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GOVERNMENT OF THE HONG KONG
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21 December 2017

Legislative Council Secretariat
1 Legislative Council Road
Central, Hong Kong
(Attn: Miss Katherine Chan)

Dear Miss Chan,

Bills Committee on Banking (Amendment) Bill 2017

Follow-up to meeting on 21 November 2017

I refer to your email dated 22 November 2017. The Administration's responses are set out in **Annex** for your information.

Yours sincerely,

(Ms Eureka Cheung)
for Secretary for Financial Services and the Treasury

c.c.
Bills Committee Chairman (Attn: Hon. Chan Chun-ying)
The Monetary Authority (Attn: Mr. Daryl Ho)
Secretary for Justice (Attn: Mr Michael Lam)
Mr Jonathan Luk)

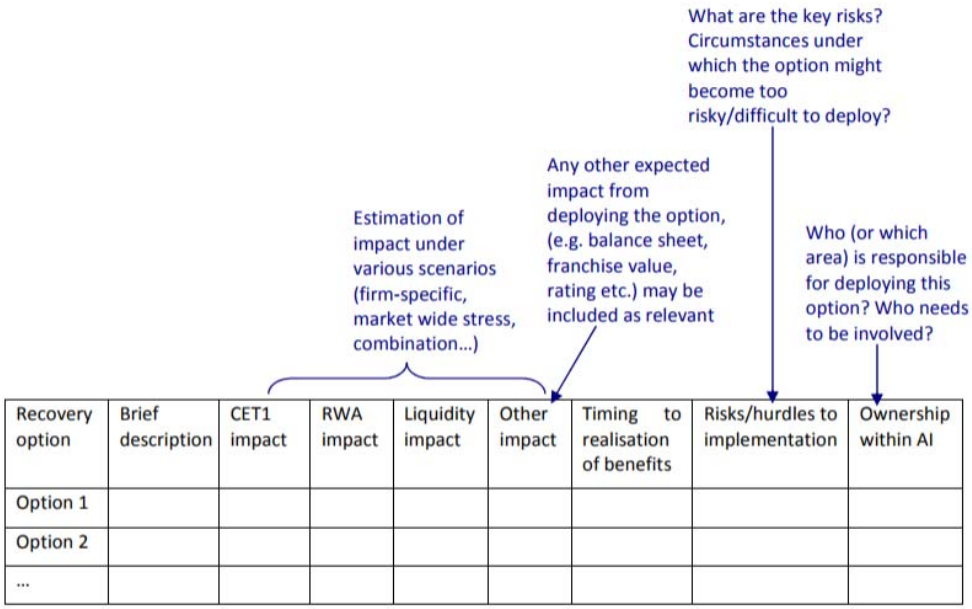
Annex

Sample(s) of recovery plan setting out the relevant measures

1. In general, an authorized institution's ("AI") recovery plan, regardless of its size or complexity, should:

   - identify and explain how the AI will monitor the need to trigger recovery actions;
   - set out a full menu of recovery options;
   - assess the impact of the recovery options;
   - identify the key steps and milestones in implementing the recovery options and the key management personnel involved in activation and decision-making; and
   - map out a communication strategy to support the deployment of the recovery options.

2. For reference, we include below an illustrative template summarising factors to be assessed in relation to the recovery options:



Recovery option	Brief description	CET1 impact	RWA impact	Liquidity impact	Other impact	Timing to realisation of benefits	Risks/hurdles to implementation	Ownership within AI
Option 1								
Option 2								
…								

3. The range of options varies among AIs depending on the size and complexity of their business. However, for all AIs including medium-sized AIs, recovery plans should include options for addressing capital and liquidity shortfalls. Moreover, some forms of disposal option, including the disposal of part or even all of an institution or its assets should be included in the AI's recovery plan.

4. Specifically, for medium-sized AIs with relatively fewer and simpler businesses, the recovery options will tend to be less complex and easier to implement. For example, a possible recovery option might be a restriction on new business activities.

