立法會
Legislative Council

LC Paper No. CB(1)289/15-16(01)

Ref: CB1/BC/5/15

Bills Committee on Financial Institutions (Resolution) Bill

Background brief

Purpose

This paper provides background information on the Financial Institutions (Resolution) Bill ("the Bill"), and summarizes the major views and concerns expressed by members of the Panel on Financial Affairs ("FA Panel") on the proposed resolution regime for financial institutions ("FIs") in Hong Kong in the 2014-2015 legislative session.

Background

2. During the financial crisis in 2008 and 2009, governments in various jurisdictions spent unprecedented amounts of public money rescuing failing FIs. This has led to a series of international regulatory reform initiatives to enhance the resilience and stability of the financial system. In line with these initiatives, the Financial Stability Board ("FSB")[1] published the Key Attributes of Effective Resolution Regimes for Financial Institutions ("Key Attributes") in 2011 to establish new international standards for effective resolution regimes[2]. These standards, which all FSB member jurisdictions are expected to meet by the end of 2015, require that public authorities be empowered to intervene to resolve FIs which become non-viable and whose failure would pose unacceptable risks to the continuation of critical financial services and wider financial stability. An effective resolution regime should provide alternative means of containing these

[1] FSB was established in April 2009 to coordinate at the international level the work of national financial authorities and international standard-setting bodies and promote the reform of international financial regulations. It was tasked by the Group of Twenty leaders with developing policy measures to reduce the risks posed by systemically important FIs. Hong Kong is a member of FSB.

[2] FSB reissued the Key Attributes in October 2014 incorporating new annexes which provide more specific guidance to assist authorities in implementing the Key Attributes. The publication is available at FSB's website at http://www.financialstabilityboard.org/wp-content/uploads/r_141015.pdf.

risks and ensure that the costs of failure and resolution are borne by the failing FIs' shareholders and creditors rather than being met by public funds.

3. According to the Government, there were significant gaps in the existing intervention powers of the Hong Kong Monetary Authority ("HKMA"), the Securities and Futures Commission ("SFC") and the Insurance Authority ("IA") as compared to those stipulated by FSB for an effective resolution regime. The Thematic Review on Resolution Regimes: Peer Review Report released by FSB reached a similar conclusion. The Government considers that without a Key Attributes-compliant resolution regime in place, foreign resolution authorities of cross-board FIs may require the FIs to take actions to reduce exposures to and dependencies upon their Hong Kong operations in order to improve the resolvability of the wider group. This could have a negative impact on the commercial viability of the operations of global systemically important financial institutions ("G-SIFIs") in Hong Kong and result in their gradual transfer to other jurisdictions in the region which have more developed resolution frameworks.

Proposals to establish a resolution regime for financial institutions in Hong Kong

4. HKMA, SFC, IA and the Financial Services and the Treasury Bureau jointly conducted two three-month public consultations to gauge views on the proposals for establishing a resolution regime for FIs in Hong Kong in January 2014 and January 2015 respectively[3]. The key aspects of the proposals are summarized in paragraphs 5 to 13 below.

Scope of the resolution regime

5. In accordance with the requirement of the Key Attributes that any FI which could be systemically significant or critical if it fails should be within the scope of an effective resolution regime, it is proposed that the following FIs be captured by the local regime:

(a) all authorized institutions ("AIs") (i.e. banks, restricted licence banks and deposit-taking companies) within the meaning of the Banking Ordinance (Cap. 155);

(b) certain financial market infrastructures ("FMIs") designated under the Clearing and Settlement Systems Ordinance (Cap. 584) and

[3] The consultation conclusions to the first public consultation were issued together with the second public consultation paper in January 2015. The consultation responses to the second public consultation were issued in October 2015. The consultation responses also elaborate on certain issues in respect of the proposed resolution regime.

clearing houses recognized under the Securities and Futures Ordinance (Cap. 571) ("SFO");

(c) recognized exchange companies that are considered to be systemically important to the functioning of the financial markets in Hong Kong;

(d) licensed corporations ("LCs") within the meaning of SFO (i.e. securities firms) which are non-bank non-insurer G-SIFIs, or LCs which are subsidiaries or branches of, or subsidiaries of holding companies of, G-SIFIs;

(e) local branches and subsidiaries of insurers that are global systemically important insurers;

(f) branches of foreign FIs that are within scope as per the proposals made for each sector (i.e. all AIs, certain LCs and certain insurers) and the holding companies of within scope FIs; and

(g) affiliated operational entities which are in the same groups of companies of within scope FIs and provide services, directly or indirectly, to the FIs.

