

# HONG KONG MONETARY AUTHORITY PROPOSES MANDATORY REFERENCE CHECKING SCHEME TO ADDRESS “ROLLING BAD APPLES” PHENOMENON

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Legal Briefings - By **William Hallatt, Hannah Cassidy, Natalie Curtis, Tess Lumsdaine, Emily Rumble and Valerie Tao**

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On 8 May 2020, the Hong Kong Monetary Authority (**HKMA**) commenced a three-month industry consultation on a [proposed framework for a mandatory reference checking scheme \(MRC Scheme\)](#) to address the phenomenon of “rolling bad apples” moving between financial institutions without disclosing previous misconduct to their new employer.

Through the MRC Scheme, the HKMA has indicated that it intends to establish a common protocol for reference checking which helps enhance the disclosure of employment history of prospective employees to future employers.

Importantly, the HKMA has proposed that the MRC Scheme will initially only apply to:

banks regulated by the HKMA (ie, all authorised institutions (**AIs**), including registered institutions (**RIs**)), in that there will be no obligation on banks recruiting new staff to seek references from previous employers that are based outside of Hong Kong and are not regulated by the HKMA; and

senior staff (including directors, chief executives (**CEs**) and alternate chief executives (**ACEs**), section 72B managers and executive officers (**EOs**)).

The HKMA has also proposed that references should cover ten years of an individual's employment history, and that the MRC Scheme be implemented as an industry-led initiative with the endorsement of the HKMA, rather than imposed as a supervisory requirement.

The MRC Scheme proposed by the HKMA builds on global, regional and local developments. On a global level, the Financial Stability Board (**FSB**)'s April 2018 toolkit to address misconduct risk identified "rolling bad apples" as one of three key areas relevant to reducing misconduct in financial institutions (see our [24 April 2018 bulletin](#)). Regionally, the Monetary Authority of Singapore (**MAS**) consulted in 2018 on a similar reference check proposal (see our [17 July 2018 bulletin](#)).

Locally, the Securities and Futures Commission (**SFC**) last year introduced an internal investigation disclosure requirement to address the phenomenon of "rolling bad apples" (see our bulletins of [4 February 2019](#), [22 May 2019](#), [6 June 2019](#) and [19 June 2019](#)).

## **JOINT WEBINAR WITH ASIFMA ON 26 MAY 2020**

Herbert Smith Freehills has been an industry leader on governance and misconduct issues, having been involved in the development of the FSB toolkit and the informal consultation on the SFC's internal investigation disclosure requirement. We also advised ASIFMA on its response to the SFC's internal investigation disclosure obligation, as well as MAS' reference check proposal.

We will be holding a webinar in conjunction with ASIFMA to share our insights on how these developments will impact the banking industry in Hong Kong and form part of broader conduct and culture-focused reforms across the Asia-Pacific region.

**Date:** Tuesday, 26 May 2020

**Time:** 9:00am to 10:00am

To register for the webinar, please click [here](#).

## **OBLIGATIONS UNDER PROPOSED MRC SCHEME**

The MRC Scheme proposed by the HKMA would oblige "recruiting" banks (ie, those looking to employ a particular individual) to do the following before deciding to hire a new employee:

obtain written consent from the candidate for reference checks to be undertaken under the MRC Scheme, including authorising “reference providing” banks (ie, the candidate’s current or previous employer) to disclose his/her employment records to the recruiting bank, and exempting the reference providing bank from any contractual obligations which may limit its ability to disclose information relating to him/her under the MRC Scheme;

approach all former and current employers of the candidate that are HKMA regulated banks to request the required employment information relating to the previous 10 years (scope of information is discussed below);

when approaching the relevant former and current employers, indicate that it has obtained the candidate’s consent above and attach the written consent;

assess the information received from the reference providing bank and seek clarification or further information if necessary;

provide the candidate with an opportunity to be heard in relation to the information provided by the reference providing bank; and

take into account all information received as well as comments and responses by the candidate in finalising the employment decision.

