

ALLEN & OVERY

Mapping responsibility

HKMA extends focus on management and its accountability

On the day the transition period for the implementation of the Securities and Futures Commission's (SFC) Manager-in-Charge regime (MIC Regime) for licensed corporations ended, the Hong Kong Monetary Authority (HKMA) announced the introduction of a new Management Accountability Initiative (MAI) aimed at increasing the accountability of the senior management of Hong Kong registered institutions (RIs), i.e. Hong Kong banks registered to carry on one or more regulated activities (RAs) under the Securities and Futures Ordinance (SFO).¹

The MAI is intended to clarify the HKMA's expectations on the responsibility and accountability of RIs' senior management and enhance its information gathering on RIs' RAs, while requiring RIs to better identify lines of responsibility and accountability for their RAs.

Importantly, the existing framework for management approval/appointment under the Banking Ordinance, together with the liabilities imposed on management by the Banking Ordinance and the SFO in the context of RAs, remain unchanged.

The introduction of the MAI demonstrates the HKMA's continuing focus on the corporate governance of banks, which was most recently evidenced by its 2 March 2017 circular on bank culture reform and a newly revised Supervisory Policy Manual (SPM) module CG-1 on the corporate governance of Hong Kong-incorporated banks, which banks are required to implement by 1 January 2018.

In this bulletin, we provide an overview of the MAI, look at who the HKMA expects RIs to earmark under the MAI, consider how the MAI is expected to work with the existing regimes for executive officers (EOs) and managers appointed under section 72B of the Banking Ordinance (Section 72B Managers), consider the implications of reporting requirements to the HKMA and the SFC, and consider timing and next steps.

Given the similarities between the MAI and the MIC Regime, this bulletin should be read alongside our series of three bulletins on the MIC Regime, *The Manager-in-Charge Regime: Ruffling feathers in the year of the Rooster?*, which can be viewed [here](#), [here](#), and [here](#). Many of the practical considerations, issues around senior management responsibility and potential disciplinary action in those bulletins will apply equally to RIs as they prepare for the implementation of the MAI and corporate governance generally.

¹ <http://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2017/20171016e1.pdf>.

GENERAL

What is the MAI?

- The MAI requires every RI to identify (and disclose to the HKMA and the SFC) at least one individual principally responsible for: (a) the overall management of the whole of the business of the RI; and (b) each of seven business lines and six middle/back office functions listed in the Fourteenth Schedule to the Banking Ordinance (**Fourteenth Schedule**), but only to the extent that the individuals are involved in the management of the business constituting an RA for which the RI is registered.
- The business lines are: retail banking, private banking, corporate banking, international banking, institutional banking, treasury, and any other business that is material to the RI.
- The middle/back office functions are: finance, risk management, AML, IT, internal audit, and compliance.

Does the MAI change existing laws and regulations?

- Similar to the MIC Regime, the MAI is framed as a clarification of the HKMA's expectations and an enhancement of existing information gathering arrangements. It expressly states that the MAI is not intended to change the existing framework for management approval/appointment under the Banking Ordinance or impose any additional regulatory obligations or legal liabilities on the management of RIs.
- In large part, that is true. The individuals against whom the SFC may take disciplinary action, which includes "a person involved in the management of the business constituting any regulated activity for which [an RI] is or was (as the case may be) registered", has not changed, and it is arguable that the MAI is simply a clarification of the persons who may be held responsible should an issue arise.
- However, the HKMA has in the MAI expressed certain expectations, which may require changes to an RI's EOs. See *Does an RI need to change its EOs as a result of the MAI?* below.

Are non-executive directors (NEDs) and independent non-executive directors (INEDs) subject to the MAI?

- The HKMA excludes NEDs and INEDs from the management of an RI for the purposes of the MAI. As a result, NEDs and INEDs should not be identified by an RI as a principally responsible individual.
- However, this does **not** necessarily insulate NEDs and INEDs from disciplinary action. The Board of an RI has ultimate responsibility for an RI's operations and financial soundness, and an NED or INED could be considered "a person involved in the management of the business constituting any regulated activity for which [an RI] is or was (as the case may be) registered"², depending on the circumstances of a particular case.

