File Ref: B&M/2/1/29/4/1C(2018)

LEGISLATIVE COUNCIL BRIEF

Financial Institutions (Resolution) Ordinance (Chapter 628)

FINANCIAL INSTITUTIONS (RESOLUTION) (LOSS-ABSORBING CAPACITY REQUIREMENTS – BANKING SECTOR) RULES

Inland Revenue Ordinance (Chapter 112)

INLAND REVENUE (AMENDMENT) (NO.6) BILL 2018

INTRODUCTION

In relation to the implementation of loss-absorbing capacity[1] ("LAC") requirements in Hong Kong –

(a) the Monetary Authority ("MA") has made the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules ("the Rules"), at **Annex A**, pursuant to section 19(1) of the Financial Institutions Resolution Ordinance (Cap. 628) ("FIRO"); and

---

[1] Under the Rules, "loss-absorbing capacity" –
(a) in relation to a resolution entity, means external loss-absorbing capacity;
(b) in relation to a material subsidiary, means internal loss-absorbing capacity; or
(c) in relation to an entity established or incorporated outside Hong Kong, means any liabilities or other financial resources that are recognized as being eligible to count towards a requirement under a regulatory regime in a non-Hong Kong jurisdiction that corresponds to a LAC requirement (including a requirement designed to reflect the principles set out in Financial Stability Board ("FSB")'s *Principles on Loss-absorbing and Recapitalisation Capacity of global systemically important banks ("G-SIBs") in Resolution and Total Loss-absorbing Capacity ("TLAC") Term Sheet* (the "*TLAC Term Sheet*")), to the extent of that recognition.

(b) at the meeting of the Executive Council on 9 October 2018, the Council **ADVISED** and the Chief Executive **ORDERED** that, the Inland Revenue (Amendment) (No. 6) Bill 2018 ("the Bill"), at **Annex B**, should be introduced into the Legislative Council ("LegCo") to clarify the profits tax treatments for LAC debt instruments[2].

JUSTIFICATIONS

Resolution Regime in Hong Kong

2. The FIRO establishes a resolution regime for financial institutions ("FIs") in Hong Kong with systemic importance. The purpose is to forestall or mitigate, as the case may be, the risks otherwise posed by their non-viability to the stability and effective working of the financial system of Hong Kong, including the continued performance of critical financial functions. Under the FIRO, the MA, the Insurance Authority and the Securities and Futures Commission are the resolution authorities for those FIs that fall within the scope of the FIRO ("within scope FIs") and operate under their respective purviews – banking sector entities (including all authorized institutions[3] ("AIs")), insurance sector entities, and securities and futures sector entities respectively. The FIRO confers powers and imposes duties on the resolution authorities. The core powers include the application, subject to the requisite conditions being met, of five stabilization options for an orderly resolution of a non-viable within scope FI, having regard to the resolution objectives set out in the FIRO.

3. The five stabilization options under the FIRO fall into two broad categories: (a) four transfer stabilization options, whereby some or

---

[2] Under the Rules, "LAC debt instrument" means an external LAC debt instrument or an internal LAC debt instrument. An "external LAC debt instrument" and an "internal LAC debt instrument" mean an instrument that meets all the criteria respectively set out in Schedule 1 and Schedule 2 to the Rules.

[3] Under Banking Ordinance (Cap. 155), an AI means a bank, a restricted licence bank or a deposit-taking company.

all of the assets, rights or liabilities of, or securities issued by, a within scope FI, are transferred to (i) a purchaser; (ii) a bridge institution; (iii) an asset management vehicle; and/or (iv) (as a last resort) a temporary public ownership company; and (b) the bail-in stabilization option, whereby certain liabilities issued by a within scope FI are written down or converted into equity so as to reduce the issuer's debt, thereby absorbing losses and recapitalizing the within scope FI. The availability of sufficient LAC instruments issued by within scope FIs is an essential prerequisite to the effective application of the bail-in stabilization option. LAC can also support the orderly resolution of a non-viable within scope FI where a transfer stabilization option has been applied to move some or all of the assets, rights or liabilities of, or securities issued by, that within scope FI to a transferee[4].

LEGISLATIVE PROPOSAL

The Rules

4. Section 19 of the FIRO empowers each of the three resolution authorities to prescribe LAC requirements for within scope FIs and their group companies[5] under their auspices. Taking into account the size, systemic importance, level of concentration and scale of critical financial functions of Hong Kong's banking sector, we consider that priority should be given to AIs in the development of LAC requirements. This is also necessary in keeping with the development of international guidelines on LAC for banks, in particular the FSB's guidance on LAC as set out in its *TLAC Term Sheet*.

---

[4] LAC can support an orderly resolution in which one or more transfer stabilization options are applied as the LAC instruments could be (a) written down or converted into equity to absorb losses and (re)capitalize the non-viable within scope FI or its transferee; or (b) written down to absorb losses in the residual FI ahead of other liabilities in liquidation alongside the application of a transfer stabilization option.

[5] According to section 2(1) of the FIRO, in relation to an FI, group companies mean body corporates that are (or, but for the performance of a function by a resolution authority or a non-Hong Kong resolution authority, would be) members of the same group of companies as the FI.

5. The Rules will prescribe LAC requirements for AIs and their group companies, under which they will be required to maintain minimum levels of LAC, which can be used to absorb losses and provide recapitalisation resources to facilitate orderly resolution should the relevant AI cease, or become likely to cease, to be viable.

6. To be specific, the Rules will provide that where a resolution strategy envisages the application of one or more stabilization options to an AI, a holding company of an AI or an affiliated operational entity ("AOE")[6] of an AI, which in each case is incorporated in Hong Kong, the MA may classify that entity as a "resolution entity". A resolution entity must meet a LAC requirement with external LAC instruments that are issued to an entity outside its resolution group ("external LAC requirement"). External LAC instruments can be used in resolution to absorb losses experienced by a resolution entity and provide recapitalization resources to such entity.

7. The Rules will also provide that the MA may classify an AI, a holding company of an AI or an AOE of an AI, which in each case is incorporated in Hong Kong, that is in a resolution group (or overseas equivalent) but is not itself a resolution entity as a "material subsidiary". A material subsidiary must meet a LAC requirement with internal LAC instruments that are issued, directly or indirectly, to the resolution entity in the material subsidiary's resolution group ("internal LAC requirement"). Internal LAC instruments can be contractually written down or converted into equity in case of the non-viability of a material subsidiary, thereby passing losses up to the resolution entity in its resolution group and restoring the material subsidiary to viability without it having to go into resolution itself.

8. The Rules will specify certain qualifying criteria to be met in order for an instrument to count towards meeting an external/internal LAC requirement, and such qualifying criteria will be closely aligned with those set out in FSB's *TLAC Term Sheet*.

---

[6] Under the FIRO, an AOE, in relation to a within scope FI, means a body corporate that is a group company of the FI and that provides services, directly or indirectly, to the FI.

9. Under the Rules, a resolution entity's minimum external LAC requirement is two times its minimum regulatory capital requirement, subject to any variations that may be made by the MA in light of an entity's particular circumstances. A material subsidiary's minimum internal LAC requirement is proposed to be scaled in the range of 75% to 100% of the external LAC requirement to which the material subsidiary would be subject to were it a resolution entity. Resolution entities and material subsidiaries must meet their relevant LAC requirements within 24 months of being classified as resolution entities or material subsidiaries, as the case may be. In addition, where a resolution entity or a material subsidiary is part of a G-SIB group that is required to meet TLAC requirements from 1 January 2019 under FSB's *TLAC Term Sheet*, it will be required to meet LAC requirements based on the FSB "floors"[7] within three months of being classified as a resolution entity or a material subsidiary.

10. LAC instruments consist of: (a) regulatory capital instruments (namely Common Equity Tier 1 ("CET1") capital instruments, Additional Tier 1 ("AT1") capital instruments and Tier 2 ("T2") capital instruments)[8]; and (b) other LAC-eligible liabilities. The loss-absorbing characteristics of AT1 capital instruments, T2 capital instruments and other LAC-eligible liabilities (collectively "LAC debt instruments") make it difficult to assess the likelihood and quantum of potential losses in advance, rendering these instruments unsuitable for retail investors. It is proposed that AIs which issue LAC debt instruments should be subject to appropriate restrictions in the sale and marketing of the instruments. In particular, for an instrument to be eligible as a LAC debt instrument, primary issuance of such instrument in Hong Kong needs to be limited to Professional Investors[9] only.

---

7 Under the FSB TLAC Term Sheet, the "floors" are set as 16% of risk-weighted amount or 6% of the Basel III leverage ratio denominator, whichever is higher.

8 Regulatory capital instruments are generally eligible as LAC instruments under the Rules, the principal exception being those with remaining maturity of less than one year.

9 As defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571).

11. The Rules also contain provisions requiring that: (a) where an entity that is subject to a LAC requirement holds LAC instruments issued by another entity, the amount of that holding should be deducted from its own capital or LAC resources when determining whether it meets any minimum capital or LAC requirements of its own[10]; (b) unless varied by the MA in light of an entity's particular circumstances, at least one-third of any LAC requirement must be met with relevant LAC debt instruments (i.e. cannot be fully met with CET1 capital instruments); and (c) relevant entities must periodically disclose to the general public details of their LAC issuance.

Amendments to the Inland Revenue Ordinance (Cap. 112) ("the Ordinance")

LAC debt instruments

12. Unlike CET1 capital instruments (which are equity in nature), LAC debt instruments are hybrid in nature. While their legal form is debt-like, LAC debt instruments have an equity-like loss-absorbing feature as they can be converted into equity, or be written down, to absorb losses at the point of non-viability of the relevant AI (which is the issuer itself or, where the issuer is not an AI, the principal AI to which the issuer is related). Their hybrid nature raises questions about their tax treatment, in particular whether they are eligible for debt-like tax treatment under the Ordinance.

13. To address this uncertainty in respect of AT1 capital instruments and T2 capital instruments issued by AIs under the regulatory capital regime, the Ordinance was amended in 2016 to provide debt-like tax treatment for these instruments. Other LAC-eligible liabilities were not covered in the previous amendment exercise since the FIRO and the Rules were not in place then. Therefore, it is now necessary to amend the Ordinance to remove tax uncertainty over other LAC-eligible liabilities with a view to facilitating the implementation of the Rules.

---

[10] Note that it is proposed that deductions from capital resources under item (a) will be set out in the Banking (Capital) Rules (Cap. 155L), not in the Rules, to the extent that they apply to AIs.

14. An AI incorporated outside Hong Kong may issue instruments under a LAC-equivalent requirement of a non-Hong Kong jurisdiction. We consider that these instruments should be afforded the same tax treatment. This is consistent with the approach taken and reflected in the existing provisions of the Ordinance in respect of AT1 capital instruments and T2 capital instruments under the regulatory capital regime, in the sense that capital instruments which are qualified as AT1 capital instruments or T2 capital instruments under the Banking (Capital) Rulesor non-Hong Kong equivalent regulatory requirements are afforded the same tax treatment.

Entities to be afforded the proposed tax treatment

15. The MA may devise a resolution strategy for any AI within scope. Depending on the circumstances, the preferred strategy may be for LAC debt instruments to be issued by a Hong Kong incorporated AOE or a Hong Kong incorporated holding company[11] ("Holding Company") of a Hong Kong incorporated AI, in addition to or in the stead of the AI, to external investors or a non-Hong Kong group company. Under the existing provisions of the Ordinance, there are different tax treatments for interest expenses incurred by entities which fall within the definition of "financial institution" under section 2(1) of the Ordinance, such as AIs, and those that do not, such as an AOE or a Holding Company[12] of an AI. Consequently, any distributions in respect of a LAC debt instrument issued by an AOE or a Holding Company of an AI, even if they are treated as interest expenses, will be subject to more stringent rules for interest deductibility than those in respect of a LAC debt instrument issued by an AI.

---

[11] For a holding company to be afforded the proposed tax treatment, it has to be a "clean HK holding company", as defined under the Rules, which, amongst others, satisfies the following: (a) it is a holding company incorporated in Hong Kong of a Hong Kong-incorporated AI; (b) it is not itself an AI; and (c) its activities are limited to (i) issuing funding instruments; (ii) holding funding instruments issued by its subsidiaries; and (iii) any related ancillary activities.

[12] A Holding Company is not a financial institution if it is not itself an AI or an "associated corporation" (as defined in section 2(1) of the Ordinance) of an AI which would have been liable to be authorized as a deposit-taking company or restricted licence bank but for certain exemptions under the Banking Ordinance.

16. We propose to amend the Ordinance to provide certainty of tax treatment for LAC debt instruments and to create a level playing field for different entities within a banking group and different banking groups in relation to interest expenses deduction for LAC debt instruments, irrespective of whether such instruments are issued by an AI or its AOE or Holding Company.

Proposed tax treatment for LAC debt instruments under the Ordinance

17. Under the proposed amendments, the following instruments will be treated as debts for profits tax purposes (i.e. the same profits tax treatment currently afforded to AT1 capital instruments or T2 capital instruments issued by AIs):

(a) LAC debt instruments issued by AIs, excluding AT1 capital instruments and T2 capital instruments (which have already been afforded the benefit from debt-like tax treatment);

(b) all LAC debt instruments issued by an AOE or clean Holding Company of an AI; and

(c) all instruments issued by a non-Hong Kong incorporated AI under a LAC-equivalent requirement of a non-Hong Kong jurisdiction.

18. To provide a level playing field for different entities within a banking group and different banking groups, interest payable by an AOE or a clean Holding Company of an AI in respect of all LAC debt instruments issued by the AOE or clean Holding Company will be allowable for deduction (i.e. the same profits tax treatment currently afforded to interest payable by AIs).

19. To uphold the tax symmetry, interest, gains or profits received by or accrued to an AI or its AOE or clean Holding Company from all LAC debt instruments will be deemed trading receipts and hence be chargeable to profits tax. This would extend the current treatment for interest, gains or profits derived from AT1 capital instruments and T2 capital instruments received by or accrued to an AI to all LAC debt

instruments and to that received by or accrued to an AOE or clean Holding Company of an AI.

20. An AOE or a clean Holding Company of an AI will not be eligible to be a qualifying corporate treasury centre ("CTC") for the purpose of profits tax concession, and would be carved out from the CTC regime. This is on par with the current treatment for the Hong Kong banking industry (i.e. FIs (including AIs) are not eligible to be qualifying CTCs).

Anti-avoidance provisions

21. The same set of constraints and anti-avoidance provisions currently applicable to interest expenses deduction by AIs in respect of AT1 capital instruments and T2 capital instruments will be applicable to the LAC debt instruments proposed to be covered by the Bill. These include:

(a) application of the arm's length principle to ensure that the chargeable profits from a transaction of LAC debt instruments between an AI or its AOE or Holding Company and its associate will be assessed by reference to the amount of profits that would have accrued had the same transaction been carried out at arm's length terms between parties who are not associated; and

(b) restrictions and conditions on deduction for sums payable in respect of a LAC debt instrument issued to or for the benefit of, or held by or for the benefit of, a specified connected person of the issuer.

22. We have taken the opportunity to clarify the policy intent that section 17D of the Ordinance should be applicable to "specified connected persons" as defined in section 17D of the Ordinance (i.e. fair value accounting, any write-down or write-up of the paid-up amount and any conversion to equity should be disregarded in ascertaining profits in respect of a specified connected person of the issuer of a regulatory capital security). Under the current provisions, section 17D cannot operate effectively because any connected person who is chargeable to

tax in Hong Kong would be excepted by virtue of subsection (6)(a). In other words, no specified connected person is chargeable to tax in Hong Kong and subject to section 17D. Amendments are proposed to properly reflect the policy intent.

Related transactions for stamp duty purpose

23. We propose to exempt the transfer of LAC debt instruments from stamp duty under the Stamp Duty Ordinance (Cap. 117) ("SDO"). As a result of amending the definition of "regulatory capital security" under the Ordinance, transfers of all LAC debt instruments will be exempt from stamp duty under the SDO. This would extend the current stamp duty treatment for transfers of AT1 capital instruments and T2 capital instruments to all LAC debt instruments.

THE RULES

24. The main provisions of the Rules are as follows –

(a) **Part 1** provides for commencement, sets out definitions of terms used in the Rules, and provides for the resolution authority to notify a classifiable entity (an entity that can be classified as a resolution entity or material subsidiary) of the preferred resolution strategy covering that entity (Rules 1 to 3);

(b) **Part 2** empowers the resolution authority to classify a classifiable entity as a resolution entity or a material subsidiary, and in certain circumstances to vary the entity's LAC consolidation group (Rules 4 to 7). Part 2 also sets out the procedure for such classification or variation (Rule 8). In addition, Part 2 contains a provision requiring a resolution entity or material subsidiary to notify the resolution authority of changes to its LAC consolidation group including changes to the principal activities of group members (Rule 9);

(c) **Part 3** sets out the relevant external and internal LAC ratios for a resolution entity and a material subsidiary respectively (Rules

10 to 13), and describes how these LAC ratios are calculated on a solo, solo-consolidated or consolidated basis (Rules 14 to 17);

(d) **Part 4** provides for determination of minimum LAC ratios and it includes the following –

(i) **Division 1** sets out a resolution entity's capital component ratio and resolution component ratio, which are used to determine the minimum external LAC ratios for the entity (Rules 18 and 19). The Division empowers the resolution authority to vary either or both of these ratios in certain circumstances, sets out the procedure for the variation, and provides that the resolution entity may apply for a review of a variation decision of the resolution authority (Rule 20);

(ii) **Division 2** establishes the minimum external LAC ratios for a resolution entity, by reference to the entity's capital component ratio and resolution component ratio. Both minimum ratios may be varied in some circumstances if the resolution entity is a G-SIB (Rules 21 to 22);

(iii) **Division 3** establishes the minimum internal LAC ratios for a material subsidiary, which are the modelled minimum external LAC ratios for the subsidiary multiplied by its internal LAC scalar (Rules 23 to 24). Rule 25 sets out how a material subsidiary's modelled minimum external LAC ratios are calculated and rule 26 sets the internal LAC scalar at 75%, subject to the power of the resolution authority to increase this figure in certain circumstances, using the procedure set out in Rule 27;

(iv) **Division 4** sets out the requirements on resolution entities and material subsidiaries to maintain their minimum LAC ratios at all times after the relevant period, which is generally a period of 24 months following their classification as a resolution entity or material subsidiary

(unless that period is extended by the resolution authority). The minimum LAC ratios must be met on a consolidated basis with reference to the entity's LAC consolidation group. If the entity is an AI, the minimum LAC ratios must also be met on a solo or solo-consolidated basis, adjusted by the entity's solo LAC scalar. (Rules 28, 29 and 31). Rule 30 sets out how the solo LAC scalar is determined. Rule 32 imposes further LAC ratio requirements on certain G-SIBs;

(v) **Division 5** sets out the minimum LAC debt requirements for resolution entities and material subsidiaries (Rules 33 and 34). The Division also empowers the resolution authority to reduce the minimum LAC debt requirement in certain circumstances (Rule 35);

(vi) **Division 6** provides for the suspension of LAC requirements following certain occurrences (Rule 36);

(e) **Part 5** sets out how LAC is calculated for the purposes of the Rules, including the items that are to be included in a resolution entity's / material subsidiary's external LAC / internal LAC (Rules 37 and 39) and the items that are to be deducted from the entity's / subsidiary's external LAC / internal LAC (Rules 38 and 40). The resolution authority is empowered to require a resolution entity or material subsidiary to provide evidence that items claimed to form part of its LAC meet the necessary requirements (Rule 41). The resolution authority is empowered to require a resolution entity or material subsidiary not to include, or to discontinue the inclusion of, any specified items in the calculation of its LAC (Rule 42), using the procedure set out in Rule 43. A resolution entity or material subsidiary, with the approval of the resolution authority, is allowed to use a revised methodology for calculating its LAC (Rule 44);

(f) **Part 6** imposes disclosure requirements on resolution entities and material subsidiaries in relation to their LAC. Rules 47

to 51 set out the required subject matter that must be disclosed and the frequency of disclosure. Rule 52 sets out how disclosures are to be made and rule 53 sets out the timing for disclosures. Further disclosure requirements in rules 54 to 59 also provide for group disclosures, disclosures on internet websites, verification of matters disclosed and how proprietary or confidential information is handled;

(g) **Part 7** provides that an entity that is subject to a requirement under the Rules must notify the resolution authority if the entity fails to comply or becomes aware that it is likely to fail to comply with the requirement (Rule 60). Part 7 also deals with remedial action. Rule 61 empowers the resolution authority to require an entity that contravenes the Rules to take specified remedial action to remedy the contravention. Rule 62 sets out the procedure for requiring remedial action, including the right of the entity to apply for a review of the resolution authority's decision to require remedial action;

(h) **Part 8** sets out the procedure for applying to the Resolvability Review Tribunal for a review of a reviewable decision made by the resolution authority and sets out the Tribunal's powers and procedure on a review (Rules 63 and 64);

(i) **Schedule 1** sets out the criteria that must be met by an instrument in order to qualify as an external LAC debt instrument for inclusion in a resolution entity's external LAC;

(j) **Schedule 2** sets out the criteria that must be met by an instrument in order to qualify as an internal LAC debt instrument for inclusion in a material subsidiary's internal LAC;

(k) **Schedule 3** sets out how deductions are to be made from the LAC of a resolution entity or material subsidiary in relation to holdings of its own non-capital LAC liabilities; and

(l) **Schedule 4** sets out how deductions are to be made from the LAC of a resolution entity or material subsidiary in relation to

holdings of other entities' non-capital LAC liabilities.

THE BILL

25. The main provisions of the Bill are as follows –

(a) **Clause 3** amends section 2 of the Ordinance to add the definitions of "banking LAC requirement" and "LAC banking entity" to that section. In particular, "LAC banking entity" is defined as an HK AOE or clean HK holding company within the meaning of the Rules, that is required to meet a requirement in respect of LAC under those Rules;

(b) **Clauses 4 and 5** amend sections 14D and 14F of the Ordinance respectively so that a LAC banking entity is not eligible to be a qualifying CTC for the purpose of profits tax concession;

(c) **Clause 6** amends section 15 of the Ordinance to add new sections 15(1)(ib) and (lb) to deem the following sums as trading receipts –

(i) certain sums received by or accrued to a LAC banking entity by way of interest in respect of a regulatory capital security;

(ii) certain sums received by or accrued to a LAC banking entity in connection with its business from the sale or other disposal, or on the redemption, of a regulatory capital security;

(d) **Clause 7** amends section 16 of the Ordinance so that interest payable on money borrowed by a LAC banking entity by way of issuing a regulatory capital security is deductible for ascertaining chargeable profits;

(e) **Clause 8** amends section 17A of the Ordinance to amend the definitions of "fair value" and "fair value accounting", and to

expand the definition of "regulatory capital security" to include LAC debt instruments other than AT1 capital instruments and T2 capital instruments;

(f) **Clause 9** amends section 17D of the Ordinance so that it applies to a connected person of an issuer of a regulatory capital security even if the connected person is chargeable to profits tax in respect of a sum payable in respect of the security;

(g) **Clause 10** amends section 17E of the Ordinance to make it applicable to a LAC banking entity;

(h) **Clause 11** amends section 17F of the Ordinance in consequence of the amendment made to section 17D of the Ordinance; and

(i) **Clauses 12** amends section 89 of, and **clause 14** adds Schedule 47 to, the Ordinance to provide for transitional arrangements.

The existing provisions being amended are at **Annex C**.

LEGISLATIVE TIMETABLE

26. The Rules will be published in the Gazette on the same day as the Bill on 19 October 2018 and tabled at LegCo at its sitting of 24 October 2018. Subject to the completion of the negative vetting process of LegCo, the Rules will commence operation on 14 December 2018[13].

[13] As promulgated by the FSB, G-SIBs are required to meet the minimum total LAC requirements by 1 January 2019. As Hong Kong is a member jurisdiction of the FSB, it would be desirable to have the relevant LAC requirements implemented in Hong Kong, through the Rules, by then.

27. Without prejudice to the legislative process, we aim to commence the Bill, upon enactment, on or after the Rules have taken effect (i.e. on or after 14 December 2018). The legislative timetable of the Bill will be –

Publication in the Gazette	19 October 2018
First Reading and commencement of Second Reading debate	31 October 2018
Resumption of Second Reading debate, committee stage and Third Reading	to be notified

IMPLICATIONS OF THE PROPOSAL

28. The Bill is in conformity with the Basic Law, including the provisions concerning human rights. It will not affect the current binding effect of the existing provisions of the Ordinance. There are no productivity, environmental, family or gender implications, and no sustainability implications other than the economic implications set out in paragraph 30 below. There are also no civil service implications to the Government as the Inland Revenue Department will absorb the additional workload using its existing resources.

29. On financial implications, with reference to the current information provided by the Hong Kong Monetary Authority ("HKMA") concerning instruments that may be issued by the Hong Kong banking sector to meet the LAC requirements, allowing interest deduction for LAC debt instruments (excluding that for AT1/T2 instruments of AIs which are covered under the current regime) issued by AIs, AOEs and clean Holding Companies may reduce the revenue by about $1.7 billion per year, but this has not taken into account: (a) the additional revenue brought to the Government payable by investors holding such securities and carrying on a trade, profession or business in Hong Kong; and (b) reduction in sums incurred (and thus claimed as allowable expenses for profits tax assessment) by way of interest by AIs in respect of other sources of funding, e.g. deposit funding as they replace part of their funding with the issuance of LAC debt instruments. The stamp duty

foregone in respect of the relief for relevant transactions is unlikely to be significant.

30. On economic implications, the clarification of the tax treatment for all the LAC debt instruments will help facilitate banks' compliance with the relevant LAC requirements, and is conducive to their strengthening of capital positions.

PUBLIC CONSULTATION

31. The HKMA conducted a two-month public consultation (from 17 January to 16 March 2018) on the legislative proposals on LAC (including the proposed amendments to the Ordinance). The HKMA has engaged certain key stakeholders during the consultation period, and received ten submissions from AIs, industry associations, professional bodies and others. Most comments received were technical in nature. We briefed the LegCo Panel on Financial Affairs on the proposal on 3 April 2018. Members generally supported the proposal. We have considered the views received in formulating the legislative proposal and further consulted the industry on the draft text of the Rules and the Bill from 25 July to 5 September 2018. Relevant technical comments have been addressed as appropriate.