Penalties for committing an offence relating to recovery planning

5. The proposed new Part XIIA seeks to introduce recovery planning requirements that are part of prudential regulatory requirements of the HKMA. In formulating the offence provisions under Part XIIA, we have made reference to the Banking Ordinance, which contains similar prudential regulatory requirements, and the Financial Institution (Resolution) Ordinance ("FIRO"), which establishes a cross-sectoral resolution regime for financial institutions across banking, insurance as well as the securities and futures sectors in line with the Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions. The offence provisions under Part XIIA are broadly in line with those under the two Ordinances.

6. We are of the view that the proposed penalties for committing an offence under the new proposed Part XIIA are commensurate with the seriousness of the offence, taking into account that an AI's non-compliance with the requirements under Part XIIA could materially affect the financial health of the AI and have adverse impacts on the stability of the financial system in Hong Kong. It should also be noted that the offence provisions specifically provide that an offence might only be committed if the non-compliance is "without reasonable excuse".

7. With respect to the offence provisions relating to recovery planning requirements in other comparable jurisdictions, a summary table prepared on the basis of publicly accessible information is at **Appendix**. It indicates that while a range of approaches has been adopted by other jurisdictions, each approach reflects the local specificities in the jurisdictions. Similar to the case in Hong Kong, the penalty levels vary depending on the seriousness of the offence.

Notification of recovery planning requirements by the Monetary Authority ("MA")

8. Under the new Part XIIA, the MA should notify the AI of requirements or directions in relation to recovery planning by notice in writing (see new sections 68C(1), 68D(1), 68E(2) and 68F(2)). The AI and its senior management, board and directors (including independent non-executive directors) will be made aware of the MA's recovery planning requirements through the AI's established internal communication mechanisms.

9. The MA's guidance to AIs on recovery planning covers governance structure and oversight to ensure that senior management and the board of directors are appropriately informed about an AI's recovery plan. The MA's guidance also specifies that responsibilities for the development, review, approval and the ongoing maintenance should be clearly assigned within an AI. These are in line with the Financial Stability Board's requirements, which states that AIs' should have a robust governance structure which includes "clear responsibilities of business units, senior managers up to and including board members, and identifying a senior level executive responsible for ensuring the firm is and

remains in compliance" with recovery plans.[1]

10. With respect to an AI's board and its non-executive directors, the MA's guidance also sets out the expected level of the board's engagement on recovery planning. Specifically, an AI's board is expected to review and approve the AI's recovery plan at the time of its initial formulation, and thereafter at least on an annual basis. The HKMA considers it essential that all members of the AI's board understand how the AI's recovery plan can be effectively deployed as a management tool to restore financial viability in a crisis. It is expected that a trigger event should always be brought to the attention of an AI's board, which should also be informed of the corresponding course of action determined by senior management and the relevant board committee.

11. Moreover, it is the general practice of the HKMA to maintain an ongoing dialogue with AIs on its prudential requirements, including the recovery planning requirements. This includes engaging in discussions with the board or senior management on the AI's regulatory requirements including recovery plan requirements as necessary. If appropriate, such engagement may also extend to the AI's directors.

Requirements imposed on persons responsible for implementing the recovery plan

12. The HKMA does not impose any specific requirement or restriction on directors or persons in the context of recovery planning. Instead, a recovery plan is a management tool "owned" by an AI, and it follows that the AI itself is best placed to assign appropriate personnel responsible for implementing the recovery plan, and impose any associated requirements/restrictions on the personnel as the AI deems appropriate.

13. More generally, however, the HKMA has issued guidance on corporate governance of locally-incorporated AIs, which sets out the minimum standards the HKMA expects locally-incorporated AIs to adopt in respect of their corporate governance as a whole. This includes the expectation on the board of an AI to ensure that appropriate succession plans are in place for senior management, to actively engage in the succession plans for the chief executive and other key senior executives as appropriate, as well as to manage the associated risks in a range of possible scenarios.

Commitments of major shareholders of an AI under severe stress

14. As noted above, a recovery plan is a management tool "owned" by an AI. As such the HKMA does not mandate specific recovery options in an AI's recovery plan. Whilst issuance of capital instruments (including shares) at short notice is generally deemed as one of the recovery options which an AI may consider, this does not envisage a "mandatory" or a "pre-committed" investment by major shareholders of the AI. That said, in a severe stress scenario, existing investors of the AI would have the greatest incentive to invest as they have a direct interest

[1] Paragraph 1.18 of I-Annex 4 of the Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions.

in the financial soundness and viability of the AI.

