This module should be read in conjunction with the Introduction and with the Glossary, which contains an explanation of abbreviations and other terms used in this Manual. If reading on-line, click on blue underlined headings to activate hyperlinks to the relevant module.

Interpretation

In this module:

- ***BELR*** means the Banking (Exposure Limits) Rules (Cap. 155S);
- unless specified otherwise, a reference to a Rule or a Part means a Rule or a Part respectively of the BELR

Purpose

To set out the manner in which the MA will exercise the powers of consent or approval under Part 3

Classification

A statutory guideline issued by the MA under the Banking Ordinance, §7(3)

Previous guidelines superseded

Guideline "Major Acquisitions by Authorized Institutions of Share Capital in Companies - §87A of the Banking Ordinance" dated 17.02.00; CR-L-5 "Major Acquisitions and Investments: §87A" (V.1) dated 31.08.01; and CR-L-5 "Major Acquisitions and Investments: BELR Part 3" (V.2) dated 09.08.19

Application

To all AIs incorporated in Hong Kong

Structure

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Annex 1

Illustration of exemption under Rule 23(2)(c) of the BELR

1. Introduction

1.1 Under Rule 23 of Part 3, an AI incorporated in Hong Kong should not acquire, whether by one acquisition or a series of acquisitions, all or part of the share capital[1] of a company to a value of 5% or more of the AI's Tier 1 capital at the time of the acquisition, except with a written consent from MA under Rule 24(1). Nor should such a shareholding continue if the consent is revoked by the MA subsequently. The restriction also applies to the establishment of a company.

1.2 The purpose of Part 3 is to enable the MA to establish criteria for reviewing major acquisitions or investments by an AI and ensure that corporate affiliations or structures do not expose the AI to undue risks or hinder effective supervision.

2. Supervisory approach

2.1 Tier 1 capital

2.1.1 For the purposes of Part 3, Tier 1 capital is as defined under section 2(1) of the Banking (Capital) Rules and is that which applies at the time of the acquisition of the relevant shares (see also section 2.3 below). Normally the figure as at the end of the previous quarter will be used for the sake of convenience. The MA may, however, require an AI to use its latest Tier 1 capital figure for this purpose if it has fallen significantly compared with the figure at the end of the previous quarter.

2.1.2 For calculating the 5% threshold, the value of the shares is that at which they would be shown in the books of the AI at the time of the acquisition, together with the amount for the time being remaining unpaid on the shares, if any. Normally this value will be determined by the cost of acquisition.

2.1.3 An AI is not required to seek the MA's prior consent (which may be given pursuant to Rule 24(1)) for an acquisition of the share capital of a company where the sum of the value of the

[1] As stipulated in Rule 21(2), a reference to "share" or "share capital" in Part 3 of the BELR includes a cryptoasset (as defined under rule 2(2) of the BELR) that conveys the economic substance of equity ownership. The same interpretation applies in this module.

acquisition and the value of the AI's existing holding of share capital of the company is less than 5% of the AI's Tier 1 capital at the time of the acquisition. The AI also does not have to seek the MA's consent where a subsequent fall in the AI's Tier 1 capital causes the value of its holding of share capital of the company to rise to 5% or more of the AI's Tier 1 capital. Similarly, the MA's consent is not required if a rise in the market value of an AI's existing holding of share capital of the company causes the current book value of such share capital to rise to 5% or more of the AI's Tier 1 capital.

2.2 Exemptions from the prior consent requirement on acquisition of share capital

2.2.1 Rule 23(2) sets out the following acquisitions where the threshold for the prior consent requirement on acquisition of share capital of company under Rule 23(1) does not apply:

- Rule 23(2)(a) – the acquisition of any share capital of a company in the course of the satisfaction of debts due to an AI [2] or under an underwriting or sub-underwriting contract for up to seven working days or such further period as the MA may approve in writing.
- Rule 23(2)(b) – the acquisition of any share capital of a company in the ordinary course of the insurance business of the AI or its subsidiary which is consolidated for the purposes of Rule 6 if –

  (i) the acquisition (A) is principally funded by the insurance premiums collected from the insurance business of the AI or the consolidated subsidiary, including any investment return and reinvestment return from such premiums and; (B) complies with applicable regulations imposed by the relevant insurance authority or regulator; and

  (ii) the AI and the relevant subsidiary have established adequate policies and procedures

[2] This includes an acquisition of share capital that an AI receives as a payment in the form of shares in lieu of an existing debt from a defaulting counterparty.

and have implemented them effectively to ensure that the share acquisition decisions in the insurance business are made independently from the share acquisition decisions in other business of the AI and the subsidiary.

