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DIRECT DIAL
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BY HAND

Ms Bernice Wong
Legislative Council Secretariat
Legal Services Division
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Ms Wong,

CITIC Ka Wah Bank Limited (Merger) Bill (the "Bill")

Thank you for your letter fax dated 9 April 2002 in respect of the Bill requesting clarification of a number of points. For ease of reference I have set out our response beneath each point follow your order.

- 1. At the Financial Affairs Panel meeting on 9 April 2002, a Member has expressed concern that CITTC Ka Wah Bank Limited ("CKWB") is a listed company. Please confirm the steps that CKWB would take to protect its shareholders with regard to any contract or document governed otherwise than by the laws of Hong Kong containing a provision which prohibits or has the effect of prohibiting the transfer and vesting of the undertaking of CKWB, or a provision to the effect that default shall occur or deemed to occur as a results of such transfer and vesting. How soon would such due diligence be completed?***

1.1 Contracts and documents governed by Hong Kong law:

Those contracts and documents where the governing law is stated to be that of Hong Kong are transferred by way of the Bill, are the appointed day, from CKWB to The Hong Kong Chinese Bank, Limited ("HKCB"). The Bill includes, at Section 12, a

provision which, amongst other things, waives any provision which prohibits or has the effect of prohibiting the transfer to, and vesting in, HKCB of the undertaking of CKWB. Section 12 of the Bill also includes a provision to the effect that if a contract or document has a default clause, this shall also be waived. It should be noted, however, that the effectiveness of the Bill is not expressly limited to those contracts and documents governed by Hong Kong law.

1.2 Contracts and documents not governed by Hong Kong law:

Whether or not a Hong Kong ordinance, such as the Bill, has effect in a foreign jurisdiction is, in accordance with the principles of international private law, a matter for the law of the relevant foreign jurisdiction. In other words, in order to determine whether a contract governed by, say, English law is transferred (at the appointed day of the merger by the Bill) from CKWB to HKCB, the advice of English counsel would be required. Advice previously received is that some foreign jurisdictions' laws recognise the effect of Hong Kong bank merger ordinances but some do not. Accordingly if CKWB and HKCB were to rely solely on the Bill to transfer both Hong Kong assets and liabilities and non Hong Kong assets and liabilities comprising the undertaking, the concern raised at the Financial Affairs Panel is correct: Any contract and documents governed by a law of a foreign jurisdiction (which does not recognise the intended effect of the Bill) would not pass from CKWB to HKCB by virtue of the Bill and, if such contract or document includes a prohibition on merger clause, then Section 12 of the Bill (waiving such prohibitions) could not be relied upon. There is no legislative way around this problem because, if the Bill is not effective, any change to it will also not be effective such jurisdiction.

1.3 Due diligence and timing:

However it should be noted that in conjunction with the merger under the Bill, CKWB will seek the revocation of its banking licence by the Hong Kong Monetary Authority (the "HKMA") pursuant to the Banking Ordinance. As a matter of practice, the revocation of the transferring bank's banking licence occurs at the same time of the merger of its banking business, and accordingly the HKMA must usually agree to the date of the date of the merger.

Prior to agreeing to the revocation of the banking licence, the HKMA requires a law firm to opine to the HKMA's satisfaction that all the relevant assets and liabilities, including foreign law governed contracts, have been transferred. In anticipation of this (as with other bank mergers), Clifford Chance as CKWB's legal advisers, must assist in conducting due diligence, inter alia, to (i) identify all foreign law governed contracts and documents to which CKWB is a party; and (ii) take overseas' counsel's advice, where necessary, as to the steps required to transfer the foreign law governed contracts from CKWB to HKCB (usually by way of novation). Where any such foreign law governed contract or document includes a provision prohibiting merger and where such foreign law does not recognise the effect of the Bill, it is necessary to obtain the

relevant counterparty's consent to the merger. The HKMA monitors this process and has to be satisfied that the necessary steps have been taken before it revokes the merging bank's licence, in effect permitting the merger under the Bill to proceed. As a result, foreign law contracts and documents are dealt with on a case by case basis, individually, to ensure insofar as possible that these are transferred to the surviving bank and there is no breach of contract caused by the merger.

