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Report of the Bills Committee on Financial Institutions (Resolution) Bill

Purpose

This paper reports on the deliberations of the Bills Committee on Financial Institutions (Resolution) Bill ("the Bills Committee").

Background

2. During the financial crisis which began in 2007/2008, a number of governments around the world intervened to support their largest financial institutions ("FIs"), including by bailing them out with public money, in order to allow the financial system to continue to function. This was necessary because of the reliance of individuals, businesses and governments on the services FIs provide and the inadequacy of existing tools for dealing with the failure of a systemically important FI. In turn, this has led to a series of international regulatory reform initiatives put forward by the Financial Stability Board ("FSB")[1] to address the "too big to fail" phenomenon. One such initiative, designed to reduce the impact of failure of systemically important FIs, resulted in FSB's publication, in 2011 (and subsequent re-issue in October 2014),[2] of the "Key Attributes of Effective Resolution Regimes for Financial Institutions ("KAs")" which establish new international standards for effective resolution regimes.

3. According to the Government, not all of the powers required under KAs are currently available to the extent required by KAs in the existing regulatory regimes of the Monetary Authority ("MA"), the Securities and Futures Commission ("SFC") and the Insurance Authority ("IA") for their

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1 FSB was established in April 2009 to coordinate at the international level the work of national financial authorities and international standard-setting bodies and promote the reform of international financial regulations. Hong Kong is a member of FSB.

2 The 2014 re-issue of KAs adopted additional guidelines elaborating on specific areas to assist authorities in implementing KAs.

respective regulatees. The Government considers that without a KA-compliant resolution regime in place, there is a risk that foreign resolution authorities of cross-border FIs may require the FIs to, or the FIs on their own initiative may, take actions to reduce exposures to, and dependencies upon, their Hong Kong operations in order to improve the resolvability of the wider group. This would have a negative impact on the commercial viability of the operations of global systemically important financial institutions ("G-SIFIs")[3] in Hong Kong and could result in their gradual transfer to other jurisdictions in the region which have more developed resolution regimes. An effective resolution regime will complement other prudential regulatory standards and mechanisms adopted by Hong Kong to strengthen resilience of the local financial system.

4. The Financial Services and the Treasury Bureau ("FSTB"), the Hong Kong Monetary Authority ("HKMA"), SFC, and IA jointly conducted two three-month public consultations in January 2014 and January 2015 to gauge views on the proposals involved for establishing a resolution regime for FIs in Hong Kong. A final consultation response was published in October 2015. According to the Government, the vast majority of respondents to the two public consultations indicated broad support for the proposals.

The Bill

5. With a view to establishing a regime for the orderly resolution of systemically important FIs in Hong Kong and conferring various powers on MA, SFC and IA for the purposes of the regime, the Government published the Financial Institutions (Resolution) Bill ("the Bill") in the Gazette on 20 November 2015. The Bill received its First Reading at the Legislative Council ("LegCo") meeting of 2 December 2015. The Bill contains 15 Parts and 9 Schedules. The main provisions of the Bill are explained in the ensuing paragraphs.

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[3] A G-SIFI is a financial institution whose distress or disorderly failure, because of its size, complexity and systemic interconnectedness, would cause significant disruption to the global financial system and economic activity. The term G-SIFI encapsulates global systemically important bank ("G-SIBs"), global systemically important insurers ("G-SIIs") and global systemically important non-bank non-insurers ("NBNI G-SIFIs"). As at November 2015, 30 G-SIBs and 9 G-SIIs had been designated. The methodology for designating NBNI G-SIFIs is still under development and so currently none are designated by FSB.

Part 1 (clauses 1 – 7)

6. Part 1 contains preliminary provisions which introduce key, operative definitions used in the Bill and through such definitions set the scope of FIs covered by the proposed regime (i.e. within scope FIs) and identify each of MA, SFC and IA as resolution authorities ("RAs") (clauses 2 and 3); set out the objects of the Bill (clause 4); and provide powers for the Financial Secretary ("FS") to designate additional FIs to be covered by the proposed resolution regime (and MA, SFC or IA as the RA for any such designated FI), and to designate a lead RA ("LRA") for a cross-sectoral group (clauses 6 and 7).

Part 2 (clauses 8 – 11)

7. Part 2 contains provisions on the RAs. These provisions set out the resolution objectives to which an RA must have regard in performing its functions under the Bill (clause 8), and the role of the LRA (clause 9).

Part 3 (clauses 12 – 24)

8. Part 3 contains provisions on powers related to preparing for resolution. Provisions in Division 1 include giving power to an RA to undertake resolvability assessment and resolution planning for within scope FIs or their holding companies (clauses 12 and 13), to give directions for removing any impediments to the orderly resolution of such entities (clause 14) and to make loss-absorbing capacity requirement rules for within scope FIs or their group companies (clause 19). The RA's directions to remove impediments under clause 14 are reviewable by the Resolvability Review Tribunal ("RRT") (to be established under Part 7 (Division 1)) (clause 17). Divisions 2 and 3 relate to the period when resolution is imminent and certain conditions have been met. Provisions are about directions given by an RA to within scope FIs or related persons[4] for taking or refraining from taking specified actions (clauses 21 and 22), and the power of an RA to revoke a person's appointment as a director, chief executive officer ("CEO") or deputy chief executive officer ("DCEO") of a within scope FI or its locally incorporated holding company (clauses 23 and 24).

Part 4 (clauses 25 – 32)

9. Division 1 of Part 4 contains provisions on moving to resolution, including the three conjunctive conditions that must be satisfied before an RA may begin to resolve a within scope FI (clause 25), the need for the RA to

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[4] "Related person" is defined under clause 20 to refer to (a) a group company of the FI; (b) a director of the FI or of a group company of the FI; and (c) the CEO or DCEO of the FI or of a group company of the FI.

consult FS on the matter (clause 27), and a requirement upon the RA to issue a "letter of mindedness" to the entity to be resolved, providing it with an opportunity to make representations to the RA before resolution may be initiated (clause 30). Division 2 provides that in the case of a within scope FI that is an authorized institution ("AI") under the Banking Ordinance (Cap. 155) ("BO") the RA may, immediately before resolution is initiated, make a capital reduction instrument. The making of the instrument is to be regarded as a trigger event for the purposes of the point of non-viability provision applicable to the capital instrument that is the subject of the capital reduction instrument.

Part 5 (clauses 33 – 93)

10. Division 1 contains provisions relating to the five stabilization options which can be applied to a failed FI under the Bill (clause 33) in order to secure orderly resolution. These options are applied through the issuance of an instrument defined under the Bill as a "Part 5 instrument".[5] An RA is required to make a valuation before applying a stabilization option to, or making a capital reduction instrument in respect of, a within scope FI (clause 35). Provisions governing the five stabilization options are set out in clauses 38 to 73. Under clauses 74-75, the Secretary for Financial Services and the Treasury ("SFST") is empowered to make regulations prescribing requirements to be complied with by an RA in making a Part 5 instrument that results in a partial property transfer being effected or that contains a bail-in provision (one of the stabilization options under Part 5). The purpose of the requirements is to safeguard the economic effect of protected arrangements, including set-off arrangements, netting arrangements, secured arrangements, structured finance arrangements, clearing and settlement systems arrangements, and title transfer arrangements. Division 2 (clauses 79 – 82) provides an RA with power to direct continued performance of essential services from a residual FI or from an affiliated operational entity ("AOE").[6] Division 3 (clauses 83 – 85) deals with a suspension of obligations of an FI under resolution to make a payment or delivery. Division 4 (clauses 86 – 92) contains provisions on default event, including the power for an RA to impose a short (two days) stay on the termination rights of certain counterparties to qualifying contracts that would otherwise be exercisable (clause 90).

Part 6 (clauses 94 – 108)

11. Part 6 contains provisions pertaining to compensation. Pre-resolution creditors or pre-resolution shareholders treated less favourably in resolution than they would have been on a hypothetical winding up will be

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[5] According to clause 199, Part 5 instruments are not subsidiary legislation.

[6] An AOE is defined as a company that is (or but for the exercise of a resolution action would be) in the same group of companies as a within scope FI and which provides services, directly or indirectly, to that FI.

eligible for compensation (clause 102) (i.e. "no creditor worse off than in liquidation" ("NCWOL") compensation). Pre-resolution shareholders, pre-resolution creditors and the RA that has initiated resolution can make applications to the Resolution Compensation Tribunal ("RCT") (to be established under Part 7 (Division 2)) for a review of a decision of an independent valuer on the valuation and the compensation amount (clause 107). Clause 108 sets out the procedure to be followed on an application for compensation. The clause empowers RCT to confirm or vary the decision or set it aside and substitute a fresh decision for it, or remit the matter back to the independent valuer.

Part 7 (clauses 109 – 141)

12. Part 7 contains provisions on RRT (Division 1) and RCT (Division 2).

Part 8 (clauses 142 – 146)

13. Part 8 contains provisions concerning clawback of remuneration. An RA can apply to the Court of First Instance ("the Court") for a clawback order against an officer or former officer[7] of a within scope FI after the initiation of resolution of the FI (clause 143). Clause 144 describes the remuneration that may be the subject of a clawback order. The making of a clawback order has no effect on any criminal or civil liability incurred by the person in acting as an officer of the FI. Clause 145 provides that repaid or returned remuneration must be provided to the RA which must pay it into the resolution funding account.

Part 9 (clauses 147 – 151)

14. Part 9 contains provisions on the deferral of certain disclosure requirements under certain circumstances when it is reasonably likely that an FI will be resolved or when an FI is under resolution.

Part 10 (clauses 152 – 169)

15. Part 10 contains provisions governing an RA's information gathering, inspection and investigation powers in relation to within scope FIs, their group companies and third parties. These powers are designed to assist RAs in making resolvability assessments and undertaking resolution planning, and in assessing whether or not the conditions for initiating resolution are met. These powers are exercisable whether or not resolution has been initiated.

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[7] The term officer is defined in the Bill so as to capture the most senior management of an FI as well as those whose positions enable them to have a material impact on the risk profile of an FI (clause 142).

Part 11 (clauses 170 – 173)

16. Part 11 contains provisions governing confidentiality. Secrecy requirements are imposed on: (a) various persons operating in an official capacity (clause 171); and (b) current or former within scope FIs, their current or former group companies, and their members, officers, employees, agents, consultants and advisers (clause 172). Contravention of the requirements is an offence and certain disclosure gateways are provided by the clauses. An RA may disclose information in certain circumstances to counterpart authorities outside Hong Kong (clause 173).

Part 12 (clauses 174 – 183)

17. Part 12 contains provisions about the resolution funding arrangements, including the operation of a resolution funding account (clause 176), imposition of an ex post resolution levy, the making of rules by FS relating to the levy and the setting of the levy rate via resolution of LegCo (clauses 178, 179 and 180).

Part 13 (clauses 184 – 189)

18. Part 13 contains provisions relating to non-Hong Kong resolution actions. The provisions enable an RA to recognize and support cross-border resolution actions and thereby act in coordination with overseas RAs to achieve coordinated approaches to cross-border resolution where appropriate.

Part 14 (clauses 190 – 201)

19. Part 14 contains miscellaneous provisions. Clause 190 requires that the RA be notified, and afforded a short period of time (seven days) to determine whether resolution should instead be initiated, before a winding up petition in respect of a within scope FI or its holding company may be presented to the Court. Clause 194 enables an RA to issue a code of practice about the performance of its functions. Clause 197 protects any person from civil liability in respect of anything done or omitted to be done by such person in good faith in performing, or purportedly performing, a function under the Bill or assisting a person in such a performance or purported performance. The clause does not apply to RRT, RCT or their members whose immunities are covered separately under Schedules 8 and 9.

Part 15 (clauses 202 – 239)

20. Part 15 contains related and consequential amendments pertaining to other ordinances, including BO, Securities and Futures Ordinance (Cap. 571) ("SFO"), Deposit Protection Scheme Ordinance (Cap. 581), Payment Systems

and Stored Value Facilities Ordinance (Cap. 584) ("PSSVFO"), Insurance Companies Ordinance (Cap. 41) ("ICO"), and Insurance Companies (Amendment) Ordinance 2015.

Schedules 1 to 9 to the Bill

21. Schedule 1 contains the list of protective schemes that is relevant to the comparison required to be made under clause 8(1)(b) (i.e. one of the resolution objectives) of the Bill. Schedule 2 sets out the criteria for the appointment of an independent valuer. Schedule 3 deals with Part 5 instruments that are securities transfer instruments. Schedule 4 deals with Part 5 instruments that are property transfer instruments. Schedule 5 lists out liabilities excluded from the application of a bail-in provision. Schedule 6 deals with Part 5 instruments that are bail-in instruments. Schedule 7 sets out the assumptions and principles that an independent valuer is required to make and apply under the Bill. Schedule 8 relates to RRT. Schedule 9 relates to RCT.

22. An overview of the proposed resolution regime and the various stages of resolution are summarized in **Appendix I**.

The Bills Committee

23. At the House Committee meeting on 4 December 2015, Members agreed to form a Bills Committee to study the Bill. The membership list of the Bills Committee is in **Appendix II**. Under the chairmanship of Mr CHAN Kam-lam, the Bills Committee has held 14 meetings to study the Bill with the Government, including one meeting to receive views from deputations/individuals. The Bills Committee has also received a total of 17 written submissions. The list of organizations/individuals which have provided views to/attended the meeting arranged by the Bills Committee is in **Appendix III**.

Deliberations of the Bills Committee

24. The Bills Committee supports the objectives of the Bill and its major proposals. Members note that deputations are supportive of the Bill and recognize that its early enactment would enable Hong Kong to comply with the relevant international standards in KAs, thereby enhance the resilience of the local financial systems and benefit Hong Kong's position as an international financial centre ("IFC"). The major deliberations of the Bills Committee covered the following issues:

(a) Scope of the proposed resolution regime (paragraphs 25-30);

(b) Designation of resolution authorities and their powers (paragraphs 31-34);

(c) Resolvability assessment and resolution planning (paragraphs 35-38);

(d) Initiation of resolution (paragraphs 39-41);

(e) Stabilization options (paragraphs 42-46);

(f) Protection of client assets under resolution (paragraphs 47-48);

(g) Protection of pre-resolution employees of institutions (paragraphs 49-50);

(h) Suspension of obligations and excluded obligations of the institution under resolution (paragraphs 51-52);

(i) Removal of directors under Schedules 3, 4 and 6 (paragraphs 53-55);

(j) Effect of an instrument under Schedules 3, 4 and 6 (paragraphs 56-57);

(k) Stamp duty exemption for Part 5 instruments (paragraphs 58-60);

(l) Appointing person, independent valuer and rules for valuation (paragraphs 61-64);

(m) Rules for valuation (paragraphs 65-66);

(n) Resolution Compensation Tribunal and Resolvability Review Tribunal (paragraphs 67-72);

(o) Clawback of remuneration of officers of a financial institution in resolution (paragraphs 73-91);

(p) Confidentiality requirements under the Bill (paragraphs 92-93);

(q) Funding for the proposed resolution regime (paragraphs 94-98); and

(r) The resolution of cross-border financial institutions (paragraphs 99-106).

