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Panel on Financial Affairs

Meeting on 5 December 2016

Bank of Communications (Hong Kong) Limited (Merger) Bill

Background brief

Purpose

This paper provides background information on the Bank of Communications (Hong Kong) Limited (Merger) Bill which is a Members' bill to be introduced by Hon CHAN Chun-ying into the Legislative Council ("LegCo"). It also summarizes the major views and concerns expressed by Members during deliberations of the Bank of Communications (Hong Kong) Limited (Merger) Bill which was a Members' bill introduced into LegCo by the then Hon NG Leung-sing in the Fifth LegCo ("the 2016 Merger Bill").

Background

2. To implement a bank merger, acquisition or transfer of business (collectively referred to as "merger") in Hong Kong, the institutions concerned must first obtain the relevant supervisory approvals of the Monetary Authority under the Banking Ordinance (Cap. 155) ("BO"). In addition, they should find a legally effective way to transfer the existing assets and liabilities to a new entity or to the institution which remains after the merger. Currently, there is no common international practice in effecting transfer of banking business. Mergers in Hong Kong involving locally-incorporated banks are normally effected by private legislation with the approval of LegCo.

3. The then Hon NG Leung-sing consulted the Panel on Financial Affairs ("FA Panel") on the proposed 2016 Merger Bill at the meeting on 6 July 2015. The 2016 Merger Bill was published in the Gazette on 18 December and 24 December 2015, and received its First Reading at the LegCo meeting of 22 June 2016.

4. The purpose of the 2016 Merger Bill is to provide for the transfer of the activities, assets and liabilities which constitute the retail banking business and private banking business of Bank of Communications Co., Ltd. ("BCOM") located in Hong Kong, currently operated through a branch in Hong Kong (i.e. BCOM, Hong Kong Branch) to Bank of Communications (Hong Kong) Limited ("BCOM (Hong Kong)"), which is a newly established and wholly owned subsidiary within the Bank of Communications group of companies of which BCOM is the ultimate holding company. After the proposed business transfer, BCOM (Hong Kong) will carry on the retail and private banking businesses (except for certain excluded property and liabilities) while BCOM, Hong Kong Branch will continue to carry on its corporate banking business and other businesses (excluding the retail and private banking businesses that are being carried out by BCOM (Hong Kong) on the day of the transfer).

5. A Bills Committee was formed in June 2016 to study the 2016 Merger Bill. The relevant Bills Committee held three meetings to discuss the Bill with BCOM, Hong Kong Branch, the Administration and the Hong Kong Monetary Authority ("HKMA"), and reported its deliberations to the House on 8 July 2016. Resumption of the Second Reading debate on the 2016 Merger Bill was included in the agenda of the LegCo meeting of 13 July 2016. However, owing to other pressing business LegCo had to transact, the 2016 Merger Bill did not resume Second Reading debate and was lapsed upon the prorogation of the Fifth LegCo on 16 July 2016.

Major views and concerns expressed by Members on the Bank of Communications (Hong Kong) Limited (Merger) Bill

6. The major views and concerns expressed by Members on the 2016 Merger Bill are summarized in the ensuing paragraphs.

Benefits of the proposed merger

7. Noting that after the proposed business transfer, the retail and private banking businesses would be carried out by BCOM (Hong Kong), whereas the corporate banking business and other businesses would remain

in BCOM, Hong Kong Branch, Members enquired how the proposed business transfer would benefit the development of the banks in the future.

8. BCOM, Hong Kong Branch pointed out that the proposed business transfer demonstrated the bank's long-term commitment to Hong Kong and its customers, employees and business partners by expanding and intensifying the retail and private banking businesses in Hong Kong in response to the growing demand for a variety of banking and financial services. The proposed business transfer was in line with the rising trend for international financial institutions to transfer their retail banking businesses to locally-incorporated subsidiaries. BCOM (Hong Kong) would be a licensed bank incorporated in Hong Kong with a corporate governance structure consisting mainly of the board of directors, board committees and senior management in accordance with requirements under BO. The governance of BCOM (Hong Kong) would be increasingly localized to interact with customers, employees and other business partners. Hence, strengthening the internal governance of the bank and enhancing the transparency of its operation.

Vesting of undertakings in Bank of Communications (Hong Kong) Limited

Scope of banking businesses to be transferred

9. Some Members raised concern as to whether the retail banking business and private banking business to be transferred to BCOM (Hong Kong) as well as the relevant exclusions (i.e. property and liabilities to be excluded from the proposed business transfer) were clearly defined in the 2016 Merger Bill.

10. BCOM, Hong Kong Branch advised that customers were classified into retail, private, corporate or institutional customers when they opened accounts with the bank. This would form a clear basis for determining which customer accounts should be transferred. The bank would make reference to, among other things, its books and records concerned, to determine whether certain businesses were part of the retail or private banking business, etc. Besides, as set out in the relevant definitions of the Bill, only those property, reserves and liabilities of BCOM, Hong Kong Branch which related in whole to private banking business, or in whole to retail banking business, or in whole to the retail banking business and private banking business, would be transferred.