PUBLICITY

32. We will issue a press release upon the gazettal of the Rules and the Bill. A government spokesperson will be available to answer media enquiries.

BACKGROUND

33. The FIRO was enacted by LegCo in June 2016 and came into force on 7 July 2017[14]. The FIRO establishes a cross-sectoral resolution regime for within scope FIs, which is designed to meet the international standards set by the FSB in its *Key Attributes of Effective Resolution Regimes for Financial Institutions*.

ENQUIRIES

34. Enquiries should be directed to Ms. Estrella Cheung, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) at 2810 2150, or Mr. Robert Probyn, Senior Manager (Resolution Office) of HKMA, at 2878 1106.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
16 October 2018

[14] All provisions of the FIRO commenced operation on 7 July 2017 except Part 8 (sections 144 to 148), section 192 and Division 10 of Part 15 (sections 228 to 232).

Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules

Contents

Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules

(Made by the Monetary Authority under section 19(1) of the Financial Institutions (Resolution) Ordinance (Cap. 628))

Part 1

Preliminary

1. Commencement

These Rules come into operation on 14 December 2018.

2. Interpretation

(1) In these Rules—

Additional Tier 1 capital instrument (額外一級資本票據)—

(a) in relation to an instrument issued by an authorized institution, has the meaning given by section 2(1) of the Ordinance; or

(b) in relation to an instrument issued by any other entity, has the meaning it would be given by section 2(1) of the Ordinance if the entity were an authorized institution;

banking book (銀行帳)—

(a) in relation to an authorized institution, has the meaning given by section 2(1) of the Capital Rules; or

(b) in relation to any other entity, has the meaning it would be given by section 2(1) of the Capital Rules if the entity were an authorized institution;

capital adequacy ratio (資本充足比率)—

(a) in relation to an authorized institution, has the meaning given by section 3 of the Capital Rules; or

(b) in relation to any other entity, has the meaning it would be given by section 3 of the Capital Rules if the entity were an authorized institution;

capital component ratio (資本組成部分比率)—see rule 18;

capital consolidation group (資本綜合集團), in relation to an authorized institution, means the authorized institution's consolidation group within the meaning of section 4 of the Capital Rules;

Capital Rules (《資本規則》) means the Banking (Capital) Rules (Cap. 155 sub. leg. L);

CET1 capital instrument (CET1 資本票據)—

(a) in relation to an instrument issued by an authorized institution, has the meaning given by section 2(1) of the Capital Rules; or

(b) in relation to an instrument issued by any other entity, has the meaning it would be given by section 2(1) of the Capital Rules if the entity were an authorized institution;

classifiable entity (可歸類實體)—see rule 4;

classification date (歸類日期), in relation to an entity that is a resolution entity or material subsidiary, means—

(a) subject to paragraph (b), the date on which the classification of the entity as a resolution entity or material subsidiary takes effect; or

(b) if the entity has been declassified as a resolution entity or material subsidiary and later reclassified, the date on which the reclassification or, if the entity has been reclassified more than once, the latest reclassification, takes effect;

clean HK holding company (香港純控權公司) means an HK holding company—

(a) the activities of which are limited to—

(i) issuing funding instruments;

(ii) holding funding instruments issued by its subsidiaries; and

(iii) any related ancillary activities; and

(b) the liabilities of which that are none of Additional Tier 1 capital instruments, Tier 2 capital instruments or non-capital LAC debt instruments, and that, on a winding up of the company, would rank equally with, or below, any Additional Tier 1 capital instruments, Tier 2 capital instruments or non-capital LAC debt instruments, do not exceed 5% of the sum of—

(i) the company's loss-absorbing capacity; and

(ii) any items that would constitute loss-absorbing capacity but for section 1(1)(e) of Schedule 1 or section 1(1)(d) of Schedule 2;

consolidated basis (綜合基礎)—

(a) subject to paragraph (b), when used in relation to the calculation of a LAC ratio—

(i) for a resolution entity or material subsidiary that is an authorized institution, means the basis set out in rule 15 on which the institution calculates that ratio; or

(ii) for a resolution entity or material subsidiary that is an HK holding company or HK affiliated operational entity, means the basis set out in rule 16 on which the resolution entity or material subsidiary calculates that ratio; or

(b) when used in relation to the Capital Rules, unless otherwise specified, has the meaning it would have in those Rules if—

(i) a reference in those Rules to a consolidation group were a reference to a LAC consolidation group; and

(ii) in the case of an entity that is not an authorized institution, a reference in those Rules to an authorized institution were a reference to that entity;

counterparty credit risk (對手方信用風險)—

(a) in relation to an authorized institution, has the meaning given by section 2(1) of the Capital Rules; or

(b) in relation to any other entity, has the meaning it would be given by section 2(1) of the Capital Rules if the entity were an authorized institution;

exposure measure (風險承擔計量)—

(a) in relation to a resolution entity or material subsidiary that is an authorized institution—

(i) for the purpose of calculating a LAC ratio on a solo or solo-consolidated basis—means the amount of the denominator determined under rule 14(3)(a), less any contribution to the denominator in respect of—

(A) items deducted from its loss-absorbing capacity in accordance with rule 38 or 40 (as the case requires); and

(B) items deducted from Tier 2 capital in accordance with the Capital Rules; or

(ii) for the purpose of calculating a LAC ratio on a consolidated basis—means the amount of the denominator determined under rule 15(3)(a), less any contribution to the denominator in respect of—

(A) items deducted from its loss-absorbing capacity in accordance with rule 38 or 40 (as the case requires); and

(B) items deducted from Tier 2 capital in accordance with the Capital Rules; or

(b) in relation to a resolution entity or material subsidiary that is an HK holding company or HK affiliated operational entity, for the purpose of calculating a LAC ratio on a consolidated basis—means the amount of the denominator determined under rule 16(3)(a), less any contribution to the denominator in respect of—

(i) items deducted from its loss-absorbing capacity in accordance with rule 38 or 40 (as the case requires); and

(ii) items that, if the resolution entity or material subsidiary were an authorized institution, would be deducted from Tier 2 capital in accordance with the Capital Rules;

external LAC debt instrument (外部 LAC 債務票據) means an instrument that meets the qualifying criteria set out in Schedule 1;

external LAC leverage ratio (外部 LAC 槓桿比率)—see rule 11;

external LAC risk-weighted ratio (外部 LAC 風險加權比率)—see rule 10;

external loss-absorbing capacity (外部吸收虧損能力)—see rule 37;

external non-capital LAC debt instrument (外部非資本 LAC 債務票據) means an external LAC debt instrument that is not—

(a) an Additional Tier 1 capital instrument; or

(b) a Tier 2 capital instrument;

financial sector entity (金融業實體) has the meaning given by section 35 of the Capital Rules;

funding instrument (集資票據) means any of the following—

(a) a CET1 capital instrument;

(b) an Additional Tier 1 capital instrument;

(c) a Tier 2 capital instrument;

(d) a non-capital LAC debt instrument;

(e) any other debt instrument;

HK affiliated operational entity (香港相聯營運實體) means an entity that is an affiliated operational entity incorporated in Hong Kong of an authorized institution incorporated in Hong Kong, but is not itself an authorized institution or HK holding company;

HK holding company (香港控權公司) means an entity that is a holding company incorporated in Hong Kong of an authorized institution incorporated in Hong Kong, but is not itself an authorized institution;

indirect holding (間接曝險)—

(a) in relation to an authorized institution, has the meaning given by section 35 of the Capital Rules; or

(b) in relation to any other entity, has the meaning it would be given by section 35 of the Capital Rules if the entity were an authorized institution;

internal LAC debt instrument (內部 LAC 債務票據) means an instrument that meets the qualifying criteria set out in Schedule 2;

internal LAC leverage ratio (內部 LAC 槓桿比率)—see rule 13;

internal LAC risk-weighted ratio (內部 LAC 風險加權比率)—see rule 12;

internal LAC scalar (內部 LAC 純量)—see rule 26;

internal loss-absorbing capacity (內部吸收虧損能力)—see rule 39;

internal non-capital LAC debt instrument (內部非資本 LAC 債務票據) means an internal LAC debt instrument that is not—

(a) an Additional Tier 1 capital instrument; or

(b) a Tier 2 capital instrument;

LAC consolidation group (LAC 綜合集團), in relation to a resolution entity or material subsidiary, means—

(a) subject to paragraph (b)—

(i) for a resolution entity or material subsidiary that is an authorized institution—its capital consolidation group;

(ii) for a resolution entity or material subsidiary that is an HK holding company—the group consisting of the HK holding company and the capital consolidation group of its principal authorized institution; or

(iii) for a resolution entity or material subsidiary that is an HK affiliated operational entity—the group consisting of the HK affiliated operational entity and the capital consolidation group of its principal authorized institution; or

(b) if the resolution authority varies the group under rule 7, the group as varied from time to time;

LAC debt instrument (LAC 債務票據) means—

(a) an external LAC debt instrument; or

(b) an internal LAC debt instrument;

LAC instrument (LAC 票據) means—

(a) a CET1 capital instrument; or

(b) a LAC debt instrument;

LAC ratio (LAC 比率)—

(a) in relation to a resolution entity, means its external LAC risk-weighted ratio or its external LAC leverage ratio; or

(b) in relation to a material subsidiary, means its internal LAC risk-weighted ratio or its internal LAC leverage ratio;

LAC requirement (LAC 規定) means a requirement under these Rules for—

(a) a resolution entity to maintain any of its LAC ratios at or above a specified minimum; or

(b) a material subsidiary to maintain any of its LAC ratios at or above a specified minimum;

leverage ratio (槓桿比率), in relation to an authorized institution, has the meaning given by section 3Y of the Capital Rules;

loss-absorbing capacity (吸收虧損能力)—

(a) in relation to a resolution entity, means external loss-absorbing capacity;

(b) in relation to a material subsidiary, means internal loss-absorbing capacity; or

(c) in relation to an entity established or incorporated in a non-Hong Kong jurisdiction, means any liabilities or other financial resources that are recognized as being eligible to count towards a requirement under a regulatory regime in a non-Hong Kong jurisdiction that corresponds to a LAC requirement (including a requirement designed to reflect the principles set out in the TLAC term sheet), to the extent of that recognition;

material sub-group (重要子集團), in relation to a material subsidiary, means the group consisting of—

(a) the material subsidiary; and

(b) all subsidiaries of the material subsidiary;

material subsidiary (重要附屬公司) means an entity classified as a material subsidiary under rule 6;

minimum external LAC leverage ratio (最低外部 LAC 槓桿比率) means the minimum external LAC leverage ratio for a resolution entity determined under Division 2 of Part 4;

minimum external LAC risk-weighted ratio (最低外部 LAC 風險加權比率) means the minimum external LAC risk-weighted ratio for a resolution entity determined under Division 2 of Part 4;

minimum internal LAC leverage ratio (最低內部 LAC 槓桿比率) means the minimum internal LAC leverage ratio for a material subsidiary determined under Division 3 of Part 4;

minimum internal LAC risk-weighted ratio (最低內部 LAC 風險加權比率) means the minimum internal LAC risk-weighted ratio for a material subsidiary determined under Division 3 of Part 4;

minimum LAC ratio (最低 LAC 比率) means any of the following—

(a) a minimum external LAC leverage ratio;

(b) a minimum external LAC risk-weighted ratio;

(c) a minimum internal LAC leverage ratio;

(d) a minimum internal LAC risk-weighted ratio;

modelled minimum external LAC leverage ratio (模擬最低外部 LAC 槓桿比率) means the modelled minimum external LAC leverage ratio for a material subsidiary determined under rule 25;

modelled minimum external LAC risk-weighted ratio (模擬最低外部 LAC 風險加權比率) means the modelled minimum external LAC risk-weighted ratio for a material subsidiary determined under rule 25;

non-capital LAC debt instrument (非資本 LAC 債務票據) means—

(a) an external non-capital LAC debt instrument; or

(b) an internal non-capital LAC debt instrument;

non-capital LAC liability (非資本 LAC 負債) means any of the following—

(a) a liability that is constituted by a non-capital LAC debt instrument;

(b) a liability referred to in paragraph (c) of the definition of ***loss-absorbing capacity***, other than any such liability that is constituted by a regulatory capital instrument;

(c) any other liability that—

(i) is not constituted by a regulatory capital instrument; and

(ii) on a winding up of the entity owing the liability, would rank equally with, or below—

(A) a liability referred to in paragraph (a); or

(B) a liability referred to in paragraph (b) that is recognized as being eligible to count towards a requirement under a regulatory regime in a non-Hong Kong jurisdiction that corresponds to a LAC requirement other than by virtue of any provisions in such regulatory regime designed to reflect the principles set out in the antepenultimate or penultimate paragraph of section 11 of the TLAC term sheet,

excluding any such other liability that, under a relevant regulatory regime, is excluded from bearing loss in a resolution of the entity owing the liability;

non-HK resolution entity (非香港處置實體), in relation to a material subsidiary, means an entity established or incorporated in a non-Hong Kong jurisdiction where the preferred resolution strategy covering the material subsidiary contemplates the taking of a non-Hong Kong resolution action in relation to the entity;

preferred resolution strategy (首選處置策略), in relation to a classifiable entity, means—

(a) the resolution strategy notified to the entity under rule 3 as the preferred resolution strategy covering the entity; or

(b) if the resolution authority has not notified the entity under rule 3 and the entity is in the resolution group of another classifiable entity—the preferred resolution strategy notified to that other classifiable entity under that rule;

principal authorized institution (首要認可機構)—

(a) in relation to a resolution entity or material subsidiary that is an HK holding company—

(i) if it has only one subsidiary that is an authorized institution incorporated in Hong Kong—means that subsidiary; or

(ii) if it has more than one subsidiary that is an authorized institution incorporated in Hong Kong, means—

(A) subject to sub-subparagraph (B), the subsidiary authorized institution incorporated in Hong Kong that has the highest risk-weighted amount calculated on a consolidated basis with reference to its capital consolidation group under the Capital Rules; or

(B) the authorized institution designated by the resolution authority under subrule (2); or

(b) in relation to a resolution entity or material subsidiary that is an HK affiliated operational entity—

(i) if it is an affiliated operational entity of only one authorized institution incorporated in Hong Kong—means that authorized institution; or

(ii) if it is an affiliated operational entity of more than one authorized institution incorporated in Hong Kong, means—

(A) subject to sub-subparagraph (B), the authorized institution incorporated in Hong Kong that has the highest risk-weighted amount calculated on a consolidated basis

with reference to its capital consolidation group under the Capital Rules; or

(B) the authorized institution designated by the resolution authority under subrule (2);

professional investor (專業投資者) has the meaning given by section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571);

regulatory capital instrument (監管資本票據) means—

(a) a CET1 capital instrument, Additional Tier 1 capital instrument or Tier 2 capital instrument; or

(b) an instrument that counts towards a requirement under a regulatory regime in a non-Hong Kong jurisdiction that corresponds to a requirement on an authorized institution to maintain minimum capital adequacy ratios under the Capital Rules;

resolution (處置) means—

(a) resolution as defined by section 2(1) of the Ordinance; or

(b) a process in a non-Hong Kong jurisdiction of a similar nature to resolution referred to in paragraph (a);

resolution authority (處置機制當局) means the resolution authority in relation to a banking sector entity;

Note—

Under section 2(1) of the Ordinance, the resolution authority in relation to a banking sector entity is the Monetary Authority.

resolution component ratio (處置組成部分比率)—see rule 19;

resolution entity (處置實體) means an entity classified as a resolution entity under rule 5;

resolution group (處置集團), in relation to an entity that is covered by a preferred resolution strategy, means the group identified in that strategy as the resolution group of which the entity is a member;

resolution strategy (處置策略) means—

(a) a strategy devised by the resolution authority under section 13(1)(a) or (2)(a) of the Ordinance for securing an orderly resolution of a within scope financial institution or a holding company of a within scope financial institution; or

(b) a strategy of a similar nature to a strategy referred to in paragraph (a) devised or adopted by a non-Hong Kong resolution authority covering one or more group companies of a within scope financial institution;

reviewable decision (可覆核決定) means a decision of the resolution authority under these Rules that may be reviewed by the Resolvability Review Tribunal;

risk-weighted amount (風險加權數額)—

(a) in relation to a resolution entity or material subsidiary that is an authorized institution—

(i) for the purpose of calculating a LAC ratio on a solo or solo-consolidated basis—means the amount of the denominator determined under rule 14(2)(a), less any contribution to the denominator in respect of items deducted from its loss-absorbing capacity in accordance with rule 38 or 40 (as the case requires); or

(ii) for the purpose of calculating a LAC ratio on a consolidated basis—means the amount of the denominator determined under rule 15(2)(a), less any contribution to the denominator in respect of items deducted from its loss-absorbing capacity in accordance with rule 38 or 40 (as the case requires);

(b) in relation to a resolution entity or material subsidiary that is an HK holding company or HK affiliated operational entity, for the purpose of calculating a LAC ratio on a consolidated basis—means the amount of the denominator determined under rule 16(2)(a), less any contribution to the denominator in respect of items deducted from its loss absorbing capacity in accordance with rule 38 or 40 (as the case requires); or

(c) in relation to an authorized institution that is not a resolution entity or material subsidiary—means the amount of the denominator of its capital adequacy ratio as calculated under the Capital Rules on a solo basis, solo-consolidated basis or consolidated basis with reference to its capital consolidation group (as the case requires);

solo basis (單獨基礎)—

(a) in relation to calculating a capital adequacy ratio, means the basis set out in section 29 of the Capital Rules; or

(b) in relation to calculating a LAC ratio, has the meaning that results in an equivalent approach in the calculation of the LAC ratio to that set out in section 29 of the Capital Rules for the calculation of a capital adequacy ratio;

solo LAC scalar (單獨 LAC 純量)—see rule 30;

solo-consolidated basis (單獨—綜合基礎)—

(a) in relation to calculating a capital adequacy ratio, means the basis set out in section 30 of the Capital Rules; or

(b) in relation to calculating a LAC ratio, has the meaning that results in an equivalent approach in the calculation of the LAC ratio to that set out in section 30 of the Capital Rules for the calculation of a capital adequacy ratio;

solo-consolidated subsidiary (單獨—綜合附屬公司) has the meaning given by section 4 of the Capital Rules;

synthetic holding (合成曝險)—

(a) in relation to an authorized institution, has the meaning given by section 35 of the Capital Rules; or

(b) in relation to any other entity, has the meaning it would be given by section 35 of the Capital Rules if the entity were an authorized institution;

Tier 1 capital (一級資本), subject to rule 17—

(a) in relation to an authorized institution, has the meaning given by section 2(1) of the Capital Rules; or

(b) in relation to any other entity, has the meaning it would be given by section 2(1) of the Capital Rules if the entity were an authorized institution;

Tier 2 capital (二級資本), subject to rule 17—

(a) in relation to an authorized institution, has the meaning given by section 2(1) of the Capital Rules; or

(b) in relation to any other entity, has the meaning it would be given by section 2(1) of the Capital Rules if the entity were an authorized institution;

Tier 2 capital instrument (二級資本票據)—

(a) in relation to an instrument issued by an authorized institution, has the meaning given by section 2(1) of the Capital Rules; or

(b) in relation to an instrument issued by any other entity, has the meaning it would be given by section 2(1) of the Capital Rules if the entity were an authorized institution;

TLAC term sheet (《TLAC 細則清單》) means the Total Loss-absorbing Capacity (TLAC) Term Sheet issued by the Financial Stability Board on 9 November 2015;

total capital (總資本), in relation to an entity, means the sum of its Tier 1 capital and Tier 2 capital;

Total capital ratio (總資本比率)—

(a) in relation to an authorized institution, has the meaning given by section 2(1) of the Capital Rules; or

(b) in relation to any other entity, has the meaning it would be given by section 2(1) of the Capital Rules if the entity were an authorized institution and if a reference to Total capital in that section were a reference to total capital (as defined in this rule);

trading book (交易帳)—

(a) in relation to an authorized institution, has the meaning given by section 2(1) of the Capital Rules; or

(b) in relation to any other entity, has the meaning it would be given by section 2(1) of the Capital Rules if the entity were an authorized institution;

underlying exposures (組成項目)—

(a) in relation to an authorized institution, has the meaning given by section 2(1) of the Capital Rules; or

(b) in relation to any other entity, has the meaning it would be given by section 2(1) of the Capital Rules if the entity were an authorized institution.

(2) For the purposes of the definition of ***principal authorized institution*** in subrule (1), the resolution authority, by written notice served on a resolution entity or material subsidiary that is an HK holding company or HK affiliated operational entity, may designate a group company of the resolution entity or material subsidiary that is an authorized institution incorporated in Hong Kong as the principal authorized institution of the resolution entity or material subsidiary.

3. Preferred resolution strategy

The resolution authority, by written notice served on a classifiable entity, may identify a resolution strategy as the preferred resolution strategy covering the entity.

Part 2

Resolution Entities, Material Subsidiaries and LAC Consolidation Groups

4. What entities can be classified as resolution entities or material subsidiaries

(1) The following entities may be classified as a resolution entity or a material subsidiary under this Part—

(a) an authorized institution incorporated in Hong Kong;

(b) an HK holding company;

(c) an HK affiliated operational entity.

(2) For the purposes of these Rules, an entity referred to in subrule (1) is a ***classifiable entity***.

5. Resolution entities

(1) The resolution authority may, in accordance with rule 8, classify a classifiable entity as a resolution entity if there is a preferred resolution strategy covering the classifiable entity that contemplates the application of a stabilization option in respect of any assets, rights or liabilities of, or securities issued by, the classifiable entity.

(2) In determining whether to classify a classifiable entity as a resolution entity, the resolution authority may take into account—

(a) the preferred resolution strategy covering the classifiable entity; and

(b) any other matters the resolution authority considers relevant.

(3) The resolution authority, by written notice served on a resolution entity, may at any time declassify it as a resolution entity.

6. Material subsidiaries

(1) The resolution authority may, in accordance with rule 8, classify a classifiable entity as a material subsidiary if—

(a) the classifiable entity is in a resolution group but is not a resolution entity; and

(b) the resolution authority determines that the classifiable entity taken on its own, or together with any of its subsidiaries in the resolution group—

(i) contains more than 5% of the risk-weighted assets of the resolution group;

(ii) generates more than 5% of the total operating income of the resolution group;

(iii) contains more than 5% of the unweighted assets of the resolution group; or

(iv) is material to the provision of critical financial functions.

(2) The resolution authority, by written notice served on a material subsidiary, may at any time declassify it as a material subsidiary.

(3) In making a determination under subrule (1)(b), the resolution authority may draw on any information and make any assumptions the resolution authority considers appropriate, taking into account the following matters—

(a) the availability of data relating to the risk-weighted assets, total operating income and unweighted assets of

the classifiable entity and other members of the resolution group;

(b) the comparability of data referred to in paragraph (a), taking into account that the classifiable entity and other members of the resolution group—

(i) may not all be authorized institutions or be otherwise regulated in Hong Kong or in a non-Hong Kong jurisdiction; and

(ii) may not all be located in the same jurisdiction;

(c) any other matters the resolution authority considers relevant.

7. Variation of LAC consolidation groups

(1) The resolution authority may, in accordance with rule 8, vary the LAC consolidation group of a resolution entity or material subsidiary by—

(a) removing one or more subsidiaries of the resolution entity or material subsidiary from the group; or

(b) adding one or more subsidiaries of the resolution entity or material subsidiary to the group.

(2) The resolution authority may vary the LAC consolidation group of a resolution entity or material subsidiary under this rule if satisfied that it is prudent to do so.

(3) In determining whether it is prudent to vary the LAC consolidation group of a resolution entity or material subsidiary, the resolution authority may take into account—

(a) the extent to which the subsidiary to be removed or added is connected to the resolution entity or material subsidiary and the potential for the level of

connectedness to contribute to a risk of contagion between them;

(b) the preferred resolution strategy covering the resolution entity or material subsidiary; and

(c) any other matters the resolution authority considers relevant.

8. Procedure for classifying resolution entities and material subsidiaries and varying LAC consolidation groups

(1) If the resolution authority proposes to classify an entity as a resolution entity or material subsidiary, or vary the LAC consolidation group of an entity that is a resolution entity or material subsidiary, the resolution authority must serve a written notice on the entity—

(a) specifying the resolution authority's proposed classification or variation;

(b) specifying the grounds for the proposed classification or variation; and

(c) including a statement that the entity may, within 14 days (or a longer period allowed by the resolution authority), make written representations to the resolution authority on any matter specified in the notice.

(2) If representations are made in accordance with subrule (1)(c), the resolution authority, after considering the representations, may—

(a) serve a further written notice on the entity—

(i) confirming the proposed classification or variation; or

(ii) modifying the proposed classification or variation to take into account any of the representations; or

(b) decide not to make the proposed classification or variation.

(3) If no representations are made in accordance with subrule (1)(c), the resolution authority may serve a further written notice on the entity confirming the proposed classification or variation.

(4) Subject to subrule (5), the further written notice served under subrule (2)(a) or (3) has the effect of classifying the entity as a resolution entity or material subsidiary, or varying the LAC consolidation group, in accordance with its terms, on the date specified in the notice.

(5) For a variation of a LAC consolidation group that results in an increase in the amount of loss-absorbing capacity that a resolution entity or material subsidiary needs to maintain in order to meet its LAC requirements, the date referred to in subrule (4) must be at least 12 months after the date on which the further written notice is served under subrule (2)(a) or (3).

9. Notification of changes to LAC consolidation group or group activities

(1) A resolution entity must give written notice to the resolution authority of the following matters as soon as practicable after the resolution entity is aware of the matter or ought to be aware of the matter—

(a) a subsidiary ceasing to be a member of the resolution entity's LAC consolidation group, other than as a result of the resolution authority removing the subsidiary from the group under rule 7(1)(a);

(b) a subsidiary becoming a member of the resolution entity's LAC consolidation group, other than as a result

of the resolution authority adding the subsidiary to the group under rule 7(1)(b);

(c) the principal activities of a subsidiary referred to in paragraph (b);

(d) any significant change to the principal activities of the resolution entity or any of its subsidiaries (including a subsidiary referred to in paragraph (b)).

