Bills Committee on the Financial Institutions (Resolution) Bill ("the Bill")
Government's responses to submissions and comments given by deputations
on the meeting held on 19 January 2016
Policy Issues

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General comments	
Deputations supported the main objectives and content of the Bill and agreed that the Bill should be passed promptly with a view to complying with the relevant international standards in this regard. *[Allen & Overy (A&O), Deutsche Bank, Freshfields, Clifford Chance, Mr. Peter Lake, International Swaps and Derivations Association (ISDA), UBS]*	The Government appreciates the constructive comments the stakeholders gave during the consultation process and to the Bills Committee. We look forward to communicating closely with the stakeholders as the rules, regulations and Code of Practice, etc. under the Bill are being developed.
1. Contractual recognition clauses	
Some submissions noted that the details regarding requirements to include provisions into contracts, acknowledging and agreeing to the potential imposition of stays on termination and of bail-in, were to be included in rules to be made under the Bill, and cautioned that industry should be fully consulted on such rules (and given time to consider their impact and provide comments) and that the	Before making the relevant rules (under clause 60 in relation to bail-in, and clause 92 in relation to stays on termination rights), it is the intention that a resolution authority would consult the financial industry and relevant stakeholders on the scope and content of each set of rules before such rules are finalized and submitted to the Legislative Council (LegCo) for negative vetting. In

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scope of the proposed requirements should be clear, appropriate and proportionate. Consideration might also be given to phased implementation. *[Deutsche Bank, Hong Kong Association of Banks (HKAB), Dr. Ludmilla K Robinson]*	developing the rules and considering any phased implementation, the resolution authorities will make reference to the approaches adopted overseas, for instance in the European Union (EU), where similar rules have recently come into effect.
2. "No creditor worse off than in liquidation" (NCWOL) compensation and valuation	
One submission considered that further clarity should be provided on the timing of the issue of the regulations to be produced under clause 105 of the Bill in relation to NCWOL valuation assumptions and processes. The submission noted that whilst rules may be required at the point of resolution to specify certain details, valuation rules should be developed *ex ante* in order to avoid potential uncertainty about the basis of valuation and minimize legal challenge. *[Deutsche Bank]*	Regulations regarding NCWOL assumptions and processes are intended to be made shortly following the enactment of the Bill and well in advance of any resolution action being taken. The Government fully recognizes the importance of providing sufficient details on the basis of NCWOL valuation so that affected parties can understand the process and valuations underpinning the NCWOL safeguard. In developing the regulations under clause 105 of the Bill, the Government will continue to monitor ongoing work to implement similar safeguards in other jurisdictions (such as the European Banking Authority's progress in refining its regulatory technical standards for NCWOL valuations) and would consult stakeholders on the regulations before they are finalized for negative vetting by the LegCo.

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3. Protected arrangements	
Some submissions noted that the details regarding the safeguards for "protected arrangements" (i.e. those arrangements such as netting, set-off and security as well as clearing and settlement systems, whose economic effect could be undermined if one "leg" of the arrangement is separated from the other either by partial transfer or by bail-in in resolution) is to be provided in regulations. Clarity was sought on (i) whether bail-in would only affect the net amount under the arrangement; (ii) whether netting of derivatives transactions could be excluded from bail-in; and (iii) the scope of the definition of "clearing and settlement systems arrangements". *[Deutsche Bank, HKAB, undisclosed recipient]*	The Government intends to consult the financial industry and relevant stakeholders on the regulations to be made in respect of protected arrangements under clause 75 of the Bill. In developing the regulations, the Government will draw reference from relevant approaches adopted overseas (e.g. the UK and the US). It is intended that only the net amount under any protected arrangement could be subject to bail-in and this is foreshadowed by clause 75(2)(e) of the Bill. The Government's approach to the potential bail-in of derivative liabilities is set out in item 11 below. The Government proposes that the definition of "clearing and settlement systems arrangements" be considered in the context of the clause-by-clause scrutiny of the Bill.
4. Total Loss-absorbing Capacity (TLAC) standard	
Submissions noted that total loss absorbing capacity	The Government will keep in view the latest international