PRINCIPALLY RESPONSIBLE INDIVIDUALS

Who should be identified as a principally responsible individual?

- The HKMA's general position is that the chief executive (**CE**) of an RI is principally responsible for the overall management of the whole of the business of the RI.
- As for the business lines and middle/back office functions, similar to the HKMA's existing expectations on the appointment of Section 72B Managers, the HKMA expects the principally responsible individuals:
 - to have sufficient seniority and authority³ within the RI over the relevant business line or function; and
 - therefore to be the CE, an alternate chief executive (**ACE**), (in the case of RIs incorporated in Hong Kong) a director other than an NED or INED (**HK Director**), or a Section 72B Manager of the RI.
- It appears from the HKMA's guidance that a director of an RI incorporated outside Hong Kong cannot be identified as a principally responsible individual unless he/she is also a CE or ACE of the RI.⁴

Can an RI comply with the MAI simply by identifying its existing Section 72B Managers as the individuals principally responsible for their respective business lines or functions?

- There will be situations where it is appropriate for the Section 72B Manager for a business line or function to be identified as the principally responsible individual. However, this may not always be the case, for example:
 - if the business line does not constitute one or more RAs for which the RI is registered, there is no need to identify an individual under the MAI;
 - where there is more than one Section 72B Manager for a particular business line or function, only the Section 72B Manager(s) principally involved in the management of that part of the business constituting an RA for which the RI is registered need be identified; for example, if responsibility is split between RA and non-RA business, only the Section 72B Manager(s) principally responsible for RA business would need to be identified under the MAI, though there will be difficulties where there is a significant overlap in day-to-day responsibilities; or
 - it may be more appropriate for a CE, ACE, or HK Director – none of whom can be appointed as Section 72B Managers – to be identified as a principally responsible individual for a business line or function.
- These examples demonstrate the potential complexity involved in implementing the MAI. For many institutions, divisions of responsibility within a business line will not be based on whether a particular activity is or is not an RA.

² See section 196 of the SFO.

³ See paragraph 2.3.3 of module CG-2 (Systems of Control for the Appointment of Managers) of the HKMA's SPM (**CG-2**), available [here](#).

⁴ See footnote 4 of module CG-2.

<p>Does a principally responsible individual need to be “fit and proper”?</p>	<ul style="list-style-type: none"> – Yes. However, RIs should not have to modify their existing systems to introduce a new check for fitness and properness since: <ul style="list-style-type: none"> – all CEs, ACEs, and HK Directors are required to be approved by the HKMA, and the HKMA will not approve a person unless he/she is fit and proper; – an RI is already required under module CG-2 (<i>Systems of Control for the Appointment of Managers</i>) of the HKMA’s SPM to have controls in place to ensure that all Section 72B Managers are fit and proper. – This means that RIs should only have to consider the fitness and properness of individuals (if any) elevated to the position of a CE, ACE, HK Director, or Section 72B Manager as a result of the MAI.
<p>Does a principally responsible individual need to be an employee of the RI?</p>	<ul style="list-style-type: none"> – For middle/back office functions, no, provided the individual has sufficient authority and seniority within the RI and is accountable for the function for which he/she is identified as being principally responsible. – For business lines, the position is less clear, as the HKMA’s guidance on this issue addresses “functions”. We see no reason why the guidance on middle/back office functions should not apply equally to business lines, which would be consistent with the MIC Regime. Clarification from the HKMA on this point would be welcome.
<p>Where an RI has outsourced certain functions to an independent third party, can an RI identify an individual at that third party to be principally responsible for that function?</p>	<ul style="list-style-type: none"> – No. Consistent with the MIC Regime and the HKMA’s general approach to outsourcing, the HKMA expects that the management of an RI should retain ultimate accountability for an outsourced function. Accordingly, only a member of the RI’s management (i.e. a CE, ACE, HK Director, or Section 72B Manager) should be identified as principally responsible for an outsourced function.
<p>How are temporary vacancies to be handled under the MAI?</p>	<ul style="list-style-type: none"> – Persons who are on a temporary basis principally responsible for the overall management of the whole of the business of the RI, or any of the business lines or functions specified in the Fourteenth Schedule, are not required to be identified under the MAI. – The HKMA has not set a bright line test for when a role would not be considered temporary, although it suggests that identification is not needed where a role is not expected to last for “more than a few months”.
<p>EXECUTIVE OFFICERS</p>	
<p>Are the individuals principally responsible for the overall management of the business of the RI or any of the seven business lines required to become EOs?</p>	<ul style="list-style-type: none"> – No. This is in contrast to the MIC Regime, which requires that the Overall Management Oversight and Key Business Line MICs be licensed by the SFC as responsible officers. – Only those CEs, ACEs, or HK Directors who are directly responsible for supervising the conduct of RAs should be appointed as EOs, subject to the ability of the HKMA to require that others be appointed.
<p>Does an RI need to change its EOs as a result of the MAI?</p>	<ul style="list-style-type: none"> – It depends on the RI’s existing corporate governance. – The HKMA has expressed two expectations as to whom an RI’s EOs should be: <ul style="list-style-type: none"> – RIs will need to have at least one EO for each RA who is also a CE, ACE, HK Director, or Section 72B Manager. This is similar to the statutory requirement for licensed corporations to have for each RA at least one responsible officer who is also an executive director; however, unlike licensed corporations, an RI would not commit a criminal offence if it does not satisfy this expectation. – All EOs must be no more than one rank below a CE, ACE, HK Director, or Section 72B Manager. We read this to mean that any EO who is not a CE, ACE, HK Director, or Section 72B Manager must report directly to such a person. – These expectations represent the HKMA’s general position; the HKMA has indicated it may be flexible where sufficient justifications can be provided.