(2) A material subsidiary must give written notice to the resolution authority of the following matters as soon as practicable after the material subsidiary is aware of the matter or ought to be aware of the matter—

(a) a subsidiary ceasing to be a member of the material subsidiary's LAC consolidation group, other than as a result of the resolution authority removing the subsidiary from the group under rule 7(1)(a);

(b) a subsidiary becoming a member of the material subsidiary's LAC consolidation group, other than as a result of the resolution authority adding the subsidiary to the group under rule 7(1)(b);

(c) the principal activities of a subsidiary referred to in paragraph (b);

(d) any significant change to the principal activities of the material subsidiary or any of its subsidiaries (including a subsidiary referred to in paragraph (b)).

Part 3

LAC Ratios

Division 1—External LAC Ratios for Resolution Entities

10. External LAC risk-weighted ratio

A resolution entity's external LAC risk-weighted ratio is the ratio, expressed as a percentage, of the resolution entity's external loss-absorbing capacity to its risk-weighted amount on either a solo or solo-consolidated basis, or a consolidated basis, determined in accordance with these Rules.

11. External LAC leverage ratio

A resolution entity's external LAC leverage ratio is the ratio, expressed as a percentage, of the resolution entity's external loss-absorbing capacity to its exposure measure on either a solo or solo-consolidated basis, or a consolidated basis, determined in accordance with these Rules.

Division 2—Internal LAC Ratios for Material Subsidiaries

12. Internal LAC risk-weighted ratio

A material subsidiary's internal LAC risk-weighted ratio is the ratio, expressed as a percentage, of the material subsidiary's internal loss-absorbing capacity to its risk-weighted amount on either a solo or solo-consolidated basis, or a consolidated basis, determined in accordance with these Rules.

13. Internal LAC leverage ratio

A material subsidiary's internal LAC leverage ratio is the ratio, expressed as a percentage, of the material subsidiary's internal loss-absorbing capacity to its exposure measure on either a solo or solo-consolidated basis, or a consolidated basis, determined in accordance with these Rules.

Division 3—Solo, Solo-consolidated and Consolidated Bases for Calculating LAC Ratios

14. Solo or solo-consolidated basis for calculating LAC ratios for resolution entities or material subsidiaries that are authorized institutions

(1) This rule applies to a resolution entity or material subsidiary that is an authorized institution.

(2) In calculating its external or internal LAC risk-weighted ratio (as the case requires) on a solo or solo-consolidated basis, the resolution entity or material subsidiary must—

(a) determine the denominator of its capital adequacy ratio as calculated under the Capital Rules on a solo or solo-consolidated basis;

(b) determine its risk-weighted amount on a solo or solo-consolidated basis;

(c) determine its external or internal loss-absorbing capacity on a solo or solo-consolidated basis; and

(d) determine its external or internal LAC risk-weighted ratio in accordance with these Rules on a solo or solo-consolidated basis.

(3) In calculating its external or internal LAC leverage ratio (as the case requires) on a solo or solo-consolidated basis, the resolution entity or material subsidiary must—

(a) determine the denominator of its leverage ratio as calculated under the Capital Rules on a solo or solo-consolidated basis;

(b) determine its exposure measure on a solo or solo-consolidated basis;

(c) determine its external or internal loss-absorbing capacity on a solo or solo-consolidated basis; and

(d) determine its external or internal LAC leverage ratio in accordance with these Rules on a solo or solo-consolidated basis.

15. Consolidated basis for calculating LAC ratios for resolution entities or material subsidiaries that are authorized institutions

(1) This rule applies to a resolution entity or material subsidiary that is an authorized institution.

(2) In calculating its external or internal LAC risk-weighted ratio (as the case requires) on a consolidated basis with reference to its LAC consolidation group, the resolution entity or material subsidiary must—

(a) subject to subrule (4), determine the denominator of its capital adequacy ratio as it would be calculated under the Capital Rules on a consolidated basis with reference to its LAC consolidation group;

(b) determine its risk-weighted amount on a consolidated basis with reference to its LAC consolidation group;

(c) determine its external or internal loss-absorbing capacity on a consolidated basis with reference to its LAC consolidation group; and

(d) determine its external or internal LAC risk-weighted ratio in accordance with these Rules on a consolidated basis with reference to its LAC consolidation group.

(3) In calculating its external or internal LAC leverage ratio (as the case requires) on a consolidated basis with reference to its LAC consolidation group, the resolution entity or material subsidiary must—

(a) determine the denominator of its leverage ratio as it would be calculated under the Capital Rules on a consolidated basis with reference to its LAC consolidation group;

(b) determine its exposure measure on a consolidated basis with reference to its LAC consolidation group;

(c) determine its external or internal loss-absorbing capacity on a consolidated basis with reference to its LAC consolidation group; and

(d) determine its external or internal LAC leverage ratio in accordance with these Rules on a consolidated basis with reference to its LAC consolidation group.

(4) For the purposes of subrule (2)(a)—

(a) in determining the contribution made to the denominator of its capital adequacy ratio by exposures of any entity that—

(i) is a member of the LAC consolidation group of the resolution entity or material subsidiary but not a member of the capital consolidation group of the resolution entity or material subsidiary; and

(ii) is not an authorized institution,

the resolution entity or material subsidiary must, unless otherwise approved in writing by the resolution authority, use the methodology that would apply if that entity were an authorized institution using the prescribed approaches in relation to calculation of capital adequacy ratios referred to in Part 2 of the Capital Rules which do not require the Monetary Authority to be satisfied as to any matter, or require any consent of or consultation with the Monetary Authority under that Part; and

(b) in determining the contribution made to the denominator of its capital adequacy ratio by exposures of any entity that—

(i) is a member of the capital consolidation group of the resolution entity or material subsidiary; or

(ii) is a member of the LAC consolidation group of the resolution entity or material subsidiary but not a member of the capital consolidation group of the resolution entity or material subsidiary and that is an authorized institution,

the resolution entity or material subsidiary must, unless otherwise approved in writing by the resolution authority, use the methodology that applies to that entity under the Capital Rules in determining the contribution made to the denominator of the applicable capital adequacy ratio.

16. Consolidated basis for calculating LAC ratios for resolution entities or material subsidiaries that are not authorized institutions

(1) This rule applies to a resolution entity or material subsidiary that is—

(a) an HK holding company; or

(b) an HK affiliated operational entity.

(2) In calculating its external or internal LAC risk-weighted ratio (as the case requires) on a consolidated basis with reference to its LAC consolidation group, the resolution entity or material subsidiary must—

(a) subject to subrule (4), determine the denominator of its capital adequacy ratio as it would be calculated under the Capital Rules on a consolidated basis with reference to its LAC consolidation group if the resolution entity or material subsidiary were an authorized institution;

(b) determine its risk-weighted amount on a consolidated basis with reference to its LAC consolidation group;

(c) determine its external or internal loss-absorbing capacity on a consolidated basis with reference to its LAC consolidation group; and

(d) determine its external or internal LAC risk-weighted ratio in accordance with these Rules on a consolidated basis with reference to its LAC consolidation group.

(3) In calculating its external or internal LAC leverage ratio (as the case requires) on a consolidated basis with reference to its LAC consolidation group, the resolution entity or material subsidiary must—

(a) determine the denominator of its leverage ratio as it would be calculated under the Capital Rules on a consolidated basis with reference to its LAC consolidation group if the resolution entity or material subsidiary were an authorized institution;

(b) determine its exposure measure on a consolidated basis with reference to its LAC consolidation group;

(c) determine its external or internal loss-absorbing capacity on a consolidated basis with reference to its LAC consolidation group; and

(d) determine its external or internal LAC leverage ratio in accordance with these Rules on a consolidated basis with reference to its LAC consolidation group.

(4) For the purposes of subrule (2)(a)—

(a) in determining the contribution made to the denominator of its capital adequacy ratio by exposures of—

(i) the resolution entity or material subsidiary; or

(ii) any entity that—

(A) is a member of the LAC consolidation group of the resolution entity or material subsidiary but not a member of the capital consolidation group of the principal authorized institution of the resolution entity or material subsidiary; and

(B) is not an authorized institution,

the resolution entity or material subsidiary must, unless otherwise approved in writing by the resolution authority, use the methodology that would apply if the resolution entity or material subsidiary or that entity were an authorized institution using the prescribed approaches in relation to calculation of capital adequacy ratios referred to in Part 2 of the Capital Rules which do

not require the Monetary Authority to be satisfied as to any matter, or require any consent of or consultation with the Monetary Authority under that Part; and

(b) in determining the contribution made to the denominator of its capital adequacy ratio by exposures of any entity that—

(i) is a member of the capital consolidation group of the principal authorized institution of the resolution entity or material subsidiary; or

(ii) is a member of the LAC consolidation group of the resolution entity or material subsidiary but not a member of the capital consolidation group of the principal authorized institution of the resolution entity or material subsidiary and that is an authorized institution,

the resolution entity or material subsidiary must, unless otherwise approved in writing by the resolution authority, use the methodology that applies to that entity under the Capital Rules in determining the contribution made to the denominator of the applicable capital adequacy ratio.

17. Consolidated basis for calculating capital

For the purpose of determining a resolution entity's or material subsidiary's Tier 1 capital and Tier 2 capital on a consolidated basis with reference to its LAC consolidation group, the Capital Rules apply as if a reference in the Capital Rules to its consolidation group were a reference to its LAC consolidation group.

Part 4

Determination of Minimum LAC Ratios

Division 1—Capital Component Ratio and Resolution Component Ratio

18. Capital component ratio

(1) For a resolution entity that is an authorized institution the membership of whose LAC consolidation group is the same as its capital consolidation group, the capital component ratio is equal to—

(a) the minimum Total capital ratio that the entity is required to maintain on a consolidated basis in respect of its capital consolidation group under the Capital Rules; or

(b) if that minimum is varied under section 97F of the Banking Ordinance (Cap. 155), that minimum as so varied.

(2) Subject to subrule (4), for a resolution entity that is an authorized institution the membership of whose LAC consolidation group is different from its capital consolidation group, the capital component ratio is equal to—

(a) the minimum Total capital ratio that the entity is required to maintain on a consolidated basis in respect of its capital consolidation group under the Capital Rules; or

(b) if that minimum is varied under section 97F of the Banking Ordinance (Cap. 155), that minimum as so varied.

(3) Subject to subrule (4), for a resolution entity that is an HK holding company or HK affiliated operational entity, the capital component ratio is equal to—

(a) the minimum Total capital ratio that the entity's principal authorized institution is required to maintain on a consolidated basis in respect of its capital consolidation group under the Capital Rules; or

(b) if that minimum is varied under section 97F of the Banking Ordinance (Cap. 155), that minimum as so varied.

(4) The resolution authority may, in accordance with rule 20, vary the capital component ratio for a resolution entity referred to in subrule (2) or (3) if satisfied that it is prudent to do so to reflect the difference in membership of the resolution entity's LAC consolidation group and the capital consolidation group referred to in subrule (2) or (3) (as the case requires).

19. Resolution component ratio

(1) Subject to subrules (2) and (6), a resolution entity's resolution component ratio is equal to its capital component ratio.

(2) The resolution authority may, on the resolution authority's volition or on a resolution entity's application, in accordance with rule 20, vary a resolution entity's resolution component ratio if satisfied that it is prudent to do so.

(3) For the purposes of subrule (2), a resolution entity may, within the relevant period, apply in writing to the resolution authority, requesting a variation—

(a) to reduce its resolution component ratio; or

(b) to reduce an increase to its resolution component ratio that would apply to it as a result of a variation made under section 97F of the Banking Ordinance (Cap. 155).

(4) An application under subrule (3) must specify—

(a) the reduction requested; and

(b) the grounds for the reduction requested.

(5) In determining whether it is prudent to vary a resolution entity's resolution component ratio (including whether to accept a resolution entity's application for variation under subrule (3)), the resolution authority may take into account—

(a) any stabilization options expected to be applied under the preferred resolution strategy covering the resolution entity;

(b) any risks to resolvability related to the fact that there may be entities that are in the resolution entity's resolution group but not in its LAC consolidation group, and whose assets are therefore not otherwise taken into account when determining the resolution entity's LAC requirements; and

(c) any other matters the resolution authority considers relevant.

(6) If a resolution entity's capital component ratio has increased as a result of the exercise by the Monetary Authority of the power of variation under section 97F of the Banking Ordinance (Cap. 155), the corresponding increase in the resolution entity's resolution component ratio under subrule (1) takes effect 12 months after the increase in the capital component ratio.

(7) In this rule—

relevant period (有關限期)—

(a) in relation to subrule (3)(a), means the period of 14 days beginning on the date on which the further written notice

classifying the resolution entity under rule 8(2)(a) or (3) (as the case requires) was served; or

(b) in relation to subrule (3)(b), means the period of 14 days beginning on the date on which the increase in the resolution entity's capital component ratio, mentioned in subrule (6), takes effect.

20. Procedure for varying capital component ratio or resolution component ratio

(1) If the resolution authority proposes to vary a resolution entity's capital component ratio or resolution component ratio, the resolution authority must serve a written notice on the resolution entity—

(a) specifying the resolution authority's proposed variation;

(b) specifying the grounds for the proposed variation; and

(c) including a statement that the resolution entity may, within 14 days (or a longer period allowed by the resolution authority), make written representations to the resolution authority on any matter specified in the notice.

(2) If the resolution authority proposes not to vary a resolution entity's resolution component ratio following the resolution entity's application under rule 19(3), the resolution authority must serve a written notice on the resolution entity—

(a) specifying the resolution authority's proposed decision not to vary the resolution component ratio;

(b) specifying the grounds for the proposed decision; and

(c) including a statement that the resolution entity may, within 14 days (or a longer period allowed by the resolution authority), make written representations to the

resolution authority on any matter specified in the notice.

(3) If representations are made in accordance with subrule (1)(c), the resolution authority, after considering the representations, may—

(a) serve a further written notice on the resolution entity—

(i) confirming the proposed variation; or

(ii) modifying the proposed variation to take into account any of the representations; or

(b) decide not to make the proposed variation.

(4) If representations are made in accordance with subrule (2)(c), the resolution authority, after considering the representations, may serve a further written notice on the resolution entity—

(a) confirming the proposed decision not to vary the resolution component ratio; or

(b) notifying the resolution entity of the variation, as determined by the resolution authority.

(5) If no representations are made in accordance with subrule (1)(c), the resolution authority may serve a further written notice on the resolution entity confirming the proposed variation.

(6) If no representations are made in accordance with subrule (2)(c), the resolution authority may serve a further written notice on the resolution entity confirming the proposed decision not to vary the resolution component ratio.

(7) Subject to subrule (8), the further written notice served under subrule (3)(a), (4)(b) or (5) has the effect of varying the capital component ratio or the resolution component ratio, in accordance with its terms, on the date specified in the notice.

(8) For a variation of a resolution entity's capital component ratio or resolution component ratio that results in an increase in any of its minimum LAC ratios, the date referred to in subrule (7) must be at least 12 months after the date on which the further written notice is served under subrule (3)(a) or (5).

(9) The following decisions of the resolution authority are reviewable decisions—

(a) a decision to vary a resolution entity's resolution component ratio;

(b) a decision not to vary a resolution entity's resolution component ratio following the resolution entity's application under rule 19(3).

Division 2—Minimum External LAC Ratios for Resolution Entities

21. Minimum external LAC risk-weighted ratio

(1) Subject to subrule (2), the minimum external LAC risk-weighted ratio for a resolution entity is equal to the sum of its capital component ratio and its resolution component ratio.

(2) The resolution authority, by written notice served on a resolution entity that is a global systemically important bank, may increase the resolution entity's minimum external LAC risk-weighted ratio to reflect the minimum TLAC requirements set out in the TLAC term sheet.

Note—

The TLAC term sheet sets out minimum risk-weighted ratios of 16% and 18% from certain dates for global systemically important banks.

22. Minimum external LAC leverage ratio

(1) Subject to subrule (2), the minimum external LAC leverage ratio for a resolution entity is determined in accordance with the following formula—

$$\left(1+\frac{\text{resolution component ratio}}{\text{capital component ratio}}\right)\times 3\%$$

(2) The resolution authority, by written notice served on a resolution entity that is a global systemically important bank, may increase the resolution entity's minimum external LAC leverage ratio to reflect the minimum TLAC requirements set out in the TLAC term sheet.

Note—

The TLAC term sheet sets out minimum leverage ratios of 6% and 6.75% from certain dates for global systemically important banks.

Division 3—Minimum Internal LAC Ratios for Material Subsidiaries

23. Minimum internal LAC risk-weighted ratio

A material subsidiary's minimum internal LAC risk-weighted ratio is equal to the material subsidiary's modelled minimum external LAC risk-weighted ratio multiplied by the material subsidiary's internal LAC scalar.

24. Minimum internal LAC leverage ratio

A material subsidiary's minimum internal LAC leverage ratio is equal to the material subsidiary's modelled minimum external LAC leverage ratio multiplied by the material subsidiary's internal LAC scalar.

25. Modelled minimum external LAC risk-weighted ratio and modelled minimum external LAC leverage ratio

(1) A material subsidiary's modelled minimum external LAC risk-weighted ratio and modelled minimum external LAC leverage ratio are equal to the minimum external LAC risk-weighted ratio and minimum external LAC leverage ratio, respectively, that would apply to the material subsidiary if it were a resolution entity.

(2) For the purposes of determining its modelled minimum external LAC risk-weighted ratio and modelled minimum external LAC leverage ratio, these Rules apply to a material subsidiary in the same way, and to the same extent, as they apply to a resolution entity in the determination of its minimum external LAC risk-weighted ratio and minimum external LAC leverage ratio.

26. Internal LAC scalar

(1) Subject to subrules (2) and (5), a material subsidiary's internal LAC scalar is 75%.

(2) The resolution authority may, in accordance with rule 27, increase a material subsidiary's internal LAC scalar if satisfied that it is prudent to do so.

(3) In determining whether it is prudent to increase a material subsidiary's internal LAC scalar, the resolution authority may take into account—

(a) the preferred resolution strategy covering the material subsidiary;

(b) the likely availability of additional financial resources within the material subsidiary's resolution group that could be expected to be deployed to restore to viability

any authorized institution in the material subsidiary's material sub-group; and

(c) any other matters the resolution authority considers relevant.

(4) The maximum percentage to which the resolution authority may increase a material subsidiary's internal LAC scalar under subrule (2) is—

(a) 90% where the preferred resolution strategy covering the material subsidiary envisages all internal loss-absorbing capacity issued by the material subsidiary being issued directly to an entity that is not incorporated in Hong Kong; or

(b) 100% where the preferred resolution strategy covering the material subsidiary envisages some or all internal loss-absorbing capacity issued by the material subsidiary being issued directly to an entity that is incorporated in Hong Kong.

(5) Subject to subrule (6), the resolution authority, by written notice served on a material subsidiary, may at any time revoke or reduce a previous increase of a material subsidiary's internal LAC scalar if satisfied that it is prudent to do so.

(6) Subrule (3) applies for the purposes of determining whether to revoke or reduce a previous increase of a material subsidiary's internal LAC scalar in the same way as it applies for the purposes of determining whether to increase the material subsidiary's internal LAC scalar.

27. Procedure for increasing internal LAC scalar

(1) If the resolution authority proposes to increase a material subsidiary's internal LAC scalar, the resolution authority must serve a written notice on the material subsidiary—

(a) specifying the resolution authority's proposed increase;

(b) specifying the grounds for the proposed increase; and

(c) including a statement that the material subsidiary may, within 14 days (or a longer period allowed by the resolution authority), make written representations to the resolution authority on any matter specified in the notice.

(2) If representations are made in accordance with subrule (1)(c), the resolution authority, after considering the representations, may—

(a) serve a further written notice on the material subsidiary—

(i) confirming the proposed increase; or

(ii) modifying the proposed increase to take into account any of the representations; or

(b) decide not to make the proposed increase.

(3) If no representations are made in accordance with subrule (1)(c), the resolution authority may serve a further written notice on the material subsidiary confirming the proposed increase.

(4) Subject to subrule (5), the further written notice served under subrule (2)(a) or (3) has the effect of increasing the internal LAC scalar, in accordance with its terms, on the date specified in the notice.

(5) The date referred to in subrule (4) must be at least 12 months after the date on which the further written notice is served under subrule (2)(a) or (3).

Division 4—Requirements to Maintain Minimum LAC Ratios

28. Requirement for resolution entities to maintain minimum external LAC ratios

(1) Subject to rule 36, at all times after the relevant period, a resolution entity must have—

(a) an external LAC risk-weighted ratio that is not less than its minimum external LAC risk-weighted ratio, calculated on a consolidated basis with reference to its LAC consolidation group; and

(b) an external LAC leverage ratio that is not less than its minimum external LAC leverage ratio, calculated on a consolidated basis with reference to its LAC consolidation group.

(2) Subject to rule 36, at all times after the relevant period, a resolution entity that is an authorized institution must, in addition to complying with subrule (1), have—

(a) an external LAC risk-weighted ratio that is not less than its minimum external LAC risk-weighted ratio multiplied by its solo LAC scalar, calculated on—

(i) a solo basis; or

(ii) if the authorized institution has been granted an approval under section 28(2)(a) of the Capital Rules—a solo-consolidated basis with reference to the subsidiaries specified in the approval; and

(b) an external LAC leverage ratio that is not less than its minimum external LAC leverage ratio multiplied by its solo LAC scalar, calculated on—

(i) a solo basis; or

(ii) if the authorized institution has been granted an approval under section 28(2)(a) of the Capital Rules—a solo-consolidated basis with reference to the subsidiaries specified in the approval.

(3) In this rule—

relevant period (有關限期), in relation to a resolution entity, means—

(a) the period of 24 months immediately following the classification date for the resolution entity; or

(b) any longer period notified to the resolution entity by the resolution authority under rule 31.

29. Requirement for material subsidiaries to maintain minimum internal LAC ratios

(1) Subject to rule 36, at all times after the relevant period, a material subsidiary must have—

(a) an internal LAC risk-weighted ratio that is not less than its minimum internal LAC risk-weighted ratio, calculated on a consolidated basis with reference to its LAC consolidation group; and

(b) an internal LAC leverage ratio that is not less than its minimum internal LAC leverage ratio, calculated on a consolidated basis with reference to its LAC consolidation group.

(2) Subject to rule 36, at all times after the relevant period, a material subsidiary that is an authorized institution must, in addition to complying with subrule (1), have—

(a) an internal LAC risk-weighted ratio that is not less than its minimum internal LAC risk-weighted ratio multiplied by its solo LAC scalar, calculated on—

(i) a solo basis; or

(ii) if the authorized institution has been granted an approval under section 28(2)(a) of the Capital Rules—a solo-consolidated basis with reference to the subsidiaries specified in the approval; and

(b) an internal LAC leverage ratio that is not less than its minimum internal LAC leverage ratio multiplied by its solo LAC scalar, calculated on—

(i) a solo basis; or

(ii) if the authorized institution has been granted an approval under section 28(2)(a) of the Capital Rules—a solo-consolidated basis with reference to the subsidiaries specified in the approval.

(3) In this rule—

relevant period (有關限期), in relation to a material subsidiary, means—

(a) the period of 24 months immediately following the classification date for the material subsidiary; or

(b) any longer period notified to the material subsidiary by the resolution authority under rule 31.

30. Solo LAC scalar

(1) Subject to subrules (2) and (5), the solo LAC scalar for a resolution entity or material subsidiary that is an authorized institution is 100%.

(2) The resolution authority, by written notice served on a resolution entity or material subsidiary that is an authorized institution, may reduce the solo LAC scalar for the resolution entity or material subsidiary if satisfied that it is prudent to do so.

(3) In determining whether it is prudent to reduce a solo LAC scalar for a resolution entity or material subsidiary that is an authorized institution, the resolution authority may take into account—

(a) the extent to which the solo LAC scalar being set at 100% would result in the resolution entity or material subsidiary having to maintain a greater amount of loss-absorbing capacity than required to meet its LAC requirements on a consolidated basis;

(b) the extent to which the solo LAC scalar being set at 100% would impact on the quantity and availability of non-pre-positioned loss-absorbing capacity; and

(c) any other matters the resolution authority considers relevant.

(4) For the purposes of this rule, the non-pre-positioned loss-absorbing capacity of a resolution entity or material subsidiary is the amount of loss-absorbing capacity that the resolution entity or material subsidiary needs to maintain to meet its LAC requirements on a consolidated basis, less—

(a) the amount of loss-absorbing capacity that the resolution entity or material subsidiary needs to maintain to meet its LAC requirements on a solo basis; and

(b) any holdings by the resolution entity or material subsidiary of loss-absorbing capacity maintained by other members of its resolution group that those other members are required to maintain to meet—

(i) any applicable LAC requirement;

(ii) any applicable requirement under a regulatory regime in a non-Hong Kong jurisdiction that corresponds to a LAC requirement; or

(iii) any applicable regulatory capital requirement.

(5) Subject to subrules (6) and (7), the resolution authority, by written notice served on a resolution entity or material subsidiary that is an authorized institution, may at any time revoke or reduce a previous reduction of the solo LAC scalar for the resolution entity or material subsidiary if satisfied that it is prudent to do so.

(6) Subrule (3) applies for the purposes of determining whether to revoke or reduce a previous reduction of the solo LAC scalar for a resolution entity or material subsidiary in the same way as it applies for the purposes of determining whether to reduce the solo LAC scalar for the resolution entity or material subsidiary.

(7) A revocation or reduction of a previous reduction of a solo LAC scalar for a resolution entity or material subsidiary takes effect on the date specified in the notice under subrule (5), which must be at least 12 months after the date on which the notice is served on the resolution entity or material subsidiary.

31. Extension of relevant period

The resolution authority, by written notice served on a resolution entity or material subsidiary, may extend the period after which the resolution entity or material subsidiary must meet a LAC requirement, if satisfied that it is prudent to do so.

32. Further LAC ratio requirement for certain G-SIBs designated before 2016

(1) This rule applies if—

(a) a resolution entity or material subsidiary that is an authorized institution or HK holding company is a global systemically important bank;

(b) the resolution entity or material subsidiary, or the group of companies of which it is a member, or another member of that group (as the case may be) was designated as a global systemically important bank by the Financial Stability Board on or before 31 December 2015 and has been continuously so designated since its date of designation;

(c) the global systemically important bank is required by section 21 of the TLAC term sheet to meet minimum TLAC requirements from 1 January 2019; and

(d) the classification date for the resolution entity or material subsidiary is on or before 30 September 2021.