As the due diligence process must cover all relevant contracts and documents up to the merger and given the large volume of contracts and documents to which banks are generally a party, the process is usually completed immediately before the appointed day of the merger and after the enactment of the Bill.

1.4 Protection of CKWB's shareholders:

CKWB's listed on The Stock Exchange of Hong Kong Limited (the "SEHK") and the intends to maintain its listed status following the merger. The SEHK has reviewed the Bill.

HKCB is a wholly owned subsidiary of CKWB. There is no intention that CKWB should dispose of HKCB. After the merger HKCB (renamed "CITIC Ka Wah Bank Limited") will remain a wholly owned subsidiary of CKWB.

For the reasons set out in 1.3 above, CKWB will seek to ensure that contracts and documents governed by laws other than Hong Kong are transferred and default clauses are not breached. However this cannot be guaranteed as a foreign counterparty may always object or refuse to novate, or amend, the relevant contract or document. As with all other bank mergers, there is always this risk. Where the amounts or liabilities concerned are "de minimis" or immaterial to the business operation of CKWB, such contracts and documents would usually be terminated. In other cases, however, in order to protect CKWB, and ultimately its shareholders, CKWB will seek consent of the relevant counterparties.

The foregoing needs to be balanced against the ultimate benefits the merger will bring to CKWB's shareholders. The consolidation of the banking business of the CKWB group into a single bank will strengthen that business. HKCB will also remain owned by CKWB.

2. *Since CKWB is a listed company and The Hong Kong Chinese Bank, Limited is not, would the degree of protection to depositors be reduced after the merger?*

Immediately prior to the appointed day of the merger CKWB will apply to the HKMA pursuant to Part V of the Banking Ordinance to revoke CKWB's banking licence. In order to do this, the HKMA is required (by paragraph 19 of the English Schedule to the Banking Ordinance) to be satisfied that the interests of depositors of the bank will be adequately safeguarded. The HKMA has already approved, under Section 69 of the Banking Ordinance, the disposal by CKWB of its banking business to HKCB. After

the merger, as mentioned, HKCB will continue to be a fully authorised bank, regulated by the HKMA. As such, the degree of protection of former CKWB depositors should not be reduced after the merger. As the business of the two banks is consolidated, the contrary should be the case. In addition, as CKWB will continue to be HKCB's holding company, CKWB's listed status (compared to HKCB's non listed status) will not be relevant.

3. ***According to paragraph 8 of the Information Note dated 28 March 2002 [LC Paper CB(1) 140/01-02(01)], it is intended that only the banking business of CKWB will form part of the undertaking to be vested in HKCB. What are the property and liabilities intended to be excluded by way of resolution(s) of the board of directors of CKWB pursuant to paragraph (d) of the definition of "excluded property and liabilities" in Section 2(1) of the Bill?***

The definition of "excluded property and liabilities" in Section 2(1) of the Bill specifies what will constitute those property and liabilities which will be retained by CKWB. Sub-paragraph (d) of the Bill specifies that, in addition to the property listed in subparagraphs (a) to (c), CKWB's board of directors may by resolution add, with the agreement of HKCB, to such excluded property and liabilities.

It is not possible at this stage to provide an exact indication of what such property and liabilities to be excluded will comprise. As stated in 5. below, the appointed day under the Bill will likely occur towards the end of this year. However it is proposed (subject to regulatory approvals) that the excluded property and liabilities (to be retained with CKWB) will include:

- CKWB's listing agreement with the SEHK and related documentation;
- CKWB's shareholdings in HKCB and in CKWB's non-banking subsidiaries;
- Employment contracts of staff who will remain with CKWB;
- Loan agreements and related security documentation in respect of non-performing loans which have been sub-participated prior to the merger; and
- Any sub-participation agreements and enforced assets in respect of non-performing loans.

4. ***Is it intended to define "property" in Section 2(1) of the Bill without excluding "the excluded property and liabilities"? If so, please confirm that references to "property" in the Bill have been appropriately restricted to those property vested in HKCB by virtue of the Bills?***

Correct, the definition of "property" in Section 2(1) of the Bill does not exclude "excluded property and liabilities" (nor does the corresponding definition of "liabilities"). This is the same formulation as that used in the Bank of China (Hong Kong Limited (Merger) Ordinance. We confirm that references to property" as used

in the Bill have been appropriately restricted to the property vested in HKCB by the Bill.