Technical comments by the banking industry during consultation

15. The banking industry was generally supportive of the proposed amendments. Meanwhile, it raised a number of comments in respect of the proposals for implementing the recovery planning requirements and the exposure limits framework.

16. On recovery planning, the industry suggested that the MA should (i) take into consideration what had been developed by branches of overseas-incorporated AIs and locally incorporated AIs (that are part of the overseas banking group) in terms of its group recovery plan; and (ii) review the coverage of the term "revised plan". The industry also sought clarifications from the MA on (i) the reliance on group recovery plans which local branches of foreign incorporated banks should be allowed to place; and (ii) the process for the MA to issue a notice in writing for the imposition of requirements on an AI's recovery plans.

17. On exposure limits framework, the industry suggested modernising certain definitions and large exposure limits to keep pace with market developments, as well as ways to apply certain large exposures standards locally, such as to relieve smaller AIs from monitoring exposures on the basis of a group of linked counterparties. They also sought clarification on certain technical terms and implementation details, such as the scope of aggregation of limits under the exposure limits regime.

18. The industry's comments have been taken into consideration in the formulation of the Bill, and clarifications have been made as appropriate.

Measures included in the recovery plan

19. It is not envisaged that the implementation of an AI's recovery plan would adversely affect the general public. Indeed, a key objective of recovery planning is that AIs can manage their operations on a business-as-usual basis. Moreover, recovery options are designed to restore an AI's viability, thereby avoiding the potential transmission of contagion to other AIs or to the wider financial system. Consequently, the development of recovery plan will promote the stability and effective working of the banking system.

20. Since recovery plans are prepared and managed by AIs, it is the responsibility of each AI to devise and propose what it considers to be the optimal approach for covering its operations and related entities in its recovery plan. Common examples of recovery options include:

- selling or disposing of part (e.g. business units or subsidiaries) or all of an AI's business and assets;
- issuance of capital instruments at short notice;
- measures to secure additional liquidity from existing new sources;
- debt exchanges and voluntary restructuring of liabilities;

- lowering or suspending dividends and payment of variable remuneration; and
- restricting new business activities.

21. The above are examples of possible courses of action that an AI might feasibly take in a range of severe stress situations. Considering that recovery options need to be feasible, credible and material enough to substantially preserve or restore AIs' liquidity and capital level in a timely fashion, options involving retail customers are unlikely to be considered the most effective recovery options. As such, it is not envisaged that the execution of these measures by an AI would impact on the general public.

22. Similarly, in view of the effectiveness in restoring an AI's capital and liquidity level under severe stress, while deleveraging capital intensive asset classes can form part of an AI's recovery plan, this is likely to be achieved by not refinancing wholesale loans on maturity or exiting trading position overtime. It is also considered highly unlikely that exercising call provisions in retail loan arrangements would be considered a recovery option that an AI would be able to utilise swiftly and effectively under severe stress to restore its capital or liquidity position.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
21 December 2017