Scope of the proposed resolution regime

25. The proposed regime would apply to "within scope financial institutions" which are entities in the "banking sector", "insurance sector", or "securities and futures sector" (clause 2(1)). FS may also, by notice published in the Gazette, designate an FI (or, on the recommendation of SFC, a recognized exchange company) as a within scope FI if he is of the opinion that risks could be posed to the stability and effective working of the financial system of Hong Kong, including to the continued performance of critical financial functions, if such an FI (or recognized exchange company) were to cease, or be likely to cease, to be viable (clause 6(1)(a)(i) and (b), and (2))[8]. Further, FS may, by notice published in the Gazette, designate a current list (irrespective of its title) published by FSB as, for the purposes of the Bill, equivalent to a list of global systemically important banks ("G-SIBs"), global systemically important insurers ("G-SIIs") and non-bank non-insurer global systemically important financial institutions ("NBNI G-SIFIs") (clause 6(4)),[9] which are referred to in the definitions of "insurance sector entity" and "securities and futures sector entity".

26. The Bills Committee has examined the scope of the proposed resolution regime, and the mechanism for bringing other FIs under the regime in future. The Government has explained that to be consistent with the requirements of the KAs, namely that any FI that could be systemically significant or critical if it fails should be subject to an effective resolution regime, the scope of the proposed resolution regime will include:

(a) All banks: all AIs (including all licensed banks, restricted licence banks and deposit-taking companies) under BO;

(b) Certain financial market infrastructures ("FMIs"): all clearing and settlement systems which are designated to be overseen by MA under PSSVFO (other than those that are wholly

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[8] The definition of viability of a within scope FI is provided in clause 5.

[9] According to clause 199, the Gazette notices published under clause 6(1) and 6(4) are not subsidiary legislation and are therefore not subject to amendment by LegCo.

owned and operated by the Government)[10] and those FMIs that are recognized as clearing houses under SFO;

(c) Exchanges: exchange companies recognized under SFO that are designated by FS on the recommendation of SFC to be within scope because they are considered to be systemically important to the functioning of the financial markets in Hong Kong;

(d) Certain securities firms: licensed corporations ("LCs") under SFO which are NBNI G-SIFIs[11]; or any LC that is a branch or subsidiary of, or a subsidiary of a holding company of, a G-SIFI;

(e) Certain insurers: an authorized insurer under ICO that is, or is a branch or a subsidiary of, a G-SII;

(f) Branches and holding companies: branches of foreign FIs, that are within scope as per the proposals made above for each sector (i.e. all AIs, certain LCs and certain insurers) and the holding companies of within scope FIs[12]; and

(g) AOEs: resolution action may be taken in respect of an AOE where the services provided by the AOE to a failed within scope FI are essential to that FI's (or its successor's) continued

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[10] This includes a system operator and a settlement institution of a designated system (to the extent that the settlement institution is not already scoped into the regime (e.g. it is an AI)). Clearing and settlement systems wholly owned by the Government and operated by MA include the Hong Kong Dollar Clearing House Automated Transfer System (i.e. Hong Kong dollar Real Time Gross Settlement system), the Central Moneymarkets Unit (i.e. the debt securities settlement system in Hong Kong) and the Over-the-Counter-Derivatives Trade Repository.

[11] The criteria for designating NBNI G-SIFIs will be set out in an FSB/International Organization of Securities Commissions consultation conclusion for identifying NBNI G-SIFIs. On 30 July 2015, FSB announced that it will finalise the assessment methodologies for NBNI G-SIFIs once FSB's work on financial stability risks from asset management activities is completed.

[12] Certain conditions are set in the Bill for taking resolution action in respect of a holding company, primarily that action can only be taken at holding company level where (i) an FI under the holding company has met the conditions for resolution; and (ii) that orderly resolution of the FI that meets the resolution objectives can be more effectively achieved by taking action at the holding company level. The RA is also further restricted in taking action at the level of a holding company which has material business interests outside the financial services sector, to cases only where it is necessary to do so because of the way in which the group of companies is structured and operates in order to reduce the risk of the action of an RA impacting other operations of that holding company in non-financial sectors.

performance of critical financial functions and orderly resolution cannot otherwise be achieved by the RA directing the AOE to continue to provide such services.

27. The Government has explained that in order to accommodate any change in the potential risks posed by different types of FIs, clause 6(1) provides FS with a designation power to subsequently bring FIs that are not initially covered by the regime within scope if, in future, it should become apparent that systemic disruption could result from their becoming non-viable. The designation power of FS covers both regulated and unregulated FIs.

28. The Bills Committee notes that some deputations consider that central counterparties ("CCPs") (as FMIs) and insurers should not be covered under the proposed regime given their activities are different from those of other FIs. In particular, some deputations have commented that traditional tools available to the insurance sector such as run-off and portfolio transfers may be used to achieve the orderly failure of an insurer without applying the resolution powers in the Bill. In this connection, the Bills Committee has sought clarification on whether the existing intervention powers under the various regulatory regimes would still be applicable with implementation of the proposed resolution regime.

29. The Government considers that CCPs are important FMIs, and that insurers can also pose risks to financial stability. As the failure of CCPs and insurers could have a systemic impact on the financial markets, it would be essential to cover them under the resolution regime. Further, for the insurance sector, the Government has pointed out that the proposed regime does not cover all insurers but only G-SIIs (including their subsidiaries and branches) as required under KAs. It should also be noted that including G-SIIs in the proposed regime does not mean that a distressed insurer will automatically be resolved. If traditional tools such as run-off and portfolio transfer could safely be used without the failure of the insurer posing systemic risk to the financial system, then the three conjunctive conditions for resolution under clause 25 would unlikely be fulfilled and resolution will not be triggered for the insurer. The Government has stressed that the proposed resolution regime will not remove or constrain any of the supervisory intervention powers currently available to the regulators. Instead, the proposed regime introduces additional powers to better equip regulators (i.e. RAs) to take action to protect financial stability through securing the continuity of critical financial functions in Hong Kong, in the case of failure of a systemically important FI.

30. As to some deputations' concern about extending the resolution regime to the holding companies of within scope FIs, the Government has explained that it may be necessary to resolve a within scope FI at the holding company level. For instance, 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 an operating FI directly, it may be more feasible to intervene at the level of a holding company. The RA's ability to apply resolution tools directly to a holding company is counterbalanced by the need for the RA to be satisfied that an orderly resolution that meets the resolution objectives can be more effectively achieved by resolving the holding company (clause 28(3)(b)).

Designation of resolution authorities and their powers

31. As discussed above, the definitions in clause 2(1) identify each of the MA, SFC and IA as RAs for those within scope FIs operating under their respective existing regulatory purviews. FS may also, by notice published in the Gazette, designate IA, MA or SFC as the RA for any FI which is subsequently designated as within scope of the regime (clause 6(1)(a)(ii)); and by notice published in the Gazette, designate an RA as the LRA of a cross-sectoral group of within scope FIs (clause 7).[13] An LRA will coordinate the resolution planning for, and resolution of, the within scope FIs in that cross-sectoral group. An RA may appoint entities to assist it in performing its functions as an RA or LRA (i.e. "section 10 entities") (clause 10). An RA is conferred with a general power to do anything that is necessary or expedient for it to do in the performance of its functions under the Bill (clause 11).

32. The Bills Committee has enquired about the rationale for establishing a single resolution regime conferring powers on three sectoral RAs instead of a regime led by FSTB which may better ensure efficiency and consistency in securing the resolution objectives. Some members are concerned that clause 11 would provide unfettered power to an RA, and enquired about the reasons for not empowering FS to give directions to RAs and section 10 entities so that he can oversee the overall resolution process and ensure that public interest is safeguarded.

33. The Government has responded that the sectoral approach proposed in the Bill is more appropriate in the context of Hong Kong as the sectoral regulators are each best placed to identify concerns over the condition of an FI under their respective purviews. Moreover, KA 2.5 states that RAs should have operational independence[14] and the International Monetary Fund's 2014

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[13] According to clause 199, the Gazette notices published under clauses 6(1) and 7 are not subsidiary legislation and are therefore not subject to amendment by LegCo.

[14] Key Attribute 2.5 states that "The resolution authority should have operational independence consistent with its statutory responsibilities, transparent processes, sound governance and adequate resources and be subject to rigorous evaluation and accountability mechanisms to assess the effectiveness of any resolution measures. It should have the expertise, resources and the operational capacity to implement resolution measures with respect to large and complex firms."

Financial Sector Assessment Program (the Crisis Management and Bank Resolution Framework – Technical Note of July 2014) on Hong Kong specifically emphasized that any RA should be sufficiently operationally independent from the Government and not bound by decision-making procedures which could impede the prompt and decisive exercise of resolution powers. As checks and balances, the Bill provides accountability through requirements for an RA to consult FS (clauses 27) before initiating resolution and also through ex post reporting requirements to FS, and FS will cause a copy of such report to be laid on the table of LegCo (clauses 40, 46, 55, 65 and 72). Moreover, section 10 entities will act in accordance with instructions from the RA given that their role is to assist the RA in performing its functions. It would be therefore inappropriate for section 10 entities to be subject to direction by FS.

34. Concerning the general power under clause 11, the Government has stressed that the RA will only exercise such power within the boundaries of the performance of the functions under the Bill. The inclusion of the provision under clause 11 is consistent with existing drafting practice in Hong Kong legislation and such "general power" clauses are also found in the resolution legislation of other jurisdictions[15].

Resolvability assessment and resolution planning

35. Part 3 of the Bill contains provisions enabling an RA to perform from time to time resolvability assessments of a within scope FI and/or the FI's holding company to ascertain whether there are any impediment (such as structural impediments, operational impediments or impediments arising from business practices) to the FI's orderly resolution (clause 12), and to give directions to the FI for the purpose of removing the identified impediments (clause 14). An RA will be empowered to devise resolution strategies and resolution plans from time to time for a within scope FI and/or the FI's holding company to secure the FI's orderly resolution (clause 13). An RA may also make rules on requirements relating to the loss-absorbing capacity of within scope FIs, to facilitate the effective application of stabilization options, including bail-in, and the implementation of international standards on total loss-absorbing capacity", taking into account local circumstances (clause 19). Furthermore, an RA may give directions to a within scope FI or a group company of the FI, their directors, CEO or DCEO, requiring them to take or refrain from taking actions (clause 22); or may remove these officers from their positions where certain conditions are met (clause 24).

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[15] Such "general power" clauses can be found in the Insurance Companies Ordinance (Cap. 41), the Electronic Health Record Sharing System Ordinance (Cap.625) and the Property Management Services Bill and similar powers are available under the resolution legislation in the United States and the United Kingdom.

36. The Bills Committee notes that some deputations have expressed concern that the RA's power under clause 14 to remove impediments may preclude rational and commercial efforts to rescue an FI, and substitute the business judgement of the RA for that of the managers and directors of the FI. Some deputations have stressed that the RA's powers under clauses 22 and 24 should only be exercisable in extreme circumstances and with transparency.

37. The Government has explained that what would be regarded by an RA as impediments to an FI's orderly resolution will depend upon the organizational structures and business practices of the FI. The future RAs would provide guidance on the approach to, and procedures for, resolution planning and resolvability assessment (including the removal of impediments to orderly resolution) in the Code of Practice (clause 194(2)(a)(i)). The power of the RA to remove significant impediments to orderly resolution is a necessary part of the resolution toolkit to ensure that FIs are resolvable in practice. However, this power is not intended, and cannot be used, to routinely substitute the judgement of the RA for that of the directors and management of the FI. To use the power, the RA must be of the opinion that the item to be addressed is a significant impediment to orderly resolution (clauses 14(1)), and must give the reasons to the FI why it is of this opinion (clause 15(1)(b)). The RA is obliged to consider how difficult it would be to carry out orderly resolution if the impediments are not removed, and must have regard to the likely impact of the contemplated actions on the future viability and capacity of the FI to continue to perform critical financial functions (clause 14(3)). The FI may make representations to the RA (clause 15(1)(c)) and may seek review of the RA's direction at RRT (clause 17). The Government expects that the RA and the senior management of the FI will work together on the removal of impediments during the course of resolution planning, and the FI will be at liberty to suggest alternative ways in which the identified impediment may be removed.

38. In respect of the direction and removal powers of an RA under clauses 22 and 24 respectively, the Government has explained that an RA may only exercise such powers in the short period before resolution where it is satisfied that Conditions 1 and 3 for initiating resolution have been met but has yet to make a final determination on Condition 2 (clauses 21 and 23). The powers are designed to prevent malicious/unsupportive action to be taken by the directors, CEO or DCEO of an FI or related group company that could serve to frustrate the RA achieving the legitimate aim of meeting the resolution objectives. It is envisaged that these powers are not intended to be exercised casually, routinely or without restraint by the RA. Instead, the exercise of such powers must be reasonable, rational and proportionate. In invoking the power, the RA must be satisfied that the actions will assist in meeting the resolution objectives, and must give the reasons for the actions (clauses 22(2) and 24(4)).

Initiation of resolution

39. The Bills Committee has discussed the circumstances when an RA would initiate the resolution of a within scope FI and the factors the RA would consider in the process. In particular, the Bills Committee has examined what would be regarded by the RA as "non-viability" of a within scope FI, and whether the factors to be considered by the RA should be expressly provided in the Bill.

40. The Government has advised that an RA may only initiate the resolution of a within scope FI if it is satisfied that three conjunctive conditions are met (clause 25). Condition 1 is that the FI has ceased, or is likely to cease, to be viable. Condition 2 is that there is no reasonable prospect that private sector action outside of resolution would result in the FI again becoming viable within a reasonable period. Condition 3 is that the non-viability of the FI poses risks to the stability and effective working of the financial system in Hong Kong, including to the continued performance of critical financial services, and resolution will avoid or mitigate those risks. Clause 5 sets out when a within scope FI ceases to be viable for the purposes of Condition 1, linking non-viability in the case of a regulated FI to a breach of the FI's authorization/licensing criteria that warrants removal of its authorization/licence, or, in the case of an unregulated FI, when the FI is unable to discharge its obligations as required for the effective carrying on of its business. It is however not automatically the case that any contravention of an authorization/licensing criterion will be regarded as non-viability. Much will depend upon the surrounding circumstances. An RA has to exercise judgement in determining the non-viability of the FI and whether Conditions 2 and 3 are met. It would be infeasible to set out in the Bill exhaustively all factors the RA would consider in the process. To provide clarity to the industry on how an RA would determine whether Conditions 1, 2 or 3 is met, the future RAs would develop appropriate guidance and provide illustrative examples in the Code of Practice to be issued under clause 194(2)(a)(ii).

