

Bills Committee on Financial Institutions (Resolution) Bill

**Response to Matters Raised by Members at the Meeting
on 31 March 2016**

Further to LC Paper No. CB(1)799/15-16(02), this paper sets out the Government's response to an issue raised by Members in relation to the Financial Institutions (Resolution) Bill (the Bill) at the Bills Committee (BC) meeting on 31 March 2016.

Schedules 3 and 4 – Removal of directors etc.

Section 7(1) of Part 1 of Schedule 3 and section 9(1) of Part 1 of Schedule 4 to the Bill respectively specify that a securities transfer instrument or a property transfer instrument may revoke the appointment of a person as a director, chief executive officer or deputy chief executive officer of a prescribed entity. However, sections 7(2) and 9(2) of Schedules 3 and 4 explicitly provide that the revocation of appointment does not terminate, or affect the rights of any party to, a contract of employment or services with the prescribed entity. Members express grave concern that the provisions may protect the employment of the directors or senior officers of the failing financial institution (FI) whose actions or omissions may have directly caused the non-viability of FI concerned. The Administration is requested to: (a) review the provisions to address members' concern; and (b) provide information on similar provisions adopted by overseas jurisdictions in their resolution regimes.

2. As explained at the BC meeting on 31 March 2016, the rationale behind section 7(2) of Schedule 3 and section 9(2) of Schedule 4 (as well as clause 24(8) and section 6(2) of Schedule 6, which are drafted similarly) is to remove any doubt about whether any revocation of a person's appointment to a post as a director, chief executive officer (CEO) or deputy chief executive officer (DCEO) of an FI under the relevant provisions by a resolution authority would, of itself, constitute a termination of his/her employment with the FI, thereby affecting his/her rights under the employment contract, the Employment Ordinance (Cap. 57), and other applicable legislation, such as the Protection of Wages on Insolvency Ordinance (Cap. 380) (in the event that the failed FI goes into liquidation) (e.g. where a residual FI remains following a partial transfer of business).

3. Under other Ordinances, regulators can at present withdraw approvals given to persons appointed to a senior post in a regulated entity, such as a chief executive or director, where the regulator has assessed that the person is no longer "fit and proper" for appointment to the post (see, for example, section 71 of the Banking Ordinance (Cap. 155)(BO), sections 194 and 196 of the

Securities and Futures Ordinance (Cap. 571)(SFO) and sections 13AC(7) and 13AE(7) of the Insurance Companies Ordinance (Cap. 41)(ICO))¹. However, there is no specific provision under the relevant provisions of the BO, the SFO and the ICO to the effect that the withdrawal of an approval, of itself, serves to automatically terminate any contract of employment. The treatment of the contract will be dictated by its terms and the general law of contract.

4. The provisions of the Bill cited in paragraph 2 above are not designed to be exercised as a result of any considered assessment of “fault”. Instead, it is intended to provide a resolution authority with flexibility to revoke the appointment of a person from their post as a director/CEO/DCEO of an FI entering into resolution if doing so could, for example, support the achievement of the resolution objectives. Taking such action over a “resolution weekend” would not provide sufficient time for a resolution authority to assess a director/CEO/DCEO’s culpability for an FI’s non-viability. Later, if found culpable, then in all likelihood an officer’s employment would be terminated by any new owner/controller of the failed FI, taking into account the terms of his/her individual contracts. A resolution authority may also seek a clawback order from the Court against “officers”² of the FI (under Part 8 of the Bill) to recover fixed and variable remuneration from the officer.

5. Having reviewed the provisions and made reference to existing supervisory powers under other Ordinances in light of Members’ comments and views raised at the BC meeting on 31 March 2016, we will move a Committee Stage Amendment (CSA) to amend clause 24(8), section 7(2) of Schedule 3, section 9(2) of Schedule 4 and section 6(2) of Schedule 6 such that the instrument or notice *“does not of itself terminate, or affect the rights of any party to, a contract of employment or services under which a director, chief executive officer or deputy chief executive office is employed by, or acts for or on behalf of or under an arrangement with...”*.

6. In respect of our understanding of related powers available in other jurisdictions, provisions vary from jurisdiction to jurisdiction. According to the United Kingdom’s Banking Act 2009, share transfer, property transfer and resolution instruments, under sections 20, 36A and 48N respectively, may make

¹ Sections 13AC(7) and 13AE(7) of the ICO, as additionally provided by section 26 of the Insurance Companies (Amendment) Ordinance 2015, have not yet come into operation.

² Under clause 142 of the Bill, for the purposes of the clawback provisions, “officer, in relation to a within scope financial institution, means a person who is — (a) a director or shadow director of the financial institution; (b) the chief executive officer or deputy chief executive officer of the financial institution; (c) a person who is employed by, or acts for or on behalf of or under an arrangement with, the financial institution and who as such— (i) is principally responsible (alone or jointly with others) for — (A) the management of part of the business of the financial institution; or (B) the performance of one or more of the control functions of the financial institution; or (ii) has the potential to have a material impact on the risk profile of the financial institution; or (d) a person who was a person mentioned in paragraph (a), (b) or (c)”.

provision to: (a) remove a director or senior manager; (b) vary the service contract of a director or senior manager; (c) terminate the service contract of a director or senior manager; or (d) appoint a director or senior manager of a bank or group company of that bank. Our view is that the UK legislation provides the resolution authority with a wider range of powers when compared to what is proposed in the context of the removal of a director, CEO or DCEO under the provisions of the Bill as it provides for termination of the service contract of a director/senior manager by way of a provision made in an instrument, in addition to the ability to remove a person appointed as a director or senior manager from his/her posts. We have, however, on balance preferred to adopt a model similar to those available under existing regulatory Ordinances (in respect of the fitness and properness of persons appointed to senior posts in a regulated institution) given our assessment of the significant constraints on a resolution authority to determine any culpability over a “resolution weekend”, as well as the risks of legal challenge that such actions might constitute a deprivation of, or unlawful interference with, those persons’ private property rights.

7. In Singapore, under section 30AAI(2) of the Monetary Authority of Singapore (MAS) Act, although we understand not specifically related to resolution, the MAS is empowered to, if it thinks necessary in the public interest, give directions to an FI to remove a director or executive officer from his office or employment where satisfied that the director or executive officer: (a) has wilfully contravened or wilfully caused the relevant financial institution to contravene any provision of the MAS Act; (b) has, without reasonable excuse, failed to secure the compliance of the relevant financial institution with the MAS Act; or (c) has failed to discharge any of the duties of his office. The MAS provisions therefore seem closely tied to an assessment of fault/culpability, and operate not solely in the resolution context, as opposed to the objective of the provisions under the Bill which are primarily focused on effectively achieving the resolution objectives.

8. As mentioned above, fault/culpability would be addressed through the clawback powers under Part 8 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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