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Via email sc_subleg@legco.gov.hk
and delivery by hand

15 November 2018

Mr. Hugo Chiu
Clerk to Subcommittee on Financial Institutions
(Resolution) (Loss-absorbing Capacity Requirements -
Banking Sector) Rules
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong

Dear Mr. Chiu,

Subcommittee on Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements — Banking Sector) Rules (the “Subcommittee”)
----- Submission by (in alphabetical order) Chong Hing Bank, Limited, Dah Sing Bank, Limited, Fubon Bank (Hong Kong) Limited, Public Bank (Hong Kong) Limited and Shanghai Commercial Bank Limited

We refer to the letter from the Subcommittee dated 14 November, 2018.

We write as the secretary of a group of small banks in Hong Kong comprising Chong Hing Bank, Dah Sing Bank, Fubon Bank (Hong Kong), Public Bank (Hong Kong), and Shanghai Commercial Bank (the “Small Banks”) to submit to the Subcommittee the views and comments of the Small Banks on the Rules on Loss-Absorbing Capacity Requirements for Authorized Institutions, and have pleasure in enclosing herewith our written submission on the matter.

Should you have any queries on the paper or require any further information, please do not hesitate to contact the undersigned at 2507-8616 or via email at doriswong@dahsing.com.

Yours faithfully,
For and on behalf of
a group of Small Banks as defined above



Doris Wong
Company Secretary of Dah Sing Bank, Limited

cc: Hon Chan Chun-Ying, JP (Chairman of the Subcommittee)
Chong Hing Bank, Fubon Bank (Hong Kong), Public Bank (Hong Kong), and Shanghai
Commercial Bank

Rules on Loss-Absorbing Capacity Requirements for Authorized Institutions

Submission to the **Subcommittee on Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements -- Banking Sector) Rules of the Legislative Council** by (in alphabetical order) Chong Hing Bank, Dah Sing Bank, Fubon Bank (Hong Kong), Public Bank (Hong Kong) and Shanghai Commercial Bank

15 November 2018

1. Introduction

A group of Hong Kong Authorized Institutions, each representing less than 2% market share in each of loans, deposits and total assets in Hong Kong (the “Small Banks”) made a submission to the HKMA in response to its consultation paper on the Rules on Loss-Absorbing Capacity (“LAC”) Requirements for Authorized Institutions dated 17th January 2018 (the “Consultation Paper”) on 15th March 2018. The Small Banks submitted to the HKMA, *inter alia*, that it is not appropriate for the Small Banks to be subject to the LAC requirements.

The HKMA published draft rules relating to LAC on 25 July 2018 (the “Draft Rules”). Rule 5 of the Draft Rules has given the HKMA unfettered discretion in determining whether a bank shall be classified as a “resolution entity” and thereby subject to the LAC requirements. And in particular, under the said rule 5, in determining whether a bank shall be classified as a “resolution entity”, the HKMA “may” take into account “any other matters the resolution authority considers relevant”, without setting out in the rule any more objective criteria or threshold.

Subsequently, when the consultation draft code of practice chapter “LAC-1: Resolution Planning – LAC requirements” was issued by the HKMA on 19th October 2018 (“Code of Practice”), it is clear that the HKMA intends to set the threshold for inclusion in-scope for LAC requirements at HK\$150 billion consolidated total assets or currently around 0.6% market share (instead of a 2% market share threshold as proposed by the Small Banks). The Subcommittee on Financial Institutions (Resolution)(Loss-absorbing Capacity Requirements -- Banking Sector) Rules of the Legislative Council (the “Subcommittee”) may wish to refer to section 2 of the Code of Practice.

We are very grateful now to have the opportunity to make a similar submission directly to the Subcommittee.

2. Views of the Small Banks

The setting of a threshold at HK\$150 billion would mean that banks currently with around 0.6% market share are in-scope for LAC requirements. Moreover, the HK\$150 billion threshold as proposed is static, which has the implication that as banks grow along with the total assets in the banking sector in Hong Kong (total assets would typically grow with inflation as well), more banks with less than 0.6% share of a growing market will also become in-scope for LAC requirements. Surely, the genesis of the LAC regime was to deal with the situation where banks are “too big to fail”, and we trust the regime was not intended for banks with such small scale and market share which are not systemically important. As stated by HKMA at Pg. 6 under the

heading of “Part II: Capital and LAC” of the Consultation Paper, “*Small AIs which are not expected to cause systemic risk in the event of failure are unlikely to be classified as resolution entities*”. And again, the HKMA had in paragraph 9 of its Consultation Conclusion (for the Consultation Paper) at Pg. 4 reiterated that “*The MA’s view is that where ex ante it is not evident, or not expected, that the failure of a particular AI would be likely to pose a risk to the stability and effective working of the financial system of Hong Kong, including to the continued performance of critical financial functions, it is unlikely that a resolution strategy would need to be developed for such an entity, and it is therefore unlikely to be classified as a resolution entity or material subsidiary*”.

