Bill, which already appear to be more severe than the sanctions in most established jurisdictions, provide sufficient and more adequate deterrence.
- b) Disqualification orders under Section 101 of the Bill should only be made against directors who have actual knowledge that the conduct of their company constituted a contravention of a competition rule. Director disqualifications do not exist in most of the established competition law

regimes. Any disqualification sanction should be perceived and experienced as fair and reasonable and should not be imposed except in relation to the most serious infringements and in circumstances that will not defeat other important policy objectives (such as ensuring effective leniency procedures or promoting compliance programs).

- c) Negligence or omission should not be sufficient to attribute criminal liability, which should only be applicable in exceptional circumstances to sanction reckless conduct or deliberate attempts to obstruct competition law investigations. In particular, we believe obstructions of competition law investigations should only give rise to criminal liability under Section 173 of the Bill in case a person *intentionally* and without reasonable excuse obstructs a specified person in the performance of its functions¹². Similarly, directors and managers should not be held liable for offences committed by a body corporate under Section 174 of the Bill unless it is proved that the offence was committed with his or her consent or connivance¹³. Holding directors and managers criminally liable for mere negligence would constitute an overly broad extension of director and manager duties in Hong Kong.

¹² This is consistent with the practice in other jurisdictions. See for instance Article 42 of the UK Competition Act 1998.

¹³ This proposal is consistent with the standard retained in Section 32 of the Hong Kong Telecommunications Ordinance, where proof of consent or connivance is required to attribute an offence committed by a corporation to its directors or officers.



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23 November 2010

By email: hysiu@legco.gov.hk

Ms. Debbie Siu
Clerk to Bills Committee on Competition Bill
Legislative Council Building
8 Jackson Road, Central
Hong Kong

Dear Ms. Siu

COMPETITION BILL

The Hong Kong Association of Banks (HKAB) is pleased to present this submission to the Bills Committee regarding the Competition Bill presently before Hong Kong's Legislative Council. HKAB hopes this submission will assist the Bills Committee to work to secure appropriate refinements to the Bill, so that if enacted the Bill will support the continued growth of the Hong Kong economy and provide maximum benefit to the community.

In particular, the submission includes recommendations that are aimed at ensuring that any new competition law in Hong Kong is implemented in a manner that balances the interests of safeguarding competition in Hong Kong with the benefits of facilitating the free play of market forces and continuing to promote a business-friendly environment in the region.

Reflecting the sectoral focus of HKAB, the submission also includes recommendations intended to ensure any new competition law aligns with, and appropriately complements, the existing regulatory framework applicable to Hong Kong's banking sector.

In addition to the detailed content of the submission, an Executive Summary focussing on the primary recommendations of HKAB is included in Annex A. Please note that this submission is confidential and not for publication. However, the Executive Summary in Annex A is not confidential and may be published for public review.

HKAB trusts the Bills Committee will give due consideration to the issues and recommendations set out in the submission, and would be pleased to discuss the submission further with Bills Committee representatives.

Chairman Standard Chartered Bank (Hong Kong) Ltd
Vice Chairmen Bank of China (Hong Kong) Ltd
The Hongkong and Shanghai Banking Corporation Ltd
Secretary Rita Liu

主席 渣打銀行（香港）有限公司
副主席 中國銀行（香港）有限公司
香港上海匯豐銀行有限公司
秘書 廖碧瑩



HKAB looks forward to working with the Government and relevant parties to progress consideration and refinement of the Competition Bill.

Yours sincerely

A stylized, handwritten signature in black ink, consisting of a large, sweeping loop followed by a smaller, more intricate flourish.

Rita Liu
Secretary

Enc.

Submission to the Bills Committee of the Legislative Council regarding the Competition Bill

Prepared by The Hong Kong Association of Banks and submitted on 23 November 2010

Please note that capitalised terms used in this submission have the meaning given to those terms in the Hong Kong Competition Bill unless it is indicated otherwise.

1. Introduction

1.1 About The Hong Kong Association of Banks

The Hong Kong Association of Banks ("**HKAB**") was created by The Hong Kong Association of Banks Ordinance, Cap.364 ("**Ordinance**") in 1981 to replace the Exchange Banks' Association. The Ordinance provides a framework for the Government to exchange views with the banking sector for the further development of the industry. The key roles of HKAB include:

- promotion of the interests of fully licensed banks in Hong Kong;
- being a focal point for consultation on law reform, new legislation and regulatory matters; and
- forming a sounding-board for the Government and other relevant bodies on general business and banking issues.

1.2 HKAB and Hong Kong's proposed competition law

1.2.1 HKAB has been monitoring developments in relation to the proposed Hong Kong competition ("**Proposed Law**") for a number of years, in accordance with its responsibility to members and to the broader community to play an active role in consultation on new legislation and regulatory matters.

1.2.2 As part of this process, HKAB has:

- written to the then Economic Development and Labour Bureau on 2 February 2007, in response to the Government's *A Public Discussion Document on the Way Forward for Competition Policy in Hong Kong*; and
- written to the Commerce, Industry and Tourism Branch of the Commerce and Economic Development Bureau on 1 August 2008, in response to the Government's *Public Consultation Paper on Detailed Proposals for a Competition Law*.

1.2.3 Following introduction of the Competition Bill into the Legislative Council in July 2010 and formation of the Bills Committee in October 2010, HKAB is pleased to provide this submission, outlining HKAB's comments and recommendations with respect to the Bill.

1.3 Confidentiality

This submission is confidential and not for publication. However, the Executive Summary extract provided in Annex A is not confidential and may be published for public review.

2. Executive Summary

Annex A to this submission contains a high-level summary of the key issues and recommendations of HKAB in relation to this Bill, which issues and recommendations are also referenced (in the boxed text) and explained more fully in sections 3.1 to 3.9 below.

3. Substantive submission comments

Explained in sections 3.1 to 3.9 below are HKAB's primary observations and recommendations in relation to the Bill:

3.1 Immunity for agreements and conduct required by relevant codes of practice, circulars, guidelines, etc

Recommendation 1: HKAB recommends that the Bills Committee seek an amendment to the definition of "legal requirements" in section 2 of Schedule 1 of the Bill, so that conduct engaged in or agreements made in compliance with any requirements applicable under codes of practice, circulars, guidelines or other directions or guidance in any form issued or endorsed by a Government-approved regulatory or supervisory authority in Hong Kong (or a relevant supranational body) are excluded from challenge under the Conduct Rules. Additionally, HKAB recommends that the Bills Committee highlight to the Government the importance of ensuring that the Competition Commission ("**Commission**") takes appropriate steps (in consultation with the banking sector) to effectively exempt from the Conduct Rules conduct in compliance with directives or guidance issued by relevant supranational bodies or any other foreign regulatory or supervisory bodies outside Hong Kong having jurisdiction over the undertaking concerned.

3.1.1 Section 2 of Schedule 1 of the Bill effectively provides that:

- the First Conduct Rule does not apply to an agreement to the extent that it is made for the purpose of complying with a legal requirement;
- the Second Conduct Rule does not apply to conduct to the extent that it is engaged in for the purposes of complying with a legal requirement; and
- in this context, "legal requirement" means a requirement imposed by or under any enactment in force in Hong Kong, or imposed by any national law applying in Hong Kong.

3.1.2 HKAB is concerned that these exclusions will not extend to agreements made (in the context of the First Conduct Rule) or conduct engaged in (in the context of the Second Conduct Rule) for the purposes of complying with all of the important codes of practice, circulars and regulatory guidance or directives applicable to the banking sector in Hong Kong.