6. In addition, it is proposed that the Financial Secretary ("FS") be provided with the power to designate other FIs which are not initially captured by the resolution regime as being within scope in future, if it is considered that the failure of such FIs will bring about systemic disruption.

Resolution authorities

7. It is proposed that HKMA, SFC and IA each be designated as a resolution authority ("RA") responsible for exercising the resolution powers available under the regime in relation to the FIs or FMIs they respectively regulate or oversee. A lead resolution authority ("LRA") will be designated by FS among the regulators for each cross-sector group containing multiple FIs to coordinate resolution cases where a failing FI or its group operates in multiple sectors of the local financial system. The LRA will be responsible for consulting and coordinating with the other RAs to plan for and execute an orderly resolution of the FIs in the group, and will assume an ultimate decision-making role in the event that a consensus cannot be reached among the resolution authorities. Resolution will only be used where a within scope FI is assessed to be non-viable, with no reasonable prospect of timely recovery again, and that resolution will serve to contain risks posed by its non-viability to the continuity of critical financial services and the wider financial system.

Furthermore, the regime will require an RA to consult FS ahead of initiating resolution of a failing FI.

Stabilization options and powers of the resolution authorities

8. The resolution regime will enable an RA to step in and take prompt actions to stabilize and restructure an entire FI or key parts of its business without the consent of its shareholders and creditors. The five proposed stabilization options (which can be applied individually, in combination or sequentially) are:

(a) transfer of ownership of a failing FI, or some or all of its business, to commercial purchaser(s);

(b) transfer of some or all of the business of a failing FI to a bridge institution owned by the Government and controlled by the relevant RA, so that the business may continue in the short term and be returned to the private sector subsequently;

(c) transfer of some or all of the assets and liabilities of a failing FI to an asset management vehicle, potentially owned by the Government and controlled by the relevant RA, for their orderly winding-down or disposal over time;

(d) officially mandated creditor-financed recapitalization (commonly knows as "bail-in") to restructure the liabilities of a failing FI and restore its viability[4]; and

(e) temporary public ownership of the failing FI as a last resort[5].

9. To enable resolution to be carried out successfully, RAs will be empowered to devise strategies for securing an orderly resolution for a within scope FI and make resolvability assessment to determine whether there are any impediments to the orderly resolution of the FI, and to require the FI to remove any substantive barrier to its orderly resolution. RAs will also be empowered to

---

[4] To provide for the bail-in option, the resolution authorities should be allowed to write down shareholders and certain unsecured creditors, and impose a debt-for-equity swap on certain unsecured creditors, in a manner that generally respects the hierarchy of claims in liquidation.

[5] Temporary public ownership differs from a publicly-funded rescue in the sense that it can be designed to better ensure that losses can be imposed on shareholders and certain creditors. Furthermore, in taking full control of an FI under the temporary public ownership approach, the resolution authority will be better placed to identify and implement a more permanent solution. Temporary public ownership is not a requirement of the Key Attributes, but where the option is provided for, jurisdictions are required to provide for a mechanism through which any costs to public money are recovered from industry.

gather information from and inspect records or documents of within scope FIs, and carry out investigation on the FIs.

Safeguards

10. Given that an RA will be empowered to act in a manner that can affect contractual and property rights, it is necessary to provide checks and balances to protect the positions of those affected by a resolution. As a guiding principle, it is proposed that an RA should respect the statutory creditor hierarchy when imposing losses on the shareholders and creditors of an FI in resolution. In the event that an RA is unable to carry out an effective resolution in strict adherence to the principle, it is proposed that the RA will be allowed to depart from the equal treatment of creditors in the same class in resolution. Such a departure must be justified against the objectives for resolution.

11. A "no creditor worse off than in liquidation" ("NCWOL") compensation mechanism is also suggested, such that creditors and shareholders of a failing FI will be provided with a right to compensation where they do not receive at a minimum in resolution what they would have received in liquidation of the FI in question. This compensation mechanism will involve the appointment of an independent valuer to calculate any compensation due to affected parties in line with certain fundamental valuation principles, such as (a) adherence to the creditor hierarchy, (b) disregard of any public financial support, and (c) disregard of the effect of any stabilization option. It is proposed to establish a Resolution Compensation Tribunal to hear appeals on NCWOL valuation. A Resolvability Review Tribunal is also proposed to be established to review an RA's decisions to require an FI under resolution to remove impediments to the orderly resolution or decisions made pursuant to the loss-absorbing capacity requirements rules for the FI.