The Small Banks are of the view that they should not be in-scope and this matter here, the result of which may also affect all other smaller banks in Hong Kong, is so important to the local banking industry and the public at large that it ought to be clearly dealt with in the Draft Rules.

The Small Banks continue to be of the view that they should not be in-scope because:

- a. The LAC regime is designed for large, systemically important banks. It was a basic tenet of the new Basel III regulations that large, systemically important banks with complex international operations need to bear higher levels of capital to protect against the greater risks they present to the operation of the financial system. The Small Banks individually have very small market share of less than 2% in the Hong Kong banking market, whether measured in terms of total assets, loans or deposits, and none of them perform critical functions which by virtue of their failure would put the operation of the Hong Kong banking system at risk. They are therefore not considered systemically important, nor would their failure pose risks to the stability and effective working of the financial system of Hong Kong.
- b. Issuance of LAC debt will require the Small Banks to reduce their customer deposits therefore reducing their deposit taking activities and customer relationships and their services to community and SME customers, thus worsening the competitive landscape of the Hong Kong banking sector.
- c. The reduction in profitability of the Small Banks due to the high costs of the LAC regime would curtail business activities, reduce competitiveness and reduce services to customers, particularly to community and SME customers. It should be noted that the Small Banks are generally focused on serving SME customers, which have been affected by an increasingly tough operating environment, lately further exacerbated by the ongoing trade war.
- d. There are uncertainties as to whether the Small Banks will be able to issue meaningful amounts of LAC debt, and if so at what cost. Even if LAC debt can be issued, the cost involved, versus the cost paid on customer deposits, is anticipated to be significantly higher, thus reducing profitability and the ability to generate core equity capital through retention of earnings, as well as potentially increasing costs to customers. As some retail deposits are being replaced by wholesale funding in the form of LAC debt, it is also highly uncertain what level of access the Small Banks will have to such funding, particularly in difficult market conditions, in contrast with retail deposits which are very stable.
- e. The LAC regime is highly complex, and we understand that the large banks have specialized teams to deal with implementation. The Small Banks do not have such resources, so it is

inevitable that to implement LAC, management resources would need to be diverted from other tasks.

- f. There are questions as to whether the imposition of the LAC regime to the Small Banks would be of any benefit to the Hong Kong economy. It is likely that the high cost of the LAC regime for the Small Banks would reduce lending to domestic customers, or increase its cost, neither of which will be of benefit to the economy. The point made in the Consultation Paper about LAC saving huge costs to the Hong Kong economy and Hong Kong taxpayers in the event of a financial crisis is not relevant as no local banks in Hong Kong were bailed out in the financial crisis, nor did they need taxpayer money.
- g. We understand that many regulators in Asia have no plans to implement LAC at present for banks under their supervision. We are not aware of any concrete plans for implementation of LAC in Singapore, Australia, Malaysia, Thailand or Taiwan, especially in respect of LAC requirement for their smaller banks not classified as G-SIBs/D-SIBs. We further understand that other regulators, including Mainland China, may implement LAC eventually, but on a much slower timetable than that proposed in Hong Kong, and even then possibly only for banks that are G-SIB's. We believe that a LAC regime in Hong Kong that is not followed or adopted by other regulators in the region, or is adopted by other regulators on a much slower timetable or smaller extent, could put banks in Hong Kong, including the Small Banks, at a significant competitive disadvantage. Under this scenario it may also be the case that banks with a regional presence choose to book business in other jurisdictions not subject to LAC requirements, or subject to less onerous LAC requirements, thus reducing the competitiveness of the Hong Kong banking sector as a whole, which would not be consistent with the positioning of Hong Kong as an international financial centre.

3. Conclusions

We therefore humbly submit that the Small Banks should not be treated as resolution entities in the Draft Rules and therefore that they should not be subject to the LAC requirements, and seek the understanding of the Subcommittee on this matter.

We therefore propose that rule 5 of the Draft Rules be amended to set a threshold for smaller banks to be excluded from the application of the LAC requirements and that such threshold shall be set at a percentage level not lower than 2% market share by total assets.