

# Representations on Case AD/01XX

14 Authorized Institutions (“**AIs**”) are asserting that their adherence to the practices in the Code of Practice (the “**Code**”) is exempted from the first conduct rule by virtue of Section 2(1) of Schedule 1 of the Competition Ordinance (Cap. 619) (the “**CO**”). AIs refer to licensed banks, restricted licence banks and deposit taking companies as a whole for the purpose of this representation.

The first conduct rule refers to the prohibition imposed by Section 6(1) of the CO: Section 6(3) of the CO. Section 6(1) of the CO provides that “[a]n undertaking must not—

- (a) make or give effect to an agreement;
- (b) engage in a concerted practice; or
- (c) as a member of an association of undertakings, make or give effect to a decision of the association,

*if the object or effect of the agreement, concerted practice or decision is to prevent, restrict or distort competition in Hong Kong.”*

Section 2(1) of the CO provides that “[t]he 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 “**Legal Requirement Exemption**”) Section 6(2) provides that “[u]nless the context otherwise requires, a provision of [the BO] which is expressed to apply to, or in relation to, an agreement is to be read as applying equally to, or in relation to, a concerted practice and a decision by an association of undertakings (but with any necessary modifications)”. It is evident that, in addition to an agreement, the Legal Requirement Exemption applies to a concerted practice and a decision by an association of undertakings to the extent that it is made for the purpose of complying with a legal requirement.

Whether there is an agreement, a concerted practice or a decision by an association of undertakings to adhere to the Code

The Competition Commission (the “**Commission**”) would like to know if the adherence to the practices in the Code amounts to an agreement, a concerted practice or a decision by an association of undertakings.

An “undertaking” means any entity, regardless of its legal status or the way in which it is financed, engaged in economic activity, and includes a natural person engaged in economic activity: Section 2(1) of the CO.

Als engage in banking business or the business of taking deposits in Hong Kong. Since these businesses are clearly economic activities, Als are undertakings. Hong Kong Association of Banks (“**HKAB**”) is the industry association of licensed banks while DTC Association (“**DTCA**”) is that of restricted licence banks and deposit taking companies. The Hong Kong Monetary Authority (“**HKMA**”) is the office of the Monetary Authority who regulates and supervises Als.

The Code is jointly issued by HKAB and DTCA and endorsed by the HKMA: Section 1.1 of the Code. Section 1.4 of the Code provides that *“HKAB and DTCA expect their respective members to comply with the Code. HKMA expects all institutions to comply with the Code and will monitor compliance as part of its regular supervision.”*

HKAB, DTCA and the Monetary Authority have decided that Als should conduct their businesses in accordance with the Code (the “**Decision**”). Als are expected to give effect both the letter and the spirit of the Code (the “**Expectation**”). The Expectation arises from the Decision. There is a decision by these associations of undertakings to adhere to the Code.

#### Whether the Decision is made for the purpose of complying with a legal requirement

The Commission would like to know if the Decision is made with the purpose of complying with any legal requirement.

A “legal requirement” means a requirement:

- (a) imposed by or under any enactment in force in Hong Kong; or
- (b) imposed by any national law applying in Hong Kong: Section 2 of Schedule 1 of the CO.

An enactment has the same meaning as Ordinance: Section 3 of the Interpretation and General Clauses Ordinance (Cap. 1). Adopting a literal interpretation, a requirement is imposed by an enactment if an Ordinance stipulates mandatory compliance to that requirement. A requirement is imposed under an enactment if the requirement is introduced through a piece of subsidiary legislation. The

legitimacy of the subsidiary legislation derives from the corresponding Ordinance.

The Banking Ordinance (Cap. 155) (the “**BO**”) is the primary legislation which governs banking business and the business of taking deposits. Section 11(1) of the BO provides that “[n]o banking business shall be carried on in Hong Kong except by a bank”. Section 12(1) provides that “[n]o business of taking deposits shall be carried on in Hong Kong except by an authorized institution”. A company which proposes to carry on a banking business or a business of taking deposits shall apply to the Monetary Authority for authorization to carry on that business: Section 15 of the BO.

