

## HKMA IMPLEMENTS MEASURES TO REFINE MANAGEMENT ACCOUNTABILITY

**The global financial crisis exposed corporate governance weaknesses of financial institutions around the world and regulators have since required the board and senior management of financial institutions to introduce better culture and ethics and changes to their corporate governance structures. Hong Kong is no exception.**

### Introduction

On 16 December 2016, the Securities and Futures Commission (SFC) took steps to enhance senior management accountability of licensed corporations via its manager-in-charge regime<sup>1</sup>, which became fully operational on 17 October 2017 following a six-month transition period. On 16 October 2017, the Hong Kong Monetary Authority (HKMA) took similar steps and published its new [guidance](#) on management accountability at registered institutions (Guidance). The measures are set out in a set of [FAQs](#) accompanying the Guidance.

### What are the key purposes of the Guidance and to whom does the Guidance apply?

The key purposes of the Guidance are to heighten personal accountability for the "management" of registered institutions (discussed below) and to augment the definition of "management". This will mean that more individuals will fall within the definition and therefore be subject to the HKMA's tighter scrutiny.

The Guidance applies to the "management" of registered institutions. The term "management" under the Guidance refers to:

- chief executives (CEs);
- alternate chief executives (ACEs)
- directors approved under section 71 of the Banking Ordinance<sup>2</sup> (BO);

<sup>1</sup> See Clifford Chance [briefing](#) on the SFC manager-in-charge regime.

<sup>2</sup> Only locally incorporated banks need to seek the HKMA's approval before it appoints a director.

### Key Issues

- Registered institutions are required to review their corporate governance structures and reporting lines and identify individuals who are principally responsible for particular businesses or functions of a regulated activity.
- The new measures are likely to prompt sensitive discussions similar to those that have taken place in the UK over the past few years.
- Registered institutions must also review indemnification, directors and officers insurance for all "in-scope" members of the management.
- Registered institutions need to submit relevant information on CEs, ACEs, directors and "section 72 managers" and an organisation chart to the HKMA and the SFC by 16 April 2018. Updates to the information must be submitted within 14 days.

- section 72B managers<sup>3</sup>;
- executive officers (EOs) approved under section 71C of the BO; and
- any other persons, not included in the above categories who are involved in the management of any business that constitutes a regulated activity (RA) for which the registered institution is registered.

The HKMA clarifies that independent non-executive directors (INEDs) or non-executive directors (NEDs) should not be regarded as part of the registered institution's management for the purpose of this Guidance, as they are not expected to be responsible for the day-to-day management of RAs or other businesses<sup>4</sup>.

## **What are the requirements introduced under the Guidance?**

Under the Guidance, registered institutions will need to identify at least one individual (Identified Individual) as principally responsible for (i) the overall management of the whole business of the registered institution; and (ii) managing each of the businesses or functions listed in paragraphs 2 to 8 of the Fourteenth Schedule to the BO<sup>5</sup> (Manager Functions), to the extent where these individuals are involved in the management of the business constituting any RAs. In this respect, if a Manager Function does not constitute any RAs, then no Identified Individual is required.

## **How to determine whether an individual should be identified as principally involved for a particular business or function?**

The Identified Individual must have sufficient authority within the registered institution in relation to the relevant RA and is accountable for the functions for which he or she is principally responsible for.

Generally, the CE is principally responsible for the overall management of the whole business of the registered institution. For the Manager Functions, the HKMA expects that a CE, ACE, director or section 72B manager be the Identified Individual for each relevant Manager Function; an EO alone would not be sufficient.

## **What is the HKMA's expectation on the identification of individuals as principally responsible for business that constitutes regulated activities?**

A registered institution may appoint more than one Identified Individual for a particular function. Similarities can be drawn from the mapping of managers to the "core functions" under the SFC's manager-in-charge regime. For example an individual can be identified as principally responsible for more than one business/core function. It is also not necessary for a person to be an employee of the registered institution, so long as that person has sufficient authority within the registered institution and is accountable for the function for which he or she is identified as principally responsible, but an independent

<sup>3</sup> Section 72B manager includes persons that are principally responsible for: (A) any of retail banking, private banking, corporate banking, international banking, treasury and any other business which is material to the authorized institution; (B) maintenance of the accounts or the accounting systems; (C) maintenance of systems of controls; (D) development, operation and maintenance of computer systems; (E) conduct of internal audits or inspections of the authorized institution's affairs or business; and (F) function of ensuring the authorized institution complies with laws, regulations or guidelines that are applicable to it.