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(TLAC) requirements are to be specified in rules made under the Bill. In this regard, attention should be paid to any future developments and documentation issued by the Financial Stability Board (FSB) in respect of TLAC requirements. Banks operating in Hong Kong should not be subject to higher requirements than those in other jurisdictions. More certainty is required on the rules to be put forward to ensure that requirements are proportionate. *[A&O, HKAB, AIA]*	developments on TLAC with a view to ensuring that the resolution regime in Hong Kong aligns with international standards. Rules to be made under clause 19 of the Bill will take into account both international standards and prevailing local circumstances (including the likely resolution strategies for financial institutions (FIs) which are systemic locally). The rules will be subject to industry consultation before they are finalized and tabled before the LegCo for negative vetting.
5. Cross-border resolution	
Most submissions which commented on cross-border issues were supportive of the provisions in the Bill enabling a resolution authority to recognize and support an overseas resolution action, with some noting that the provisions achieve an effective balance between providing a resolution authority with flexibility to act in coordination and cooperation with a home authority in respect of a cross-border group and providing adequate "safeguards" to protect the interests of Hong Kong.	The Government noted the broad support in the submissions for the relevant provisions in the Bill. In developing the cross-border provisions in the Bill, the Government has sought to implement mechanisms that align with international standards and principles to allow for effective cross-border coordination and cooperation but, at the same time, allow for local interests to be duly considered and protected. Further, we expect that resolution planning and resolvability assessment, expected to be undertaken proportionately in respect of domestic FIs that could be systemically significant or critical if they fail, will

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	underpin the development of coordinated and cooperative approaches to cross-border resolution between home and host authorities, enhancing certainty that the interests of both can be met satisfactorily, thereby increasing the chances of an orderly, value-preserving cross-border resolution.
A few submissions noted the need for more guidance on how recognition of overseas resolution action and cooperation in cross-border resolution would work in practice and the need to monitor international developments in this area.	The Government agrees that we need to monitor work at the international level on recognition and support of cross-border resolution action and will endeavour to ensure further guidance is provided, potentially in the Code of Practice referred to in clause 194 of the Bill.
One submission noted that recognition of overseas resolution action should be industry and corporate specific.	Recognition of overseas resolution action will be made by the issuance of a recognition instrument in respect of a given corporate entity.
Another submission made reference to one of their members not fully supporting the condition under which a recognition instrument must not be made under clause 185(6)(a) of the Bill (i.e. where a resolution authority considers it would have an adverse effect on financial stability in Hong Kong),	The Government remains of the view that there must be sufficient flexibility within the regime to ensure that local interests are not unduly jeopardized in the recognition of a cross-border resolution action. It is noted that the condition in clause 185(6)(a) is similar to those for refusing

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considering that the general rule of recognition should rather focus on the equity of treatment between jurisdictions and not specific treatment of any specific one. Several submissions referred to resolution planning and were broadly supportive of the local resolution authorities (i) recognizing the work conducted internationally and by home resolution authorities in this area; and (ii) being able to adopt all or part of group resolution plans or develop their own plans. *[A&O, Deutsche Bank, Consumer Council, Clifford Chance, HKAB, AIA, Hong Kong Federation of Insurers (HKFI), UBS, Freshfields, Mr. Peter Lake, undisclosed recipient]*	recognition of foreign resolution action under the UK Banking Act 2009 (section 89H(4)(a)) and the EU Bank Recovery and Resolution Directive (article 95(a)). The Government notes the support and considers that the provisions in the Bill will allow the local resolution authorities to adopt a rational and proportionate approach to resolution planning, depending on the size and nature of an FI's local and overseas activities as well as the resolution planning requirements to which an FI is subject in overseas jurisdictions.
6. Continuity of access to financial market infrastructure (FMI) and resolution of central counterparties (CCP)	
A couple of submissions suggested including provisions within the Bill to ensure continuation of memberships of, and hence continuity of services from, FMIs for an FI in resolution in light of explicit requirements in the EU Bank Recovery and Resolution Directive.	In order to meet the objective of securing continuity of critical financial functions, the Government recognizes the importance of ensuring that an FI in resolution can maintain its access to FMI(s) and benefit from continuity of access to their services. Work on this is still ongoing at the international level and, until such time as that work is concluded and resulting standards or principles issued by

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	the FSB, the Government proposes that the local resolution authorities should consider the issue in the context of their resolution planning, and initiate discussions as necessary with local FMIs to ascertain whether criteria can be drawn-up and consensus achieved on a basis by which continued access can be secured at least locally.
One submission strongly disagreed with covering CCPs within the scope of the Hong Kong resolution regime given the specialized nature of CCP activities which are different from those of other FIs (e.g. banks). The submission considered that CCPs should be liquidated on failure but that if, on the contrary, Government provided support to a CCP to preserve its functioning or service lines, then Government should be granted a 100% ownership stake in that CCP. The CCP's participants should not be compelled to contribute to a levy (beyond their tax payment) given that Government has mandated that certain transactions must be cleared through CCPs. *[Deutsche Bank, HKAB, Alternative Investment Management Association (AIMA)]*	Given the anticipated substantial systemic impact on the financial markets that could arise from an abrupt cessation of the services provided by CCPs, the Government, in line with the developed international consensus, does not see the liquidation of a CCP as a viable option in most cases. Resolution and recovery planning for CCPs is therefore essential. It is acknowledged that work in the area of CCP resolution, whilst ongoing internationally, is less developed than that in respect of banks given the nature of the global financial crisis which prompted the development of the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions (KA). Nonetheless, the KAs specifically require that resolution regimes should extend to FMI, including CCPs. The Government will continue to