BUSINESS LINES AND MIDDLE/BACK OFFICE FUNCTIONS

Does an RI need to identify a principally responsible individual for business lines that it does not carry on?

– No. This is consistent with the existing position for Sections 72B Managers. If an RI does not carry on a business line specified in the Fourteenth Schedule, there is no need to appoint a Section 72B Manager in respect of that business line.

Does an RI need to identify a principally responsible individual for business lines that do not constitute one or more RAs?

– No. It is only necessary to appoint a principally responsible individual for a business line where that business line constitutes one or more RAs for which the RI is registered.
– The RI will, however, need to appoint a Section 72B Manager with respect to such a business line if it falls within the Fourteenth Schedule.

Does an RI need to identify a principally responsible individual for business lines that constitute the RAs of leveraged foreign exchange trading (Type 3) or securities margin financing (Type 8)?

– No. It is only necessary to appoint a principally responsible individual for a business line where that business line constitutes one or more RAs for which the RI is registered. Hong Kong banks cannot be registered to conduct leveraged foreign exchange trading or securities margin financing.

Does an RI need to identify a principally responsible individual for a business line that constitutes one or more RAs for which the RI is registered but is not a business line specified in the Fourteenth Schedule?

– Yes. Any business that constitutes one or more RAs for which an RI is registered should be regarded as material to the RI, and therefore fall within the Fourteenth Schedule.
– In addition, to the extent this is not already the case, a Section 72B Manager should be appointed in respect of that business.

Can an RI identify more than one principally responsible individual for a business line or function?

– Yes. It will be very important, in the interests of both the RI and the identified individuals, to ensure that individual responsibilities are clearly allocated and that there are no gaps. Every part of a business line that constitutes one or more RAs for which an RI is registered must be covered by at least one principally responsible individual.

Can a person be a principally responsible individual for more than one business line or function?

– In most cases, yes.
– Although the HKMA's guidance does not specifically address conflicts of interest, we would expect the HKMA to query if an RI identified the same person to be the principally responsible individual for a business line and the compliance function, which is of course meant to be separate from an RI's business.



INITIAL SUBMISSION AND ON-GOING REPORTING REQUIREMENTS

What information is required to be submitted under the MAI?