Under the proposed MRC Scheme, reference providing banks should:

upon receiving a request for information from a recruiting bank, provide the relevant information within 10 working days – in exceptional circumstances where it is unable to provide information within such time, it should at least provide an interim reply explaining why it is unable to do so, with an estimated timeframe within which it can provide the information; and

provide information which is (to the best of its knowledge) true, fair, complete, accurate and capable of substantiation, with documentary support.

The HKMA has also proposed that where a reference providing bank receives a request relating to a current or former employee which is the subject of an ongoing investigation, the reference providing bank may provide information relating to the investigation or disciplinary action, but care must be taken not to disclose premature or inconclusive information which may stigmatise a presumed innocent individual. However, if an employee is subsequently found to be guilty of misconduct or other misconduct issues are uncovered which substantively change the reference provided, the reference providing bank should update the recruiting bank.

## **SCOPE OF APPLICATION OF MRC SCHEME**

### **HKMA regulated banking sector**

As noted above, the proposed MRC Scheme will initially apply only to AIs (including RIs) – ie, banks regulated by the HKMA. The HKMA has proposed that there be no obligation for recruiting banks to obtain references from all current and former employers where those current / former employers are not HKMA regulated AIs or do not have a presence in Hong Kong.

### **Specified categories of AI employees**

The HKMA has proposed that there be two phases of implementation, with Phase 1 covering the following senior management positions:

Directors, CEs and ACEs approved under section 71 of the *Banking Ordinance* (**BO**);

Managers notified to the HKMA under section 72B of the BO;

EOs approved under section 71C of the BO.

The HKMA has suggested that Phase 2 will have a significantly broader scope, and would cover the following AI / RI employees heading key supporting functions or who have client facing or sales responsibilities (where any misconduct by them would have a direct impact on end customers):

Heads and deputy heads of key supporting functions (including human resources, risk management, legal, compliance, internal audit and other equivalent units);

Relevant individuals approved to carry out securities-related regulated activities under the *Securities and Futures Ordinance* (**SFO**);

Responsible officers and technical representatives approved/licensed to carry out insurance-related regulated activities under the *Insurance Ordinance* (**IO**);

Subsidiary intermediaries registered to carry out regulated activities under the *Mandatory Provident Fund Schemes Ordinance* (**MPFSO**); and

Client facing staff responsible for the provision of general banking products and services (ie, bank branch managers, tellers and customer relationship representatives).

The HKMA has proposed that a review of Phase 1 take place one year after implementation, and that the approach taken to Phase 2 will be shaped by feedback from Phase 1.

### **Duration of reference check information**

It is proposed that the duration of reference check information should cover the prospective employee's employment records in the previous 10 years up to the date of application for employment. This is consistent with the HKMA's existing requirement that applicants for directors, CEs, ACEs and EOs of AIs disclose information relating to the past 10 years of employment.

AIs should therefore maintain employment records of their employees for at least 10 years from the date of departure.

### **INFORMATION TO BE PROVIDED BY CURRENT OR FORMER EMPLOYERS**

The HKMA has proposed the development of a standard information template (which is included as [Annex 2](#) to the consultation paper) to ensure consistency in the reference checks. The proposed template includes matters such as the reason for the employee's cessation of employment, and whether the employee:

- a. breached any legal or regulatory requirements relating to the BO, IO, MPFSO and SFO;

- b. was involved in incidents related to honesty, integrity or matters of similar nature;
- c. was the subject of any misconduct reports filed with the HKMA; and
- d. received any internal or external disciplinary actions arising from conduct matters

In contrast to the SFC's internal investigation disclosure obligation, the HKMA has proposed a materiality threshold for matters disclosed in these references by suggesting that disciplinary actions arising from misconduct of a minor nature (such as minor breach of internal staff code such as repeated losses of staff card) and performance related matters (such as consistently poor performance) need not be reported. Notably, the HKMA has proposed that reportable internal disciplinary actions would include those resulting from misconduct similar in nature to those specified in (a), (b) and (c) above, and other gross misconduct such as fraud and serious criminal offences.

Other internal disciplinary actions which the HKMA has proposed should be reported are internal warnings, reduction or claw-back of remuneration including salary, commissions, bonuses, etc and suspension and dismissal as a result of misconduct.



## KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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