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	work on the practical implementation of the resolution framework for CCPs, as for other FIs, including through monitoring the development of relevant international standards. In view of the financial stability imperative in resolving and preserving continuity of the functions of systemically important CCPs, it follows that there will need to be a mechanism to ensure that if any public funds are expended in resolving a CCP, and not recouped, then those funds can be recovered. A "user pays" levy is considered most appropriate for CCPs given the limited number of systemically important CCPs in Hong Kong and that the participants in a CCP arguably benefit most from its resolution. There is precedent for this from the 1987 publicly funded rescue of the clearing house for the futures market in Hong Kong, the costs of which were recovered, at least in part, through a transaction levy on the futures exchange and a special levy on the stock exchange.
7. Insurance sector matters	
Some submissions noted that there are fundamental	The FSB recognizes that in some circumstances insurers can

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differences between the insurance sector and other sectors within the financial services industry. These differences relate in particular to interconnectedness and contagion, where insurers are considered to pose lower systemic risk given that insurers do not provide "short term functions" to the economy in the same way as banks. Given these differences, traditional tools (such as run-off and portfolio transfers) may be able to "resolve" an insurer without the need to apply the stabilization options in the Bill. Further, the proposed Policyholders Protection Fund should deal with any losses of customers on the failure of an insurer. *[HKFI, AIA]*	pose risks to financial stability (drawing on lessons learned from the global financial crisis) and the KAs require that "any insurer that could be systemically significant or critical if it fails and, in particular, all insurers designated as Global Systemically Important Insurers (G-SIIs) should be subject to a resolution regime". Taking into account this KA requirement whilst acknowledging that the insurance sector is different from other financial sectors, the proposed scope of the regime in the Bill does not cover all insurers but only those which are G-SIIs (including their subsidiaries and branches) as designated by the FSB. Should it be assessed in future that another insurer (which is not identified by the FSB as a G-SII) is systemic locally, the Financial Secretary (FS) may designate such an insurer as coming within the scope of the local regime under clause 6 of the Bill. Even in the event that an insurer within the scope of the local regime comes under stress, it is not automatic that the insurer will be resolved using the stabilization options in the regime. If traditional tools such as run-off and portfolio transfer could safely be used without the insurer posing systemic risk to the financial system, then the conditions for

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	resolution under the Bill would likely not be fulfilled. The proposed Policyholders Protection Fund is intended to serve as a compensation fund for policyholders in the event of an insurer becoming insolvent. Similar to the Deposit Protection Scheme for banks, it is not proposed that the Policyholders Protection Fund should be used for the purposes of funding resolution. Therefore, a separate funding arrangement to recover any costs incurred as a result of resolution action is needed. During the two stages of public consultation, the Government consulted on the most appropriate cost recovery mechanism, and noted that a majority of respondents favoured an ex post model for recovery through a levy, mainly because the scale of any ex ante fund could be so large as to be inefficient and that its very existence could be a source of moral hazard. A number of respondents also supported a sector-specific model, under which any levy could only be imposed on those within scope FIs operating in the same sector as the FI in resolution.

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8. Funding of resolution	
One submission noted that the Bill does not include provision for a cap on the maximum amount of levy to be imposed on the industry and that certain parameters should be established around the maximum potential liability for the industry, whether those parameters are included in the Bill or in rules issued at a later date.	The Bill does not endeavour to set any cap on the amount of any levy that may be imposed as it is not possible to predict in advance the amount of public funds which may need to expended in a given resolution and which may not be recovered in the course of that resolution. That said, there are constraints on the resolution authority in relation to resolution funding under the Bill given that one of the objectives of resolution, and to which the resolution authority must have regard, is "to seek to contain the costs of resolution and, in so doing, protect public money" (clause 8(1)(d)). Moreover, before determining whether funds may be deployed to facilitate resolution, the resolution authority must have regard (under clause 176(3) of the Bill) to the degree to which (i) liabilities of the entity in resolution can be written off or converted to enable the absorption of losses and its recapitalisation; (ii) assets of the entity can be sold; and (iii) private sector funding can be obtained by the entity. This obligates the resolution