<sup>4</sup> For NEDs and INEDs the FAQs note that the board has the ultimate responsibility for the operations and the financial soundness of the authorized institution.

<sup>5</sup> These are functions or businesses covered by section 72B managers.

third party (for example, with respect to an outsourced function) would not be eligible.

The Guidance also highlights that for other functions, such as compliance, risk management and internal audit, they are of no less importance than the front office roles with respect to the regulated activities business. If an individual is overseeing both regulated and non-regulated activities, he or she should be captured for the purpose of the Guidance.

## **EO Requirements**

One of the concerns the industry raised during the soft consultation was whether the Identified Individuals will need to be appointed as EOs. The HKMA clarified that while CEs, ACEs, directors, or section 72B managers are often also EOs, it does not require them all to be approved as EOs, as they may not be responsible for direct supervision of RAs on a day-to-day basis.

However the HKMA further clarified that the registered institutions should ensure that, other than in exceptional cases:

- i. all EOs are not more than one rank below the CE, ACE, directors or section 72B managers; and
- ii. at least one of the EOs for a given RA should be a CE, ACE, director or section 72B manager.

## **Implications – Personal Liability**

The HKMA emphasised that the Guidance does not change any approval or reporting requirements in relation to CEs, ACEs, directors, section 72B managers or EOs, or impose any additional regulatory obligations or legal liability on the management of registered institutions.

The HKMA has taken this opportunity to remind banks that under Part IX of the Securities and Futures Ordinance (SFO), a person involved in the management of the business constituting any regulated activities in registered institutions is a “regulated person”<sup>6</sup> and is subject to the disciplinary powers under the SFO.

The new reporting requirements will enhance the personal accountability of the board and senior management by removing ambiguity and clarifying the roles and responsibilities of each board and senior management members. This will allow the regulator to quickly identify the individual(s) responsible for the area at fault in any instance of regulatory breach.

## **Implications – Sensitive Discussions**

From an international perspective, the requirements under the Guidance are less prescriptive than those under the individual accountability regimes in the UK. For example, the UK requirements include the need to set out a person's duties in a statement of responsibilities. Whilst this is not required in Hong Kong, requesting a person who has not previously been directly subject to HKMA's scrutiny to be an Identified Individual may prompt difficult and sensitive discussions similar to those which have taken place in some UK financial institutions over the past few years.

The measures will also mean that registered institutions must review indemnification, directors and officers insurance for all "in-scope" members of the management to offer protecting from claims that may arise from the decisions and actions directors take within the scope of their duties.

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<sup>6</sup> Section 196(8)(c) of the SFO defines “regulated person” as including “a person involved in the management of the business constituting any regulated activity for which a registered institution is or was (as the case may be) registered.”

## **Timeline**

Registered institutions will have six months to prepare and submit the required information, including an updated organisation chart, by 16 April 2018.

## CONTACTS

### **Francis Edwards**

Partner  
T: +852 2826 3453  
E: Francis.Edwards  
@cliffordchance.com

### **Mark Shipman**

Partner  
T: +852 2825 8992  
E: Mark.Shipman  
@cliffordchance.com

### **Helen Fok**

Consultant  
T: +852 2825 8801  
E: Helen.Fok  
@cliffordchance.com

### **Rocky Mui**

Senior Associate  
T: +852 2826 3481  
E: Rocky.Mui  
@cliffordchance.com

### **Matt Feldmann**

Partner  
T: +852 2825 8859  
E: Matthias.Feldmann  
@cliffordchance.com

### **Donna Wacker**

Partner  
T: +852 2826 3478  
E: Donna.Wacker  
@cliffordchance.com

### **William Wong**

Consultant  
T: +852 2826 3588  
E: William.Wong  
@cliffordchance.com

### **Edward Johnson**

Partner  
T: +852 2826 3427  
E: Edward.Johnson  
@cliffordchance.com

### **Terry Yang**

Partner  
T: +852 2825 8863  
E: Terry.Yang  
@cliffordchance.com

### **Viola Lui**

Senior Associate  
T: +852 2825 8842  
E: Viola.Lui  
@cliffordchance.com

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One Connaught Place, Hong Kong

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