For information

Legislative Council
Panel on Financial Affairs

An Effective Resolution Regime for Financial Institutions in Hong Kong Consultation Response and Certain Further Issues

PURPOSE

This paper informs members on the publication of the consultation response of the second stage of public consultation on an effective resolution regime for financial institutions in Hong Kong.

DETAILS

2. The second stage of public consultation on the establishment of a resolution regime for financial institutions in Hong Kong was conducted from January to April 2015. The consultation response, together with elaboration on certain aspects of the proposed resolution regime, was published on 9 October 2015. We attach the document at Annex for members' information.

3. We consulted the FA Panel at its meeting of 2 March 2015. As indicated at the meeting, we intend to introduce a bill into LegCo by the end of 2015.

CONCLUSION

4. Members are invited to note the consultation response at Annex of this paper and our proposed legislative timetable.

Financial Services Branch
Financial Services and the Treasury Bureau
October 2015

AN EFFECTIVE RESOLUTION REGIME FOR FINANCIAL INSTITUTIONS IN HONG KONG

Consultation Response

and

Certain Further Issues

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
Securities and Futures Commission
Insurance Authority

9 October 2015

Introduction

1. The Financial Services and the Treasury Bureau ("FSTB") of the Government of the Hong Kong Special Administrative Region ("HKSARG"), in conjunction with the Hong Kong Monetary Authority ("HKMA"), the Securities and Futures Commission ("SFC") and the Insurance Authority ("IA") (together "the authorities"), issued a second consultation paper ("CP2") on their proposals for establishing an effective cross sectoral resolution regime for financial institutions in Hong Kong on 21 January 2015.[1] This followed the publication of an earlier stage consultation paper ("CP1") on the same subject in January 2014.[2]

2. This paper concludes the consultations mentioned above and summarises the key comments received following the issuance of CP2, the authorities' responses to those comments and the authorities' proposals for taking forward this initiative. It also discusses certain further issues, which were referenced in CP2 as remaining under development internationally.

Consultation Feedback

3. The three-month consultation period for CP2 ended on 20 April 2015. A total of 28 submissions were received from a variety of sources including industry associations, professional bodies and financial institutions. The names of the respondents to CP2 ("respondents") (other than those who requested anonymity) are listed in **Annex 1**.

4. The vast majority of respondents continued to indicate broad support for the resolution regime proposals, noting in particular the importance of timely implementation for Hong Kong as a major international financial hub, with some respondents strongly encouraging the authorities to prioritise implementation of the reforms. A number of respondents provided constructive comments for further developing the proposals and others sought clarification on certain operational details. The major comments received and the authorities' responses are discussed below

[1] http://www.fstb.gov.hk/fsb/ppr/consult/doc/resolutionregime_e.pdf

[2] http://www.fstb.gov.hk/fsb/ppr/consult/resolution_e.pdf

together with the authorities' latest policy stance on a number of items. **Annex 2** sets out the major comments received and the authorities' responses in more detailed tabular form for ease of reference.

5. No specific questions are asked in this paper. However, if any interested party wishes to raise further substantive points regarding the contents of this paper, they may do so via the relevant regulatory authorities. Any further comments should however be provided swiftly as the intention remains to submit a Bill to the Legislative Council ("LegCo") by the end of year.

CP2 - Major Comments and Authorities' Responses

Scope of the Resolution Regime

6. As articulated in CP2, the scope of the resolution regime will be tailored to reflect the risks which the authorities currently perceive could be posed to the continuity of critical financial services and wider financial stability locally by the failure of certain types of financial institution ("FI"). The scope in respect of authorized institutions ("AIs"), licensed corporations ("LCs"), insurers and financial market infrastructures ("FMIs") remains as proposed in CP2. Respondents indicated broad support for the proposal to bring systemically important recognized exchange companies ("RECs") (i.e. companies that operate systemically important stock markets or future markets) within the scope of the regime. In CP2 it was proposed that the SFC should be responsible for this process. However, on further reflection, the authorities consider it preferable for the Financial Secretary ("FS") to be empowered to designate systemically important RECs as being within the scope of the regime, on the recommendation of the SFC.

7. In addition, with a view to accommodating any future changes in the potential risks posed by different types of FI, CP2 also consulted on whether the FS should have a designation power with which to subsequently bring FIs (not initially covered by the regime), within its scope if, in future, it should become apparent that systemic disruption could result were they ever to become non-viable.[3] Respondents

[3] See paragraph 34 of CP2.

generally agreed with this proposal, with some indicating that the power should be based on clear, transparent and consistent principles or guidelines and a few suggesting that the power should be subject to public consultation before being exercised.

8. The proposal in CP2 did not explicitly discuss whether the proposed designation power should be limited to regulated FIs or whether it could (or should) be extended to unregulated FIs. Having carefully considered respondents' comments, and with a view to ensuring that the regime remains fit for purpose in addressing the risks posed by any FIs that could be systemically significant or critical on failure, the authorities intend to provide for the designation power to extend to both regulated and unregulated FIs.

9. It is of course clearly desirable that an unregulated FI should first be brought within the regulatory perimeter before being made subject to the resolution regime. However, it is not inconceivable that future financial innovation could swiftly result in the creation of new entities or structures that rapidly interpose themselves into the financial system, gaining a significant foothold, before the case for regulation becomes apparent or before the necessary regulatory regime and apparatus can be established and made operational. In the aftermath of the recent global financial crisis, there has been an increased focus on "shadow banking" and the identification of significant shadow banking activities and entities. The financial services sector is also evolving rapidly in terms of infrastructure, systems and products, and so going forward, it will likely continue to be the case that more resources will be devoted to monitoring the boundaries of regulation. This should work to reduce the prospect of having to designate an unregulated class of FIs as falling within the scope of the resolution regime. However, to avoid the possibility of being caught without any of the tools necessary to address a systemic institution, regulated or unregulated, particularly at a time when its condition is deteriorating rapidly, the authorities consider it prudent to provide for the FS's power of designation to extend to bringing unregulated FIs within the scope of the resolution regime.

Lead resolution authority ("LRA")

10. Respondents all agreed that an LRA should be designated for each

cross-sector financial group (i.e. a group containing within-scope FIs under the purview of different resolution authorities) in circumstances where the interconnection between the within-scope FIs within the group structure renders a "group" resolution more appropriate. Respondents also agreed with the proposal that the FS should designate the LRA by reference to the relative systemic importance of the within-scope FIs within the group once the legislation establishing the regime comes into effect (i.e. that designation should be made "in advance" and not at the time of any actual resolution). A few respondents sought further clarity on how the authorities would undertake an assessment of relative systemic significance in a manner that would ensure objectivity and consistency when applied to FIs operating in different sectors of the financial system. The authorities note these comments and intend to develop an assessment methodology drawing upon elements of the processes established internationally to assess the systemic importance of banks, insurers and other entities.

11. The vast majority of respondents agreed that the role of the LRA should be one of coordination and, if and when required, ultimate decision maker. Some respondents noted that the regime would need to contain sufficient detail on how the LRA and the other resolution authorities would interact with each other, including during resolution planning for a cross-sector financial group.

12. Having further considered the need to ensure that the LRA can act swiftly and flexibly under all circumstances in order to effect timely resolution, the authorities have concluded that the LRA's "ultimate decision making" power should include both an ability to direct another resolution authority to take (or not to take) a specified action, and where necessary, to take an action itself (in both cases in accordance with the powers provided in the legislation establishing the resolution regime) in respect of a within-scope FI which would not usually be under its purview. The authorities expect, however, that it would be relatively rare for an LRA to act "unilaterally" in taking action in place of another resolution authority. Effective resolution planning should inform in advance the likely courses of action to be taken by each resolution authority, with the aim of facilitating swift coordinated action to resolve a cross-sector financial group. It is envisaged that the practical aspects of coordination, including how resolution authorities: conduct group resolvability assessments; develop

group-specific resolution strategies and plans; and communicate with FIs as regards such plans; will be set out in a Memorandum of Understanding ("MoU") between the resolution authorities specifically focussed on their resolution functions.

Bail-in

13. Overall there remained general support from respondents for the five proposed stabilization options,[4] discussed in both CP1 and CP2. A number of respondents considered that the approach to bail-in to be adopted in Hong Kong should be consistent with current international developments relating to cross-border resolution and might emulate the "Bank of England's Approach to Resolution"[5] including the use of certificates of entitlement. Respondents also made a number of constructive comments on various issues (including valuation) with respect to the bail-in mechanism. The authorities will take note of these in developing processes and procedures for the practical execution of bail-in. The authorities expect to issue guidance or a Code of Practice setting out their approach to carrying out bail-in once the legislation establishing the resolution regime comes into effect.

Liabilities excluded from bail-in

14. The authorities intend that the legislation establishing the local resolution regime will identify those liabilities permanently excluded from the application of bail-in, based on the grounds set out in paragraph 107 of CP2. Since CP2, the authorities have considered and identified some additional liabilities which they now intend to exclude from any bail-in, including:

15. Deposits: Having reflected further on the potential systemic consequences of bailing-in depositors, the authorities are now minded to exclude all deposits from the scope of bail-in. Hence it is intended that the exclusion extend to all deposits falling within the definition of "protected deposit" under the Deposit Protection Scheme Ordinance (Cap. 581)

[4] Namely: (i) transfer to a commercial purchaser; (ii) transfer to a bridge institution; (iii) transfer to an asset management vehicle; (iv) bail-in and; (v) temporary public ownership.

[5] http://www.bankofengland.co.uk/financialstability/Documents/resolution/apr231014.pdf

(irrespective of amount) and to deposits held by restricted licence banks or deposit-taking companies which, had they been taken by a Scheme member, would have fallen within the definition of "protected deposit".

16. Liabilities to former or current employees of FI in respect of wages: Rather than excluding liabilities to former or current employees of an FI in respect of "fixed salary and pension benefits" as proposed in CP2, the authorities are now minded to exclude liabilities to former or current employees of the FI that fall within the definition of "wages" under the Employment Ordinance (Cap. 57) as well certain "benefit" provided for in that Ordinance. This reflects the intention that the regime should protect the basic constituents of pay which employees rely on for their livelihood. The "benefits" proposed to be excluded from bail-in are holiday pay, annual leave pay, sickness allowance, maternity leave pay, paternity leave pay, severance payment, long service payment, payment in lieu of notice, end of year payment and terminal payment.

17. A full list of liabilities which the authorities propose to exclude from bail-in is at **Annex 3**.

Bridge institution

18. Respondents were generally receptive to the bridge institution stabilization option outlined in CP1 and CP2. CP1 and CP2 proposed powers for the resolution authority to transfer all or selected assets, rights and liabilities from a non-viable FI to a bridge institution. However, observing developing practices in other jurisdictions[6] and assessing the desirability of taking such an approach locally, the authorities now also intend to provide for the possibility of transferring shares of a non-viable FI to a bridge institution. It remains the case that the authorities continue to think that the most likely use of a bridge institution would be as a vehicle to ensure continuity for particular critical financial services (e.g. deposit-taking), necessitating a partial transfer of assets, rights and liabilities whilst leaving non-critical parts of the business in the residual FI. However, extending the scope of the bridge institution stabilization

[6] Article 40(1)(a) of the EU's Bank Recovery and Resolution Directive ("BRRD") requires that member states provide resolution authorities with the power to transfer to a bridge institution shares or other instruments of ownership issued by one or more institutions under resolution.

option in the manner described above, offers a resolution authority the additional flexibility to secure the onward sale of the entire FI in the short- to medium-term, perhaps once a third party purchaser(s) has been afforded sufficient opportunity to conduct due diligence, whilst maintaining the provision of critical financial services in the interim.

19. As explained in CP2, a key purpose of using a bridge institution is to allow a resolution authority to swiftly stabilise and, importantly, continue part or all of an FI's business to ensure uninterrupted provision of critical financial services in circumstances where the resolution authority assesses that there is a realistic prospect of concluding a purchase on suitable terms relatively soon but which cannot be arranged immediately. The resolution authority would accordingly be seeking to dispose of the business of the bridge institution and wind it up without delay once it had served its purpose. To this end, and to impose discipline on the resolution authority in this regard, it is intended that the legislation establishing the resolution regime will require a resolution authority to wind up a bridge institution within two years following the last transfer made to the bridge institution. Where a sale is pending or extension is otherwise necessary to meet the resolution objectives, the legislation will provide for the possibility to extend this two year period, after consultation with the FS.

20. It was envisaged in CP2 that a bridge institution would be a company limited by shares and incorporated under the Companies Ordinance (Cap. 622) with the Government as the initial shareholder. The authorities intend to proceed on this basis.