The Monetary Authority shall refuse to authorize a company if any one or more of the criteria specified in the Seventh Schedule applicable to or in relation to the company are not fulfilled with respect to the company: Section 16(2) of the BO. Paragraph 12 of the Seventh Schedule provides that the Monetary Authority must be satisfied that the business (which includes any business that is not banking business or the business of taking deposits) of the institution is presently, and will if it is authorized continue to be, carried on with integrity, prudence and the appropriate degree of professional competence and in a manner which is not detrimental to the interests of depositors or potential depositors (the “**Criterion**”).

Guide to Authorization (the “**Guide**”) sets out, among other things, the Monetary Authority's interpretation of the authorization criteria and the grounds for revocation in the BO. The Monetary Authority may feel doubtful as to the integrity of an AI if it fails to comply with recognised ethical standards of conduct such as those embodied in various codes of conduct including the Code. In considering what action to take in respect of a breach of a code of conduct, the Monetary Authority would have regard to the seriousness of the breach, whether the breach was deliberate or an unintentional or unusual occurrence, and whether it could be detrimental to the interests of depositors or potential depositors: paragraph 4.96 of Chapter 4 of the Guide. The Monetary Authority may revoke the authorization of an AI if it no longer satisfies any of the criteria set out in the Seventh Schedule of the BO: Paragraph 5.6 of Chapter 5 of the Guide.

The minimum requirements for authorization are legal requirements imposed by the BO. A banking business or a business of taking deposits represents the primary business of an AI. The AI has to remain authorized to carry out these businesses. Failure to comply with the Code casts doubt as to whether the AI satisfies the minimum criteria for authorization. The authorization of the AI may be revoked if it

fails to fulfil any of the minimum criteria. HKAB and DTCA make the Decision with the purpose of facilitating AIs to meet the Criterion, which is one of the legal requirements to obtain and retain authorization.

#### The extent to which the Decision is made for the purpose of meeting the Criterion

The extent to which a decision of an association of undertakings is made for the purpose of complying with a legal requirement depends on whether the scope of the decision is larger than that of the legal requirement. The larger the scope of a decision is relative to the scope of a legal requirement, the lesser the extent to which the decision is made for the purpose of meeting that legal requirement. The scope of a decision or a legal requirement should be analysed in two dimensions. The first dimension is the number of undertakings which are expected or required to give effect to a decision or a legal requirement. If more undertakings are expected to adhere to a decision than a legal requirement, it can be reasonably inferred that the decision is made for some other purpose(s) in addition to complying with that legal requirement. The second dimension is the number of economic activities to which a decision or a legal requirement applies. If a decision applies to more economic activities than a legal requirement, the same implication can be drawn.

#### The scope of the Criterion

For easy reference, the Criterion is repeated as follows: the Monetary Authority must be satisfied that the business (which includes any business that is not banking business or the business of taking deposits) of the institution is presently, and will if it is authorized continue to be, carried on with integrity, prudence and the appropriate degree of professional competence and in a manner which is not detrimental to the interests of depositors or potential depositors.

An AI is required to fulfil, among other things, the Criterion so as to obtain or retain authorization. Neither the controllers, affiliated companies nor the subsidiaries of the AI have to meet the Criterion. Furthermore, the Criterion applies to all businesses of an AI.

#### The scope of the Code

Section 1.2 of the Code provides that “[the Code] is to be observed by authorized institutions (institutions) in dealing with and providing services to their customers...

*the principles of the Code apply to the overall relationship between institutions and their customers in Hong Kong. Institutions' subsidiaries and affiliated companies controlled by them which are not institutions and are not licensed, regulated or supervised by any financial regulators in Hong Kong should also observe the Code where applicable when providing banking services in Hong Kong, such as lending, remittance or gold bullion service."*

The HKAB and DTCA expect an AI, its subsidiaries and the affiliated companies controlled by it comply with the Code even if the subsidiaries and affiliated companies are not AIs. The Code applies to all businesses of these entities.

The scope of Decision is wider than the Criterion in the dimension of undertakings but not economic activities. The Decision is made for the purpose of complying with the Criterion to the extent when HKAB and DTCA expect an AI to comply with the Code.

The first conduct rule does not apply to the Decision with respect to AIs only.

#### The arguments of the Applicants

I will briefly deal with the arguments of the Applicants and explain why these arguments do not substantiate their assertion.