- Rule 23(2)(c) – the acquisition of any share capital of a company that is booked in the AI's trading book, if the "assessment amount"[3] is less than –
  - (i) 5% of the amount of the AI's Tier 1 capital; or
  - (ii) a higher percentage approved by the MA in writing.

2.2.2 In plain language, Rule 23(2)(c) provides that if an AI's assessment amount does not exceed 5% of the AI's Tier 1 capital, the shares of the company acquired and booked in the AI's trading book is excluded from the prior consent requirement on share acquisition under Rule 23(1). An example is set out in **Annex 1**. This exclusion is mechanical and does not require the MA's approval.

2.2.3 An AI may apply for a higher threshold under Rule 23(2)(c). As a general policy, we only expect to accept applications from a specialized AI or small AI, which by nature has a smaller amount of capital and so the amount equivalent to 5% of its Tier 1 capital may appear inadequate for operational purposes. Interested AI should submit an application at an early stage, supported with the following information:

- the business case or class of business cases contributing to the need for a higher threshold;
- the proposed threshold;
- the rationale/justifications for the proposed threshold;
- any internal control measures to address

[3] As defined under Rule 23(5), the "assessment amount" refers to the part of the AI's aggregate equity exposure (within the meaning of Rule 13) that would be attributable to its equity exposures (within the meaning of Rule 9) to the company and be booked in its trading book, if the acquisition were made and the resulting equity exposure were duly booked.

concentration of risk exposures in a single company;

- any other factors that may assist the MA's decision.

2.2.4 The MA may approve a higher threshold if the MA considers that it is reasonable to do so having regard to:

- the nature of, and risks associated with, the relevant acquisition concerned in its business case or class of business cases;
- any policies and procedures implemented by the institution to monitor and control those risks; and
- any other factors that the MA considers relevant. For example, whether the share acquisition proposed to be subject to a higher threshold is consistent with the business model of the AI, the duration of the risk exposure and whether the proposed threshold level is excessive.

2.3 Consolidated supervision

2.3.1 The MA will, as appropriate, apply the provisions of Rule 23 on both a solo and a consolidated basis in accordance with Rule 6. This means that an acquisition of shares in a company through an AI's subsidiary which is consolidated for the purposes of Rule 6 will require the MA's prior approval if the total value of the shares acquired (whether by one acquisition or a series of acquisitions) at the time of acquisition is 5% or more of the AI's consolidated Tier 1 capital unless the exemptions under Rule 23(2) apply.

2.3.2 Subsidiaries included for consolidated supervision for the purposes of Rule 6 are generally the same as those included for consolidation under section 79A of the Banking Ordinance ("the Ordinance") which was in effect immediately before 1 July 2019, unless otherwise advised by the MA. See CR-L-1 "Consolidated Supervision of Concentration Risks: BELR Rule 6" for more information.

2.3.3 Under Rule 102, a notice given under section 79A of the Ordinance (former section 79A notice) requiring an AI to apply section 87A of the Ordinance on a certain basis is

deemed, if the notice was in effect immediately before 1 July 2019, to be a notice given under Rule 6(1) to the AI on that date requiring it to apply Rule 23 on the same basis as specified in the former section 79A notice.

2.4 Deemed consent

2.4.1 Under Rule 103(1), if an approval (i) given under section 87A(2)(a) of the Ordinance or (ii) deemed to be granted under section 87A(2)(a) of the Ordinance by virtue of section 87A(3) of the Ordinance (collectively referred to as "former section 87A(2)(a) approval" hereafter) was in effect immediately before 1 July 2019, the approval is deemed to be a consent given to the institution under Rule 24(1) on 1 July 2019.

2.4.2 A condition attached to the former section 87A(2)(a) approval, if it was in effect immediately before 1 July 2019, is deemed to be a condition attached to the deemed consent referred to in section 2.4.1 on that date. Besides, a condition is deemed to be attached to the deemed consent on 1 July 2019 requiring the institution to come to hold the share capital, that is the subject matter of the former section 87A(2)(a) approval, no later than 30 September 2019. In other words, if an AI was given a former section 87A(2)(a) approval before 1 July 2019 in respect of the acquisition of the share capital of a company to a value of 5% or more of the AI's capital base and the AI has not completed the relevant acquisition before 1 July 2019, the AI should complete the acquisition or the series of acquisitions no later than 30 September 2019. AIs must inform the MA if it fails to comply with any conditions deemed to be attached to the deemed consent.

