

Banking portfolio transfers: Key commercial and legal issues

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Summary

1. No statutory transfer mechanism in Hong Kong - need contract-by-contract transfers
2. Early communication between IT teams is key - to plan and manage data mapping process and transfer process (including ensuring compliance with data privacy rules)
3. Early communication with HKMA is key - to settle what client consents are required
4. Different types of client investment / loan products require different transfer mechanisms

Banking portfolio transfers, in particular those involving products for high-net-worth (HNW) clients, can be complex. This briefing provides a high level overview of key commercial and legal considerations.

1. Statutory transfer mechanism?

Hong Kong does not have a statutory banking business/portfolio transfer mechanism. This differs from other jurisdictions such as the UK and Singapore.

The usual mechanism for a banking business/portfolio transfer in Hong Kong is individual contract-by-contract transfers, with initial closing on a single day (possibly with subsequent specified days for late-consenting clients).

2. Where is the value?

- (i) AUM?

Often the purchase price will be determined with an eye on the valuation of the target assets under management (AUM).

- (ii) Relationship managers?

Substantial value resides in the relationship HNW clients have with their individual relationship managers. A key consideration for the purchaser is to ensure transfer and retention of the appropriate relationship managers, along with the underlying AUM.

3. Why is IT important?

Usually HNW acquisitions involve the acquisition of clients and the client products but not the transfer of software systems. Early communication between seller and purchaser IT teams is key in working out steps and timing to complete the transaction and avoid bottlenecks. Data mapping between software systems will take significant time. Dual running of systems prior to (and possibly after) closing is usual to reduce systems failure risk. Live data is often used on both systems and so data privacy issues will need to be managed.

4. What about data privacy?

The seller's data privacy terms and disclosures will be reviewed by the purchaser to determine how client data may be transferred and used.

5. How to wind down tail of clients left with seller?

In a regulated business, there will usually be a tail of clients which will take the seller years to wind down completely.

The seller will generally seek to reduce the tail of clients to as small a number as possible.

6. Client consents required?

The seller bank's terms of business usually include clauses whereby clients agree that their investment products may be transferred from the seller bank to the purchaser bank.

Notwithstanding those pre-agreed terms, the Hong Kong Monetary Authority (HKMA) will likely require new client consents for the transfer for certain categories of client, in particular for those clients who are depositors only. Deposits are a particular concern because a client's credit risk profile on repayment will change when the deposit is transferred from the seller bank to the purchaser bank.

7. How to transfer loans?

(i) Fully disbursed loans

Assignment is the usual approach for fully disbursed loans. The loan is an amount owed to the seller bank and therefore an asset which is capable of assignment.

For secured loans, assignment ensures that the seller loan 'continues' (and so that the related security continues). Transfer of the loan by novation suggests that the seller loan has been replaced by a different purchaser loan and so raises questions around whether the security extends to that replacement loan or whether the security is no longer effective.

(ii) Partially disbursed loans and security

For a partially disbursed loan, the seller bank has possible future obligations to make further loans. Obligations cannot be assigned and must be

undertaken by the purchaser. Although security usually continues in respect of a receivable (here the right to repayment) that is assigned, the analysis is more difficult when considering whether security extends to a new obligation (here, the purchaser's undertaking to make new disbursements).

This means that a careful analysis is required to work out whether new disbursements made by the purchaser would benefit from existing security granted to the seller. There are a number of mechanics that can be used to alleviate the concern (one of them being that standard loan terms in a HNW context often give the bank broad discretion to refuse to lend further amounts until the bank has received any documentation it considers necessary or desirable for such purpose).

8. How to transfer deposits?

(i) Assign or novate?

As noted above, obligations (such as the obligation to repay a client deposit) cannot be assigned and must be undertaken by the purchaser.

Although the transfer of a deposit can be drafted as an 'assignment and undertaking of obligations', in reality there is little 'assignment of rights' and most of the transfer relates to the purchaser undertaking obligations. There is a risk that the courts may therefore characterise the transfer as creating new client deposits with the purchaser bank, rather than a continuation of the seller bank deposits.

(ii) What if a client has secured its deposit for obligations it owes to the seller bank (e.g. loan obligations)?

In this scenario, it may be unclear whether a charge granted by a client over the client deposit held with the seller will continue because what is charged - the deposit - may no longer continue. As mentioned above, the purchaser bank deposit

may be treated as a new deposit, rather than a continuation of the seller bank deposit.

There are a number of mechanics that can be used to alleviate the purchaser's concern, such as set-off rights.

9. How to transfer equities, mutual funds, hedge funds, private equity funds, structured products?

These products relate to underlying client assets / investments where a seller bank custodian / nominee entity likely holds legal title on behalf of the beneficial owner clients. (If clients hold legal title themselves then no transfer is required.)

For such products, legal title to the assets should be transferred from the relevant seller bank custodian / nominee entity to the purchaser bank custodian / nominee entity (assuming the purchaser bank does not wish to continue to use the existing seller bank custodian / nominee). If this is not possible, sub-custodial arrangements should be considered.

10. How to deal with OTC derivatives?

Seller and purchaser bank product teams should discuss the commercial implications and practicalities of transfer of OTC derivatives (e.g.

ability to transfer associated hedges). Discussions should include the most efficient way for the purchaser bank to continue the seller bank's mirror-hedges for ongoing derivatives.

11. Registration/notices of transferred security required?

Registration requirements will be jurisdiction-specific and may include, for example:

- Registration of security with relevant companies registries
- Registration of security with relevant land registries
- Updates to chargor statutory books
- Annotations in share/debenture issuer's statutory books

Notices may be required to be made to payors of receivables which have been assigned in favour of the purchaser bank. Examples may include notices to tenants (where rental payments have been assigned to the purchaser bank) or notices to insurers (where insurance policy entitlements have been assigned to the purchaser bank).



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