

立法會
Legislative Council

LC Paper No. CB(1)538/18-19

(These minutes have been seen
by the Administration)

Ref : CB1/SS/2/18

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

**Minutes of the first meeting on
Monday, 12 November 2018, at 4:30 pm
in Conference Room 2 of the Legislative Council Complex**

Members present : Hon CHAN Chun-ying, JP (Chairman)
Hon James TO Kun-sun
Hon Abraham SHEK Lai-him, GBS, JP
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon CHAN Kin-por, GBS, JP
Hon YIU Si-wing, BBS
Hon Kenneth LEUNG
Hon Dennis KWOK Wing-hang
Ir Dr Hon LO Wai-kwok, SBS, MH, JP
Hon YUNG Hoi-yan

Members absent : Hon WONG Ting-kwong, GBS, JP
Hon Christopher CHEUNG Wah-fung, SBS, JP

Public officers attending : Ms Estrella CHEUNG
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services)³

Mr Robert PROBYN
Senior Manager (Resolution Office) (Policy)³
Hong Kong Monetary Authority

Ms Helen CHAN
Acting Senior Manager (Resolution) (Policy)1
Hong Kong Monetary Authority

Ms Carmen CHU
Senior Government Counsel
Law Drafting Division
Department of Justice

Clerk in attendance : Ms Connie SZETO
Chief Council Secretary (1)4

Staff in attendance : Mr Mark LAM
Assistant Legal Adviser 7

Mr Hugo CHIU
Senior Council Secretary (1)4

Ms Sharon CHAN
Legislative Assistant (1)4

Ms Vivian CHAN
Clerical Assistant (1)4

Action

I Election of Chairman (and Deputy Chairman)

Election of Chairman

Mr James TO, the member with the highest precedence among those who were present at the meeting, presided over the election of the Chairman of the Subcommittee and invited nominations for the chairmanship of the Subcommittee.

2. Mr CHAN Chun-ying was nominated by Mr Dennis KWOK and the nomination was seconded by Mr CHAN Kin-por. Mr CHAN Chun-ying accepted the nomination. There being no other nomination, Mr James TO declared that Mr CHAN Chun-ying was elected the Chairman of the Subcommittee. Mr CHAN then took the chair.

Action

Election of Deputy Chairman

3. Members agreed that there was no need to elect a Deputy Chairman.

Declaration of interest

4. The Chairman declared that he was a consultant of the Bank of China (Hong Kong) Limited. Mr CHAN Kin-por declared that he was an independent non-executive director of the Bank of East Asia, Limited.

II Meeting with the Administration

(L.N. 195 of 2018	— Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements — Banking Sector) Rules
File Ref: B&M/2/1/29/4/1C(2018)	— Legislative Council Brief
LC Paper No. LS5/18-19	— Legal Service Division Report
LC Paper No. CB(1)157/18-19(01)	— Letter dated 6 November 2018 from the Legal Service Division to the Administration
LC Paper No. CB(1)157/18-19(02)	— Background brief prepared by the Legislative Council Secretariat)

Discussion

5. The Subcommittee deliberated (Index of proceedings attached at **Appendix**).

Follow-up actions to be taken by the Administration

6. The Administration and the Hong Kong Monetary Authority ("HKMA") were requested to provide the following information:
- (a) a comparison on the implementation progress of the resolution regime and the corresponding loss-absorbing capacity ("LAC") rules

Action

of Hong Kong with other major international financial markets including the United States, the United Kingdom, Singapore, Japan and the Mainland;

- (b) the estimated interest rates of LAC instruments to be issued by local authorized institutions ("AIs") (particularly those AIs without any single major shareholders), and details of the relevant studies conducted by HKMA on the matter; and
- (c) given the expected substantial amount of loss-absorbing capacity products to be issued by the major banks in the Mainland, HKMA's assessment on the demand for LAC instruments to be issued by local AIs and thus the cost impact on local AIs.

7. The Administration and HKMA were requested to consider some members' suggestion of allowing an AI to use part of its assets for meeting the capital adequacy ratio to fulfill the minimum external LAC requirement (if the AI was classified as a resolution entity) or minimum internal LAC requirement (if the AI was classified as a material subsidiary).

(Post meeting note: The Administration's written responses were issued to members vide LC Paper No. CB(1)198/18-19(02) on 22 November 2018.)

III Any other business

Invitation of views

8. Members agreed to meet with deputations at the second meeting for views on the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements — Banking Sector) Rules ("the Rules").

