FRESHFIELDS BRUCKHAUS DERINGER
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SPEAKING NOTES - BILLS COMMITTEE MEETING
FINANCIAL INSTITUTIONS (RESOLUTION) BILL
19 JANUARY 2015

Mr. Chairman and honoured members of the Bills Committee –

I am speaking on behalf of the leading global law firm Freshfields Bruckhaus Deringer, where I head the financial services regulatory practice in Asia. We are leading advisors on "too big to fail" and resolution issues globally. We have over 2,500 lawyers globally, and we recently celebrated our 30th anniversary in Hong Kong.[1]

We strongly support the Bill, and believe that passage of the Bill this year is extremely important for Hong Kong and its standing as a leading global financial centre. We have separately provided a written submission that (i) provides background information on the global governmental and regulatory consensus that all key financial centres need to have in place resolution powers similar to those envisioned in the Bill, (ii) explains how the Bill is extremely important for addressing and managing local risks, as well as being important in connection with Hong Kong playing its part as a key financial centre in addressing and managing global and cross-border risks, and (ii) includes two hypothetical scenarios that compare foreseeable consequences for Hong Kong and financial institutions operating in Hong Kong if the Bill does not, or does, become law.

For the remainder of my time, I will give a quick overview of these hypothetical scenarios.

<u>Scenario 1</u> is as follows:

> *A global financial institution is headquartered in Europe, and it is required by its home county regulator to put in place a Resolution Plan that will explain how if the group becomes non-viable in the future critical and systemically important functions will be permitted to continue. A key strategy in the Resolution Plan is to bail-in liabilities and transfer a large European bank in the group temporarily into a bridge bank so that critical functions can continue to operate pending transfers to other institutions or orderly wind-downs. The institution operates in Hong Kong through a branch and subsidiaries of this large European bank. The headquarters regulator wants to make sure that the global Resolution Plan will work in the jurisdictions around the world where the group has material operations – so it will look at the businesses and operations in Hong Kong and whether the Resolution Plan can work in Hong Kong.*

Here are the possible outcomes:

> <u>If the Bill does not become HK law</u> the HK authorities won't have powers to implement actions in Hong Kong to recognise the bail-in or the transfer to the bridge bank. The headquarters authority decides that the group is not resolvable while there

[1] The views expressed here and in our separate written submission are our views, and do not necessarily reflect the views of all of our clients.

are key operations in Hong Kong, and requires the institution to divest itself of all critical businesses from Hong Kong or to shut down those businesses in Hong Kong and move them to another Asia Pacific host jurisdiction that has revised its laws to have a robust resolution regime following internationally agreed standards.

On the other hand, if the Bill becomes HK law Hong Kong's laws will not be a barrier to bail-in or transfer to a bridge institution and there won't be a barrier to resolvability of the European bank. That means that the home authority won't require the institution to divest itself of critical businesses in Hong Kong or to move those businesses to another jurisdiction. (Of course, if in the future there is an actual resolution instituted by the overseas headquarters authority, Hong Kong authorities won't automatically follow the directions of the overseas authority without first considering the protections for Hong Kong that are hard-wired into the Bill.)

Scenario 2 is as follows:

A large bank headquartered in Hong Kong has an international network of branches and subsidiaries in other countries (host countries), and it has strategic plans to expand into other host jurisdictions in the future. A branch in a particular host country provides services that are domestically critical for the host country.

Here are the possible outcomes:

If the Bill does not become HK law: The host country regulator legitimately considers whether the critical services in its country would continue in the event that the bank becomes non-viable, and it is concerned that Hong Kong authorities don't have resolution powers. It knows that in the event of non-viability the institution would be subject to a Hong Kong insolvency procedure - absent a bail-out from the Hong Kong government - under which critical functions in the host jurisdiction would cease to continue.

The host country regulator can't take the risk of the critical functions in its country ceasing, so it requires the institution to incorporate a local subsidiary in the host country and to move the branch business into the local subsidiary. Further, it requires the new local subsidiary to have large amounts of equity and debt subject to bail-in under the host country's resolution laws. The host authority restricts the ability of the local subsidiary to transfer liquidity to other parts of the group. Particularly if multiple host jurisdictions take similar steps, this disrupts operational synergies within the Hong Kong institution's group, hugely increases capital and funding costs for the group as a whole and could render the group less viable.

Because of this, management of the bank consider moving the headquarters from Hong Kong to another jurisdiction where there is a robust resolution regime following internationally agreed standards.

On the other hand, if the Bill becomes HK law: The host authority is aware of how Hong Kong authorities have planned that bail-in and other resolution actions would be implemented if the bank becomes non-viable, and it believes that the bail-in and other actions if implemented in accordance with the Hong Kong resolution plan would treat the host country fairly so it doesn't require the bank to move its local operations into a separately capitalized local subsidiary with sufficient equity and debt subject to bail-in.

Alternatively, even if the host authority determines that local subsidiarization is still needed, this may be limited to the parts of the business that are locally critical and the institution may retain more flexibility with respect to business and funds flows between the host country and the rest of its group.

The group does not consider moving its headquarters from Hong Kong to another jurisdiction.

These scenarios are realistic and are not far-fetched. Some of our clients and their regulators already are conducting analyses of resolution powers in the jurisdictions where they have material operations, including Hong Kong and other Asia Pacific jurisdictions, and are already assessing whether and how they may need to reorganise their groups based on resolution issues.

These scenarios illustrate some possible very negative consequences for Hong Kong if the Bill does not become law in a timely manner. These scenarios also illustrate benefits to Hong Kong and its financial institutions when the Bill becomes law, including Hong Kong being seen as a jurisdiction in which global financial institutions can have material businesses and operations, and where institutions headquartered in Hong Kong have fewer barriers in operating in other jurisdictions.

Finally, I thank you for the opportunity to speak about these very important issues.