41. The Bills Committee has sought explanation for not providing in the Bill an appeal or review mechanism for the decisions on initiation of resolution of a within scope FI. The Government has responded that it is imperative that an RA be able to implement resolution actions swiftly and decisively in order to secure continuity of critical financial functions and maintain confidence and certainty in the market. Moreover, KA 5.5 provides that legislation establishing resolution regimes should not provide for judicial actions that could constrain the implementation of measures by RAs but should provide for

redress by awarding compensation if justified.[16] Although the Bill does not provide a specific avenue of appeal against a decision to initiate resolution, the RA's exercise of powers is subject to checks and balances and appropriate governance arrangements. In addition to the need for the RA to consult FS before the initiation of a resolution (clause 27), the RA must issue a "letter of mindedness" to the FI to be resolved which: (a) states that the RA is minded to initiate resolution, is satisfied that Conditions 1, 2 and 3 are met and the reasons; and (b) permits the directors of the FI to make representations within a period that is reasonable in the circumstances (clause 30). Further, the decision of an RA remains subject to judicial review.

Stabilization options

42. Part 5 provides for five stabilization options which can be applied, individually, in combination or sequentially, by an RA to an FI in resolving the institution, or to the FI's holding company or AOE where the conditions in clauses 28 and 29 are met respectively. The five stabilization options are as follows:

(a) transfer of some or all of the failing FI's business[17] to a purchaser (clauses 38 - 40);

(b) transfer of some or all of the failing FI's business to a bridge institution[18] (clauses 41 - 48);

(c) transfer of assets, rights or liabilities of the failing FI to an Asset Management Vehicle[19] ("AMV") (clauses 49 - 56);

(d) statutory bail-in (i.e. write-off or conversion into shares) of liabilities of the failing FI to absorb losses and recapitalize the failing FI (clauses 57 - 65); and

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[16] KA 5.5 provides that: "[t]he legislation establishing resolution regimes should not provide for judicial actions that could constrain the implementation of, or result in a reversal of, measures taken by resolution authorities acting within their legal powers and in good faith. Instead, it should provide for redress by awarding compensation, if justified."

[17] A transfer of business may be effected by the transfer of shares or of some or all of the assets, rights and liabilities of a non-viable FI.

[18] A bridge institution (a company established under the Companies Ordinance (Cap. 622)) is a vehicle wholly or partially owned by the Government and established specifically to take on and operate all or part of an FI's business to secure continuity of provision of critical financial functions and to protect financial stability.

[19] An AMV (a company established under the Companies Ordinance (Cap. 622)) is a vehicle wholly or partially owned by the Government and its role will be to acquire and maximize the value of a part of a failing FI's portfolios through eventual sale or orderly wind down.

(e) transfer of the failing FI to temporary public ownership ("TPO")[20] (clauses 66 - 73).

43. Further information on the five stabilization options is set out in **Appendix IV**. Transfer instruments made under Part 5 may take the form of securities transfers, transferring the instruments of ownership in an FI, or of property transfers, transferring assets, rights and liabilities from the FI in resolution to another entity. Bail-in instruments impose losses on shareholders and certain creditors of the failing FI through a write-down and conversion of liabilities to recapitalize the institution and secure its continuity. Details of the securities transfer instruments, property transfer instruments and bail-in instruments are respectively provided in Schedules 3, 4 and 6 to the Bill. Schedule 5 to the Bill lists out the liabilities excluded from the application of a bail-in provision.

44. The Bills Committee has sought clarification as to whether the stabilization options proposed in the Bill would deprive private property rights, which Article 105 of the Basic Law ("BL 105") seeks to protect.

45. The Government has explained that BL 105 does not prohibit lawful deprivation of property per se and protects the right to compensation for lawful deprivation of property. The second paragraph of BL105 further provides that such compensation shall correspond to the real value of the property concerned at the time. The Government has supplemented that clause 33(3) provides for payment of "real value consideration" to the person whose property is transferred when resolution is initiated. This clause states that consideration that is fair and reasonable in the circumstances is due to the transferor in respect of any transfer under a Part 5 instrument (e.g. to the FI in a property transfer, or to the FI's shareholders in a share transfer). In addition, clause 102 provides that pre-resolution creditors and pre-resolution shareholders are eligible for payment of NCWOL compensation where, as a result of the resolution of the FI, they have received, are receiving or are likely to receive less favourable treatment than would have been the case had the winding-up of the entity commenced immediately before its resolution was initiated. The Government considers that NCWOL compensation would provide fair compensation (based on valuation assumptions and principles set out in

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[20] A TPO company (a company established under the Companies Ordinance (Cap. 622)) is a vehicle set up by Government to acquire the shares of the failing FI and hence results in public acquisition of the institution. The TPO stabilization option is intended to serve as a last resort when the RA is satisfied that an orderly resolution of the FI that meets the resolution objectives is most appropriately achieved by TPO and FS has approved it. TPO is not a requirement of KAs, but where the option is provided for, KAs state that jurisdictions are required to provide for a mechanism through which any costs to public money are recovered from industry.

Schedule 7 to the Bill and in the regulations to be made by SFST under clause 105) to the above-mentioned parties who suffer loss as a result of the resolution, instead of the FI entering into liquidation. Moreover, there is an appeal mechanism to RCT available to those aggrieved by any decision made by the independent valuer who undertakes the NCWOL compensation calculation. The Government has sought to take the prudent approach to ensure that any lawful interference with property rights, even if it does not amount to deprivation, would need to be proportionate, i.e. a fair balance would be struck between the extent of the interference and the legitimate aim served by interference so that any interference should be no more than is necessary to accomplish the aim.

46. The Government has stressed that the policy intention is that any application of stabilization options and exercise of resolution powers under the Bill will be pursued by the RAs proportionately in the circumstances in a way that will best deliver the resolution objectives. In view of the significant public interest that the Bill will serve (i.e. enabling orderly resolution of systematically important FIs to mitigate the risks otherwise posed by their failure to the stability and effective working of the entire financial system of Hong Kong, including to the continued performance of critical financial functions, as stated in the Long Title and clause 4), it is considered that interference with property rights by enactment of the Bill would satisfy the proportionality requirement that may be implicit in BL105.

Protection of client assets under resolution

47. The Bills Committee has examined the protection for assets held by an FI on behalf of its clients when the institution is under resolution. For instance, if the FI is a trustee of MPF schemes, whether the accrued benefits in those schemes would be affected by the stabilization options.

48. The Government has explained that the resolution objective to protect "client assets" (clause 8(1)(c)) obliges an RA to protect client assets to no less an extent than they would be protected on a winding up. Client assets are defined under clause 3 to include, among others, securities and other property held by an FI in the course of carrying on a business as a trustee or custodian. Accordingly, where an FI in resolution is an MPF trustee, the MPF assets held on trust are to be protected under the Bill. In applying a stabilization option whilst the RA can transfer the MPF assets held on trust by the FI in resolution to a purchaser or bridge institution, in doing so it cannot affect the beneficial interest of a client in those client assets (section 4(8) of Schedule 4). If bail-in, rather than transfer, is the preferred resolution strategy, then client assets are protected from bail-in as they are not assets beneficially owned by the FI in resolution (section 2(m) of Schedule 5 provides that liabilities arising because of holding client assets are excluded from bail-in).

Protection of pre-resolution employees of institutions

49. The Bills Committee is concerned as to whether the treatment for employees of an FI in resolution would be worse than in a winding-up of the FI.

50. The Government has responded that given the objective of resolution is to secure continuity in the provision of critical financial services, many employees may fare better on resolution than in a winding-up because they will be retained in employment in order to continue to provide these services. On any transfer of shares in an FI to a purchaser, bridge institution or TPO company, employees would continue to be employed by the FI. On bail-in, likewise, as the entity (whose shareholders and creditors are bailed-in) continues in existence and continues to provide services, its employees will continue to be required. On any transfer of business to a purchaser, bridge institution or AMV, employees engaged in that business can move to employment with the acquirer and any employees that remain with the residual FI, after the transfer, will be entitled upon subsequent liquidation of the residual FI to the same treatment as they would have received had the whole FI otherwise been wound-up. The Government has explained that there are provisions in the Bill which serve to protect the interests of employees in resolution. Examples include section 7(4) of Schedule 4 empowering the RA to include provision for continuity of employment in a property transfer instrument, and the exclusion of a number of employee benefits from the application of bail-in (listed in section 2(n) of Schedule 5) such as liabilities owed to employees or former employees in respect of "wages" and certain other specified benefits. Moreover, where an employee falls within the definition of a pre-resolution creditor, he would be eligible for NCWOL compensation if he is treated less favourably on the resolution than he would have been on a winding up of the FI.

Suspension of obligations and excluded obligations of the institution under resolution

51. The Bills Committee notes that while an RA in a Part 5 instrument may suspend obligations of a within scope FI to make a payment or delivery arising under a contract to which the FI or its subsidiary is a party, some obligations (e.g. end of year payment and terminal payment) are excluded from the suspension (clauses 83 and 84). Mr Albert HO and Mr Dennis KWOK have raised concerns as to whether the provisions might allow the FI to make bonus payments to senior officers of the FI who have/may have contributed to the non-viability of the FI.

52. The Government has explained that clause 83 provides the RA with discretion whether to impose a temporary (two business days) suspension on the FI's obligations, and clause 84 is designed to limit the RA's power under clause 83 with a view to ensuring that any suspension will not impose undue hardship on certain individuals. Clause 84 is not designed to allow or facilitate discretionary bonus payments upon initiation of resolution. End of year payment and terminal payment, which are obligations to be excluded from the suspension in clause 83, are defined terms under the Employment Ordinance (Cap. 57) ("EO"). These obligations refer to employees' entitlements that are non-discretionary, and do not include any payment which is of a gratuitous nature.

Removal of directors under Schedules 3, 4 and 6

53. Section 7(1) of Schedule 3, section 9(1) of Schedule 4 and section 6(1) of Schedule 6 respectively specify that a securities transfer instrument, a property transfer instrument, and a bail-in instrument may revoke the appointment of a person as a director, CEO or DCEO of an FI, its holding company or AOE. However, sections 7(2), 9(2) and 6(2) of Schedules 3, 4 and 6 respectively provide explicitly that the revocation of appointment "does not of itself terminate, or affect the rights of any party to, a contract of employment or services" with the FI. Mr Albert HO and Mr SIN Chung-kai are concerned that the provisions may protect the employment of the directors or senior officers of the failing FI whose actions or omissions may have directly caused the non-viability of FI concerned.

54. The Government has explained that the rationale behind the aforesaid provisions and also clause 24(8) (i.e. power of an RA to remove directors of an FI or its holding company the resolution of which is imminent or which is under resolution) is to remove any doubt about whether any revocation of a person's appointment to a post as a director, CEO or DCEO under the relevant provisions by an RA would, of itself, constitute a termination of his employment with the FI, thereby affecting his rights under the employment contract, EO (e.g. where a residual FI remains following a partial transfer of business), and other applicable legislation (e.g. the Protection of Wages on Insolvency Ordinance (Cap. 380) in the event that the failed FI goes into liquidation). The provisions are intended to provide an RA with flexibility to revoke the appointment of a person from his 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. They are not designed to be exercised as a result of any considered assessment of "fault" as there would not be sufficient time for an RA to thoroughly assess a director/CEO/DCEO's culpability for an FI's non-viability during a "resolution weekend" where its focus will be on securing orderly resolution in a way that meets the resolution objectives.

55. The Government has explained that while the regulators may withdraw approvals given to persons appointed to senior positions on grounds that they are no longer "fit and proper" under the relevant supervisory powers in BO, SFO and ICO, there are no specific powers in these Ordinances 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. In order to address members' concern, the Government 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 to delete the words "of itself terminate, or" from the clauses. The proposed CSAs will clarify that any revocation of a person's appointment to a post as a director, CEO or DCEO by an RA would not affect the person's rights under their employment contract with the FI, the EO, and other applicable legislation.

Effect of an instrument under Schedules 3, 4 and 6

56. The Bills Committee has expressed concern about the overriding power of the provisions in Schedules 3, 4 and 6 which provide that a securities or property transfer instrument, or a bail-in instrument "takes effect despite any restriction (including a restriction requiring the sanction of the Court, or the approval of a regulatory body, for a transfer) arising under contract or legislation or in any other way" (section 4(3) in both Schedules 3 and 4, and section 3(2) of Schedule 6).

57. The Government has reiterated that an RA must be able to act quickly and decisively to initiate resolution and apply a stabilization option to mitigate the risks posed to financial stability by a failing FI. Requiring an RA to identify and obtain all consents or approvals that might otherwise be needed for action to be taken under a Part 5 instrument would severely restrict an RA's ability to act promptly in order to meet the resolution objectives. In light of members' concerns, the Government has reviewed the relevant provisions and noted that the present drafting might arguably be interpreted as to exclude the ability of any person affected by the acts of an RA to seek judicial review of those acts. Given that there is no intention for the regime to exclude such ability of any person, the Government will move a CSA to remove the text in parenthesis "(including a restriction requiring the sanction of the Court, or the approval of a regulatory body, for a transfer)" from each of section 4(3) of Schedule 3, section 4(3) of Schedule 4 and section 3(2) of Schedule 6. The Government has pointed out that with the proposed amendments, such provisions would be similar to those under the resolution regimes in the United Kingdom ("UK") and Singapore as well as the European Union's Bank Recovery and Resolution Directive.

Stamp duty exemption for Part 5 instruments

58. The Bills Committee has enquired whether securities transfer instruments issued by an RA would be subject to stamp duty under the Stamp Duty Ordinance (Cap. 117) ("SDO"). The Government has advised that while such instruments would be subject to stamp duty, the policy intention is to grant exemption to the instruments on a case-by-case basis recognizing that the relevant stamp duty consequence arises not out of a normal commercial transaction but as a result of the exercise of a stabilization option in protecting financial stability and integrity of the financial system of Hong Kong. The approach to implement this policy is to rely on an existing mechanism under section 52 of SDO whereby the Chief Executive ("CE") may exempt or remit any stamp duty after taking into account the circumstances of the case and the transfers involved.

59. The Bills Committee is of the view that there should be ex ante certainty on the stamp duty exemption for securities transfer instruments which would facilitate smooth conduct of resolution, especially since a stamp duty exemption may incentivize a private sector acquirer to consider acquiring part or all of the business of the failing or failed FI to facilitate a swift transaction. Members have stressed that stamp duty exemption for the instruments will be justified on the ground that the transfers in resolution are to protect the financial stability of Hong Kong.

60. The Government has reiterated that it is the policy intention to exempt stamp duty arising from the application of stabilization options, unless there are sound policy reasons not to do so. Having considered members' comments and the need for certainty in light of the urgency of resolution cases, the Government has agreed to look into how the stamp duty exemption policy will be effected in the context of the resolution legislative framework by developing appropriate amendments to the enacted Ordinance in a separate legislative exercise in the future. The Bills Committee has requested the Government to provide an undertaking regarding its general policy on the exemption of stamp duty for Part 5 instruments and the incorporation of the exemption into the enacted Ordinance in a future legislative exercise. The Government has undertaken to do so during the resumption of the Second Reading debate of the Bill.

Appointing person and independent valuer

61. An NCWOL compensation mechanism is incorporated in the resolution regime. Pre-resolution shareholders and pre-resolution creditors of a failing FI would be eligible for compensation if they are treated less favourably on resolution than they would have been on a winding up (clause 102). An independent valuer is to be appointed for the purpose of making a

valuation in relation to a failing FI in order to determine whether NCWOL compensation is due and, if so, deciding on the amount of compensation (clauses 96, 101, 103 and 104). The independent valuer to be appointed has to meet the criteria specified in Schedule 2 to the Bill.