- 3.1.3 For example, HKAB members are committed to complying with the Code of Banking Practice ("Code"), which aims to promote good banking practices by setting out minimum service standards that HKAB member banks and authorized institutions should meet when providing services to personal customers. The Code is issued on a voluntary basis by HKAB and the DTC Association. Accordingly, HKAB understands that compliance with the Code may not be a "legal requirement" in the context of section 2 of Schedule 1 of the Bill.
- 3.1.4 However all HKAB member banks and other relevant authorized institutions are expected to comply with the Code, which has been endorsed by the Hong Kong Monetary Authority ("HKMA"). Indeed, in section 1.4 of the Code it is noted that "HKMA expects all institutions to comply with the Code and will monitor compliance as part of its regular supervision". Any authorized institution that fails to comply with the Code may be viewed by the HKMA as failing in its duty to conduct business in the fit and proper manner required of authorized institutions.
- 3.1.5 As the Code aims to promote good banking practice and a fair and cordial relationship between authorized institutions and their customers, HKAB does not expect that conduct undertaken in compliance with the Code would commonly raise competition-related concerns. However, it is also clear that this cannot be determined with precision until the scope of application of the Conduct Rules is more fully explained by regulations and guidance documents that the Bill indicates would be issued in due course by the Commission - and which may be amended from time to time.
- 3.1.6 In this context, HKAB believes that it would be improper for banks to be placed in a position where they would need to assess the legality under the Proposed Law of agreements made (in the context of the First Conduct Rule) or conduct engaged in (in the context of the Second Conduct Rule) for the purposes of complying with the Code. Instead, HKAB believes that requirements under the Code should be treated as "legal requirements" to which the existing Conduct Rules exclusion would extend.
- 3.1.7 Similarly, the HKMA regularly issues circulars, guidelines and other forms of guidance or directives to authorized institutions on matters aimed at ensuring best banking practice and the stability of the banking sector in Hong Kong. For example, in August 2010, HKMA issued a circular concerning prudential measures for residential mortgage loans. Similar instruments impacting the banking and financial sector are also issued from time to time by other regulatory bodies such as the Securities and Futures Commission ("SFC"). It is not always clear on the face of instruments of this or a similar nature whether they will be characterised as subsidiary legislation in the context of the Interpretation and General Clauses Ordinance and thus "legal requirements" in the context of section 2 of Schedule 1 of the Competition Bill.
- 3.1.8 For reasons analogous to those stated in paragraph 3.16 in the context of the Code, HKAB also believes that these forms of guidance or directives should be treated as "legal requirements" given that relevant institutions are expected to comply with them in the same way that they are expected to comply with applicable Ordinances and regulations, etc.
- 3.1.9 Beyond these examples, there are a range of other circumstances and modes in which bodies such as the HKMA may provide directions or guidance to banks regarding the manner in which they conduct their business which may not qualify as "legal requirements" in the relevant context. Additionally, banks in Hong Kong may from time to time be required to comply with directives or guidance issued by supranational bodies such as the Basel Committee on Banking Supervision.

- 3.1.10 Although the examples mentioned above are specific to the banking sector, it is clear that the same concern may arise in relation to other industry sectors in Hong Kong.
- 3.1.11 Accordingly, HKAB recommends that the Bills Committee seek an amendment to the definition of the term "legal requirements" in section 2 of Schedule 1 of the Bill, so that conduct engaged in or agreements made in compliance with any requirements applying under codes of practice, circulars, guidelines or other directions or guidance in any form issued or endorsed by a Government-approved regulatory or supervisory authority in Hong Kong are excluded from challenge under the Conduct Rules.
- 3.1.12 HKAB recognises that in contrast to the position regarding Government-approved regulatory or supervisory authorities in Hong Kong, it may be difficult to define with precision in the Bill the scope of supranational or other foreign bodies whose directions or guidance to Hong Kong banks should be treated as "legal requirements" in the context of section 2 of Schedule 1 of the Bill. Accordingly, HKAB recommends that the Bills Committee also highlight to the Government the importance of ensuring that the Commission takes appropriate steps (such as through the drafting of relevant enforcement guidelines in consultation with the banking sector) to effectively exempt from the Conduct Rules conduct in compliance with directives or guidance issued by relevant supranational bodies or any other foreign regulatory or supervisory bodies outside Hong Kong having jurisdiction over the undertaking concerned.

3.2 Banking-specific guidelines

Recommendation 2: HKAB recommends that the Bills Committee highlight to the Government the importance of ensuring competition-orientated guidelines relating to relevant banking practices are developed by the Commission as a priority, in consultation with relevant sector representatives, and published well prior to commencement of the Conduct Rules. This could be done by amending section 35 of the Bill (Guidelines) to include references to the banking and other sectors in the text that requires the Commission to issue guidelines on its interpretation and enforcement approach, or by the Government liaising with the Commission after it is established to emphasize the benefit of developing and prioritising such guidance.

- 3.2.1 According to section 35 of the Bill (Guidelines), the Commission is required to issue guidelines explaining, amongst other things, the manner in which it intends to interpret and give effect to the Conduct Rules.
- 3.2.2 In addition to more general cross-sector guidelines, HKAB submits that the Government should require the Commission to issue guidelines specifically applicable to industry sectors whose structure or regulatory environment may raise particularly complex or challenging competition issues in respect of which additional clarity regarding the Commission's interpretation and enforcement approach will be appropriate. In particular, HKAB submits that the banking sector should be amongst the industry sectors that are the subject of such guidelines, for reasons such as those referenced in paragraph 3.1.12 above and in the remainder of this section 3.2.
- 3.2.3 There is international precedent for such approach. By way of example, it is noted that the European Commission has existing and forthcoming regulations incorporating guidance on the application of competition laws to cross-border banking payments and direct debit schemes¹. There are also many further examples of competition-related

¹ For example, refer to Regulation (EC) No 924/2009 of the European Parliament and of the Council of 16 September 2009.

guidance being issued in Europe and elsewhere specific to the banking and/or financial services sectors².

- 3.2.4 There can be no doubt that the development of guidance for specific industry sectors will promote understanding and compliance with the Proposed Law, and enhance legal fairness. With particular reference to the banking sector, it is also clear that there are relatively unique structural and regulatory features in this sector that lead to business arrangements and activities in respect of which guidance is especially warranted.
- 3.2.5 For example, banks are commonly required by regulation or business necessity to enter into co-operative arrangements with other banks, for reasons such as to ensure the efficient and secure operation of inter-bank networks and systems. Examples include networks relating to automatic teller machines, international credit card or national debit transfer systems, payments clearing systems, and credit history databases. Prudent administration of these arrangements requires a level of information exchange and inter-bank coordination that it is recognised may need to be managed carefully to ensure strict compliance with competition laws. Accordingly, banks will benefit from guidance from the Commission regarding how they can best ensure such compliance whilst fulfilling other regulatory requirements and maximising the efficient and secure operation of the relevant networks and systems.
- 3.2.6 Accordingly, HKAB recommends that the Bills Committee highlight to the Government the importance of ensuring competition-orientated guidelines relating to relevant banking practices are developed by the Commission as a priority, and published well prior to commencement of the Conduct Rules. HKAB also submits that development of such guidelines by the Commission should occur in consultation with banking sector representatives, to ensure the guidelines address an appropriate range of banking practices and that the Commission is furnished with appropriate information regarding the rationale for and benefits from relevant practices, etc.
- 3.2.7 This could be done by amending section 35 of the Bill to include references to the banking and other sectors in the text that requires the Commission to issue guidelines on its interpretation and enforcement approach, and by expressly linking this section with the consultation requirement discussed in section 3.5 of this submission. Alternatively, the Government should liaise with the Commission after it is established to emphasise the benefit of developing and prioritising guidance in this manner.

3.3 Appropriate market definition guidance:

Recommendation 3: HKAB recommends that the Bills Committee seek an amendment to the Bill to introduce a definition of the term 'market', and that this definition expressly reflect the fact that the geographic scope of many product and service markets contested by undertakings in Hong Kong extends beyond the territorial boundaries of the Hong Kong S.A.R. and will commonly encompass mainland China and beyond.

² For example, Canada's Competition Bureau has issued guidelines regarding merger control enforcement in relation to the financial services sector (refer to the Bureau publication *The Merger Enforcement Guidelines as applies to a Bank Merger*, available at www.competitionbureau.gc.ca), and the Norwegian Competition Authority has reportedly circulated guidance on the appropriate definition of relevant financial markets.

3.3.1 HKAB notes that many key sections of the Bill use the term 'market', such as:

- section 21, which prohibits an undertaking that has "a substantial degree of market power in a market" from engaging in certain conduct;
- section 129, which empowers the Commission to "conduct market studies into matters affecting competition in markets in Hong Kong"; and
- section 6, which effectively prohibits undertakings from entering into agreements or arrangements pursuant to which they will "share markets" with competitors in certain circumstances.

3.3.2 Additionally, HKAB understands that the process of defining the relevant markets in which undertakings participate will be a key step in identifying whether their conduct prevents, restricts or distorts competition in those (or related) markets in Hong Kong and thereby violates the Conduct Rules. Put simply, the narrower the definition of such a market, the more scope there will be to discern that certain conduct by an undertaking participating in the relevant market prevents, restricts or distorts competition.