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	authority to impose losses on the entity in resolution to the extent possible and to seek other private sector funding solutions before deploying any public funding.
Some submissions disagreed with an *ex post* levy made on a sectoral basis (i) considering it unfair to call upon viable within-scope insurers to pay for the resolution costs of a non-viable peer, raising concerns about the effects of the levy on Hong Kong's competitiveness or; (ii) considering that a "user pays" levy for resolution of FMI might disincentivize use of FMI. *[HKAB, HKFI , undisclosed recipient]*	The Government considers on balance that an *ex post* funding model is appropriate as there would be no upfront impact on industry and the levies can be set once it is clear how much actually needs to be recouped (i.e. recovery of public funds expended in resolution that cannot otherwise be recovered in the course of resolution). The levy will be imposed by resolution of the LegCo, in accordance with the regulations made by the FS under clause 179, and can be collected over a number of years to reduce any impact on healthy FIs. Please see the response under item 6 above regarding an *ex post* "user pays" levy in respect of FMI.
9. Clawback of remuneration	
A couple of submissions queried the application of clawback to fixed remuneration noting that it might create disincentives for taking on leadership positions.	In developing the provisions on clawback in the Bill the Government, having considered a range of overseas practices, has sought to strike a balance by opting for a court-based process which will allow a court to order clawback of both fixed and variable remuneration (going

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	back three years before the date of resolution and a further three years in cases of dishonesty), after taking into account the financial circumstances of the officer and the extent to which the officer contributed to the failure of the FI. Therefore even though the clawback can extend to fixed remuneration, the Court will consider the effect on the officer's financial circumstances and the clawback is not automatic by reference to seniority of rank within the FI but depends specifically upon contribution to/causation of the FI's failure and this should mitigate against any general concerns arising from taking on leadership positons. Further, in considering the forms of remuneration to be subject to clawback, the Government considered that limiting clawback to variable remuneration might incentivize a structural shift in FIs' remuneration packages towards a higher proportion of fixed pay, which may in the long run reduce FIs' ability to cut back remuneration in a downturn or times of stress.
One submission focussed on the need for clawback to be founded on a strong exacting causal link between an	Given the Bill is focused on addressing the impact of failure of systemically important FIs, the triggers for clawback in

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officer's act/conduct and the extent to which it actually caused the FI to become non-viable.	the Bill are deliberately linked to actions or omissions that have caused or materially contributed to the financial institution ceasing, or being likely to cease, to be viable where the action/omission is done/made intentionally, recklessly or negligently.
The same submission also noted that more than mere negligence should be required to trigger clawback and the period should not be longer than two years. *[HKFI, Hong Kong Institute of Directors (HKIoD), HKAB]*	As noted above, the selection of a three-year period was carefully thought out after considering approaches in other jurisdictions and is considered a middle ground. In assessing whether to grant a clawback order and the amount to be clawed back, the Court will be able to take into account the degree of "culpability" of the officer concerned and whether his/her conduct fell below the standard of a reasonably competent officer in their position. To fall within the scope of the clawback provision in the first place, an officer of an FI must be of a certain seniority or hold a certain position of responsibility and, as such, would be expected to act with due skill and care in the execution of their duties for the FI. Taking these two considerations into account, it does not seem unreasonable

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	for clawback to be triggered by the negligence of a senior/responsible officer where their conduct falls below that to be expected of a reasonably competent officer in their position (so as to be considered negligent) and where that negligence causes or materially contributes to a systemically important FI becoming non-viable. Currently, actions for negligence can already be brought against professionals such as accountants, lawyers and doctors, so a negligence threshold for clawback in circumstances where a systemic FI has failed and that failure is causally linked to the activities of specified officers does not appear unreasonable.
10. Conditions for initiating resolution	
Some submissions expressed the view that there should be greater clarity on the indicators to be used in respect of the conditions for initiating resolution. *[AIA, AIMA, A&O]*	Clause 5 of the Bill defines when an FI ceases to be viable for the purpose of determining whether Condition 1 (under clause 25(2)) has been met, linking non-viability to a breach of authorization criteria warranting withdrawal of the FI's authorization. While the Government recognizes the desire for certainty with respect to the factors triggering resolution, we do not consider it feasible to set out