(Post-meeting note: The notice was posted on the Legislative Council website on 13 November 2018 to invite interested parties for written submissions and/or attending the second meeting to give views.)

Legislative timetable

9. The Subcommittee noted that the scrutiny period of the Rules would expire at the Council meeting of 21 November 2018. To allow sufficient time for the Subcommittee to study the Rules, members agreed that the Chairman

Action

would move a motion at the Council meeting of 21 November 2018 to extend the scrutiny period to the Council meeting of 12 December 2018. Members noted that, upon extension of the scrutiny period, the deadline for giving notice of motion to amend the Rules would be 5 December 2018.

(Post-meeting note: The motion moved by the Chairman to extend the scrutiny period of the Rules was passed at the Council meeting of 21 November 2018.)

Date of next meeting

10. The Chairman informed members that the next meeting was tentatively scheduled for 23 November 2018.

(Post-meeting note: The second meeting was scheduled for 23 November 2018 from 9:30 am to 12:30 pm to meet with deputations and the Administration. The notice of meeting was issued vide LC Paper No. CB(1)171/18-19 on 13 November 2018.)

11. There being no other business, the meeting ended at 5:58 pm.

Council Business Division 1
Legislative Council Secretariat
31 January 2019

**Proceedings of the first meeting of
the Subcommittee on Financial Institutions (Resolution)
(Loss-absorbing Capacity Requirements — Banking Sector) Rules
on Monday, 12 November 2018, at 4:30 pm
in Conference Room 2 of the Legislative Council Complex**

Time Marker	Speaker	Subject(s)	Action Required
Agenda item I — Election of Chairman (and Deputy Chairman)			
000416 – 000528	Mr James TO Mr Dennis KWOK Mr CHAN Kin-por Mr CHAN Chun-ying	Election of Chairman	
000529 – 000615	Chairman	Declaration of interest	
Agenda item II — Meeting with the Administration			
000616 – 001552	Chairman Administration	Briefing by the Administration on the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements — Banking Sector) Rules ("the Rules") (<i>Post-meeting note:</i> The powerpoint presentation materials (LC Paper No. CB(1)174/18-19(01)) were issued to Members vide Lotus Notes e-mail on 13 November 2018.)	
001553 – 002428	Chairman Mr Jeffrey LAM Administration	Mr LAM's views as follows: (a) a number of small and medium-sized ("SMS") authorized institutions ("AIs") pointed out that their views expressed during the public consultation on the Rules had not been taken into account by the Hong Kong Monetary Authority ("HKMA"); (b) the policy objective of the Financial Institutions (Resolution) Ordinance (Cap. 628) ("FIRO") was to establish a resolution regime for financial institutions ("FIs") in Hong Kong which were systemically important. However, the scope of the Rules might	

Time Marker	Speaker	Subject(s)	Action Required
		<p>be excessive covering most AIs in Hong Kong, local entities in the insurance sector and securities and futures sector;</p> <p>(c) the Rules might increase the operating costs of many SMS AIs, thus undermining their competitiveness; and</p> <p>(d) the Subcommittee should hold a public hearing to receive views of relevant stakeholders on the Rules.</p> <p>The Administration responded as follows:</p> <p>(a) the policy objective of FIRO was to establish a cross-sectoral resolution regime for the banking, insurance and securities and futures industries. Having regard to the situation of Hong Kong and international development, the Administration considered that priority should be accorded to AIs in the development of loss-absorbing capacity ("LAC") requirements. Thus, the Rules would cover the banking sector only;</p> <p>(b) HKMA conducted two rounds of public consultation in January and July 2018. Relevant amendments had been made to the legislative proposals having regard to the feedback received; and</p> <p>(c) while FIRO and the Rules covered all AIs in Hong Kong, only AIs classified by the Monetary Authority ("MA") (i.e. HKMA) as resolution entities or material subsidiaries would be subject to external or internal LAC requirements respectively. MA would consider a number of criteria (especially whether it was anticipated that the AI concerned would, on failure, pose risks to Hong Kong's financial stability, including to the continued performance of critical financial functions) in making the classification decisions.</p>	

