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**Paper for the House Committee Meeting
on 4 December 2015**

**Legal Service Division Report on
Financial Institutions (Resolution) Bill**

I. SUMMARY

- 1. The Bill** The Bill seeks to:-

 - (a) establish a regime for the orderly resolution of financial institutions in Hong Kong that are within the scope of the Bill;
 - (b) confer various powers on the Monetary Authority, the Insurance Authority and the Securities and Futures Commission for the purposes of the regime;
 - (c) make consequential and related amendments; and
 - (d) provide for incidental and related matters.

- 2. Public Consultation** According to the LegCo Brief, two three-month public consultation exercises were respectively conducted in January 2014 and January 2015. Respondents were broadly supportive of the legislative proposal to establish a resolution regime in line with the latest international standards.

- 3. Consultation with LegCo Panel** The Panel on Financial Affairs was briefed on 2 March 2015 on the proposals during the second stage of public consultation. Panel members did not oppose the relevant legislative proposals but certain concerns were raised.

- 4. Conclusion** In view of the implications of the Bill on financial institutions and the financial system of Hong Kong, Members may wish to form a Bills Committee to study the Bill in detail.

II. REPORT

The date of First Reading of the Bill is 2 December 2015. Members may refer to the Legislative Council (LegCo) Brief (File Reference: B&M/2/1/27C) issued by the Financial Services and the Treasury Bureau on 18 November 2015 for further details.

Object of the Bill

2. The objects of the Bill are to:-
- (a) establish a regime for the orderly resolution of financial institutions (FIs) in Hong Kong that are within the scope of the Bill;
 - (b) confer various powers on the Monetary Authority (MA), the Insurance Authority (IA) and the Securities and Futures Commission (SFC) for the purposes of the regime;
 - (c) make consequential and related amendments; and
 - (d) provide for incidental and related matters.

Background

3. After the international financial crisis that began in 2007, the Financial Stability Board (FSB), of which Hong Kong is a member jurisdiction, published "Key Attributes of Effective Resolution Regimes for Financial Institutions" (Key Attributes) in 2011 to set the new international standards for effective resolution regimes for systemically important financial institutions. According to paragraph 2 of the LegCo Brief, while MA, IA and SFC already possess a range of supervisory intervention powers under the Banking Ordinance (Cap. 155), the Securities and Futures Ordinance (Cap. 571) and the Insurance Companies Ordinance (Cap. 41) respectively for dealing with distressed FIs, not all powers required by the Key Attributes are currently available to such authorities in Hong Kong. The Administration therefore introduces the Bill to establish a cross-sector resolution regime for FIs in line with the international standards as set out in the Key Attributes.

Provisions of the Bill

4. The main features of the proposed resolution regime are summarized below.

Scope of resolution regime and designation of resolution authorities

5. The proposed resolution regime would apply to "within scope financial institution" which is defined in clause 2(1) of the Bill to mean a banking sector entity, an insurance sector entity, or a securities and futures sector entity. Clause 6(1)

provides that the Financial Secretary (FS) may, by notice published in the Gazette, designate a FI as a within scope FI and IA, MA or SFC as the resolution authority of that FI. Under clause 6(4), FS may, by notice published in the Gazette, designate a current list published by FSB as, for the purposes of the Bill, a list of global systemically important banks, global systemically important insurers and global systemically important (non-bank non-insurer) financial institutions.

6. Under clause 7, FS may, by notice published in Gazette, designate a resolution authority as the lead resolution authority of a cross-sectoral group of within scope FIs. Under clause 9, the lead resolution authority may give written directions to the resolution authority of a within scope FI in such a group and such directions must be complied with by the relevant resolution authority.

7. According to clause 199, the Gazette notices published under clauses 6(1), 6(4) and 7 are not subsidiary legislation and are therefore not subject to amendment by LegCo.

Resolution objectives

8. A resolution authority must have regard to the resolution objectives set out in clause 8 in performing any function under the Bill. Those objectives include promoting and maintaining the stability and effective working of the financial system of Hong Kong (including the continued performance of critical financial functions), protecting deposits or insurance policies of within scope FIs, protecting client assets of within scope FIs, and containing the costs of resolution and, in so doing, protecting public money.

Initiation of resolution and stabilization options

9. Under Part 4 of the Bill, after consulting FS a resolution authority may initiate the resolution of a within scope FI if it is satisfied that all of the following conditions are met:-

- (a) the FI has ceased, or is likely to cease, to be viable;
- (b) there is no reasonable prospect that private sector action (outside of resolution) would result in the FI again becoming viable within a reasonable period; and
- (c) the non-viability of the FI poses risks to the stability and effective working of the financial system of Hong Kong, including to the continued performance of critical financial functions, and resolution will avoid or mitigate those risks.