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	"automatic" triggers, nor an exhaustive list of criteria, in the Bill. However, the Government and the future resolution authorities will consider how to best use indicative examples in the Code of Practice proposed to be issued under clause 194 of the Bill to provide further clarity. This proposed approach is similar to that adopted under the UK Banking Act 2009, where further details are set out in the Special Resolution Regime Code of Practice (March 2015).
11. Bail-in	
A number of submissions (i) requested greater clarity or guidance on how discretionary exclusions from bail-in would be made; and (ii) noted the difficulties of bailing-in derivatives liabilities and suggested excluding them from bail-in "*ab initio*" rather than on a discretionary basis. One submission sought confirmation that bail-in would be on a net basis in respect of protected arrangements *[Deutsche Bank, HKAB, AIMA, A&O]*	The Government acknowledges the preference for defined exclusions from bail-in, however it is also important to minimize exclusions (given that exclusions reduce loss absorbing capacity) and to avoid creating incentives for FIs to structure their liabilities in specific ways to avoid bail-in. The Government therefore favours leaving derivatives liabilities within the scope of bail-in, thereby allowing a resolution authority to consider on a case-by-case basis whether to exclude them given the circumstances prevailing at the relevant time in relation to the FI in resolution.

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	Generally speaking, it is important for a resolution authority to have some discretion as regards the bail-in of liabilities. So if it should transpire at the time any bail-in is sought to be effected that the act of bailing in certain liabilities might itself have a potential adverse impact on financial stability (e.g. in terms of potential contagion) or it is not practicable to effect the bail-in within a reasonable time (e.g. because ascertaining the precise amount of the liability is complex) the resolution authority can, on a case-by-case basis, exclude it. The discretionary exclusions from bail-in will be addressed in the Code of Practice to be issued under the Bill which is designed to provide guidance on, amongst other things, the procedures to be followed in connection with the application of any stabilization option. The resolution authorities would consult on the scope and content of the chapters in the Code of Practice before they are issued. As noted in the response above under item 3 regarding protected arrangements, the Government considers that it appropriate in the relevant regulations to be issued under

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	clause 75 of the Bill to impose restrictions on a resolution authority such that it should seek only to bail-in the "net" amount under any secured, set-off, netting or title transfer arrangement and in the case of any inadvertent bail-in of a gross amount the resolution authority would be empowered to take remedial action (clause 75(2)(e) and (f) of the Bill).
12. Investigation, information gathering, inspection power	
One submission noted that the investigation, information gathering and inspection powers are exercisable whether or not the financial institution has ceased or is likely to be ceased to be viable and whether or not resolution has been initiated and, as such, are very wide. *[AIA]*	The investigation, information gathering and inspection powers under part 10 of the Bill are intentionally designed to be used irrespective of whether an FI has reached the point of non-viability or whether resolution has been initiated. This is because the information gathering powers are required to support the resolution authority in carrying out resolution planning and resolvability assessment in advance of resolution as well as in undertaking actual resolution and monitoring compliance with the terms of directions, instruments, etc. issued under the Bill. It is however the case that the information to be sought must be such as the resolution authority reasonably requires in connection with the performance of its functions under the

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	Bill (clause 156(2)) and so there is a direct nexus between the information gathering powers and the functions which the resolution authority must undertake. The information gathering powers are generally in line with those found in other regulatory ordinances (e.g. the Securities and Futures Ordinance (Cap. 571) and the Insurance Companies (Amendment) Ordinance 2015).
13. Resolvability assessment and resolution planning	
Some expressed concern in relation to the power of the resolution authority to give direction(s) to remove impediments to orderly resolution under clause 14 of the Bill, including (i) whether this would preclude rational and commercial efforts or arrangements to rescue an FI, on the basis they may be seen by a resolution authority as impediments to orderly resolution; (ii) that "routine" use of the power could lead to the substitution of the resolution authority's judgement instead of the business judgement of the managers and directors of the FI; and (iii) because an insurance company is highly industry-specific it should retain control over how best to structure its operations and	A distinction should be drawn between recovery planning and resolution planning. An FI should have its own recovery plan with a menu of options which it can deploy should it come under stress. This recovery plan is owned and implemented by the FI. However, should these recovery options not work to restore the FI to health then, if the FI is systemic, it may go into resolution. To prepare for resolution, a resolution authority can undertake advance resolution planning and assessments of an FI's resolvability, and in normal circumstances this will be done whilst the FI is healthy and in business as usual

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so such powers should only be exercisable in extreme circumstances with utmost transparency and with the ability of the FI to make representations. *[HKIoD, HKFI]*	mode (i.e. long before any resolution may ever be in prospect). The KAs require the provision of specific powers to enable the removal of significant impediments to orderly resolution which may be identified during resolvability assessment, and the Government considers that such a power is a necessary part of the resolution toolkit to ensure that FIs is resolvable in practice. However, this power is not intended, and cannot be used, to routinely substitute the judgement of the resolution authority for that of the directors and management of the FI. To use the power, the resolution authority must be of the opinion that the item to be addressed is a significant impediment to orderly resolution, and must give the reasons to the FI why it is of this opinion. The resolution authority is obliged to consider how difficult it would be to carry out orderly resolution if the contemplated measures are not taken and, fully recognizing the potential commercial impact which the exercise of this power could have, the Bill requires the resolution authority to have regard to the likely impact of

