

Establishing an effective resolution regime for financial institutions in Hong Kong

FA Panel, 2 March 2015

Intro (I)

- Second consultation on effective resolution regime for financial institutions (FIs) launched*
- Initial public consultation exercise in January to April 2014
- Legislative reform to meet standards set by Financial Stability Board (FSB)
- “Key Attributes of Effective Resolution Regimes for Financial Institutions” (“Key Attributes”)
- Mitigate risks posed by systemically important financial institutions (SIFIs), “too-big-to-fail”

* The consultation paper can be downloaded from <http://www.fstb.gov.hk/fsb/ppr/consult/resolutionregime.htm> as well as from the websites of the Hong Kong Monetary Authority (www.hkma.gov.hk), Securities and Futures Commission (www.sfc.hk) and Insurance Authority (www.oci.gov.hk).

Intro (II)

- Reform needed to fill gaps in existing regulatory and supervisory toolkits in Hong Kong
- 30+ responses received in first consultation exercise covering initial proposals
- Majority indicated reform important for local resilience and/or cross-border coordination
- IMF FSAP (2014) also concluded reform needed as Hong Kong is an international financial centre
- Second consultation paper:
 - Contains the conclusions to the initial consultation exercise and summaries of major responses and
 - Provides more detail on certain aspects of regime (incl. powers, governance, safeguards)

Intro (III)

- Global financial crisis, unprecedented use of public money to prevent FIs failing in a number of jurisdictions
- Resolution regimes should provide robust alternatives to bail-out / liquidation to:
 - Better protect individuals, companies by securing continuity of critical financial services (e.g. access to deposits, payment services)
 - Contain potential contagion from failure of an FI to other FIs, and thereby stability of wider financial system and real economy
 - Impose costs of failure on FI's shareholders and creditors and thereby protect public funds

Scope

- CP1 consensus that scope should extend to:
 - All authorized institutions (AIs)
 - Financial market infrastructures (FMIs) designated to be overseen by HKMA and recognised clearing houses regulated by the SFC
 - Local operations of those LCs and insurers which are part of G-SIFI groups
- CP2 further consults on:
 - Insurers on local risks posed
 - Related group companies (holding companies, affiliated operational entities)
 - Exchanges

Governance

- CP1 majority in favour of proposed approach:
 - MA, SFC and IA as Resolution Authorities (RAs) for FIs under respective purviews
 - Lead resolution authority (LRA) to coordinate resolution of cross-sector groups
- Resolution only when an FI is failing and poses threat to financial stability
- Clear objectives set to guide use of powers and to protect:
 - critical financial services and financial stability;
 - depositors, investors with client assets, policyholders; and,
 - public funds

Resolution powers (I)

- CP1 broad consensus on key options needed for the regime to secure continuity
 - Transfer of business to a commercial purchaser
 - (As an intermediate step) transfer to a bridge institution
 - Bail-in to recapitalise a failing FI
 - Use of an asset management vehicle
 - (As a last resort) temporary public ownership
 - Supporting powers including to:
 - Require removal of barriers to resolution (to improve resolvability)
 - Prevent exercise of early termination rights in a way that could undermine resolution

Resolution powers (II)

- Second consultation provides additional detail on aspects of the powers including:
 - Bail-in:
 - liabilities to be excluded (in all, or some cases)
 - loss absorbing capacity to support bail-in
 - Framework for improving resolvability
 - Relationship with insolvency arrangements

Safeguards

- Resolution should deliver better outcomes, as compared with liquidation, for:
 - Depositors, investors with client assets and policyholders *given* continued access to funds (and assets) as well as financial services
 - Creditors *given* less value destructive
- Consensus on the need for “no creditor worse off than in liquidation” safeguard
- CP2 outlines proposals for independent valuer, principles for valuation, appeals mechanism

Funding

- Seek to avoid public funds being used to rescue (i.e. bail-out) failing FIs
- Resolution (including bail-in) imposes costs on failing FI's shareholders and creditors
- Mechanism for recovery of any losses incurred in provision of temporary financing
- Ex post levies on financial system (as in US), rather than fund built up in advance (as in EU)
- Aim remains to minimise any need for ex post mutualisation of costs however

Cross-border resolution (I)

- When cross-border FIs failed during recent crisis, options included home jurisdiction bail-out of:
 - Entire group (at great cost) or;
 - Local operations only (regardless of financial stability impact in other jurisdictions)
- Regimes meeting common standards of the Key Attributes make coordination possible
- FSB member jurisdictions, particularly major financial centres, expected to implement in full
 - Hong Kong hosts 29 of 30 banks, 8 of 9 insurers identified by FSB as globally systemic

Cross-border resolution (II)

- CP1 broad support for use of local regime to recognise / support foreign resolution
- Subject to “cross border” conditions being met:
 - Local RA assesses resolution will deliver outcomes consistent with objectives set for resolution in Hong Kong and will not disadvantage local creditors
- Otherwise, if local conditions are met, retain flexibility to undertake independent action under the regime
 - To directly resolve local operations to deliver on local resolution objectives

Next steps

- Second consultation exercise runs to 20 April 2015
- Subject to responses introduce legislation by end-2015
- Possible third, shorter, consultation exercise in the summer, including to reflect FSB guidance on:
 - Total loss absorbing capacity to facilitate bail-in
 - Provisions to allow for coordinated approach to cross-border resolution
- Work continues to meet other (non legislative) requirements of Key Attributes
 - E.g. cross-border and local recovery and resolution planning for banking sector