

Bills Committee on Financial Institutions (Resolution) Bill

Response to Matters Raised by Members at the Meeting on 29 February 2016

This paper sets out the Government's response to the matters raised by Members in relation to the Financial Institutions (Resolution) Bill (the Bill) at the meeting on 29 February 2016.

Loss-absorbing requirements

Clause 19(5)(b) of the Bill provides that an officer of an entity commits an offence if he/she was knowingly "concerned" (涉及) in the commission of the offence by the entity under subsection (4). Some members are concerned about the broad scope of the term "concerned" (涉及) where a senior executive of the entity may attract criminal liability merely by having knowledge about the commission of the offence by the entity even if he/she have not participated in the offence. The Administration is requested to respond to the above concern and provide information on similar provisions in other local legislation or examples of case law which have also adopted the word "concerned" (涉及) in similar circumstances.

2. In paragraphs 61-65 of the Government's response to the letter from the Assistant Legal Adviser ("ALA") of the Legislative Council Secretariat dated 4 January 2016 (LC Paper No. CB(1)545/15-16(01)), the Government, among other things, explained what constitutes "knowingly concerned" in the context of clause 16(3)(b), the wording of which is similar to that of clause 19(5)(b). The rationale for its use in 19(5)(b) is also similar.

3. In order to establish an offence under clause 19(5)(b), the prosecution needs to prove beyond reasonable doubt the following elements:

- (i) the entity to which the officer belongs to committed an offence under clause 19(4); and
- (ii) the officer was knowingly concerned in any way (whether by act or omission) in the commission of the offence by the entity.

4. While the term "knowingly concerned" is not defined in the Bill ,

and there has been no explicit definition elsewhere in local legislation, this term has been used in a number of Ordinances.¹ It has been held that:

- (i) the accused must have had actual knowledge of the facts on which the relevant contravention of law depends (though it is irrelevant whether he knew those facts constituted a contravention) (i.e. “knowingly”); and
- (ii) the accused must have had actual involvement in the contravention (i.e. “concerned”).² The actual involvement must be with the accused’s knowledge that doing so would contribute to the factual circumstances constituting the offence, though such knowledge might be inferred if the accused had deliberately shut his eyes to the obvious or refrained from inquiry because he suspected the truth but did not want his suspicions confirmed (although suspicion alone would not seem to be enough).³

5. Apart from positive action, criminal liability under clause 19(5)(b) could also arise by way of an omission to act because the words in parenthesis “whether by act or omission” appearing in clause 19(5)(b) serve to categorise how an accused may be “concerned” (which verb is qualified by “knowingly”). For an omission, rather than having knowingly acted, it must be proved beyond reasonable doubt that the accused had knowingly omitted to act in a way that he knew would further the facts leading to the commission of the offence by the entity. For example, if the senior executive (again having actual knowledge of the facts) omitted or failed to give a necessary approval to implement changes to comply with the loss-absorbing capacity requirements by the

¹ For example, section 38M(2)(b) of the Dangerous Drugs Ordinance (Cap. 134), section 67(1) of the Construction Industry Council Ordinance (Cap. 587) and section 228(1)(b) of the Companies Ordinance (Cap. 622).

² Regarding actual knowledge and involvement, see *Securities and Investments Board v Pantell SA and others (No 2)* [1993] 1 All ER 134 at 148 (a decision of the English Court of Appeal) and *R. v Taaffe* [1983] 1 WLR 627 at 630 (a decision of the English Court of Appeal affirmed by the English House of Lords in [1984] 2 WLR 326). Regarding knowledge of the facts, see *Securities and Investments Board v Scandex Capital Management A/S and another* [1998] 1 All ER 514 at 521 (a decision of the English Court of Appeal).

³ See *R. v Corrigan* [2014] NICA 85 at paragraph 37 (a decision of the Court of Appeal in Northern Ireland).

resolution authority, that would be an example in which he could be “knowingly concerned” in the commission of the offence under clause 19(5)(b) of the Bill.

6. The offence in clause 19(5)(b) is intentionally directed at an “officer” of a within scope financial institution (“FI”) (or of its group companies) which, given the definition of “officer” in clause 2, should only capture persons who are in a position to do something (because of their relative seniority) about a prospective contravention by the FI or its group companies.

Overview of the proposed resolution regime

The Administration is requested to illustrate by a flow chart the various procedures in and actions to be taken by the resolution authority (“RA”) during different stages of the resolution process (e.g. resolution planning, applying stabilization options, etc.), and the safeguards and remedies available to entities for opposing RA’s decisions (e.g. making representations, apply for review by relevant Tribunal or apply for judicial review).

7. We provide the requested flowcharts at Annex.

Drafting issues

In the light of comments by the legal adviser to the Bills Committee, the Administration is requested to:

- (a) clarify whether the word “extent” in clause 28(2) of the Bill intends to specify the “scope (範圍)” or “degree (程度)” of actions the RA may apply to the holding company, and review the appropriateness of using the Chinese rendition “程度” for the word “extent”; and
- (b) consider replacing the expression “該公司” with “其控權公司” in clause 28(3)(b) in the Chinese text of the Bill to better reflect the meaning of “resolving the holding company” in that context.

8. Having carefully considered ALA’s comments, we confirm that the word “extent” in the particular context of clauses 28(2) and 29(2) should be construed to cover both scope and degree. In that case, the

Chinese equivalent for “extent” should be “程度及範圍”. We will move a Committee Stage Amendment to amend “方式及程度” (wherever appearing) in the Chinese text of clauses 28(2) and 29(2) to “方式、程度及範圍”.

9. As for item (b), we consider that it is clear from the context that “該公司” refers to the holding company (控權公司) mentioned in the lead-in of clause 28(3), and would not be construed as referring to any other entity. This drafting approach achieves succinctness and is in line with our usual drafting practice; hence no amendment is considered necessary.