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	the contemplated actions on the future viability and capacity of the FI to continue to perform critical financial functions. In practice, it is expected that the resolution authority and the senior management of the FI in question will work together on the removal of impediments during the course of resolution planning, harnessing the expertise and corporate knowledge of the senior management and directors who will be at liberty to suggest alternative ways in which the identified impediment may be removed.
14. Removal of Directors and Giving of Directions	
A concern was expressed in one submission that the power to remove directors, the CEO or Deputy CEO in clause 24 of the Bill (which only becomes operable once conditions 1 and 3 are met under the Bill[1]) must only be exercised on a proper basis and the rationale should be determined on a case-by-case basis and not simply relate to title or level of responsibility. Removal should not be routine or imply the	The power to remove a director or senior management is only operable when (i) it appears resolution is imminent and (ii) the resolution authority is satisfied that the removal will assist in meeting the resolution objectives (which reason must be communicated to the person removed). The power is intended to support the resolution authority in implementing an orderly resolution by allowing the

[1] Under the Bill (1) a resolution authority may only initiate the resolution of a within scope financial institution if it is satisfied that conditions 1,2 and 3 are met in the case of the financial institution, (2) Condition 1 is that the FI has ceased, or is likely to cease, to be viable; (3) Condition 2 is that there is no reasonable prospect that private sector action (outside of resolution) would result in the FI becoming viable again within a reasonable period; (4) Condition 3 is that the non-viability of the FI will pose risks to the stability and effective working of the financial system of Hong Kong, including to the continued performance of critical financial functions, and resolution will avoid or mitigate those risks.

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relevant directors/management will be subject to remuneration clawback. *[HKIoD]*	resolution authority to prevent deliberate actions being taken by those still ostensibly "in charge" of the FI which could prove detrimental to, or pre-empt, the execution of the resolution authority's preferred resolution strategy and thereby potentially reduce the ability of the resolution authority to ensure continuity of critical financial functions. The power would not be used routinely given that the resolution authority will not be best placed to manage a systemic FI and will inevitably need to rely to some degree on the corporate knowledge of the incumbent directors and management. Rather the power will be used to remove any directors/management who are deliberately intent on taking action which runs counter to, and potentially jeopardizes, the resolution authority's ability to meet the resolution objectives. It is noted (as is also noted in the submission) that the interconnectedness of FIs is an element which is monitored in ongoing supervision and is, in some sectors, taken into account in determining systemic importance and the consequences which flow from that. The Government

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	further notes that resolution can be triggered under the regime before an FI becomes balance-sheet insolvent, when it is "likely to cease to be viable" on a forward-looking basis.
A further concern was expressed in the same submission that the prospect of removal of directors/management may incentivise them to behave in a concerted manner to "achieve the prospect of a correlated failure scenario" which may overwhelm the resolution authority and oblige it to retain managers and directors. The submission notes that this may encourage interconnectedness and the resolution regime will be of limited utility if it is only invoked when FIs have become balance-sheet insolvent.	The Government considers it unlikely that the directors/management of unrelated FIs would work in concert to bring about a correlated failure scenario.
A concern was expressed in one submission that the power to give directions to require an FI or its directors/senior management to take or refrain from taking specified action in relation to the FI's business or property under clause 22 of the Bill (which only becomes operable once conditions 1 and 3 are met under the Bill) should be exercised with caution and restraint (not in an unfettered manner) and not in such a manner as to oust private sector action taken by	As set out above that the power to remove directors is not intended to be invoked as a routine matter. The Government is aware of the challenges in managing a systemic FI and considers the resolution authority will likely require assistance from incumbent directors/management. The power to remove directors will therefore be exercised on a case-by-case basis and only where resolution is imminent and the removal will assist in

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the directors/management.	meeting the resolution objectives. As noted in the response to item 13 above, FIs within the scope of the regime will be expected to develop, and should the need arise implement, their own recovery plans to restore themselves to viability should they come under stress. These plans are prepared by, owned by and implemented by the FI and its directors/management. However, if the recovery options in the recovery plan fail to return an FI to a healthy state, the resolution authority will need to consider resolution. When resolution is imminent (i.e. conditions 1 and 3 are met) but the possibility of any private sector action is still under consideration, the resolution authority will be looking to work with directors/management to realistically assess the likelihood of any such rescue being forthcoming. The resolution authority must be able to exercise a degree of control in this situation to prevent abrupt unilateral action by a director/manager which could jeopardize either a private sector solution (outside of resolution) or an orderly resolution. The power to give directions at the point when