62. The Bills Committee notes that clause 95 provides that FS will appoint an appointing person, who in turn will be responsible for appointing the independent valuer. Mr SIN Chung-kai and Mr Albert HO have expressed concern about the mechanism in clause 95, and proposed that the independent valuer should be appointed by FS direct so that FS could take direct responsibility for the appointment. They have requested the Government to review clause 95 making reference to the mechanisms adopted in the resolution regimes of overseas jurisdictions.

63. The Government has advised that the proposed appointment mechanism in the Bill is designed to provide comfort to the shareholders and creditors of an FI under resolution that an independent valuer performing the NCWOL valuation is at least a step removed from the Government, so that the valuation process is, and is seen to be, independent and impartial. The separation is necessary so as to dispel any perception about Government's possible incentive to minimize any NCWOL compensation given that public money may need to be deployed in the first instance to service the payment of any such compensation pending subsequent recovery from the industry through the resolution levy. KAs are designed to provide high-level policy directives and have not set standards on the appointment mechanism for the independent valuer or any rules on how the appointment process must operate. The proposed appointment mechanism in the Bill has been devised taking into account the practices of the resolution regimes of other jurisdictions, and is in line with that in the UK where the independent valuer is to be appointed by a person appointed by the Treasury.

64. As regards when the appointment of an appointing person would take effect under clause 95(3), the Government has confirmed that the appointment would take effect upon gazettal. For greater clarity, the Government will move a CSA to clause 95 to add a new clause 95(3A) to specify explicitly that the appointment takes effect upon publication in the Gazette.

Rules for valuation

65. The Bills Committee has enquired about how the NCWOL valuation and any resulting compensation will be worked out. Members also note some deputations' view that the rules and regulations for making valuation and compensation should be developed before resolution actions take place.

66. The Government has pointed out that clause 103 specifies what the independent valuer must assess and certain assumptions and principles to be applied in making a valuation. Clause 105 empowers SFST to make regulations for valuation (such as detailed assumptions and principles to be used in making a valuation, processes for conducting a valuation, method for making a compensation payment, etc.). Such regulations are subsidiary legislation subject to the negative vetting procedure of LegCo. The Government intends to make the regulations following the enactment of the Bill and in advance of any resolution action being taken. In developing the regulations, the Government will continue to monitor ongoing work to implement the NCWOL valuation and compensation in other jurisdictions and would consult stakeholders.

Resolution Compensation Tribunal and Resolvability Review Tribunal

67. Clause 107 provides aggrieved parties (including the RA as well as any pre-resolution shareholders and pre-resolution creditors of the FI in resolution) with the right to apply to RCT (established under Part 7 Division 2) for a review of the independent valuer's decisions regarding the eligibility of pre-resolution shareholders and pre-resolution creditors for compensation, and the amount of compensation due, if any. RCT will conduct hearings of reviews of the independent valuer's decisions in public. RCT's determinations, except those on questions of law, would not be subject to further appeal (clause 137). Anyone with sufficient standing to challenge administrative decisions under the resolution regime will, in addition, retain their rights to judicial review. The details of the composition and operation of RCT are provided in Schedule 9 to the Bill.

68. RRT is proposed to be established under Part 7 Division 1 to review: (a) any decision made by an RA to serve a notice on a within scope FI, requiring it to take measures to remove or mitigate the effect of impediments to an orderly resolution of the FI; and (b) specified decisions of an RA made pursuant to the loss-absorbing capacity requirements rules for within scope FIs. Hearings of RRT will be held in private given that they are likely to consider FI-specific, commercially sensitive information. The determinations made by RRT, except those on questions of law would not be subject to further appeal (clause 120). The details of the composition and operation of RRT are provided in Schedule 8 to the Bill.

Chairpersons and members of Resolvability Review Tribunal and Resolution Compensation Tribunal

69. RRT and RCT will each consist of a chairperson (who is a former judge, a former recorder, a former deputy judge or who is eligible for appointment as a judge) and two other "ordinary" members (clauses 110 and

126). CE will appoint a tribunal panel for each of RRT and RCT, and FS will appoint two panel members as ordinary members for a proceeding of RRT or RCT (sections 3 and 4 in both Schedules 8 and 9).

70. The Bills Committee notes some deputations' view that panel members of RRT and RCT should include representatives from the relevant industry or people who are knowledgeable about the various sectors in the financial services industry. The Government has responded that the provisions in Schedules 8 and 9 have already catered for this. Section 3(1) and 3(2)(a) in both Schedules 8 and 9 require that CE must appoint "qualified persons" to a panel and such persons must, among others, have "relevant expertise" and "relevant practical experience" in the relevant fields.

71. Whilst noting that the policy intention is that CE can establish more than one RRT/RCT for operation at the same time, the Bills Committee considers that the relevant provisions in Schedules 8 and 9 do not clearly reflected the above arrangement. The Government has explained that the present drafting does not prevent the establishment of additional tribunals. However, having considered members' views and in order to improve clarity, the Government will move CSAs to add new clauses following each of clauses 110 and 126, to provide expressly that CE may establish additional tribunals should he consider it appropriate to do so.

72. The Bills Committee notes that there are no provisions in Schedules 8 and 9 to the Bill providing for the declaration of interest by the chairpersons and ordinary members of RRT and RCT to prevent possible conflict of interest in their appointments and in the hearings of the tribunals. The Government has explained that disclosure under administrative arrangements would be adequate in the case of existing statutory tribunals, and such arrangements have been running smoothly. Declaration of interests and avoidance of conflicts of interest relating to the chairpersons and ordinary members of RRT and RCT can be dealt with by issuance of administrative guidelines for the two tribunals in the future.

Clawback of remuneration of officers of a financial institution in resolution

73. Under Part 8 of the Bill, an RA may, at any time after it has initiated the resolution of a within scope FI, apply to the Court for a clawback order against an officer or former officer[21] of that institution (clause 143(1)) to recover remuneration (fixed or variable) already received by the officer and/or

[21] "Officer" is defined as a director or shadow director, CEO or DCEO, or a person who is principally responsible for the management and performance of the financial institution and has the potential to have a material impact on the risk profile of that institution, etc. (clause 142).

to cease the officer's entitlement to receive unpaid remuneration (fixed or variable) awarded during the controlled period (clause 144(1)). The controlled period is three years immediately preceding the date on which the resolution of the FI was initiated. However, the Court may extend the controlled period by a further period of up to three years (i.e. a maximum of six years in total) in cases of dishonesty (clause 142). The Court may make a clawback order if it is satisfied that the acts, or omissions to act, of the officer concerned have caused or materially contributed to the FI ceasing, or being likely to cease, to be viable (clause 143(2)(a)), and the acts, or omissions to act, were made intentionally, recklessly or negligently (clause 143(2)(b)). In determining the extent to which the officer's remuneration would be covered by the clawback order, the Court must take into account the extent to which the acts, or omissions to act, of the officer have contributed to the FI ceasing, or being likely to cease, to be viable (clause 143(3)(a)), and the financial circumstances of the officer (clause 143(3)(b)).

Duration of the controlled period and proposed power for the resolution authority to retain senior officers' variable remuneration

74. While the Bills Committee notes that some deputations consider that the duration of the controlled period should not be longer than two years, Mr Albert HO and Mr SIN Chung-kai have urged the Government to extend the period. They consider that a longer controlled period is warranted given the serious consequence of the officer's acts, or omissions to act, causing or materially contributing to the non-viability of the FI. Mr SIN Chung-kai has indicated that he may consider moving a CSA to the definition of "controlled period" to lengthen the period from three years to five years.

75. Mr Albert HO and Mr SIN Chung-kai have also expressed 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. To complement the provisions on clawback, Mr Albert HO, Mr SIN Chung-kai and Mr Dennis KWOK have proposed empowering the RA to retain the officers' variable remuneration (e.g. bonus) for a certain period upon initiation of resolution of the FI. They opine that the proposal would foster better market discipline where poor performance of the officers causing the failure of the FI should not be rewarded with bonus payments, and would address the absurdity where huge sums of public money used to bail out large failing FIs during the global financial crisis have been spent on bonus payments to the FIs' senior officers whose acts have caused or materially contributed to the FIs' non-viability. As a safeguard, the RA could be required to consult the relevant regulators before exercising such retention power.

76. Some members including Mr Andrew LEUNG and Mr CHAN Kin-por are of the view that the clawback regime under the Bill should be in

line with those of comparable jurisdictions. They also note the concern raised by some deputations that application of clawback may create disincentives for officers in taking up leadership positions within FIs in Hong Kong, and caution about the risks for Hong Kong to adopt the proposed retention power which is not present in the resolution regimes of other major jurisdictions.

77. The Government has advised that KAs are not specific in their requirements (including the controlled period) on clawback, except that the RAs should have a power to "recover monies from responsible persons, including clawback of variable remuneration".[22] The Government has taken into account overseas practices when developing Part 8 of the Bill, and sought to adopt a "middle ground". The controlled period in the regime in the UK is seven years from the date on which variable remuneration is awarded, but it must be noted that such power (a) applies to variable remuneration only, whereas the power in the Bill extends to both fixed and variable remuneration; and (b) is part of a broader supervisory remuneration framework that is not specific to resolution and, accordingly, it is the FI which seeks clawback rather than the regulator or the RA. On the other hand, the controlled period in the regimes in both the United States ("US") and Singapore is two years (extendable in the case of fraud by two years in Singapore and indefinitely in the US), and in each case the power is linked to resolution and exercised by an RA through a court-based process. On balance, having considered these different models, the proposal in the Bill is to have a three-year clawback period (extendable by up to a further three years in cases of dishonesty); including both fixed and variable remuneration; covering directors and shadow directors, certain senior management and risk-takers (including CEO, DCEO and any persons defined as "officers" in clause 142); and using a court-based system. The proposal introduces a statutory remedy sought by an RA in the public interest from the Court which can impartially assess the role of a given officer in the failure of an FI.

78. As regards some members' proposal of empowering the RA to retain the variable remuneration of the officers, the Government has responded that it is unaware of any examples in overseas jurisdictions in which RAs are specifically given similar powers. Neither is this a KA requirement. There is concern that building such specific powers, which the Government is not aware of that are present in other major jurisdictions, into the Hong Kong resolution regime might disincentivize financial talents from working in Hong Kong and prompt international FIs to re-domicile their operations in Hong Kong elsewhere, thereby threatening Hong Kong's position as an IFC.

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[22] KA 3.2(i) states that "resolution authorities should have at their disposal a broad range of resolution powers, which should include powers to: [r]emove and replace the senior management and directors and recover monies from responsible persons, including claw-back of variable remuneration."

Moreover, upon the initiation of resolution, the primary priority for the RA will be to stabilize the failing FI swiftly, thereby securing the continuity of critical financial services and maintaining the stability of the financial system. Identifying and analyzing the evidence concerning which senior officer(s) are culpable for the failure, and the extent of their culpability, is unlikely to be feasible at the point of initiation of resolution and is likely to distract from this fundamental objective. Furthermore, the retention of remuneration by the RA based on premature prima facie evidence would also stigmatize the officer(s) concerned and would be presuming guilt before trial.

79. The Government understands members' concern that officers' variable remuneration should be symmetric with performance. Following the global financial crisis and with the subsequent adoption of FSB's Principles for Sound Compensation Practices (and their corresponding Implementation Standards) ("FSB's Principles"), employment contracts of FIs should now be constructed so as to link bonus payments with performance, not only of the officer but also of the FI as a whole. For instance, under HKMA's prevailing Supervisory Policy Manual module CG-5 "Guideline on a Sound Remuneration System" ("SPM module"), AIs should devise remuneration packages that are consistent with those guidelines, which include provisions in respect of the assessment of performance and the deferral and "claw-back" of unvested variable remuneration based on FSB's Principles. Compliance with the terms of SPM module is monitored as part of HKMA's risk-based supervisory review process. Accordingly, it should primarily be a matter for the supervisory authorities, rather than the RA, to ensure that FIs adopt sound remuneration practices.

80. In order to provide greater certainty that inappropriate bonus payments will not be made as an FI encounters difficulties and moves towards resolution, the Government has stressed that MA, SFC and IA are committed to reviewing and developing, as appropriate, mechanisms under their existing supervisory intervention powers to achieve such aims. These supervisory powers include sections 7 and 52 of BO relating to MA's power to issue statutory guidelines and give directions to AIs, section 204 and relevant provisions in SFO empowering SFC to issue restriction notices to LCs regarding their business, and section 35(1) and relevant provisions in ICO providing for IA's power to impose requirements on insurers for taking actions in respect of their affairs. The guidelines, directions, restriction notices, and requirements given to FIs may stop inappropriate payment of variable remuneration to officers of the FIs.

81. Given members' concern about inappropriate bonus payments being made to the officers' of an FI in the run-up to resolution, the Government will move a CSA to amend clause 22 to widen the purpose for which an RA may give directions in the run-up to resolution. With adoption of the CSA, in addition to giving directions which assist in meeting the resolution objectives,

an RA can also give directions if it is of the opinion that such directions will facilitate future application of a power conferred on the RA 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 remuneration framework referred to above. Upon resolution being initiated, the RA will have greater control over the FI given its power to manage the affairs, business or property of an entity in resolution.

82. The Government has supplemented that the prevailing supervisory intervention powers of MA, SFC and IA in their respective Ordinances (i.e. BO, SFO and ICO) (as discussed in paragraph 80 above) can be deployed when the conditions under the respective Ordinances 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. In light of members' concerns over the coordination between the powers of the RA and those of the relevant regulators, the Government will move a CSA to amend clause 27 to provide that before initiating resolution, the RA must liaise with MA, SFC or IA as appropriate, for securing coordination of their exercise of any supervisory powers under BO, SFO and ICO respectively and the exercise of the powers by RA under the Bill to facilitate the effective implementation of the enacted Ordinance.

Factors to be taken into consideration in a clawback order

83. The Bills Committee has enquired whether the Court when making a clawback order is required to consider the negligence and fault (including concealed fault) of the officer concerned under the common law. Given 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 (clause 143(3)(b)), members including Mr Alert HO, Mr SIN Chung-kai and Mr CHEUNG Wah-fung are concerned that the officer may conceal his financial circumstances. Moreover, since the term "financial circumstances" is not defined and the factors to be considered by the Court in this regard are not set out in the Bill, there is also concern that the officer may exaggerate his financial hardship, family burden, etc. in an attempt to persuade the Court to reduce the amount of remuneration to be subject to a clawback order. The Bills Committee has suggested deleting clause 143(3)(b) or setting out in the Bill the principles such as fairness, justice and equity that the Court should have regard to in considering a clawback order.

84. The Government has advised that under clause 143(2), the Court may make a clawback order as long as the two conditions set out in clause 143(2)(a) and (b) are fulfilled (i.e. the acts, or omissions to act, by the officer have caused or materially contributed to the FI ceasing, or being likely to cease, to be viable;

and such acts, or omissions to act, were made intentionally, recklessly or negligently). If "negligence and fault (including concealed fault) of the officer concerned" is present in a particular case, it would be a matter for the Court to consider whether that is relevant to the two conditions set out in clause 143(2) and whether that should be taken into account when making the clawback order in the circumstances of the case.