Excluded property and liabilities

11. Pursuant to the definition of "excluded property and liabilities" in the 2016 Merger Bill, BCOM may specify, on or before the appointed day¹, by a resolution or resolutions of its board of directors, or by a certificate given by an authorized person of BCOM, certain property and liabilities of the retail or private banking business of BCOM, Hong Kong Branch to be excluded from the proposed business transfer. Members queried whether it was appropriate to confer on BCOM the power to designate such exclusions. There was concern that the power might give rise to possible loopholes for BCOM to manipulate the scope of transfer or exclusion, and undermine the certainty of whether certain customers/accounts would be transferred to BCOM (Hong Kong).

12. BCOM, Hong Kong Branch explained that BCOM would exercise the said power only in very limited cases. For instance, there might be some selected customers requesting to retain their accounts with BCOM, Hong Kong Branch and whom were appropriate to be retained by the Branch. Some contracts between BCOM, Hong Kong Branch and certain counterparties (e.g. service providers) which, for the sake of clarity and to avoid uncertainty, should be clearly specified that they would not be transferred to BCOM (Hong Kong). Also, for some foreign law governed contracts, steps were required to be taken under the relevant foreign law to individually transfer the contract to BCOM (Hong Kong). BCOM, Hong Kong Branch further pointed out that:

- (a) the 2016 Merger Bill contained saving provisions to ensure that nothing in the Bill would affect the legal rights of customers and other relevant stakeholders as a result of the proposed business transfer;
- (b) BCOM, Hong Kong Branch had been conducting due diligence review of its contracts and other instruments on an ongoing basis to ensure that the terms and conditions contained therein would secure an effective transfer of such contracts/instruments to BCOM (Hong Kong); and

¹ The board of directors of Bank of Communications (Hong Kong) Limited may determine an appointed day upon which the merger will take effect and that such appointed day must be notified by both Bank of Communications (Hong Kong) Limited and Bank of Communications, Hong Kong Branch in the Gazette.

- (c) where any property and liabilities of BCOM, Hong Kong Branch could not be transferred to BCOM (Hong Kong) as a result of them being governed by foreign laws, BCOM, Hong Kong Branch might hold any of those property and liabilities in trust absolutely for BCOM (Hong Kong) from the appointed day until the transfer and vesting was effective by completing all the necessary steps.

13. Some Members remained concerned and suggested that Mr NG Leung-sing, Member in charge of the 2016 Merger Bill, should consider moving Committee Stage amendments, or giving an undertaking at the resumption of Second Reading debate of the Bill, to specify the circumstances under which BCOM could or could not exercise the designating power in question. BCOM, Hong Kong Branch advised that the suggestion might not be practicable as it would be difficult to make an exhaustive list of the circumstances for BCOM to exercise, or not to exercise, the power in question.

Impact on customers

Notification to existing customers about the proposed business transfer

14. Members were concerned about how BCOM, Hong Kong Branch would ensure that its existing customers, in particular the dormant account holders and account holders residing outside Hong Kong, would be duly informed of the proposed business transfer, and how the personal data of customers would be protected during the transfer process.

15. BCOM, Hong Kong Branch advised that there would be a two-month notification period prior to the appointed day. The bank would issue letters of notification to its existing customers and set up a designated hotline to answer enquiries and provide assistance to the customers. The bank would also contact the holders of relevant dormant accounts² and account holders residing outside Hong Kong if they did not respond to the bank within the two-month notification period. To ensure protection for the dormant account holders, a matching escrow account would be maintained by BCOM (Hong Kong) upon transferring of relevant dormant accounts from BCOM, Hong Kong Branch.

² Accounts which do not have any transactions within 24 months.

16. As regards the transfer of personal data, BCOM, Hong Kong Branch emphasized that there were provisions in the 2016 Merger Bill stipulating that the business transfer should not result in a breach of any duty of confidentiality or a contravention of the Personal Data (Privacy) Ordinance (Cap. 486) or the data protection principles. BCOM, Hong Kong Branch had consulted the relevant government departments and the Privacy Commissioner for Personal Data on the relevant provisions and related arrangements, and the latter had not raised any issues of concerns.

Capital base and financial soundness of Bank of Communications (Hong Kong) Limited

17. Given that BCOM, Hong Kong Branch was a branch of BCOM which was a nationwide state-owned commercial bank well established in the Mainland with a huge capital size, whereas the BCOM (Hong Kong) would only be a subsidiary of BCOM established in Hong Kong with its capital size and financial soundness yet to be established, some Members were concerned whether the proposed business transfer would have an impact on the existing customers of BCOM, Hong Kong Branch. Members also sought information on the capital base and financial soundness of BCOM (Hong Kong) in examining how far the newly established subsidiary could provide sufficient protection for customers' interests.