2.5 Application procedures

2.5.1 AIs should contact the HKMA at an early stage to discuss intended acquisitions that may be captured under Rule 23. A formal notice in writing in advance of the acquisition should be submitted, seeking the MA's written consent under Rule 24(1). The notice should be accompanied by information on the proposed acquisition, including the following, where

relevant[4]:

- the name of the company being acquired;
- its place of incorporation or establishment;
- the value of the acquisition in money terms and as a percentage of the AI's Tier 1 capital;
- the impact of the acquisition on the AI's solo and consolidated capital adequacy ratios;
- the percentage of the company's shares that will be held by the AI and whether the company will become an associate or subsidiary of the AI as a result of the acquisition;
- how the acquisition will fit into the AI's group structure;
- how the acquisition will be funded;
- the nature of the business of the company and its internal control systems;
- financial information on the company (balance sheet, profitability, capital ratios, etc.) for three consecutive years;
- the management structure and corporate affiliations of the company;
- the proposed degree of involvement of the AI in the direction and management of the company's affairs, including representation on the Board of Directors;
- the proposed business plan for the company;
- the manner in which the investment will be managed and controlled by the AI, including reporting lines from the company to the AI and any limits established over the company's activities;
- whether the company is subject to any formal

[4] The relevance of some of the items will depend on whether the acquisition will represent a portfolio or a direct investment by the AI.

regulation or supervision in its place of incorporation or establishment, e.g. by stock exchanges or financial regulators, and if so the names of the regulators or supervisors concerned; and

- details of any secrecy constraints on disclosure of information to the AI by the company being acquired.

2.5.2 After receiving a formal notice, the MA will, as soon as practicable, issue either a written consent or refusal of consent to the AI.

2.5.3 The AI should inform the HKMA of any major changes to the above information between submission of the application for consent and the acquisition.

2.6 Refusal of consent

2.6.1 The MA may refuse to give written consent under Rule 24(1) if it is considered that the interests of depositors or potential depositors of the AI would be threatened by the proposed acquisition. In forming this view, the following factors will be taken into consideration:

- the financial capacity and ability of the AI to make the acquisition;
- the impact on the capital adequacy of the AI and its ability to fund the acquisition;
- the present financial condition and the possible future requirements of the company in terms of injections of capital and liquidity and any consequent drain on the financial resources of the AI;
- the managerial capacity of the AI to ensure that the activities of the company are conducted in a prudent and reputable manner;
- any undue risks to which the AI may be exposed arising from the acquisition. Factors to be taken into account would include:
  - the size and nature of the business of the company;

- the reputation and standing of the company;
- the present or proposed management structure of the company and the quality of its management;
- the present or proposed nature of the internal control systems within the company;
- the reporting lines to the AI and its monitoring arrangements (including the type and frequency of information to be provided);
- the arrangements within the AI to monitor the company and the amount of time to be devoted to such monitoring;
- the past experience and skills of the AI in managing its investments or acquisitions; and

- the place of incorporation or establishment of the company, in particular whether the relevant corporate laws are inconsistent with the laws of Hong Kong and whether there are any secrecy constraints which would inhibit effective consolidated supervision by the HKMA.

2.6.2 Where the MA intends to refuse to give consent, the AI will be advised of the proposed reasons in order to allow the AI to make representations, prior to making the final decision.

2.6.3 The formal notice of refusal of consent will specify the particular grounds on which the MA refuses to give consent for the proposed acquisition.

2.7 Conditions

2.7.1 Under Rule 24(2), the MA may attach conditions to a written consent given under Rule 24(1). Besides, a condition attached to a former section 87A(2)(a) approval, if it was in effect immediately before 1 July 2019, is deemed to be a condition attached to the deemed consent referred to in section 2.4.1 under Rule 24(2) (see section 2.4 above). Such conditions may be attached when the initial consent to acquire a company is given or subsequently, when the MA is of the view that such conditions are necessary to safeguard

the interests of depositors or potential depositors of the relevant AI. The conditions will be set out in a written notice specifying the reasons for them. Under Rule 24(4), the MA may by written notice to the AI attach a further condition to a consent given under Rule 24(1), or amend or cancel a condition attached to the consent.