85. As regards the term "financial circumstances" in clause 143(3)(b), the Government has pointed out that the term would be given its ordinary meaning by the Court, which would have the discretion to determine the factors to be taken into account when considering the matter. However, in the light of members' concern and, having further reviewed the relevant provisions, the Government has agreed to move a CSA to delete clause 143(3)(b). The Government considers that deleting this provision will not fetter the discretion of the Court to take into account such factors and circumstances (i.e. the financial circumstances of the officer concerned) as it may see fit in making a clawback order. The Government will also introduce a related CSA 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).

86. The Bills Committee has examined the Government's proposed CSAs mentioned in paragraphs 81, 82 and 85, and has not raised further question.

Effect of the Limitation Ordinance on a clawback order

87. The Bills Committee has enquired if the RA's power to apply for a clawback order would be restricted by section 4(1)(d) and 4(5) of the Limitation Ordinance (Cap. 347) ("LO") which specifically provides that actions to recover any sum by virtue of any Ordinance or penalty (or forfeiture) shall not be brought respectively after the expiration of 6 years and 2 years respectively from the date on which the cause of action accrued.

88. The Government has pointed out that clause 143(1) expressly states that an RA may "at any time after it has initiated the resolution of a within scope FI" apply to the Court for a clawback order. No time limit is imposed, and hence, provisions in LO would not apply in respect of the RA's application for a clawback order. However, having noted members' views and to achieve greater clarity in reflecting the policy intention that an RA's application to the Court for a clawback order should not be subject to any time limit, the Government will move a CSA to amend clause 143 to expressly provide that no period of limitation prescribed by LO applies to an application for a clawback order.

Operation of the clawback provisions with the Employment Ordinance

89. The Bills Committee has requested the Government to review if the clawback provisions would conflict with the provisions in EO, in particular whether the clawback order relating to fixed remuneration would override the provisions in EO relating to any entitlement of the officer to wages and to a sum on termination of contract.

90. The Government has advised that the time for an employer to pay wages or any such sum on termination of contract to employees is stipulated in sections 23, 24 and 25 of EO. It is an offence for an employer who wilfully and without reasonable excuse contravenes such provisions.

91. The Government is of the view that a clawback order under clause 144(1)(a) would not affect the obligations of an FI as an employer, since the remuneration in question i.e. the wages or any sum payable to an officer under section 23, 24 or 25 of EO has already been paid to the officer. However, it seems that a clawback order under clause 144(1)(b) might arguably be in conflict with section 23, 24 or 25 of EO given that it relates to remuneration not yet paid to an officer. To put beyond doubt that a clawback order under clause 144(1)(b) could override the FI's obligations to pay wages and any sum payable to an officer under these provisions in EO, the Government will move a CSA to expressly provide in clause 144 that an order made under clause 144(1) would, in case of conflict, override any obligations of the FI concerned under the EO.

<u>Confidentiality requirements under the Bill</u>

92. Clause 171 imposes secrecy requirements on various persons operating in an official capacity with regard to information that has come to their knowledge through performing or assisting others in performing the functions under the Bill. Contravention of the requirements is an offence (clause 171(9)). Certain disclosure gateways are provided in clause 171(3). Mr Albert HO and Mr SIN Chung-kai consider that the disclosure gateways are restrictive. They have urged the Government to consider providing explicitly in clause 171 the power for senior government officials (e.g. FS) to make public statements or answer enquiries regarding resolution of an FI. In particular, they consider that such disclosure would prevent panic arising from rumours of a distressed FI, and ultimately help in meeting the resolution objectives, particularly in the context of maintaining financial stability.

93. The Government has pointed out that the disclosure gateways provided in clause 171(3) could support disclosure in the circumstances mentioned by members. Under clause 171(3)(a), an RA may disclose information as necessary for the purposes of performing its functions under the

Bill. This could include situations where such disclosure was intended to calm the public thereby facilitating orderly resolution, including maintaining financial stability. Moreover, under clause 171(3)(f), FS could make disclosure of the information disclosed to him by an RA (where the RA is of the opinion that such disclosure will enable or assist FS to perform his functions and it is not contrary to the resolution objectives or the orderly resolution of a within scope FI) and the RA has consented to FS's disclosure pursuant to clause 171(7). The RA will, in considering whether to give the consent, take into account financial stability as a public interest concern. Nonetheless, having considered members' views, the Government has agreed to move a CSA to amend clause 171(3) to add a new gateway expressly empowering the RA to disclose information where it is of the opinion that doing so is in the interest of promoting and maintaining the stability and effective working of the financial system of Hong Kong. Another CSA will be moved to add a new clause following clause 171(7) to empower FS to do the same, where information has been disclosed to him, without the need to obtain the RA's consent.

Funding for the proposed resolution regime

94. The regime is designed to minimize the impact on public funds of a systemically important FI becoming non-viable. However, it is recognized that orderly resolution may not be achievable in all cases without some provision of temporary public funding support. The proposed resolution regime therefore allows the provision of temporary public funding support to an FI in resolution with ex post recovery from the industry of any losses incurred as a result. The deployment of temporary public funding support will be subject to consideration of the extent to which: (a) the resources of the FI in resolution can be applied towards the effective application of a stabilization option, including the extent to which the liabilities of the FI can be written down or converted to absorb losses and restore or re-establish its capital position; (b) the assets of the FI can be sold; or (c) the FI in resolution can obtain access to private funding sources (clause 176(3)). The RA and FS can charge the FI in resolution (including its holding company where a stabilization option has been applied to the holding company) for all reasonable costs that have been properly incurred in actually effecting resolution (clause 175(2)). However, they must take into account whether such charges might undermine the achievement of the resolution objectives (clause 175(3)). Where it is necessary to recover any losses incurred from the industry, once resolution is completed, by an ex post levy (i.e. any temporary public funding deployed (plus interest thereon) has not otherwise been fully recovered), only within scope FIs operating in the same sector as the FI in resolution will be levied (clause 178). However, in the case of FMIs and recognized exchange companies, a "user pays" levy is proposed to be adopted. A regulation making power is provided for FS to specify how a levy would be imposed in a specific case, and in making such regulations, FS would be required to consult

the relevant industry sector, each RA and the general public (clause 179). LegCo may, on the recommendation of FS, by resolution then specify the amount of levy contribution (clause 180).

Ex post funding model and cap on levy

95. The Bills Committee notes that some deputations are opposed to imposing the ex post levy on a sectoral basis as it would be unfair to call upon viable within scope FIs to pay for the resolution costs of a non-viable peer. Moreover, a "user pays" levy for resolution of FMIs may disincentivize the use of FMIs. Some deputations opine that the Bill should set a cap on the ex post levy.

96. The Government considers that on balance an ex post funding model is appropriate (and is to be preferred to the alternative of an ex ante levy to establish a resolution fund) 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. The majority of respondents to the public consultations have favoured the ex post as opposed to the ex ante funding model. The ex post levy can be collected over a number of years to reduce any impact on healthy FIs.

97. Regarding an ex post "user pays" levy in respect of FMIs, the Government has explained that such levy is considered most appropriate for FMIs as the participants in an FMI arguably benefit most from its resolution. A precedent was that the costs for the 1987 publicly funded rescue of the clearing house for the futures market in Hong Kong were partially recovered through a transaction levy on the futures exchange and a special levy on the stock exchange which were imposed on their participants.

98. As for the suggestion of setting a cap on the ex post levy, the Government has responded that it would be difficult to prescribe any cap as it would be impossible to predict in advance the amount of public funds incurred in a given resolution that has to be recouped through the levy. There are constraints on the RA in relation to limiting resolution funding as one of the resolution objectives it needs to meet is "…to seek to contain the costs of resolution and, in so doing, protect public money" (clause 8(1)(d)). Moreover, before determining whether public funds may be deployed to facilitate resolution, the RA must have regard to the entity's own resources (clause 176(3)). This obligates the RA to impose losses on the entity in resolution to the extent possible and seek other private sector funding solutions before deploying any public funding, thus minimizing the need for an ex post levy.

The resolution of cross-border financial institutions

99. Part 13 provides a statutory recognition framework enabling an RA to make a recognition instrument to recognize all or part of a resolution action taken in a non-Hong Kong jurisdiction if certain conditions are met (clause 185). The effect of recognition is that a non-Hong Kong resolution action produces substantially the same legal effect in Hong Kong that it would have produced if it had been made, and been authorized to be made, under the laws of Hong Kong (clause 186(2)). An RA may also use its own powers available under the Hong Kong resolution framework (including the application of stabilization options where warranted) to support a non-Hong Kong resolution action where the conditions for initiating resolution have been met by a within scope FI and to do so would be consistent with the resolution objectives (clause 189).

Benefits of and conditions for recognizing a non-Hong Kong resolution action

100. The Bills Committee has examined the rationale for and benefits to Hong Kong in recognizing a non-Hong Kong resolution action, and the circumstances under which the Hong Kong RA would make a recognition instrument, or use the power under the Bill to support a non-Hong Kong resolution action.

101. The Government has explained that Part 13 is designed to meet KA 7.3 which provides that an RA "should have resolution powers over local branches of foreign firms and the capacity to use its power either to support a resolution carried out by a foreign home authority…or, in exceptional cases, to take measures on its own initiative where the home jurisdiction is not taking action or acts in a manner that does not take sufficient account of the need to preserve the local jurisdiction's financial stability". Recognizing a non-Hong Kong (i.e. foreign) resolution action may benefit Hong Kong since resolution of a cross-border group in a coordinated fashion is likely to be less value destructive than a disorderly break-up of the group and concerted action can mitigate the spill-over of risks in groups which tend to be relatively highly integrated. This in turn can deliver a satisfactory outcome for financial stability in Hong Kong. In respect of an integrated cross-border group, cooperation by RAs in host jurisdictions with the RA of the home jurisdiction in a group-wide resolution carried out in the home jurisdiction would enable the constituent parts of the group to continue as a going concern and hence benefit home and host jurisdictions alike. Hence, it would be critical to provide flexibility in the Hong Kong resolution regime for the RAs to act in coordination and cooperation with those overseas.

102. On the conditions to be met before making a recognition instrument, the Government has advised that the RA must consult FS (clause 185(5)) and

that it must not make the instrument if it is of the opinion that: (a) recognition would have an adverse effect on financial stability in Hong Kong; (b) recognition would not deliver outcomes that are consistent with the resolution objectives; or (c) recognition would disadvantage Hong Kong shareholders or Hong Kong creditors (or both) relative to their counterparts outside Hong Kong (clause 185(6)). The RA must not recognize a foreign resolution action unless it is of the opinion that any Hong Kong shareholder or creditor would be eligible to claim compensation under an arrangement with the foreign RA that is taking the resolution action which is broadly consistent with the eligibility for the NCWOL compensation mechanism provided under clause 102 (clause 187). Also, the RA may take into account any fiscal implications for Hong Kong in deciding whether to recognize a non-Hong Kong resolution action (clause 185(7)). In contrast, in the taking of "support measures" with respect to a non-Hong Kong resolution action, the Hong Kong RA has to be satisfied that the three conjunctive conditions under clause 25 are met, consult FS (clause 27) and issue a letter of mindedness (clause 30) before initiating resolution of the relevant within scope FI. The RA then uses the powers it has under the Bill for the purpose of supporting the non-Hong Kong resolution action if it is of the opinion that doing so would be consistent with the resolution objectives (clause 189).

103. The Bills Committee has sought clarification on whether resolution would be initiated for a within scope Hong Kong FI which is part of a cross-border group when the group is under resolution overseas but the Hong Kong FI remains viable. Moreover, questions have been raised as to how the RA can protect the interest of creditors, shareholders and customers of the Hong Kong FI concerned in a group-wide resolution initiated overseas.

104. The Government has clarified that the initiation of resolution overseas does not automatically trigger the making of a recognition instrument or the issuance of a Part 5 instrument for the exercise of stabilization options and accompanying resolution powers by the Hong Kong RA under the local resolution regime. In deciding how to use the powers under the regime, the Hong Kong RA will consider, in the case of a cross-border financial group, whether to pursue a coordinated approach. If the RA is of the opinion that recognition will result in a situation referred to in clause 185(6) (as discussed in paragraph 102 above) or that taking supportive action will not be consistent with the resolution objectives (clause 189) then the Hong Kong RA cannot recognize a foreign resolution action or use its powers to support a foreign resolution authority. But it can use the powers under the Bill to act independently if the three conjunctive conditions under clause 25 for initiating resolution have been met locally and the FI is within scope of the regime. If the Hong Kong FI remains viable and the clause 25 conditions are not met, no resolution action could be initiated for the Hong Kong FI. Where necessary, the relevant regulator of the FI will consider the use of its supervisory

intervention powers, for the purpose of protecting depositors, policyholders and client assets etc. given that the FI's parent company overseas (i.e. the controller of the FI) is in trouble, and hence arguably no longer fit and proper. These supervisory intervention powers may include the issuing of directions to the FI, restrictions on the FI's business, etc. under BO, SFO and ICO. However, past experience suggests that the Hong Kong FI may quickly suffer a loss of confidence once its customers and counterparties become aware of the problems in the overseas parent company. This may render the Hong Kong FI "likely to become" non-viable, and if the clause 25 conditions are met, the use of powers under the Bill could be triggered. If the Hong Kong FI is not a within scope FI, resolution could not be initiated locally under the Bill. Nonetheless, the relevant regulator of the FI may use the above mentioned supervisory intervention powers to protect the interests of customers of the FI.

Development of cross-border group resolution plans

105. The Bills Committee shares the views of deputations that there should be more guidance on how recognition of non-Hong Kong resolution actions and cooperation in cross-border resolutions would work in practice, including the development of cross-border group resolution plans under which the interests of both the home and host jurisdictions would be ensured, thereby underpinning the implementation of orderly cross-border resolution actions.

106. The Government has stressed that for any group resolution plan to operate credibly, both home and relevant host authorities must be incentivized to "play their part". This means that in drawing up a group resolution plan, home authorities must provide host authorities with assurance that financial stability and continuity of critical financial services will be suitably protected in host jurisdictions by the proposed plan and that creditors and shareholders in host jurisdictions will not be disadvantaged or treated less favourably than those in other jurisdictions. In the absence of such assurance, host authorities will not agree to a group resolution plan as it will not serve their local resolution objectives. The Government agrees with the need to monitor work at the international level on recognition and support of cross-border resolution actions and will endeavour to develop further guidance in this area through the Code of Practice under clause 194.

Committee Stage amendments to be moved by the Administration

107. Apart from the CSAs explained in paragraphs 55, 57, 64, 71, 81, 82, 85, 88, 91, and 93 above, the Government will move CSAs to clarify the intention of some provisions, improve drafting, align the wording of provisions in the Bill, and introduce other technical amendments. Some of these CSAs are proposed in the light of comments from the Bills Committee and the Legal

Adviser to the Bills Committee. The major ones are highlighted below.