Time Marker	Speaker	Subject(s)	Action Required
002429 – 003432	Chairman Mr James TO Administration	<p>Mr TO's enquiries about:</p> <ul style="list-style-type: none"> (a) the number of AIs that would be classified as resolution entities or material subsidiaries under the Rules, and whether AIs could evaluate if they would be classified as resolution entities or material subsidiaries so that they could make preparation in advance; (b) whether AIs could estimate at this stage the amount of LAC instruments they had to issue for meeting the relevant LAC requirements; and (c) the timeline for classified resolution entities and material subsidiaries to comply with the relevant LAC requirements. <p>The Administration responded as follows:</p> <ul style="list-style-type: none"> (a) while FIRO covered all AIs (more than 200), the Rules only covered those AIs incorporated in Hong Kong. It was envisaged that the 22 Hong Kong incorporated licensed banks could potentially be classified as resolution entities or material subsidiaries under the Rules; (b) HKMA was consulting the banking industry on a draft FIRO Code of Practice chapter for LAC requirements ("LAC CoP"), which set out, inter alia, the assessment criteria (like asset threshold) that would be adopted by MA in making the classification decisions. An AI could assess whether it would be classified as a resolution entity or a material subsidiary by studying both the Rules and the draft LAC CoP. Based on the assessment criteria (i.e. a threshold of HKD 150 billion total consolidated assets) set out in the draft LAC CoP, it was anticipated that 17 Hong Kong incorporated licensed banks would be classified as resolution entities or material subsidiaries; 	