21. The manner in which a bridge institution is capitalised will depend to some extent upon the resolution strategy deployed in any given case. If a bridge institution is used in conjunction with a bail-in, then all or part of the capitalisation might be achieved through debt write-off or the conversion of the FI's debt instruments into equity in the bridge institution. Given that the philosophy underlying resolution is to minimise the use of public funds, approaches involving capitalisation by write-off or conversion of the FI's debt would obviously be preferred. However, where necessary to achieve a swift and orderly resolution, some public funds might be deployed temporarily to capitalise a bridge institution. This would be on the basis that such funds would be recouped from sales of shares in, or assets from, the bridge institution or, failing which, from

the resolution funding arrangements (see section under Resolution funding arrangements).

Temporary stays on early termination rights

22. Respondents generally agreed with the resolution authority having the power to temporarily stay counterparties' early termination rights in respect of financial contracts. Respondents were also generally satisfied with the proposed conditions for, timing and duration of temporary stays described in CP2, emphasising the need to broadly follow the approach being adopted in key overseas jurisdictions. Furthermore, a considerable number of respondents were of the view that broader provision should be made such that the resolution authority may also apply a temporary stay to non-financial contracts where such contracts contain early termination rights and are critical to the operational continuity of the FI in resolution.

23. The authorities concur that, although financial contracts will likely be the most sensitive to the exercise of early termination rights, there are other contracts of particular importance to the ongoing business of an FI (for instance in some cases leases of branch premises) which may well contain default provisions that could be triggered by matters related to resolution. The authorities have consequently determined that, in order to avoid precipitating any disorderly termination of contracts that could undermine resolution action, the scope of the temporary stay should be extended to all contracts whose early termination could hinder the ability of the resolution authority to achieve the resolution objectives. Accordingly, both financial and non-financial contracts will be within the scope of the temporary stay (and will be equally subject to the relevant safeguards).

24. It is expected that FIs, in the course of resolution planning, will identify the contracts that are critical to their business and that therefore must be continued in resolution and will further identify the extent to which they contain early termination rights that could pose a threat to continuity on resolution.

Power of the resolution authority in relation to the filing of a winding-up petition

25. If resolution can be pre-empted and avoided by a single creditor petitioning for the winding-up of a within-scope FI, this could frustrate

the underlying objective of maintaining financial stability. Therefore, CP2 proposed that a resolution authority be afforded a period of 14 days to consider whether to initiate resolution before any winding-up petition could be filed with the Court. While respondents in general did not raise any major objection to this concept, some expressed concern that 14 days might be unduly long. Having considered respondents' comments, the authorities propose to shorten the period from 14 to 7 days.

26. In the context of bail-in, whilst an FI remains "in resolution" in the sense that the resolution authority is continuing to take steps to achieve the effective application of the bail-in stabilization option (including primarily valuation for the purpose of determining final bail-in terms), there remains a need to prevent any competing winding-up action being taken and the authorities intend to provide for this in the legislation establishing the local resolution regime. However, where the application of a stabilization option results in the critical financial services being transferred out of a residual FI, it is envisaged that any such residual FI may enter winding-up proceedings.

Supporting the transferred business

27. There may still however be links between a residual FI and any business transferred by application of a stabilization option. In such cases, the authorities intend to empower the resolution authority to direct the residual FI to continue to provide any support services (such as information technology, human resources and compliance functions): (i) which are essential to the continuity of any critical financial services that have been transferred out of the residual FI, but (ii) which, for some reason, have not been transferred alongside them. Where such a direction is issued by the resolution authority, it must provide for the residual FI to receive consideration on reasonable commercial terms for the provision of such support services.

28. In the circumstances described in paragraph 27, there would be no intention to prevent the residual FI from entering into winding up proceedings (should the shareholders and/or creditors move to do so). However, if the winding up of the residual FI does commence, it is intended that this should not immediately affect the resolution authority's ability to direct the residual FI to continue the provision of services essential to the continuity of critical financial services which have been

transferred. Winding-up proceedings could commence and continue in respect of any other parts of the residual FI's assets. When, however, the liquidator eventually needs to deal with the assets deployed in providing the support services, in order to complete the liquidation of the residual FI, the intention is that the liquidator should give the resolution authority six months' notice to make other arrangements for the provision of such services. It is also intended that a liquidator of a residual FI should be obliged to support the resolution authority if it should be necessary, following the application of a stabilization option, to undertake any supplemental or reverse transfer of assets, rights or liabilities out of, or into, the residual entity in order to ensure the effectiveness of resolution.

29. This approach reflects respondents' preference in their submissions to CP2 that continuity of support services from the residual FI should be provided for by means of direction to a person controlling the FI (in this case the board of the FI or any liquidator of the FI) rather than by the establishment of a new service company for the purpose.

Remuneration claw-back

30. As described in CP2, the authorities intend to provide in the legislation establishing the local resolution regime, for applications by a resolution authority for claw-back of remuneration to be determined by the court. It is intended that such applications may be made at any time by the resolution authority once the resolution of an FI has been initiated. Respondents' views on whether claw-back should apply to both fixed and variable, or only to variable, remuneration, as well as on how far back in time the claw-back power should reach, were mixed. In order to avoid creating incentives to skew compensation packages towards fixed remuneration (and thereby reduce FIs' flexibility in reducing remuneration levels in periods of poor performance), the authorities intend to apply claw-back to both fixed and variable remuneration. CP2 discussed approaches observed overseas to setting time limits on the period preceding initiation of resolution in relation to which remuneration may be subject to claw-back. On balance the authorities are inclined to limit claw-back to the period of three years preceding the initiation of resolution but extendable by the court for up to three further years back in cases of dishonesty.

Safeguards

31. Respondents to CP1 agreed that the regime should provide for a "no creditor worse off than in liquidation" ("NCWOL") safeguard and sought further detail on aspects of the mechanism, which were subsequently included in CP2 for further consultation. A core element underpinning NCWOL is valuation. CP2 proposed that a NCWOL valuer would undertake a hypothetical valuation of how pre-resolution shareholders and pre-resolution creditors of an FI would have fared in a winding-up and contrast this with an assessment of the actual treatment those pre-resolution shareholders and creditors have received as a result of resolution. This determines whether they may be worse off on resolution than in liquidation and, in turn, whether any NCWOL compensation may consequently be due.

32. Counterparties whose contracts are transferred on resolution to a new entity to be continued to be performed on the same terms and conditions arguably benefit from the resolution action, as their contracts continue with a new financially sound entity without any disruption. Similarly, counterparties of a within-scope FI which is subject to bail-in, but whose liabilities are not included within the scope of the bail-in provision, would also benefit from maintaining their relationship with a financially stronger entity. In these circumstances, the authorities intend to create a rebuttable presumption that counterparties in this position are no worse off in resolution and hence should not be entitled to receive NCWOL compensation.

33. The majority of respondents supported the proposal in CP2 that the resolution authority should be the entity tasked with appointing a NCWOL valuer. On further reflection, however, bearing in mind the importance of ensuring that the valuation process is (and is manifestly seen to be) independent and taking note that the resolution authority may be a party to any appeals against the NCWOL valuer's assessments, the authorities have come to the view that the resolution authority is not best placed to appoint the NCWOL valuer. The authorities now intend, instead, to provide for the FS to appoint a person ("appointing person") who, in turn, would appoint a NCWOL valuer based on the independence and expertise criteria set out in Box F in CP2. Any terms and conditions for the appointment of the NCWOL valuer by the appointing person would be approved by the FS. The authorities believe that this

arrangement will reinforce the independence of the appointment process which should, in turn, strengthen the overall credibility of the NCWOL mechanism.

34. As noted in CP2, the authorities will set out in the legislation establishing the resolution regime some high level valuation principles, to which the NCWOL valuer must adhere in discharging his functions. These relate to: (i) adherence to the creditor hierarchy in the hypothetical liquation valuation; (ii) disregard of any public financial support; and (iii) disregard of the effect of any stabilization option. The authorities intend to include a provision in the legislation to enable the Secretary for Financial Services and the Treasury ("SFST") to make rules prescribing the process for the conduct of, and specifying any further assumptions (such as the valuation reference date for the hypothetical liquidation valuation) to be made by the NCWOL valuer in undertaking, the NCWOL valuation.

Appeal against NCWOL valuation

35. Respondents expressed support for the establishment of a Resolution Compensation Tribunal ("RCT") specifically to hear appeals on NCWOL valuation, as well as for the proposed approach for establishing the RCT as set out in CP2. Accordingly, the legislation establishing the resolution regime will provide for the setting up of the RCT and for the Chief Justice to set rules in relation to the RCT's operation. It is also intended that the RCT would, on application by any pre-resolution shareholder or pre-resolution creditor or the resolution authority, have the power to revoke the appointment of the NCWOL valuer on the grounds set out in CP2 (paragraph 174).

Resolution authority's decisions in requiring FIs to adopt appropriate measures to remove barriers to orderly resolution and appeal mechanism

36. As explained in CP2, the resolution authority's power to issue a direction requiring a within-scope FI to make changes (for example, in relation to structure and operations) for the purpose of improving its resolvability ("*ex ante* resolvability measures") will assist in promoting financial stability. Respondents indicated broad support for this, noting however that such power should be subject to checks and balances. To this end, the authorities intend to set out in the legislation establishing the resolution regime certain considerations to which a resolution authority

must have regard before issuing a direction relating to an *ex ante* resolvability measure, including those as set out in paragraph 132 of CP2 (e.g. how difficult it would be to carry out an orderly resolution of the FI if the contemplated measures were not taken, the likely impact of complying with direction, including on future viability and capacity of the FI to continue to provide critical financial services).

37. The authorities have also considered further the necessary reach of the *ex ante* resolvability measures in order to ensure orderly resolution is achievable for FIs. Observing practices overseas,[7] and noting that in some cases orderly resolution of a within-scope FI may only be feasibly achieved by initiating resolution at the holding company level due to the way in which a group is structured or operates, the authorities intend to extend the scope of powers to require *ex ante* resolvability measures to be taken by holding companies of within-scope FIs. This should also allow more flexibility in the way in which identified impediments may be removed.

38. Given the potentially intrusive nature of such powers, the authorities recognise the need to provide an avenue of appeal in relation to the exercise of *ex ante* resolvability measures (to supplement the iterative process between the resolution authority and the FI/holding company during the course of which formal representations against proposed *ex ante* resolvability measures may be made to the resolution authority). After further deliberation, the authorities are inclined to the view that appeals relating to *ex ante* resolvability measures should be heard by a separate Resolvability Review Tribunal ("RRT") to be established specifically for the purpose. Accordingly, provision will be made for this in the legislation establishing the regime. The skill-sets and experience expected to be required of members of the RRT may differ in substance from those required in assessing valuation and compensation. Hence it is considered preferable not to seek to use the RCT for this

[7] Under Article 17 of the EU's BRRD, certain measures to address or remove impediments to resolvability are applicable to the holding company and parent holding company of an FI, including requiring changes to legal or operational structures of any group entity, and requiring the issue of eligible liabilities (or otherwise take other steps) to meet the minimum requirement for own funds and eligible liabilities under the BRRD.

purpose. The authorities have also considered making use of the existing "sectoral" tribunals established (or to be established) under the relevant regulatory Ordinance for each sector (e.g. the Banking Review Tribunal for AIs, the Securities and Futures Appeal Tribunal for LCs; and the Insurance Appeals Tribunal (after the Independent Insurance Authority has been established) for authorized insurers). However, this would require extending the jurisdiction of these tribunals; there may also be some mismatch in terms of the experience and skill-sets required and difficulties may be encountered in connection with resolvability assessments by an LRA of a cross-sector group and identifying the correspondingly appropriate tribunal of appeal in such circumstances.

Protecting certain types of financial arrangements in resolution

39. CP2 continued the discussion from CP1 on measures to protect the economic effect of certain financial arrangements on the application of stabilization options. These "protected arrangements", as identified in Annex IV of CP2, are: secured arrangements; set-off and netting arrangements; title-transfer arrangements; structured finance arrangements; and clearing and settlement systems arrangements. Under these arrangements, significant numbers of market participants rely on the interaction of the arrangements' constituent parts to limit their exposures to loss and so there is merit, from the perspective of preserving broader financial stability, in endeavouring to limit the effects of resolution powers which could separate, modify or terminate the constituent parts of such arrangements or avoid and override the effect of set-off or netting.

40. Separation of the constituent parts of one of these types of arrangement is most likely to occur with a partial property transfer (where only part but not all of a failed FI's assets, rights and liabilities are transferred). CP2 however also noted that certain arrangements may need specific protection in bail-in as any bail-in of a gross liability under one leg, or one part, of an arrangement might likewise have the effect of undermining the economic purpose of the arrangement. Respondents to CP2 did not make any specific suggestions on safeguards in respect of bail-in, but a number suggested that a similar approach to that proposed for protecting financial arrangements on a partial property transfer might suffice.

41. In the case of bail-in, the authorities consider that it may be appropriate to impose restrictions on the resolution authority such that it should seek

only to bail-in the "net" amount under any secured, set-off, netting or title-transfer arrangement. Furthermore, in the case of any inadvertent bail-in of a gross amount in breach of this safeguard, there is merit in the resolution authority having the ability to take remedial action to reinstate, restore or otherwise address the position of a person adversely affected, by using the resolution authority's power under the regime to effect an issuance or transfer of securities or a transfer of assets (i.e. cash), for example.

