<u>ANNEX 2</u>

Guideline 1.6

BANKING ORDINANCE

(Chapter 155)

Guideline on activities that can be conducted at regional offices and back offices by overseas incorporated bank and restricted licence banks which are subject to <u>the "three-building condition" ("relevant banks and relevant RLBs")</u>

Background

Relevant banks are subject to the following condition (the "Three-building Condition") attached to their respective licences issued by the Monetary Authority:

> "The bank may maintain offices in not more than three buildings to which customers and others have access (physical or otherwise) for the purpose of banking business and/or for the arranging or entering into of any other financial transactions.
>
> In this context, the word "office" includes any automated teller machine or similar terminal device which provides facilities to customers or others.
>
> In addition to the offices mentioned in the first paragraph, the bank may, without restriction on numbers, maintain regional office(s) and back office(s) in a separate building or buildings to which customers and others have access (physical or otherwise) for the purpose of activities other than banking business or the arranging or entering into of financial transactions as set out in guidelines to be issued from time to time by the Monetary Authority."

2. Relevant RLBs are subject to the following condition (the "Three-building Condition") attached to their respective licences by the Monetary Authority:

> "The RLB may maintain offices in not more than three buildings to which customers and others have access (physical or otherwise) for the purpose of the business of taking deposits and/or for the arranging or entering into of any other financial transactions.

In this context, the word "office" includes any automated teller machine or similar terminal device which provides facilities to customers or others.

In addition to the offices mentioned in the first paragraph, the RLB may, without restriction on numbers, maintain regional office(s) and back office(s) in a separate building or buildings to which customers and others have access (physical or otherwise) for the purpose of activities other than the business of taking deposits or the arranging or entering into of financial transactions as set out in guidelines to be issued from time to time by the Monetary Authority."

3. Each relevant bank and relevant RLB may establish regional office(s) and back office(s) in a separate building or buildings to which customers and others have access. In the case of relevant banks, these offices will not be allowed to engage in banking business, namely, the receiving of deposits and the payment or collection of cheques drawn by or paid in by customers. In the case of relevant RLBs, these offices will not be allowed to engage in the business of taking deposits.

4. Relevant banks and relevant RLBs are also not allowed, at their regional offices and back offices, to arrange or enter into any other financial transactions of a type or nature that are normally transacted between a relevant bank or relevant RLB and its customers or counterparties (such as other authorized institutions), including loans, trade finance, buying and selling of foreign exchange, money market transactions and remittance business. Such activities must continue to be conducted by front offices of relevant banks and relevant RLBs. Relevant banks and relevant RLBs may however process, at their back offices, transactions that have been arranged or entered into by their front offices.

5. This guideline is issued for the purpose of providing guidance to relevant banks and relevant RLBs on the types of activities that can be conducted in their regional and back offices. For the purpose of this guideline, the term "front office" has the same meaning as the word "office" referred to in the "Three-building Condition".

Regional Offices

6. The typical activities which a regional office may carry out include:

(a) strategic planning, direction and control of regional operations;

(b) formulation of regional policies and monitoring compliance with such policies;

7 (c) providing administrative support at regional level including budgetary control, human resources management, evaluation of management in the region, research, etc;

(d) development, co-ordination and monitoring of group activities in the region;

(e) monitoring and overview of risk exposures including credit, country, currency, interest rate and liquidity risks;

(f) general liaison with correspondent banks, government bodies and corporate entities in the region;

(g) promotion of group products, services and activities and fostering of public relations on a regional basis (but not the sale of such products or services);

(h) approval of credit facilities that exceed the limits of regional branches;

(i) internal audit; and

(j) monitoring compliance with local laws and regulations by regional branches.

7. It is recognised that a regional office may from time to time need to have contact with customers who have business connections with other offices in the region under its control. However, it is expected that the regional office would confine its customer contacts to liaison activities and that no business of any kind should be undertaken.

Back Offices

8. For the purpose of this guideline, a “back office” is defined as one which carries out internal administrative functions on behalf of front offices and/or which is only involved in recording, processing or settling transactions already entered into or arranged by front offices. Apart from its separate location, a back office should be regarded as an integral part of the Hong Kong branch of the relevant banks or relevant RLBs and should be managed and controlled as such.

9. The typical activities which a back office may carry out include :

(a) internal administration (including personnel functions);

(b) accounting;

(c) data processing;

(d) loan administration, including the processing of drawdowns and repayment of facilities approved by front offices;

(e) processing trade financing documents including the issue and advising of letters of credit, confirmation of letters of credit, the negotiation of bills of exchange, collection of bills etc. insofar as these activities or transactions are covered by a trade finance facility already arranged or entered into with customers or counterparties by the front offices;

(f) despatch and receipt of confirmations;

(g) settlement of treasury transactions; and

(h) processing remittances through SWIFT, Telex and other electronic devices.

10. Although back offices may need to have contact with customers or counterparties for the purpose of carrying out the permitted functions, transactions with customers or counterparties must be arranged and entered into only by front offices of relevant banks and relevant RLBs. In particular, for relevant banks, cheques for collection on behalf of customers must be lodged with their front offices.

Compliance

11. Relevant banks and relevant RLBs which intend to establish regional and/or back offices in a building(s) separate from front offices are required to notify the Monetary Authority in advance of their intention to do so, the address of the proposed office(s) and the activities which they intend to carry out at such additional offices.

12. The Monetary Authority will check compliance of each relevant bank and relevant RLB with this guideline during regular on-site examinations conducted under the Banking Ordinance.

13. Failure to comply with the provisions of this guideline by a relevant bank or relevant RLB would be a breach of the above condition of its licence.

Monetary Authority

17 September 1999