Resolution funding arrangements

12. It is proposed that funding arrangements be established under the resolution regime to recover, from the wider financial market, any excess resolution costs that cannot be imposed on or met by the failing FI and its shareholders and creditors. The recovery of the costs will be made on an ex post basis (i.e. after the resolution) from levies imposed on the industry.

Cross-border cooperation

13. The Government has pointed out that there is consensus internationally that, in many cases, the most effective way of stabilizing distressed cross-border FIs and securing continuity of their critical financial services is a group-wide resolution (mostly by means of a bail-in) carried out by the home jurisdiction and supported by key host jurisdictions. To facilitate cross-border cooperation

in this regard, it is proposed that a provision be made for a statutory recognition framework enabling an RA, after consultation with FS, to recognize all or part of a foreign resolution action on fulfilment of certain conditions, so that it will have legal effect in Hong Kong[6]. A recognition must not be granted if the RA is of the opinion that the recognition will (a) have an adverse effect on financial stability in Hong Kong; (b) not deliver outcomes that are consistent with the resolution objectives; or (c) disadvantage Hong Kong creditors or shareholders relative to their counterparts overseas.

The Financial Institutions (Resolution) Bill

14. According to the Government, the vast majority of respondents to the two public consultations indicated broad support for the resolution regime proposals. The Bill was published in the Gazette on 20 November 2015 and received its First Reading at the Legislative Council ("LegCo") meeting of 2 December 2015. The main provisions of the Bill are explained in paragraph 19 of the LegCo Brief (File Ref: B&M/2/1/27C) and paragraphs 4 to 15 of the Legal Service Division Report on the Bill (LC Paper No. LS15/15-16).

Major views and concerns expressed by Members

15. FA Panel was consulted on the resolution regime for FIs at the meeting on 2 March 2015. The major views and concerns expressed by members at the meeting are summarized in the ensuing paragraphs.

Scope of the resolution regime and compliance costs

16. While members noted the benefits of the proposed resolution regime in enhancing the resilience and stability of the local and global financial systems, some members expressed concern about the extensive scope of the resolution regime which could increase the compliance costs on the relevant financial services sectors. Members raised enquiries on how the scope had been worked out, and why financial companies undertaking money lending business were not covered although their operation also posed high risks on the local financial market.

17. HKMA explained that the resolution regime would capture FIs which were considered systemically significant or critical in the sense that, in the unlikely event they were to fail, they could pose risk to the continuity of critical

[6] FSB conducted a consultation on cross-border recognition of resolution actions from September to December 2014. It issued the finalized guidance paper on cross-border recognition frameworks on 3 November 2015.

financial services and financial stability. It was considered that all AIs should fall under the scope of the resolution regime because any cessation of the AIs' services, regardless of their sizes of operation, could potentially be detrimental to the interests of their depositors, operation of related payment/settlement systems and financial stability. Under the current assessment, money lenders, which were not AIs, would not be captured by the resolution regime as they were not considered systemically significant.

18. Pointing out that the global financial crisis had triggered a series of international regulatory reform initiatives, some members cautioned that the Government should be mindful of the increasing compliance costs on the financial services sectors. They also called on the Government to review various regulatory regimes on a regular basis to identity room for streamlining or removing regulatory requirements so as to reduce the compliance costs, in particular on the small and medium-sized FIs.

19. HKMA responded that the compliance costs on FIs arising from the resolution regime would be commensurate with the scale and complexity of the operation of individual FIs. For instance, it would be more likely that larger and more complex FIs would be required to provide more information for resolution planning and resolvability assessment than smaller AIs whose business tended to be simpler. FIs which were relatively larger or complex would also be more likely to be affected by the resolution authorities' powers to require them to remove any substantive barriers to their orderly resolution, as such barriers tended to be generated from the way in which FIs were structured and operated.

Resolution funding arrangements

20. Members expressed concern about the potential moral hazard associated with the ex post funding model for meeting the resolution costs. Under the model, the failing FI would not be required to contribute to the costs upfront but the costs might be borne by other FIs in the market. Members considered it fairer and more appropriate to require all FIs captured by the resolution regime to duly bear their risk of failure by making ex ante contributions (i.e. in advance of any resolution). Moreover, as compared with the ex post model, ex ante model might lower the compliance cost on the industry. On the other hand, there was a suggestion for the Government to explore implementing a funding model with both ex ante and ex post levies.