42. As indicated in CP2, and having considered the matter further, the authorities intend to provide in the legislation establishing the local resolution regime for a rule-making power enabling the SFST to prescribe requirements in relation to a resolution authority's treatment of protected arrangements when applying stabilization options. The technical details of how arrangements are to be protected, exclusions from the scope of protection and remedies for inadvertent breaches under bail-in and partial transfer will be set out in these rules.

Resolution funding arrangements

43. While the proposed resolution regime provides a means by which to ensure that the cost of failure (and of resolution) are borne by the shareholders and creditors of a failed FI, there may be some cases where the costs of resolution exceed the costs which can actually be imposed on shareholders and creditors through the resolution process. CP2 consulted on providing resolution funding arrangements for the regime such that recovery of the "excess" costs of resolution may be made on an *ex post* basis, once it is clear how much needs to be recouped, from the wider financial system.

44. Respondents generally agreed that it would be appropriate to set overarching principles for an *ex post* funding mechanism to guide the setting of the levies to recover the costs incurred. With regard to the costs which can be met through the resolution funding arrangements, there was support from some respondents for a non-exhaustive list of such costs, but more support for an exhaustive list. The authorities are however inclined to the view that any list would of necessity have to be non-exhaustive as the types of cost involved would likely vary in practice, depending upon the way in which a given FI is ultimately resolved. However, the

authorities would emphasise the intention that resolution funding may only be used for, or in connection with, the application of a stabilization option(s) for carrying into effect the provisions under the regime. This would include preparatory work leading directly to the application of a stabilization option(s) (but not, for example, resolution planning and resolvability assessment conducted in "business as usual" circumstances), as well as the costs that follow as a result of the application of the stabilization option(s) (e.g. payment of any NCWOL compensation assessed to be payable and the costs relating to the appointment of a NCWOL valuer and the conduct of the NCWOL valuation). However, before deploying any such funds, the resolution authority would be obliged to have regard to the available resources at the failed FI before doing so.

45. A variety of suggestions were received regarding the scope of the *ex post* levy (i.e. which FIs should be required to contribute) and, in particular, some respondents felt that it was not appropriate for all sectors to contribute to resolution funding arrangements. Respondents generally expressed support for a proportionate, risk-based assessment of contributions, with assessed contributions taking into account the size of, and risks posed by, an FI's local operations. One respondent noted that the EU has still not decided on how to allocate FMI losses and thought any decisions on FMI loss allocation at this stage would be premature. Other respondents thought resolution costs may be more properly allocated on a case-by-case basis, having assessed the range of market participants that would have been affected by the failure of the particular FI in resolution.

46. Having considered respondents' views, the authorities confirm their intention to provide in the legislation establishing the local resolution regime for a mechanism for an *ex post* recovery of the relevant costs incurred in the resolution of an FI (as described in paragraph 44), after having taken into account any "proceeds of resolution" that may contribute to the resolution funding arrangement.[8] It is considered highly unlikely that any "proceeds of resolution" would be sufficient to cover all

[8] Such proceeds of resolution may include, for example, any proceeds from the sale or disposal of securities in, or assets, rights and liabilities of, a bridge institution, temporary public ownership company or asset management vehicle.

costs of resolution in excess of those which can be imposed on shareholders and creditors of the failed FI, and hence an *ex post* levy would still be necessary in most cases. However, to cover the very unlikely event if there should be a "surplus" of funds in the resolution funding arrangement once a resolution has been completed, the authorities are minded to provide in the legislation for the FS to make rules with respect to entitlements to, and distribution of, any surplus.

47. In terms of the apportionment of a levy to the financial sector, the authorities intend it be imposed on those FIs which are both within the scope of the resolution regime and within the same sector as the failed FI. For cross-sector groups, a mechanism will be established on a case-by-case basis to apportion contributions across the relevant sectors by reference to the composition of the failed cross-sector group. In the case of FMIs (and by extrapolation any recognized exchange companies designated as within-scope) it would not seem logical to confine a levy only to other within-scope FMIs or within-scope exchanges (i.e. within-scope entities operating in the same sector) as a wide variety of FIs, across all sectors, arguably benefit from the orderly resolution of an FMI (or an exchange) and the resulting continuity of its critical financial services. Accordingly, for FMIs (and exchanges), the authorities are inclined to favour a "user pays" levy model.[9]

48. In view of the possible variations in the apportionment of costs among different types of FIs, the authorities are of the view that the mechanism for raising the levy should be able to take into account the particular circumstances of each resolution and apportion cost in a proportionate manner in each case, whilst respecting the overarching approach outlined in paragraph 46 above. The authorities intend to achieve this by providing legislating for the rate of levy to be prescribed by resolution of LegCo for a given resolution case. The detailed mechanism for the calculation and apportionment of the levy underpinning the LegCo resolution for prescribing the rate of levy will be set out in rules made, after public consultation, by the FS and subject to vetting by LegCo.

<u>Cross-border resolution and information sharing</u>

[9] A "user" of an FMI or exchange refers to a participant of the FMI or the exchange or a client of such a participant.

49. Most respondents agreed with the setting of specific "cross-border conditions" as outlined in CP2 before the local regime may be used to recognise or support foreign resolution measures. Respondents generally emphasised the importance of collaboration and information sharing between home and host resolution authorities. Whilst most respondents agreed that support and recognition of foreign-led resolution action should not be automatic, some stated that any discretionary powers which the resolution authority in Hong Kong may have not to recognise or support a cross-border resolution should be limited only to those circumstances identified in the Financial Stability Board ("FSB")'s consultation paper on cross-border recognition of resolution actions ("FSB cross-border CP").[10]

50. The authorities remain of the view that, in principle, a coordinated and cooperative approach to the resolution of a cross-border FI has the potential to better protect financial stability across both home and host jurisdictions. A resolution authority could therefore be expected to recognise and act in support of a cross-border resolution action if it will deliver a satisfactory outcome for stability in Hong Kong and will not disadvantage local creditors relative to foreign creditors. As Hong Kong plays host to a significant number of FIs operating as subsidiaries or branches of foreign firms, it is important that the local resolution regime balances the need to promote financial stability and fair treatment locally with measures to recognise resolution actions being taken by a foreign resolution authority to resolve an overseas incorporated FI. Accordingly, the authorities propose to make provision for a statutory recognition framework enabling a resolution authority, after consultation with the FS, to recognise all or part of a foreign resolution action, to the extent that it would produce substantially the same legal effect in Hong Kong. A resolution authority may recognise a foreign resolution action irrespective of whether the "trigger conditions" for initiation of resolution locally are met[11], and such recognition may have effect with respect not only to within-scope FIs but all FIs.[12]

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[10] See FSB (2014), http://www.financialstabilityboard.org/wp-content/uploads/c_140929.pdf

[11] These "trigger conditions" are that, the FI is non-viable and poses systemic risk locally and no private sector solution is at hand. See paragraph 59 of CP2.

[12] It is envisaged that recognition may also be given in respect of assets, liabilities or contracts of a foreign FI in resolution which are located or booked in, or subject to the law of, Hong Kong even if

51. However, other conditions must be met before a resolution authority can recognise a foreign resolution action; specifically recognition must not be granted if the resolution authority is of the opinion that recognition would: (i) have an adverse effect on financial stability in Hong Kong; (ii) not deliver outcomes that are consistent with the resolution objectives; or (iii) disadvantage Hong Kong creditors or shareholders (or both) relative to their counterparts overseas. Moreover, a resolution authority could only recognise a foreign resolution action if it is of the opinion that an arrangement is in place such that any Hong Kong shareholders or creditors would be eligible to claim compensation broadly consistent with what they would be eligible to claim if the resolution action had been originated locally. A resolution authority may also take into account any fiscal implications for Hong Kong in deciding whether to recognise a foreign resolution action.

52. The FSB cross-border CP also explains that "recognition and support measures complement each other and in some cases both may be required to achieve the desired outcome", and provides examples in its Annex on how different resolution scenarios may call for the use of either (or both) recognition and support measures. In addition to a framework for recognising foreign resolution actions described in paragraph 50 above, a resolution authority may also be able to use the stabilization options in the local regime in respect of within-scope FIs to support foreign resolution actions, provided that the "trigger conditions" for resolution are also met in such cases.

53. The merits of establishing contractual approaches to the cross-border recognition of resolution actions, particularly in respect of the recognition of stays on early termination rights and the exercise of bail-in powers, are also discussed in the FSB cross-border CP. Such approaches could be used as an interim recognition measure while statutory frameworks are being developed, but they might also support the efficacy of the statutory frameworks once the latter are in place. The authorities accept that the use of contractual provisions can support the application of stabilization options by underpinning powers to impose stays and to effect bail-in, particularly in a cross-border context. Accordingly, the authorities

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the FI has no physical presence in Hong Kong. See Scenario 2 of the Annex to the FSB cross-border CP.

intend to provide, in the legislation establishing the local resolution regime, for: (i) amendments to the Banking (Capital) Rules (Cap. 155L) so that the terms and conditions of Additional Tier 1 and Tier 2 capital instruments issued by AIs must contain provisions by which the holder of any such instrument explicitly recognises the potential for such instruments to be written off or converted by the resolution authority; (ii) the resolution authority to be able to make rules requiring the terms and conditions of other liabilities, which are not specifically excluded from bail-in, to contain provisions by which the holder explicitly recognises that the liability may be subject to "bail-in" and; (iii) the resolution authority to be able to make rules requiring the terms and conditions of certain financial and other contracts (considered of importance in maintaining continuity of critical services) to contain provisions by which each counterparty agrees to be bound by a temporary stay on early termination imposed by the resolution authority to the contract.

54. Information sharing was discussed in CP2 (building upon the earlier discussion in CP1) although no specific questions were raised. The authorities intend the legislation establishing the local resolution regime to provide for a broad confidentiality requirement to attach to the undertaking of resolution-related functions but with specified gateways to allow the resolution authority to disclose information. Gateways would allow provision of information, amongst others, to: (i) other resolution authorities (and authorities that carry out functions in relation to resolution), including those overseas, where disclosure will assist the recipient to perform its functions and the recipient is itself subject to adequate confidentiality restrictions; (ii) NCWOL valuers for the purpose of enabling them to undertake the necessary valuation exercises required under the regime; and (iii) the RCT and the RRT. The information sharing powers as regards other resolution authorities will apply continuously (i.e. not just when an FI becomes non-viable or when it is apparent that the FI is in difficulty and approaching the point of non-viability) and will hence support advance resolution planning.

55. In line with the information gathering provisions which are generally common in regulatory ordinances, it is intended that the legislation establishing the local resolution regime will provide powers for a resolution authority to require the provision of information, records and documents which the resolution authority needs in order to perform its

functions. These powers will be supported by powers of inspection and investigation, including the application for a magistrate's warrant to enter premises specified in the warrant to search for, seize and remove such records or documents.

56. As discussed in CP2, the proposed resolution regime will empower the resolution authority to devise resolution strategies, develop resolution plans and perform resolvability assessments. In parallel with the legislative process, further consideration will be given to approaches to resolution planning. A proportionate approach will be adopted and requirements may vary across sectors.[13] As previously noted, the authorities' intention is to issue a Code of Practice to provide guidance on the manner in which resolution functions will be performed. The authorities' approach to resolution planning may be included within the Code or separate standalone guidance may be issued on various aspects of the resolution planning process as appropriate.

Discussion of Further Issues

Deferral of authorization criteria

57. Where a transfer of a regulated business from a non-viable FI to a bridge institution takes place, the bridge institution will in the normal course need to be authorized or licensed to conduct that business. In these circumstances, the authorities are inclined to provide flexibility for the bridge institution by deferring the application of certain authorization criteria required for the conduct of regulated businesses under the Banking Ordinance (Cap. 155), Securities and Futures Ordinance (Cap.

[13] For example, the HKMA has already begun to roll out its recovery planning requirements for local AIs and has clearly set out in its guidance the expectation that an AI's recovery plan should be proportionate to the nature, scale and complexity of its operations. The HKMA has also indicated its intention to issue a corresponding Supervisory Policy Manual ("SPM") module on Resolution Planning in due course. For the full SPM module on Recovery Planning (RE-1) see: http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/RE-1.pdf

571) or the Insurance Companies Ordinance (Cap. 41) for a relatively short period of time (not more than 12 months). The intention would be: (i) to facilitate speed of transfer to a bridge institution whilst ensuring continuity in the provision of critical financial services; and (ii) to reduce the extent to which public funds might need to be immediately deployed upon the initiation of resolution in order to meet capital, liquidity or other financial resources ratios in circumstances where the Government stands behind the bridge institution, pending an anticipated swift, onward sale of the shares in, or assets from, the bridge institution to a purchaser. The authorities are cognisant of the need to avoid competitive distortion in the market and, weighing this against the public interest in securing swift and orderly resolution, on balance consider a temporary deferral from compliance with all of the relevant authorization criteria to be justifiable in the case of a bridge institution. On a case-by-case basis the decision of whether to provide such a temporary deferral will be made by the relevant licensing authority upon an application by a relevant bridge institution.