3.3.3 Despite its significance, and in contrast to the approach taken by legislators in many jurisdictions with developed or influential competition law regimes³, the term 'market' is not defined in the Bill.

3.3.4 HKAB understands that it is likely some form of definition and guiding principles relating to the term would be provided in the guidelines that section 35 of the Bill requires the Commission to issue after the Bill is enacted.

3.3.5 However, as it is clearly integral to the effective and just application of the Proposed Law that proper principles of market definition are employed, and to ensure a proper understanding of the scope of the Proposed Law at this Bill consideration stage, HKAB believes it is appropriate to include in the Bill specific wording explaining the intended meaning of the term 'market' and embodying some key principles relevant to market definition. This definitional wording could be supplemented, but not contradicted, by later Commission guidelines.

3.3.6 HKAB believes that this issue is of particular importance given that the Bill now provides for a judicial enforcement model. Specifically, as any guidelines issued by the Commission will not be binding on the judiciary, HKAB submits that it is proper for certain integral issues such as the appropriate process for (and relevant fundamental aspects of) market definition to be set out in the Bill itself.

3.3.7 This approach would have the additional benefit of aiding the Government's stated intention of reducing the risk of ill founded complaints and private actions based on a misconception about market definition (and, in particular, the misconception that all 'markets' referenced in the Bill should be assumed to have a geographic scope encompassing just the territory of Hong Kong). The importance of this can be underlined by recent litigation experience in China, where the vast majority of reported private actions brought by plaintiffs under China's Anti-Monopoly Law have been rejected by China's courts for reasons that include incorrect or unsupported market

³ For example, the legislators in Australia, China, and Taiwan all incorporated definitions for the term 'market' (or the related term 'relevant market') in their primary competition laws. Refer to section 4E of Australia's *Trade Practices Act 1974* (Cth), Article 12 of China's *Anti-Monopoly Law of the People's Republic of China*, and Article 5 of Taiwan's *Fair Trade Act*.

definition and market power allegations⁴. As the Bill does not limit private litigation to 'follow on' actions after determination of a claim brought by the Commission, it is important that steps such as this be taken to reduce the potential for misconceived stand alone actions.

- 3.3.8 Reflecting the geographic principle mentioned in paragraph 3.3.7, HKAB is of the view that any new definition of the term 'market' included in the Bill should be tailored to reflect certain unique aspects of the Hong Kong economy.
- 3.3.9 In particular, and in addition to ensuring any new definitional wording reflects international best practice, HKAB believes it is essential that such wording expressly reflect the fact that:
- Hong Kong's open economy and the increasingly porous nature of trade and general business activity between Hong Kong and mainland China allows a very high degree of competition in Hong Kong from firms outside of the region⁵; and
 - this aspect of Hong Kong's economy will mean that many markets in which businesses participate in Hong Kong will have a geographic scope that is properly defined as extending beyond the region.
- 3.3.10 Indeed, it is well recognised that many Hong Kong companies that may be substantial players in the domestic economy are (in the context of competition laws) properly viewed as competitors in a global or broad regional market place where they are just one of many businesses operating in an intensely competitive environment. This was even touched upon in the Government's May 2008 *Detailed Proposals for a Competition Law* consultation paper ("**May 2008 Consultation Paper**")⁶.
- 3.3.11 With specific regard to the banking sector, HKAB notes that there are a broad range of banking-related services that take place in markets that are properly characterised as being highly competitive regional or international markets, clear examples of which include (but are not limited to) provision of wholesale banking services, corporate banking services, investment management services, and forms of insurance and private equity services. International jurisprudence supports this view⁷, and it is also clear that the scope of banking service examples will continue to expand as more steps are taken to facilitate greater banking integration between Hong Kong and mainland China.
- 3.3.12 Express recognition of the unique cross-border market integration between Hong Kong and mainland China in the Proposed Law would assist to ensure that, at a minimum, a competition regulator in Hong Kong considers this issue when determining the appropriate geographic scope of markets, and identifying the boundaries of competitor pressure for the purpose of reviewing conduct under the law.

⁴ For an in-depth discussion of this issue, refer the Mayer Brown JSM legal update dated 8 February 2010, *Civil Actions Under China's Anti-Monopoly Law - Five Major Cases, Five Major Lessons*.

⁵ Refer, for example, paragraph 20 of the May 2008 Consultation Paper (as defined in paragraph 3.3.11).

⁶ Refer to paragraph 20 of Chapter III of the May 2008 Consultation Paper.

⁷ See, for example, the 2001 decision of the U.K. Competition Commission in respect of the merger of *Lloyds/Abbey*, where the Competition Commission considered that the market for financial products sold to customers larger than SMEs is global. Decision available at: http://www.competition-commission.org.uk/rep_pub/reports/2001/458lloyds.htm

3.3.13 There is precedent for such a step. For example, Australia's Trade Practices Act includes express recognition that there will be "Trans-Tasman" markets (that is, markets geographically encompassing a region at least as broad as both Australia and New Zealand)⁸.

3.3.14 Accordingly, in summary, HKAB recommends that the Bill Committee seek an amendment to the Bill to introduce a definition of the term 'market', and that this definition expressly reflect that the geographic scope of many product and service markets contested by undertakings in Hong Kong extends beyond the territorial boundaries of Hong Kong and will commonly encompass mainland China and beyond.

3.4 Exclusion of vertical agreements & 'M&A' from the First Conduct Rule

Recommendation 4: HKAB recommends that the Bills Committee seek an amendment to the Bill to expressly exempt vertical agreements and M&A agreements from the scope of the First Conduct Rule. In the alternative, if M&A agreements are to be subject to challenge, then HKAB submits that this should be in accordance with specific merger review provisions that will ensure there are appropriate procedural safeguards and review thresholds.

3.4.1 Prior to publication of the Bill, HKAB had assumed that vertical agreements and M&A agreements (relevant to sectors other than telecommunications) would be exempt from challenge under the Proposed Law. However, as explained below, this is not the case.

Potential application of the Proposed Law to challenge vertical agreements

3.4.2 Section 6(1) of the Bill, referred to as the First Conduct Rule, can be summarised as prohibiting business operators from entering into agreements or arrangements that have the purpose or effect of preventing, restricting or distorting competition in Hong Kong.

3.4.3 Section 6(2) of the Bill provides a non-exhaustive list of examples of the types of agreements that may be deemed to violate the First Conduct Rule. Each of these examples is a 'horizontal agreement' (i.e. an agreement between competitors, such as a price-fixing agreement).

3.4.4 However, notwithstanding that these examples are confined to horizontal agreements, it is clear that the First Conduct Rule is worded broadly enough to apply to 'vertical agreements' (that is, agreements or arrangements between business operators at different levels of the supply chain, such as suppliers and customers or manufacturers and distributors). There is no wording in the Bill exempting these types of agreements from the First Conduct Rule.

3.4.5 This development has the potential to be inconsistent with previous Government proposals, pursuant to which it was suggested that the Government favoured a broad exclusion from the First Conduct Rule for vertical agreements that met relevant conditions. For example, in 'Proposal 26' in the May 2008 Consultation Paper, the Commerce and Economic Development Bureau stated in relation to the then-proposed First Conduct Rule that - "The focus of the prohibition on agreements should be on horizontal agreements. Vertical agreements should only be addressed in the context of abuse of substantial market power."

3.4.6 For substantially the same reasons as those referenced in paragraph 9 of Chapter II of the May 2008 Consultation Paper, HKAB holds the view that vertical agreements should only

⁸ Refer to section 46A of Australia's *Trade Practices Act 1974* (Cth), which utilises and defines the term "trans-Tasman market".

be subject to challenge under the Proposed Law in the context of abuse of substantial market power.