5. ***When is the intended appointed day?***

It is not possible to identify the "appointed day" at this stage. The Bill provides, in Section 3(1), for the directors of CKWB to appoint a day in the same manner as the previous four bank merger ordinances. Such appointment by the directors of CKWB cannot be made until the Bill is enacted as an ordinance.

The main determinant for the timing of the appointed day is practical and relates to (i) the ability of CKWB and HKCB to integrate staff and systems before such date, and (ii) the ability of CKWB and its legal advisers to satisfy the HKMA to revoke CKWB's banking licence under the Banking Ordinance. With this in mind, it is anticipated that the appointed day should occur no later than December 2002. CKWB has confirmed to the necessary authorities that, pending the passing of the Bill, the appointed day (on which the merger of CKWB's banking business with HKCB becomes effective) will take place as soon as possible.

6. ***Section 9 of the Bill provides for taxation and revenue matters. Please clarify whether there is any loss sustained by CKWB with regard to the undertaking to be vested in HKCB which is capable of but has not been carried forward and set off against assessable profits.***

Section 9 of the Bill is substantially the same as the corresponding provisions in The Bank of China (Hong Kong) Limited Ordinance and the Mizuho Corporate Bank, Ltd (Hong Kong Consolidation) Ordinance. The purpose of the inclusion of an express provision in the Bill pertaining to the carrying forward of tax losses is to clarify and give certainty to the treatment of Hong Kong profits tax issues, including tax losses.

The effect of this section is consistent with Government policy on taxation as stated in the Government information note [CB(1)1408/01-02(03)] circulated prior to the Financial Affairs Panel meeting. The Inland Revenue Department have also commented on this provision. It is anticipated that certain losses sustained by CKWB with regard to the undertaking to be vested in HKCB will be carried forward and set off against assessable profits of HKCB.

7. ***Section 11 of the Bill relates to pensions, provident funds and gratuity benefits. Please let us know the estimated number of officers or employees of CKWB who would become officers or employees of HKCB by virtue of the Bill. Since some officers or employees would remain with CKWB, is there any need to qualify Section 10 of the Bill so that Section 7(a) would not apply to all contract for employment by CKWB?***

7.1 *Number of CKWB officers and employees to be transferred:*

As stated by CKWB at the Financial Affairs Panel meeting, not all of CKWB's staff will be transferred to HKCB, only those working in connection with CKWB's banking business. At the end of March 2002 the combined headcount of CKWB and HKCB was 1,490 (comprising 992 CKWB employees and 498 HKCB employees). Of the CKWB employees, CKWB anticipates that approximately 950 of its officers' and employees' contracts of employment will be transferred to HKCB before or at the appointed day of the merger pursuant to the Bill. As provided by the Bill, this will be treated as a continuous employment.

7.2 *Section 10 of the Bill:*

Section 10(1) of the Bill, which deals the treatment of contracts of employment of employees of CKWB, is qualified by the reference to Section 7(a) of the Bill. Section 7(a) of the Bill provides, in brief, that contracts entered into by CKWB must be construed as if HKCB were the party thereto. However Section 7(a) must be construed in conjunction with the first paragraph of Section 7 of the Bill which states that Section 7(a) has effect "other than in relation to the excluded property and liabilities"— in other words Section 7(a) only apply to contracts vested in HKCB. Accordingly if a contract of employment forms part of the excluded property and liabilities of CKWB (i.e. an employee is retained by CKWB and not transferred), Section 7(a) does not apply to it. Section 10(1) of the Bill clarifies that Section 7(a) applies to contracts of employment. However Section 7(a) cannot, for the reason provided, apply to any contract of employment which is excluded property and liabilities. Section 10(2) of the Bill does nor need to be qualified as it excludes from the effect of the Bill, the directors, secretary and auditors of CKWB. Accordingly we do not think it necessary to amend Section 10.