18. BCOM, Hong Kong Branch emphasized that all relevant contracts and agreements (including long-term contracts) made with, given to or addressed to BCOM, Hong Kong Branch with respect to the retail and private banking businesses would be transferred to BCOM (Hong Kong) upon the transfer. The rights and liabilities under these contracts and agreements would be adequately protected in accordance with law. With a more transparent mode of operation and stringent controls under Hong Kong's regulatory regime, customers' assets and interests would be better protected after the transfer.

19. Regarding the capital adequacy of BCOM (Hong Kong), HKMA advised that the bank would be subject to the same statutory minimum capital adequacy ratio ("CAR") for locally-incorporated banks and minimum share capital level for licensed banks, which were set at 8% and \$300 million respectively. The CARs of locally-incorporated banks usually exceeded the statutory minimum level due to the need to meet other regulatory requirements under BO, and commercial considerations such as enhancing customers' confidence in the banks. When considering the banking licence application in respect of BCOM (Hong Kong), HKMA had

examined the bank's business plan, and considered that it could meet the statutory minimum share capital requirement for locally-incorporated banks. BCOM (Hong Kong) had to continuously observe the regulatory requirements on capital adequacy after the granting of banking licence.

Impact on employees

20. Some Members expressed concern about the possible impacts of the proposed business transfer on existing employees of BCOM, Hong Kong Branch. Members also enquired if the business transfer would fully recognize the years of services of existing employees and preserve their rights and accrued benefits under their employment contracts, and whether their promotion prospects would be affected.

21. BCOM, Hong Kong Branch stressed that the terms and conditions of employment contracts with BCOM (Hong Kong) would be in line with those with BCOM, Hong Kong Branch. All relevant contracts of employment of BCOM, Hong Kong Branch would be transferred upon the business transfer and deemed for all purposes to be a single continuing employment. The accrued benefits of existing employees, including their years of services, would also be fully recognized. Following the transfer of business, BCOM, Hong Kong Branch and BCOM (Hong Kong) would continue to expand their businesses, and the relevant employees were expected to have a better career prospect after the transfer.

22. As it might be difficult to classify the job duties of the existing staff of BCOM, Hong Kong Branch into retail and private banking businesses, or corporate and other banking businesses in making staff transfer, some Members suggested that the existing staff should be informed of, as early as practicable, whether they were to be transferred to BCOM (Hong Kong). BCOM, Hong Kong Branch took note of the concern and suggestion.

Bank mergers in Hong Kong

23. Some Members enquired about the existing legislative framework governing bank mergers in Hong Kong and the reasons for introducing a private member's bill into LegCo to effect a bank merger in lieu of seeking approval from the court on the transfer of banking businesses between the entities as in the case of merger and reorganization of companies.

24. The Administration responded that the role of the Government was to ensure consolidation in the banking sector would not undermine the stability and the effective working of the banking system, and that the

interests of the depositors and any concerned third parties would be properly protected. The Government conducted a study in 2006 to review the present framework for effecting bank merger by means of a private member's bill and examine the framework adopted by overseas jurisdictions in facilitating such bank mergers. The study revealed that there was no common international practice in effecting transfer of banking business, and that the introduction of private member's bills had been an effective way to take forward bank mergers. The views of the Judiciary were also sought then on whether the court should be designated as the sanctioning authority for the transfer of bank business. The Judiciary considered it not appropriate for the court to take on such a role, on the grounds that the transfer would involve a wide range of public policy issues falling outside the purview of the Judiciary, and the arrangements of effecting bank merger by private legislation in the status quo had worked well.

Latest development

25. HON CHAN Chun-ying will re-introduce the Bank of Communications (Hong Kong) Limited (Merger) Bill in the Sixth LegCo, and will brief FA Panel on the Bill on 5 December 2016.

Relevant papers

26. A list of relevant papers with hyperlinks is at **Appendix I**.

Council Business Division 1
Legislative Council Secretariat
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Appendix I

List of relevant papers

Date	Event	Paper/Minutes of meeting
6 July 2015	Meeting of the Panel on Financial Affairs	Information Note (LC Paper No. CB(1)1034/14-15 (01)) Minutes (paragraphs 3-20) (LC Paper No. CB(1)1258/14-15)
16 November 2015	President's ruling on the Bank of Communications (Hong Kong) Limited (Merger) Bill intended to be introduced by Hon NG Leung-sing	President's ruling (LC Paper No. CB(3)143/15-16)
22 June 2016	Bank of Communications (Hong Kong) Limited (Merger) Bill was introduced into the Legislative Council	The Bill Legislative Council Brief Legal Service Division Report (LC Paper No. LS24/15-16)
8 July 2016	The Bills Committee on Bank of Communications (Hong Kong) Limited (Merger) Bill submitted its report to the House Committee	Report (LC Paper No. CB(1)1111/15-16)