Potential application of the Proposed Law to challenge M&A deals in any sector

- 3.4.7 The Bill contains what is commonly referred to as a 'merger regime', pursuant to which certain mergers and acquisitions ("M&As") will be unlawful if they substantially lessen competition in Hong Kong. However, the merger regime will apply only to transactions involving telecommunications licensees. HKAB notes that this is consistent with options set out in previous Government proposal documents, and supports the approach that has been adopted.
- 3.4.8 Notwithstanding this, it is clear that M&As conducted by business operators in other industry sectors may also be challenged as anti-competitive and unlawful. This is on the basis that the First Conduct Rule applies to any form of 'agreement' which has the purpose or effect of preventing, restricting or distorting competition in Hong Kong. There is no exclusion for M&A agreements.
- 3.4.9 For substantially the same reasons as set out in paragraphs 20 and 21 of Chapter III of the May 2008 Consultation Paper, HKAB holds the view that M&A agreements unrelated to the telecommunications sector in Hong Kong should be excluded from challenge under the Proposed Law. In the alternative, if M&A agreements are to be subject to challenge, then HKAB submits that this should be in accordance with a specific merger control regime analogous to that which will apply in respect of the telecommunications sector under the Bill. That will ensure there are appropriate procedural safeguards (i.e. a specific timeframe in which challenges may occur, and mechanisms via which parties can seek advance clearance) and appropriate review thresholds (i.e. violations only for relevant deals that prevent or *substantially* restrict or distort competition) for M&A agreements, which do not exist in relation to the First Conduct Rule as it is currently framed.

Role of regulations and guidelines

- 3.4.10 HKAB recognises that it may be possible for the Commission to wholly or partially exempt vertical agreements and M&A agreements from the First Conduct Rule after the Bill is passed in its current form, through later Block Exemption Orders or enforcement guidelines. Indeed, the May 2008 Consultation Paper indicated that this may be a mechanism utilised by the Government to exempt vertical agreements from the Proposed Law. However, for the reasons set out below, HKAB believes that this would not be an appropriate way forward on this issue if it is indeed still the intention of the Government to provide such exemptions.
- 3.4.11 Firstly, HKAB notes that the Commission will be an independent statutory body, and not a servant or agent of the Government⁹, and therefore will presumably not be bound to follow the preferences of Government officials when it comes to drafting and implementing later regulations or guidelines. Accordingly, HKAB believes that it is important that such fundamental exemptions be provided in the Bill itself - for the purposes of certainty (both regarding the intended operation of the Proposed Law going forward, and current debate about the merits of the Bill more generally).
- 3.4.12 Secondly, and with specific reference to the possible use of Block Exemption Orders to exempt vertical agreements and/or M&A agreements from the application of the First Conduct Rule, HKAB notes that section 16 of the Bill sets out detailed procedures that

⁹ Refer to section 130 of the Bill.

must be followed by the Commission before such orders can be issued, including a form of consultation with interested parties. Given the significant workload that will be borne by the Commission once established, it is suggested that the burden of dealing with exemption of vertical agreements and/or M&A agreements from the application of the First Conduct Rule should not be added to its responsibilities when it can be dealt with in the text of the Bill.

- 3.4.13 In relation to the potential for the Commission to use guidelines to effectively exempt vertical agreements and/or M&A agreements, then as noted in paragraph 3.3.6, any guidelines issued by the Commission will not be binding on the judiciary. Accordingly, it is not clear how the Commission could exclude private litigants from challenging vertical agreements and/or M&A agreements in 'stand alone' actions before the Competition Tribunal.
- 3.4.14 In light of the above matters, HKAB recommends that the Bills Committee seek an amendment to the Bill to expressly exempt vertical agreements and M&A agreements from the scope of the First Conduct Rule.

3.5 Consultation between the Commission and banking sector representatives

Recommendation 5: HKAB believes that the Bills Committee should highlight to the Government the importance of ensuring the Commission consults with banking regulators and other key banking sector representatives before conducting investigations and enforcement actions in relation to the sector or when developing guidelines specifically relating to the sector. More particularly, HKAB recommends the Bills Committee:

- seek an amendment to section 35 of the Bill (Guidelines) to require that when the Commission is drafting or amending relevant guidelines in relation to the bill it must, at a minimum, consult with any body or association in Hong Kong that, under a Hong Kong Ordinance, is provided with regulatory, supervisory or representative functions or responsibilities in relation to an industry sector to which the relevant guidelines wholly or substantially relate; and
- seek an amendment to section 129 of the Bill (Functions of the Commission) so that the Commission is required to consult with any body or association in Hong Kong that, under a Hong Kong Ordinance, is provided with regulatory, supervisory or representative functions or responsibilities in relation to an industry sector before commencing any investigation or enforcement action in fulfilment of its function under paragraph (a) of that section ("to investigate conduct that may contravene the competition rules and enforce the provisions of this Ordinance").

- 3.5.1 Under the Bill, the existing role of the Telecommunications Authority and Broadcasting Authority as the primary competition regulator in relation to their respective sectors is retained. According to paragraph 7 of Chapter VI of the May 2008 Consultation Paper, this is for reasons that include the merit of retaining this "specialist knowledge" of the sector.
- 3.5.2 HKAB supports this approach, and also believes that it is appropriate to ensure that the expertise of existing banking regulators such as HKMA and other key banking sector representatives is appropriately utilised by the competition regulator.

3.5.3 In particular, HKAB recommends that the Government take steps to ensure that the banking regulators and other key banking sector representatives are consulted by the Commission in respect of key activities that it is required or may seek to undertake, such as:

- undertaking relevant investigations and enforcement actions; and
- developing relevant guidelines,

specifically relating to the banking sector.

Consultation before undertaking relevant investigations and enforcement actions

3.5.4 HKAB believes consultation between banking sector representatives and the Commission should occur prior to the Commission seeking to open any investigations or enforcement action pertaining to the sector. Open dialogue between competition regulators and sectoral regulators for the purposes of ensuring informed decision is common in many mature competition law jurisdictions, and has even been formalised in some areas¹⁰.

3.5.5 For example, HKMA responsibilities extend beyond prudential supervision of the banking sector and include monitoring the conduct of banks to ensure they act in a manner which is not detrimental to the interests of customers. HKMA also works with other regulators such as the SFC to ensure that there is an open market and level playing field for service providers in their relevant sectors. These functions and duties provide HKMA with special knowledge of Hong Kong's banking industry and the optimum competition environment for the sector.

3.5.6 Accordingly, HKAB believes it will be appropriate for the Commission to liaise closely with HKMA and obtain its input in relation to issues such as appropriate market definition, and the market effect and public policy benefits of common industry practices.

3.5.7 Dialogue with banking regulators will also be prudent to ensure that any remedies sought by the Commission are appropriate with regard to the prudential operation of the banking sector.

3.5.8 For example, under section 1 of Schedule 3 to the Bill, the Competition Tribunal has very broad powers to make orders with respect to a contravention of the competition rules, including orders requiring a person to dispose of assets and operations, and orders mandating the provision of services or access to facilities. It is expected that such orders would most commonly be considered upon application by the Commission in the context of a particular enforcement action.

3.5.9 To the extent that such cases may concern participants in the banking and financial sectors, it will be important that the Commission works closely with the banking regulators to ensure that any enforcement orders are not inconsistent with the obligations relevant instructions may have under sectoral regulations, such as line-of-business restrictions or restrictions on the portfolio of assets that banks can hold.

¹⁰ For example, in Norway the Competition Authority and The Financial Supervisory Authority have entered into supervisory cooperation arrangements.

Consultation before development of relevant guidelines

- 3.5.10 As noted in section 3.2 of this submission, HKAB believes that competition-orientated guidelines relating to relevant banking practices should be developed by the Commission as a priority, and published well prior to commencement of the Conduct Rules.
- 3.5.11 HKAB believes that these guidelines should be developed in consultation with banking regulators and other key banking sector representatives, to ensure (for example) that the guidelines address an appropriate range of banking practices and that the Commission is furnished with appropriate information regarding the rationale for and benefits from such practices.

How the consultation requirement should be integrated into the Bill

- 3.5.12 It is common practice for regulatory bodies to be required by law to consult with appropriate persons and institutions before engaging in key activities. For example, in the banking and financial sector, section 60A of the Banking Ordinance requires the HKMA to consult with bodies such as The DTC Association and HKAB when fulfilling key functions such as the drafting of rules prescribing information to be disclosed to the general public by authorized institutions (regarding financial affairs) and when calculating the capital adequacy ratio.
- 3.5.13 Accordingly, HKAB considers that relevant consultation requirements may be most appropriately incorporated into the Competition Bill via:
- an amendment to the existing section 35 (Guidelines), which provides that the Commission must consult any persons "it considers appropriate" when issuing or amending relevant guidelines relating to the Bill. Specifically, HKAB recommends that the Bills Committee seek an amendment to this section so that the consultation requirement is extended to require the Commission to, at a minimum, consult with any body or association in Hong Kong that, under a Hong Kong Ordinance, is provided with regulatory, supervisory or representative functions or responsibilities in relation to an industry sector to which the relevant guidelines wholly or substantially relate; and
 - an amendment to the existing section 129 (Functions of Commission), which lists the primary functions of the Commission. Specifically, HKAB recommends that the Bills Committee seek an amendment to this section so that the Commission is required to consult with any body or association in Hong Kong that, under a Hong Kong Ordinance, is provided with regulatory, supervisory or representative functions or responsibilities in relation to an industry sector before commencing any investigation or enforcement action in fulfilment of its function under paragraph (a) of that section ("to investigate conduct that may contravene the competition rules and enforce the provisions of this Ordinance").