The Chinese rendition "內部財務調整文書"

108. The Bills Committee considers that the proposed Chinese rendition "內部財務調整文書" for the term "bail-in instruments" in the Bill has not reflected the urgency and seriousness of the situation where such instruments are made, and has requested the Government to consider replacing the words "調整" by "重整". Having considered members' views, the Government will move CSAs to amend "內部財務調整" to "內部財務重整" wherever the Chinese term appears in the Bill. The relevant clauses include clauses 2(1), 19(3)(h), 32, 33(2)(d), 35(1)(c)(ii), the title of Part 5, Division 1, Subdivision 5, clauses 57-64, 65(1), 74, 75(2)(e), 91(1)(b), 103(4)(a), 151(1), 191(1)(a), Schedule 5, section 1; title of Schedule 6; Schedule 6, sections 2-5, Schedule 6, section 6(1); Schedule 6, section 7; Schedule 6, section 8; title of Schedule 6, Part 2; Schedule 6, section 9.

Definition of chief executive officer and deputy chief executive officer

109. Under clause 2(1), "chief executive officer" means a person (except in Part 9) who is responsible under the immediate authority of the directors for the management of the whole of the business of the entity. Whereas "deputy chief executive officer" means a person who is responsible under the immediate authority of the chief executive officer for the management of the whole of the business of the entity. As there may be a scenario the CEO/DCEO is only responsible for the management of part of the business of the entity, the Government will move CSAs to amend the two definitions in clause 2(1) so that CEO will be the person responsible for "the implementation of the general strategy of the entity and for the general management of the business of the entity". A similar amendment will be made to the definition of DCEO.

Appointment criteria for section 10 entities and independent valuer

110. To avoid possible conflicts of interest of an independent valuer and a section 10 entity (to be appointed by an RA to assist the RA in performing a pre-resolution valuation) which may influence their judgement in the performance of their functions, section 4 of Schedule 2 and clause 37(2)(b) respectively provide that the appointed persons must not have any interest in common or in conflict with any of the following: (a) the entity under resolution; (b) an entity in the same group of companies as the entity concerned; (c) a creditor or shareholder of the entity. Due to the significant practical difficulty of identifying fully, and on an ex ante basis, each and every shareholder and creditor of an FI, a situation may arise that it is not possible to appoint an independent valuer or a section 10 entity if the above criterion (c) remains in

place. In order to reduce the potential for such a situation to arise, the Government will introduce CSAs to delete the above mentioned criterion (c) from section 4 of Schedule 2 and clause 37(2)(b). The effect of the CSAs will be that the appointed persons must not have any interest in common or in conflict with either of the entities mentioned in (a) or (b) above.

Mistakes in valuation made by the independent valuer

111. Under clause 104(3), an independent valuer may at any time before a decision under that section takes effect, correct a clerical mistake in the decision or an error in it arising from any accidental slip or omission. As the policy intention is that the correction made should not cover errors which when corrected would affect the actual valuation decision, the Government will introduce a CSA to clause 104 to add a new clause 104(4) to provide that the correction of a clerical mistake, or error arising from an accidental slip or omission, in the valuation decision or the assessment on which the decision is made should not be capable of affecting the valuation decision or the level of compensation payable as a result of the correction.

Cost order made by the Court of Appeal

112. Clauses 123(3) and 140(3) stipulate that on an appeal, the Court of Appeal ("CoA") may make any order as to the costs that it considers appropriate. The Bills Committee has enquired if CoA allows an appeal against the decisions of RRT or RCT, whether the provisions would empower CoA to vary the cost order made by RRT or RCT relating to the proceedings before the relevant tribunal. The Government has clarified that the policy intention is that, on an appeal made to CoA, CoA may (a) make any order as to costs that it considers appropriate; and (b) where it allows an appeal, include in any such order costs to be paid by the respondent to the appellant incurred in relation to the proceedings of the tribunal and the application to the tribunal in question. The Government will move CSAs to amend clauses 123 and 140 to clearly reflect the above policy intention.

Employees etc. employed by section 10 entity or an independent valuer to be covered by the confidentiality requirement

113. Having considered the Bills Committee's views that the members, employees and agents of, and the consultants and advisors to, a section 10 entity or an independent valuer should be covered by the secrecy requirements imposed under clause 171(1), the Government has agreed to move a CSA to amend clause 171(2) to make explicit that the above mentioned parties or persons are also covered by the confidentiality requirements under clause 171(1).

Code of practice in clauses 194 and 199

114. Clause 199 provides that certain instruments in the Bill (e.g. notices of FS's designations regarding within scope FIs and LRA under clauses 6 and 7, Part 5 instruments, recognition instruments, etc.) are not subsidiary legislation. As a code of practice issued under clause 194 is to provide guidance and will not have any legislative effect, the Government will move a CSA to clarify that such code of practice is not subsidiary legislation. The Government will also move a CSA to expand clause 194 to enable RAs to issue codes of practice about any matter relating to the functions given to them, including providing guidance on the operation of any provision of the Ordinance. Under the new clause 194(4), RAs will issue their own code of practice governing issues common to all within scope FIs and providing for sector specific requirements. The CSA seeks to provide that a code of practice issued by an RA may incorporate or refer to other codes of practice issued by other RAs.

115. The Bills Committee has examined all proposed CSAs from the Administration and raised no objection. The Bills Committee will not propose any CSAs to the Bill.

Resumption of Second Reading debate

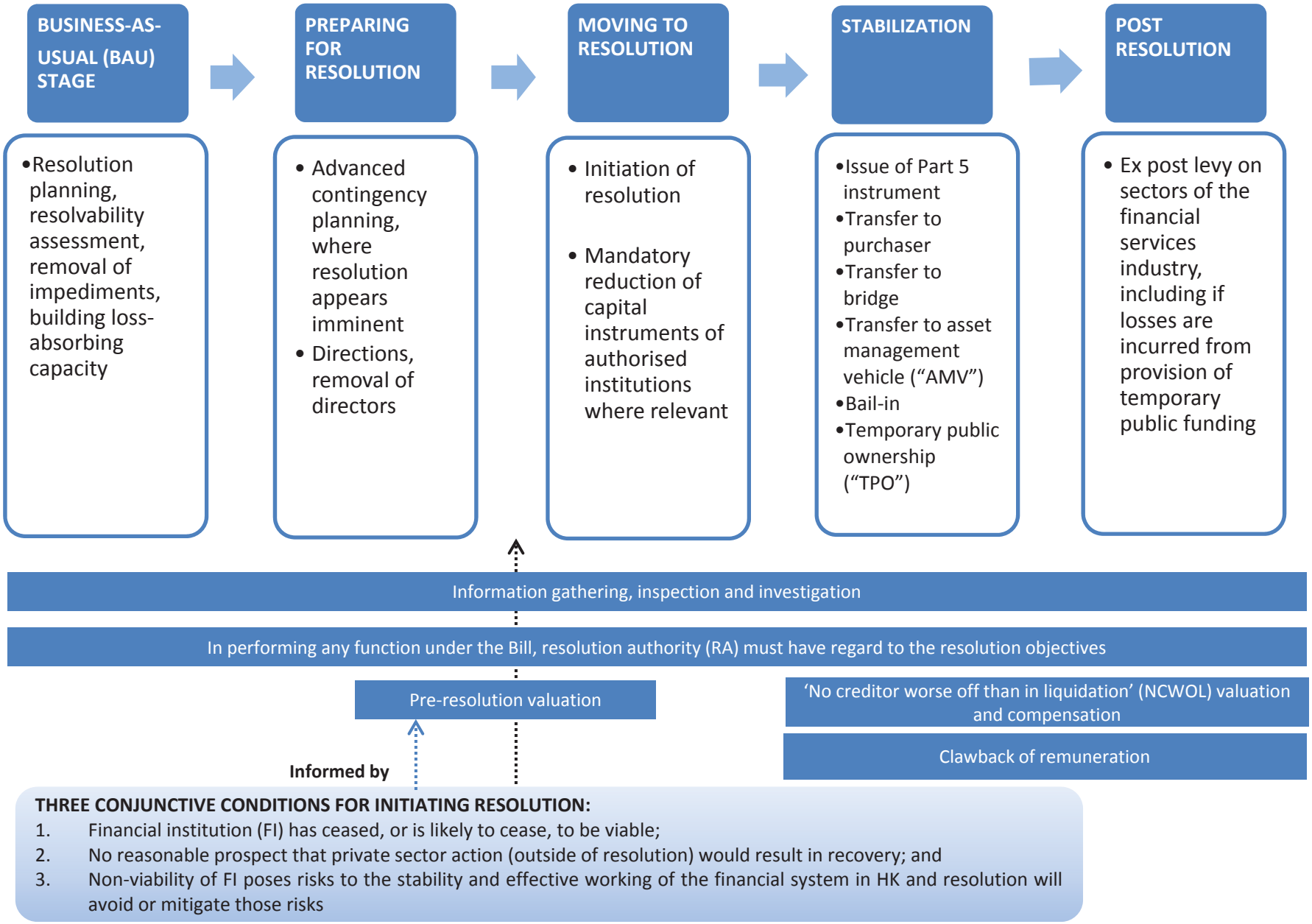
116. The Bills Committee has no objection to the resumption of the Second Reading debate on the Bill at the LegCo meeting of 22 June 2016.

Consultation with the House Committee

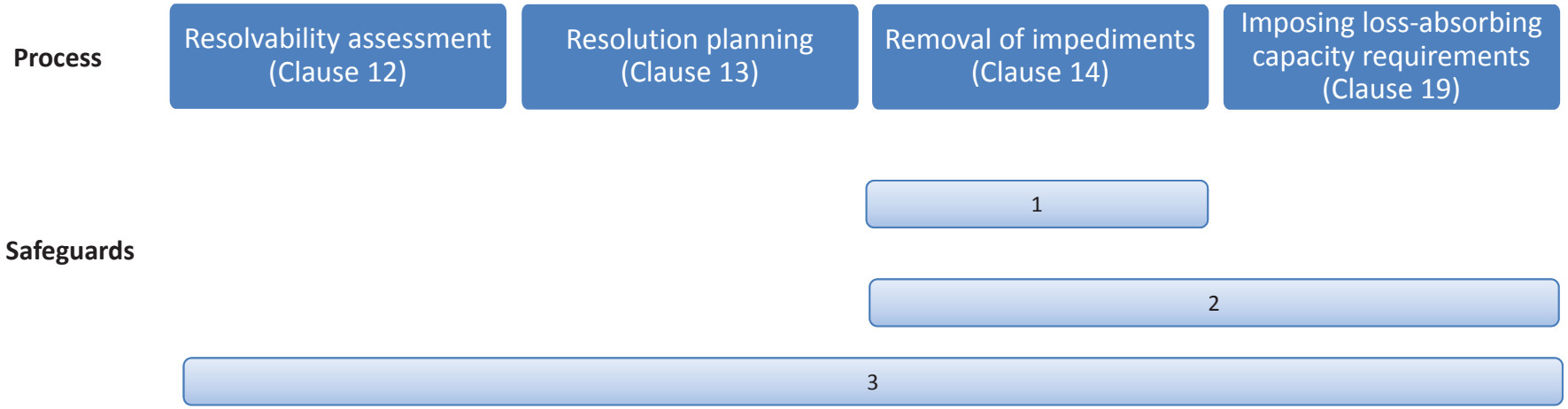
117. The Bills Committee reported its deliberations to the House Committee on 10 June 2016.

Council Business Division 1
Legislative Council Secretariat
16 June 2016

Resolution life cycle - overview

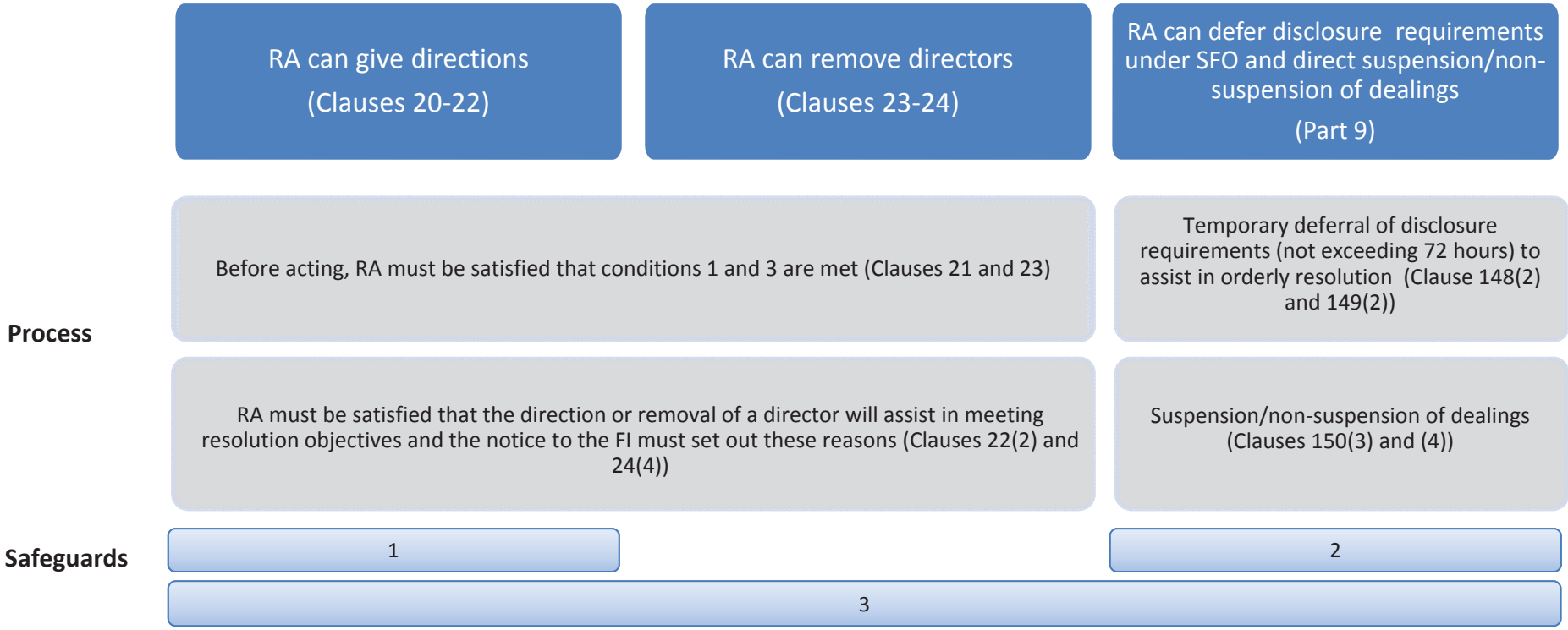


Part 3 – Preparing for resolution (business as usual)