- Similar to the MIC Regime, an RI (not the principally responsible individuals) is required to initially submit to the HKMA and the SFC:
 - certain basic information relating to each principally responsible individual (name, job title, business or function for which he/she is principally responsible, and upward reporting lines) by way of a prescribed form; and
 - an organisation chart depicting the RI's management and governance structure relevant to its RA business(es) and showing the CE, ACEs, HK Directors, and Section 72B Managers identified under the MAI, the individual businesses or functions for which they are responsible, as well as the job titles of their upward and downward reporting lines.
- For an RI incorporated in Hong Kong, the organisation chart should be consistent with the formal document adopted at Board level setting out the role, responsibilities, accountability, and reporting lines of senior management.⁵ That formal document will also need to be updated to reflect the introduction of the MAI.
- The HKMA also expects RIs to ensure that each principally responsible individual has acknowledged his or her responsibility for the particular business or function for which he or she is identified. Although documentation of this acknowledgement is not required to be submitted, RIs should ensure that this is in place so that it can be relied upon in the event the HKMA asks to see such documentation or there is a question in the future as to who had responsibility for what.

Do changes to the principally responsible individuals need to be reported?

- Yes. An RI must notify the HKMA and the SFC of changes to the individuals identified for the purposes of the MAI and/or their information previously submitted to the HKMA and the SFC within 14 days. Where one or more individuals change, an updated organisational chart should also be submitted.
- This 14 day deadline is longer than that for licensed corporations in respect of changes to their MICs (seven business days), but is consistent with the HKMA's existing approach for Section 72B Managers.

What else should RIs be aware of when considering the MAI reporting requirements

- The form for reporting changes to an RI's principally responsible individuals requires that a reason be provided where a person ceases to be a principally responsible individual. Providing an explanation will be straight forward where an individual ceases to be principally responsible due to resignation or change of role. Disclosure of reasons relating to an individual's fulfilment of management responsibilities or fitness and properness may, however, give cause for the HKMA or the SFC to make further enquiries, both of the RI submitting the form and of the former principally responsible individual.
- RIs should also keep in mind the need to ensure consistency in reporting to the regulators both under the MAI and under existing requirements, which include notifying:
 - the HKMA where they become aware of any material information which may negatively affect the fitness and properness of a board member or a member of senior management;⁶
 - the SFC (and in practice, the HKMA) where they suspect a material breach, infringement, or non-compliance with any law, rules, regulation, etc. by persons they employ or appoint to conduct business with clients or other intermediaries;⁷
 - the SFC and the HKMA where an event occurs that may have an impact on the fitness and properness of their relevant individuals;⁸ and
 - the HKMA where a Section 72B Manager is removed for fraud, dishonesty, or malpractice.⁹
- These other requirements – which have substantially shorter time limits – may as a practical matter mean that the HKMA and the SFC will need to be notified of the change in personnel much sooner than 14 days.

⁵ See paragraph 2.5.3 of module CG-1 (Corporate Governance of Locally Incorporated Authorized Institutions) of the HKMA's SPM (**CG-1**), available [here](#).

⁶ See paragraph 11.3.3 of CG-1.

⁷ See paragraph 12.5 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, available [here](#).

⁸ See the SFC's 11 May 2015 circular, Circular to Intermediaries Regarding Compliance with Notification Requirements, available [here](#).

⁹ See paragraph 6.1.5 of CG-2.

TIMING AND NEXT STEPS

When will the MAI commence?

- The HKMA and the SFC will commence collecting the required information from 16 March 2018.
- All required information must be submitted on or before 16 April 2018.

What does an RI need to do now?

- As with the MIC Regime, the MAI is more than a simple form filling exercise and will require a careful assessment of an RI's governance structure, personnel, and responsibilities in light of the MAI and to ensure consistency with other relevant governance requirements. In doing so, RIs should also take account of the HKMA's 2 March 2017 [circular](#) on bank culture reform and the HKMA's newly revised SPM [module CG-1](#) on the corporate governance of Hong Kong-incorporated banks.
- It is accordingly important that RIs consider their existing positions and any practical steps that may be required well in advance of April next year.

Does the MAI affect banks who later apply for registration as an RI or existing RIs who apply for additional registrations?

- From 16 April 2018, banks applying to be an RI, or to add a new RA, will need to include information under the MAI relevant to their applications.

Allen & Overy has extensive experience advising financial institutions on management responsibility, including the MIC Regime in Hong Kong and on similar regimes in other jurisdictions, such as the Senior Managers and Certification Regime in the UK, and is well placed to advise on the MAI. If you would like further information about how Allen & Overy can assist your firm in relation the MAI, please do not hesitate to contact us.

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