Financial Services and the Treasury Bureau (Financial Services Branch)

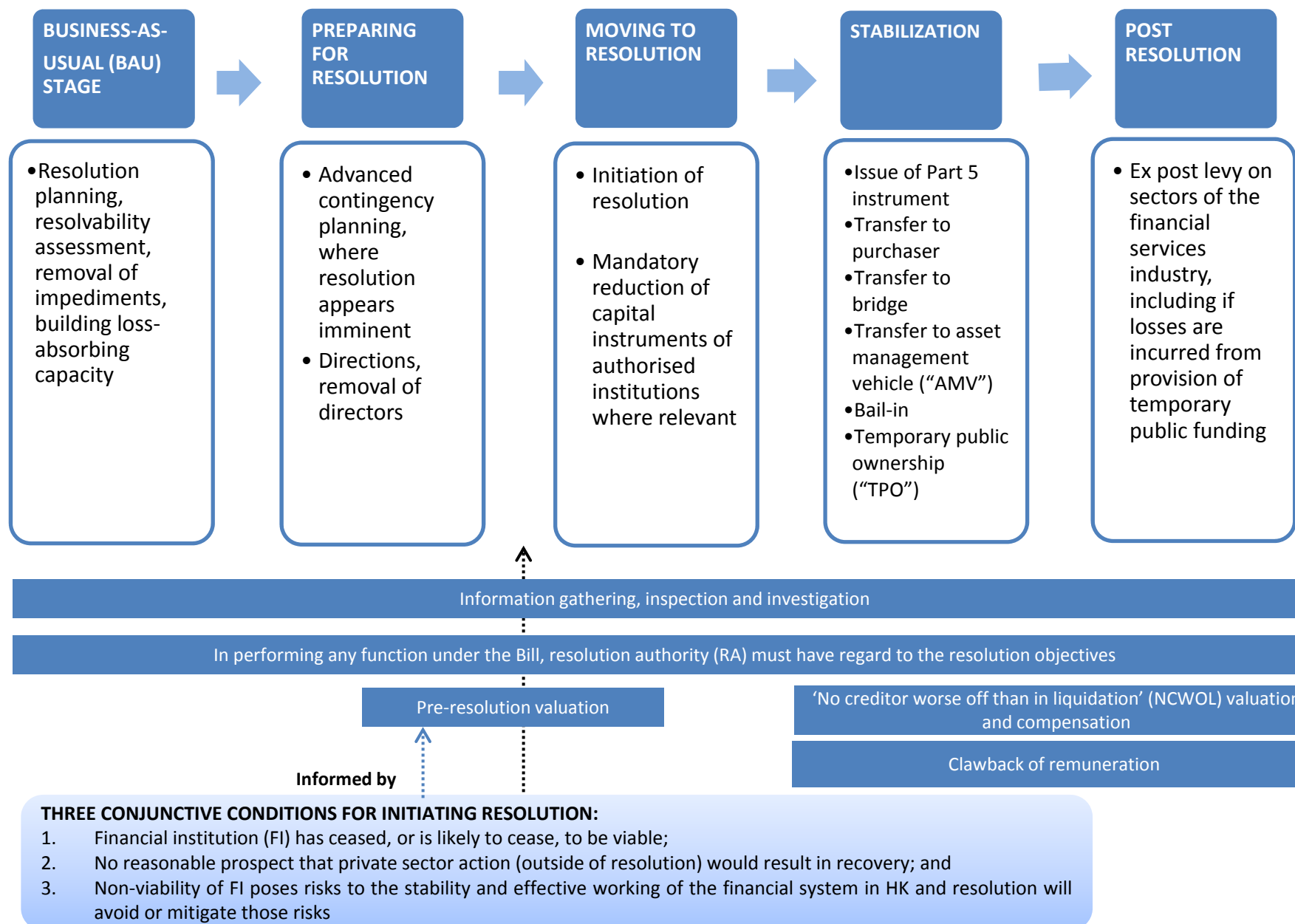
Hong Kong Monetary Authority

Securities and Futures Commission

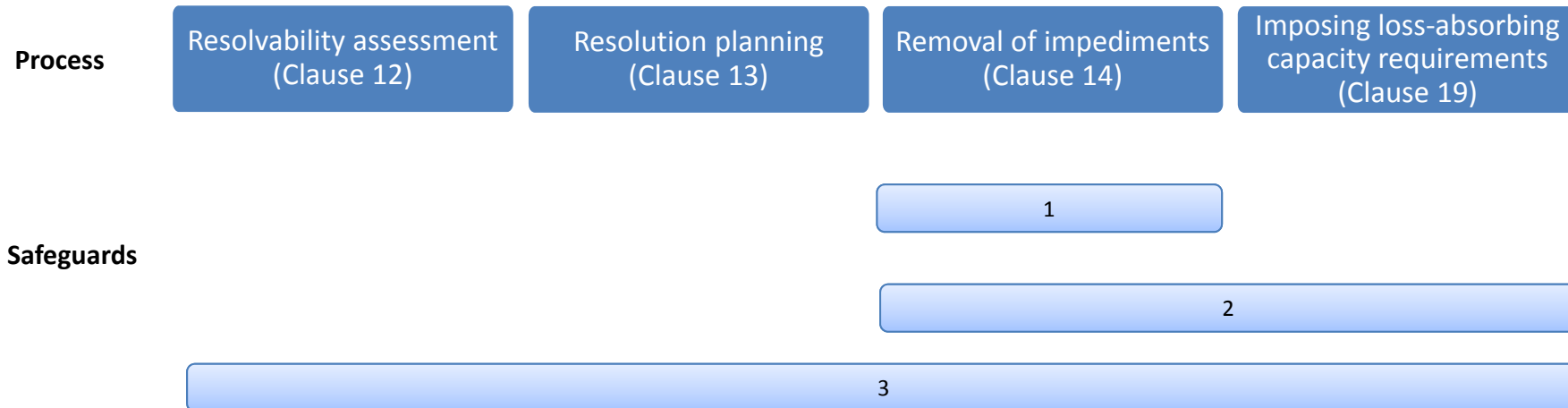
Office of the Commissioner of Insurance

March 2016

Resolution life cycle - overview



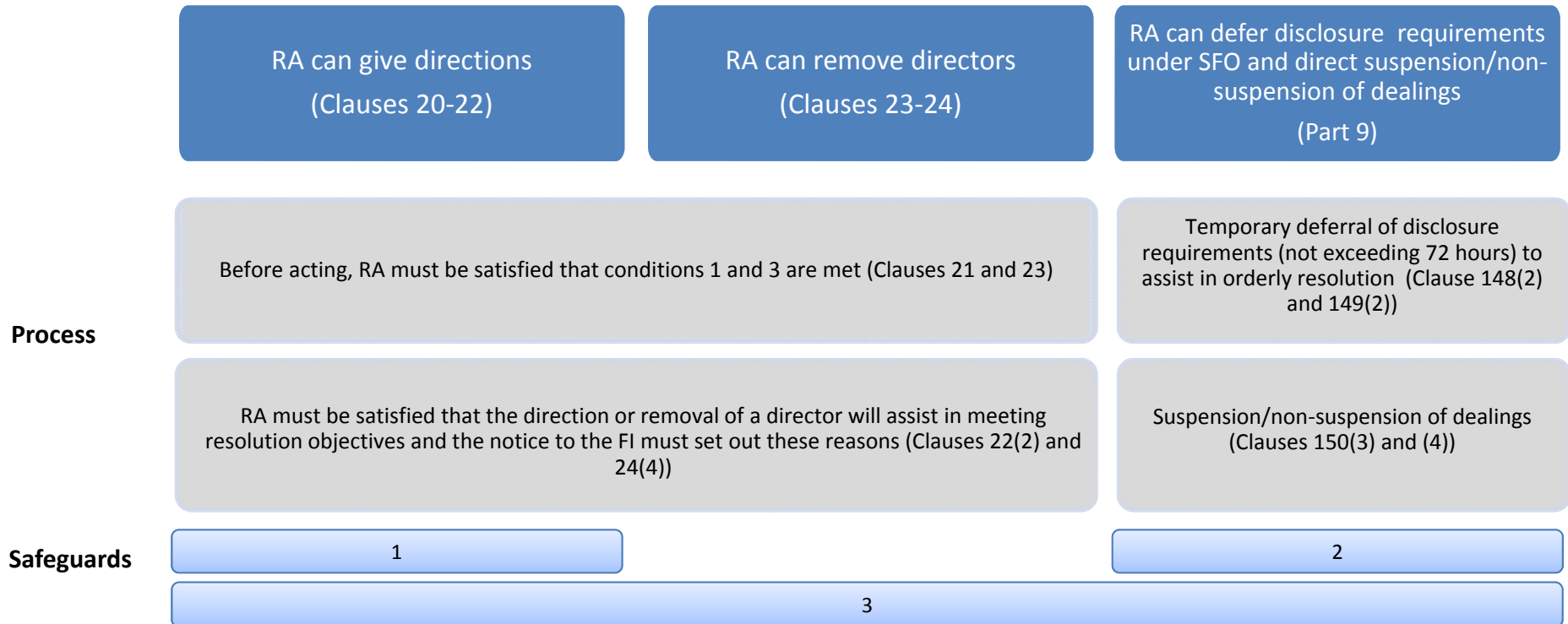
Part 3 – Preparing for resolution (business as usual)



Safeguards	
1	- FI must be afforded opportunity to make representations (Clause 15(1)(c))
2	- Resolvability Review Tribunal (RRT) (Clauses 17 and 18; Clause 19(3)(k); provisions pertinent to role, constitution and processes of RRT are under Part 7 Division 1; Schedule 8)
3	- Right to apply for judicial review

Part 3 – Preparing for resolution (advanced contingency planning)