Time Marker	Speaker	Subject(s)	Action Required
		<p>(c) the Rules had clearly set out the external and internal LAC requirements, and AIs could estimate the amount of LAC instruments they needed to issue if they were classified as resolution entities or material subsidiaries; and</p> <p>(d) a resolution entity or a material subsidiary must meet any relevant LAC requirements within 24 months of being classified as such by MA, unless it was part of the group of a non-emerging market economy ("EME") headquartered global systemically important bank ("G-SIB") (in which case the deadline for meeting the relevant LAC requirements was three months after classification.) HKMA's current planning assumption was that domestic systemically important bank ("D-SIB") would be classified by the end of 2019, so that they had to start meeting LAC requirements from January 2022 at the earliest. For other relevant AIs, the classification would take place no earlier than January 2020.</p> <p>The Chairman remarked that if the assessment criteria set out in the draft LAC CoP remained unchanged after the consultation, only a small number of SMS AIs would be exempt from LAC requirements.</p>	
003433 – 004544	Chairman Mr Dennis KWOK Administration	<p>Mr KWOK's enquiries as follows:</p> <p>(a) whether the LAC requirements prescribed in the Rules were on a par with the total loss-absorbing capacity ("TLAC") requirements formulated by the Financial Stability Board ("FSB") and similar requirements promulgated by the United Kingdom ("UK") recently;</p> <p>(b) whether there were safeguard measures to ensure LAC instruments issued by AIs incorporated outside Hong Kong could be legally enforceable, and had the same</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>quality and legal certainty as those issued by AIs incorporated in Hong Kong;</p> <p>(c) whether LAC instruments issued in jurisdictions that had yet to implement any TLAC regimes (including the Mainland which would be expected to implement a TLAC regime by 2025) could be used to meet the LAC requirements under the Rules; and</p> <p>(d) whether HKMA had conducted any impact assessments on the implementation of the Rules on the banking sector including possible adverse impact on the banks' abilities to provide liquidity and credit to the market.</p> <p>The Administration responded as follows:</p> <p>(a) the calibration of LAC requirements in Hong Kong was broadly the same as TLAC requirements formulated by FSB and relevant legislation promulgated by the UK;</p> <p>(b) since the Rules only covered Hong Kong incorporated AIs, it was not envisaged that LAC instruments would be issued by AIs that were incorporated outside Hong Kong. Schedules 1 and 2 to the Rules set out the qualifying criteria for external and internal LAC debt instruments respectively, and one of the criteria was that instruments should be subject to Hong Kong law. If an instrument was governed by non-Hong Kong law, independent legal advice that the application of powers under FIRO in relation to the instrument or any liability constituted by the instrument would be effective and enforceable should be provided to MA. Such criteria also applied to LAC debt instruments issued by Hong Kong incorporated AIs outside Hong Kong. MA would seek legal opinions and</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>examine relevant evidence as necessary in assessing the eligibility of LAC debt instrument issued by Hong Kong incorporated AIs. MA's expectation was that an instrument could not be used to count towards LAC requirements if MA was not satisfied that it had met the relevant qualifying criteria;</p> <p>(c) for LAC instruments issued in a jurisdiction where a resolution regime was not in place, HKMA would examine the interaction of relevant laws of Hong Kong and the jurisdiction concerned in assessing the eligibility of the LAC instruments involved for meeting the LAC requirements under the Rules; and</p> <p>(d) HKMA had conducted an impact assessment which was modelled on those carried out in comparable jurisdictions, and concluded that calibrating the LAC requirements as two times of the regulatory capital requirements would be beneficial to maintaining financial stability and to the wider economy in Hong Kong.</p>	
004545 – 012139	<p>Chairman Mr Kenneth LEUNG Mr CHAN Kin-por Mr Dennis KWOK Administration</p>	<p><u>Necessity and implementation progress of the Rules</u></p> <p>Mr LEUNG enquired about the timeline for AIs incorporated in Hong Kong to comply with the relevant LAC requirements.</p> <p>Mr CHAN declared that he was an independent non-executive director of the Bank of East Asia, Limited. His views and enquiries as follows:</p> <p>(a) implementation of the Rules would impose a new capital requirement on and thereby increase the operating cost of banks, which were already facing fierce competition from other parties including the virtual banks to be licensed in Hong Kong. HKMA should first observe the implementation of relevant</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>LAC rules in other jurisdictions and implement the LAC requirements on local AIs at a slower pace;</p> <p>(b) the Administration should review the necessity of the Rules given that the average capital adequacy ratio of AIs in Hong Kong was already well above the statutory requirement;</p> <p>(c) whether Hong Kong's LAC implementation timetable was on a par with those of other international financial centres and comparable jurisdictions in Asia including Singapore; and</p> <p>(d) the Subcommittee should hold a public hearing to receive views on the Rules.</p> <p>Mr KWOK concurred that HKMA should examine whether it should implement the LAC requirements on AIs at a slower pace.</p> <p>The Chairman asked if HKMA would consider deferring the implementation of LAC requirements (say, for three to six months) given that the operating environment of the banking industry might be deteriorating as a result of the lingering trade conflict between China and the United States ("the US").</p> <p>The Administration responded as follows:</p> <p>(a) having considered banking industry's concern about the Rules, HKMA remained of the view that the Rules would enhance the financial stability of Hong Kong;</p> <p>(b) upon the enactment of FIRO in 2016, the banking industry should be aware of HKMA's intention to make subsidiary legislation on LAC requirements;</p> <p>(c) HKMA had carried out two rounds of consultation in 2018. While the respondents had different views on the</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>implementation details of the Rules, they were generally supportive of a resolution regime underpinned by the Rules;</p> <p>(d) other home or host jurisdictions of G-SIBs including the US, the UK and Japan would implement similar LAC rules. Hong Kong was not the front-runner in implementing such rules; and</p> <p>(e) the Rules had already provided flexibility in implementation. MA would, starting from January 2020, assess each AI in Hong Kong (which was not a D-SIB or G-SIB) one by one (with priority given to AIs with higher systemic importance) to determine whether they should be classified as resolution entities or material subsidiaries. Besides, an AI (except that which was part of a non-EME headquartered G-SIB group) being classified as a resolution entity or a material subsidiary by MA had 24 months to make preparation for meeting the relevant LAC requirements. Depending on the circumstances of individual AIs, MA could vary the LAC conformance period applicable to them if necessary.</p> <p>At the Chairman's request, the Administration was required to provide a comparison of the implementation progress of the resolution regime and the corresponding LAC rules of Hong Kong with other major international financial markets including the US, the UK, Singapore, Japan and the Mainland.</p> <p>At the request of the Chairman, Mr CHAN and Mr LEUNG, the Administration was required to consider the feasibility of allowing an AI to use part of its assets for meeting the capital adequacy ratio to fulfill the minimum external LAC requirement (if the AI was classified as a resolution entity) or minimum internal LAC requirement (if</p>	<p>The Administration to take action as per paragraph 6(a) of the minutes</p> <p>The Administration to take action as per paragraph 7 of the minutes</p>