The Applicants assert that *'there is overseas precedent to show that the phrase "under an enactment" can be interpreted as referring to an act or a decision made in pursuance of or under the authority of an enactment, which in [their] case could refer to the Monetary Authority's statutory powers to impose supervisory sanctions under the [BO] in the event of failure to comply with the Code'*: paragraph 4.3.4 (c) of the Form AD. The requirement from the Monetary Authority to comply with the Code in effect amounts to imposing a legal requirement on AIs to comply with the Code, thus constituting a requirement imposed under any enactment in force in Hong Kong: paragraph 4.3.4 (c) of the Form AD.

The Applicants have not provided further information about that overseas precedent. I am not convinced by this argument. I opine that a requirement is imposed under an enactment only if that requirement is introduced through a piece of subsidiary legislation. I have not found any subsidiary legislation which imposes the requirement to comply with the Code on AIs. Compliance with the Code is an

expectation of HKAB, DTCA and HKMA instead of a requirement under any enactment.

The Applicants contend that *“compliance with the Code is a requirement under the [BO] in the sense that AIs have no margin of autonomy but must comply with the Code, because any non-compliance with the Code will call into question whether the AI concerned meets the minimum criteria for authorization under the [BO]”*: paragraph 4.3.4 (b) of the Form AD.

I am not persuaded by this argument either. The Commission considers that for the Legal Requirement Exclusion to apply, the relevant legal requirement must eliminate any margin of autonomy on the part of the undertakings concerned compelling them to enter into or engage in the agreement or conduct in question. The fact that an undertaking does not have any margin of autonomy does not imply that a legal requirement compels that undertaking to enter into or engage in the agreement or conduct. The absence of any margin of autonomy can be a result of something other than a legal requirement. HKAB, DTCA and HKMA expect an AI to comply with the Code. An AI does not have any margin of autonomy or scope for independent judgment not because the law has eliminated these. The absence of margin of autonomy or scope for independent judgment is the corollary of the Expectation. Therefore, compliance with the Code is not a requirement imposed by or under any Ordinance.

The Applicants contend that *“the Code has always been subject to extensive regulatory input and consultation, and should appropriately be considered to be an important element of the regulatory framework for AIs”*: paragraph 4.3.11 of the Form AD. This fact that the Code is an important element of the regulatory framework for AIs is irrelevant and does not support the case of the Applicants.

The Applicants argue that *“whilst the framework of the Code itself is not statutory, compliance with its provisions is overseen by the framework of the [BO] and in practice is tantamount in effect to a legal requirement for the purpose of the [CO]”*: paragraph 4.3.13 of the Form AD. The Applicants argue that the way the Code is enforced is similar to the way a legal requirement is enforced. Therefore, the Code is a legal requirement. This argument is flawed. The way a requirement is enforced has nothing to do with whether it is imposed by or under any Ordinance.

The Applicants opine that the supervisory action of the Monetary Authority exerts a

powerful deterrent effect to AIs and fosters strict compliance with the Code by AIs: paragraph 4.3.19 of the Form AD. This opinion does not support the case of the Applicants. The extent of the deterrent effect arising from the action of the Monetary Authority and the extent that AIs comply with the Code are all irrelevant.

The Applicants suggest that the Monetary Authority might not be satisfied that an AI conducts its businesses with integrity, prudence and the appropriate degree of professional competence if it does not comply with the Code. The Monetary Authority might be of the view that the AI fails to meet one of the minimum criteria for authorization (paragraph 4.3.21 of Form AD); or the interests of depositors or potential depositors of the AI are threatened by the AI continuing to be authorized; or the AI engages in business practices which would be likely to prejudice the interest of Hong Kong as an international finance centre (paragraph 4.3.23 of Form AD). As a result, the Monetary Authority might revoke the authorization of the AI. The potential consequence of failing to comply with the Code is very serious. The Applicants assert that *'the fact that [they] treat compliance with the Code as seriously as compliance with a condition of authorization makes it clear that, in effect, compliance with the Code is a legal requirement imposed under the [BO], and thus a "legal requirement" for the purposes of the [CO]'*: paragraph 4.3.22 of the Form AD. The seriousness of the consequence of not complying with the Code is irrelevant, so as the extent to which the Applicants treat compliance with the Code seriously.

The arguments of the Applicants do not support their case.

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