3.6 Preserving the role and authority of existing sectoral regulators

Recommendation 6: HKAB recommends that the Bills Committee seek an amendment to section 129 of the Bill (Functions of Commission) so that the Commission will be precluded from conducting market studies in respect of industry sectors that are already supervised by a sectoral regulator empowered to review and respond to instances of market failure.

- 3.6.1 Section 129 (Functions of Commission) of the Bill empowers the Commission to conduct market studies into matters affecting competition in markets in Hong Kong.
- 3.6.2 No further details are provided in the Bill regarding the nature of such market studies, and their implications. However, it is recognised by HKAB that the Government may intend the market study powers of the Commission to be exercised in a similar manner to the market investigation powers that the Office of Fair Trading has in the United Kingdom under that jurisdiction's Enterprise Act 2002.
- 3.6.3 In this context, HKAB believes it is appropriate to ensure that mechanisms are built into the Bill to avoid unnecessary overlap in the functions of the Commission and existing sectoral regulators, particularly in the context of examining instances of market failure and how these may be best addressed.
- 3.6.4 With regard to the banking sector, HKAB notes that there is already significant regulatory oversight of banking markets in Hong Kong, through bodies such as the HKMA. As mentioned previously in this submission, the HKMA's supervisory role extends beyond mere prudential supervision of the sector to include reviewing and addressing a broad range of issues relating to malpractice and market failure.
- 3.6.5 For example, under the Banking Ordinance, the HKMA is required to promote proper standards of conduct and sound business practices by banks (section 7(c)), suppress or aid in suppressing illegal or improper practices in the sector (section 7(d)), and take steps to ensure banking business is carried on with integrity and in a manner not detrimental to the interests of depositors or potential depositors (section 7(g)).
- 3.6.6 Additionally, the HKMA scrutinizes the overall operation of the banking sector and may from time to time issue directives to banks aimed at ensuring they operate in a manner that enhances efficiency and serves the interests of customers. The HKMA may also liaise with Government representatives such as the Financial Secretary to recommend regulatory or structural changes as it deems appropriate.
- 3.6.7 HKAB therefore believes the HKMA's legislative responsibilities and the scope of its supervisory role is sufficient to ensure appropriate ongoing review of banking markets, and the HKMA's special knowledge of the banking sector also positions it as the most appropriate body to conduct any intensive assessment of specific banking structures or practices whenever this may be necessary. Accordingly, HKAB believes that it is appropriate for the scope of the Commission's market study powers to exclude review of the banking sector.
- 3.6.8 HKAB therefore recommends that the Bills Committee seek an amendment to section 129 of the Bill (Functions of Commission) to clarify that market studies should be restricted to sectors in which there is no existing sectoral regulator already in a position to review and if necessary act on any instances of market failure.

3.7 Appropriate Block Exemption Regulations:

Recommendation 7: HKAB recommends that the Bills Committee highlight to the Government the importance of the Commission introducing Block Exemption Orders or other exemptions and exclusions relating to relevant aspects of banking and financial sector practice, and for the Commission to consult foreign competition regimes and liaise with Hong Kong's banking sector representatives in order to achieve this end.

- 3.7.1 Many countries around the world have introduced competition law exemptions or other forms of sector-specific treatment for banks and/or other types of financial institutions, most commonly granted so as to reduce risk and uncertainty and ensure systemic stability.
- 3.7.2 In this context, HKAB believes that it is important for the Government to ensure that, once established, the Commission gives priority to considering the banking and financial sector and what types of exemptions and exclusions it is appropriate to adopt in respect of the sector.
- 3.7.3 The importance of this is well recognised around the world. For example, in Europe, the insurance sector benefits from a Block Exemption Regulation that allows European insurers to collaborate in certain specified circumstances that may otherwise be subject to challenge under Europe's equivalent to the First Conduct Rule ("**the EU Insurance BER**").
- 3.7.4 Exemptions have previously existed in other jurisdictions for selected activities of financial institutions such as consortium lending and implementation of certain restrictive agreements, for reasons such as ensuring the stability of the banking system. Additionally, many merger regimes have incorporated special arrangements or provisions applicable to the banking and/or financial sector¹¹.
- 3.7.5 Importantly, even where exemptions or special arrangements of the type mentioned in clause 3.7.4 have been removed after a period of application, this has commonly occurred as part of broader steps to streamline administration of the relevant competition law regime and facilitate more 'self assessment' by businesses subject to the regime, rather than necessarily as a result of a change in perspective regarding whether the relevant business practices warrant clearance or some form of special treatment. Moreover, such steps are usually pursued only after the regime has been in place for a sufficient period of time to afford the business sector a high level of understanding regarding how the regime operates in practice and how broadly worded provisions and prohibitions will be interpreted and applied by the competition regulator(s) and courts. Obviously it will take some time to reach this point in Hong Kong, given that participants in most domestic industry sectors have not previously had to deal with the application of competition laws. Accordingly, in the lead-up to introduction of the Proposed Law in Hong Kong, it will be more appropriate to focus on ensuring clarity when it comes to implementing relevant guidelines and exemptions in the initial phase of regime implementation.

The EU Insurance BER as an illustration of why sector-specific issues require special treatment

- 3.7.6 The EU Insurance BER is a helpful case study in the context of this submission. The EU Insurance BER recognises that many forms of cooperation between insurers are necessary and appropriate in order for the insurance system to operate in a way that is both prudent and works best for customers, such as:

¹¹ For example: (a) Prior to 1998, Finnish legislation included special provisions applicable to competition review of bank mergers; (b) the French Authorities have been required to consult with the banking regulator before taking a decision and to provide a full explanation, should they decide to deviate; and (c) prior to 1986, interbank agreements and mergers involving banks were exempted from Canada's competition law.

- the sharing of information to make prudent premium calculation possible and limits the risk of vigorous market-based competition proving ruinous in insurance markets; and
 - certain insurance pooling arrangements to assist the industry to properly accommodate insurance risks.
- 3.7.7 The European Commission recently reviewed the scope of the EU Insurance BER and decided to continue these aforementioned exemptions for a further 7 years.
- 3.7.8 HKAB believes that there are a number of areas where issues broadly analogous to those referenced in paragraph 3.7.6 arise in relation to the banking and financial sector, such as in respect of the activities mentioned in paragraph 3.2.5 of this submission.
- 3.7.9 Accordingly, the HKAB believes it will be appropriate for the Hong Kong Government to ensure the Commission makes it a priority to:
- (a) identify areas of business activity that are properly excluded from, or specially dealt with under, the Conduct Rules; and
 - (b) more generally liaise with representatives of the banking sector to determine where existing industry arrangements are already subject to appropriate regulation and control or should otherwise properly fall outside of the proper ambit of competition review.
- 3.7.10 HKAB recognises that, given the existing mechanisms in the Bill for the Commission to consider and introduce Block Exemption Orders after it has been established, it may be unnecessary or extraneous to include a specific reference in the Bill to the need for such orders or other exclusions specific to the banking sector. Accordingly, at this stage HKAB recommends that the Bills Committee focus on highlighting to the Government the importance of ensuring that the Commission introduces Block Exemption Orders or other exemptions and exclusions covering relevant aspects of banking and financial sector practice, and for the Commission to consult foreign competition regimes and liaise with Hong Kong's banking sector representatives in order to achieve this end.
- 3.8 **A level playing field where banks compete with statutory bodies:**

Recommendation 8: HKAB recommends that the Bills Committee seek amendments to the Bill to remove any specific form of exemption for statutory bodies. Alternatively, if this recommendation is not adopted, or the Government continues to resist this form of amendment to the proposed competition law regime, then HKAB recommends that the Bills Committee:

- request that, as soon as possible, the Government should publish a preliminary list of those statutory bodies (and the scope of their activities) that the Government favours making subject to the Conduct Rules in accordance with section 3 of the Bill, and should then allow submissions to be made by interested parties regarding the list before it is finalised; and
- highlight to the Government the importance of ensuring that any statutory body which provides goods or services in competition with private sector entities should be required to comply with the Conduct Rules when providing those goods or services (subject to the application of other relevant exemptions and exclusions), including the Hong Kong Export Credit Insurance Corporation ("HKECIC").