58. In the case of a transfer of the shares in a within-scope FI to a bridge institution, the authorities consider that it is relatively less likely for the need for such a deferral. The FI would continue to conduct the regulated business and the FI should retain its existing authorization. Similar considerations apply in the case of a temporary public ownership ("TPO") company where the shares in the within-scope FI would be transferred to a TPO company owned by the Government.

59. In the case of a transfer to a commercial purchaser of all or part of the failing FI's regulated business, the authorities consider it important that any acquirer must be capable (financially and operationally) of absorbing and running the business transferred. Hence the authorities are not minded to provide for a deferral of authorization criteria in such cases.

60. The authorities have also considered whether an asset management vehicle ("AMV") might need to be authorized to conduct a regulated business and, if so, whether there is justification for allowing it to operate for any period before complying with authorization criteria. Generally, it seems unlikely, at least in the case of AIs, insurers and FMIs, that any business requiring ongoing compliance with authorization criteria would in fact be transferred to an AMV. However, an AMV set up to hold the assets and/or outstanding positions of a failed FI might conceivably be

conducting SFC regulated activities and would in these circumstances be required to be licensed by the SFC. In such a case, the authorities consider that the licensing authority should also be able to defer the application of authorization criteria to an AMV on a temporary basis in the same way as proposed for a bridge institution.

Total loss-absorbing capacity ("TLAC")

61. As noted in CP2, work continues at the international level on the development of requirements for global systemically important banks ("G-SIBs") to maintain in issue a sufficient minimum level of loss-absorbing instruments in order to facilitate resolution and, in particular, render bail-in a feasible and credible resolution option.

62. Nearly sixty public submissions were made to the FSB by a variety of stakeholders in response to its consultation on a draft TLAC Term Sheet for G-SIBs at the turn of the year.

63. Most respondents expressed overall support for the objective of TLAC, with some viewing a TLAC requirement as an important step in promoting confidence in orderly resolution and ending the too-big-to-fail phenomenon observed during the global financial crisis.

64. A variety of views were expressed by respondents on: (i) the calibration of TLAC requirements in the light of both historical loss experience and post-crisis reforms; (ii) the need for additional institution-specific requirements above a common minimum TLAC requirement; (iii) the "neutrality" of TLAC between single-point-of-entry ("SPE") and multiple-point-of-entry ("MPE") resolution strategies; [14] (iv) the prepositioning of internal TLAC at material subsidiaries within a group in terms of its location, calibration, and composition; (v) the criteria for instruments to qualify as TLAC; (vi) the duration of any exemption from TLAC requirements for G-SIBs headquartered in Emerging Market Economies; (vii) the public disclosure of TLAC to advance investor confidence and market discipline; and (viii) any restrictions to be imposed on the holdings of TLAC by other banks.

65. The FSB is now revising the TLAC Term Sheet in light of the comments

[14] SPE and MPE strategies were discussed in Box I of CP1.

received and the results of a range of impact studies. The final version of the TLAC Term Sheet is expected to be finalised ahead of the G20 Summit in November 2015. Thereafter a "conformance" period (informed by the results of the impact studies) will be allowed for G-SIBs to comply with the TLAC standard.

66. Reflecting the FSB's international mandate, the TLAC standard is applicable to banks which are systemic cross-border (i.e. G-SIBs). Although there are currently no G-SIBs headquartered in Hong Kong, many G-SIBs have a significant presence here[15] and the authorities consider it important that the local resolution regime should provide a means for the imposition of loss-absorbing capacity requirements on locally incorporated entities of G-SIB groups in line with the groups' resolution strategies and the TLAC Term Sheet. Furthermore, the concept underlying TLAC (namely that feasible resolution, particularly bail-in, of a systemically important financial institution depends upon the institution having sufficient loss-absorbing capacity) could apply to entities other than G-SIBs, for which the preferred resolution strategy emanating from the resolution planning process involves bail-in. Generally speaking, this might be expected to be the case for the larger, more complex, FIs where it becomes increasingly unlikely that a resolution authority could either separate or dispose of individual business lines swiftly or find a purchaser capable of acquiring the entire institution. It is also the case that in future the FSB may seek to tailor other loss-absorbing capacity requirements for globally systemic entities from other sectors and the authorities see merit in providing in advance for this by inclusion of a rule-making power into the framework of the local resolution legislation. Implementation might then subsequently be effected through the issuance of rules, which would be subsidiary legislation, once international standards are issued.

67. Accordingly, to: (i) provide a means to operationalise the TLAC Term Sheet once finalised; (ii) accommodate resolution strategies involving bail-in for other (non-G-SIB) banks; and (iii) facilitate the imposition of loss-absorbing capacity requirements for FIs in other sectors; the authorities propose to include in the legislation establishing the local

[15] 29 of the 30 G-SIBs (from the list designated by the FSB in November 2014) have a presence in Hong Kong.

resolution regime provisions allowing a resolution authority to make rules prescribing loss-absorbing capacity requirements applicable to classes of within-scope FIs (or their holding companies or subsidiaries). Such rules, which as noted above would be subsidiary legislation, could give effect to global standards on loss-absorbing capacity promulgated by the FSB subject to such modifications as the local resolution authority thinks fit, having regard to local circumstances. This approach could be used to extend the provisions of the TLAC Term Sheet to other classes of AI (in addition to G-SIBs) if the resolution authority considers it appropriate to make a modification to this effect in Hong Kong.

68. To the extent any instruments included within the required loss absorption pool (or indeed any debt instruments within the scope of the bail-in power) are governed by a law other than that of Hong Kong, there is a risk that the exercise of the bail-in power under Hong Kong's resolution regime may not be recognised in foreign jurisdictions. To address this, as noted in paragraph 53 above, it is intended that a resolution authority should be able to require any such instruments to include within their terms and conditions "contractual recognition clauses" by which the holder of the instrument explicitly recognises and agrees to be bound by the terms of a bail-in under the Hong Kong resolution regime.

Write-off and conversion of capital instruments issued by AIs

69. Currently, the regulatory capital framework in Hong Kong (which reflects the international Basel III standard) requires banks to maintain regulatory capital in a form that is considered loss-absorbing. To achieve this, provision is made in the Banking (Capital) Rules (Cap. 155L) for Additional Tier 1 capital instruments and Tier 2 capital instruments to be issued on terms that they can be converted into common equity or written off should the issuing AI reach the point of non-viability ("PONV").

70. There could be instances where these contractual provisions for write-off or conversion of Additional Tier 1 capital instruments or Tier 2 capital instruments have not been triggered under the provisions of the Banking (Capital) Rules (Cap. 155L) before the resolution authority decides that an AI fulfils the conditions for resolution under the resolution regime. In these circumstances, the FSB's Key Attributes of Effective Resolution

Regimes for Financial Institutions ("Key Attributes")[16] (3.5(iii)) provide that the resolution authority should have power to:

"upon entry into resolution, convert or write-down any contingent convertible or contractual bail-in instruments whose terms had not been triggered prior to entry into resolution"….. and treat any instruments resulting from the conversion alongside other existing equity or debt instruments in the bail-in of the firm.

71. The sequence of events envisaged by the Key Attributes means that the write-off or conversion of Additional Tier 1 capital instruments or Tier 2 capital instruments should occur before the application of any stabilization option. Accordingly, the authorities intend to provide in the legislation establishing the local resolution regime for the HKMA, as the resolution authority for AIs, to either convert into equity or write-off Additional Tier 1 capital instruments or Tier 2 capital instruments in accordance with their terms once the HKMA has decided that the conditions for resolving an AI are met and before a stabilization option is applied to the AI.

72. As non-viability is the principal element of the first condition proposed for initiating resolution and PONV is the contractual trigger for the capital instruments as prescribed by the Banking (Capital) Rules (Cap. 155L) and, as in each case, the HKMA is the authority charged with assessing whether the condition or trigger is met, the position of the holders of the relevant capital instruments should not be materially affected by the proposed power referred to in paragraph 71.

Preparatory powers

73. The authorities consider that the orderly resolution of a within-scope FI will require substantial advance planning both in a "business as usual" environment and, with increasing intensity, in any period leading up to resolution. To permit a resolution authority to undertake necessary planning activities pre-resolution, the authorities propose to include a range of "preparatory" powers in the legislation establishing the resolution regime which will be exercisable before (and, in certain circumstances, continue to be exercisable after) the commencement of resolution.

[16] See FSB (2014), Key Attributes of Effective Resolution Regimes for Financial Institutions (re-issued), http://www.financialstabilityboard.org/wp-content/uploads/r_141015.pdf

74. The first such power relates to the gathering of information needed (i) for "business as usual" resolution planning and assessment of resolvability as well as (ii) for the evaluation of the financial condition of the FI and the determination of the potential systemic impact of its failure in contemplation of any resolution (see paragraph 55 above).

75. In any lead-up to a potential resolution, the resolution authority may need to take steps to ascertain whether putative resolution strategies or plans can be put into operation. This might, for instance, extend to ascertaining any expression of interest from a prospective commercial purchaser. In this connection, the authorities note that during the preparatory phase for a potential resolution, certain parties both within and outside the FI may become privy to sensitive information relating to the impending resolution which, if disclosed, could jeopardise its success. To protect confidentiality, in these circumstances the authorities propose that the resolution authority should have the power to require specified persons (including FIs, their affiliates and relevant classes of professionals providing advice or other services to an FI or the resolution authority) not to disclose certain information (whether to the public or third parties) without the prior consent in writing of the resolution authority.

76. It is also not inconceivable that in the run-up to a potential resolution, officers of a failing FI might seek (not necessarily with any malign intention) to take actions that may impede the ability of the resolution authority to effectively exercise a stabilization option. To address this, the authorities intend to provide the resolution authority with a power of direction. Where the resolution authority is satisfied that the FI has ceased, or is likely to cease, to be viable, and that resolution will avoid or mitigate the systemic risks otherwise posed by the non-viability of the FI (regardless of whether there is reasonable prospect of private sector action that might avert the need for resolution) the resolution authority should have the power to issue such directions to the FI or its directors, or senior management in relation to its affairs, business and property as the resolution authority deems fit. Both positive (to do something) and negative (to refrain from doing something) directions could be issued for the purpose of securing orderly resolution and thereby furthering the resolution objectives. The power to issue directions would supplement the powers of the resolution authority to seek to improve resolvability by requiring barriers to resolution to be removed (see paragraph 36).

77. Respondents to CP2 were generally not in favour of an automatic removal of all directors or senior management of a failing FI entering into a resolution and many expressed the view that case-by-case consideration was more appropriate. On further reflection, the authorities are inclined to agree with the respondents and now propose to empower the resolution authority to remove directors and senior management of an FI, as well as those of a holding company of an FI, on a case-by-case basis both: (i) in the period immediately preceding potential resolution (i.e., where the resolution authority is satisfied that the FI has ceased, or is likely to cease, to be viable, and that resolution will avoid or mitigate the risks otherwise posed by the non-viability of the FI to the stability of the financial system of Hong Kong); and (ii) at the time of application of any of the stabilization options. Such a power might be exercised for instance in situations where a director or a member of senior management is no longer needed in order to conduct the ongoing business of the FI because of the effect of the stabilization option on that business.

Initiation of Resolution

78. Prior to initiating resolution, it is intended that the resolution authority should issue a "letter of mindedness" to the FI concerned, informing it that the authority is minded to initiate resolution, and should thereafter allow the FI to make representations to the resolution authority. The resolution authority will seek to allow the FI a reasonable period of time to make such representations but this must of course be interpreted in the context of the particular circumstances of the FI and the urgency with which the resolution authority may need to take resolution action. In practice it is expected that the senior management or directors will be closely engaged in the course of resolution planning (or seeking private sector options) well before the formal issuance of a letter of mindedness.

Client assets in resolution

79. CP2 consulted on whether it is necessary to introduce an additional resolution objective in respect of the protection of client assets. Whilst respondents' views were mixed, more respondents expressed support for an additional objective than those who did not. The authorities, on further reflection and for the sake of clarity, propose to include such a specific objective in the legislation establishing the local resolution

regime. This is in line with the approach adopted in the EU BRRD (Article 31) and the UK Banking Act (section 4(8)) as well as the Key Attributes (Preamble and Section 2 in Appendix II Annex 3).

