Bills Committee on Financial Institutions (Resolution) Bill

Response to Matters Raised by Members at the Meeting On 16 May 2016

This paper sets out the Government's response to the matters raised by Members in relation to the Financial Institutions (Resolution) Bill (the Bill) at the Bills Committee (BC) meeting on 16 May 2016.

Schedule 3 – Stamp duty exemption for securities transfer instruments

Members note that the Administration plans to develop appropriate amendments to the enacted Financial Institutions (Resolution) Ordinance in a future legislative exercise to effect the stamp duty exemption policy in the context of the resolution legislative framework. The Administration is requested to give the above undertaking during the resumption of the Second Reading debate on the Bill.

2. We note Members' views and are prepared to give the undertaking during the resumption of the Second Reading debate on the Bill.

Part 8 – Clawback of Remuneration

Effect of the Limitation Ordinance to clawback of remuneration

Section 4(1)(d) and section 4(5) of the Limitation Ordinance (Cap. 347) (LO) respectively provide that actions to recover any sum, or any penalty or forfeiture, or sum by way of penalty or forfeiture, which are recoverable by virtue of any Ordinance or imperial enactment shall not be brought after the expiration of 6 years and 2 years from the date on which the cause of action accrued. In the light of comments from members and the legal adviser to the Bills Committee, the Administration is requested to clarify whether the resolution authorities would be subject to the time limit under section 4(1)(d) or section 4(5) of LO when applying to the Court for a clawback order against an officer or former officer of a within scope financial institution (FI).

3. At paragraphs 4-5 of the Government's response to the matters raised by Members at the meeting on 3 May 2016 (LC Paper No. CB(1)909/15-16(03)), we confirmed that the Limitation Ordinance (Cap. 347)

(LO) would not apply on the application to the Court for a clawback order under the Bill given that clause 143(1) expressly states that a resolution authority may "at any time after it has initiated the resolution of a within scope FI" apply to the Court for a clawback order. Subsequent to the BC meeting on 16 May 2016, we have further consulted the Department of Justice regarding the specific sections 4(1)(d) and 4(5) of the LO. Our view remains that the LO, including the specific sections cited, would not apply in respect of the application to the Court for a clawback order under the Bill.

4. However, to address concerns raised by Members and the legal adviser at the BC meeting on 16 May 2016 and to achieve greater clarity in reflecting our policy intention that a resolution authority's application to the Court for a clawback order should not be subject to any time limit, we will move a Committee Stage Amendment (CSA) to expressly provide that no period of limitation prescribed by the LO applies to an action for a clawback order under clause 143.

The need to consider the financial circumstances of the officer in making a clawback order

Clause 143(3)(b) provides that the Court "must" take into account the financial circumstances of the officer in determining the extent to which the officer's remuneration would be covered by the clawback order. Given that the term "financial circumstances" is not defined and the factors to be considered by the Court are not set out in the Bill, members are concerned that the officer may abuse the provision by exaggerating his/her financial hardship, family burden, etc. so that the Court would reduce the amount of remuneration to be subject to the clawback order. The Administration is requested to:

(a) review the relevant provisions to address members' concern;
(b) re-consider deleting clause 143(3)(b) from the Bill;
(c) consider setting out in the provision the principles such as fairness, justice and equity the Court should take into account in determining the clawback order; and
(d) consider the views of the legal adviser to the Bills Committee to provide in clause 143(3)(b) that the Court may consider the financial circumstances of the officer if it considers doing so is appropriate and equitable (在合適及公平的情況下原訟法庭可考慮該人員的財務狀

況).

5. We duly noted Members' concern and, having further reviewed the relevant provisions, have determined to move a CSA to delete clause 143(3)(b). The removal of this provision will not however fetter the discretion of the Court to take into account such factors and circumstances as it may see fit in making a clawback order. We also propose to delete clause 143(4) as this is linked to clause 143(3)(b) and as such would be redundant following the deletion of 143(3)(b).

6. With the deletion of clause 143(3)(b) we consider that the use of the word "must" rather than "may" in clause 143(3) remains appropriate. Following the deletion of 143(3)(b) clause 143(3) will simply provide that the Court must, in making a clawback order, take into account the extent to which an act or omission of an officer contributed to an FI becoming non-viable. This is appropriate since the assessment of the degree of individual culpability should play a fundamental role in determining the quantum of an officer's remuneration to be subject to clawback.

Proposed power for resolution authorities to retain the remuneration of the officers of FIs for a certain period

Some members have expressed grave concern about whether a clawback order would be enforceable especially when the officers are expatriates who may leave Hong Kong shortly after initiation of resolution of an FI. There is a proposal to empower the resolution authorities to retain the remuneration of the officers for a certain period. While the amount of remuneration subject to retention may be relatively small, the proposal would send a clear message to the market that reckless and negligent behaviours of the officers causing the failure of the FI should not be tolerated. The Administration is requested to:

(a) consider empowering resolution authorities to retain the remuneration of the officers, in particular the variable remuneration (e.g. bonus), for a certain period after initiation of resolution of an FI;

7. Following the global financial crisis in 2007-2008 and with the subsequent adoption of the Financial Stability Board's Principles for Sound Compensation Practices (and their corresponding Implementation Standards),

employment contracts should now be constructed in such a way that any bonus is symmetric with performance, not only of the individual but also of the business-unit in which they work and of the FI as a whole. Accordingly, given that the institution reaching the Point of Non-Viability is clear evidence of poor performance, the contractual arrangements themselves should operate to prevent a bonus becoming payable. Further, in the case of banks, if their levels of common equity capital have fallen to within a pre-specified zone above the required statutory minimum (which would be expected as an institution approaches the Point of Non-Viability), the Banking (Capital) Rules (Cap. 155L) prohibit the payment of discretionary bonuses (as well as certain other discretionary payments) on a sliding scale, and up to 100% where the common equity capital ratio is within the lowest quartile of the buffer range.