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	resolution may be imminent provides this degree of control. The intention is not that the power will be exercised casually, routinely or without restraint. Instead, it is a tool which the resolution authority can use on a case-by-case basis to protect the prospects for orderly resolution at a time when a systemic FI, under the direction of its board and senior management, has become or is likely to become non-viable.
15. Stabilization tools	
One submission noted that there is no dedicated option within the suite of stabilization tools for the immediate winding up and liquidation of FIs. It was suggested that an additional tool be added to enable the winding-up of an institution where most appropriate.	The proposed resolution regime is intended to sit alongside existing insolvency arrangements, and insolvency will remain the default option in cases where it is assessed that the entry of an FI into liquidation would pose little threat to the continuity of critical financial services and financial stability. Similarly, it is envisaged that following a resolution, where only part of a critical or systemic FI is stabilized, the residual entity would, in most cases, be expected to be dealt with through existing insolvency arrangements.

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One submission disagreed with "forced acquisition" and overriding existing contractual terms in connection with the "transfer to a purchaser" stabilization option, considering instead that, at least for insurers, temporary public ownership (TPO), transfer to a bridge institution and "voluntary" transfer of impaired FIs to non-impaired FIs could provide sufficient protection for Hong Kong. *[AIMA, HKFI]*	There is no concept of "forced acquisition" under clause 33(2)(a) of the Bill. Whilst a resolution authority can transfer shares or property without the consent of the FI in resolution or its shareholders, the resolution authority cannot force a third party to acquire those shares or assets against its will. It should also be noted that TPO is the last resort stabilization option and is to be used only when the resolution authority has considered all other stabilization options and is satisfied that orderly resolution of the FI that meets the resolution objectives is most appropriately achieved by TPO and the FS approves the use of TPO. We expect that effective resolution planning and the removal of impediments to FIs' resolvability should serve to reduce the likelihood that TPO would need to be deployed as a resolution option.
16. Scope	
One submission queried the need to extend the resolution regime to holding companies.	In line with the KAs and international practice, the Bill provides for the orderly resolution of one or more FIs at the level of a locally incorporated holding company. For a range

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	of reasons, including cases where there are two interconnected within-scope FIs under the same holding company or where there are difficulties or concerns in applying the resolution powers to the balance sheet of an operating FI directly, it may be more feasible to intervene at the level of a holding company. The resolution authority's ability to apply resolution tools directly to a holding company is counterbalanced by the need for the resolution authority to be satisfied that the resolution objectives can be more effectively achieved by resolving the holding company (clause 28(3)(b) of the Bill). Indeed, experience to date in group level resolution planning for global systemically important banks (G-SIBs) indicates that in many cases the most effective resolution strategy is to apply stabilization tools to a "clean" holding company, rather than an operating bank, in order to minimize reputational concerns, operational disruption and potential NCWOL claims.
One submission noted that any FI should be covered by the	We see merit in monitoring the scope of the regime, and the

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regime if its failure poses systemic risk in Hong Kong (be it a bank or non-bank, a securities or investment firm, an insurance company and irrespective of whether it is now subject to regulatory oversight). The submission suggested regular review of the scope of the regime with clear and prompt disclosure to the public of any change in scope.	regulatory boundary more broadly, given continuing innovation in the financial sector. We intend to keep the scope of the regime in view as part of its ongoing processes (and those of the sectoral regulators) to monitor activities in the financial sector and the nature of activities which should be subject to regulation.
One submission states that the FS's power to designate FIs as within scope FIs (i.e. as coming within the scope of the regime) should be exercised with due care not to interfere with the free market.	The FS is required to act reasonably, rationally and within the ambit of the empowering provision in making any designation as a matter of administrative law principles. Nonetheless, the Government recognises that greater clarity could be provided with regard to the defining characteristics of an FI which would make such designation likely. However, at the same time care must be taken not to reveal potentially commercially sensitive details pertaining to an assessment of the systemic risk posed by an FI. We are therefore minded to describe in the Code of Practice, proposed to be issued under the Bill (clause 194), the high level factors that would be taken into account when determining whether an FI should be brought within scope