80. CP2 proposed that client assets held by or on behalf of a within-scope FI that are protected under applicable domestic laws and regulation should be excluded from bail-in. The authorities propose to adopt the definition of "client assets" under the Securities and Futures Ordinance (Cap. 571) ("SFO") and expand the definition to cover assets held by a within-scope FI or its affiliated operational entity and holding company in the course of conducting the business of acting as a trustee or custodian.[17] The intention of this extended definition is to protect the existing common law position that trust/custody assets are protected from the insolvency of trustees/custodians and so should continue to be protected despite the introduction of the resolution regime.

Tax treatment on exercise of certain resolution powers

81. Some respondents to CP1 raised the need to consider the treatment of stamp duty and profits tax in connection with the exercise of stabilization options. The authorities have considered this matter and intend to consider requests for such tax exemptions on a case-by-case basis, where justified.

Next Steps

82. The authorities are proceeding to prepare a Bill for introduction into LegCo by the end of the year. The authorities intend to continue their dialogue with various stakeholders throughout the legislative process and thereafter as rules, Codes of Practice and guidance are developed and issued.

[17] It should however be noted that, for the sake of clarity, where liabilities of, or securities issued by, a within-scope FI form part of client assets, then these liabilities or securities may nevertheless be bailed-in.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
Securities and Futures Commission
Insurance Authority
9 October 2015

Annex 1

List of Respondents

1. Alternative Investment Management Association Limited (AIMA)
2. AIA Group Limited
3. Allen & Overy
4. BOC Group Life Assurance Company Limited
5. British Chamber of Commerce in Hong Kong
6. Clifford Chance and Asia Securities Industry and Financial Markets Association (ASIFMA)
7. CLS Bank International
8. Consumer Council
9. Deutsche Bank
10. Hong Kong Association of Banks
11. DTC Association (Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies)
12. Hong Kong Deposit Protection Board
13. Hong Kong Federation of Insurers, The[18]
14. Hong Kong Institute of Certified Public Accountants
15. Hong Kong Institute of Directors
16. Hong Kong Investment Funds Association
17. International Swaps and Derivatives Association
18. Law Society of Hong Kong
19. Lloyd's
20. LCH.Clearnet
21. Manulife (International) Limited
22. MetLife Limited, Metropolitan Life Insurance Company of Hong Kong Limited
23. Robinson, Ludmilla K. and Young, Angus of University of Western Sydney
24. UBS

* *Four respondents asked not to be identified.*

[18] The submission from The Hong Kong Federation of Insurers comprised its own comments as well as comments from BOC Group Life Assurance Company Limited.

Annex 2

Summary of Comments and the Authorities' Responses

Respondents' comments	Authorities' response
SCOPE	
1. Scope – LCs	
a. The vast majority of respondents agreed that it was appropriate for the subsets of licensed corporations identified in CP2 to be included within the scope of the resolution regime (i.e. licensed corporations which are themselves designated as non-bank non-insurer global systemically important financial institutions or which are subsidiaries or branches of groups which are identified as being (or containing) global systemically important financial institutions ("G-SIFIs")).	The authorities intend to reflect this scope of application in the legislation establishing the local resolution regime.
b. One respondent suggested that a licensed corporation which is a subsidiary of a group identified as being (or containing) global systemically important insurers ("G-SIIs") should be excluded from scope, as it has a different nature of business than its G-SIFI parent.	The authorities are of the view that licensed corporations which are subsidiaries of G-SIIs would necessarily have to be within the scope of the regime, in order to ensure that Hong Kong can reliably exercise resolution powers locally to support a group-wide strategy for a G-SIFI resolution as appropriate.
2. Factors in assessing the local systemic importance of insurers	
a. Respondents agreed with the authorities' proposal that the scope of the regime should not automatically capture Internationally Active Insurance Groups.	The authorities now intend that the initial scope of the regime will, as far as the insurance sector is concerned, extend to insurers that are themselves, or are members of groups containing, G-SIIs. In future, the FS may designate other

Respondents' comments	Authorities' response
	insurers as falling within the scope of the regime if they are assessed to be of systemic importance locally.
b. Several suggestions were received from respondents on the factors to be considered in assessing the local systemic importance of insurers. These included: i. Impact of the business size of the insurance industry on the Hong Kong financial sector ii. Impact on Hong Kong medical services iii. Impact on Hong Kong enterprises and governmental infrastructure construction. Some respondents suggested that the focus should be on non-traditional and non-insurance activities in assessing the systemic importance of insurers.	The authorities will consider respondents' suggestions when developing the methodology to determine the local systemic importance of insurers in Hong Kong. The authorities will also take reference from the International Association of Insurance Supervisors' methodology for identifying G-SIIs as appropriate.
3. Power to designate additional FIs as being within-scope	
a. Respondents generally agreed that it was appropriate that the FS should have the power to designate additional FIs as being within the scope of the local resolution regime, stressing that there should be a set of clear, transparent and consistent guidelines to govern how the FS may exercise this power.	See paragraph 8 of the main text on the FS's powers to designate FIs as within scope of the regime in cases where they had not been initially covered by the regime.
4. Financial services holding company / Mixed activity holding company	
a. Most respondents agreed with the presumption that resolution should be undertaken at the financial services holding company level, and that resolution would only be undertaken at the level of a locally incorporated mixed-activity	Provision is intended to be made to this effect in the legislation establishing the regime, in order to restrict the resolution authority's ability to affect the non-financial operations of a group only to those cases where not doing so

Respondents' comments	Authorities' response
holding company in exceptional circumstances where the way in which an FI has structured itself means orderly resolution cannot otherwise be achieved.	could prejudice orderly resolution.
b. Two respondents from the insurance sector disagreed with extending the scope of the local resolution regime to locally incorporated holding companies for the insurance sector.	The authorities remain of the view that the proposals regarding the extension of scope to locally incorporated holding companies are relevant to the insurance sector, as there may be cases where resolution may only be reliably executed at the holding company level, in order to deliver orderly resolution of the insurer itself.
5. Affiliated Operating Entities ("AOEs")	
a. Respondents generally agreed with the approach and scope in respect of AOEs. A couple of respondents proposed modifications to the definition of AOEs to the effect that it may be tied more directly to the provision of critical services and functions.	The intention is that the operative provisions of the legislation establishing the local resolution regime in respect of AOEs will only apply to AOEs' provision of services which are essential to the continuation of critical financial services, even if the definition of AOE is broader.
6. Recognized exchange companies under the resolution regime	
a. No respondents objected to bringing systemically important RECs within the scope of the resolution regime. Some respondents sought more clarity on the additional factors which the SFC would consider in determining the systemic importance of recognized exchange companies.	On further reflection, the authorities are minded to provide for the FS (rather than the SFC as discussed in CP2) to make the designation but he would only do so on the recommendation of the SFC.
GOVERNANCE ARRANGEMENTS	
7. Protection of client assets as an additional resolution objective	
a. Responses were somewhat mixed as to whether there should be an additional	On further reflection and for the sake of clarity, the authorities are inclined to

Respondents' comments	Authorities' response
resolution objective specifically on the protection of client assets. Those respondents who considered that an additional objective is not necessary believed that protection of client assets is already an implicit objective in view of the current resolution objective to "seek an appropriate degree of protection for depositors, investors and policyholders". Many of the respondents who expressed support to including an additional objective cited the need to ensure that the regime in Hong Kong is in line with the Key Attributes.	include a specific objective related to the protection of client assets in the legislation establishing the local resolution regime. This is in line with the approach adopted in the EU BRRD (Article 31) and the UK Banking Act (section 4(8)) as well as the Key Attributes (Preamble and Section 2 in Appendix II Annex 3).
8. Designation of LRA for cross-sector financial group	
a. Respondents generally agreed that the criteria for the designation of the LRA should be based upon the resolution authorities' assessment of the relative systemic importance of the individual within-scope FIs within a cross-sector financial group locally. Many respondents noted they would appreciate further clarity on how systemic significance will be measured and compared across sector.	The authorities intend to draw upon the methodologies devised internationally to assess the systemic importance of banks, insurers and other global institutions. In this regard, the authorities note that the HKMA published a SPM module CA-B-2 on "Systemically Important Banks" in February 2015, which sets out factors forming the basis of an assessment of the systemic importance of AIs in Hong Kong.

Respondents' comments	Authorities' response
b. The vast majority of respondents agreed that the LRA's role should be one of coordination and, when required, ultimate decision maker. One respondent, however, considered that the FSTB would be best placed to take on this role instead.	The legislation establishing the local resolution regime will specify the powers of the LRA. The authorities anticipate entering into specific MoUs focussed on their resolution functions to set out the basis for cross-sector coordination in resolvability assessment, resolution planning and undertaking resolution action should the need arise (see paragraph 12 in the main text). As for the suggestion that the FSTB assume this role, the authorities note that the role and function of an LRA have been carefully considered in CP1 and CP2, and the FSTB as a policy bureau of the HKSARG with responsibility for the overall financial sector in Hong Kong is not best placed to undertake the role or functions of an LRA in respect of individual cross-sector groups. Furthermore, as explained in CP1 and CP2, the authorities are cognisant of the need to provide the resolution authority with operational independence in line with Key Attribute 2.5 and have concerns that such an active role for the FSTB in resolution decision making would constrain that independence. The view remains that it is most appropriate for one of the resolution authorities to act in the capacity of an LRA.
c. A couple of respondents thought that the authorities should elaborate on the role of LRA, and more generally, on how the resolution authorities are envisaged to interact with each other, including during resolution planning for a cross-sector group.	It is expected that "mechanics" in this area will be set out in an MoU between the resolution authorities. See further details in paragraph 12 of the main text.

Respondents' comments	Authorities' response
RESOLUTION POWERS	
9. Temporary increase in Deposit Protection Scheme ("DPS") cover	
a. Respondents agreed with the proposal in general. One respondent suggested the proposal be extended to other depositors while another suggested that more details should be provided regarding any additional costs of temporary additional DPS cover.	Regarding the suggestion to extend the temporary DPS cover to "other depositors", the authorities note that the membership and coverage of the DPS are not within the scope of this consultation, and that these issues have been kept under review by the Deposit Protection Board from time to time to ensure the continual efficiency and effectiveness of the DPS. The proposal for temporary additional DPS cover will not result in additional costs being borne by the DPS levy. As mentioned in CP2 (paragraph 91), it is not proposed that a levy will be imposed on the transferred deposits for the duration of the additional DPS cover, given that the proposed increase is only temporary (lasting six months) and the annual DPS contributions are collected at the beginning of each year.
10. Bail-in mechanism	
a. Many respondents agreed that the BoE bail-in approach could be adopted in Hong Kong and supported the use of certificates of entitlement.	The authorities envisage that the provisions included in the local legislation on bail-in will be broadly in line with those in the UK Banking Act, thereby enabling a resolution authority in Hong Kong to take a similar approach to their UK counterpart in implementing the bail-in stabilization option.
b. Some respondents were concerned that the valuation process for bail-in would be different from that for NCWOL compensation and that more details on valuation should be provided.	The authorities consider that a number of valuations will be required to execute resolution using bail-in. These valuations will be conducted for different purposes and at different points in time, and will thus need to be conducted

Respondents' comments	Authorities' response
	separately. In the first instance, before a resolution authority can apply a stabilization option (including bail-in), it must make a valuation of the FI for the purpose of informing its decision on: (i) whether the conditions for initiating resolution have been met; and (ii) if those conditions are met, which stabilization option to apply. Secondly, as discussed in CP2, in the specific case of a bail-in, further detailed valuation work is likely to be required following the initiation of resolution (and the initial announcement of those liabilities potentially within the scope of a bail-in) and before the final terms of the bail-in can be finalised (i.e. to ensure losses are fully recognised and to inform the extent of write-down and/or conversion required). To provide greater detail on the bail-in mechanism, the authorities intend to issue guidance or a Code of Practice on the process once the legislation establishing the regime comes into effect. Finally, the NCWOL valuation is distinct from the pre-resolution valuation discussed above, as it is specifically designed to support a fundamental safeguard under the regime by determining whether the application of any of the stabilization options, including bail-in, has resulted in pre-resolution shareholders or creditors incurring greater loss in resolution than would have been the case had the FI otherwise entered into liquidation. The assumptions used for the NCWOL valuation will naturally differ from those used in the

Respondents' comments	Authorities' response
	pre-resolution valuation. The fundamental difference is that the valuer appointed to undertake the NCWOL valuation must assume that the FI had entered into liquidation on the date that resolution was initiated in order to generate a valuation of what pre-resolution shareholders and creditors would have received in a hypothetical liquidation. The NCWOL valuer must then assess the treatment that pre-resolution shareholders and creditors actually received as a result of the resolution action(s) taken. Where the treatment in resolution is assessed to be worse than would have been the case in the hypothetical liquidation scenario, the affected pre-resolution shareholders and creditors will be eligible for compensation amounting to the difference in treatment (see section under Safeguards in the main text). The NCWOL valuation can only take place following the application of one or more stabilization options. As noted above, the authorities intend to issue guidance or a Code of Practice on the mechanics for bail-in (including valuation) and on the manner in which the NCWOL valuation is expected to be conducted. This guidance will be in addition to the rules governing the conduct of the NCWOL valuation process to be issued by SFST as referred to in paragraph 34 of the main text.
c. One respondent commented that that the bail-in option should not impose a new requirement that loss-absorbing resources be held in local subsidiaries or branches of cross-border FIs.	It has been agreed internationally that an adequate amount of loss-absorbing capacity is essential to successful implementation of bail-in, and work is already well underway on the setting of a TLAC requirement for G-SIBs requiring them