- 3.8.1 Section 3 of the Bill effectively excludes statutory bodies from the scope of the Conduct Rules, except and to the extent that one or more particular statutory bodies (or certain activities of one or more statutory bodies) are specified in regulations made by the Chief Executive in Council.
- 3.8.2 Based on statements made by the Secretary for Commerce and Economic Development in June 2010, HKAB understands that the Government is reviewing the activities and functions of all statutory bodies in Hong Kong, and will announce in due course which of these bodies will be (or have certain of their activities) specified in a regulation made by the Chief Executive in Council under section 5 of the Bill with the effect that those bodies/activities will be subject to the Conduct Rules.
- 3.8.3 HKAB does not believe that a compelling case has been made for the introduction of a specific exemption for statutory bodies (or certain activities of statutory bodies) from the Proposed Law, and believes that inclusion of such an exemption undermines principles of fairness and promotion of a 'level playing field' for businesses in Hong Kong.
- 3.8.4 As noted in previous consultation papers, many (but by no means all) statutory bodies engage in activities that are not economic in nature, or provide services that may be considered essential public services, and thus may benefit from separate forms of exclusion or exemption from the law. However, HKAB strongly believes that activities of statutory bodies that do not fall into these categories should be subject to the Conduct Rules, particularly where undertaken in competition with private sector entities.
- 3.8.5 To date, HKAB is aware of only two main arguments that the Government has raised in support of the proposed exemption for statutory bodies, being¹²:
- to shield such bodies from unfounded and misconceived complaints; and
 - anti-competitive conduct in the private sector is the main competition-related concern of the public.
- 3.8.6 HKAB believes that these arguments are obviously flawed, for reasons that include the following:
- In relation to the issue of unfounded and misconceived complaints, it is noted that section 37 of the Bill provides that the Commission is not required to investigate a complaint if it is satisfied that the complaint is "trivial, frivolous or vexatious" or "is misconceived or lacking in substance", and this safeguard against such complaints would automatically apply in relation to any complaints relating to statutory bodies. In any case, it is difficult to see why any concern about statutory bodies being required to deal with such complaints is not equally a concern in relation to the private sector.
 - In relation to the issue of the 'main' concerns of the public, it is not clear how the Government has reached this view. Even if it is correct that submissions made by the general public during consultation on the Proposed Law focussed on conduct by the private sector (and this is unclear), this could not reasonably be viewed as

¹²

Refer paragraph 16 of Chapter VII of the May 2008 Consultation Paper, where it is stated that "This approach [of exempting statutory bodies] should help ensure that the operation of ... statutory bodies would not be affected by unfounded and misconceived complaints" and "Feedback from the previous consultation exercise and subsequent discussion with stakeholders indicated that the main concern of the public is anti-competitive conduct in the private sector".

indicating that the public accepted or was unconcerned by anti-competitive practices by statutory bodies. Rather, HKAB submits that it is reasonable to expect that the public interest demands that the Bill be framed in a manner that reflects the aim of fairness and a level playing field, and thus should be capable of addressing anti-competitive practices in all areas of Hong Kong's economy.

- 3.8.7 Accordingly, HKAB's primary recommendation to the Bills Committee in relation to this issue is that the Bills Committee seeks to amend the Bill to remove any specific form of exemption for statutory bodies.
- 3.8.8 However, if this recommendation is not adopted, or the Government continues to resist this form of amendment to the proposed competition law regime, then HKAB suggests that it will be important for the Bills Committee to highlight to the Government the need for greater transparency and consultation in relation to its ongoing review of statutory bodies in the context of section 3 of the Bill, as well as reinforce to the Government the need to ensure that any statutory body that acts wholly or partly as a commercial entity in competition with private sector entities is specified to be a non-exempt body in the context of the aforementioned section.
- 3.8.9 In this context, HKAB welcomes the inclusion in section 5(2) of the Bill of a list of criteria that the Chief Executive should have regard to before deciding to specify a particular statutory bodies or certain of its activities in accordance with section 3, namely that:-
- the statutory body is engaging in an economic activity in direct competition with another undertaking;
 - the economic activity of the statutory body is affecting the economic efficiency of a specific market;
 - the economic activity of the statutory body is not directly related to the provision of an essential public service or the implementation of public policy; and
 - there are no other exceptional and compelling reasons of public policy against making such a regulation.
- 3.8.10 In particular, HKAB welcomes the implicit recognition of the Government by inclusion of the aforementioned wording in the Bill that some statutory bodies compete against the private sector in certain markets, and in doing so may engage in activities that detrimentally affect the economic efficiency of those markets.
- 3.8.11 Indeed, HKAB notes that there are several key examples of entities that have been formed under an Ordinance, or are given certain monopoly or significant rights under an Ordinance, and who compete with member banks and other financial institutions or may be seen to engage in activities which materially affect the markets in which banks and financial institutions compete, such as:
- the Hong Kong Mortgage Corporation ("HKMC"), which competes with the private sector in providing mortgage guarantee and fixed adjustable rate mortgage programs;
 - the HKECIC, which offers certain insurance services to Hong Kong exporters; and

- Hong Kong Exchanges and Clearing Ltd ("**HKEx**"), which provides a trading venue that competes with the private sector "dark pools" which provide trading capabilities for Hong Kong listed equities.

3.8.12 If the broad exemption for statutory bodies is retained in the Bill, then HKAB understands:

- the exclusion of 'companies' from the definition of the term 'statutory body' in the Bill means that HKMC (which was incorporated in Hong Kong as a limited liability company under the Companies Ordinance on 3 March 1997) and HKEx would not benefit from the exemption, which position is supported by HKAB; but
- HKECIC would benefit from the exemption on the basis that it was formed under the Hong Kong Export Credit Insurance Corporation Ordinance, which position is not supported by HKAB on the basis that HKECIC clearly operates in competition with private sector entities.

3.8.13 HKAB submits that it is clear any failure to subject bodies such as the HKECIC to the Proposed Law would put them at a significant competitive and regulatory advantage over private organisations that were subject to such a law and the burdens it necessarily entails.

3.8.14 Accordingly, if the HKAB's primary recommendation to the Bills Committee in relation to this issue (that the Bills Committee seek to amend the Bill to remove any specific form of exemption for statutory bodies) is not adopted or able to be implemented, then HKAB recommends that the Bills Committee:

- request that, as soon as possible, the Government should publish a preliminary list of those statutory bodies (and the scope of their activities) that the Government favours making subject to the Conduct Rules in accordance with section 3 of the Bill, and should then allow submissions to be made by interested parties regarding the list before it is finalised; and
- highlight to the Government the importance of ensuring that, at a minimum, economic activities of statutory bodies such as the HKECIC should be made subject to the Conduct Rules, along with any other body that acts wholly or partly as a commercial entity in competition with private sector entities.

3.9 Other matters:

Recommendations 9 - 11: HKAB recommends that the Bills Committee consider seeking:

- removal of some of the restrictions on the process set out in Subdivision 2 of Part 2 of the Bill pursuant to which undertakings may apply to the Commission for a decision as to whether or not an agreement that they have entered into (or propose to enter into) would benefit from a relevant exemption or exclusion from the Conduct Rules;
- the introduction of a substantiality requirement into the Conduct Rules so as to ensure that conduct which exerts an insignificant or unappreciable effect on a market will not be subject to unnecessary regulatory intervention; and

- the introduction of certain 'de minimus' thresholds into the Bill to automatically exclude from challenge under the First Conduct Rule agreements of minor importance.

3.9.1 Paragraphs 3.1 to 3.8 of this submission address the priority concerns of HKAB members in relation to the Bill as at the date of this submission. However, HKAB would also like to briefly supplement the comments in those paragraphs with three further recommendations explained below.

Broadening the 'Application Process'

3.9.2 Clause 9 of the Bill provides that an undertaking may apply to the Commission for a decision as to whether or not an agreement that they have entered into (or propose to enter into) would benefit from a relevant exemption or exclusion (hereafter, the "**Application Process**") - including the exclusion under Schedule 1 of the Bill for agreements that enhance overall economic efficiency.