(2) Subject to rule 36, in addition to any requirement to maintain minimum LAC ratios under this Division, the resolution entity or material subsidiary must ensure that, at all times after the period of 3 months after its classification date, or any longer period notified in writing to the resolution entity or material subsidiary by the resolution authority—

(a) in the case of a resolution entity—

(i) its external LAC risk-weighted ratio calculated on a consolidated basis is not less than 16%; and

(ii) its external LAC leverage ratio calculated on a consolidated basis is not less than 6%; or

(b) in the case of a material subsidiary—

(i) its internal LAC risk-weighted ratio calculated on a consolidated basis is not less than 16% multiplied by its internal LAC scalar; and

(ii) its internal LAC leverage ratio calculated on a consolidated basis is not less than 6% multiplied by its internal LAC scalar.

Division 5—Minimum LAC Debt Requirement

33. Minimum LAC debt requirement for resolution entities

(1) Subject to rule 35—

(a) if a resolution entity is required by these Rules to meet a minimum external LAC risk-weighted ratio, the external LAC risk-weighted ratio that it would have if its external loss-absorbing capacity was equal to the sum of its relevant debt instruments must be not less than one-third of its minimum external LAC risk-weighted ratio;

(b) if a resolution entity is required by these Rules to meet a minimum external LAC leverage ratio, the external LAC leverage ratio that it would have if its external loss-absorbing capacity was equal to the sum of its relevant debt instruments must be not less than one-third of its minimum external LAC leverage ratio;

(c) if a resolution entity is subject to a requirement under rule 32(2)(a)(i), the external LAC risk-weighted ratio that it would have if its external loss-absorbing capacity was equal to the sum of its relevant debt instruments must be not less than one-third of the external LAC risk-weighted ratio required by rule 32(2)(a)(i); and

(d) if a resolution entity is subject to a requirement under rule 32(2)(a)(ii), the external LAC leverage ratio that it would have if its external loss-absorbing capacity was equal to the sum of its relevant debt instruments must be not less than one-third of the external LAC leverage ratio required by rule 32(2)(a)(ii).

(2) For the purposes of this rule, a relevant debt instrument is an external LAC debt instrument that—

(a) constitutes a liability; and

(b) is issued by the resolution entity.

34. Minimum LAC debt requirement for material subsidiaries

(1) Subject to rule 35—

(a) if a material subsidiary is required by these Rules to meet a minimum internal LAC risk-weighted ratio, the internal LAC risk-weighted ratio that it would have if its internal loss-absorbing capacity was equal to the sum of its relevant debt instruments must be not less than one-third of its minimum internal LAC risk-weighted ratio;

(b) if a material subsidiary is required by these Rules to meet a minimum internal LAC leverage ratio, the internal LAC leverage ratio that it would have if its internal loss-absorbing capacity was equal to the sum of its relevant debt instruments must be not less than one-third of its minimum internal LAC leverage ratio;

(c) if a material subsidiary is subject to a requirement under rule 32(2)(b)(i), the internal LAC risk-weighted ratio that it would have if its internal loss-absorbing capacity was equal to the sum of its relevant debt instruments must be not less than one-third of the internal LAC risk-weighted ratio required by rule 32(2)(b)(i); and

(d) if a material subsidiary is subject to a requirement under rule 32(2)(b)(ii), the internal LAC leverage ratio that it would have if its internal loss-absorbing capacity was equal to the sum of its relevant debt instruments must be not less than one-third of the internal LAC leverage ratio required by rule 32(2)(b)(ii).

(2) For the purposes of this rule, a relevant debt instrument is an internal LAC debt instrument that—

(a) constitutes a liability; and

(b) is issued directly or indirectly to, and held directly or indirectly by, the resolution entity or non-HK resolution entity in the material subsidiary's resolution group.

35. Reduction of minimum LAC debt requirement

(1) The resolution authority, by written notice served on a resolution entity or material subsidiary, may reduce the minimum LAC debt requirement under rule 33 or 34 for the resolution entity or material subsidiary to below one-third, if satisfied that it is prudent to do so.

(2) In determining whether it is prudent to reduce the minimum LAC debt requirement for a resolution entity or material subsidiary, the resolution authority may take into account—

(a) the LAC requirements of, and the capital adequacy ratios maintained by, the resolution entity or material subsidiary;

(b) the preferred resolution strategy covering the resolution entity or material subsidiary; and

(c) any other matters the resolution authority considers relevant.

(3) Subject to subrules (4) and (5), the resolution authority, by written notice served on a resolution entity or material subsidiary, may at any time revoke or reduce a previous reduction of the minimum LAC debt requirement for the resolution entity or material subsidiary if satisfied that it is prudent to do so.

(4) Subrule (2) applies for the purposes of determining whether to revoke or reduce a previous reduction of the minimum LAC debt requirement for a resolution entity or material subsidiary in the same way as it applies for the purposes of determining

whether to reduce the minimum LAC debt requirement for the resolution entity or material subsidiary.

(5) A revocation or reduction of a previous reduction of a minimum LAC debt requirement for a resolution entity or material subsidiary takes effect on the date specified in the notice under subrule (3), which must be at least 12 months after the date on which the notice is served on the resolution entity or material subsidiary.

Division 6—Suspension of LAC Requirements

36. Suspension of LAC requirements following certain occurrences

(1) This rule applies if any of the following events occurs—

(a) a stabilization option is applied in respect of an asset, right or liability of, or a security issued by, a resolution entity or material subsidiary;

(b) any Additional Tier 1 capital instrument, Tier 2 capital instrument or non-capital LAC debt instrument of a resolution entity or material subsidiary is written down or converted into ordinary shares as contemplated in the terms and conditions of the instrument;

(c) a capital reduction instrument is made in respect of a resolution entity or material subsidiary;

(d) anything is done in accordance with an agreement made, with the written consent of the resolution authority, between a resolution entity or material subsidiary and any of its creditors to write down, cancel, convert, change the form of or otherwise modify any of its LAC instruments.

(2) If the occurrence results in the resolution entity or material subsidiary failing to meet any of its LAC requirements, the

resolution entity or material subsidiary is not required to meet any LAC requirement before the expiry of—

(a) the period of 24 months after the occurrence; or

(b) any longer period notified in writing to the resolution entity or material subsidiary by the resolution authority.

Part 5

Calculation of Loss-absorbing Capacity

37. Calculation of external loss-absorbing capacity of resolution entity

Subject to rules 42 and 44, a resolution entity's external loss-absorbing capacity is the sum of the following items, calculated in Hong Kong dollars, and after the deductions specified in rule 38 have been made in accordance with that rule—

(a) the total capital of the resolution entity less any contribution to the total capital from—

(i) any Additional Tier 1 capital instrument or Tier 2 capital instrument that is not an external LAC debt instrument;

(ii) where a resolution entity's external loss-absorbing capacity is being calculated on a consolidated basis, any regulatory capital instrument—

(A) that is not a CET1 capital instrument; and

(B) that is issued by a member of the resolution entity's LAC consolidation group other than the resolution entity;

(b) any portion that has been amortized in accordance with section 1(d) of Schedule 4C to the Capital Rules of any Tier 2 capital instruments that are external LAC debt instruments issued by the resolution entity;

(c) the amounts of any external non-capital LAC debt instruments issued by the resolution entity.

38. Deductions from external loss-absorbing capacity

(1) A resolution entity must deduct from its external loss-absorbing capacity—

(a) the amount of any direct holdings, indirect holdings and synthetic holdings by the resolution entity of its own non-capital LAC liabilities, unless already derecognized under applicable accounting standards, calculated in accordance with Schedule 3;

(b) the amount of any direct holdings, indirect holdings and synthetic holdings by the resolution entity of non-capital LAC liabilities issued by a financial sector entity that is a group company that is not a member of the resolution entity's LAC consolidation group, calculated in accordance with Schedule 4;

(c) if the resolution entity is required to meet a minimum external LAC risk-weighted ratio or minimum external LAC leverage ratio on a solo basis—the amount of the resolution entity's direct holdings of non-capital LAC liabilities issued by entities that are members of the resolution entity's LAC consolidation group; and

(d) if the resolution entity is required to meet a minimum external LAC risk-weighted ratio or minimum external LAC leverage ratio on a solo-consolidated basis—the amount of the resolution entity's direct holdings of non-capital LAC liabilities issued by entities, other than any solo-consolidated subsidiaries in relation to the resolution entity, that are members of the resolution entity's LAC consolidation group.

(2) A resolution entity must include in the amount to be deducted under subrule (1) potential future holdings that the resolution entity could be contractually obliged to purchase.

39. Calculation of internal loss-absorbing capacity of material subsidiary

Subject to rules 42 and 44, a material subsidiary's internal loss-absorbing capacity is the sum of the following items, calculated in Hong Kong dollars, and after the deductions specified in rule 40 have been made in accordance with that rule—

(a) the total capital of the material subsidiary less any contribution to the total capital from—

(i) any Additional Tier 1 capital instrument or Tier 2 capital instrument that is not an internal LAC debt instrument; and

(ii) any Additional Tier 1 capital instrument or Tier 2 capital instrument that is not issued directly or indirectly to, and held directly or indirectly by, the resolution entity or non-HK resolution entity in the material subsidiary's resolution group;

(b) any portion that has been amortized in accordance with section 1(d) of Schedule 4C to the Capital Rules of any of the material subsidiary's Tier 2 capital instruments that are internal LAC debt instruments issued directly or indirectly to, and held directly or indirectly by, the resolution entity or non-HK resolution entity in the material subsidiary's resolution group;

(c) the amounts of the material subsidiary's internal non-capital LAC debt instruments issued directly or indirectly to, and held directly or indirectly by, the resolution entity or non-HK resolution entity in the material subsidiary's resolution group.

40. Deductions from internal loss-absorbing capacity

(1) A material subsidiary must deduct from its internal loss-absorbing capacity—

(a) the amount of any direct holdings, indirect holdings and synthetic holdings by the material subsidiary of its own non-capital LAC liabilities, unless already derecognized under applicable accounting standards, calculated in accordance with Schedule 3;

(b) the amount of any direct holdings, indirect holdings and synthetic holdings by the material subsidiary of non-capital LAC liabilities issued by a financial sector entity that is a group company that is not a member of the material subsidiary's LAC consolidation group, calculated in accordance with Schedule 4;

(c) if the material subsidiary is required to meet a minimum internal LAC risk-weighted ratio or minimum internal LAC leverage ratio on a solo basis—the amount of the material subsidiary's direct holdings of non-capital LAC liabilities issued by entities that are members of the material subsidiary's LAC consolidation group; and

(d) if the material subsidiary is required to meet a minimum internal LAC risk-weighted ratio or minimum internal LAC leverage ratio on a solo-consolidated basis—the amount of the material subsidiary's direct holdings of non-capital LAC liabilities issued by entities, other than any solo-consolidated subsidiaries in relation to the material subsidiary, that are members of the material subsidiary's LAC consolidation group.

(2) A material subsidiary must include in the amount to be deducted under subrule (1) potential future holdings that the

material subsidiary could be contractually obliged to purchase.

41. Resolution authority may require evidence

(1) The resolution authority, by written notice served on a resolution entity, may require the resolution entity to provide to the resolution authority, within the time specified in the notice, evidence of a kind specified by the resolution authority that the resolution entity's external loss-absorbing capacity, or items claimed by the resolution entity to form part of its external loss-absorbing capacity, meet the requirements of these Rules.

(2) The resolution authority, by written notice served on a material subsidiary, may require the material subsidiary to provide to the resolution authority, within the time specified in the notice, evidence of a kind specified by the resolution authority that the material subsidiary's internal loss-absorbing capacity, or items claimed by the material subsidiary to form part of its internal loss-absorbing capacity, meet the requirements of these Rules.

(3) Without limiting the kinds of evidence the resolution authority may specify, the resolution authority may require a resolution entity or material subsidiary to obtain, and provide to the resolution authority, independent legal advice acceptable to the resolution authority.

42. Requirement not to include, or to discontinue inclusion of, items in external or internal loss-absorbing capacity

(1) If the resolution authority is satisfied that it is prudent to do so, the resolution authority may, in accordance with rule 43—

(a) require a resolution entity—

(i) not to include an item in the calculation of its external loss-absorbing capacity; or

(ii) to discontinue the inclusion of an item in the calculation of its external loss-absorbing capacity; or

(b) require a material subsidiary—

(i) not to include an item in the calculation of its internal loss-absorbing capacity; or

(ii) to discontinue the inclusion of an item in the calculation of its internal loss-absorbing capacity.

(2) In determining whether it is prudent to require a resolution entity or material subsidiary not to include, or to discontinue the inclusion of, an item, the resolution authority may take into account—

(a) any matters that, in the opinion of the resolution authority, may undermine the ability of the item to absorb losses or otherwise contribute to an orderly resolution as contemplated by the preferred resolution strategy covering the resolution entity or material subsidiary; and

(b) any other matters the resolution authority considers relevant.

43. Procedure for imposing requirement not to include, or to discontinue inclusion of, items in external or internal loss-absorbing capacity

(1) If the resolution authority proposes to impose a requirement on a resolution entity or material subsidiary under rule 42, the resolution authority must serve a written notice on the resolution entity or material subsidiary—

(a) specifying the resolution authority's proposed requirement;

(b) specifying the grounds for the proposed requirement; and

(c) including a statement that the resolution entity or material subsidiary may, within 14 days (or a longer period allowed by the resolution authority), make written representations to the resolution authority on any matter specified in the notice.

(2) If representations are made in accordance with subrule (1)(c), the resolution authority, after considering the representations, may—

(a) serve a further written notice on the resolution entity or material subsidiary—

(i) confirming the proposed requirement; or

(ii) modifying the proposed requirement to take into account any of the representations; or

(b) decide not to impose the proposed requirement.

(3) If no representations are made in accordance with subrule (1)(c), the resolution authority may serve a further written notice on the resolution entity or material subsidiary confirming the proposed requirement.

(4) The further written notice served under subrule (2)(a) or (3) has the effect of imposing the requirement on the resolution entity or material subsidiary in accordance with its terms, on the date specified in the notice.

44. Revisions to methodology for calculating loss-absorbing capacity

(1) In calculating its external loss-absorbing capacity or internal loss-absorbing capacity (as the case requires), a resolution entity or material subsidiary may apply any revisions to the methodology set out in rule 37 or 39 that are approved in writing by the resolution authority.

(2) The resolution authority may approve a revision to the methodology set out in rule 37 or 39 for a resolution entity or material subsidiary under this rule if satisfied that it is prudent to do so.

(3) In determining whether it is prudent to approve a revision to the methodology set out in rule 37 or 39 for a resolution entity or material subsidiary, the resolution authority may take into account—

(a) the practicality of the resolution entity or material subsidiary applying the relevant methodology, both with and without the proposed revision;

(b) whether, in the resolution authority's opinion, applying the revision may result in the external loss-absorbing capacity or internal loss-absorbing capacity being higher than it otherwise would have been and, if it would, the likely extent of the increase; and

(c) any other matters the resolution authority considers relevant.

Part 6

Disclosure

45. Interpretation (Part 6)

In this Part—

annual reporting period (周年報告期), in relation to a disclosure entity, means a financial year of the entity;

disclosure entity (披露實體) means a resolution entity or a material subsidiary;

disclosure statement (披露報表) means a statement required to be prepared under rule 52(1)(a);

interim reporting period (中期報告期), in relation to a disclosure entity, means the first 6-month period of a financial year of the entity;

quarterly reporting period (季度報告期), in relation to a disclosure entity, means the first, second, third or fourth 3-month period of a financial year of the entity;

semi-annual reporting period (半年度報告期), in relation to a disclosure entity, means the first or second 6-month period of a financial year of the entity.

46. When disclosure requirements apply

A requirement on a disclosure entity to make a quarterly or semi-annual disclosure under this Part applies in relation to each quarterly reporting period or semi-annual reporting period (as the case requires) of the disclosure entity that ends at least 3 months after the classification date of the disclosure entity.

47. Key metrics—loss-absorbing capacity—quarterly disclosures

(1) A disclosure entity must disclose, for each quarterly reporting period—

(a) summary information on its loss-absorbing capacity; and

(b) an explanation of any material changes to its loss-absorbing capacity during the period, including the key drivers of those changes.

(2) In addition to subrule (1), a disclosure entity that is a material subsidiary in a resolution group a member of which is a non-HK resolution entity must disclose, for each quarterly reporting period, to the extent to which the disclosure entity can reasonably obtain the necessary information—

(a) summary information on the loss-absorbing capacity of the non-HK resolution entity; and

(b) an explanation of any material changes to the loss-absorbing capacity of the non-HK resolution entity during the period, including the key drivers of those changes.

48. Composition of loss-absorbing capacity—semi-annual disclosures

A disclosure entity must disclose, for each semi-annual reporting period—

(a) a detailed breakdown of its loss-absorbing capacity; and

(b) an explanation of any material changes to the composition of its loss-absorbing capacity during the period, including the key drivers of those changes.

49. Resolution entity—creditor ranking at legal entity level—semi-annual disclosures

A disclosure entity that is a resolution entity must disclose, for each semi-annual reporting period—

(a) information on the priority that creditors would enjoy on a winding up of the disclosure entity; and

(b) where appropriate, institution-specific or jurisdiction-specific information relating to creditor hierarchies on a winding up of the disclosure entity.

50. Material subsidiary—creditor ranking at legal entity level—semi-annual disclosures

A disclosure entity that is a material subsidiary must disclose, for each semi-annual reporting period—

(a) information on the priority that creditors would enjoy on a winding up of the disclosure entity; and

(b) where appropriate, institution-specific or jurisdiction-specific information relating to creditor hierarchies on a winding up of the disclosure entity.

51. Main features of regulatory capital instruments and of other non-capital LAC debt instruments—semi-annual disclosures

(1) A disclosure entity must disclose, for each semi-annual reporting period—

(a) the main features of its CET1 capital instruments, Additional Tier 1 capital instruments, Tier 2 capital instruments and non-capital LAC debt instruments (each referred to in this rule as a ***relevant instrument***); and

(b) a direct link to the relevant section of its internet website where the full terms and conditions of all relevant instruments can be found.

(2) Whenever—

(a) a relevant instrument—

(i) is issued and included in a disclosure entity's loss-absorbing capacity;

(ii) is repaid; or

(iii) ceases to be included in a disclosure entity's loss-absorbing capacity; or

(b) there is a redemption, conversion or write-down, or any other material change in the nature, of a relevant instrument included in a disclosure entity's loss-absorbing capacity,

the disclosure entity must, as soon as practicable, update the disclosure it has made under subrule (1) in order to reflect the changes arising from the event referred to in paragraph (a) or (b).

52. Medium of disclosure

(1) If a disclosure entity is required under these Rules to disclose information, it must make that disclosure by—

(a) preparing, in the Chinese and English languages, a statement—

(i) that, subject to subrule (2) and rule 56, is in the form exclusively of a standalone document or a discrete section of the disclosure entity's financial statements (***discrete section***); and

(ii) in which the information required to be disclosed is readily identifiable;

(b) subject to subrule (2) and rule 56, presenting the information required to be disclosed in the format, and using the standard disclosure templates or tables, specified by the resolution authority; and

(c) complying with the other provisions of this rule applicable to or in relation to the statement.

(2) If the resolution authority permits in a specification under subrule (1)(b) and if all the conditions specified in subrule (3) are met, any part of the information required to be disclosed may be contained in a separate document that is signposted in the standalone document or the discrete section.

(3) The conditions are—

(a) that the disclosure entity signposts clearly, in the standalone document or the discrete section, the location where the information published elsewhere is published, providing, at a minimum, the following information—

(i) a reference to the format, templates and tables specified by the resolution authority to which the signposting relates;

(ii) the full title of the separate document in which the information is published;

(iii) a link to the relevant section of the disclosure entity's internet website where the separate document can be accessed (if applicable);

(iv) the page and paragraph number of the separate document where the information is located; and

(b) that the level of assurance on the reliability of data in the separate document is equivalent to, or greater than, the internal assurance level required for the information

presented in the standalone document or the discrete section.

(4) For the purposes of these Rules, a reference to a disclosure entity making a disclosure to the general public includes the disclosure entity making the disclosure—

(a) on the disclosure entity's internet website or a section of its internet website; or

(b) if approved in writing by the resolution authority, on the internet website, or a section of the internet website, of a group company of the disclosure entity.

53. Timing of disclosure

(1) For disclosures under these Rules for a quarterly reporting period that ends otherwise than at the close of an interim or annual reporting period, the disclosure entity must publish the disclosure statement—

(a) if the disclosure entity publishes quarterly financial statements for the quarterly reporting period (***quarterly financial statements***) within 8 weeks after the end of the quarterly reporting period—concurrently with the publication of the quarterly financial statements; or

(b) if the disclosure entity does not publish quarterly financial statements within 8 weeks after the end of the quarterly reporting period—within that 8-week period.

(2) For disclosures under these Rules for a quarterly or semi-annual reporting period that ends at the close of an interim reporting period, the disclosure entity must publish the disclosure statement—

(a) if the disclosure entity publishes interim financial statements for the interim reporting period (***interim***

financial statements) within 3 months after the end of the quarterly or semi-annual reporting period—

(i) concurrently with the publication of the interim financial statements; or

(ii) if a permission is given under subrule (4)—within the time permitted; or

(b) if the disclosure entity does not publish interim financial statements within 3 months after the end of the quarterly or semi-annual reporting period—within that 3-month period.

(3) For disclosures under these Rules for a quarterly or semi-annual reporting period that ends at the close of an annual reporting period, the disclosure entity must publish the disclosure statement—

(a) if the disclosure entity publishes annual financial statements for the annual reporting period (***annual financial statements***) within 4 months after the end of the quarterly or semi-annual reporting period—

(i) concurrently with the publication of the annual financial statements; or

(ii) if a permission is given under subrule (4)—within the time permitted; or

(b) if the disclosure entity does not publish annual financial statements within 4 months after the end of the quarterly or semi-annual reporting period—within that 4-month period.

(4) Subject to subrule (5), the resolution authority, by written notice served on a disclosure entity, may permit the publication of a disclosure statement under subrule (2)(a) or (3)(a) at a time later than the publication of the interim

financial statements or annual financial statements but within the following period after the end of the quarterly or semi-annual reporting period to which the disclosure statement relates—

(a) if subrule (2)(a) applies—3 months;

(b) if subrule (3)(a) applies—4 months.

(5) The resolution authority may give a permission under subrule (4) if the disclosure entity demonstrates to the satisfaction of the resolution authority that—

(a) concurrent publication under subrule (2)(a) or (3)(a) is not practicable or feasible, or will result in a delay in the publication of the relevant financial statements; and

(b) the proposed difference in time between the publication of the relevant financial statements and the publication of the disclosure statement is reasonable in all the circumstances of the case.

54. Location of disclosure statements

(1) Subject to subrules (2) and (3), a disclosure entity must—

(a) keep at least one copy of each of its disclosure statements (***relevant copy***) in its principal place of business in Hong Kong; and

(b) make a relevant copy available for inspection by the general public during the business hours of the disclosure entity at its principal place of business in Hong Kong.

(2) A disclosure entity must ensure that a relevant copy of a disclosure statement is available for inspection under subrule (1)(b) for at least 12 months beginning on the date of publication of the disclosure statement.

(3) If a disclosure entity does not have a principal place of business in Hong Kong that is accessible to the general public, the disclosure entity complies with subrules (1) and (2) if—

(a) those subrules are complied with by a group company of the disclosure entity that is an authorized institution that has a principal place of business in Hong Kong accessible to the general public; and

(b) the disclosure entity discloses the location of the principal place of business referred to in paragraph (a).

55. Further requirements for disclosure statements

(1) A disclosure entity must make it clear in its disclosure statement—

(a) which information contained in the statement has been audited; and

(b) which information contained in the statement has not been audited.

(2) A disclosure entity must ensure that when its disclosure statement is published—

(a) the statement contains all the disclosures required under these Rules to be made by the disclosure entity for the reporting period to which the statement relates; and

(b) the disclosures referred to in paragraph (a) are not false or misleading in any material respect.

(3) A disclosure entity—

(a) must establish and maintain an archive of all disclosure statements; and

(b) unless otherwise approved in writing by the resolution authority, must establish and maintain the archive—

(i) on the disclosure entity's internet website; or

(ii) if an approval is given under rule 52(4)(b)—on the internet website, or a section of the internet website, of the disclosure entity's relevant group company.

(4) A disclosure entity must lodge a copy of its disclosure statement with the resolution authority before it publishes the statement.

(5) The resolution authority must ensure that each copy lodged with it under subrule (4) is kept with the register maintained under section 20 of the Banking Ordinance (Cap. 155).

56. Group disclosures and internet websites

(1) A disclosure entity may treat disclosures made by a group company of the disclosure entity (***group disclosures***) as being part of the disclosures the disclosure entity is required to make under these Rules (***entity disclosures***) if the disclosure entity demonstrates to the satisfaction of the resolution authority that—

(a) the group disclosures are not materially different from the entity disclosures;

(b) if the group company is established or incorporated in a non-Hong Kong jurisdiction—the group disclosures are prepared in accordance with the prevailing banking supervisory standards relating to disclosure issued by the Basel Committee and adopted by the relevant banking supervisory authority of that group company (if any);

(c) the group disclosures provide a sufficient level of detail to permit third parties to form a considered view of the relevant aspects of the disclosure entity's loss-absorbing capacity;

(d) the disclosure statement of the disclosure entity contains a statement of the location where all the group disclosures can be found;

(e) the group disclosures are set out on an internet website of the group company that is accessible by the general public; and

(f) the disclosure entity has an internet website (or a section of an internet website) that—

(i) is specifically intended to be accessible by the general public in Hong Kong; and

(ii) contains a link to the section of the internet website setting out the group disclosures as referred to in paragraph (e).

(2) If a disclosure entity that is not an authorized institution does not have its own internet website, the disclosure entity complies with a requirement under these Rules to make information available, or to establish and maintain an archive, on its internet website if—

(a) a group company of the disclosure entity has an internet website (or a section of an internet website) specifically intended to be accessible by the general public in Hong Kong and the required information is made available, or the required archive is established and maintained, on that internet website (or section of that internet website); and

(b) the disclosure entity has demonstrated to the satisfaction of the resolution authority that making the information available, or establishing and maintaining the archive, on such an internet website (or a section of such an internet website) will not materially diminish the ease of access

to, or utility of, the information or archive for the general public in Hong Kong.