Time Marker	Speaker	Subject(s)	Action Required
		<p>the AI was classified as a material subsidiary).</p> <p><u>Demand for LAC instruments</u></p> <p>The Chairman pointed out that some SMS AIs raised concerns about the Rules because:</p> <p>(a) if an AI within a banking group was classified as a material subsidiary, it would need to issue internal LAC instruments to its parent company in order to meet the internal LAC requirements. However, the parent company could not raise funds through the issuance of external LAC instruments if it was not classified as a resolution entity leading to a reduction in the capital base of the banking group; and</p> <p>(b) there were restrictions for banks and insurance companies in purchasing LAC debt instruments. SMS AIs might need to issue LAC debt instruments with high coupon rates owing to the lack of potential buyers.</p> <p>Mr LEUNG expressed concern that the liquidity of LAC debt instruments would be limited given that their primary issuance in Hong Kong was confined to professional investors.</p> <p>The Administration responded as follows:</p> <p>(a) it was envisaged that most AIs in Hong Kong would be classified as material subsidiaries (rather than resolution entities). A material subsidiary only had to issue internal LAC instruments to its parent company (rather than an external entity as in the case of a resolution entity). The parent company of the material subsidiary could raise funds through the issuance of external LAC instruments; and</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>(b) HKMA could adjust, where necessary, the conformance period for LAC requirements for specific AIs to avoid a glut of LAC instruments in Hong Kong.</p> <p>At the request of the Chairman, Mr CHAN and Mr LEUNG, the Administration was required to provide information on the estimated coupon rates of LAC debt instruments to be issued by local AIs (particularly those AIs without any single major shareholders), and details of the relevant studies conducted by HKMA on the matter.</p> <p>At Mr KWOK's request, the Administration was required to provide information on HKMA's assessment on the demand for LAC debt instruments to be issued by local AIs and thus the cost impact on local AIs given the expected substantial amount of loss-absorbing capacity products to be issued by the major banks in the Mainland.</p> <p>Mr LEUNG's enquiries about:</p> <p>(a) whether different AIs would be subject to different external/internal LAC requirements;</p> <p>(b) whether an entity would be subject to both external and internal LAC requirements;</p> <p>(c) the criteria for classifying AIs as resolution entities or material subsidiaries;</p> <p>(d) whether an AI could use its existing capital instruments to meet the LAC requirements, and whether any AIs in Hong Kong could fulfill the LAC requirements without the need to issue LAC debt instruments; and</p> <p>(e) how AIs could use the funds raised through the issuance of LAC debt instruments.</p>	<p>The Administration to take action as per paragraph 6(b) of the minutes</p> <p>The Administration to take action as per paragraph 6(c) of the minutes</p>

Time Marker	Speaker	Subject(s)	Action Required
		<p>The Administration responded as follows:</p> <ul style="list-style-type: none"> (a) the basic formula for calculating the external and internal LAC requirements were set out in the Rules. Nevertheless, MA might vary the external or internal LAC requirements on a resolution entity or material subsidiary taking into account its particular circumstances; (b) an entity would either be classified as a resolution entity (which would be subject to external LAC requirements) or a material subsidiary (which would be subject to internal LAC requirements) but not both; (c) the Rules had set out some factors that MA might take into account in classifying resolution entities and material subsidiaries. The LAC CoP provided guidance on how MA intended to exercise its powers under the Rules, including classification of resolution entities and material subsidiaries; (d) most of the regulatory capital of an AI for meeting its capital adequacy ratio could be counted towards meeting the LAC requirements; and (e) there were no provisions in the Rules restricting the use of funds raised by AIs through the issuance of LAC debt instruments. AIs could use such funds for normal business activities, and carrying out such activities was subject to the normal supervision by MA as the regulator. 	
012140 – 012859	Chairman Administration	<p>The Chairman's enquiries as follows:</p> <ul style="list-style-type: none"> (a) liaison among the three resolution authorities ("RAs") under FIRO (i.e. MA, the Insurance Authority ("IA") and the Securities and Futures Commission ("SFC")) regarding the development of 	

Time Marker	Speaker	Subject(s)	Action Required
		<p>respective LAC rules for their sectors; and</p> <p>(b) under the draft LAC CoP, a locally-incorporated AI with total consolidated assets above HK\$ 150 billion would be classified as a resolution entity or a material subsidiary. Whether HKMA could review the threshold on a regular basis.</p> <p>The Administration responded as follows:</p> <p>(a) under FIRO, MA, IA and SFC were RAs for those FIs that fell within the scope of FIRO ("within scope FIs") and operated under their respective purviews. FIRO empowered each RA to prescribe LAC requirements for within scope FIs and their group companies under their auspices. For a cross-sectoral group of within scope FIs, the Financial Secretary would designate an RA as its lead RA;</p> <p>(b) IA and SFC had no plan to issue LAC rules for their within scope FIs and group companies under their auspices at the moment; and</p> <p>(c) HKMA's consultation on the draft LAC CoP would end on 3 December 2018 and stakeholders were welcome to give views.</p>	
Agenda item III — Any other business			
012900 – 013058	Chairman Mr Abraham SHEK Administration	Invitation of views, legislative timetable and date of next meeting	