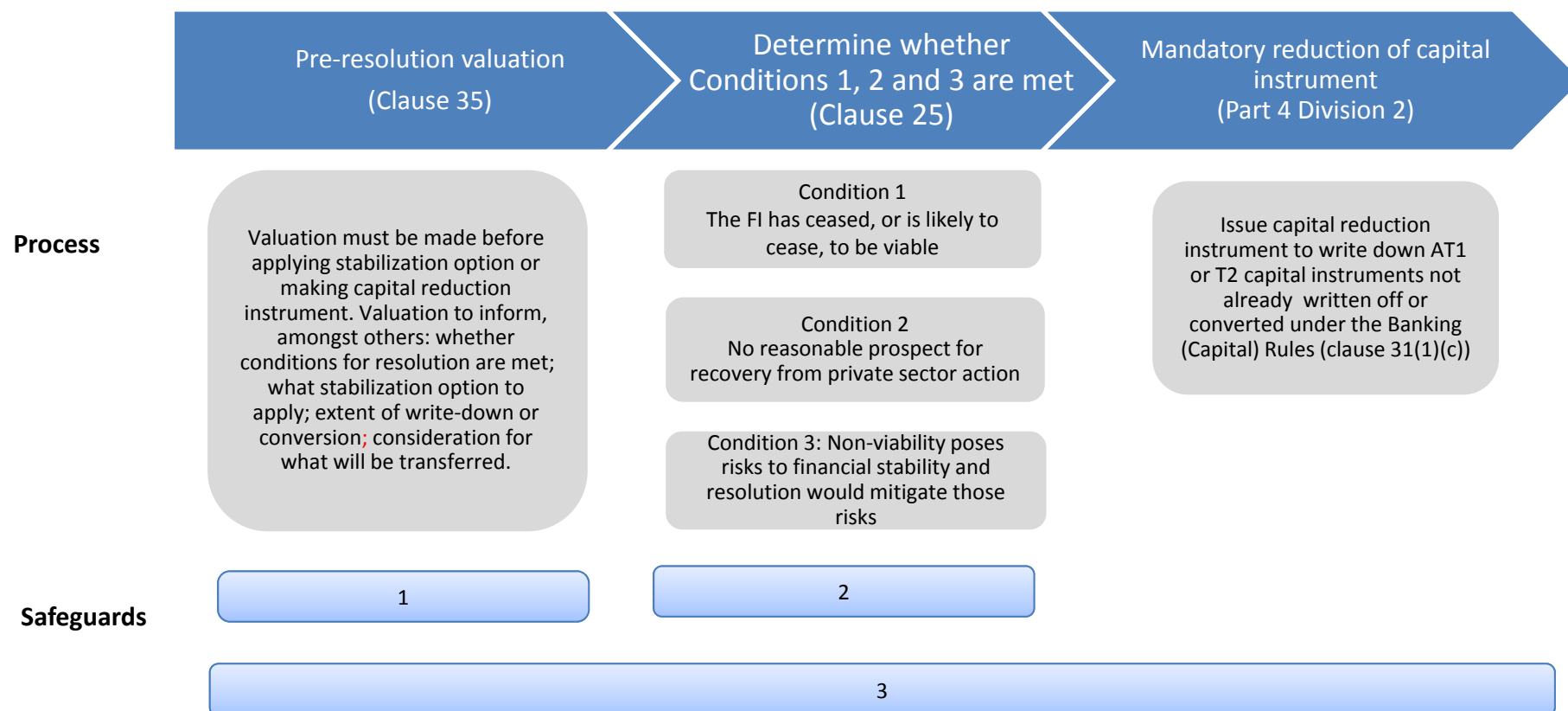
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SAFEGUARDS	1	<ul style="list-style-type: none"> - Saving provision for directors of FI or group company in respect of discharge of directors' duties when complying in a good faith with a direction (Clause 22(4)) - Immunity from liability in damages for FI or related person when complying in a good faith with a direction (Clause 22(5))
	2	<ul style="list-style-type: none"> - RA may only act if satisfied that : (i) it is likely that a listed entity, or its group company, will have stabilization option applied; (ii) disclosure will likely lead to non-viability of the entity, or its group company; and (iii) disclosure will likely impede RA's ability to achieve orderly resolution; <u>and</u> (iv) the information is confidential and its confidentiality can be preserved (Clauses 148(3) and 149(3)). - Requirements that before granting the temporary deferral of disclosure requirements or issuing a direction regarding suspension/non-suspension of dealings in securities, RA must consult SFC if the SFC is not the RA (Clauses 148(5), 149(5), 150(4) and (5))
	3	<ul style="list-style-type: none"> - Right to apply for judicial review