2.7.2 In deciding whether to attach or amend attached conditions, the MA will take into account the same factors as those set out in section 2.6.1 above. Before the MA attaches conditions or amends attached conditions to any consent, the conditions, amendments to the conditions and the reasons for them will be discussed with the AI in order to give it an opportunity to make representations.

2.8 Revocation of consent

2.8.1 Under Rule 24(5), the MA may revoke a consent that has been given, or is deemed to have been given under Rule 24(1) (see section 2.4 above), if the MA considers that it is no longer reasonable to allow the AI to hold share capital of the relevant company to a value equivalent to 5% or more of the amount of the institution's Tier 1 capital. The relevant AI will be required to reduce its holding in the company concerned to less than 5% of its Tier 1 capital on or before the date the revocation comes into effect.

2.8.2 Such action may be taken when the MA is of the opinion that the interests of depositors or potential depositors of the relevant AI are threatened in some manner. The factors that will cause the MA to form this view are the same as those set out in section 2.6.1 above.

2.8.3 Where the MA intends to revoke a consent, the AI will be advised of the proposed reasons in order to allow the AI to make representations, prior to issuing the formal notice.

2.8.4 The formal notice will state the particular grounds on which the MA has revoked the consent and specify a period within which the AI should make the necessary reduction in its shareholding. Such period will be discussed with the AI and will be reasonable, taking into account the particular

circumstances of the case.

2.8.5 The MA will be prepared to consider an extension of the deadline for the reduction in shareholding if it is believed that the AI has made genuine attempts to achieve the disposal but has been unable to find a buyer for the shares within the original deadline.

2.9 Advance notice of other acquisitions

2.9.1 In addition to the statutory requirement under Rule 23, AIs are expected to notify the MA at least one month in advance of acquisitions that may have significant impact on their financial position, business strategy, managerial resources or reputation.

2.9.2 Examples of such acquisitions would include the following:

- those where the AI would become a significant shareholder in another financial institution, whether in or outside Hong Kong, and in particular where consent would be required from another regulator for such acquisitions;
- those which would result in the company concerned becoming a subsidiary of the AI and subject to consolidation for the purposes of Rule 6 or Part XV of the Ordinance;
- those which would have a material adverse impact on the capital adequacy ratio of the AI (say 0.5% or more); and
- those which would represent a significant diversification by the AI into a new line of business or into non-financial activities (including, for example, investment in a property company).

2.9.3 The MA reserves the right in such cases, following notification, to request the AI concerned to supply it with additional information along the lines specified in section 2.5.1 above.

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Illustration of exemption under Rule 23(2)(c) of the BELR

For example, an AI holds the following equity interests of company A:

(1) shares in the trading book with book value equivalent to 4% of its Tier 1 capital,

(2) an offsetting position in the trading book such that the overall equity exposure to company A in the trading book equivalent to 2% of its Tier 1 capital, and

(3) shares in the banking book with book value equivalent to 0.5% of its Tier 1 capital.

The AI's relevant equity exposure to company A for the purposes of the trading book exemption (i.e. equity exposures in the trading book) amounts to 2% of its Tier 1 capital.

If the AI plans to further acquire in its trading book shares of company A with book value equivalent to 1.5 % of its Tier 1 capital, at the time of acquisition, the AI's relevant equity exposure to company A in the trading book will equal 3.5% (i.e. 2%+1.5%) of its Tier 1 capital and the acquisition will be excluded from the threshold for consent under Rule 23(1) by virtue of Rule 23(2)(c).

However, if instead the AI plans to acquire in its trading book shares of company A with a value equivalent to, say, 4% of its Tier 1 capital, the AI's relevant equity exposure to company A in the trading book will equal 6% (i.e. 2%+4%) of its Tier 1 capital and the condition under Rule 23(2)(c) is not fulfilled. The aggregate value of shares acquired in company A (including the planned acquisition) will be subject to the threshold for consent under Rule 23(1). Given that the book value of shares of company A held by the AI at the time of the acquisition will exceed 5% (i.e. 4%+0.5%+4%) of the AI's Tier 1 capital, the AI should obtain the MA's prior consent to make the planned acquisition under Rule 23(1).