Appendix: Comparison of selected overseas jurisdictions

Jurisdiction	USA	EU BRRD	Ireland	United Kingdom	Singapore
Responsible authority	The Office of the Comptroller of the Currency ("OCC")	N/A	Central Bank of Ireland ("CBI")	Bank of England (Prudential Regulation Authority ("PRA"))	Monetary Authority of Singapore ("MAS")
Legal basis for recovery planning	12 Code of Federal Regulations ("CFR") Part 30	Bank Recovery and Resolution Directive 2014 ("BRRD")	Central Bank and Credit Institutions (Resolution) Act 2011	PRA Rulebook and the Financial Services and Markets Act ("FSMA") 2000	Monetary Authority of Singapore (MAS) (Amendment) Bill 2017[2]
Applicability	Applies to covered banks, which are banks with average total consolidated assets of USD$50 billion or more. The civil money penalty are also applicable to institution affiliated parties, which includes, amongst other parties, any director, officer, employee or controlling stockholder of or agent for the bank.	Applies to all credit institutions except those subject to consolidated supervision (the latter to whom consolidating supervisor requirements apply in consolidating jurisdiction). BRRD requires Member States to implement administrative penalties and/or measures for relevant institutions that fail to draw up and maintain recovery plans as required. BRRD sets minimum harmonization requirements to be transposed by Member States into national law. Therefore administrative penalties are not set specifically, but a minimum list of penalties/measures is set out per below.	Applies to a director, manager, secretary or other officer of the authorised credit institution as well as the authorised credit institution.	Applies to all PRA-authorised persons except those subject to consolidated supervision (the latter to whom consolidating supervisor requirements apply in consolidating jurisdiction). Also applies to certain UK-incorporated parents of UK authorised persons subject to consolidated supervision by a different supervisor in the European Economic Area (i.e. not the PRA).	Applies to "pertinent financial institutions" as set out in section 30AAK of the MAS Act. The term means "any person who is approved, authorised, designated, recognised, registered, licensed or otherwise regulated by the [MAS] under [the MAS Act] or any of the written laws set out in the Schedule".
Extract or summary of offence provisions	Refer to Section 39 of the Federal Deposit Insurance Act (FDIA), 12 USC 1831p-1. If a covered bank fails to meet a standard prescribed by the guidelines, the OCC may	Refer to Article 111 of the BRRD, which states that: 1. Member States shall ensure that their laws, regulations and administrative provisions provide for penalties and other	Refer to Section 94.— "(1) An authorised credit institution that fails to comply with a direction under this Part commits an offence and is liable –	While no fixed penalties are established, provision confers discretion on the regulator to impose a penalty of such amount as it considers appropriate.	Refer to new division 2 of Part IVA Clause 12: "The principal Act is amended by inserting, immediately after section 41, the following Division: "Division 2 —

[2] Please note that the 2017 reforms were passed by the Singaporean Parliament in July 2017 and will commence operation on a date to be appointed. The MAS (Amendment Bill) Bill also provides for renumbering of the MAS Act, the main legislation for the Monetary Authority of Singapore. Therefore, certain references in this summary table will be referring to previous numbering of the MAS Act.

Jurisdiction	USA	EU BRRD	Ireland	United Kingdom	Singapore
	require the covered bank to submit a plan specifying the steps it will take to comply with the standard. The OCC may issue an order enforceable under section 8 of the FDIA, 12 USC 1818(b), if a covered bank, after being notified that it is in violation of a standard, fails to submit an acceptable compliance plan or fails materially to comply with an OCC-approved plan. Orders are formal, public documents, and the OCC may enforce them in Federal district court. The OCC may also assess a civil money penalty, pursuant to 12 USC 1818, against any bank that fails to comply with any final order and against any institution-affiliated party who participates in such noncompliance. The civil money penalty comprises of three tiers of escalating daily civil money penalties ("First Tier", "Second Tier" and "Third Tier"). The civil money penalty is applicable to both the covered bank and any institution-affiliated party. For example, the Third Tier civil money penalty applies the maximum amounts of penalties, and provides that any covered	administrative measures at least in respect of the following situations: (a) failure to draw up, maintain and update recovery plans and group recovery plans, infringing Article 5 or 7. 2. Member States shall ensure that, in the cases referred to in paragraph 1, the administrative penalties and other administrative measures that can be applied include at least the following: (a) a public statement which indicates the natural person, institution, financial institution, Union parent undertaking or other legal person responsible and the nature of the infringement; (b) an order requiring the natural or legal person responsible to cease the conduct and to desist from a repetition of that conduct; (c) a temporary ban against any member of the management body or senior management of the institution or the entity referred to in point (b), (c) or (d) of Article 1(1) or any other natural person, who is held responsible, to exercise functions in institutions or entities referred to in point (b), (c) or (d) of Article 1(1);	(a) on summary conviction, to a class A fine (€5,000), or (b) on conviction on indictment, to a fine not exceeding €10,000,000. (2) If an offence under this section is committed by an authorised credit institution, and is proved to have been committed with the consent or connivance, or to be attributable to any wilful neglect, of a person who, when the offence is committed, is – (a) a director, manager, secretary or other officer of the authorised credit institution or a person purporting to act in that capacity, or (b) a member of the committee of management or other controlling authority of the authorised credit institution or a person purporting to act in that capacity, that person is taken to have also committed an offence and may be proceeded against and punished in accordance with subsection (3). (3) A person referred to in subsection (2) is liable – (a) on summary conviction, to a class A fine (€5,000) or to imprisonment for a term not exceeding 12 months, or both,	Section 205 of FSMA (Public censure) If the appropriate regulator considers that an authorised person has contravened a relevant requirement imposed on the person, it may publish a statement to that effect. Section 206 FSMA (Financial penalties) (1) If the appropriate regulator considers that an authorised person has contravened a relevant requirement imposed on the person, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate. Section 206A of FSMA (Suspending permission to carry on regulated activities etc) (1) If the appropriate regulator considers that an authorised person has contravened a relevant requirement imposed on the person, it may – (a) suspend, for such period as it considers appropriate, any permission which the person has to carry on a regulated activity; or (b) impose, for such period as it considers appropriate, such limitations or other restrictions	Recovery and resolution planning "Offences under this Division section 48 – (1) A pertinent financial institution that does not comply with a direction or notice of the Authority under this Division shall be guilty of an offence and shall be liable on conviction to a fine not exceeding SGD$250,000 and, in the case of a continuing offence, to a further fine not exceeding SGD$25,000 for every day or part of a day during which the offence continues after conviction. (2) A pertinent financial institution that, in purported compliance with a direction or notice under this Division, knowingly or recklessly furnishes to the Authority any information or document that is false or misleading in a material particular, shall be guilty of an offence and shall be liable on conviction to a fine not exceeding SGD$250,000."