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	of the regime.
One submission noted the need to inform entities facing designation under clause 6 of the Bill (which would bring them within the scope of the regime) to be notified before they are so designated.	The Government acknowledges the need for a potential "designee" under clause 6 of the Bill to be informed of its potential designation and given an opportunity to make representations. The Government would intend to do this in order to satisfy general principles of fairness, but to provide greater certainty, it is proposed that the future resolution authorities should include a description of the administrative process in a chapter of the Code of Practice to be issued under the Bill (clause 194).
Another submission stated that the scope of the regime should extend to cross-border FMIs only to the extent necessary to enable a resolution authority in Hong Kong to take action in cooperation and coordination with an FMI's primary regulator in order to mitigate the risk of confusion and uncertainty in the case of distress leading to a lack of clarity between different authorities seeking to exercise their own powers in an uncoordinated manner.	As per the submissions and responses under item 5 above, the regime provides for a balanced framework for cross-border resolution and we recognise that coordinated and cooperative approaches to cross-border resolution should result in better outcomes for both home and host jurisdictions. The regime therefore confers discretion upon a resolution authority to "recognise" foreign resolution actions (which may limit the actual operational role it plays in any resolution of a cross-border FMI) but also it also

Comments	The Government's response
[HKFI, Consumer Council]	confers a broad set of safeguards that preserves the right of the resolution authority in Hong Kong to take independent actions under the local regime in respect of within scope FIs that are part of cross-border groups, where the resolution authority determines that to do so will best protect local interests.
17. Competitiveness of Hong Kong as an international financial centre ("IFC")	
One submission notes as a first and utmost concern that the new regime should not damage the competitiveness and continued development of Hong Kong as a regional finance hub. And that funding levies should never compromise the competitiveness of Hong Kong as a financial hub. Other submissions noted that the passage of the Bill is essential for preserving the ongoing stature of Hong Kong as a key global financial centre and that failure to introduce a KA compliant regime would make Hong Kong uncompetitive internationally and create needlessly onerous requirements for market participants faced with multiple regulatory standards.	The Government agrees that Hong Kong's position as an IFC should be reinforced by the adoption of the regime specified in the Bill. In building its reputation as an open and well-regulated IFC, Hong Kong has as a matter of policy sought to adopt international standards into its regulatory framework and to participate at an international level in the development of those standards. Resolution and the adoption of the FSB's KAs are no different in this regard.

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[Clifford Chance, HKFI, Freshfields, Mr. Peter Lake]	
18. Resolution Authority	
One submission notes that it previously proposed a single resolution regime led by the Financial Services and the Treasury Bureau to avoid inefficiencies in the resolution of cross-sectoral groups. However, the respondent accepts the proposal in the Bill that the Monetary Authority (MA), the Securities and Futures Commission (SFC) and the Insurance Authority (IA) be appointed as resolution authorities for those FIs operating under their existing purviews, but reiterates the importance of efficiency and consistency in securing the resolution objectives. *[Consumer Council]*	The Bill provides for a single resolution regime that confers powers on sectoral resolution authorities, namely the MA, the SFC and the IA. The Government carefully considered the pros and cons of establishing a single resolution authority as opposed to the sectoral approach proposed in the Bill. On balance, it was determined that the latter was most appropriate in the context of Hong Kong, mainly because the sectoral regulators are each best placed to identify concerns over the condition of an FI under their respective purviews. The role of the Government in resolution is limited in order to respect the requirement of the KAs, and recommendations from the most recent International Monetary Fund Financial Stability Assessment Program of Hong Kong, that a resolution authority should have operational independence (KA 2.5), not least to ensure a resolution authority's ability to act quickly and decisively in a crisis situation.

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	We note that the proposed model is considered acceptable by the respondent, and are satisfied that the role of a lead resolution authority (LRA) (clause 9) is designed to ensure efficiency and consistency in respect of cross-sectoral groups by conferring ultimate control over the resolution planning for, and if necessary resolution of, entities within a cross-sectoral group on the LRA, supported by the other sectoral resolution authorities as appropriate.
19. Settlement finality	
One submission noted that the Payment Systems and Stored Value Facilities Ordinance (PSSVFO) should be amended to ensure that all PSSVFO settlement finality protections clearly apply in resolution scenarios. *[Undisclosed recipient]*	The focus of resolution is the preservation of continuity of critical financial functions. Accordingly, the Government has no intention to disrupt settlement finality under the PSSVFO by virtue of activities conducted under the powers set out in the Bill. The Bill (clause 223) has incorporated a saving provision into the PSSVFO to the effect that the performance of a function under the Bill has no effect on the designation of clearing and settlement systems under the PSSVFO or the certificates of finality issued under the PSSVFO in respect of designated clearing and settlement systems.

Comments	The Government's response
	We would propose to consider whether anything additional is required during the clause-by-clause scrutiny of the Bill.

Financial Services and the Treasury Bureau (Financial Services Branch)
Hong Kong Monetary Authority
Securities and Futures Commission
Office of the Commissioner of Insurance
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