57. Verification

(1) The board of directors (or a committee designated by the board) and the senior management of a disclosure entity must ensure that the information which the disclosure entity is required to disclose under these Rules is, before being disclosed, scrutinized and subjected to an internal review to ensure that the information is not false or misleading in any material respect.

(2) The internal review referred to in subrule (1) must be carried out by a disclosure entity's adequately qualified personnel who are independent of the disclosure entity's staff or management responsible for preparing the information required to be disclosed.

(3) A disclosure entity must ensure that one or more members of the senior management of the disclosure entity attest in writing that the disclosures made by the disclosure entity under these Rules have been prepared in accordance with the internal review and internal control processes approved by the disclosure entity's board of directors.

(4) The internal review and internal control processes applied to the information disclosed by a disclosure entity under these Rules for a reporting period that ends at the close of an interim or annual reporting period must be no less stringent than those applied to the information provided by the disclosure entity within the management discussion and analysis part of its financial statements.

(5) This rule does not apply in relation to any information that a disclosure entity is required to disclose under rule 47(2) in respect of a non-HK resolution entity.

58. Proprietary or confidential information

(1) A disclosure entity may, with the prior consent of the resolution authority, decline to disclose proprietary or confidential information the disclosure of which would otherwise be required under these Rules (***relevant requirement***) if the disclosure entity—

(a) discloses general information relating to the subject matter of the relevant requirement in its disclosure statement (whether or not under the relevant requirement); and

(b) includes a statement in that disclosure statement stating what information it has declined to disclose.

(2) In this rule—

proprietary or confidential information (專有或機密資料), in relation to a disclosure entity, means information—

(a) that, if it became publicly available, would cause serious prejudice to the competitive position of the disclosure entity; or

(b) in respect of which the disclosure entity has legally binding obligations to its customers or other counterparties that prevent the disclosure entity from disclosing the information.

59. Materiality

(1) The senior management of a disclosure entity must ensure that a disclosure made by the entity under these Rules contains all the material information.

(2) In this rule—

material information (重要資料) means information—

(a) that is required to be disclosed under these Rules; and

(b) that, if it were not disclosed or were misstated, could change or influence the assessment or decision of a person relying on the disclosure concerned for the purposes of making investment or other economic decisions.

Part 7

Enforcement

Division 1—Notifiable Matters

60. Requirement to notify resolution authority of failure or likely failure to comply

If an entity that is subject to a requirement under these Rules fails to comply, or becomes aware that it is likely to fail to comply, with the requirement, the entity must—

(a) as soon as practicable notify the resolution authority; and

(b) provide particulars to the resolution authority on request.

Note—

Under section 19(4) of the Ordinance, failure to comply, without reasonable excuse, with this rule is an offence.

Division 2—Remedial Action

61. Requirement to take remedial action

(1) If an entity contravenes these Rules, the resolution authority may, in accordance with rule 62, require the entity to take remedial action specified by the resolution authority, within the period specified by the resolution authority, to remedy the contravention.

(2) The resolution authority may require an entity to take remedial action under subrule (1) if satisfied, on reasonable grounds, that it is prudent to require the entity to take the action.

Note—

Under section 19(5) of the Ordinance, failure to comply, without reasonable excuse, with a requirement to take remedial action is an offence.

62. Procedure for requiring entity to take remedial action

(1) If the resolution authority proposes to require an entity to take remedial action, the resolution authority must serve a written notice on the entity—

(a) specifying the details of the proposed remedial action and the proposed period in which it is to be taken;

(b) specifying the grounds for the proposed requirement to take remedial action; and

(c) including a statement that the entity may, within 14 days (or a longer period allowed by the resolution authority), make written representations to the resolution authority on any matter specified in the notice.

(2) If representations are made in accordance with subrule (1)(c), the resolution authority, after considering the representations, may—

(a) serve a further written notice on the entity—

(i) confirming the proposed requirement to take remedial action and the proposed period in which it is to be taken; or

(ii) modifying the proposed requirement or proposed period to take into account any of the representations; or

(b) decide not to require the entity to take remedial action.

(3) If no representations are made in accordance with subrule (1)(c), the resolution authority may serve a further written notice on the entity confirming the proposed requirement to

take remedial action and the proposed period in which it is to be taken.

(4) The further written notice served under subrule (2)(a) or (3) has the effect of requiring the entity to take remedial action in accordance with its terms.

(5) A decision of the resolution authority to require an entity to take remedial action is a reviewable decision.

Part 8

Review by Resolvability Review Tribunal

63. Application for review of reviewable decision

(1) A relevant entity that is aggrieved by a reviewable decision may, at any time within the period specified in subrule (3), apply to the Resolvability Review Tribunal for a review of the decision.

(2) An application for review must set out the grounds for the application and be accompanied by a copy of the relevant notice.

(3) The period specified for the purposes of subrule (1) is the period of 30 days beginning on the date on which the relevant notice was served on the relevant entity.

(4) Despite subrule (3), the Resolvability Review Tribunal, on the written application of any person, may by order extend the time within which an application for review may be made if satisfied that there is good cause for granting the extension.

(5) The making of an application to the Resolvability Review Tribunal for review of a reviewable decision operates as a stay of execution of the decision.

(6) In this rule—

relevant entity (有關實體)—

(a) in relation to a decision to vary a resolution entity's resolution component ratio, means the resolution entity;

(b) in relation to a decision not to vary a resolution entity's resolution component ratio following an application made under rule 19(3), means the resolution entity; or

(c) in relation to a decision to require an entity to take remedial action, means the entity;

relevant notice (有關通知)—

(a) in relation to a decision to vary a resolution entity's resolution component ratio, means the further written notice served under rule 20(3)(a) or (5) (as the case requires);

(b) in relation to a decision not to vary a resolution entity's resolution component ratio following an application made under rule 19(3), means the further written notice served under rule 20(4)(a) or (6) (as the case requires); or

(c) in relation to a decision to require an entity to take remedial action, means the further written notice served under rule 62(2)(a) or (3) (as the case requires).

64. Determination of application for review

(1) As soon as practicable after an application under rule 63(1) is received by it, the Resolvability Review Tribunal must send a copy of the application to the resolution authority.

(2) In reviewing a reviewable decision, the Resolvability Review Tribunal must ensure that the parties to the proceeding are given a reasonable opportunity of being heard.

(3) The standard of proof required to determine any question or issue before the Resolvability Review Tribunal is the standard of proof applicable to civil proceedings in a court of law.

(4) In determining a review of a reviewable decision, the Resolvability Review Tribunal may—

(a) confirm or set aside the decision; or

(b) remit the matter in question to the resolution authority with any direction that it considers appropriate, which may include a direction to make a fresh decision in respect of any matter specified by the Tribunal.

Schedule 1

[r. 2]

Qualifying Criteria to be Met to be External LAC Debt Instrument

1. Qualifying criteria to be met to be external LAC debt instrument

(1) An instrument qualifies as an external LAC debt instrument of a resolution entity only if the following criteria are met—

(a) the instrument is issued and fully paid up;

(b) subject to subsection (6), if issued in Hong Kong, the instrument is issued to a professional investor;

(c) the instrument is not secured;

(d) the instrument is not subject to—

(i) any set off or netting right; or

(ii) any other arrangement that legally or economically enhances the seniority of any claim under the instrument;

(e) the instrument has a remaining contractual maturity of at least 12 months or is perpetual;

(f) subject to subsection (2), the holder of the instrument has no right to accelerate the payment or repayment of future scheduled payments (coupon or principal) except in the event of a liquidation of the entity;

(g) subject to subsection (3), the cashflows arising from the instrument do not change by reference to the value of, or

any fluctuation in the value of, one or more than one underlying asset, index, financial instrument, rate or thing designated in the instrument and the instrument does not otherwise have derivative-linked features;

(h) any liability constituted by the instrument does not arise other than through a contract;

(i) the instrument is either—

(i) subordinated to depositors and general creditors of the entity; or

(ii) issued by a clean HK holding company;

(j) any liability constituted by the instrument is not an excluded liability within the meaning of section 58(9) of the Ordinance;

(k) subject to subsection (4), the instrument is subject to the law of Hong Kong;

(l) subject to subsection (5), the terms and conditions of the instrument contain a provision that the holder of the instrument—

(i) acknowledges that the instrument is subject to being written off, cancelled, converted, modified, or to having its form changed, in the exercise of powers under the Ordinance;

(ii) agrees to be bound by any such write-off, cancellation, conversion, modification or form change; and

(iii) acknowledges that the rights of the holder are subject to anything done in the exercise of those powers;

(m) subject to subsections (6) and (7)—

(i) the terms and conditions of the instrument contain a provision that the instrument is intended to qualify as a LAC debt instrument under these Rules; and

(ii) any prospectus or offering document prepared by or for the issuer in relation to the instrument—

(A) adequately discloses the risks inherent in the holding of the instrument, including the risks in relation to its subordination and the circumstances in which the holder may suffer loss as a result of the holding;

(B) contains a statement that the instrument is complex and high risk; and

(C) contains a statement that, if issued in Hong Kong, the instrument must be issued to a professional investor;

(n) subject to subsection (6), the instrument is in a denomination of not less than—

(i) if denominated in Hong Kong dollars—HK$2,000,000;

(ii) if denominated in US dollars—US$250,000;

(iii) if denominated in Euros—Euro 200,000; or

(iv) if denominated in any other currency—the equivalent in that currency to HK$2,000,000 with reference to the relevant exchange rate on the date of issue;

(o) the instrument is not funded or guaranteed directly or indirectly by the resolution entity or another entity that is in the same resolution group as the resolution entity, unless otherwise approved in writing by the resolution

authority on being satisfied that the instrument being so funded or guaranteed is not inconsistent with the preferred resolution strategy covering the resolution entity;

(p) subject to subsection (8), if the terms and conditions of the instrument contain one or more call options—

(i) to exercise a call option, the entity must have the prior consent of the resolution authority; and

(ii) the entity has not created, and has not done anything to create, an expectation at issuance that the call option will be exercised.

(2) Subsection (1)(f) does not apply to a right of the holder to require the resolution entity to redeem the instrument that is exercisable only on one or more dates specified as a date or dates certain in the instrument, but in that case the date of the contractual maturity of the instrument for the purposes of subsection (1)(e) is the date certain or, if more than one, the earliest of those dates.

(3) Subsection (1)(g) does not apply only because—

(a) the instrument contains one or more call options; or

(b) a coupon on the instrument is calculated by reference to a reference rate.

(4) Subsection (1)(k) does not apply if the resolution entity has obtained independent legal advice acceptable to the resolution authority that, under the governing law of the instrument, the application of resolution powers under the Ordinance, including the application of any stabilization option, in relation to the instrument or any liability constituted by the instrument, would be effective and enforceable on the basis of

binding statutory provisions or legally enforceable contractual provisions.

(5) Subsection (1)(l) does not apply to an instrument issued before the day on which Part 5 of the Ordinance came into operation.

(6) Subsection (1)(b), (m)(ii) and (n) does not apply to—

(a) an Additional Tier 1 capital instrument or Tier 2 capital instrument issued before the day on which these Rules come into operation; or

(b) an instrument issued to and held by a group company of the issuer.

(7) Subsection (1)(m)(i) does not apply to an instrument issued before the classification date for the resolution entity.

(8) Subsection (1)(p) does not apply to an Additional Tier 1 capital instrument or Tier 2 capital instrument.

Schedule 2

[r. 2]

Qualifying Criteria to be Met to be Internal LAC Debt Instrument

1. Qualifying criteria to be met to be internal LAC debt instrument

(1) An instrument qualifies as an internal LAC debt instrument of a material subsidiary only if the following criteria are met—

(a) the instrument is issued and fully paid up;

(b) the instrument is not secured;

(c) the instrument is not subject to—

(i) any set off or netting right; or

(ii) any other arrangement that legally or economically enhances the seniority of any claim under the instrument;

(d) the instrument has a remaining contractual maturity of at least 12 months or is perpetual;

(e) subject to subsection (2), the holder of the instrument has no right to accelerate the payment or repayment of future scheduled payments (coupon or principal) except in the event of a liquidation of the material subsidiary;

(f) subject to subsection (3), the cashflows arising from the instrument do not change by reference to the value of, or any fluctuation in the value of, one or more than one underlying asset, index, financial instrument, rate or

thing designated in the instrument and the instrument does not otherwise have derivative-linked features;

(g) any liability constituted by the instrument does not arise other than through a contract;

(h) the instrument is either—

(i) subordinated to depositors and general creditors of the material subsidiary; or

(ii) issued by a clean HK holding company;

(i) any liability constituted by the instrument is not an excluded liability within the meaning of section 58(9) of the Ordinance;

(j) subject to subsection (4), the instrument is subject to the law of Hong Kong;

(k) subject to subsection (5), the terms and conditions of the instrument contain a provision that the holder of the instrument—

(i) acknowledges that the instrument is subject to being written off, cancelled, converted, modified, or to having its form changed, in the exercise of powers under the Ordinance;

(ii) agrees to be bound by any such write-off, cancellation, conversion, modification or form change; and

(iii) acknowledges that the rights of the holder are subject to anything done in the exercise of those powers;

(l) subject to subsection (6), the terms and conditions of the instrument contain a provision that the instrument is intended to qualify as a LAC debt instrument under these Rules;

(m) the instrument is not funded or guaranteed directly or indirectly by the material subsidiary or any subsidiary of the material subsidiary, unless otherwise approved in writing by the resolution authority on being satisfied that the instrument being so funded or guaranteed is not inconsistent with the preferred resolution strategy covering the material subsidiary;

(n) subject to subsection (7), if the terms and conditions of the instrument contain one or more call options—

(i) to exercise a call option, the material subsidiary must have the prior consent of the resolution authority; and

(ii) the material subsidiary has not created, and has not done anything to create, an expectation at issuance that the call option will be exercised;

(o) the instrument is—

(i) an Additional Tier 1 capital instrument;

(ii) a Tier 2 capital instrument; or

(iii) an instrument that complies with section 2 of this Schedule.

(2) Subsection (1)(e) does not apply to a right of the holder to require the material subsidiary to redeem the instrument that is exercisable only on one or more dates specified as a date or dates certain in the instrument, but in that case the date of the contractual maturity of the instrument for the purposes of subsection (1)(d) is the date certain or, if more than one, the earliest of those dates.

(3) Subsection (1)(f) does not apply only because—

(a) the instrument contains one or more call options; or

(b) a coupon on the instrument is calculated by reference to a reference rate.

(4) Subsection (1)(j) does not apply if the material subsidiary has obtained independent legal advice acceptable to the resolution authority that, under the governing law of the instrument, the application of resolution powers under the Ordinance, including the application of any stabilization option, in relation to the instrument or any liability constituted by the instrument, would be effective and enforceable on the basis of binding statutory provisions or legally enforceable contractual provisions.

(5) Subsection (1)(k) does not apply to an instrument issued before the day on which Part 5 of the Ordinance came into operation.

(6) Subsection (1)(l) does not apply to an instrument issued before the classification date for the material subsidiary.

(7) Subsection (1)(n) does not apply to an Additional Tier 1 capital instrument or Tier 2 capital instrument.

2. Additional requirements for certain debt instruments

(1) For the purposes of section 1(1)(o)(iii) of this Schedule, an instrument complies with this section if—

(a) the terms and conditions of the instrument—

(i) contain a provision requiring the material subsidiary to ensure that the instrument will be either written down, or converted into ordinary shares, on the occurrence of the trigger event; or

(ii) if a notice has been served on the material subsidiary under subsection (3), comply with that notice;

(b) at all times, the material subsidiary maintains all prior authorization necessary to immediately issue the relevant number of ordinary shares specified in the terms and conditions of the instrument (if any), and there are no impediments to the write-off or automatic conversion of the instrument into ordinary shares of the material subsidiary, on the occurrence of the trigger event;

(c) before the instrument is issued, the material subsidiary submits to the resolution authority—

(i) a detailed description of the rationale for any specified conversion method set out in the terms and conditions of the instrument, including the computations of the indicative dilution of the material subsidiary's ordinary shares that would occur on the occurrence of the trigger event and the resulting ordinary shareholder structure; and

(ii) an explanation of why such a conversion method would help to ensure or maintain the viability of the material subsidiary; and

(d) for an instrument issued directly to a group company of the material subsidiary that is established or incorporated in a non-Hong Kong jurisdiction, the terms and conditions of the instrument identify—

(i) the jurisdiction of incorporation of the group company to which it is issued; and

(ii) the relevant non-Hong Kong resolution authority in that jurisdiction (***home authority***).

(2) For the purposes of subsection (1), the trigger event is the occurrence of—

(a) the resolution authority notifying the material subsidiary in writing that the resolution authority is satisfied that—

(i) if the material subsidiary is an authorized institution—it has ceased, or is likely to cease, to be viable and there is no reasonable prospect that private sector action (outside of resolution) would result in it again becoming viable within a reasonable period (in both cases, without taking into account the write-down or conversion into ordinary shares of any LAC debt instruments); or

(ii) if the material subsidiary is an HK holding company or HK affiliated operational entity—a relevant authorized institution has ceased, or is likely to cease, to be viable and there is no reasonable prospect that private sector action (outside of resolution) would result in it again becoming viable within a reasonable period (in both cases, without taking into account the write-down or conversion into ordinary shares of any LAC debt instruments); and

(b) for an instrument issued directly to a group company established or incorporated in a non-Hong Kong jurisdiction, the resolution authority notifying the material subsidiary in writing that—

(i) the resolution authority has notified the home authority of the resolution authority's intention to notify the material subsidiary under paragraph (a); and

(ii) the home authority—

(A) has consented to the write-down or conversion of the internal non-capital LAC

debt instruments issued by the material subsidiary; or

(B) has not, within 24 hours after receiving notice under subparagraph (i), objected to the write-down or conversion of the internal non-capital LAC debt instruments issued by the material subsidiary.

(3) The resolution authority may serve a written notice on a material subsidiary requiring that the terms and conditions of any or all instruments that are intended to be internal LAC debt instruments must specify which one only of writing down or conversion into ordinary shares will take place on the occurrence of the trigger event.

(4) In this section—

relevant authorized institution (有關認可機構), in relation to a material subsidiary that is an HK holding company or HK affiliated operational entity, means any authorized institution incorporated in Hong Kong—

(a) of which the material subsidiary is a holding company or affiliated operational entity (as the case requires); and

(b) that is in the same resolution group as the material subsidiary.

Schedule 3

[rr. 38 & 40]

Deduction of Holdings of Own Non-capital LAC Liabilities

1. Deduction of holdings of own non-capital LAC liabilities

(1) For the purposes of rules 38(1)(a) and 40(1)(a), a resolution entity or material subsidiary must, subject to subsections (2), (3) and (4)—

(a) calculate the amount of any direct holdings, indirect holdings or synthetic holdings of its own non-capital LAC liabilities to be deducted from its external or internal loss-absorbing capacity (as the case requires) on the basis of gross long positions (irrespective of whether the positions are booked in the banking book or the trading book); and

(b) make those deductions from its external or internal loss-absorbing capacity.

(2) A resolution entity or material subsidiary must calculate the amount of holdings of its own non-capital LAC liabilities on the basis of the net long position if the long and short positions are in the same underlying exposure and the short positions involve no counterparty credit risk.

(3) A resolution entity or material subsidiary must take the amount to be deducted for indirect holdings that take the form of holdings of index securities as the amount of holdings of

index securities that corresponds to the proportion of its own non-capital LAC liabilities included in the underlying index.

(4) A resolution entity or material subsidiary must net gross long positions in its own non-capital LAC liabilities resulting from holdings of index securities against short positions in its own non-capital LAC liabilities resulting from short positions in the same underlying index, including where those short positions involve counterparty credit risk.

Schedule 4

[rr. 38 & 40]

Deduction of Holdings of Other Non-capital LAC Liabilities

1. Deduction of holdings of other non-capital LAC liabilities

(1) For the purposes of rules 38(1)(b) and 40(1)(b), a resolution entity or material subsidiary must—

(a) calculate its aggregate holdings of non-capital LAC liabilities issued by financial sector entities to be deducted from its external or internal loss-absorbing capacity (as the case requires); and

(b) make those deductions from its external or internal loss-absorbing capacity.

(2) A resolution entity's or material subsidiary's aggregate holdings of non-capital LAC liabilities issued by financial sector entities must be calculated as follows—

(a) direct holdings, indirect holdings and synthetic holdings of non-capital LAC liabilities must be included;

(b) the net long positions in both the banking book and trading book must be included and, in this regard, the gross long position may be offset against a short position in the same underlying exposure if the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year;

(c) underwriting positions held for 5 business days or less (or the longer period approved in writing by the resolution authority) must be excluded;

(d) the resolution entity or material subsidiary may, with the prior consent of the resolution authority, temporarily exclude holdings of certain non-capital LAC liabilities where they have been created in the context of resolving or providing financial assistance to reorganize a distressed financial sector entity.

Monetary Authority

15th October, 2018

Explanatory Note

The purpose of these Rules is to prescribe loss-absorbing capacity (***LAC***) requirements for within scope financial institutions in the banking sector that are authorized institutions incorporated in Hong Kong, and for their Hong Kong incorporated holding companies or Hong Kong incorporated affiliated operational entities. The Rules are made by the Monetary Authority, being the resolution authority for banking sector entities under the Financial Institutions (Resolution) Ordinance (Cap. 628). The Rules provide for the classification of entities as resolution entities or material subsidiaries, the minimum LAC ratios they must maintain, how LAC ratios are calculated, what constitutes LAC, disclosure requirements, review of certain decisions of the resolution authority and enforcement powers.

2. The Rules are divided into 8 Parts.

Part 1—Preliminary

3. Rule 1 provides for commencement and rule 2 sets out definitions of terms used in the Rules.

4. Rule 3 provides for the resolution authority to notify a classifiable entity (an entity that can be classified as a resolution entity or material subsidiary) of the preferred resolution strategy covering that entity. The preferred resolution strategy may be taken into account by the resolution authority in making certain decisions under the Rules.

Part 2—Resolution Entities, Material Subsidiaries and LAC Consolidation Groups

5. Part 2 empowers the resolution authority to classify a classifiable entity as a resolution entity or a material subsidiary, and in certain

circumstances to vary the entity's LAC consolidation group (which is the equivalent of a capital consolidation group under the Banking (Capital) Rules (Cap. 155 sub. leg. L) (***Capital Rules***)).

6. Rule 4 states what types of entity are classifiable entities. Rules 5 and 6 empower the resolution authority to classify a classifiable entity as a resolution entity or a material subsidiary according to criteria set out in those rules. Rule 7 empowers the resolution authority to vary the LAC consolidation group of a resolution entity or material subsidiary. Rule 8 sets out the procedure for the resolution authority to classify entities or vary LAC consolidation groups.

7. Rule 9 requires a resolution entity or material subsidiary to notify the resolution authority of changes to its LAC consolidation group including changes to the principal activities of group members.

Part 3—LAC Ratios

8. Division 1 sets out the 2 relevant external LAC ratios for a resolution entity, being the external LAC risk-weighted ratio and the external LAC leverage ratio, and describes how they are calculated.

9. Division 2 sets out the 2 relevant internal LAC ratios for a material subsidiary, being the internal LAC risk-weighted ratio and the internal LAC leverage ratio, and describes how they are calculated.

10. Division 3 sets out how a resolution entity or material subsidiary calculates its LAC ratios on a solo, solo-consolidated or consolidated basis. The methodology is based on the calculation of capital adequacy ratios and leverage ratios under the Capital Rules and differs according to whether or not the resolution entity or material subsidiary is an authorized institution.

Part 4—Determination of Minimum LAC Ratios

11. Division 1 sets out a resolution entity's capital component ratio and resolution component ratio, which are used to determine the minimum external LAC ratios for the entity. Depending on the type of resolution entity, the resolution authority may vary either or both of these ratios. Rule 20 sets out the procedure for variation and provides that in some circumstances the resolution entity may apply for a review of a variation decision of the resolution authority.

12. Division 2 establishes the minimum external LAC ratios for a resolution entity. Rule 21 provides that the minimum external LAC risk-weighted ratio is the sum of its capital component ratio and its resolution component ratio. Rule 22 sets out a formula for determining the minimum external LAC leverage ratio, also by reference to the entity's capital component ratio and resolution component ratio. Both minimum ratios may be varied in some circumstances if the resolution entity is a global systemically important bank.

13. Division 3 establishes the minimum internal LAC ratios for a material subsidiary, which are the modelled minimum external LAC ratios for the subsidiary multiplied by its internal LAC scalar. Rule 25 sets out how a material subsidiary's modelled minimum external LAC ratios are calculated and rule 26 sets the internal LAC scalar at 75%, subject to the power of the resolution authority to increase this figure in certain circumstances, using the procedure set out in rule 27.

14. Division 4 sets out the requirements on resolution entities and material subsidiaries to maintain their minimum LAC ratios. They must do so at all times after the relevant period, which is generally the period of 24 months following their classification date as a resolution entity or material subsidiary, unless that period is extended by the resolution authority under rule 31. The minimum

LAC ratios must be met on a consolidated basis with reference to the entity's LAC consolidation group. If the entity is an authorized institution, the minimum LAC ratios must also be met on a solo or solo-consolidated basis, adjusted by the entity's solo LAC scalar. Rule 30 sets out how the solo LAC scalar is determined. Rule 32 imposes further LAC ratio requirements on certain global systemically important banks.

15. Division 5 sets out minimum LAC debt requirements for resolution entities and material subsidiaries. Rules 33 and 34 provide for the minimum LAC debt requirements and rule 35 empowers the resolution authority to reduce a minimum LAC debt requirement in certain circumstances.

16. Division 6 provides for the suspension of LAC requirements following certain occurrences. Following such an occurrence, the requirements are suspended for 24 months or any longer period determined by the resolution authority.

Part 5—Calculation of Loss-absorbing Capacity

17. Part 5 sets out how LAC is calculated for the purposes of the Rules. Rule 37 sets out the items that are to be included in a resolution entity's external LAC and rule 38 sets out the items that are to be deducted from the entity's external LAC. Rules 39 and 40 provide the equivalents for a material subsidiary's internal LAC. Rule 41 empowers the resolution authority to require a resolution entity or material subsidiary to provide evidence that items claimed to form part of its LAC meet the requirements of the Rules. Rule 42 empowers the resolution authority to require a resolution entity or material subsidiary not to include, or to discontinue the inclusion of, any specified items in the calculation of its LAC and rule 43 sets out the procedure for imposing this requirement. Rule 44 allows a resolution entity or material subsidiary, with the approval of the

resolution authority, to use a revised methodology for calculating its LAC.