Before initiating the resolution, the relevant FI would be offered an opportunity to make representations to the resolution authority on the intended resolution. However,

no appeal mechanism is provided for decisions on initiation of resolution of FIs under the Bill.

10. Under clause 33, there are five stabilization options that a resolution authority may apply to a within scope FI in resolving such FI. These options are:-

- (a) transfer of the FI (or all or some of its business) to a purchaser;
- (b) transfer to a bridge institution;
- (c) transfer to an asset management vehicle which would be created under clause 51 for receiving and managing some or all of the assets, rights and liabilities of a within scope FI or a bridge institution;
- (d) bail-in (e.g. cancelling or changing the form of liabilities owed by a within scope FI); and
- (e) temporary public ownership of the within scope FI.

11. Clause 34 provides that the above stabilization options may be applied singly, concurrently or sequentially and may be limited to only part of the business of a within scope FI. Clause 35 requires a resolution authority to make a valuation before applying a stabilization option to, or making a capital reduction instrument in respect of, a within scope FI.

Other powers of resolution authorities

12. The Bill confers on resolution authorities a wide-range of statutory powers relating to the implementation of the proposed resolution regime. These powers include:-

- (a) powers under Part 3 relating to resolution such as making a resolvability assessment from time to time to determine whether there are any impediments to the orderly resolution of a within scope FI (or its holding company), devising strategies for securing an orderly resolution of a within scope FI, and giving directions to a within scope FI to remove or mitigate the effect of significant impediments to the orderly resolution of the FI or its holding company;
- (b) powers under Part 5 to (i) direct a within scope FI to continue to provide services that are essential to the continued performance of critical financial functions in Hong Kong; (ii) prohibit the filing of a winding-up petition of the FI to the court unless the relevant resolution authority has been notified and afforded time to assess whether resolution should be initiated; and (iii) operate and manage the FI in resolution; and

- (c) powers under Part 10 to gather information from and inspect records or documents of within scope FIs and carry out investigation on the FIs if the relevant authorities have reasonable cause to believe that an offence under the Bill may have been committed.

Compensation and review mechanism

13. Under Part 6 of the Bill, pre-resolution creditors or pre-resolution shareholders of a FI in resolution would be eligible for compensation if they are treated less favourably on the resolution than they would have been on a winding up (clause 102). The amount of compensation would be decided by an independent valuer appointed for making a valuation and assessment of the relevant compensation (clauses 101 and 103). Any aggrieved pre-resolution creditor or shareholder of the FI may apply to the Resolution Compensation Tribunal established under Part 7 (Division 2) for a review of the independent valuer's decision (clause 107). The determinations made by the Tribunal, except those on questions of law, would not be subject to appeal (clause 137).

Resolvability Review Tribunal

14. A Resolvability Review Tribunal (RRT) is proposed to be established under Part 7 (Division 1). RRT's jurisdiction will be confined to reviewing (a) any decision made by a resolution authority 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) any decision of a resolution authority made pursuant to the loss-absorbing capacity requirements rules for within scope FIs. The determinations made by RRT, except those on questions of law would not be subject to appeal (clause 120).

Recognition of non-Hong Kong resolution actions

15. It is proposed under Part 13 that after consulting FS, a resolution authority may make a recognition instrument to recognize a resolution action taken in a non-Hong Kong jurisdiction. The resolution authority must not make a recognition instrument if it is of the opinion that (a) the recognition would have an adverse effect on the financial stability in Hong Kong; (b) the recognition would not deliver outcomes that are consistent with the resolution objectives; or (c) the recognition would disadvantage Hong Kong creditors or Hong Kong shareholders relative to their counterparts elsewhere.

Commencement

16. The Bill, if passed, would come into operation on a day to be appointed by the Secretary for Financial Services and the Treasury by notice published in the Gazette.

Public Consultation

17. According to paragraph 24 of the LegCo Brief, two three-month public consultation exercises on the proposed resolution regime were respectively conducted in January 2014 and January 2015. Respondents were broadly supportive of the proposal.

Consultation with LegCo Panel

18. The Clerk to the Panel on Financial Affairs has advised that the Panel was briefed at its meeting on 2 March 2015 on the proposals during the second stage of public consultation. Members did not oppose the introduction of the legislative proposals, but raised concerns on a number of issues, including the scope of the proposed resolution regime, compliance costs for the financial services industry, the funding model for meeting resolution costs, powers of a resolution authority, measures to protect the interests of employees of financial institutions under resolution, and interface between the proposed resolution regime and insolvency arrangements for failing financial institutions.

Conclusion

19. The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. In view of the implications of the Bill on financial institutions and the financial system of Hong Kong, Members may wish to form a Bills Committee to study the Bill in detail.

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