Respondents' comments	Authorities' response
	to issue, and maintain in issue, specified amounts of loss-absorbing instruments in order to facilitate bail-in in resolution. As part of the FSB's TLAC standard, it is likely that any local material subsidiaries or material sub-groups of a G-SIB will be required to maintain a level of "internal" TLAC (generally expected to take the form of a subordinated loan to the parent company to which resolution tools will be applied (resolution entity)). In the case of an MPE resolution strategy, any local subsidiary of a G-SIB that is itself a resolution entity would, under the proposal for the FSB TLAC standard, need to maintain TLAC in line with the level set by the standard. For local branches, as they are part of the overseas legal entity, the FSB TLAC standard would regard them as covered by the TLAC requirement applied to the legal entity as a whole. The authorities will consider how best to implement the FSB TLAC standard locally once it is finalised. To "anticipate" the standard, the authorities' intention is to pursue a rule-making power in the legislation establishing the resolution regime which will allow the resolution authority to make rules in future on loss-absorbing capacity, adopting international standards to the extent considered desirable or appropriate in local circumstances. In the banking sector the HKMA does not traditionally impose branch capital requirements and the present intention would be to follow a similar approach for TLAC.
d. A number of comments were received on the operational aspects of bail-in,	(i) Home and host resolution authorities will endeavour to collaborate on

Respondents' comments	Authorities' response
including: (i) the need for host country resolution authorities to collaborate with the home authority to identify liabilities that can be bailed in; (ii) that the preliminary valuation relating to bail-in should be conducted within a reasonably short time; and (iii) whether there is a right to challenge valuation before the terms of the bail-in are finalised.	resolvability assessment and resolution planning for systemically important cross-border financial institutions e.g. for banks primarily through the established Crisis Management Group mechanism. If the preferred resolution plan for a cross-border institution is bail-in, the home and host authorities will consider the amount and location of bail-in-able liabilities. Location is important as loss absorption must occur at resolution entity level, but there may be arrangements, such as internal TLAC, allowing for loss absorption at the resolution entity level without the application of resolution tools at subsidiary (i.e. non-resolution entity) level. (ii) and (iii) The valuation to be carried out by the resolution authority prior to a bail-in, must of necessity, be produced within a short period of time and adopt prudent assumptions. To maintain confidence in the resolution process and thereby promote financial stability, it is essential that resolution action proceed swiftly and certainly once an FI within the scope of the resolution regime is assessed to be non-viable. Therefore it is not intended that the terms of a bail-in should be made the subject of a specific right of appeal before they are finalised. Rather a pre-resolution shareholder or creditor who fares worse following a bail-in than they would have done on a hypothetical liquidation of the FI will be eligible for NCWOL compensation.
e. One respondent suggested the authorities consider creating an additional	

Respondents' comments	Authorities' response
preference for all deposits of retail and SME clients as the last tranche of liabilities to be bailed-in.	After further deliberation, the authorities are now minded to extend the exclusion from bail-in to all deposits falling within the definition of "protected deposit" under the Deposit Protection Scheme Ordinance (Cap. 581), as well as to deposits held by restricted licence banks and deposit-taking companies which, had they been taken by a DPS member, would have fallen under the definition of "protected deposit". Based on this definition, it is expected that retail and SME depositors would be excluded from bail-in to a large extent. See paragraph 15 in the main text.
f. One respondent commented that bail-in powers should not extend to, or impact upon, an FMI's default arrangements set forth in its rules.	In general a resolution authority will respect an FMI's rules for loss allocation and would not intervene unless it is necessary for achieving the resolution objectives. This approach is in line with Appendix II Annex 1 to the Key Attributes on Resolution of FMIs and FMI Participants (paragraph 4.4).
g. One respondent commented that bail-in is not an appropriate resolution strategy for subsidiary-based, traditional insurance groups and several resolution options are "ill-suited" to the resolution of an insurer. Another respondent also commented that bail-in is not appropriate in a resolution of a CCP given its capital structure is very different from that of a bank.	The stabilization options, including bail-in, are designed to provide a "tool kit" for the resolution authority. The resolution authority will determine on a case-by-case basis (most likely as a result of its resolvability assessment and resolution planning) which tool is most appropriate to resolve a given FI.
11. Excluded liabilities	
a. A majority of respondents supported the proposal to exclude from bail-in those liabilities identified in paragraph 108 of CP2. The proposed grounds to exclude further liabilities from bail-in as identified in paragraph 110 of CP2	The authorities intend that the legislation establishing the regime will identify those liabilities permanently excluded from the application of bail-in, as set out in CP2. However, having reflected further on the potential systemic

Respondents' comments	Authorities' response
were also generally supported, but some respondents felt clarity should be provided on when affected parties will be informed whether liabilities are subject to bail-in.	consequences of bailing-in depositors, the authorities are now minded to exclude (virtually) all deposits from the scope of bail-in. Hence it is intended that the exclusion will extend to deposits falling within the definition of "protected deposit" under the Deposit Protection Scheme Ordinance (Cap. 581) but irrespective of amount, and will include those deposits held by restricted licence banks and deposit-taking companies which had they been taken by a Scheme member would have fallen within the definition. In terms of the mechanics of bail-in, as noted above the authorities intend to issue guidance setting out, or include information within a Code of Practice, on their approach to bail-in.
b. A number of comments were made in terms of the scope of excluded liabilities, including: (i) to exclude certain liabilities that are more systemically important or likely to give rise to contagion than others (e.g. liabilities to payment, clearing and securities settlement systems); (ii) to consider the appropriateness of extending the maturity period of unsecured short-term inter-bank liabilities; (iii) to consider extending excluded liabilities to cover protected deposits with the failing bank that are protected by overseas schemes similar to DPS; (iv) how partially secured liabilities will be treated; (v) whether derivatives positions cleared through CCPs are covered as excluded liabilities; and (vi) to extend the protection of client assets to include a reference to international as well as domestic laws and regulations.	(i) and (ii): The authorities, after having reflected further on the potential systemic consequences and contagion effects of bailing-in certain liabilities, intend to expand the list of excluded liabilities, including depositors (see section under "Liabilities excluded from bail-in" in the main text and Annex 3). Moreover, it should be noted that the liabilities listed in paragraph 108 of CP2 serve as a minimum set of exclusions in every case and further liabilities can be excluded if certain prescribed criteria are met, namely: (i) where it is not reasonably possible to effectively bail-in those liabilities within a reasonable time; (ii) where bailing in those liabilities would be value destructive such that losses borne by other creditors would be higher than if those liabilities had not been bailed-in; and (iii) where bailing in the liabilities would undermine efforts

Respondents' comments	Authorities' response
	to meet the objectives set for resolution. (iii) and (vi): In relation to deposits protected by DPS-like insurance schemes operated overseas, the authorities are now minded to exclude (virtually) all deposits from the scope of bail-in (see item 11a above). With regard to the protection of client assets, the authorities are minded to exclude assets held in the course of carrying out regulated activities under the SFO or in the course of carrying on a business as a trustee or custodian. It should however be noted that, for the sake of clarity, where liabilities of, or securities issued by, a within-scope FI form part of client assets, then these liabilities or securities may nevertheless be bailed-in. See paragraph 80 in the main text. (iv) The authorities' intention is to exclude any liabilities so far as they are secured. In other words, any unsecured or undercollateralised "portion" of a liability could be subject to bail-in. (v) Derivatives that are cleared through domestic CCPs will be excluded liabilities insofar as liabilities arising from participation in clearing and settlement systems will be excluded from bail-in.
c. Although there were mixed views as to whether derivatives transactions can be bailed-in in practice, most respondents expressed the view that liabilities	The "protected arrangements" in relation to bail-in discussed in paragraph 41 of the main text are aimed at providing for secured and title transfer arrangements,

Respondents' comments	Authorities' response
arising from derivatives transactions should be bailed-in on a net basis after being closed out. In addition, these liabilities should not remain within the scope of bail-in powers automatically.	and contracts with set-off or close-out netting provisions (including derivatives transactions) to be bailed in on a net basis. Whilst recognising that there may be practical and operational challenges in applying bail-in powers to derivatives, the authorities do not however see it as appropriate to permanently exclude them 'wholesale' from bail-in. Further, as noted above, to the extent that derivatives are cleared through domestic CCPs, they will in any event be excluded from bail-in, insofar as liabilities arising from participation in clearing and settlement systems will be excluded.
12. TPO	
a. Most respondents agreed that an additional condition is required before the resolution authority could apply the TPO stabilization option (namely that the resolution authority assesses that an orderly resolution delivering on the resolution objectives is most appropriately achieved through TPO as the other stabilization options will not achieve the desired result within a timely fashion). Some respondents commented that TPO should remain as a last resort option.	The authorities agree that TPO should be a last resort. To this end, the authorities intend to include a condition to this effect under the regime and a requirement to seek the approval of the FS before TPO can be applied as a stabilization option.
13. Temporary stays on early termination rights	
a. Respondents generally agreed with the proposed approach for temporary stays in financial contracts and supported the extension of the scope of the stay to a wider set of contracts where the early termination of those contracts could undermine orderly resolution. However, one respondent commented that it	See paragraph 23 in the main text with regard to broadening the scope of contracts covered by the stay provisions. As regards application of stays in a cross-border context, the authorities envisage, as a simple example, that where a resolution is initiated in respect of an FI (FI-A) in a jurisdiction (Jurisdiction A)

Respondents' comments		Authorities' response
	was unclear how the application of stays would work in a cross-border situation.	other jurisdictions (i) where FI-A has operations or (ii) by whose law contracts entered into by FI-A are governed (and where related collateral is located) will be requested by Jurisdiction A to either recognise the stay imposed by Jurisdiction A or use their own resolution powers to impose a stay in their own jurisdiction in respect of FI-A (in cases where FI-A has a local presence). In such cases the local resolution authorities would need to consider whether the criteria for recognition or conditions for use of powers under the local regime in relation to FI-A were met. Work continues at the FSB on cross-border recognition of resolution actions and the authorities would intend to participate in this work and align the local resolution regime with its eventual outcomes, with a view to providing effective mechanisms locally to support the exercise of cross-border resolution actions.
b.	Respondents raised a number of other issues which need to be considered in relation to stays, including: (i) to ensure that stays imposed under Hong Kong law will be recognised in a foreign jurisdiction and vice-versa; (ii) stays should not result in increased regulatory capital requirements against relevant positions; (iii) ability to suspend contractual termination rights must be clearly defined in scope and limited in application; (iv) discretionary power should be given to the resolution authority to extend the duration of a stay in exceptional cases.	(i) The authorities intend to provide in the legislation establishing the local regime for a rule-making power enabling the resolution authority to make rules that impose requirements on a within-scope FI to ensure that the terms and conditions of certain contracts contain provisions by which each counterparty agrees to be bound by a temporary stay on early termination imposed by the resolution authority (see paragraph 53 in the main text). (ii) The authorities would not propose at this stage to increase regulatory capital requirements to reflect the effect of the stay. The authorities will however

Respondents' comments	Authorities' response
	keep in view whether any action is taken in future by international standard setting bodies in this regard. (iii) The authorities are cognizant of the need to maintain as much certainty and confidence in the financial markets as possible and accordingly to limit the effect of any stays in resolution. The authorities have, however, decided that the scope of the stay should extend beyond "financial" contracts to cover other contracts (e.g. in some cases leases of premises) which are of fundamental importance in securing the ongoing provision of critical financial services. (iv) At present the authorities are minded to limit the duration of the stay to two business days, for reasons of certainty and confidence, but will consider further the suggestion of a discretionary power for a resolution authority to extend the stay and how this might interact with the conditions relating to the ISDA Resolution Stay Protocol. The authorities note in this regard that in a consultation paper published in June 2015 the Monetary Authority of Singapore (MAS) proposed a two business day stay in similar circumstances, but with MAS "to have the flexibility to specify a longer duration when imposing the stay" (paragraph 3.8).
c. With respect to the proposed temporary suspension of insurance policyholders' surrender rights and stay on reinsurers, there was no major objection to the proposed powers although one respondent commented that it	The proposed powers are consistent with the recommendations specified in Appendix II-Annex 2 of the Key Attributes (Resolution of Insurers). The authorities are of the view that such powers are necessary to preserve the