3.9.3 However, the Bill provides that the Commission is only required to consider such an application in certain specific circumstances, which include if the application "poses novel or unresolved questions of wider importance or public interest in relation to the application of exclusions or exemptions". Further, section 10 of the Bill provides that the Commission must publish notice of the application and accept representations from third parties in relation to it before any decision on the application can be made.

3.9.4 HKAB is concerned that these restrictions on the Application Process will in most cases deprive undertakings of any useful process for consulting with the Commission to receive comfort on the legality of their agreements.

3.9.5 In this context, HKAB notes that a much broader form of Application Process applied for many years in jurisdictions such as Europe. Although businesses operating under the European regime are now required to 'self assess' the legality of their agreements under Europe's primary competition law as mentioned in paragraph 3.7.5, the move away from having a broad form of Application Process only occurred after it has been in existence for many years, ensuring that the business sector had sufficient enforcement experience to draw on for reference and sufficient time in which to ascertain the interpretation and enforcement approach of the European regulators and courts.

3.9.6 In this context, HKAB considers that it is especially appropriate for businesses in Hong Kong to have access to an Application Process of broad scope, given that many such businesses will have never previously been exposed to competition laws and will require time to fully understand the nuances of its application.

3.9.7 Accordingly, HKAB recommends that the Bills Committee give consideration to seeking removal of some of the restrictions on the Application Process, so as to broaden its utility at least in the initial years of enforcement of the Proposed Law. In the same way that the Government has indicated that the need for cross-sector merger control provisions is something that can be further considered only after a period of review of the effect of the Proposed Law, it is submitted that the Government (and Commission) should only consider narrowing the scope of an initially broad Application Process after an initial period from which its ongoing utility can be assessed.

Threshold of harm

- 3.9.8 The First Conduct Rule effectively prohibits agreements or arrangements that have the purpose or effect of preventing, restricting or distorting competition in Hong Kong. The Bill does not specify that a certain 'threshold of harm' (such as an 'appreciable' or 'substantial' restriction or distortion of competition) must be achieved - or be the purpose - of a relevant agreement or arrangement before the First Conduct Rule is reached. Indeed, on its face the First Conduct Rule could be breached even by conduct that caused an extremely minimal restriction of competition - notwithstanding that such conduct would not normally be subject to challenge in most mature competition law regimes.
- 3.9.9 This can be contrasted with the prohibition that applies to relevant 'M&A' transactions involving telecommunications licensees - which is only breached if the relevant transactions "*substantially* lessen competition" in a relevant market.
- 3.9.10 In many other jurisdictions, similar thresholds of harm are specified in prohibitions that are broadly equivalent to the First Conduct Rule. For example, in Australia most anti-competitive conduct is not actionable unless it results in (or has the purpose of) substantially lessening competition.
- 3.9.11 HKAB supports the amendment of the First Conduct Rule to incorporate a substantiality requirement, to ensure that conduct which exerts an insignificant or unappreciable effect on a market will not be subject to unnecessary regulatory intervention.
- 3.9.12 HKAB recognises that a form of substantiality requirement could conceivably be introduced via Commission guidelines outlining its enforcement priorities. However, it is again noted that any guidelines issued by the Commission will not be binding on the judiciary. Accordingly, HKAB submits that the matter is best dealt with by amendment of the Bill, and encourages the Bills Committee to seek such amendment.

De minimis rule

- 3.9.13 Finally, and as a follow-on to the matters discussed in paragraphs 3.9.8 to 3.9.12 of this submission, HKAB supports the adoption of an appropriately framed 'de minimis' rule as part of the enforcement framework for the Proposed Law. Such a rule aims to take conduct that does not relate to a 'substantial part' of a relevant market (such as agreements between small and medium sized businesses) outside of the purview of the relevant competition law.
- 3.9.14 A useful example of such a 'de minimis' rule is found in the 'Guidelines on the Major Provisions' (of Singapore's Competition Act) published by the Competition Commission of Singapore, which state that:

"As Singapore is a small and open economy, an agreement will generally have no appreciable adverse effect on competition:

- if the aggregate market share of the parties to the agreement does not exceed 20 per cent on any of the relevant markets affected by the agreement where the arrangement made is between competing undertakings (i.e. undertakings which are actual or potential competitors on any of the markets concerned);*

- *if the market share of each of the parties to the agreement does not exceed 25 per cent on any of the relevant markets affected by the agreement, where the agreement is made between non-competing undertakings (i.e. undertakings which are neither actual nor potential competitors on any of the markets concerned);*
- *in the case of an agreement between undertakings where each undertaking is a small or medium enterprise ('SME')."*

3.9.15 As the equivalent prohibitions to the Hong Kong Bill's Conduct Rules in Singapore's Competition Act only apply where the relevant conduct has the effect of *appreciably* preventing, restricting or distorting competition within Singapore, the above 'de minimis' rule has the effect of ensuring that agreements that fall within the 3 stated categories will not (subject to relevant exceptions stated elsewhere in the Guidelines) be subject to review under relevant anti-competitive conduct prohibitions.

3.9.16 It is submitted that provisions or guidelines of this nature would be appropriate for inclusion in the Bill or subsequent enforcement guidelines, and HKAB encourages the Bills Committee to seek this outcome. This would assist to provide comfort to smaller businesses or participants in strongly contested markets regarding the potential impact of the Proposed Law, and relieve those businesses of some of the administrative and economic burden that may otherwise arise relating to legal review of all agreements.

4. Conclusion

HKAB requests that the Bills Committee give due consideration to the comments and recommendations set out in the submission, which are provided in the interests of ensuring that any new competition law in Hong Kong is implemented in a manner that balances the interests of safeguarding competition in Hong Kong with the benefits of facilitating the free play of market forces and continuing to promote a business-friendly environment in the region.

HKAB would be pleased to discuss or supplement this submission in any manner that may be useful for the Bills Committee, and any enquiries in this regard may be directed to:

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ANNEX A

EXECUTIVE SUMMARY (RECOMMENDATIONS)

For the reasons set out in the attached submission, HKAB makes the following recommendations to the Bills Committee regarding the Competition Bill:

- **Recommendation 1:** HKAB recommends that the Bills Committee seek an amendment to the definition of "legal requirements" in section 2 of Schedule 1 of the Bill, so that conduct engaged in or agreements made in compliance with any requirements applicable under codes of practice, circulars, guidelines or other directions or guidance in any form issued or endorsed by a Government-approved regulatory or supervisory authority in Hong Kong (or a relevant supranational body) are excluded from challenge under the Conduct Rules. Additionally, HKAB recommends that the Bills Committee highlight to the Government the importance of ensuring that the Competition Commission takes appropriate steps (in consultation with the banking sector) to effectively exempt from the Conduct Rules conduct in compliance with directives or guidance issued by relevant supranational bodies or any other foreign regulatory or supervisory bodies outside Hong Kong having jurisdiction over the undertaking concerned.
- **Recommendation 2:** HKAB recommends that the Bills Committee highlight to the Government the importance of ensuring competition-orientated guidelines relating to relevant banking practices are developed by the Competition Commission as a priority, in consultation with relevant sector representatives, and published well prior to commencement of the Conduct Rules. This could be done by amending section 35 of the Bill to include references to the banking and other sectors in the text that requires the Competition Commission to issue guidelines on its interpretation and enforcement approach, or by the Government liaising with the Competition Commission after it is established to emphasize the benefit of developing and prioritising such guidance.
- **Recommendation 3:** HKAB recommends that the Bills Committee seek an amendment to the Bill to introduce a definition of the term 'market', and that this definition expressly reflect the fact that the geographic scope of many product and service markets contested by undertakings in Hong Kong extends beyond the territorial boundaries of the Hong Kong S.A.R. and will commonly encompass mainland China and beyond.
- **Recommendation 4:** HKAB recommends that the Bills Committee seek an amendment to the Bill to expressly exempt vertical agreements and M&A agreements from the scope

of the First Conduct Rule. In the alternative, if M&A agreements are to be subject to challenge, then HKAB submits that this should be in accordance with specific merger review provisions that will ensure there are appropriate procedural safeguards and review thresholds.