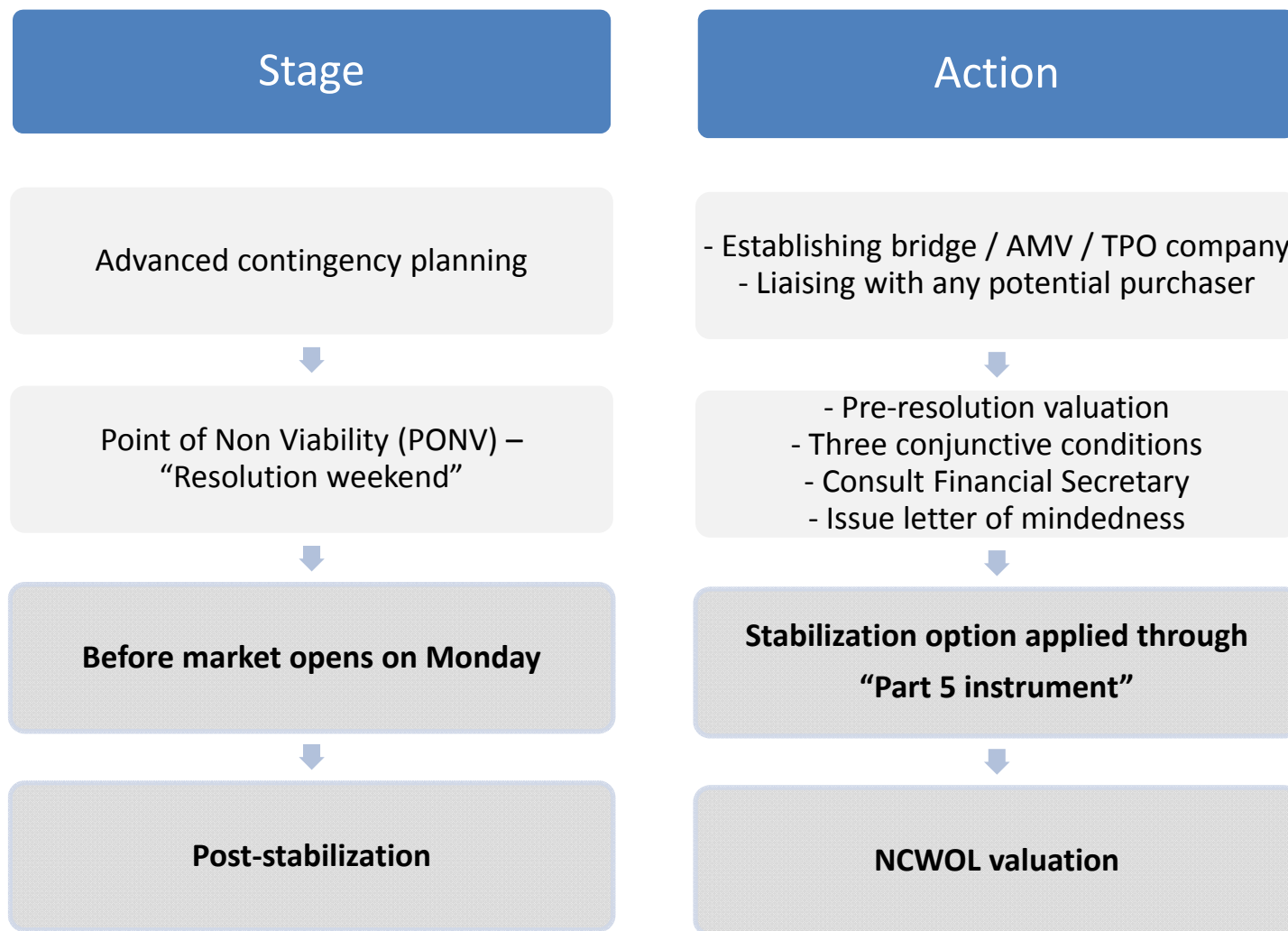
Part 4 – Moving to resolution

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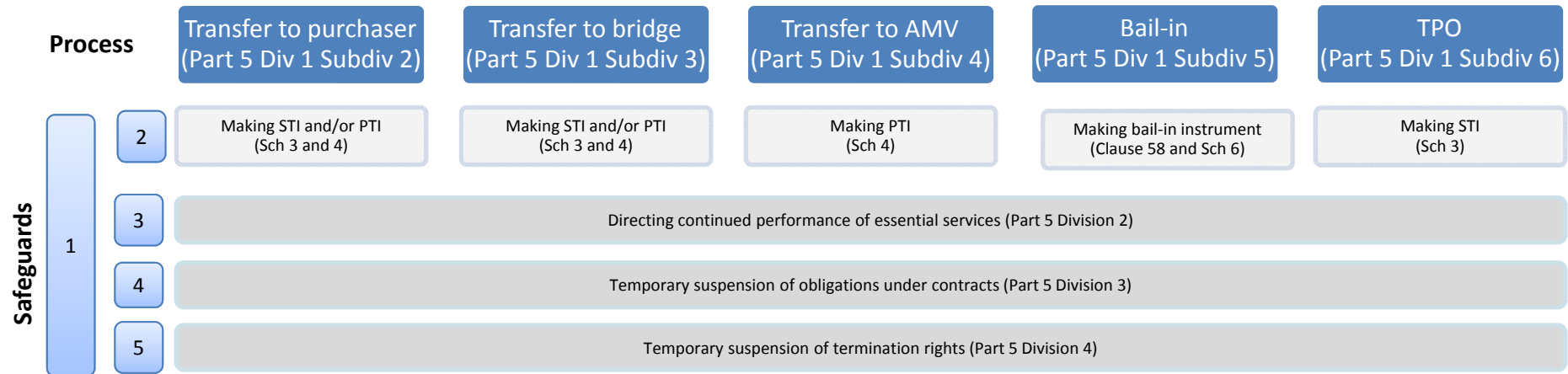


SAFEGUARDS	1	- Nature of valuation must be fair in all circumstances, based on prudent and realistic assumptions (clause 36(a))
	2	<ul style="list-style-type: none"> - Requirement for the RA to consult the Financial Secretary (Clause 27) - RA must issue a “Letter of Mindedness” (LOM), which must specify that the RA is satisfied that Conditions 1, 2 and 3 are met and why the conditions are met (Clause 30(2)(b)) - LOM must also state that directors of the FI, holding company or affiliated operational entity (“AOE”) may make representations to the RA in relation to anything stated in the letter (LOM will specify whether those representations will be made orally or in writing ,or both) (Clause 30(2)(e))
	3	- Right to apply for judicial review

Resolution 'glide-path'