Jurisdiction	USA	EU BRRD	Ireland	United Kingdom	Singapore
	bank "who knowingly commits any violation; engages in any unsafe or unsound practice in conducting the affairs of such depository institution; breaches any fiduciary duty; knowingly or recklessly causes a substantial loss to such depository institution or a substantial pecuniary gain or other benefit to such party by reason of such violation, practice, or breach shall forfeit and pay a civil penalty in an amount not to exceed the applicable maximum amount determined for each day during which such violation, practice, or breach continues". Under the Third Tier, the maximum daily amount of penalty in the case of any person other than an insured depository institution should not exceed USD$1,000,000; and in the case of any insured depository institution, an amount not to exceed the lesser of USD$1,000,000; or 1 percent of the total assets of such institution.	(d) in the case of a legal person, administrative fines of up to 10 % of the total annual net turnover of that legal person in the preceding business year. Where the legal person is a subsidiary of a parent undertaking, the relevant turnover shall be turnover resulting from the consolidated accounts of the ultimate parent undertaking in the preceding business year; (e) in the case of a natural person, administrative fines of up to EUR 5,000,000, or in the Member States where the Euro is not the official currency, the corresponding value in the national currency on 2 July 2014; and (f) administrative fines of up to twice the amount of the benefit derived from the infringement where that benefit can be determined.	or (b) on conviction on indictment, to a fine not exceeding €10,000,000 or to imprisonment for a term not exceeding 5 years, or both."	in relation to carrying on of a regulated activity by the person as it consider appropriate. Separate provisions under FSMA give the PRA the same censure and penalty powers in respect of certain UK parent undertakings of UK authorised persons where a relevant requirement has been contravened. **Senior Managers Regime** Delivery of a recovery plan is also a prescribed responsibility under the Senior Managers Regime [3] which means that there should be a named executive at each firm that is accountable for the recovery plan and resolution pack and for overseeing the internal processes regarding their governance. The PRA will hold the executives accountable for the quality of the recovery plan, for the plan being structured so as to be usable by senior executives and board members in a stress, for making improvements to the recovery plan (including in response to the PRA's feedback) and for the firm's engagement with the PRA on recovery planning issues. The executive held accountable may be subject to any of the enforcement actions described	

[3] Scope of Senior Managers Regime applies to banks (including building societies, credit unions, PRA-designated investment firms and UK branches of foreign banks).

Jurisdiction	USA	EU BRRD	Ireland	United Kingdom	Singapore
				above (censure, penalty, suspension/ restriction).	