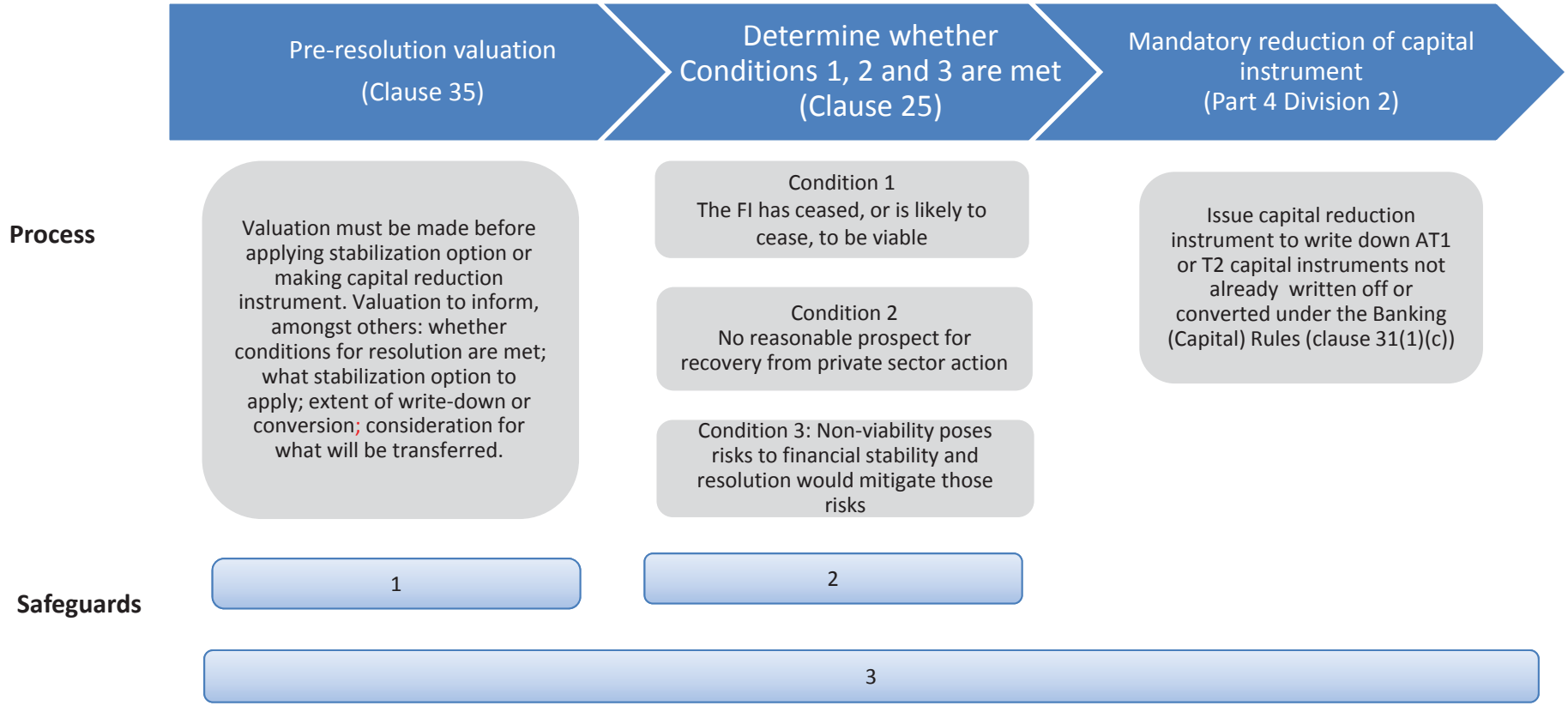
Safeguards	
1	- FI must be afforded opportunity to make representations (Clause 15(1)(c))
2	- Resolvability Review Tribunal (RRT) (Clauses 17 and 18; Clause 19(3)(k); provisions pertinent to role, constitution and processes of RRT are under Part 7 Division 1; Schedule 8)
3	- Right to apply for judicial review

Part 3 – Preparing for resolution (advanced contingency planning)



SAFEGUARDS		
	1	- Saving provision for directors of FI or group company in respect of discharge of directors' duties when complying in a good faith with a direction (Clause 22(4)) - Immunity from liability in damages for FI or related person when complying in a good faith with a direction (Clause 22(5))
	2	- RA may only act if satisfied that : (i) it is likely that a listed entity, or its group company, will have stabilization option applied; (ii) disclosure will likely lead to non-viability of the entity, or its group company; and (iii) disclosure will likely impede RA's ability to achieve orderly resolution; and (iv) the information is confidential and its confidentiality can be preserved (Clauses 148(3) and 149(3)). - Requirements that before granting the temporary deferral of disclosure requirements or issuing a direction regarding suspension/non-suspension of dealings in securities, RA must consult SFC if the SFC is not the RA (Clauses 148(5), 149(5), 150(4) and (5))
	3	- Right to apply for judicial review

Part 4 – Moving to resolution

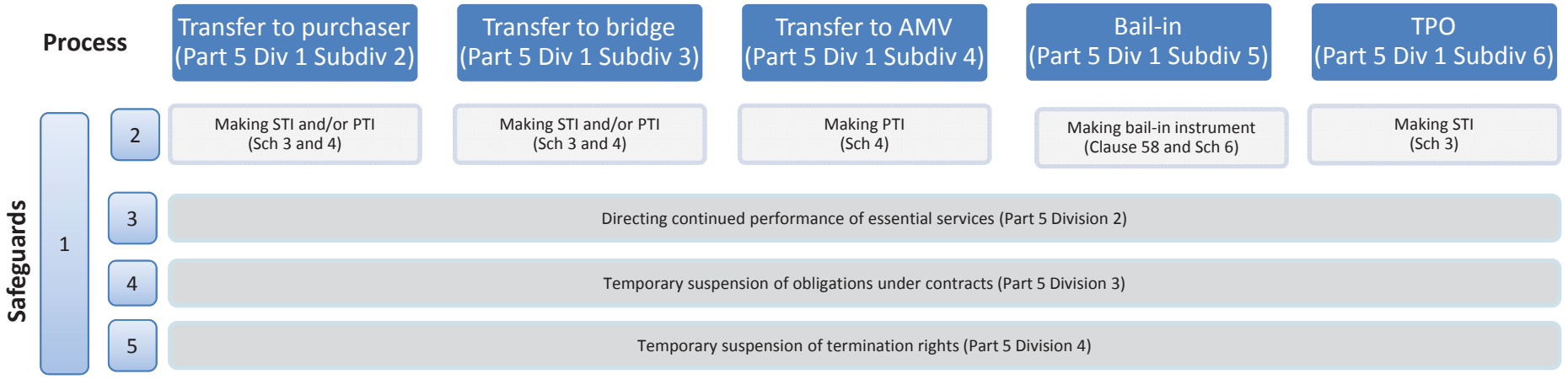


SAFEGUARDS		
	1	- Nature of valuation must be fair in all circumstances, based on prudent and realistic assumptions (clause 36(a))
	2	- Requirement for the RA to consult the Financial Secretary (Clause 27) - RA must issue a "Letter of Mindedness" (LOM), which must specify that the RA is satisfied that Conditions 1, 2 and 3 are met and why the conditions are met (Clause 30(2)(b)) - LOM must also state that directors of the FI, holding company or affiliated operational entity ("AOE") may make representations to the RA in relation to anything stated in the letter (LOM will specify whether those representations will be made orally or in writing ,or both) (Clause 30(2)(e))
	3	- Right to apply for judicial review

Resolution ‘glide-path’

Stage	Action
Advanced contingency planning	- Establishing bridge / AMV / TPO company - Liaising with any potential purchaser
Point of Non Viability (PONV) – “Resolution weekend”	- Pre-resolution valuation - Three conjunctive conditions - Consult Financial Secretary - Issue letter of mindedness
Before market opens on Monday	**Stabilization option applied through “Part 5 instrument”**
Post-stabilization	**NCWOL valuation**

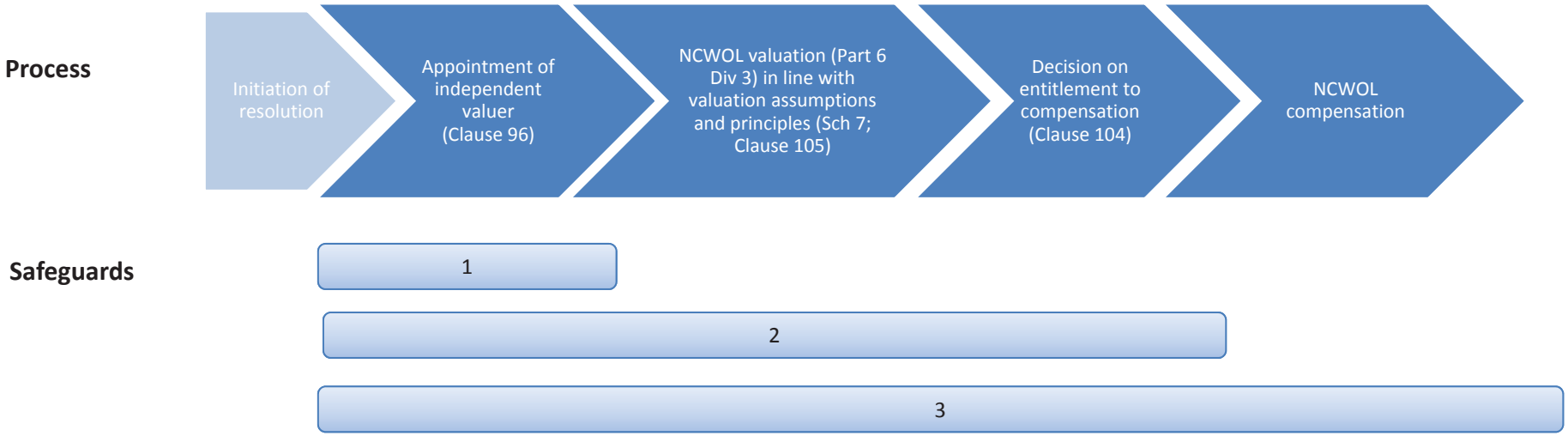
Part 5 – Stabilization options



Safeguards			
1	- "No creditor worse off than in liquidation" (NCWOL) valuation and compensation (Clause 103) - Right to apply for judicial review		
2	Notification requirements: as soon as practicable after making STI and/or PTI, RA must - send a copy to transferor, transferee and Financial Secretary - Notify the public (Sch 3 Section 3, Sch 4 Section 3)	Making of Part 5 instrument: - Regulations on "protected arrangements" (Part 5 Division 1 Subdivision 7) applies to partial transfers and bail-in - Excluding certain liabilities from bail-in (Clause 58(9) and Schedule 5)	Reporting requirements: - RA to report to the Financial Secretary who must in turn table the report before the Legislative Council (Clauses 40, 46, 55, 65, 72)
3	- RA can direct residual FI or AOE to continue to provide only those services that are essential to the continued performance of critical financial functions (residual FI: Clause 79(3); AOE: Clause 81(1)) - Must be reasonably required for facilitating orderly resolution (residual FI: Clause 79(2); AOE: Clause 81(2)) - Reasonable consideration to be paid by recipient of services (residual FI: Clause 79(3); AOE: Clause 81(6))		
4	- Exclusion of certain critical obligations from suspension (Clause 84) - Temporary suspension for no more than two business days (Clause 83(4))		
5	- Substantive obligations under affected contracts continue to be performed (Clause 88) - Temporary suspension for no more than two business days (Clause 90(4))		

Abbreviations: Asset management vehicle (AMV); Temporary public ownership (TPO); Securities transfer instrument (STI); Property transfer instrument (PTI); Affiliated Operational Entity (AOE)

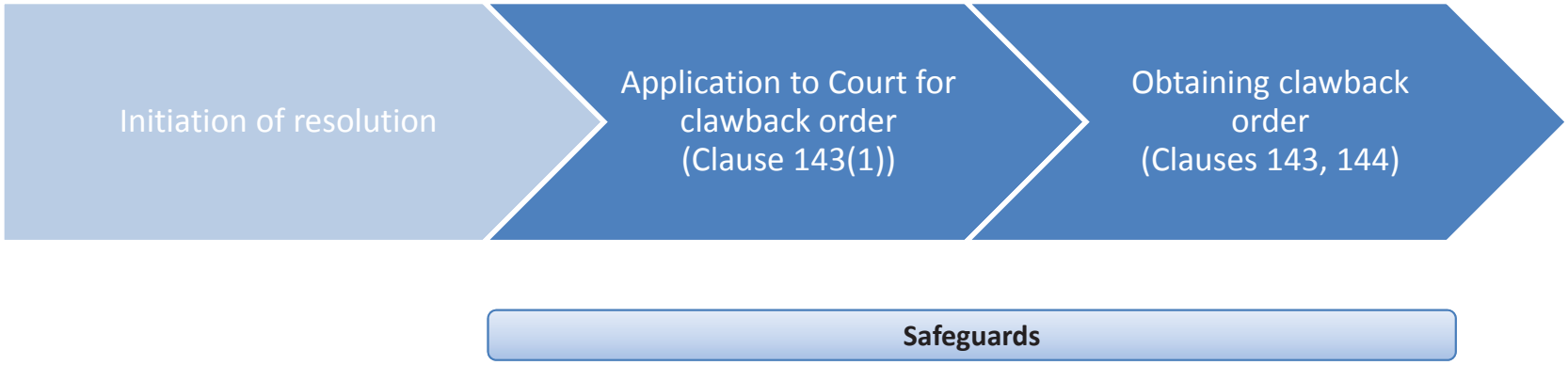
Part 6 – NCWOL valuation and compensation



Safeguards	
1	- Independent appointing person (Clause 95)
2	- Appointment criteria for independent valuer designed to provide for independence (Clause 96 and Schedule 2) - Revocation of appointment by Resolution Compensation Tribunal (RCT)(Clause 98)
3	- RCT (Part 7 Division 2, Schedule 9) - Right to apply for judicial review