Part 5 – Stabilization options

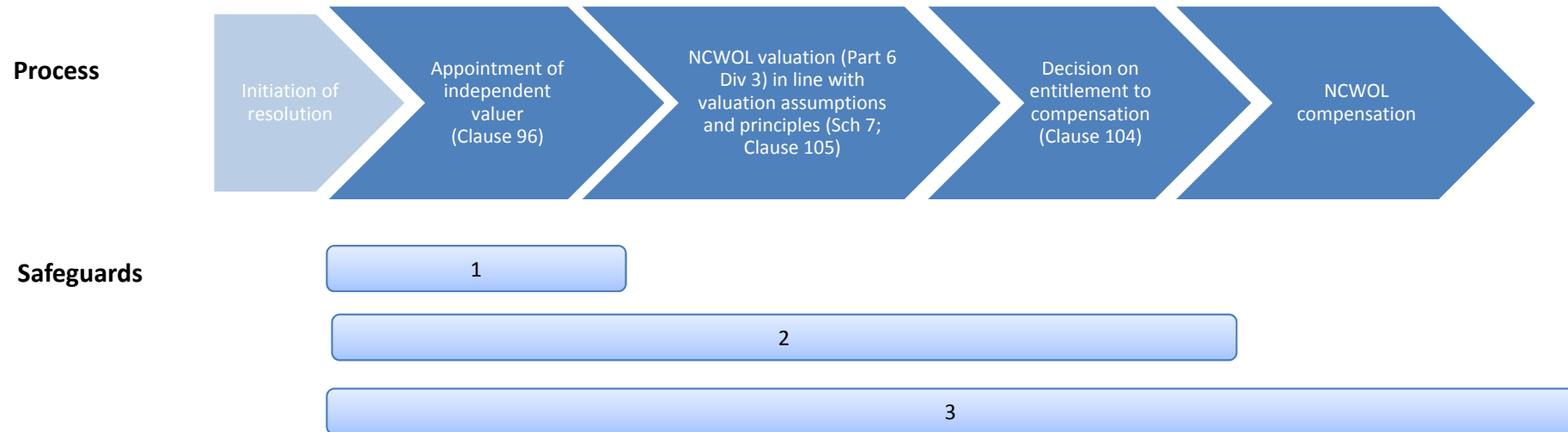


Safeguards			
1	<ul style="list-style-type: none"> - “No creditor worse off than in liquidation” (NCWOL) valuation and compensation (Clause 103) - Right to apply for judicial review 		
2	Notification requirements: as soon as practicable after making STI and/or PTI, RA must <ul style="list-style-type: none"> - send a copy to transferor, transferee and Financial Secretary - Notify the public (Sch 3 Section 3, Sch 4 Section 3) 	Making of Part 5 instrument: <ul style="list-style-type: none"> - Regulations on “protected arrangements” (Part 5 Division 1 Subdivision 7) applies to partial transfers and bail-in - Excluding certain liabilities from bail-in (Clause 58(9) and Schedule 5) 	Reporting requirements: <ul style="list-style-type: none"> - RA to report to the Financial Secretary who must in turn table the report before the Legislative Council (Clauses 40, 46, 55, 65, 72)
3	<ul style="list-style-type: none"> - RA can direct residual FI or AOE to continue to provide only those services that are <u>essential</u> to the continued performance of critical financial functions (residual FI: Clause 79(3); AOE: Clause 81(1)) - Must be reasonably required for facilitating orderly resolution (residual FI: Clause 79(2); AOE: Clause 81(2)) - Reasonable consideration to be paid by recipient of services (residual FI: Clause 79(3); AOE: Clause 81(6)) 		
4	<ul style="list-style-type: none"> - Exclusion of certain critical obligations from suspension (Clause 84) - Temporary suspension for no more than two business days (Clause 83(4)) 		
5	<ul style="list-style-type: none"> - Substantive obligations under affected contracts continue to be performed (Clause 88) - Temporary suspension for no more than two business days (Clause 90(4)) 		

Abbreviations: Asset management vehicle (AMV); Temporary public ownership (TPO); Securities transfer instrument (STI); Property transfer instrument (PTI); Affiliated Operational Entity (AOE)

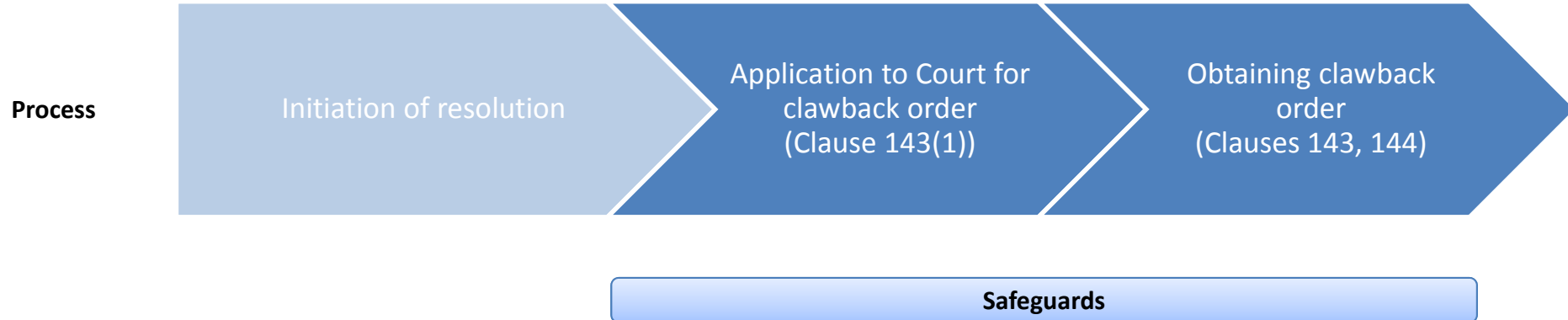
Part 6 – NCWOL valuation and compensation

7



Safeguards	
1	- Independent appointing person (Clause 95)
2	- Appointment criteria for independent valuer designed to provide for independence (Clause 96 and Schedule 2) - Revocation of appointment by Resolution Compensation Tribunal (RCT)(Clause 98)
3	- RCT (Part 7 Division 2, Schedule 9) - Right to apply for judicial review