Part 6—Disclosure

18. Part 6 imposes disclosure requirements on resolution entities and material subsidiaries (both referred to as disclosure entities in this Part) in relation to their LAC. Rules 47 to 51 set out the required subject matter that must be disclosed and the frequency of disclosure (quarterly or semi-annually). Rule 52 sets out how disclosures are to be made and rule 53 sets out the timing of disclosures. Further requirements as to disclosures are contained in rules 54 to 59, which also provide for group disclosures, disclosures on internet websites, verification of matters disclosed and how proprietary or confidential information is handled.

Part 7—Enforcement

19. Division 1 provides that an entity that is subject to a requirement under the Rules must notify the resolution authority if the entity fails to comply, or becomes aware that it is likely to fail to comply, with the requirement.

20. Division 2 deals with remedial action. Rule 61 empowers the resolution authority to require an entity that contravenes the Rules to take specified remedial action to remedy the contravention. Rule 62 sets out the procedure for requiring remedial action, including the right of the entity to apply for a review of the resolution authority's decision to require remedial action.

Part 8—Review by Resolvability Review Tribunal

21. Part 8 sets out the procedure for applying to the Resolvability Review Tribunal for a review of a reviewable decision made by the

resolution authority and sets out the Tribunal's powers and procedure on a review.

Schedule 1—Qualifying Criteria to be Met to be External LAC Debt Instrument

22. Schedule 1 sets out the criteria that must be met by an instrument in order to qualify as an external LAC debt instrument for inclusion in a resolution entity's external LAC.

Schedule 2—Qualifying Criteria to be Met to be Internal LAC Debt Instrument

23. Schedule 2 sets out the criteria that must be met by an instrument in order to qualify as an internal LAC debt instrument for inclusion in a material subsidiary's internal LAC.

Schedule 3—Deduction of Holdings of Own Non-capital LAC Liabilities

24. Schedule 3 sets out how deductions are to be made from the LAC of a resolution entity or material subsidiary in relation to holdings of its own non-capital LAC liabilities.

Schedule 4—Deduction of Holdings of Other Non-capital LAC Liabilities

25. Schedule 4 sets out how deductions are to be made from the LAC of a resolution entity or material subsidiary in relation to holdings of other entities' non-capital LAC liabilities.

Inland Revenue (Amendment) (No. 6) Bill 2018

Contents

A BILL

To

Amend the Inland Revenue Ordinance to treat certain loss-absorbing capacity debt instruments as debt securities for profits tax purposes; to deem certain sums received by or accrued to certain entities as trading receipts; to allow deduction of interest on money borrowed by certain entities in respect of a regulatory capital security in ascertaining chargeable profits; to provide that certain entities are not eligible to be qualifying corporate treasury centres; and to provide for related matters.

Enacted by the Legislative Council.

1. Short title

This Ordinance may be cited as the Inland Revenue (Amendment) (No. 6) Ordinance 2018.

2. Inland Revenue Ordinance amended

The Inland Revenue Ordinance (Cap. 112) is amended as set out in sections 3 to 14.

3. Section 2 amended (interpretation)

Section 2(1)—

Add in alphabetical order

"***banking LAC requirement*** (銀行 LAC 規定) means a LAC requirement as defined by rule 2(1) of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules;

LAC banking entity (LAC 銀行實體) means—

(a) an HK affiliated operational entity, as defined by rule 2(1) of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules, that is required to meet a banking LAC requirement under those Rules; or

(b) a clean HK holding company, as defined by rule 2(1) of those Rules, that is required to meet a banking LAC requirement under those Rules;".

4. Section 14D amended (qualifying corporate treasury centre: profits tax concession)

Section 14D(9), after "a financial institution"—

Add

"or LAC banking entity".

5. Section 14F amended (qualifying corporate treasury centre: Commissioner's determination)

Section 14F(2)(a), after "a financial institution"—

Add

"or LAC banking entity".

6. Section 15 amended (certain amounts deemed trading receipts)

(1) After section 15(1)(ia)—

Add

"(ib) sums, not otherwise chargeable to tax under this Part, received by or accrued to a LAC banking entity, by way of interest, in respect of a regulatory capital security, that arises through or from the carrying on by the entity of its business in Hong Kong, even if the moneys laid out for the acquisition of the security in respect of which the

interest is received or accrues are made available outside Hong Kong;".

(2) After section 15(1)(la)—

Add

"(lb) sums, not otherwise chargeable to tax under this Part, received by or accrued to a LAC banking entity, by way of gains or profits arising through or from the carrying on by the entity of its business in Hong Kong, from the sale or other disposal or on the redemption, on maturity or presentment or otherwise, of a regulatory capital security, even if—

(i) the moneys laid out for the acquisition of the security were made available outside Hong Kong; or

(ii) the sale, disposal or redemption is effected outside Hong Kong;".

(3) After section 15(1C)—

Add

"(1D) Subsection (1)(ib) and (lb) applies, subject to sections 17B, 17C, 17D, 17E and 17F, in relation to a regulatory capital security.".

7. Section 16 amended (ascertainment of chargeable profits)

(1) After section 16(2)(a)—

Add

"(ab) the money has been borrowed by a LAC banking entity by way of issuing a regulatory capital security;".

(2) After section 16(2AA)—

Add

"(2AAB) Subsections (1)(a) and (2)(ab) apply, subject to sections 17B, 17C, 17D, 17E and 17F, in relation to a sum payable by a LAC banking entity in respect of a regulatory capital security issued by the entity.".

8. Section 17A amended (financial institution: interpretation)

(1) Section 17A(1)—

Repeal the definition of *fair value*

Substitute

"***fair value*** (公平價值), in relation to a regulatory capital security—

(a) if the security is accounted for in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board—has the meaning given by International Financial Reporting Standard 13 (Fair Value Measurement) as issued by the board and in force from time to time; and

(b) otherwise—has the meaning given by Hong Kong Financial Reporting Standard 13 (Fair Value Measurement) as issued by the Hong Kong Institute of Certified Public Accountants and in force from time to time;".

(2) Section 17A(1), definition of ***fair value accounting***—

Repeal

"means a basis of accounting under which assets and liabilities are shown in a balance sheet at their"

Substitute

", in relation to a regulatory capital security, means a basis of accounting under which the security is shown in a balance sheet at its".

(3) Section 17A(1)—

Repeal the definition of *regulatory capital security*

Substitute

"***regulatory capital security*** (監管資本證券) means, subject to subsection (2)—

(a) a security that, for the purposes of the Banking (Capital) Rules (Cap. 155 sub. leg. L) or of the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee—

(i) qualifies or has qualified as an Additional Tier 1 capital instrument; and

(ii) forms or formed a component of Additional Tier 1 capital;

(b) a security that, for the purposes of the Banking (Capital) Rules (Cap. 155 sub. leg. L) or of the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee—

(i) qualifies or has qualified as a Tier 2 capital instrument; and

(ii) forms or formed a component of Tier 2 capital;

(c) an instrument issued by a financial institution that, for the purposes of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules—

(i) qualifies or has qualified as a banking non-capital LAC debt instrument; and

(ii) forms or formed a component of banking loss-absorbing capacity;

(d) an instrument issued by a LAC banking entity that, for the purposes of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules—

(i) qualifies or has qualified as a banking LAC debt instrument; and

(ii) forms or formed a component of banking loss-absorbing capacity; or

(e) in relation to an entity established or incorporated outside Hong Kong, an instrument that—

(i) is not a security referred to in paragraph (a) or (b); and

(ii) constitutes a liability that is recognized in the way as described in paragraph (c) of the definition of ***loss-absorbing capacity*** in rule 2(1) of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules;".

(4) Section 17A(1)—

Add in alphabetical order

"***banking LAC debt instrument*** (銀行 LAC 債務票據) means a LAC debt instrument as defined by rule 2(1) of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules;

banking loss-absorbing capacity (銀行吸收虧損能力) means loss-absorbing capacity as defined by rule 2(1) of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules;

banking non-capital LAC debt instrument (銀行非資本 LAC 債務票據) means a non-capital LAC debt instrument as defined by rule 2(1) of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules;".

(5) Section 17A(2)—

Repeal everything before paragraph (a) of the definition of *security*

Substitute

"(2) For the purposes of subsection (1), ***regulatory capital security*** does not include—".

(6) Section 17A(3)—

Repeal

"paragraph (c) of the definition of ***security*** in subsection (2)"

Substitute

"subsection (2)(c)".

9. Section 17D amended (financial institution: general provisions on regulatory capital security held by, or for benefit of, issuer's specified connected person)

Section 17D(6)—

Repeal paragraph (a).

10. Section 17E amended (financial institution: profits adjusted if associates deal not at arm's length in connection with regulatory capital security)

(1) Section 17E(1)(a)—

Repeal

"and a person who is an associate of the financial institution"

Substitute

"or LAC banking entity (***specified institution or entity***) and a person who is an associate of the specified institution or entity".

(2) Section 17E(2)—

Repeal

"to the financial institution"

Substitute

"to the specified institution or entity".

(3) Section 17E(2)—

Repeal

"of the financial institution"

Substitute

"of the specified institution or entity".

11. Section 17F amended (financial institution: issuer's deduction if regulatory capital security is issued to, held by or issued or held for benefit of specified connected person)

(1) Section 17F—

Repeal subsection (8).

(2) Section 17F(9), after "applies"—

Add

"to this section".

(3) After section 17F(9)—

Add

"(9A) For the purposes of this section, a connected person (as defined by section 17D(5)) of the issuer of a regulatory

capital security is a specified connected person of the issuer unless the connected person—

(a) is chargeable to tax under this Part in respect of a sum payable in respect of the security;

(b) is entitled to a sum payable in respect of the security in the capacity of—

(i) a person acting as a trustee of a trust estate, or holding property belonging to others pursuant to the terms of a contract, where the person is not beneficially entitled to the sum;

(ii) a beneficiary of a unit trust to which section 26A(1A)(a)(i) or (ii) applies, where the sum is payable to a trustee of the unit trust in respect of a specified investment scheme referred to in section 26A(1A)(b); or

(iii) a member of a retirement scheme that is either a recognized retirement scheme or a substantially similar retirement scheme established outside Hong Kong, where the Commissioner is satisfied that the latter scheme complies with the requirements of a supervisory authority within an acceptable regulatory regime;

(c) is a market maker who, in the ordinary course of conduct of the market maker's trade, profession or business in respect of market making, holds the security for the purpose of providing liquidity for the security;

(d) is a public body; or

(e) is a body corporate, where the Government owns beneficially more than half of the issued share capital of that body corporate for the time being.".

(4) Section 17F(10)—

Repeal

"Section 17D(6) applies"

Substitute

"However, subsection (9A) applies".

(5) Section 17F(10)(a)—

Repeal

"section 17D(6)"

Substitute

"subsection (9A)".

(6) Section 17F(10)(b)—

Repeal

"section 17D(6)(a), (b) or (c)"

Substitute

"subsection (9A)(a), (b) or (c)".

12. Section 89 amended (transitional provisions)

Section 89—

Add

"(23) Schedule 47 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) (No. 6) Ordinance 2018 (of 2018).".

13. Schedule 36 amended (transitional provisions for Inland Revenue (Amendment) (No. 2) Ordinance 2016)

Schedule 36—

Repeal

"[s. 89(16)]"

Substitute

"[s. 89(16) & Sch. 47]".

14. Schedule 47 added

The Ordinance—

Add

"Schedule 47

[s. 89(23)]

Transitional Provisions for Inland Revenue (Amendment) (No. 6) Ordinance 2018

1. In this Schedule—

   (a) ***2018 Amendment Ordinance*** (《2018 年修訂條例》) means the Inland Revenue (Amendment) (No. 6) Ordinance 2018 (of 2018);

   (b) ***commencement date*** (生效日期) means the day on which the 2018 Amendment Ordinance comes into operation;

   (c) ***specified instrument*** (指明票據) means an instrument falling within paragraph (c), (d) or (e) of the definition of ***regulatory capital security*** in

section 17A(1) that is issued before the commencement date; and

   (d) in relation to a person, a year of assessment is the ***transitional year of assessment*** (過渡課稅年度) if the commencement date falls within the basis period of the person for the year of assessment.

2. Subject to sections 3, 4, 5 and 6 of this Schedule, the amendments made to sections 2, 14D, 14F, 15, 16, 17A, 17D, 17E and 17F by the 2018 Amendment Ordinance apply only in ascertaining the profits in respect of which a person is chargeable to tax under Part 4 for the transitional year of assessment or any subsequent year of assessment.

3. Section 15(1)(ib) and (lb) and (1D) does not apply to sums received or accrued before the commencement date.

4. Section 16(2)(ab) and (2AAB) applies only to sums payable on or after the commencement date.

5. For a regulatory capital security issued before the commencement date—

   (a) section 17D as amended by the 2018 Amendment Ordinance applies only in ascertaining profits arising on or after the commencement date in respect of which a specified connected person of the issuer of the security is chargeable to tax under Part 4;

   (b) in applying section 17D(2) to a specified connected person of the issuer of the security if the specified connected person has included any sums as assessable profits or losses when bringing the security into account at a fair value—

(i) the security is taken to have been disposed of and re-acquired at its fair value on the commencement date; and

(ii) any change in value between the end of the basis period for the year of assessment immediately preceding the transitional year of assessment and the commencement date is to be brought into account for computing the assessable profits for the transitional year of assessment;

(c) section 17D(3) applies only to a write-down or conversion effected on or after the commencement date; and

(d) section 17D(4) applies only to a write-up effected on or after the commencement date.

6. For a specified instrument—

(a) the following provisions apply only to sums received or accrued, in respect of the instrument, on or after the commencement date—

(i) section 15(1)(f), (g), (i), (ia), (j), (k), (l) and (la);

(ii) section 17B (in so far as it relates to a person to whom or for whose benefit a sum is payable in respect of the instrument);

(b) the following provisions apply only to sums payable, in respect of the instrument, on or after the commencement date—

(i) section 16(1)(a) and (2AA);

(ii) section 17B (in so far as it relates to the issuer of the instrument);

(iii) section 17F;

(c) in applying section 17C(2) to the issuer of the instrument who has included any sums as assessable profits or losses when bringing the instrument into account at a fair value—

(i) the liability under the instrument is taken to have been released and re-assumed at its fair value on the commencement date; and

(ii) any change in value between the end of the basis period for the year of assessment immediately preceding the transitional year of assessment and the commencement date is to be brought into account for computing the assessable profits for the transitional year of assessment;

(d) section 17C(3) applies only to a write-down or conversion effected on or after the commencement date; and

(e) section 17C(4) applies only to a write-up effected on or after the commencement date.

7. Sections 6, 7 and 8 of Schedule 36 have effect as if section 17A had not been amended by the 2018 Amendment Ordinance.".

Explanatory Memorandum

The main object of this Bill is to amend the Inland Revenue Ordinance (Cap. 112) (***principal Ordinance***)—

(a) to treat certain loss-absorbing capacity debt instruments as debt securities for profits tax purposes;

(b) to deem certain sums received by or accrued to certain entities as trading receipts;

(c) to allow deduction of interest on money borrowed by certain entities in respect of a regulatory capital security in ascertaining chargeable profits; and

(d) to provide that certain entities are not eligible to be qualifying corporate treasury centres.

2. Clause 1 sets out the short title.

3. Clause 3 amends section 2 of the principal Ordinance to add the definitions of ***banking LAC requirement*** and ***LAC banking entity*** to that section. In particular, ***LAC banking entity*** is defined as an HK affiliated operational entity or clean HK holding company, within the meaning of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules (***Rules***), that is required to meet a requirement in respect of loss-absorbing capacity under the Rules.

4. Clauses 4 and 5 amend sections 14D and 14F of the principal Ordinance respectively so that a LAC banking entity is not eligible to be a qualifying corporate treasury centre for the purpose of profits tax concession.

5. Clause 6 amends section 15 of the principal Ordinance to add new section 15(1)(ib) and (lb) to deem the following sums as trading receipts—

(a) certain sums received by or accrued to a LAC banking entity by way of interest in respect of a regulatory capital security;

(b) certain sums received by or accrued to a LAC banking entity in connection with its business from the sale or other disposal, or on the redemption, of a regulatory capital security.

6. Clause 7 amends section 16 of the principal Ordinance so that interest payable on money borrowed by a LAC banking entity by way of issuing a regulatory capital security is deductible for ascertaining chargeable profits.

7. Clause 8 amends section 17A of the principal Ordinance to amend the definitions of ***fair value*** and ***fair value accounting***, and to expand the definition of ***regulatory capital security*** to include—

(a) certain non-capital LAC debt instruments within the meaning of the Rules;

(b) certain LAC debt instruments within the meaning of the Rules; and

(c) certain other instruments constituting loss absorbing capacity for the purposes of the Rules.

8. Clause 9 amends section 17D of the principal Ordinance so that it applies to a connected person of an issuer of a regulatory capital security even if the connected person is chargeable to profits tax in respect of a sum payable in respect of the security.

9. Clause 10 amends section 17E of the principal Ordinance to make it applicable to a LAC banking entity.

10. Clause 11 amends section 17F of the principal Ordinance in consequence of the amendment made to section 17D of the principal Ordinance.

11. Clause 12 amends section 89 of, and clause 14 adds Schedule 47 to, the principal Ordinance to provide for transitional arrangements.

14D. Qualifying corporate treasury centre: profits tax concession

(1) For the purposes of this Part, the assessable profits of a corporation that is a qualifying corporate treasury centre for a year of assessment are, subject to subsection (5) and section 26AB, chargeable to tax under this Part at one-half of the rate specified in Schedule 8 to the extent to which those profits are— *(Amended 27 of 2018 s. 27)*

(a) assessable profits derived from its intra-group lending transaction;

(b) assessable profits derived from its corporate treasury service; or

(c) assessable profits derived from its corporate treasury transaction. *(Amended 27 of 2018 s. 27)*

(2) A corporation is a qualifying corporate treasury centre for a year of assessment if, for that year of assessment—

(a) it satisfies the conditions specified in subsection (3);

(b) it satisfies the safe harbour rule under section 14E; or

(c) it has obtained the Commissioner's determination under section 14F(1).

(3) The conditions specified for the purposes of subsection (2)(a) are that, in the basis period for the year of assessment, the corporation—

(a) has carried out in Hong Kong one or more corporate treasury activities; and

(b) has not carried out in Hong Kong any activity other than a corporate treasury activity.

(4) For the purposes of subsection (3)(b), in determining whether a corporation has carried out any activity other than a corporate treasury activity, only activities that generate income to the corporation are to be taken into account.

(5) Subsection (1) applies to a corporation for a year of assessment only if—

(a) in that year of assessment—

(i) the central management and control of the corporation is exercised in Hong Kong; and

(ii) the activities that produce its qualifying profits in that year are—

(A) carried out in Hong Kong by the corporation; or

(B) arranged by the corporation to be carried out in Hong Kong; and

(b) the corporation has elected in writing that subsection (1) applies to it.

(6) An election under subsection (5)(b), once made, is irrevocable.

(7) If subsection (1) does not apply to a corporation for a year of assessment (***cessation year***) while it did for the previous year of assessment—

(a) the election made by the corporation under subsection (5)(b) ceases to be effective; and

(b) despite anything in this section, subsection (1) is not to apply to the corporation for the year of assessment that follows the cessation year.

(8) *(Repealed 27 of 2018 s. 27)*

(9) Despite subsection (2), a financial institution is not eligible to be a qualifying corporate treasury centre.

(Added 12 of 2016 s. 3)

14F. Qualifying corporate treasury centre: Commissioner's determination

(1) For the purposes of section 14D(2)(c), the Commissioner may, on application by a corporation, determine that the corporation is a qualifying corporate treasury centre for a year of assessment.

(2) A corporation may apply for the Commissioner's determination under subsection (1) only if—

(a) it is not a financial institution; and

(b) for the year of assessment, it satisfies neither of the following—

(i) the conditions specified in section 14D(3);

(ii) the safe harbour rule under section 14E.

(3) The Commissioner may make a determination under subsection (1) only if the Commissioner is of the opinion that the conditions specified in section 14D(3), or the safe harbour rule under section 14E, would, in the ordinary course of business of the corporation, have been satisfied for the year of assessment.

(Added 12 of 2016 s. 3)

15. Certain amounts deemed trading receipts

(1) For the purposes of this Ordinance, the sums described in the following paragraphs shall be deemed to be receipts arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong—

(a) sums, not otherwise chargeable to tax under this Part, received by or accrued to a person from the exhibition or use in Hong Kong of cinematograph or television film or tape, any sound recording, or any advertising material connected with such film, tape or recording;

(b) sums, not otherwise chargeable to tax under this Part, received by or accrued to a person for the use, or the right to the use, in Hong Kong of any patent, design, trade mark, copyright material, layout-design (topography) of an integrated circuit, performer's right, plant variety right, secret process or formula, or other property or right of a similar nature, or for imparting or undertaking to impart knowledge directly or indirectly connected with the use in Hong Kong of any such patent, design, trade mark, copyright material, layout-design (topography) of an integrated circuit, performer's right, plant variety right, secret process or formula, or other property or right; *(Replaced 12 of 2004 s. 5. Amended 21 of 2011 s. 3; 24 of 2018 s. 3)*

(ba) sums, not otherwise chargeable to tax under this Part, received by or accrued to a person for the use, or the

right to the use, outside Hong Kong of any patent, design, trade mark, copyright material, layout-design (topography) of an integrated circuit, performer's right, plant variety right, secret process or formula, or other property or right of a similar nature, or for imparting or undertaking to impart knowledge directly or indirectly connected with the use outside Hong Kong of any such patent, design, trade mark, copyright material, layout-design (topography) of an integrated circuit, performer's right, plant variety right, secret process or formula, or other property or right, which are deductible in ascertaining the assessable profits of a person under this Part; *(Added 12 of 2004 s. 5. Amended 21 of 2011 s. 3; 24 of 2018 s. 3)*

(bb) sums, not otherwise chargeable to tax under this Part, received by or accrued to a performer or an organizer for an assignment of, or an agreement to assign, a performer's right in relation to a performance given by the performer in Hong Kong on or after the day on which the Inland Revenue (Amendment) (No. 5) Ordinance 2018 (24 of 2018) comes into operation; *(Added 24 of 2018 s. 3)*

(c) sums received by or accrued to a person by way of grant, subsidy or similar financial assistance in connection with the carrying on of a trade, profession or business in Hong Kong, other than sums in connection with capital expenditure made or to be made by the person;

(d) sums received by or accrued to a person by way of hire, rental or similar charges for the use of movable property in Hong Kong or the right to use movable property in Hong Kong;

(e) *(Repealed 7 of 1975 s. 7)*

(f) sums received by or accrued to a corporation carrying on a trade, profession or business in Hong Kong by way of interest derived from Hong Kong; *(Replaced 19 of 1986 s. 2)*

(g) sums received by or accrued to a person, other than a corporation, carrying on a trade, profession or business in Hong Kong by way of interest derived from Hong Kong which interest is in respect of the funds of the trade, profession or business; *(Replaced 19 of 1986 s. 2. Amended 17 of 1989 s. 4)*

(h) sums received by or accrued to a person as a refund to the person of—

(i) contributions paid as an employer to a recognized occupational retirement scheme; or

(ii) voluntary contributions paid as an employer to a mandatory provident fund scheme,

but only to the extent that the sums are allowed as deductions in ascertaining the person's assessable profits under this Part; *(Replaced 4 of 1998 s. 6)*

(i) sums, not otherwise chargeable to tax under this Part, received by or accrued to a financial institution by way of interest which arises through or from the carrying on by the financial institution of its business in Hong Kong, notwithstanding that the moneys in respect of which the interest is received or accrues are made available outside Hong Kong; *(Added 73 of 1978 s. 3)*

(ia) sums, not otherwise chargeable to tax under this Part, received by or accrued to a corporation (other than a financial institution), by way of interest that arises through or from the carrying on in Hong Kong by the corporation of its intra-group financing business within the meaning of section 16(3), even if the moneys in

respect of which the interest is received or accrues are made available outside Hong Kong; *(Added 12 of 2016 s. 7)*

(j) sums received by or accrued to a corporation carrying on a trade, profession or business in Hong Kong by way of gains or profits arising in or derived from Hong Kong from the sale or other disposal or on the redemption, on maturity or presentment or otherwise, of a certificate of deposit, bill of exchange or regulatory capital security; *(Replaced 19 of 1986 s. 2. Amended 12 of 2016 s. 12)*

(k) sums received by or accrued to a person, other than a corporation, carrying on a trade, profession or business in Hong Kong by way of gains or profits arising in or derived from Hong Kong from the sale or other disposal or on the redemption, on maturity or presentment or otherwise, of a certificate of deposit, bill of exchange or regulatory capital security where such gains or profits are in respect of the funds of the trade, profession or business; *(Replaced 19 of 1986 s. 2. Amended 28 of 1987 s. 3; 17 of 1989 s. 4; 12 of 2016 s. 12)*

(l) sums, not otherwise chargeable to tax under this Part, received by or accrued to a financial institution by way of gains or profits arising through or from the carrying on by the financial institution of its business in Hong Kong from the sale or other disposal or on the redemption, on maturity or presentment or otherwise, of a certificate of deposit, bill of exchange or regulatory capital security even if— *(Amended 12 of 2016 s. 12)*

(i) the moneys laid out for the acquisition of the certificate, bill or security were made available outside Hong Kong; or *(Amended 12 of 2016 s. 12)*

(ii) the sale, disposal or redemption is effected outside Hong Kong; *(Added 19 of 1986 s. 2. Amended 28 of 1987 s. 3; 12 of 2016 s. 7)*

(la) sums, not otherwise chargeable to tax under this Part, received by or accrued to a corporation (other than a financial institution), by way of gains or profits arising through or from the carrying on in Hong Kong by the corporation of its intra-group financing business within the meaning of section 16(3), from the sale or other disposal or on the redemption, on maturity or presentment or otherwise, of a certificate of deposit, bill of exchange or regulatory capital security, even if—

(i) the moneys laid out for the acquisition of the certificate, bill or security were made available outside Hong Kong; or

(ii) the sale, disposal or redemption is effected outside Hong Kong; *(Added 12 of 2016 s. 7. Amended 9 of 2017 s. 5)*

(m) sums received or receivable by a person as consideration in respect of the transfer of a right to receive income, as provided for in section 15A; and *(Added 28 of 1987 s. 3. Amended 9 of 2017 s. 5)*

(n) sums, not otherwise chargeable to tax under this Part, received by or accrued to a corporation by way of gains or profits (other than those arising from the sale of capital assets) arising through or from the carrying on in Hong Kong by the corporation of—

(i) its business of granting a right to use an aircraft to another person (***aircraft business***), even if the aircraft is used outside Hong Kong; or

(ii) its business of managing a corporation carrying on an aircraft business or of managing an aircraft

business, even if the aircraft concerned is used outside Hong Kong. *(Added 9 of 2017 s. 5)*

(1A) Subsection (1)(j) or (k) shall not apply to gains or profits arising in or derived from Hong Kong, other than gains or profits received by or accrued to a person whose trade, profession or business comprises or includes trading in certificates of deposit or bills of exchange, to the extent to which such gains or profits relate to a period prior to 1 April 1981; and gains or profits received by or accrued to any person from the sale or other disposal or on the redemption on maturity or presentment, on or after 1 April 1981, of a certificate of deposit or bill of exchange purchased or otherwise acquired by that person before that date, shall be determined by reference to such amount as the Commissioner may consider such certificate of deposit or bill of exchange would have realized if it had been sold in the open market at the close of business on 31 March 1981 and not by reference to the amount, if any, paid by that person in so purchasing or otherwise acquiring such certificate of deposit or bill of exchange. *(Added 30 of 1981 s. 3)*

(1B) *(Repealed 36 of 1984 s. 3)*

(1C) Subsection (1)(f), (g), (i), (ia), (j), (k), (l) and (la) applies, subject to sections 17B, 17C, 17D, 17E, 17F and 17G, in relation to a regulatory capital security. *(Added 12 of 2016 s. 12)*

(2) Where, in ascertaining for the purposes of this Part the profits of a trade, profession or business carried on in Hong Kong, a deduction has been allowed for any debt incurred for the purposes of the trade, profession or business, then, if the whole or any part of that debt is thereafter released, the amount released shall be deemed to be a receipt of the trade, profession or business arising in or derived from Hong Kong at the time when the release was effected.