8. ***Section 14 of the Bill provides that document previously in the custody or control of CKWB shall by virtue of the Bill be deemed to be document previously in the custody or control of HKCB. Please consider whether the provision should apply only to document relating to the banking business of CKWB.***

Section 14(1) of the Bill provides that, in respect only of those "banker's records" of CKWB deemed to be vested in HKCB by the Bill, Part III of the Evidence Ordinance shall apply. Similarly Section 14(2) of the Bill only relates to those banker's records which have become HKCB's by virtue of the Bill.

Section 14(3) says that for the purposes of Sections 40 and 41 of the Evidence Ordinance documents previously in CKWB's custody or control, shall be deemed documents previously in HKCB's custody or control. Sections 40 and 41 of the Evidence Ordinance relate to documents in the possession of an authorised institution. An "authorised institution" is defined in Section 41 of the Evidence Ordinance as a bank.

As CKWB will cease to be a bank after the merger Sections 40 and 41 CKWB will not be able to rely upon these provisions as they cannot apply to it. Moreover Sections 40 and 41 of the Evidence Ordinance may only be relied upon where the Government or the authorised institution (i.e. bank) is in possession of the relevant records. Accordingly only the relevant documents previously in the custody or control of CKWB vested in HKCB by the Bill *can* be deemed to be in the custody or control of HKCB under Section 14(3) of the Bill. On this basis we do not think that this section of the Bill needs to be amended.

9. ***Please explain the need for Section 16(3). Should the words "not vested in Hongkong Chinese Bank by virtue of this Ordinance" be redrafted to avoid the possible construction that the provision covers interest in land vested in HKCB by other means. If the policy is to rely on Section 16(3) of the Bill for the new name of CKWB to be entered on the land register, would a provision similar to Section 16(5) be necessary? If CKWB relies on registration of the certificate of incorporation on change of name to issued by the Registrar of Companies, would Section 16(3) be superfluous?***

9.1 *"Not vested in Hong Kong Chinese bank ":*

As a matter of construction we would disagree that Section 16(3) of the Bill needs to be amended. The registrations of interests in land to which this section refers are the existing registrations in the name of CKWB at the time of the merger, i.e. at the appointed day. Even if property is vested in HKCB by means other than the Bill, this would not be affected by Section 16(3) which deems to change CKWB's entries in the land register from its old to new name.

9.2 *Should another Section 16(5) be inserted?:*

The rationale behind Section 16(5) of the Bill is that it provides a mechanism for notification in the Land Registry the fact that legal title to the relevant properties has been transferred from CKWB to HKCB. This is to assist transferees of such property in due course to deduce proper title. The actual transfer of such property is effected under Section 5 of the Bill whilst Section 16(2) provides that the register be amended by operation of the Bill, by deeming CKWB's name is replaced by HKCB's name.

Section 16(3) differs from the foregoing as it relates to CKWB's continuing property interests (which are not being vested in HKCB by virtue of the Bill). No transfer of title is being effected by the Bill in respect of such property. However as the Bill, at

the appointed day, automatically changes HKCB's name to CKWB's existing name, unless we provide in Section 16(3) for an automatic change of the registration, both those property interests retained by CKWB and those transferred to HKCB by the Bill would be registered in the same name but legally belong to different entities. The objective of Section 16(3) of the Bill is therefore to change the register to match title to the correct name. However, as no transfer of title is occurring, we do not consider it necessary to provide a similar notification as provided under Section 16(5). The Lands Registry has reviewed this provision and has no objection to it.

9.3 *Registration of the Certificate of Incorporation on a Change of Name:*

The suggestion the CKWB registers at the Lands Registry its Certificate Incorporation on Change of Name, which will be issued by the Companies Registry to evidence CKWB's new name immediately after the appointed day under the merger, not practical as to do this simultaneously, and within a short period, against all its interests would be very difficult. As you know the practice is that when a Hong Kong incorporated company changes its name and has an interest registered at the Lands Registry in its old name, the relevant certificate of incorporation on a change of name is often only registered when required to evidence of the proper title of the transferor, e.g. when a property is sold. However, if CKWB were to follow this approach then, as mentioned in 9.2 above, the register would, for a lengthy period, have interests under the same name but relating to different legal entities.

Please let me know if you have any further questions.

Yours sincerely

Rolfe Hayden

c.c. The Hon. Dr. David LI Kwok-po, GBS, JP
Mr Kelvin Lo, CITIC Ka Wah Bank Limited