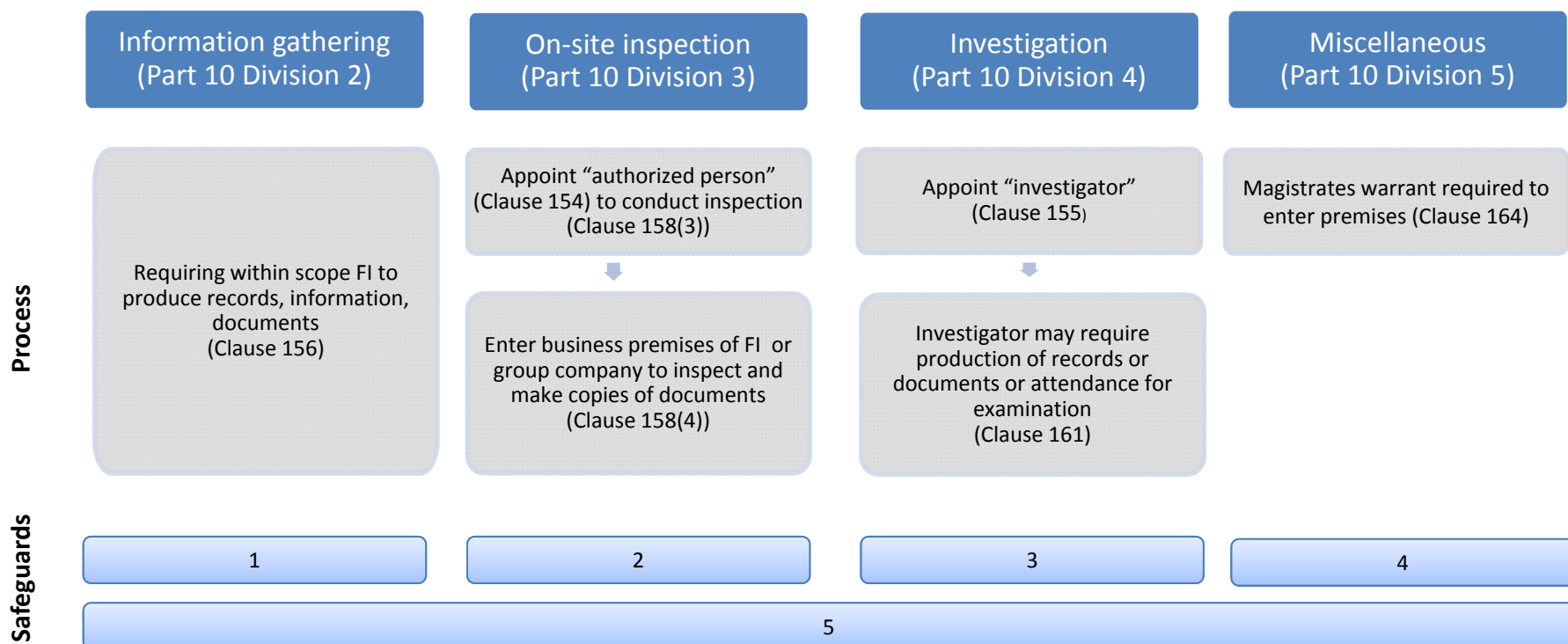
Part 8 – Clawback of remuneration



Safeguards
<ul style="list-style-type: none"> - Court process on application by RA (Clause 143(1)) - Definition of “officer” for clawback purposes limits clawback to officers of a certain level of seniority and responsibility (Clause 142) - Link must be established between failure of FI and involvement in that failure (clawback only if the officer caused, or materially contributed to the failure (Clause 143(2)(a)); and the act was done, or the omission was made, intentionally, recklessly or negligently (Clause 143(2)(b)) - In determining extent of clawback, Court must take in account: (a) the extent to which the act of the officer contributed to the FI ceasing, or likely to cease being viable and, (b) the financial circumstances of the officer, as far as practicable (clause 143(3)) - Right to appeal against a clawback order

Part 10 – Information gathering, inspection and investigation

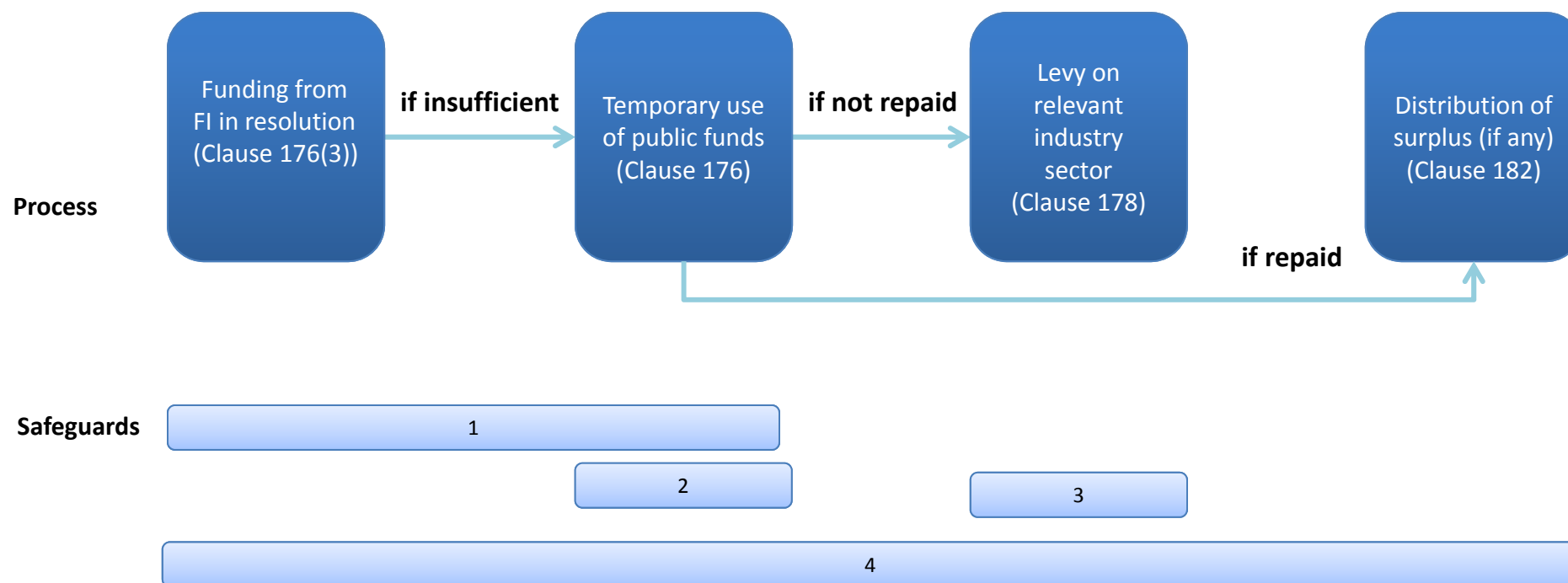
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SAFEGUARDS	1	- Must be reasonably required in connection to performance of RA’s functions (Clause 156(2))
	2	- Powers only exercisable if of the opinion that it will assist RA in performance of its functions under the Bill (Clause 158 (2) and (3))
	3	- RA must have reasonable belief that an offence has been committed under the Bill or that a direction given under the Bill has not been complied with (Clause 160) - Protection from self-incrimination (Clause 163)
	4	- Magistrate may only issue a warrant if it is satisfied that information provided by an authorised person, investigator, person that constitutes RA or employee of RA that there are reasonable grounds to suspect that there is or likely to be information or documents on the premises specified by the person (Clauses 164(1) and (2))
	5	- Powers in respect of third parties only exercisable with reasonable cause to believe that the third party has information and the information cannot be obtained from FI or group company (Clause 153(2)) - Right to apply for judicial review