8. However, given Members' concerns, the Government proposes to move a CSA to amend clause 22 of the Bill to widen the purpose for which a resolution authority may give directions in the run-up to resolution. With adoption of the CSA, rather than being confined to directions which assist in meeting the resolution objectives, a resolution authority could also give directions if of the opinion that this will facilitate future application of a power conferred on the resolution authority or the Court by the Bill. This could include a direction not to pay an inappropriate bonus in the run-up to resolution, recognizing and reinforcing the contractual (and, in the case of banks, capital maintenance) requirements referred to above. Upon resolution being initiated, the resolution authority will have greater control over the FI given its power to manage the affairs, business or property of an entity in resolution.

(b) clarify whether during resolution planning resolution authorities can direct an FI to develop measures for retaining/deferring the payment of remuneration to the officers when resolution of the FI is initiated; and

9. The measures for deferring payment of variable remuneration should already be incorporated into the contractual remuneration framework operated by FIs, which should in turn comply with the standards set by the relevant supervisory bodies. In other words, remuneration of officers is of broader interest than solely in a resolution context. Inappropriate payment of bonuses should not be made when an FI's performance is negative, irrespective of whether it goes into winding-up or resolution.

10. Accordingly, it should primarily be a matter for the supervisor, rather than the resolution authority, to ensure that FIs adopt sound remuneration practices which do not allow performance-related bonus payments to be made

where performance is demonstrably poor.

11. Nevertheless, as noted above in paragraphs 7 and 8, the Government proposes to provide the resolution authority with a "backstop" directions power to enable the resolution authority to give a direction (backed by criminal offence provisions) to prevent inappropriate bonus payments being made in the run-up to resolution.

(c) consider adding provisions in the Bill to require resolution authorities to consult the relevant regulators shortly after initiation of resolution of an FI on the need to give directions to the FI for retaining the remuneration of the officers.

12. Given that the supervisory authorities have a range of prevailing supervisory intervention powers in their respective Ordinances which can be deployed when trigger conditions relating to the viability of an FI are met, these powers may also be used on the "glide path" to resolution to prevent conduct detrimental to depositors, investors, policyholders etc., such as payment of bonuses in contravention of performance-related contractual requirements or capital maintenance rules.

13. In light of Members' concerns over the coordination between the resolution authority and the relevant regulators, the Government proposes to move a CSA to amend clause 27 of the Bill to provide for the effective coordination of the use of supervisory powers and resolution powers under the relevant ordinances to facilitate the effective implementation of the Financial Institutions (Resolution) Ordinance.

14. Further, with a view to recognizing and reinforcing this coordinated process, the financial regulators are committed to reviewing and developing, as appropriate, mechanisms under their existing supervisory intervention powers, in order to provide greater certainty that inappropriate bonus payments will not be made as an FI encounters difficulties and moves towards resolution. For example, the MA could issue guidance under section 7 of the Banking Ordinance (Cap. 155)(BO) indicating his intention to use his powers to give directions under section 52 of the BO to this effect, once the specified conditions in section 52 are met and following consultation with the Financial Secretary (FS). In the case of the Securities and Futures Commission (SFC), under section 204 of the Securities and Futures Ordinance (Cap. 571) (SFO), the SFC may issue a restriction notice to a licensed corporation (LC) restricting or

requiring the LC to carry on business in a specified manner. This power may only be exercised in circumstances specified in section 207 of the SFO, which include the following: the imposition of the prohibition or requirement is desirable in the interest of the investing public or in the public interest; the LC is not a fit and proper person to remain licensed; the licence of the LC may be revoked or suspended, etc. when one or more of which conditions would be expected to have been triggered by a failing FI. If the LC fails to comply with the prohibition or requirement imposed, the SFC may make an application to the court for an order to compel LC to comply with the prohibition or requirement (see section 211 of the SFO). If it appears to the SFC that any circumstance in section 207 exists, the SFC may issue a restriction notice to prohibit a failing LC from giving remuneration, including the making of inappropriate bonus payments, to its officers if it considers appropriate.

15. In the case of the Insurance Authority (IA), under section 35(1) of the Insurance Companies Ordinance (Cap. 41) (ICO), the IA may require an insurer to take such action in respect of its affairs, business or property as the IA considers appropriate. This power is exercisable subject to section 26(5) of the ICO where the exercise of the powers conferred on the IA by sections 27 to 34 of the ICO (intervention powers like restriction on new business, maintenance of assets in Hong Kong, limitation of premium income, etc), in respect of the insurer, would not appropriately safeguard the interests of policy holders or potential policy holders of the insurer. Such requirement exercised under section 35(1) of the ICO could include the non-payment of variable remuneration to officers where the circumstances so warrant.

Clause 171 – Official secrecy

While members note that clause 171(3)(a) and (f) provides disclosure gateway for resolution authorities and the FS to make public statements concerning the resolution of FIs, some members are concerned that such disclosure would be restrictive. The Administration is requested to consider providing explicitly in clause 171 for FS to make public statements or answer enquiries regarding the resolution of an FI taking into account public interest concern and the need to maintain financial stability.

16. We have considered Members' views and will move a CSA to amend clauses 171(3)(a) and clause 171(7) respectively in order to build in provisions such that: (i) the resolution authorities are empowered to disclose information

where they are of the opinion that disclosure is required in the interest of promoting and maintaining the stability and effective working of the financial system of Hong Kong; and (ii) that the FS is empowered to disclose information disclosed to him under the Bill where he is of the opinion that disclosure is required in the interest of promoting and maintaining the stability and effective working of the financial system of Hong Kong.

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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