(3) Where in the basis period for any year of assessment a financial institution was not a financial institution for the whole of that period, in that, if the institution is a bank it was not licensed for the whole of that period or if the institution is a deposit-taking company it was not registered for the whole of that period, then subsection (1)(i) and (l) shall apply only in respect of such part of the basis period during which the bank or deposit-taking company was licensed or registered, as the case may be. *(Added 73 of 1978 s. 3. Amended 19 of 1986 s. 2)*

(3A) Section 21 of Schedule 17A (specified alternative bond scheme and its tax treatment) provides for modifications to subsection (1)(j), (k) and (l). *(Added 10 of 2013 s. 7)*

(4) The amendments to this section effected by the Inland Revenue (Amendment) Ordinance 1984 (36 of 1984) shall not have the effect of rendering chargeable to tax sums received or accrued to any person prior to 1 April 1984 which were not chargeable to tax immediately prior to the coming into force of that Ordinance. *(Added 36 of 1984 s. 3)*

(5) The amendments to this section effected by the Inland Revenue (Amendment) (No. 2) Ordinance 1986 (19 of 1986) shall apply to sums received or accrued by way of interest, gains or profits on or after 1 April 1986, and the provisions of this section in force immediately prior to the coming into force of that Ordinance shall continue to apply to such sums received or accrued prior to 1 April 1986 as if such amendments had not been enacted. *(Added 19 of 1986 s. 2)*

(6) The amendment made to subsection (1) by section 5(a)(ii) of the Inland Revenue (Amendment) Ordinance 2004 (12 of 2004) does not apply to sums described in subsection (1)(ba) which were received by or which accrued to a person before the commencement* of that Ordinance. *(Added 12 of 2004 s. 5)*

(7) The amendments made to this section by the Inland Revenue (Amendment) (No. 5) Ordinance 2018 (24 of 2018) do not have the effect of rendering chargeable to tax sums received by or accrued to a person before the day on which that Ordinance comes into operation which were not otherwise chargeable to tax. *(Added 24 of 2018 s. 3)*

(8) In this section—

organizer (籌辦人) means a person who obtains a performer's right in a performance in Hong Kong through arranging the participation of the performer in the performance or managing the performance;

performance (表演) has the meaning given by section 200(2) of the Copyright Ordinance (Cap. 528);

performer (表演者) has the meaning given by section 200(2) of the Copyright Ordinance (Cap. 528). *(Added 24 of 2018 s. 3)*

(Replaced 2 of 1971 s. 9. Amended 7 of 1986 s. 12)

Editorial Note:

* Commencement date: 25 June 2004.

16. Ascertainment of chargeable profits

(1) In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part for any period, including—

(a) where the condition for the application of this paragraph is satisfied under subsection (2), and subject to subsections (2A), (2B), (2C), (2CA) and (2CC), sums payable by such person by way of interest on any money borrowed by him for the purpose of producing such profits, and sums payable by such person by way of legal fees, procuration fees, stamp duties and other expenses in connection with such borrowing; *(Replaced 2 of 1971 s. 11. Amended 36 of 1984 s. 4; 12 of 2004 s. 6; 12 of 2016 s. 8)*

(b) rent paid by any tenant of land or buildings occupied by him for the purpose of producing such profits, but not exceeding, in the case of rent paid to the tenant's spouse, or by a partnership to one or more of the partners thereof or to a spouse of any such partner, an amount equal to the assessable value of the land or buildings;

(Amended 76 of 1975 s. 8; 8 of 1983 s. 11; 71 of 1983 s. 14)

(c) subject to subsection (2J) and section 50AA, tax of substantially the same nature as tax imposed under this Ordinance, proved to the satisfaction of the Commissioner to have been paid elsewhere, whether by deduction or otherwise, by any corporation or by a person other than a corporation who carries on a trade, profession or business in Hong Kong, during the basis period for the year of assessment in respect of profits chargeable to tax by virtue of section 15(1)(f), (g), (i), (ia), (j), (k), (l) or (la); *(Amended 7 of 1986 s. 12; 19 of 1986 s. 3; 63 of 1997 s. 2(a); 12 of 2016 s. 8; 27 of 2018 s. 4)*

(d) bad debts incurred in any trade, business or profession, proved to the satisfaction of the assessor to have become bad during the basis period for the year of assessment, and doubtful debts to the extent that they are respectively estimated to the satisfaction of the assessor to have become bad during the said basis period notwithstanding that such bad or doubtful debts were due and payable prior to the commencement of the said basis period:

Provided that—

(i) deductions under this paragraph shall be limited to debts which were included as a trading receipt in ascertaining the profits, in respect of which the person claiming the deduction is chargeable to tax under this Part, of the period within which they arose, and debts in respect of money lent, in the ordinary course of the business of the lending of money within Hong Kong, by a person who carries on that business; *(Amended 7 of 1986 s. 12)*

(ii) all sums recovered during the said basis period on account of amounts previously allowed in respect of bad or doubtful debts shall for the purposes of this Ordinance be treated as part of the profits of the trade, business or profession for that basis period;

(e) expenditure incurred in the repair of any premises, plant, machinery, implement, utensil or article employed in the production of such profits;

(f) expenditure incurred in the replacement of any implement, utensil or article employed in the production of such profits:

Provided that no allowances have been or shall be made under the provisions of Part 6 in respect of such implement, utensil or article;

(g) notwithstanding section 17, a sum expended for the registration of a trade mark or design, or the registration or grant of a patent or plant variety right, used in the trade, profession or business which produces such profits; *(Replaced 26 of 1969 s. 14. Amended 52 of 1997 s. 160; 24 of 2018 s. 4)*

*(ga) the payments and expenditure specified in sections 16AA, 16B, 16C, 16E, 16EA, 16F, 16G and 16I, as provided in those sections; *(Added 35 of 1965 s. 9. Amended 56 of 1993 s. 9; 31 of 1998 s. 8; 32 of 1998 s. 6; 21 of 2011 s. 4)*

(h) such other deductions as may be prescribed by any rule made under this Ordinance.

(1A) In computing the amount of deduction of a person's outgoings and expenses for the purposes of subsection (1), if—

(a) the person is a connected person of a corporation;

(b) a sum is payable by the person to the corporation, whether directly or through an interposed person; and

(c) the sum is included in the assessable profits of the corporation chargeable at a reduced tax rate under section 14B(1), 14D(1), 14H(1) or 14J(1) for a year of assessment, *(Amended 27 of 2018 s. 30)*

the amount of deduction in respect of the sum is to be reduced such that the profits tax payable by the person is increased by reference to the amount of the reduction in the profits tax payable by the corporation in respect of the sum for the year of assessment or any subsequent year of assessment. *(Added 9 of 2017 s. 6)*

(1B) However, subsection (1A) does not apply in relation to a person for a year of assessment if, had the sum mentioned in subsection (1A)(b) not been so payable, it would have been included in the assessable profits of the person chargeable at a reduced rate under section 14B(1), 14D(1), 14H(1) or 14J(1) for the year of assessment. *(Added 27 of 2018 s. 30)*

(1C) For subsection (1A), a person is a connected person of a corporation if the person is—

(a) an associated corporation of the corporation; or

(b) a person (other than a corporation)—

(i) over whom the corporation has control;

(ii) who has control over the corporation; or

(iii) who is under the control of the same person as is the corporation. *(Added 27 of 2018 s. 30)*

(1D) For subsection (1A), a person is also a connected person of a corporation in relation to a case where a sum is included in the corporation's assessable profits chargeable at a reduced rate under section 14H(1) or 14J(1) for a year of assessment if the person is a partnership in which the corporation or its

associate (as defined by section 14G(1)) is a partner. *(Added 27 of 2018 s. 30)*

(2) The condition for the application of subsection (1)(a) is satisfied if— *(Amended 12 of 2004 s. 6)*

(a) the money has been borrowed by a financial institution;

(b) the money has been borrowed by a public utility company specified in Schedule 3 at a rate of interest not exceeding the rate specified by the Financial Secretary by notice in the Gazette; *(Amended 17 of 1989 s. 5)*

(c) the money has been borrowed from a person other than a financial institution or an overseas financial institution and the sums payable by way of interest are chargeable to tax under this Ordinance;

(d) the money has been borrowed from a financial institution or an overseas financial institution; *(Replaced 12 of 2004 s. 6)*

(e) the money has been borrowed wholly and exclusively to finance—

(i) capital expenditure incurred by the borrower on the provision of—

(A) any machinery or plant, where the expenditure qualifies for an allowance under Part 6;

(B) any machinery or plant for research and development, where the expenditure may be deducted under section 16B;

(C) a prescribed fixed asset (as defined in section 16G(6)), where the expenditure may be deducted under section 16G; or

(D) any environmental protection machinery or environment-friendly vehicle (as defined in section 16H(1)), where the expenditure may

be deducted under section 16I; or *(Replaced 4 of 2010 s. 4. Amended 10 of 2010 s. 2)*

(ii) the purchase of trading stock by the borrower, where the trading stock purchased is used by the borrower in the production of profits chargeable to tax under this Part,

and—

(iii) the lender is not an associate of the borrower; and

(iv) where the lender is a trustee of a trust estate or a corporation controlled by such a trustee, neither the trustee nor the corporation nor any beneficiary under the trust is the borrower or an associate of the borrower; *(Replaced 12 of 2004 s. 6. Amended 12 of 2016 s. 8)*

(f) the borrower is a corporation and the deduction claimed is in respect of interest payable by it—

(i) on debentures listed on a stock exchange in Hong Kong or on any other stock exchange recognized by the Commissioner for the purposes of this subparagraph;

(ii) on instruments (other than debentures described in subparagraph (i))—

(A) issued bona fide and in the course of carrying on business and marketed in Hong Kong or in a major financial centre outside Hong Kong recognized by the Commissioner for the purposes of this sub-subparagraph; or

(B) issued pursuant to any agreement or arrangements, where the issue of an advertisement, invitation or document in respect of the agreement or arrangements

has been authorized by the Securities and Futures Commission under section 105 of the Securities and Futures Ordinance (Cap. 571), and the advertisement, invitation or document has been issued to the public; or

(iii) on money borrowed from an associated corporation of the borrower, where the money borrowed in the hands of the associated corporation arises entirely from the proceeds of an issue by the associated corporation of debentures described in subparagraph (i) or of instruments described in subparagraph (ii), in an amount not exceeding the interest payable by the associated corporation to the holders of such debentures or instruments; or *(Replaced 12 of 2004 s. 6. Amended 12 of 2016 s. 8)*

(g) the borrower is a corporation carrying on in Hong Kong an intra-group financing business and—

(i) the deduction claimed is in respect of interest payable by it on money borrowed from a non-Hong Kong associated corporation (***lender***) in the ordinary course of that business;

(ii) the lender is, in respect of the interest, subject to a similar tax in a territory outside Hong Kong at a rate that is not lower than the reference rate; and

(iii) the lender's right to use and enjoy that interest is not constrained by a contractual or legal obligation to pass that interest to any other person, unless the obligation arises as a result of a transaction between the lender and a person other than the borrower dealing with each other at arm's length.

Note—

See subsection (2I) for elaboration on how a person is regarded as subject to a tax at a certain rate and the meanings of ***similar tax*** and ***reference rate***. *(Added 12 of 2016 s. 8)*

(2AA) Subsections (1)(a) and (2)(a) apply, subject to sections 17B, 17C, 17D, 17E, 17F and 17G, in relation to a sum payable by a financial institution in respect of a regulatory capital security issued by the financial institution. *(Added 12 of 2016 s. 13)*

(2A) Where—

(a) the condition for the application of subsection (1)(a) is satisfied under subsection (2)(c), (d) or (e);

(b) at any time during the basis period of the borrower for the year of assessment concerned, the payment of any sum payable by way of principal or interest in respect of the money borrowed is secured or guaranteed, whether wholly or in part and whether directly or indirectly, by a deposit or loan made by the borrower or an associate of the borrower with or to—

(i) the lender or an associate of the lender;

(ii) a financial institution or an associate of a financial institution; or

(iii) an overseas financial institution or an associate of an overseas financial institution; and

(c) any sum payable by way of interest on the deposit or loan is not chargeable to tax under this Ordinance,

the amount of the deduction which, but for this subsection and subsections (2B), (2C) and (2CA), would have been allowed under subsection (1)(a) for the year of assessment concerned in respect of sums payable by the borrower by way of interest on the money borrowed shall be reduced, having regard to the sum payable by way of interest on the deposit

or loan, by an amount calculated on such basis as is most reasonable and appropriate in the circumstances of the case. *(Added 12 of 2004 s. 6. Amended 12 of 2016 s. 8)*

(2B) Where—

(a) the condition for the application of subsection (1)(a) is satisfied under subsection (2)(c), (d) or (e); and

(b) at any time during the basis period of the borrower for the year of assessment concerned, arrangements are in place, whether between the borrower and the lender or otherwise, whereby any sum payable by way of interest on the money borrowed or on any part of the money borrowed is payable, whether directly or through any interposed person, to the borrower or to a person (other than the lender) who is connected with the borrower and in either case the borrower or the person, as the case may be, is not an excepted person as defined in subsection (2E)(c),

the amount of the deduction which, but for this subsection and subsections (2A) , (2C) and (2CA), would have been allowed under subsection (1)(a) for the year of assessment concerned in respect of sums payable by the borrower by way of interest on the money borrowed or on the relevant part of the money borrowed, as the case may be, shall be reduced by an amount calculated in accordance with the following formula— *(Amended 12 of 2016 s. 8)*

$$\frac{A}{B} \times C$$

where: A means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the money borrowed or in respect of the relevant part of the money borrowed, as the case may be, is outstanding and the arrangements are in place;

B means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the money borrowed or in respect of the relevant part of the money borrowed, as the case may be, is outstanding; and

C means the total amount of sums payable by the borrower by way of interest on the money borrowed or on the relevant part of the money borrowed, as the case may be, which, but for this subsection and subsections (2A) , (2C) and (2CA), would have been deductible under subsection (1)(a) for the year of assessment concerned. *(Added 12 of 2004 s. 6. Amended 12 of 2016 s. 8)*

(2C) Subject to subsection (2G), where—

(a) the condition for the application of subsection (1)(a) is satisfied under subsection (2)(f); and

(b) at any time during the basis period of the borrower for the year of assessment concerned, arrangements are in place, whether between the borrower and the holders of the debentures or instruments concerned or otherwise,

whereby any sum payable by way of interest on the debentures or instruments concerned or on any interest in the debentures or instruments concerned is payable, whether directly or through any interposed person, to the borrower or to a person who is connected with the borrower and in either case the borrower or the person, as the case may be, is not an excepted person as defined in subsection (2F)(c),

the amount of the deduction which, but for this subsection and subsections (2A) , (2B) and (2CA), would have been allowed under subsection (1)(a) for the year of assessment concerned in respect of— *(Amended 12 of 2016 s. 8)*

(c) (where the condition for the application of subsection (1)(a) is satisfied under subsection (2)(f)(i) or (ii)) the sum payable by the borrower by way of interest on the debentures or instruments concerned or on the relevant interest in the debentures or instruments concerned, as the case may be; or

(d) (where the condition for the application of subsection (1)(a) is satisfied under subsection (2)(f)(iii)) the sum payable by the borrower by way of interest on money borrowed from the associated corporation, being money arising entirely from the proceeds of the issue of the debentures or instruments concerned or of the relevant interest in the debentures or instruments concerned, as the case may be,

shall be reduced by an amount calculated in accordance with the following formula—

$$\frac{X}{Y} \times Z$$

where: X means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the debentures or instruments concerned or in respect of the relevant interest in the debentures or instruments concerned, as the case may be, is outstanding and the arrangements are in place;

Y means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the debentures or instruments concerned or in respect of the relevant interest in the debentures or instruments concerned, as the case may be, is outstanding; and

Z means the total amount of sums referred to in paragraph (c) or (d), as the case may be, which, but for this subsection and subsections (2A), (2B) and (2CA), would have been deductible under subsection (1)(a) for the year of assessment concerned. *(Added 12 of 2004 s. 6. Amended 12 of 2016 s. 8)*

(2CA) Where the condition for the application of subsection (1)(a) is satisfied under subsection (2)(g), the application of subsection (1)(a) is nevertheless qualified by subsection (2CB) if—

(a) at any time during the basis period of the borrower for the year of assessment concerned, arrangements are in place, whether between the borrower and the lender or otherwise, by which any sum payable by way of interest

on the money borrowed or on any part of the money borrowed is payable, whether directly or through any interposed person, to a related person; and

(b) the related person is, in respect of the sum—

(i) neither subject to profits tax in Hong Kong, nor subject to a similar tax in any territory outside Hong Kong; or

(ii) subject to profits tax in Hong Kong, or subject to a similar tax in a territory outside Hong Kong, but no rate at which the person is subject to such tax is equal to or higher than the reference rate.

Note—

See subsection (2I) for elaboration on how a person is regarded as subject to a tax at a certain rate and the meanings of ***similar tax***, ***reference rate*** and ***related person***. *(Added 12 of 2016 s. 8)*

(2CB) For the purposes of subsection (2CA), the amount of the deduction that, but for subsections (2A), (2B), (2C) and (2CA), would have been allowed under subsection (1)(a) for the year of assessment concerned in respect of sums payable by the borrower by way of interest on the money borrowed or on the relevant part of the money borrowed, as the case may be, is to be reduced by an amount calculated in accordance with the following formula—

$$\frac{A}{B} \times C$$

where: A means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the money borrowed or in respect of the relevant part of the money borrowed, as the case may be, is outstanding and the arrangements mentioned in subsection (2CA)(a) are in place;

B means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the money borrowed or in respect of the relevant part of the money borrowed, as the case may be, is outstanding; and

C means the total amount of sums payable by the borrower by way of interest on the money borrowed or on the relevant part of the money borrowed, as the case may be, that, but for subsections (2A), (2B), (2C) and (2CA), would have been deductible under subsection (1)(a) for the year of assessment concerned. *(Added 12 of 2016 s. 8)*

(2CC) Where a deduction under subsection (1)(a) is claimed, by virtue of subsection (2)(g), for a year of assessment in respect of interest payable on money borrowed by a corporation, no deduction is to be allowed in respect of the interest if the Commissioner is satisfied that the main purpose, or one of the main purposes, of the borrowing of the money is to utilize a loss to avoid, postpone or reduce any liability, whether of

the corporation or another person, to profits tax under this Ordinance. *(Added 12 of 2016 s. 8)*

(2CD) In subsection (2CC)—

loss (虧損)——

(a) means a loss sustained by a related person within the meaning of subsection (2I)(d)(ii) or (iii) in a trade, profession or business, whether in Hong Kong or elsewhere; and

(b) includes any balance of such loss. *(Added 12 of 2016 s. 8)*

(2D) For the purposes of subsection (2A), if a deposit or loan is made by a trustee of a trust estate or a corporation controlled by such a trustee, the deposit or loan shall be deemed to have been made by each of the trustee, the corporation and the beneficiary under the trust. *(Added 12 of 2004 s. 6)*

(2E) For the purposes of subsections (2B) and (2CA)— *(Amended 12 of 2016 s. 8)*

(a) any reference in those subsections to any sum payable by way of interest on the money borrowed or on any part of the money borrowed, however described, shall be construed as including a reference to any sum payable by way of principal or interest in respect of any other loan, where the payment of such sum is— *(Amended 12 of 2016 s. 8)*

(i) secured or guaranteed, whether wholly or in part and whether directly or indirectly, by any sum payable by way of principal or interest in respect of the money borrowed or in respect of any part of the money borrowed; or

(ii) conditional, whether wholly or in part and whether directly or indirectly, on the payment of any sum

payable by way of principal or interest in respect of the money borrowed or in respect of any part of the money borrowed;

(b) if any sum payable by way of interest on the money borrowed or on any part of the money borrowed, as construed in accordance with paragraph (a), is payable, whether directly or through any interposed person, to a trustee of a trust estate or a corporation controlled by such a trustee, such sum shall be deemed to be so payable to each of the trustee, the corporation and the beneficiary under the trust; and

(c) ***excepted person*** (除外人士) means—

(i) a person who is chargeable to tax under this Ordinance in respect of any sum payable by way of interest on the money borrowed or on any part of the money borrowed, as construed in accordance with paragraph (a);

(ii) in the case of a person (other than the lender) who is connected with the borrower—

(A) a person who is entitled to any sum referred to in subparagraph (i) in the capacity of—

(I) a person acting as a trustee of a trust estate or holding property belonging to others pursuant to the terms of a contract, where the person is not beneficially entitled to the sum in question;

(II) a beneficiary of a unit trust to which section 26A(1A)(a)(i) or (ii) applies, where the sum in question is payable to a trustee of the unit trust in respect of a

specified investment scheme referred to in section 26A(1A)(b); or

(III) a member of a retirement scheme which is either a recognized retirement scheme or a substantially similar retirement scheme established outside Hong Kong, where the Commissioner is satisfied that the latter scheme complies with the requirements of a supervisory authority within an acceptable regulatory regime;

(B) a public body;

(C) a body corporate, where the Government owns beneficially more than half of the issued share capital of that body corporate for the time being; or *(Amended 28 of 2012 ss. 912 & 920)*

(D) a financial institution or an overseas financial institution. *(Added 12 of 2004 s. 6)*

(2F) For the purposes of subsection (2C)—

(a) any reference in that subsection to any sum payable by way of interest on the debentures or instruments concerned or on any interest in the debentures or instruments concerned, however described, shall be construed as including a reference to any sum payable by way of principal or interest in respect of any other loan, where the payment of such sum is—

(i) secured or guaranteed, whether wholly or in part and whether directly or indirectly, by any sum payable by way of principal or interest in respect of the debentures or instruments concerned or in respect of any interest in the debentures or instruments concerned; or

(ii) conditional, whether wholly or in part and whether directly or indirectly, on the payment of any sum payable by way of principal or interest in respect of the debentures or instruments concerned or in respect of any interest in the debentures or instruments concerned;

(b) if any sum payable by way of interest on the debentures or instruments concerned or on any interest in the debentures or instruments concerned, as construed in accordance with paragraph (a), is payable, whether directly or through any interposed person, to a trustee of a trust estate or a corporation controlled by such a trustee, such sum shall be deemed to be so payable to each of the trustee, the corporation and the beneficiary under the trust; and

(c) ***excepted person*** (除外人士) means—

(i) a person who is chargeable to tax under this Ordinance in respect of any sum payable by way of interest on the debentures or instruments concerned or on any interest in the debentures or instruments concerned, as construed in accordance with paragraph (a);

(ii) in the case of a person who is connected with the borrower—

(A) a person who is entitled to any sum referred to in subparagraph (i) in the capacity of—

(I) a person acting as a trustee of a trust estate or holding property belonging to others pursuant to the terms of a contract, where the person is not beneficially entitled to the sum in question;

(II) a beneficiary of a unit trust to which section 26A(1A)(a)(i) or (ii) applies, where the sum in question is payable to a trustee of the unit trust in respect of a specified investment scheme referred to in section 26A(1A)(b); or

(III) a member of a retirement scheme which is either a recognized retirement scheme or a substantially similar retirement scheme established outside Hong Kong, where the Commissioner is satisfied that the latter scheme complies with the requirements of a supervisory authority within an acceptable regulatory regime;

(B) a public body;

(C) a body corporate, where the Government owns beneficially more than half of the issued share capital of that body corporate for the time being; or *(Amended 28 of 2012 ss. 912 & 920)*

(D) a financial institution or an overseas financial institution. *(Added 12 of 2004 s. 6)*

(2G) Subsection (2C) shall not apply where under the relevant arrangements, the relevant sum payable by way of interest on the debentures or instruments concerned or on any interest in the debentures or instruments concerned is payable to a market maker who, in the ordinary course of conduct of his trade, profession or business in respect of market making, holds such debentures or instruments or such interest for the purpose of providing liquidity thereof. *(Added 12 of 2004 s. 6)*

(2H) In subsection (2G), ***market maker*** (市場莊家) means a person who—

(a) is licensed or registered for dealing in securities under the Securities and Futures Ordinance (Cap. 571) or authorized to do so by a regulatory authority in a major financial centre outside Hong Kong recognized by the Commissioner for the purposes of subsection (2)(f)(ii)(A);