Respondents' comments	Authorities' response
may be difficult to establish that a reinsurance contract which contains broad powers for early termination is in fact being terminated for a reason connected to resolution, unless there are express provisions in the contract that it can be terminated on insurer resolution and that reinsurer states that to be the reason for termination.	continuity of critical financial services provided by a failed insurer.
14. Power of resolution authority	
a. There was general support to empower the resolution authority to issue directions requiring an FI to take actions for improving its resolvability. However, such power should be subject to checks and balances. A few respondents were concerned that the 3-month timeframe to remove a barrier to resolvability might be too short.	On checks and balances, it is intended that a resolution authority will be required to have regard to a number of considerations before exercising its powers to require an FI to take actions for improving its resolvability (see paragraph 36 in the main text). The detailed process and timeframe for identifying and removing barriers to resolvability will be further developed in guidance or a Code of Practice and consulted upon in due course, taking into account the responses received to CP2. Meanwhile, the authorities would like to clarify that the 3-month timeframe mentioned as an example in CP2 refers to the period during which an FI is able to make representations on how it proposes to remove an identified barrier to resolvability (as opposed to the period for actual removal of the barrier). The resolution authority would then only use its powers to direct an FI to take specific action to improve its resolvability in the event that it is assessed that the FI's proposals would not achieve the resolution authority's desired

Respondents' comments	Authorities' response
	objective and no alternative measures can be agreed. In giving a direction, the resolution authority will specify a timeframe within which any directed action to remove barriers to resolvability is to be completed having regard, amongst other things, to the complexity of, and expected length of time needed for, implementing the action. Furthermore, it is expected that the FI will be closely engaged throughout the process of identifying impediments, via the conduct of resolvability assessment and resolution planning, and this should give the FI an early view of any potential barriers before formal notification.
b. There was no major objection to the resolution authority being notified before the filing of a winding-up petition in relation to an FI, but a number of respondents suggested a notice period shorter than 14 days. One respondent questioned how such requirement would operate in the context of non-regulated AOEs.	The authorities note the concern on timing and are now minded to shorten the notice period from 14 days to 7 days. The authorities have considered how practicable it may be for petitioners (and indeed the Court Registrar) to identify within-scope FIs, their holding companies and their AOEs for the purpose of preventing petitions being presented contrary to the provisions envisaged. The authorities have concluded that, from a practical perspective, the prohibition on presenting a petition without notifying the resolution authority should be confined to petitions in respect of within-scope FIs and their holding companies (a list of which can be provided periodically to the Court Registrar). Should a petition be presented in respect of an AOE, the supervisory/resolution authority would expect to be notified of this by the within-scope FI and would then consider the ramifications for the FI and any potential future resolution.

Respondents' comments	Authorities' response
	Further, the nature and extent of reliance of within-scope FIs on their AOEs (and indeed third party suppliers) will be studied during the resolvability assessment and resolution planning process. To the extent the degree of reliance raises concerns in the context of the potential for an abrupt termination of service on the insolvency of an AOE – this may need to be addressed in the context of removing impediments to resolution. See paragraph 76 in the main text.
c. To ensure the continuity of essential services to a business transferred from a residual FI, a majority of respondents preferred the appointment of a person to take control of, and manage, the residual FI (option (a)) to the establishment of a service company (option (b)). One respondent commented that consideration should be given to the future of the residual FI once it has served its purpose and how the assets of the residual FI could be protected for distribution to creditors.	See paragraph 27 of the main text for an explanation of the intended approach to securing continuity of essential services from a residual FI upon a partial transfer.
d. Respondents were generally supportive of empowering the resolution authority to impose a temporary moratorium on payments to general creditors.	The authorities intend to include provision in the legislation establishing the local resolution regime enabling the resolution authority to impose such a temporary moratorium. Similar to the temporary stay on early termination rights, this power will be discretionary, as securing continuity of the provision of critical financial services may in many cases argue against a moratorium. Any moratorium will be limited in time (likely two business days) and subject

Respondents' comments	Authorities' response
	to exclusions including in relation to an FI's liabilities arising from participation in FMI.
e. Most respondents agreed with empowering the resolution authority to appoint a resolution manager. There was some suggestion that the incumbent executives might be in a better position to assume the role of a resolution manager, and that the specific skills, experience and expertise for the role of a resolution manager should be set out with similar clarity to that of the role of a NCWOL valuer.	On further reflection, as noted in item 15a below, the authorities no longer propose the automatic removal of all directors upon resolution. Accordingly, as it is envisaged that at least some of the incumbent senior officers will remain available to continue operating the business as required during resolution, the authorities are less inclined to articulate specific duties for a "resolution manager" but are minded rather to include in the legislation establishing the local resolution regime a more general and flexible provision allowing a resolution authority to appoint such persons as the authority thinks fit to assist the authority in the performance of any of its functions under the Ordinance. Such assistance might be in any number of areas (depending upon the ultimate characteristics of a given resolution) and would support rather than supplant the resolution authorities' functions.
f. Most respondents agreed that the resolution authority should have the power to secure continuity of essential services as set out in paragraph 156 of CP2. Comments were raised on the exercise of such power in cases where the services provided by other regulated or non-regulated entities in the group are domiciled outside Hong Kong.	The authorities intend to include provision in the legislation establishing the local resolution regime to enable the resolution authority to direct an AOE of a within-scope FI to continue to provide services that are necessary to support continuity of critical financial services on reasonable commercial terms. The difficulties of "directing" overseas companies are noted and the extent and nature of the reliance of within-scope FIs on the provision of essential services from AOEs overseas will be considered during the resolvability assessment and

Respondents' comments	Authorities' response
	resolution planning processes. In this regard, the likely extent of cross-border cooperation in resolution between the jurisdictions involved will also be a factor for consideration.
15. Removal of directors and senior management of an FI in resolution	
a. Overall, respondents disagreed with an automatic removal of the directors, CEO and Deputy CEO of an FI in resolution and preferred a case-by-case approach. Two respondents asked for further details on who might constitute "other senior management".	Taking into account respondents' views, the authorities are no longer minded to pursue an approach involving automatic removal of directors, CEO and Deputy CEO. Instead, removal will be considered on a case-by-case basis in the context of the circumstances relating to a given resolution. "Other senior management" in CP2 was intended broadly to refer to individuals who are principally responsible for the conduct of key business lines or the oversight of key functions (including control and risk management functions) within an FI.
16. Remuneration claw-back	
a. Respondents in general considered the court as an appropriate forum to consider any remuneration claw-back. However, comments were received on the following: (i) how "risk-takers" will be identified; and (ii) that the scope of personnel of an FI subject to remuneration claw-back should be the same as that of senior management and key personnel as outlined in the HKMA Supervisory Policy Manual ("SPM") module CG-5 issued by the Monetary Authority in relation to authorized institutions providing a "Guideline on a	(i) The authorities' intention is to empower the resolution authority to apply for claw-back against relevant current or former directors; CEOs and their deputies; senior management (principally responsible for the conduct of a business line); and those occupying a risk-taker role in respect of any FI in resolution. As explained in CP2, "risk-takers" might be defined as persons whose professional activities have, or have the potential to have, a material impact on the risk profile of an FI. The identification of "risk-takers" therefore inevitably has to be

Respondents' comments	Authorities' response
Sound Remuneration System" to ensure consistency.	FI-specific and case dependent in some degree. (ii) The authorities do not immediately see any conflict between the claw-back provision under the proposed resolution regime and the provisions of the SPM module CG-5. The SPM module is designed to provide guidance on how to tailor a remuneration system so that in "business as usual" conditions it does not incentivise excessive risk-taking for personal gain but rather supports effective risk-management. In providing guidance on the alignment of remuneration to the time horizon of risk, the SPM module focusses on the need to validate the performance measures used in an AI's remuneration system before bonuses are paid. The "claw-back" envisaged by the SPM is operable by the FI in respect of unvested, deferred remuneration where it is later discovered that a performance measurement has been manifestly misstated or where fraud or malfeasance or violation of internal control is discovered on the part of the employee. To the extent that a within-scope FI operates its own claw-back mechanism then any remuneration so clawed-back obviously cannot become the subject of any subsequent claw-back order made by a Court following resolution. Whereas FI driven claw-back under the SPM module targets unvested, deferred variable remuneration the authorities intend that the claw-back under the resolution regime will cover fixed as well as variable, and vested as well as unvested, remuneration (subject to the Court taking into account the financial circumstances of the officer concerned when making a

Respondents' comments	Authorities' response
	claw-back order).
b. There were mixed views on whether the remuneration claw-back should apply to both fixed and variable remuneration or only to variable remuneration, as well as in relation to the appropriate claw-back period (ranging from one to six years).	As noted above, the authorities intend to apply the claw-back to both fixed and variable remuneration. The intended claw-back period is the three years preceding the initiation of resolution but this would be extendable by the Court for up to three more years back in cases of dishonesty. See also paragraph 30 in the main text.
SAFEGUARDS AND FUNDING	
17. NCWOL valuer	
a. Respondents recognised the any NCWOL valuer appointed to undertake a NCWOL valuation must be independent and possess the necessary expertise. Respondents generally agreed with the proposed criteria for assessing the independence and expertise of a NCWOL valuer, although some noted that in practice, this means a very small pool of potential candidates in Hong Kong.	The authorities acknowledge the point with regard to the size of the pool of potential candidates for NCWOL valuers locally. The authorities would however note the possibility of appointing a NCWOL valuer from overseas, if in the circumstances of a given resolution, it were considered that an overseas valuer with more limited knowledge of local markets in Hong Kong would nevertheless be able to perform the functions of a NCWOL valuer satisfactorily.
b. A few respondents asked for clarification as to whether the NCWOL valuer is the same party which performs other types of valuation, for example, to gauge the size of any bail-in. If different, those respondents stressed the importance of having a consistent set of principles for all valuers.	The NCWOL valuation and the pre-resolution valuation (including any further detailed work on the ultimate size of any bail-in) are, as noted under item 10b above, intended for different purposes. In order to preserve the independence of the valuer conducting the NCWOL valuation, it is intended that any valuer engaged by the resolution authority to assist with any pre-resolution valuation (including further work on bail-in) should not subsequently be appointed as the NCWOL valuer.

Respondents' comments	Authorities' response
c. The vast majority of respondents expressed support for the resolution authority to appoint a NCWOL valuer, provided that the appointment process is open and transparent. One respondent suggested that, instead of the resolution authority, NCWOL valuers should be appointed by an internationally recognised professional body or independent panel.	Upon further consideration in order to reinforce the manifest "independence" of the NCWOL valuer, the authorities now propose that the FS appoints an "appointing person" who will be tasked in turn with appointing a NCWOL valuer (See paragraph 33 in the main text).
d. Respondents mostly agreed with the grounds and mechanism for removal of a NCWOL valuer.	It is now proposed that the RCT (instead of the resolution authority as proposed in CP2) be empowered to remove a NCWOL valuer, for similar reasons regarding independence as explained in item 17c above (see paragraph 35 in the main text).
18. Treatment of outgoing NCWOL valuer	
a. All respondents who provided feedback agreed that the treatment of the outgoing valuer's work up to the point of removal is a matter for any incoming valuer.	The authorities intend to include in the legislation establishing the local resolution regime requirements for any outgoing valuer to provide relevant information and documentation to a replacement valuer and for such replacement valuer to take such notice of it as he deems apppropriate.
b. One respondent queried whether joint appointments of two valuers may be possible, and if so what would be the impact should one of them be removed.	It is envisaged that only one valuer will be appointed for a NCWOL valuation. It is likely that the NCWOL valuer will be a partner, principal or director in a firm or company enabling him to call upon the resources of the firm or company in undertaking the NCWOL valuation. The NCWOL valuer may, in addition, employ or engage third parties for the purpose of, or in connection with, the performance of the NCWOL valuation (such as, for example, specialised real estate valuers).