- **Recommendation 5:** HKAB believes that the Bills Committee should highlight to the Government the importance of ensuring the Competition Commission consults with banking regulators and other key banking sector representatives before conducting investigations and enforcement actions in relation to the sector or when developing guidelines specifically relating to the sector. More particularly, HKAB recommends the Bills Committee:

(a) seek an amendment to section 35 of the Bill (Guidelines) to require that when the Competition Commission is drafting or amending relevant guidelines in relation to the bill it must, at a minimum, consult with any body or association in Hong Kong that, under a Hong Kong Ordinance, is provided with regulatory, supervisory or representative functions or responsibilities in relation to an industry sector to which the relevant guidelines wholly or substantially relate; and

(b) seek an amendment to section 129 of the Bill (Functions of Commission) so that the Competition Commission is required to consult with any body or association in Hong Kong that, under a Hong Kong Ordinance, is provided with regulatory, supervisory or representative functions or responsibilities in relation to an industry sector before commencing any investigation or enforcement action in fulfilment of its function under paragraph (a) of that section ("to investigate conduct that may contravene the competition rules and enforce the provisions of this Ordinance").

- **Recommendation 6:** HKAB recommends that the Bills Committee seek an amendment to section 129 of the Bill (Functions of Commission) so that the Commission will be precluded from conducting market studies in respect of industry sectors that are already supervised by a sectoral regulator empowered to review and respond to instances of market failure.

- **Recommendation 7:** HKAB recommends that the Bills Committee highlight to the Government the importance of the Competition Commission introducing Block Exemption Orders or other exemptions and exclusions relating to relevant aspects of banking and financial sector practice, and for the Competition Commission to consult

foreign competition regimes and liaise with Hong Kong's banking sector representatives in order to achieve this end.

- **Recommendation 8:** HKAB recommends that the Bills Committee seek amendments to the Bill to remove any specific form of exemption for statutory bodies. Alternatively, if this recommendation is not adopted, or the Government continues to resist this form of amendment to the proposed competition law regime, then HKAB recommends that the Bills Committee:
 - (a) request that, as soon as possible, the Government should publish a preliminary list of those statutory bodies (and the scope of their activities) that the Government favours making subject to the Conduct Rules in accordance with section 3 of the Bill, and should then allow submissions to be made by interested parties regarding the list before it is finalised; and
 - (b) highlight to the Government the importance of ensuring that any statutory body which provides goods or services in competition with private sector entities should be required to comply with the Conduct Rules when providing those goods or services (subject to the application of other relevant exemptions and exclusions), including the Hong Kong Export Credit Insurance Corporation.
- **Recommendation 9:** HKAB recommends that the Bills Committee consider seeking removal of some of the restrictions on the process set out in Subdivision 2 of Part 2 of the Bill pursuant to which undertakings may apply to the Competition Commission for a decision as to whether or not an agreement that they have entered into (or propose to enter into) would benefit from a relevant exemption or exclusion from the Conduct Rules.
- **Recommendation 10:** HKAB recommends that the Bills Committee consider seeking the introduction of a substantiality requirement into the Conduct Rules so as to ensure that conduct which exerts an insignificant or unappreciable effect on a market will not be subject to unnecessary regulatory intervention.
- **Recommendation 11:** HKAB recommends that the Bills Committee consider seeking the introduction of certain 'de minimus' thresholds into the Bill to automatically exclude from challenge under the First Conduct Rule agreements of minor importance.



Our Ref.: B1/15C

8 November 2011

The Chief Executive
All Authorized Institutions

Dear Sir/Madam,

Renminbi (RMB) business – Requirements on position squaring with the RMB Clearing Bank

The HKMA has received some enquiries from Participating authorized institutions (AIs) regarding the requirements on position squaring with the RMB Clearing Bank. To ensure the proper use of this supplementary RMB conversion channel, we would like to provide the following clarifications of the requirements that should be observed by all Participating AIs for position squaring in respect of RMB trade settlement transactions with the RMB Clearing Bank and to elaborate on the HKMA's supervisory expectations in this regard.

Position eligible for squaring with the RMB Clearing Bank

Cross-border trades

In determining whether trade transactions are eligible for position squaring with the RMB Clearing Bank, Participating AIs must be able to demonstrate that:

1. the trade transactions concerned are merchandise trade transactions (i.e. trade in services are not eligible);
2. such merchandise trade transactions must be cross-border with one leg of the trade touching the Mainland, as evidenced for instance by the delivery of goods to or from the Mainland, or having a trading partner located on the Mainland; and
3. the timing and sequence of the RMB conversion conducted by customers and the delivery of goods should be consistent.

Participating AIs should especially stay vigilant to cross-border merchandise trade transactions that are artificially structured to “round-trip” through Hong Kong (or other locations outside the Mainland) into Mainland China. Generally speaking, the flow of funds should not be contrary to the flow of goods for a cross-border merchandise trade transaction (e.g. RMB purchased for payment into the Mainland while the goods are also delivered into the Mainland and vice versa).

Supporting documents

To substantiate the flow of goods, invoice and sales agreement provided by the customers are not considered sufficient. In the circular dated 23 December 2010, the HKMA expects Participating AIs to request third-party documents from their customers, especially for cross-border merchandise trade transactions between related parties for verifying the genuineness of the cross-border trade transactions. Such third-party documents may include bill of lading, warehouse receipt, goods delivery note, customs-verified declaration form or other documents that can indicate the identity of the buyer and the seller of a cross-border merchandise trade transaction and the movement of goods consistent with information provided in the invoice and sales agreement.

Where third-party documents are unavailable or unable to clearly indicate the identity of the buyer and the seller of the cross-border merchandise trade transactions and/or the movement of goods consistent with information provided by customers in the invoice and sales agreement, assessment of the genuineness of the cross-border merchandise trade transactions should be supplemented by sufficient know-your-customer (KYC) and due diligence procedures. In particular, Participating AIs should be able to substantiate that the cross-border trade transactions and delivery routes for the merchandise have sound business case and are consistent with customers’ established business pattern and practices. The onus is on the Participating AIs to demonstrate to the HKMA that there are sufficient grounds to believe that the transactions are genuine cross-border trade transactions eligible for RMB position clearing with the RMB Clearing bank. Participating AIs should document their assessment including the reasons why third party documents are unavailable and why they consider these transactions are genuine cross-border trade transactions eligible for position squaring with the RMB Clearing Bank. On request, these documents should be readily made available for review by the HKMA.

Inward and outward remittances

Consistent with the above requirements, for an inward payment from the Mainland via a Mainland Correspondent Bank that is subsequently sold to the Participating AI and squared with the RMB Clearing Bank, the Participating AI receiving the inward remittance should not solely rely on the information given in the remittance instructions for determining eligibility for position squaring. It should liaise with the customer as recipient of the inward remittance, or the Mainland Corresponding Bank as appropriate, for additional trade-related information including third-party documents so as to substantiate that it is genuine cross border trade transaction. Similar due diligence and documentation are also required for outgoing payments into the Mainland for customers. If there are occasions where the conversion and payment of RMB takes place before shipment/delivery of goods, Participating AIs should have procedures to follow-up with customers for third-party documents to verify that the cross-border movements of goods are genuine and consistent with the direction of the payment made.

Positions not eligible for squaring with the RMB Clearing Bank

Participating AIs are expected to adhere strictly to the above requirements. They will be asked to unwind the RMB position squared with the RMB Clearing Bank if it is found that the underlying transaction is non-eligible trade transaction. If there are repeated instances of non-compliance, position squaring with the RMB Clearing Bank by a Participating AI may be suspended until inadequacies of its internal control in this respect are rectified. If AIs have questions on the eligibility of transactions to be squared with the RMB Clearing Bank, they should proactively approach the RMB Clearing Bank or their usual supervisory contacts at the HKMA for advice.

Compliance checking

To provide assurance that there is adequate ongoing monitoring of compliance in this regard, Internal Audit or Compliance Department of a Participating AI should conduct reviews of its top ten RMB cross-border merchandise trade transactions or the relevant remittances to verify the compliance with the relevant requirements should a net total of RMB200 million or above is squared with the RMB Clearing bank within a month. Such confirmation should be provided to the HKMA within seven days after each month-end. For the position of October 2011, Participating AIs may submit the confirmation on or before 14 November 2011. The HKMA will further verify as necessary the adequacy of compliance checking conducted by the Internal Audit or Compliance Department of the Participating AIs going forward.

If you have any question on this circular, please feel free to contact Ms Denise Tai at 2878 1589 or your usual supervisory contacts at the HKMA.

Yours faithfully,

Nelson Man
Executive Director
(Banking Supervision)