(b) in the ordinary course of conduct of his trade, profession or business in respect of market making holds himself out as being willing to buy and sell securities for his own account and on a regular basis; and

(c) is actively involved in market making in securities issued by a wide range of unrelated institutions. *(Added 12 of 2004 s. 6)*

(2I) For the purposes of this subsection and subsections (2)(g) and (2CA)—

(a) a person is, in respect of an interest or a sum, subject to a tax at a certain rate in a territory if the Commissioner is satisfied that—

(i) for a similar tax in a territory outside Hong Kong as mentioned in subsections (2)(g)(ii) and (2CA)(b)(i) and (ii)—tax of that nature has been paid or will be paid, whether by deduction or otherwise, at that rate by that person in respect of the interest or sum concerned in that territory as required by the laws of that territory; or

(ii) for profits tax in Hong Kong as mentioned in subsection (2CA)(b)(i) and (ii)—profits tax under this Ordinance has been paid or will be paid at that rate by that person in respect of the sum concerned in Hong Kong;

(b) ***similar tax*** (類似稅項) means a tax that is of substantially the same nature as profits tax under this Ordinance;

(c) ***reference rate*** (參考稅率) means—

(i) the rate specified in Schedule 8 for the year of assessment concerned; or

(ii) if section 14D(1) applies in respect of the borrower for the year of assessment concerned, the rate applicable under that section; and

(d) ***related person*** (有關連人士) means—

(i) the borrower;

(ii) a person (other than the lender) who is connected with the borrower; or

(iii) a person (other than the borrower) who is connected with the lender. *(Added 12 of 2016 s. 8)*

(2J) Subsection (1)(c) does not apply in relation to any tax paid in a territory by a person in respect of profits referred to in that subsection if—

(a) the territory is a DTA territory (as defined by section 48A); and

(b) under section 50, tax payable in the territory by a Hong Kong resident person in respect of the profits is to be allowed as a credit against tax payable in Hong Kong by the Hong Kong resident person in respect of the profits. *(Added 27 of 2018 s. 4)*

(3) In this section— *(Amended 12 of 2004 s. 6)*

associate (相聯者), in relation to a person, means—

(a) where the person is a natural person—

(i) a relative of the person;

(ii) a partner of the person and any relative of that partner;

(iii) a partnership in which the person is a partner;

(iv) any corporation controlled by the person, by a partner of the person or by a partnership in which the person is a partner;

(v) any director or principal officer of any such corporation as is referred to in subparagraph (iv);

(b) where the person is a corporation—

(i) any associated corporation;

(ii) any person who controls the corporation and any partner of such person, and, where either such person is a natural person, any relative of such person;

(iii) any director or principal officer of that corporation or of any associated corporation and any relative of any such director or officer;

(iv) any partner of the corporation and, where such partner is a natural person, any relative of such partner;

(c) where the person is a partnership—

(i) any partner of the partnership and where such partner is a partnership any partner of that partnership, any partner with the partnership in any other partnership and where such partner is a partnership any partner of that partnership and where any partner of, or with, or in any of the partnerships mentioned in this subparagraph is a natural person, any relative of such partner;

(ii) any corporation controlled by the partnership or by any partner thereof or, where such a partner is a natural person, any relative of such partner;

(iii) any corporation of which any partner is a director or principal officer;

(iv) any director or principal officer of a corporation referred to in subparagraph (ii);

associated corporation (相聯法團), in relation to a person, means—

(a) a corporation over which the person has control;

(b) if the person is a corporation—

(i) a corporation which has control over the person; or

(ii) a corporation which is under the control of the same person as is the first-mentioned person;

beneficiary under the trust (信託的受益人) means any person who benefits or is capable (whether by the exercise of a power of appointment or otherwise) of benefiting under a trust estate, either directly or through any interposed person, or who is able or might reasonably be expected to be able, whether directly or indirectly, to control the activities of the trust estate or the application of its corpus or income;

intra-group financing business (集團內部融資業務), in relation to a corporation, means the business of the borrowing of money from and lending of money to its associated corporations; *(Added 12 of 2016 s. 8)*

non-Hong Kong associated corporation (非香港相聯法團) means an associated corporation that does not carry on any trade, profession or business in Hong Kong; *(Added 12 of 2016 s. 8)*

overseas financial institution (海外財務機構) means a person carrying on the business of banking or deposit-taking outside Hong Kong other than a person whom the Commissioner has,

in accordance with the powers vested in him by subsection (4), determined shall not be recognized for the purposes of this section as an overseas financial institution; *(Amended 12 of 2004 s. 6)*

principal officer (主要職員) means—

(a) a person employed by a corporation who, either alone or jointly with one or more other persons, is responsible under the immediate authority of the directors for the conduct of the business of the corporation; or

(b) a person so employed who, under the immediate authority of a director of the corporation or a person to whom paragraph (a) applies, exercises managerial functions in respect of the corporation;

relative (親屬) means the spouse, parent, child, brother or sister of the relevant person, and, in deducing such a relationship, an adopted child shall be deemed to be a child both of the natural parents and the adopting parent and a step child to be the child of both the natural parents and of any step parent. *(Replaced 63 of 1997 s. 2)*

(3A) In this section—

(a) a corporation shall be regarded as being controlled by a person if the person has the power to secure—

(i) by means of the holding of shares or the possession of voting power in or in relation to that or any other corporation; or

(ii) by virtue of any power conferred by the articles of association or any other document regulating that or any other corporation,

that the affairs of the first-mentioned corporation are conducted in accordance with his wishes; and

(b) a person (other than a corporation) shall be regarded as being controlled by another person if the first-mentioned person is accustomed or under an obligation, whether express or implied, and whether or not enforceable or intended to be enforceable by legal proceedings, to act, in relation to his investment or business affairs, in accordance with the directions, instructions or wishes of that other person. *(Added 12 of 2004 s. 6)*

(3B) In this section, a person is regarded as being connected with a borrower if the person is— *(Amended 12 of 2016 s. 8)*

(a) an associated corporation of the borrower; or *(Amended 12 of 2016 s. 8)*

(b) a person (other than a corporation)—

(i) who controls the borrower;

(ii) who is controlled by the borrower; or

(iii) who is under the control of the same person as is the borrower. *(Added 12 of 2004 s. 6)*

(3C) In this section, a person is regarded as being connected with a lender if the person is—

(a) an associated corporation of the lender; or

(b) a person (other than a corporation)—

(i) who controls the lender;

(ii) who is controlled by the lender; or

(iii) who is under the control of the same person as is the lender. *(Added 12 of 2016 s. 8)*

(4) The Commissioner may for the purposes of this section determine that a person shall not be recognized as an overseas financial institution if he is of the opinion that that person's banking or deposit-taking business is not adequately

supervised by a supervisory authority. *(Added 36 of 1984 s. 4. Amended 12 of 2004 s. 6)*

(4A) Sections 21 and 22 of Schedule 17A (specified alternative bond scheme and its tax treatment) provide for modifications to subsection (2)(f). *(Added 10 of 2013 s. 8)*

(5) The amendments to this section effected by the Inland Revenue (Amendment) Ordinance 1984 (36 of 1984) shall not have the effect of disallowing any deduction under subsection (1)(a) which could lawfully have been made immediately prior to the coming into force of that Ordinance where the deduction is in respect of sums payable prior to 1 April 1984. *(Added 36 of 1984 s. 4. Amended 7 of 1986 s. 4)*

(5A) The amendments made to this section by section 6(a), (b), (c), (d), (e) and (f) of the Inland Revenue (Amendment) Ordinance 2004 (12 of 2004) (***the Amendment Ordinance***) do not apply to sums described in subsection (1)(a) which were incurred—

(a) before the commencement# of the Amendment Ordinance;

(b) under a transaction which was the subject of an application for advance clearance made to the Commissioner before 1 April 1998, and the Commissioner has before the commencement# of the Amendment Ordinance expressed the opinion that the transaction would not fall within the terms of section 61A; or

(c) under an arrangement which was the subject of an application made to the Commissioner under section 88A, and the Commissioner has before the commencement# of the Amendment Ordinance made a ruling under that section that the arrangement would not

fall within the terms of section 61A. *(Added 12 of 2004 s. 6)*

(5B) The amendment made to subsection (1)(g) by the Inland Revenue (Amendment) (No. 5) Ordinance 2018 (24 of 2018) applies only in relation to a year of assessment beginning on or after 1 April 2018. *(Added 24 of 2018 s. 4)*

(6) The Chief Executive in Council may, by notice in the Gazette, amend Schedule 3. *(Added 17 of 1989 s. 5. Amended 12 of 1999 s. 3)*

(7) The Secretary for Financial Services and the Treasury may by order published in the Gazette amend the definition of ***reference rate*** in subsection (2I)(c). *(Added 12 of 2016 s. 8)*

(Replaced 28 of 1964 s. 7. Amended 35 of 1965 s. 9; 12 of 2004 s. 6; E.R. 1 of 2012)

Editorial Note:

* The amendment made by Ord. No. 31 of 1998 to section 16(1)(ga) applies in relation to the year of assessment commencing on 1 April 2000 and to all subsequent years of assessment. *(31 of 1998 s. 2(2); L.N. 175 of 2000)*

Commencement date: 25 June 2004.

17. Deductions not allowed

(1) For the purpose of ascertaining profits in respect of which a person is chargeable to tax under this Part no deduction shall be allowed in respect of— *(Amended 36 of 1955 s. 25; 49 of 1956 s. 13)*

(a) domestic or private expenses, including—

(i) the cost of travelling between the person's residence and place of business; and

*(ii) subject to section 16AA, contributions made to a mandatory provident fund scheme in the person's capacity as a member of the scheme; *(Replaced 4 of 1998 s. 6. Amended 31 of 1998 s. 25)*

*(b) subject to section 16AA, any disbursements or expenses not being money expended for the purpose of producing such profits; *(Amended 36 of 1955 s. 25; 31 of 1998 s. 11)*

(c) any expenditure of a capital nature or any loss or withdrawal of capital;

(d) the cost of any improvements;

(e) any sum recoverable under an insurance or contract of indemnity;

(f) rent of, or expenses in connection with, any premises or part of premises not occupied or used for the purpose of producing such profits; *(Amended 36 of 1955 s. 25)*

(g) any tax paid or payable under this Ordinance other than salaries tax paid in respect of employees' remuneration; *(Replaced 3 of 1949 s. 7. Amended 36 of 1955 s. 25)*

(h) any sums that the person has, as an employer, paid in respect of an employee as—

(i) an ordinary annual contribution to a fund established under a recognized occupational retirement scheme; or

(ii) an ordinary annual premium for a contract of insurance under such a scheme; or

(iii) regular contributions paid to a mandatory provident fund scheme,

to the extent that the total of the payments exceeds 15 per cent of the total emoluments of the employee for

the period to which the payments relate; *(Replaced 4 of 1998 s. 6)*

(i) any provision made for the payment in respect of an employee of any sum referred to in paragraph (h), to the extent that the aggregate of such provision and any such payment as is referred to in that paragraph exceeds 15% of the total emoluments of that employee for the period in respect of which the provision is made; *(Added 7 of 1986 s. 5. Amended 76 of 1993 s. 7)*

(j) any provision made in respect of an occupational retirement scheme other than for the payment of any sum referred to in paragraph (h); *(Added 7 of 1986 s. 5. Amended 76 of 1993 s. 7)*

(k) any sum that the person has, as an employer, paid in respect of an employee as—

(i) a contribution to a fund established under a recognized occupational retirement scheme; or

(ii) a premium for a contract of insurance under such a scheme; or

(iii) a contribution to a mandatory provident fund scheme,

where provision for payment of the sum has been made in a prior year of assessment and a deduction has been allowed for the provision in that or another prior year of assessment; or *(Replaced 4 of 1998 s. 6)*

(l) any—

(i) contribution that the person has, as an employer, made to the funds of; or

(ii) payment that that person has made as an employer for the purposes of the operation of,

an occupational retirement scheme other than a recognized occupational retirement scheme. *(Added 76 of 1993 s. 7. Amended 4 of 1998 s. 6)*

(2) In computing the profits or losses of a person carrying on a trade, profession or business, no deduction is allowable for—

(a) salaries or other remuneration of the person's spouse; or

(b) interest on capital or loans provided by that spouse; or

(c) a contribution made to a mandatory provident fund scheme in respect of that spouse; or

(d) in the case of a partnership—

(i) salaries or other remuneration of a partner or a partner's spouse; or

(ii) interest on capital or loans provided by a partner or by a partner's spouse; or

*(iii) subject to section 16AA, a contribution made to a mandatory provident fund scheme in respect of a partner or a partner's spouse. *(Replaced 4 of 1998 s. 6. Amended 31 of 1998 s. 25)*

(3) In this section—

regular contributions (固定供款) has the same meaning as in section 16A(3). *(Added 4 of 1998 s. 6)*

Editorial Note:

* The amendments made by Ord. No. 31 of 1998 to section 17(1)(a)(ii) and (b) and (2)(d)(iii) apply in relation to the year of assessment commencing on 1 April 2000 and to all subsequent years of assessment. *(31 of 1998 s. 2(2); L.N. 175 of 2000)*

17A. Financial institution: interpretation

(1) In this section and sections 17B, 17C, 17D, 17E, 17F and 17G—

Additional Tier 1 capital instrument (額外一級資本票據) means a capital instrument that qualifies as Additional Tier 1 capital under Schedule 4B to the Banking (Capital) Rules (Cap. 155 sub. leg. L), or under the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee;

associate (相聯者) has the meaning given by section 16(3);

associated corporation (相聯法團) has the meaning given by section 16(3);

Basel Committee (巴塞爾委員會) has the meaning given by section 2(1) of the Banking Ordinance (Cap. 155);

Common Equity Tier 1 capital instrument ((普通股權一級資本票據) means a capital instrument that qualifies as Common Equity Tier 1 capital under Schedule 4A to the Banking (Capital) Rules (Cap. 155 sub. leg. L), or under the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee;

debt instrument (債務票據) means an instrument specified in Part 1 of Schedule 6 that is in respect of a debt issue;

fair value (公平價值)—

(a) in relation to a person's asset, means the amount that, at the time as at which the value of the asset is to be determined, the person would obtain from a knowledgeable and willing person dealing at arm's length for the sale of the asset;

(b) in relation to a person's liability, means the amount that, at the time as at which the value of the liability is to be determined, the person would have to pay to a knowledgeable and willing person dealing at arm's length for the transfer or release of the liability;

fair value accounting (公平價值會計) means a basis of accounting under which assets and liabilities are shown in a balance sheet at their fair value;

paid-up amount (已付數額), in relation to a regulatory capital security or debenture or debt instrument, means the sum paid to the issuer for the issue of the security or debenture or instrument;

regulatory capital security (監管資本證券) means a security—

(a) that qualifies or has qualified as an Additional Tier 1 capital instrument, and that forms or formed a component of Additional Tier 1 capital, for the purposes of the Banking (Capital) Rules (Cap. 155 sub. leg. L) or of the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee; or

(b) that qualifies or has qualified as a Tier 2 capital instrument, and that forms or formed a component of Tier 2 capital, for the purposes of the Banking (Capital) Rules (Cap. 155 sub. leg. L) or of the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee;

Tier 2 capital instrument (二級資本票據) means a capital instrument that qualifies as Tier 2 capital under Schedule 4C to the Banking (Capital) Rules (Cap. 155 sub. leg. L), or under the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee.

(2) For the purposes of the definition ***regulatory capital security*** in subsection (1)—

security (證券) does not include—

(a) a share;

(b) any debt instrument the terms and conditions of which provide for the issuer of the instrument converting,

or having an option to convert, the instrument into a Common Equity Tier 1 capital instrument of the issuer or any other corporation after a certain period of time; or

(c) subject to subsection (3), any debt instrument—

(i) that carries a contractual right to any distribution or redemption payment that depends to any extent on the results of the business of the issuer of the instrument or of any part of that business; or

(ii) that provides discretion to the issuer of the instrument to make any distribution or redemption payment that depends to any extent on the results of the business of that issuer or of any part of that business.

(3) A debt instrument does not fall within paragraph (c) of the definition of ***security*** in subsection (2) by reason only that the terms and conditions of the instrument provide for the reduction in distribution or redemption payment if the results of the business of the issuer of the instrument, or of any part of that business, worsen.

(Added 12 of 2016 s. 14)

(Added 12 of 2016 s. 14)

17D. Financial institution: general provisions on regulatory capital security held by, or for benefit of, issuer's specified connected person

(1) This section applies in ascertaining profits in respect of which a specified connected person of the issuer of a regulatory capital security is chargeable to tax under this Part for a year of assessment if, during the basis period for the year of assessment, the security is held by or for the benefit of the specified connected person.

(2) Profits of the specified connected person are to be determined as if fair value accounting were not generally accepted accounting practice in relation to the security or part of the security.

(3) No deduction is to be allowed to the specified connected person under section 16(1) for any sum representing—

(a) the paid-up amount of the security being written down on a permanent or temporary basis in accordance with any laws or regulatory requirements or the terms and conditions of the security; or

(b) the paid-up amount of the security being converted to a Common Equity Tier 1 capital instrument in accordance with any laws or regulatory requirements or the terms and conditions of the security.

(4) A sum representing the paid-up amount of the security being written up in accordance with any laws or regulatory requirements or the terms and conditions of the security, following a write-down of the paid-up amount on a temporary basis in accordance with those laws or requirements or those terms and conditions, is not to be treated as a receipt arising in or derived from Hong Kong by the specified connected

person from a trade, profession or business carried on in Hong Kong.

(5) In this section—

connected person (有關連者), in relation to the issuer of a regulatory capital security, means—

(a) an associated corporation of the issuer; or

(b) a person (other than a corporation) who—

(i) controls the issuer;

(ii) is controlled by the issuer; or

(iii) is under the control of the same person as is the issuer;

market maker (市場莊家) means a person who—

(a) is licensed or registered for dealing in securities under the Securities and Futures Ordinance (Cap. 571) or is authorized to do so by a regulatory authority in a major financial centre outside Hong Kong recognized by the Commissioner for the purposes of this section;

(b) in the ordinary course of conduct of the person's trade, profession or business in respect of market making, holds oneself out as being willing to buy and sell securities for the person's own account and on a regular basis; and

(c) is actively involved in market making in securities issued by a wide range of unrelated institutions;

specified connected person (指明有關連者), in relation to the issuer of a regulatory capital security, means a connected person of the issuer who is not excepted within the meaning of subsection (6).

(6) In this section, a connected person of the issuer of a regulatory capital security is excepted if the connected person—

(a) is chargeable to tax under this Part in respect of a sum payable in respect of the security;

(b) is entitled to a sum payable in respect of the security in the capacity of—

(i) a person acting as a trustee of a trust estate, or holding property belonging to others pursuant to the terms of a contract, where the person is not beneficially entitled to the sum;

(ii) a beneficiary of a unit trust to which section 26A(1A)(a)(i) or (ii) applies, where the sum is payable to a trustee of the unit trust in respect of a specified investment scheme referred to in section 26A(1A)(b); or

(iii) a member of a retirement scheme that is either a recognized retirement scheme or a substantially similar retirement scheme established outside Hong Kong, where the Commissioner is satisfied that the latter scheme complies with the requirements of a supervisory authority within an acceptable regulatory regime;

(c) is a market maker who, in the ordinary course of conduct of the market maker's trade, profession or business in respect of market making, holds the security for the purpose of providing liquidity for the security;

(d) is a public body; or

(e) is a body corporate, where the Government owns beneficially more than half of the issued share capital of that body corporate for the time being.

(Added 12 of 2016 s. 14)

17E. Financial institution: profits adjusted if associates deal not at arm's length in connection with regulatory capital security

(1) This section applies if—

(a) conditions are made or imposed between a financial institution and a person who is an associate of the financial institution, in their commercial or financial relations in connection with a regulatory capital security; and

(b) the conditions differ from those that would be made if the person were not such an associate.

(2) Any profits that, but for the conditions referred to in subsection (1)(a), would have accrued to the financial institution or the person and, by reason of those conditions, have not so accrued, are to be included in the profits of the financial institution or the person and taxed in accordance with this Part.

(Added 12 of 2016 s. 14)

17F. Financial institution: issuer's deduction if regulatory capital security is issued to, held by or issued or held for benefit of specified connected person

(1) No deduction is to be allowed to the issuer of a regulatory capital security (***specified issuer***) under section 16(1) for any sum payable in respect of the security if it is issued to, held by or issued or held for the benefit of a specified connected person of the specified issuer.

(2) Subsection (1) does not apply to a sum payable in respect of a regulatory capital security issued to or for the benefit of a specified connected person of the specified issuer if both of the following conditions are met—

(a) the money paid by or on behalf of the specified connected person for the issue of the security has been entirely funded, either directly or indirectly, by the proceeds of an external issue of a regulatory capital security or debenture or debt instrument by the specified connected person or an associated corporation of the specified issuer;

(b) the externally issued regulatory capital security or debenture or debt instrument is not, at any time during the basis period of the specified issuer for the year of assessment concerned, held by or for the benefit of a specified connected person of the specified issuer.

(3) The amount of any deduction allowable under subsection (2) is not to exceed the sum payable by the specified connected person or associated corporation (as the case requires) in respect of the externally issued regulatory capital security or debenture or debt instrument (other than the repayment of the paid-up amount).

(4) Subsection (5) applies to a deduction allowable under subsection (2) if the externally issued regulatory capital security or debenture or debt instrument is held by or for the benefit of an associate (other than a specified connected person) of the specified issuer.

(5) The amount of the deduction that, but for this subsection, would have been allowed under section 16(1) is to be reduced by any amount by which the sum payable to, or for the benefit of, that associate exceeds a reasonable commercial return on money borrowed of an amount equal to the paid-up amount for the externally issued regulatory capital security or debenture or debt instrument.

(6) For the purposes of subsection (5), a reasonable commercial return means a return that, at the time the security or debenture or instrument was issued, would be regarded in

the prevailing market conditions as a reasonable commercial return between persons dealing with each other at arm's length in the open market.

(7) In this section, a regulatory capital security or debenture or debt instrument is externally issued if the security or debenture or instrument is not issued to, or for the benefit of, a specified connected person of the specified issuer.

(8) Subject to subsections (9) and (10), section 17D(5) and (6) applies to this section.

(9) The definition of ***market maker*** in section 17D(5) applies as if a reference to "this section" in paragraph (a) of that definition were a reference to this section.

(10) Section 17D(6) applies for the purposes of construing a reference to specified connected person appearing in subsection (2)(b), (4) or (7) as if—

(a) the reference to "the issuer of a regulatory capital security" in section 17D(6) were a reference to the specified issuer; and

(b) each reference to "the security" in section 17D(6)(a), (b) or (c) were a reference to the externally issued regulatory capital security or debenture or debt instrument referred to in subsection (2)(b), (4) or (7) (as the case requires).

(Added 12 of 2016 s. 14)

89. Transitional provisions

(1) *(Repealed 12 of 2004 s. 20)*

(2) In relation to amendments made by the Inland Revenue (Amendment) (No. 2) Ordinance 1993 (52 of 1993)—

(a) it is declared that the amendments shall be without prejudice to the provisions of Part 14. *(Amended 4 of 2010 s. 17)*

(b) *(Repealed 4 of 2010 s. 17)*

(3) The transitional provisions of Schedule 9 shall have effect in relation to recognized occupational retirement schemes approved under section 87A prior to the repeal of that section by the Inland Revenue (Amendment) (No. 5) Ordinance 1993 (76 of 1993). *(Added 76 of 1993 s. 10)*

(4) The transitional provisions of Schedule 12 shall have effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment 2001/02. *(Added 29 of 2001 s. 2)*

(5) Schedule 14 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment 2005/06. *(Added 8 of 2005 s. 6)*

(6) Schedule 21 has effect in relation to the amendments made by the Inland Revenue (Amendment) Ordinance 2011 (4 of 2011). *(Added 4 of 2011 s. 5)*

(7) Schedule 22 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2011. *(Added 9 of 2011 s. 3)*

(8) Schedule 24 sets out transitional provisions that have effect for the purposes of the Inland Revenue (Amendment) (No. 3) Ordinance 2011 (21 of 2011). *(Added 21 of 2011 s. 8)*

(9) Schedule 25 has effect in relation to the following persons—

(a) a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2012 or the year of assessment commencing on 1 April 2013;

(b) a person liable to pay provisional profits tax in respect of the year of assessment commencing on 1 April 2012 or the year of assessment commencing on 1 April 2013. *(Added 21 of 2012 s. 5)*

(10) Schedule 27 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2013. *(Added 5 of 2013 s. 3)*

(11) Schedule 29 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Ordinance 2013 (10 of 2013). *(Added 10 of 2013 s. 17)*

(12) Schedule 30 has effect in relation to the following persons—

(a) a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2014 or the year of assessment commencing on 1 April 2015;

(b) a person liable to pay provisional profits tax in respect of the year of assessment commencing on 1 April 2014 or the year of assessment commencing on 1 April 2015. *(Added 3 of 2014 s. 8)*

(13) Schedule 31 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2014. *(Added 10 of 2014 s. 3)*

(14) Schedule 33 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2015. *(Added 10 of 2015 s. 3)*

(15) Schedule 35 sets out transitional provisions relating to appeals against decisions of the Board of Review made before the

commencement date of the Inland Revenue (Amendment) (No. 3) Ordinance 2015 (17 of 2015). *(Added 17 of 2015 s. 12)*

(16) Schedule 36 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) (No. 2) Ordinance 2016 (12 of 2016). *(Added 12 of 2016 s. 17)*

(17) Schedule 37 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2016. *(Added 8 of 2016 s. 3)*

(18) Schedule 39 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2017. *(Added 3 of 2017 s. 4)*

(19) Schedule 41 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) (No. 3) Ordinance 2017 (9 of 2017). *(Added 9 of 2017 s. 14)*

(20) Schedule 42 has effect in relation to a person liable to pay provisional profits tax in respect of the year of assessment commencing on 1 April 2018. *(Added 13 of 2018 s. 8)*

(21) Schedule 44 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) (No. 6) Ordinance 2018 (27 of 2018). *(Added 27 of 2018 s. 34)*

(Amended E.R. 1 of 2012)