FINANCIAL INSTITUTIONS (RESOLUTION) BILL

Submission of Dr Ludmilla K Robinson

Barrister: Co-ordinator of Equity & Trusts, Western Sydney University, New South Wales, Australia

Introductory Note

I have read the *Financial Institutions (Resolutions) Bill* ('the Bill') carefully and with great interest. Given the complexity of resolution procedures generally and the great variety of options open to the drafting Authorities, the outcome is commendable. Please note that the comments presented below were formulated in consideration of the objectives of the Bill as set out in Clause 8.

I am grateful to have been given the opportunity to comment.

PART 1

Cl. 6 (4)

In regard to the lists of 'globally important financial institutions' [(4) (a), (b) and (c)], will written notice be given to the Financial Institutions ('FIs') on the list? Although the lists will be published in the Gazette, it may be possible for some FIs to argue that they had not received written notice that they were regarded by the Financial Secretary as 'within scope' FIs. This is particularly relevant in regard to foreign FIs or their subsidiaries, which may be unaware of the status of notices published in the Gazette. Any dispute arising from this point would have the effect of delaying the resolution process.

Perhaps a brief statement could be added into this clause to the effect that 'publication in the Gazette constitutes written notice.' Such a statement is often included in Australian legislation.

PART 4

Cl. 30

The written notification of the intention to commence the resolution of a within scope FI could be more clearly described as a 'letter of intent' (or 'intention'), rather than a 'letter of mindedness.' Apart from the fact that the former conveys more forcefully the concept that resolution proceedings will be commenced, whereas the latter connotes less certainty or purpose, a 'letter of intent' is the usual heading for a written notice in Anglo-Australian legal practice.

Subdivisions 3 and 4 generally

Whilst subdivisions 3 and 4 (cls 48 and 56) provide for the disposal of proceeds at the conclusion of the activities of the Bridge Institution ('BI') and Asset Management Vehicle ('AMV'), no mention is made in either sub-section in regard to the allocation of losses.

Naturally, if the BI or AMV is wholly owned by the HK government, the issue of losses is irrelevant. However, if the BI or AMV is partly owned by a non-government entity, allocation of losses could become an issue. It is not stated in the Bill whether such losses would be borne:

1. pro rata, according to the percentage of shareholding; or

2. according to some other formula.

Perhaps this could be clarified.

PART 5

Subdivision 5 – Bail-in

Note: Although the bail-in is favoured by European and United Kingdom monetary authorities, it is, nevertheless a contentious resolution procedure, particularly since the disaster of the bail-in imposed upon the Bank of Cyprus.

Cl. 60

It is unclear from subclause (1) whether 'the provision to the effect that the parties to the contract agree that the liability is eligible to be the subject of a bail-in' will apply:

(a) *ex post facto,* i.e. the provision will be implied into all contracts existing at the time of the bail-in, but which were formed prior to the enactment of the Bill; or

(b) *ab initio,* i.e. is to be included **only** in all contracts formed after the enactment of the Bill.

Either way, the enforcement of the subclause could cause some difficulties.

If (a) is relevant, the imposition of such a provision upon extant contracts would arguably be fertile ground for litigation by creditors, in that the contract imposes a liability not contemplated at the time of the negotiation of the agreement.

If (b) is applicable, creditors may be deterred from entering into an agreement which renders their interests liable to a bail-in. This fact could, in turn, affect the profitability/viability of an FI.

Perhaps point (a) could be clarified by a statement to the effect that either (1) the subclause also applies to contracts formed prior to the enactment of the bill, or (2) only to those entered into after the date of enactment.

Cl.62

Whilst this subclause appears to provide immunity from suit for 'one or more directors' [cl 62(1)] of the FI subject to the bail-in procedure, it does not mention a similar protection in regard to the directors of the entity (whether a BI or AMV) to which the assets or liabilities

are transferred. It should also be borne in mind that negligence, breach of fiduciary duty and malfeasance of directors could negate such an immunity.[1]

Division 3

Cl. 83

Although clause 83 (5) purports to prevent commencement of recovery or enforcement proceedings by a creditor against the 'within scope' FI, the effectiveness of such a suspension order vis à vis foreign creditors is uncertain. This could be further compounded if, in the creditor's jurisdiction, the FI can be deemed to be a trustee.[2]

The issue is therefore whether a suspension order can be applied to the obligations of an FI which are wholly or even partly international in nature.

Division 4 Default Event Provisions

Clauses 86 – 92

Default event provisions (sometimes called 'adverse event' or 'adverse effect' clauses) are ubiquitous in banking and finance contracts. They are generally used as a means of protecting the interests of an FI.

It is not clear from this Division whether the default event provisions which are subject to the suspension order are those which operate against the FI or those which may be invoked by an FI to protect its interests.

This should, perhaps be clarified. If a default event clause operates to protect an FI against some default by a debtor, it would be unwise to suspend its operation, especially if the general economic climate were unstable.

PART 6

Division 2 – Independent Valuer

Clause 98

In view of the fact that the role of valuer requires extremely specialised expertise and experience, there may be a limited pool of candidates from which the resolution authority can draw. It is therefore not inconceivable that a potential appointee may have had previous dealings with the within scope FI. This could place the valuer in a perceived, if not actual, position of conflict of interest.

[1] A similar immunity is given to trustees pursuant to the *Trustee Act 1925* (NSW) and also in similar Australian and UK legislation, and which is frequently deemed to be inapplicable in instances of breach of duty, even though the trustee was acting *bona fide*.

[2] For example, a *Quistclose* trust, pursuant to which a borrower of funds for a specific purpose holds any unexpended funds on trust for the lender.

Although the issue of conflict of interest is addressed in Schedule 2 clause 4, it might be useful to make some mention of conflict in clause 98 as well.

Division 3 – Valuation

Clause 103

Although this clause states that the valuer must 'asses the treatment that a pre-resolution creditor or pre-resolution shareholder . . . would have received if the winding up of the affected entity had commenced **immediately** before its resolution was initiated' [cl 103 (a)], the term "immediately before" is vague and open to interpretation. "Immediately" could be taken to refer to hours or even days before the commencement of resolution.

Because of the extreme sensitivity of all financial markets and the immediacy of modern communications, the share value of an FI can plummet in a few minutes. This was demonstrated vividly in the GFC of 2008-2009. Thus, the time at which a valuation is carried out can affect the actual valuation.

Therefore it would be advisable to give the term "immediately before" a more specific value. For example: 'on the date and at the precise time at which the resolution process is activated.' This would provide greater certainty in regard to the valuation and reduce the risk of challenges to the valuation.

Dr Ludmilla K Robinson

Sydney, Australia

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