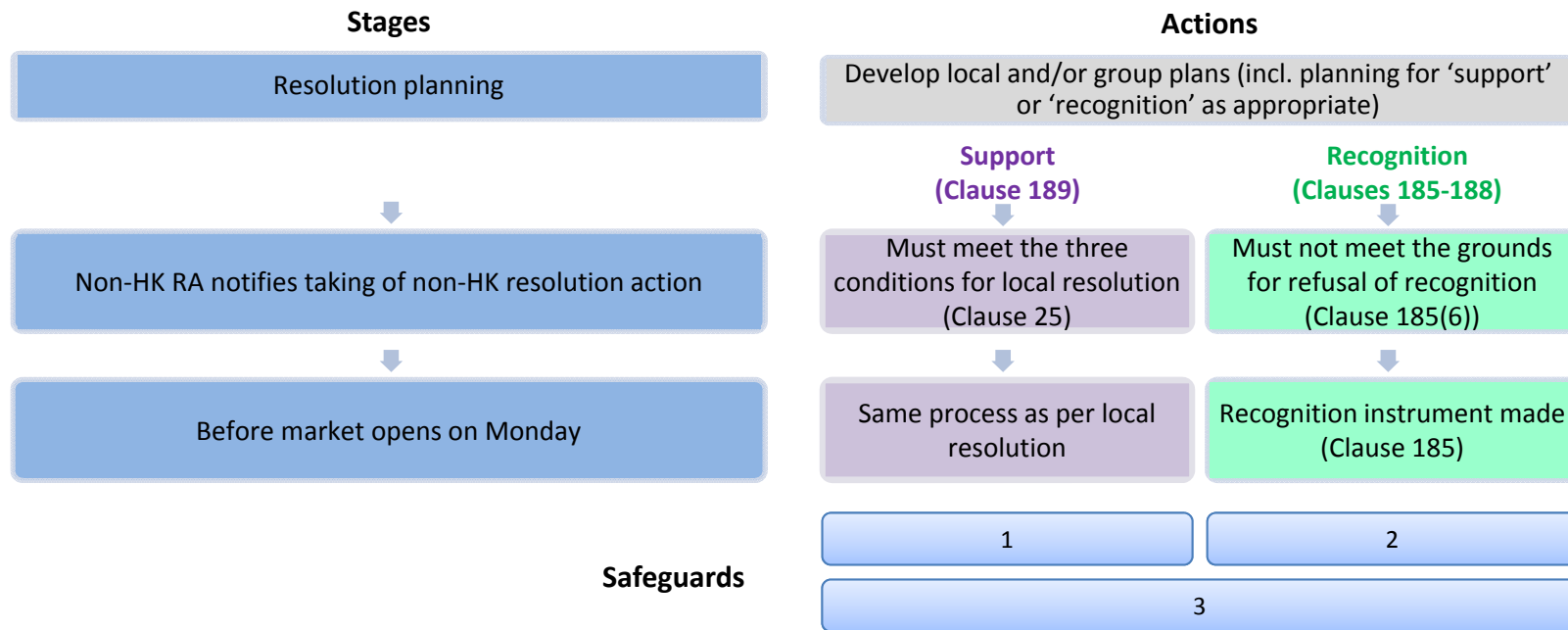
Part 12 – Resolution funding arrangements

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Safeguards	
1	- RA must consider first the extent to which the FI's own resources can be utilized (including the extent to which liabilities can be written off/converted, assets can be sold, or private sector funding can be obtained) before using public funds (Clause 176(3))
2	- Specification of purposes for which public funds may be used: in connection with preparation for and the making of a Part 5 instrument, resolution of entity including paying NCWOL compensation due (if any), or appointment of independent valuer (Clause 176(1))
3	- Levy rate to be prescribed by resolution of the Legislative Council on recommendation of Financial Secretary (Clause 180), pursuant to regulations made by Financial Secretary (Clause 179)
4	- Right to apply for judicial review

Part 13 – Non-Hong Kong resolution actions



Safeguards	
1	Support: Same safeguards as for local resolution
2	Recognition: <ul style="list-style-type: none"> - RA must not recognise non-HK resolution action if one or more of the following non-cumulative conditions are met: (i) the RA is of the opinion that (a) recognition would have an <u>adverse effect</u> on financial stability in HK (Clause 185(6)(a)); or (b) recognition <u>would not</u> deliver outcomes that are consistent with the resolution objectives (Clause 185(6)(b)); or (c) recognition <u>would disadvantage</u> HK creditors and/or HK shareholders relative to other creditors/shareholders of the entity being subject to the non-HK resolution action (Clause 185(6)(c)); or (ii) if the RA is not satisfied that an arrangement is in place with the non-HK RA that would make HK creditors or HK shareholders eligible to claim compensation on a basis that is broadly consistent with the local NCWOL eligibility for compensation (Clause 187).
3	<ul style="list-style-type: none"> - Right to apply for judicial review