Respondents' comments	Authorities' response
19. Overarching NCWOL valuation principles	
a. Respondents were generally supportive of restricting access to compensation to shareholders and creditors who held liabilities of a failed FI at the point resolution proceedings formally commenced and who suffer an economic loss as a direct result of the resolution authority's actions.	The authorities intend the legislation establishing the local resolution regime to set the scope of NCWOL protection to extend to such pre-resolution shareholders and pre-resolution creditors.
b. Respondents generally agreed the three overarching valuation principles proposed in CP2 should be applied each time a NCWOL valuation is undertaken, namely: (i) valuation reference date; (ii) creditor hierarchy; and (iii) provision of financial assistance. On (i), the vast majority of respondents expressed preference for such date to be the date the notice of entry into resolution is issued.	On the valuation reference date, the authorities agree with the view expressed by the majority of respondents and it is intended that this date should be the date when the FI enters into resolution (i.e. the date upon which a stabilization option is first exercised in relation to the FI). This, together with any other assumptions for the NCWOL valuation, is expected to be set out in rules to be made by the SFST (see paragraph 34 in main text).
20. NCWOL compensation	
a. No specific suggestions were received on how a mechanism might be provided to expedite the payment of NCWOL compensation where at least part of any valid NCWOL claims can reliably be identified. In fact, a number of respondents expressed some doubts as to whether expediting the NCWOL payment compensation would be feasible in practice.	The authorities will continue to consider whether there are any ways in which payment of NCWOL compensation may be expedited or interim NCWOL payments might be made.
21. RCT	
a. Respondents agreed that the proposed RCT should be established under the resolution regime, and were overall supportive of the proposed composition of, and process for appointment to, the RCT. One respondent questioned	Provisions relating to the establishment of an RCT will be included in the legislation establishing the local resolution regime. Regarding the proposed qualifications for the Chair of the RCT, the authorities

Respondents' comments	Authorities' response
whether the proposed qualifications for the Chair of the RCT (a judge of the High Court) were set too high.	do not consider that the proposed qualifications in CP2 were set too high, noting that they are in line with those of other similar tribunals, for example the Banking Review Tribunal where the Chair has to be a person qualified for appointment as a judge of the High Court (see section 101A(2) of the Banking Ordinance (Cap. 155)). That said, the authorities note that in practice (due to competing commitments) it may not be possible to appoint a currently serving judge and so qualifications for the chair will extend to former judges and deputy judges of the Court of First Instance and former Justices of Appeal, and persons eligible for appointment as a judge of the High Court under section 9 of the High Court Ordinance (Cap. 4).
b. No specific comments were made on the powers that should be made available to the RCT.	
c. All respondents agreed that applicants should have the right to appeal against a determination of the RCT on a point of law.	Provision is intended to be made for this in the legislation establishing the resolution regime.
22. Protected financial arrangements	
a. No specific suggestions were received either on the way in which protected financial arrangements were proposed to be safeguarded or how the remedies for inadvertent breaches should be executed. However, a considerable number of respondents asked authorities to take into account the need to establish any MIS for monitoring protected financial arrangements, highlighting that this could be a significant cost and administrative burden for FIs.	The authorities note the concerns raised by respondents regarding the potential costs associated with the establishment of MIS for monitoring protected financial arrangements. However if such arrangements are to be afforded protection, it will inevitably be necessary to identify them. With regard to secured transactions the authorities would expect financial institutions' MIS to link exposure and security in order to measure the extent of any unsecured

Respondents' comments	Authorities' response
	exposure level. Similarly for netting and title transfer arrangements under master agreements the authorities would expect FIs' MIS to be capable of identifying the net claim/obligation. Identification of protected arrangements will be considered during the course of resolution planning.
b. No specific suggestions were received in relation to a safeguard to protect certain financial arrangements in bail-in. A number of respondents generally thought that a similar arrangement to that proposed for protected financial arrangements could be used in respect of bail-in.	The authorities intend to provide in the legislation establishing the local resolution regime for a rule-making power for the SFST to prescribe requirements applicable to a resolution authority in relation to protected arrangements when the resolution authority is applying stabilization options, including bail-in (see paragraph 42 of the main text).
23. Factors in developing effective protections from civil liability	
a. Respondents were generally supportive of protecting certain parties as proposed in CP2 from civil liability, with one respondent suggesting that the approach taken by Hong Kong be consistent with those taken by overseas resolution authorities to avoid creation of an uneven playing field.	Protections for relevant persons from civil liability will be included in the legislation for the local resolution regime.
24. Exemptions and deferral of disclosure and other obligations	
a. Respondents generally agreed that the resolution authorities should have the power to defer or exempt compliance with: the disclosure requirements under the SFO and the Listing Rules, the shareholders' approval requirements under the Listing Rules and the general offer obligation under the Takeovers Code as described in CP2.	The authorities intend to include appropriate provisions in the legislation establishing the local resolution regime.
25. Funding arrangement – costs to be recovered	

Respondents' comments	Authorities' response
a. Mixed views were received as to whether there should be a non-exhaustive list of the permitted uses of the resolution funding arrangements.	The authorities continue to consider that any list of costs should be non-exhaustive as the types of cost involved may vary depending upon the form of a given resolution and its execution. However, the authorities would emphasise that resolution funding would only be used for, or in connection with, the application of a stabilization option(s) for carrying into effect the provisions under the regime. See paragraph 44 in main text.
26. Funding – overarching principles in setting levies	
a. The vast majority of respondents agreed that there should be overarching principles in setting levies. Some respondents offered further thoughts on what the overarching principles should take into consideration, including that: (i) the funding arrangement should be on an *ex post* basis; and (ii) a risk-based approach should be taken, based on criteria related to risk of failure.	Having carefully considered the pros and cons of *ex ante* and *ex post* approaches to resolution funding, the authorities continue to agree that an *ex post* funding approach is more appropriate in the Hong Kong context and agree that, in any allocation of levy, a proportionate approach (include some measure of risk adjustment) should be adopted. See paragraph 48 in main text.
b. A number of respondents provided their views on whether any levy should be sector-specific, and views were somewhat mixed; some respondents believed that resolution funds should be sector-specific, while others thought sector-specific levies may seem somewhat unwieldy, and suggested that it seems more suitable to view each resolution on a case-by-case basis so as to assess the range of market participants that would have been affected by the failure of the FI and should therefore be asked to contribute.	After further consideration, the authorities are minded to pursue a sector-specific approach to resolution funding arrangements, while noting that additional provision may be required in the case that: (i) the FI, or FIs, in resolution are part of a cross-sector financial group, or (ii) the FI in resolution is an FMI or REC, for which a user pays model may be more appropriate. See paragraph 47 in main text.
c. One respondent queried whether the cost of establishing and maintaining a	The authorities are inclined to the view that the costs of establishing and

Respondents' comments	Authorities' response
RCT is also considered a resolution cost to be funded by the financial services industry.	maintaining the RCT, such as the costs incurred in making payments to the Chair and members of the RCT for their services), can be regarded as related to the provision of an adjudication mechanism to ensure pre-resolution shareholders and creditors are not disadvantaged by resolution, and the authorities are presently minded not to consider these "housekeeping" costs as a resolution expense chargeable to the resolution funding arrangements for any given resolution. With regard to the costs of appearing before the RCT, the authorities are inclined to provide a power in the legislation for the RCT to determine by whom, and to what extent, they are paid.
d. Two respondents were of the view that levies should not be set and the resolution costs should be borne by the Government.	Key Attribute 6.3 states that "Jurisdictions should have in place privately-financed deposit insurance or resolution funds, or a funding mechanism with *ex post* recovery from the industry of the cost of providing temporary financing to facilitate the resolution of the firm". A resolution regime with costs borne by the Government would not therefore be compliant with one of the fundamental objectives of the Key Attributes. Further, the authorities would question the fairness of imposing such costs on the taxpayer as this might reinforce the private gain/public pain scenario witnessed in the lead-up to, and aftermath of, the global financial crisis. This was in fact one of the key motivations behind the development of the Key

Respondents' comments	Authorities' response
	Attributes as part of a concerted effort to overcome the problems associated with institutions that are "too-big-to-fail".
CROSS-BORDER RESOLUTION AND INFORMATION SHARING	
27. Specific cross-border conditions and scenarios	
a. Most respondents agreed with setting specific "cross-border conditions" before the local resolution regime may be used to recognise and support foreign resolution measures. However, some respondents were cautious on the second cross-border condition (i.e. that outcomes delivered should be consistent with the objectives for resolution and will not disadvantage local creditors relative to foreign creditors), citing that the grounds for not supporting home resolution action should be limited to the circumstances set out in the FSB Key Attributes and the discretionary power of the resolution authority to avoid a coordinated resolution seemed disproportionate.	The authorities intend to include both cross-border conditions for recognition into the legislation establishing the local resolution regime. The authorities are fully mindful of the potential benefits of a coordinated cross-border resolution with host authorities supporting a home resolution which, all things being equal, should serve to preserve continuity in the host jurisdictions. Hence the local resolution authority should be incentivised to cooperate wherever appropriate. That said, the authorities prefer to retain some capacity for a local resolution authority to exercise a degree of control over outcomes in Hong Kong in line with its mandate to preserve local financial stability and to deliver an outcome that does not disadvantage local creditors or shareholders. The proposed conditions are also consistent with the factors identified in the FSB cross-border CP by reference to which a foreign resolution measure might not be recognised. Accordingly, an "automatic" recognition (or support) mechanism is not considered appropriate and is not, in any event, required or indeed promoted by the Key Attributes, which refer to mutual recognition and support processes.
b. In general the respondents considered that the specific conditions identified in paragraph 239 of CP2 were appropriate. There were mixed views on the need	As noted above, the authorities intend to include the conditions cited in paragraph 239 of CP2 into the legislation establishing the local resolution

Respondents' comments	Authorities' response
to make further provision in the conditions for consideration of fiscal implications.	regime and do not propose to include a formal condition relating to fiscal considerations. The resolution authority may however take into account any fiscal implications for Hong Kong when deciding whether to recognise any foreign action.
c. To accommodate the scenarios in Box H of CP2, respondents in general emphasised the importance of collaboration and information sharing between home and host authorities. Some indicated their preference for formal recognition procedures in cross-border resolution actions. One respondent strongly recommended that effective cross-border recognition or support of resolution actions should only be introduced through legislative action rather than relying on contractual frameworks to give effect to resolution tools.	The authorities are mindful of the importance of collaboration and information sharing between home and host authorities and will seek to facilitate this both through including enabling provisions in the legislation establishing the local resolution regime and undertaking resolvability assessment and resolution planning in cooperation with their counterparts as appropriate. In line with the approach which the FSB appears to be adopting, the authorities intend that: (i) the local legislation should empower recognition of, and accommodate the taking of support measures in relation to, overseas resolutions at the discretion of the resolution authority (subject to necessary conditions being met); and (ii) suitable contractual provisions (in relation to recognition of the imposition of stays on early termination and bail-in action) will be required to be included in relevant contracts with a view to achieving a degree of recognition for the local regime before courts in foreign jurisdictions. The authorities support contractual approaches to cross-border resolution as an

Respondents' comments	Authorities' response
	interim measure but do not see them as a replacement for an effective statutory framework. The authorities also note that contractual measures can, over the longer term, be supportive of an effective statutory recognition framework (See section under Cross-border resolution and information sharing in main text).

Annex 3

Liabilities to be excluded from bail-in

1. Liabilities of a note-issuing bank in respect of legal tender notes as defined by section 2 of the Legal Tender Notes Issue Ordinance (Cap. 65);

2. Liabilities representing protected deposits;

3. Liabilities representing deposits made with a deposit-taking company or a restricted licence bank that would be protected deposits if the deposit-taking company or restricted licence bank were a Scheme member;

4. Liabilities owed to the Hong Kong Deposit Protection Board;

5. For an FI that is exempt from the Deposit Protection Scheme, liabilities owed in respect of a deposit protection scheme, or other scheme of a similar nature, that protects deposits taken by it at its Hong Kong offices;

6. Liabilities representing the level of claims under a ***policy*** as defined by regulation 2 of the Motor Vehicles Insurance (Third Party Risks) Regulations (Cap. 272A) that are protected by the Insolvency Fund administered by the Motor Insurers' Bureau of Hong Kong;

7. Liabilities owed to the Motor Insurers' Bureau of Hong Kong;

8. Liabilities representing the level of claims under a ***policy of insurance issued for the purposes of this Part*** as defined by section 38 of the Employees' Compensation Ordinance (Cap. 282) that are protected by the Employees Compensation Insurer Insolvency Scheme administered by the Employees Compensation Insurer Insolvency Bureau;

9. Liabilities owed to the Employees Compensation Insurer Insolvency Bureau;

10. Liabilities owed by an insurer to any scheme established by or under an Ordinance that is designed to secure compensation to persons in circumstances in which the insurer becomes insolvent;

11. Liabilities owed under a policy of insurance in respect of any claim for compensation under any scheme established by or under an Ordinance that is designed to secure compensation to persons in circumstances in which the insurer becomes insolvent;

12. Any secured liability, so far as it is secured;

13. Liabilities arising because of holding client assets;

14. Liabilities owed to an employee or former employee in relation to wages, holiday pay, annual leave pay, sickness allowance, maternity leave pay, paternity leave pay, severance payment, long service payment, payment in lieu of notice, end of year payment and terminal payment under the Employment Ordinance (Cap. 57);

15. Liabilities owed in relation to rights under an occupational pension scheme to an employee or former employee, except for liabilities owed in relation to a right arising out of the exercise of a discretion;

16. Liabilities owed to a creditor, other than a group company of the financial institution, arising from the provision of goods or services (other than financial services) that are critical to the daily functioning of the FI's operations;

17. Unsecured short-term inter-bank liabilities, with an original maturity of less than 7 days, owed to an entity other than a group company of the FI;

18. Liabilities arising from participation in clearing and settlement systems and owed to such systems or to the operators of, or participants in, such systems; and

19. Liabilities owed under an Ordinance to the Government that in a winding up would be discharged in priority to all other liabilities in accordance with the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32).