21. In response, HKMA pointed out that the majority of respondents to the public consultations favoured the ex post funding model on consideration that it would be inefficient to establish a fund with ex ante levies which would not be utilized until a resolution was triggered. It was noted that while the European Union Members States had adopted the ex ante funding model, the United States had adopted the ex post funding model.

22. Members enquired how an RA could impose costs on a failing FI and its shareholders and creditors to recover the resolution costs, and whether the shareholders would be required to buy new shares of the failing FI in order to meet the resolution costs. HKMA explained that if a statutory bail-in was pursued, the resolution authorities would be empowered to write off the debts of the distressed FI and divest the shareholders of their shares. However, the powers of the RAs would not go beyond the scope of shareholders' limited liability, hence the RAs would not be empowered to require shareholders to buy more shares. Creditors and shareholders of a failing FI could ultimately only be called upon to contribute to the costs of resolution up to the point at which they would have borne losses had the FI entered into liquidation. This was in line with the NCWOL principle.

Safeguards

23. Noting that under the proposed resolution regime, an RA would be allowed to depart from the equal treatment of creditors in the same class in resolution on the condition that the departure could be justified against the objectives for resolution, members sought details on the authority responsible for making such decisions and the criteria to be considered in making the decisions.

24. HKMA explained that, as a guiding principle, an RA should respect the statutory creditor hierarchy when imposing losses on the shareholders and creditors of an FI in resolution. However, the Key Attributes recognized that in certain circumstances, it would not be possible for an RA to carry out a resolution in a way that would best deliver against the objectives set without departing from the equal treatment of creditors. For instance, it might be difficult to ascertain expeditiously the actual amounts of liabilities and identities of creditors of certain derivatives contracts. As such, some derivatives creditors might be excluded from a bail-in while other types of creditors would be involved. Therefore, it was proposed that an RA could exercise judgment on whether it should depart from the equal treatment principle. There would be safeguards under the proposed regime to ensure that the NCWOL principle would be upheld.

Interface with the corporate insolvency regime

25. Noting that a failing FI might ultimately go into liquidation if attempts to resolve the FI were to no avail, some members enquired about the interface between the resolution regime and the corporate insolvency regime. In particular, they asked if the creditor hierarchy was altered during a resolution, whether it would be restored in a subsequent liquidation.

26. HKMA explained that the proposed resolution regime was meant to be an alternative to publicly-funded bail-out or liquidation. If it was assessed that a within scope FI in financial difficulties did not pose a systemic threat to the financial stability, a resolution would not be triggered and the normal winding-up provisions could apply. If an RA decided to resolve a failing FI, the winding-up of the FI would be pre-empted. It was envisaged that only once the systemically important parts of the FI's business had been transferred to a commercial purchaser or a bridge institution might it be necessary to wind up the residual business of the FI in question under the winding-up procedure. In such cases, the NCWOL principle would apply.

Latest development

27. At the House Committee meeting on 4 December 2015, Members agreed to form a Bills Committee to study the Bill.

Relevant papers

28. A list of relevant papers is in the **Appendix**.

Council Business Division 1
Legislative Council Secretariat
14 December 2015

Appendix

List of relevant papers

Date	Event	Paper/minutes of meeting
7 January 2014	First consultation paper on an effective resolution regime in Hong Kong jointly issued by the Financial Services and the Treasury Bureau, the Hong Kong Monetary Authority, the Securities and Futures Commission and the Insurance Authority ("the authorities")	Consultation paper
21 January 2015	Second consultation paper and conclusions from the first consultation jointly issued by the authorities	Consultation paper
2 March 2015	The Panel on Financial Affairs was brief on the establishment of a resolution regime for financial institutions	Discussion paper (LC Paper No. CB(1)567/14-15(04)) Minutes (LC Paper No. CB(1)844/14-15) Follow-up paper provided by the Administration (LC Paper No. CB(1)1312/14-15(01))
9 October 2015	Consultation response on the establishment of an effective resolution regime for financial institutions in Hong Kong jointly issued by the authorities	Consultation response

Date	Event	Paper/minutes of meeting
2 December 2015	The Financial Institutions (Resolution) Bill was introduced into the Legislative Council	The Bill Legislative Council Brief (File Ref: B&M/2/1/27C) Legal Service Division Report (LC Paper No. LS15/15-16)