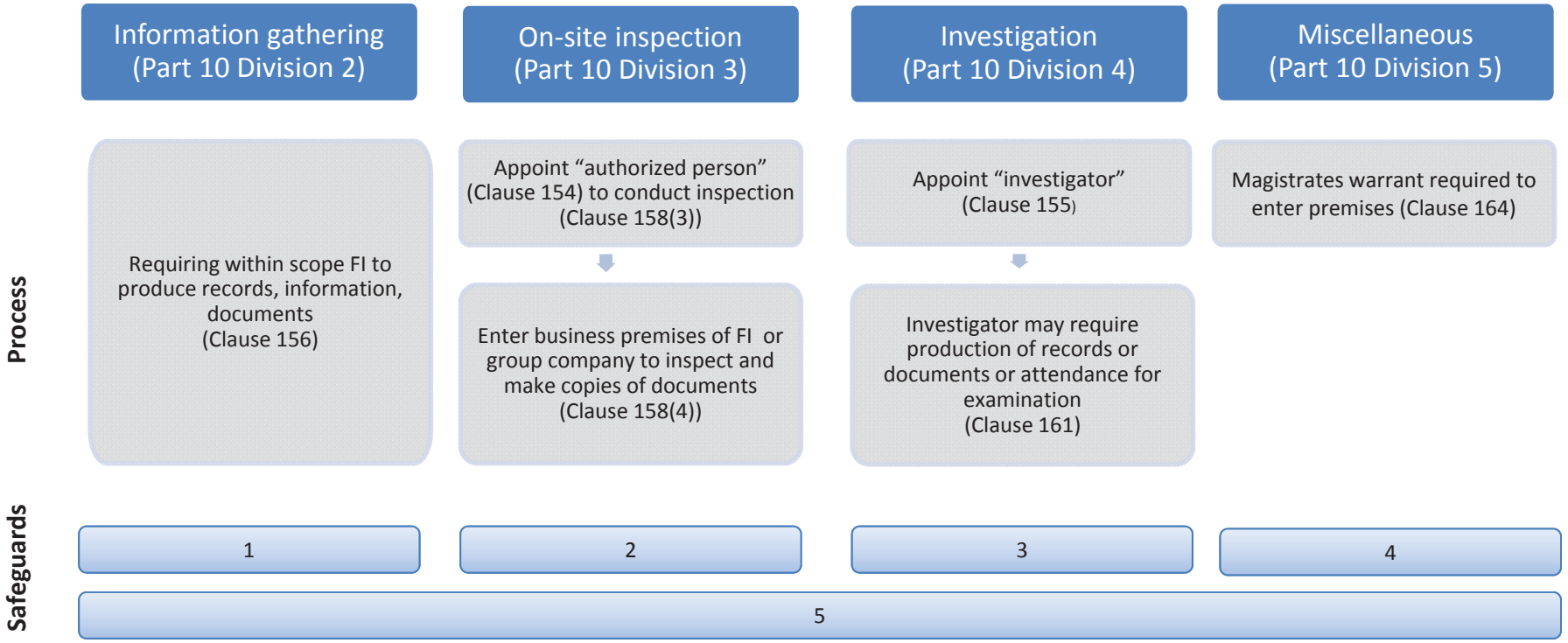
Part 8 – Clawback of remuneration

Process



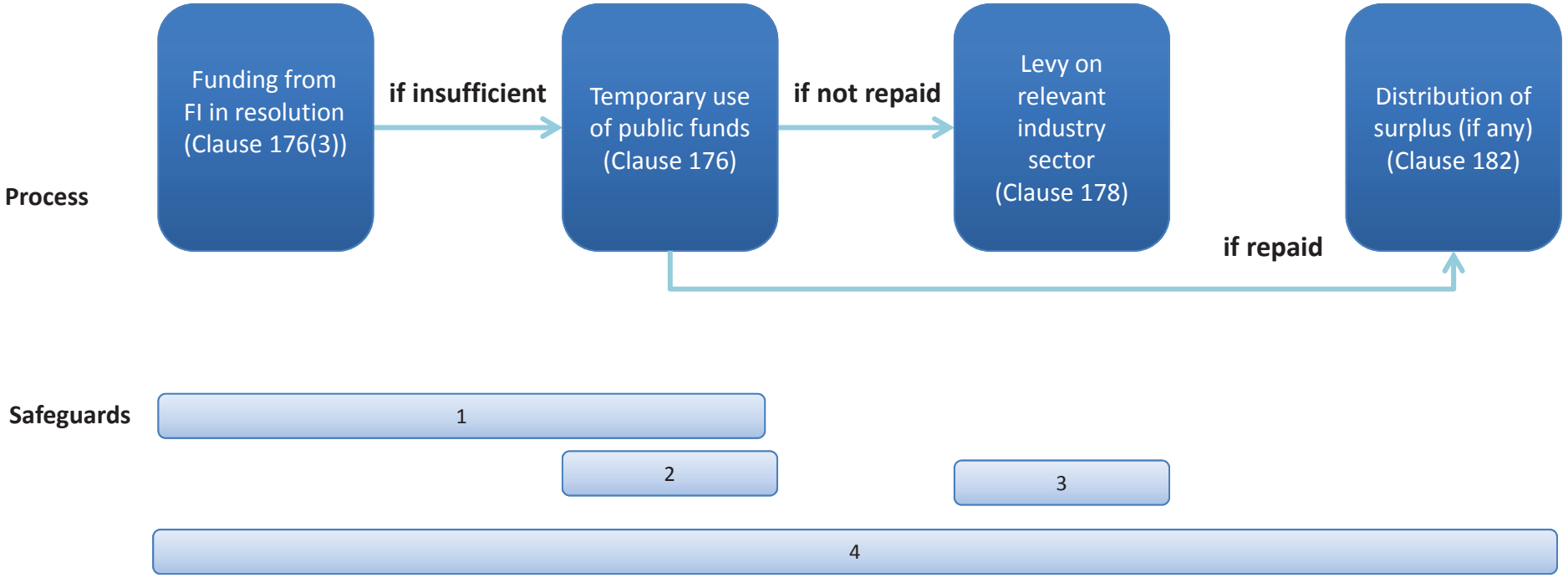
Safeguards
- Court process on application by RA (Clause 143(1))
- Definition of "officer" for clawback purposes limits clawback to officers of a certain level of seniority and responsibility (Clause 142)
- Link must be established between failure of FI and involvement in that failure (clawback only if the officer caused, or materially contributed to the failure (Clause 143(2)(a)); and the act was done, or the omission was made, intentionally, recklessly or negligently (Clause 143(2)(b))
- In determining extent of clawback, Court must take in account: (a) the extent to which the act of the officer contributed to the FI ceasing, or likely to cease being viable and, (b) the financial circumstances of the officer, as far as practicable (clause 143(3))
- Right to appeal against a clawback order

Part 10 – Information gathering, inspection and investigation



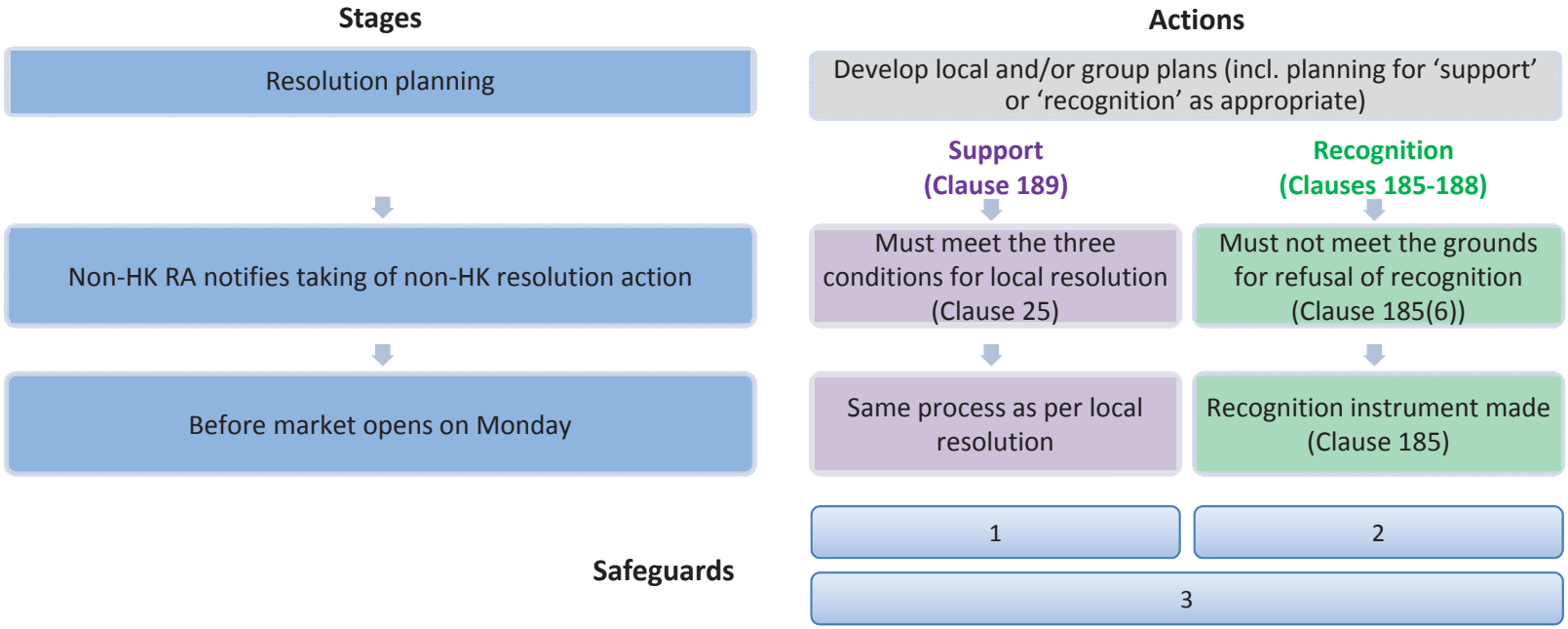
SAFEGUARDS		
	1	- Must be reasonably required in connection to performance of RA's functions (Clause 156(2))
	2	- Powers only exercisable if of the opinion that it will assist RA in performance of its functions under the Bill (Clause 158 (2) and (3))
	3	- RA must have reasonable belief that an offence has been committed under the Bill or that a direction given under the Bill has not been complied with (Clause 160) - Protection from self-incrimination (Clause 163)
	4	- Magistrate may only issue a warrant if it is satisfied that information provided by an authorised person, investigator, person that constitutes RA or employee of RA that there are reasonable grounds to suspect that there is or likely to be information or documents on the premises specified by the person (Clauses 164(1) and (2))
	5	- Powers in respect of third parties only exercisable with reasonable cause to believe that the third party has information and the information cannot be obtained from FI or group company (Clause 153(2)) - Right to apply for judicial review

Part 12 – Resolution funding arrangements



Safeguards	
1	- RA must consider first the extent to which the FI's own resources can be utilized (including the extent to which liabilities can be written off/converted, assets can be sold, or private sector funding can be obtained) before using public funds (Clause 176(3))
2	- Specification of purposes for which public funds may be used: in connection with preparation for and the making of a Part 5 instrument, resolution of entity including paying NCWOL compensation due (if any), or appointment of independent valuer (Clause 176(1))
3	- Levy rate to be prescribed by resolution of the Legislative Council on recommendation of Financial Secretary (Clause 180), pursuant to regulations made by Financial Secretary (Clause 179)
4	- Right to apply for judicial review

Part 13 – Non-Hong Kong resolution actions



Safeguards	
1	**Support**: Same safeguards as for local resolution
2	**Recognition**: - RA must not recognise non-HK resolution action if one or more of the following non-cumulative conditions are met: **(i)** the RA is of the opinion that **(a)** recognition would have an adverse effect on financial stability in HK (Clause 185(6)(a)); or **(b)** recognition would not deliver outcomes that are consistent with the resolution objectives (Clause 185(6)(b)); or **(c)** recognition would disadvantage HK creditors and/or HK shareholders relative to other creditors/shareholders of the entity being subject to the non-HK resolution action (Clause 185(6)(c)); or **(ii)** if the RA is not satisfied that an arrangement is in place with the non-HK RA that would make HK creditors or HK shareholders eligible to claim compensation on a basis that is broadly consistent with the local NCWOL eligibility for compensation (Clause 187).
3	- Right to apply for judicial review

Source : Annex to LC Paper No. CB(1)679/15-16(02)

Appendix II

Bills Committee on Financial Institutions (Resolution) Bill

Membership list

Chairman	Hon CHAN Kam-lam, SBS, JP
Members	Hon Albert HO Chun-yan Hon Andrew LEUNG Kwan-yuen, GBS, JP Hon WONG Ting-kwong, SBS, JP Hon Cyd HO Sau-lan, JP Hon CHAN Kin-por, BBS, JP Hon NG Leung-sing, SBS, JP Hon Kenneth LEUNG Hon Dennis KWOK Hon Christopher CHEUNG Wah-fung, SBS, JP Hon SIN Chung-kai, SBS, JP (Total：11 members)
Clerk	Ms Connie SZETO
Legal Adviser	Mr YICK Wing-kin

Appendix III

Bills Committee on Financial Institutions (Resolution) Bill

List of organizations/individuals who has provided views to/ attended the public hearing arranged by the Bills Committee

1. AIA Group Limited
2. Allen & Overy
3. Alternative Investment Management Association
4. Clifford Chance
5. CLS Bank International
6. Consumer Council
7. Deutsche Bank AG Hong Kong Branch
8. Dr Ludmilla K ROBINSON of Western Sydney University
9. The DTC Association
10. Freshfields Bruckhaus Deringer
11. The Hong Kong Association of Banks
12. The Hong Kong Federation of Insurers
13. The Hong Kong Institute of Directors
14. The Hong Kong Retirement Schemes Association
15. Hong Kong Securities Association
16. International Swaps and Derivatives Association, Inc
17. MetLife Limited
18. Mr Peter LAKE
19. UBS

Stabilization Options

Stabilization option	KA Requirement	Description
1. Transfer of an entire FI, or of some or all of its business, to a purchaser	KA 3.2(vi)	Allows for the compulsory transfer of an entire FI, or some or all of its business, to a willing purchaser. The purchaser takes on responsibility for continuing provision of critical financial services and for meeting claims transferred in full. Transferred customers may have close to uninterrupted access to services they rely on in their day-to-day activities. Used in cases where one (or more) willing and suitable purchasers can be found in a timely manner.
2. Transfer of an entire FI, or some or all of its business, to a bridge institution	KA 3.2(vii)	Allows for the compulsory transfer of an entire FI, or some or all of its business, to a company owned by the Government, such that critical financial functions might be continued. A solution for cases where an RA assesses that there may be a willing and suitable purchaser but that the purchase cannot be arranged immediately (e.g. to facilitate more detailed due diligence should the pre-resolution planning period not so permit).
3. Transfer of a failing FI's assets and liabilities to an Asset Management Vehicle ("AMV")	KA 3.2(viii)	Allows for the compulsory transfer of some of an FI's assets, rights and liabilities to a special purpose vehicle where they can be wound down over time. AMVs may be required where the immediate sale or liquidation (fire sale) of certain assets (although they do not relate to the provision of critical financial functions) could in and of itself have systemic consequences by negatively impacting prices in financial markets. AMVs are likely to be used in conjunction with other stabilization options.
4. Statutory bail-in powers	KA3.2 (ix)	Allows for compulsory recapitalisation of a failing FI, or a successor entity, such as a bridge institution, by allowing for claims of shareholders and certain unsecured creditors to be written-down and perhaps a debt-for-equity swap to be imposed on

		certain unsecured creditors. The recapitalization will provide the necessary capital so that the FI can continue the performance of critical financial functions, although it would not address the longer term viability of the FI, which would be addressed through a statutory requirement to produce, and carry out, a post-resolution business reorganization plan. Necessary in cases where a failing FI is assessed as so large or complex, or as otherwise carrying out a niche activity such as acting as an FMI, such that a transfer is not feasible or desirable.
5. Temporary public ownership (TPO)	Not required under the KA but the KAs set standards on recovery of funds if TPO is available	Allows for the failing FI to be compulsorily taken into TPO (through a transfer of all of its shares to a Government-owned company (a TPO company under the Bill)), with a view to ultimately returning the business to the private sector. Considered a "last resort" for use in cases where an RA is satisfied, having considered all the other stabilization options listed above, that orderly resolution that meets the resolution objectives is most appropriately achieved by TPO. The KAs specify that where a jurisdiction has provided for a power to effect TPO, any losses incurred as a result must be recovered from the wider financial industry.

Source : Annex B to Legislative Council Brief