OCBC Wing Hang Bank Limited: Feedback on The Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules

OCBC Wing Hang Bank ("OWH") has reviewed the proposed Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules ("LAC Rules"), and would like to submit the following comments for considerations by the Legislative Council:

(1) Covered AIs

In the LAC Rules, it was proposed that any locally incorporated AIs with total consolidated assets above HKD 150 billion would be in-scope for the purpose of determining a resolution strategy, which includes being subject to the LAC requirements.

OWH supports the Financial Stability Board's ("FSB") recommendation that LAC requirements should only be applied on G-SIBs (Global Systemically Important Banks) as their failure will impose systemic impact to the wider financial system and economic activities. By the same token, if the LAC requirements are implemented in Hong Kong, G-SIBs and D-SIBs (Domestic Systemically Important Banks) in Hong Kong where appropriate would be subject to the LAC requirements.

OWH also supports FSB's views that resolution planning requirements including LAC should factor in proportionality considerations for banks of varying sizes, complexity, systemic interconnectedness, substitutability and global activity. Therefore, smaller AIs which are not expected to cause systemic risk in the event of their failure should be excluded from meeting LAC requirements. As the proposed asset size threshold of HKD 150 billion would have covered many smaller AIs, which are not expected to pose systemic risk, we propose additional filters to refine the scope. This could include an AI's market share in terms of total deposits to the local industry, for example not exceeding 3%.

Furthermore, the LAC requirements should only apply to local entities in Hong Kong. Where they are overseas subsidiaries, requirements should be determined by relevant home regulators or in consultation between the relevant home and host regulators.

(2) Risk of Reduced Competitiveness

Locally: The proposed LAC rules, if applied to smaller banks, would weaken their ability to compete and may potentially pass higher costs to customers which are the retail sectors and SMEs. Smaller banks like OWH are already coping with higher regulatory compliance costs, relative to its scale, and competing against larger banks

Internationally: Other regulators in the region are either not imposing LAC requirements or are implementing LAC requirements later (e.g. China will adopt phased-in from 2025 with full implementation by 2028). This may result in regulatory arbitrage, and place banks in Hong Kong at a significant competitive disadvantage.

(3) Increase in Funding Cost and Lower Profitability for Smaller Banks

The bail-in of liabilities will increase banks' cost of funding as the possibility of claims being written off or converted to equity increases the risks borne by debt holders. This would materially reduce banks' profitability and ability to generate organic capital to maintain strong capital buffers. The LAC requirements would exacerbate the challenges faced by smaller banks, which already faced stiff competition.

(4) Weakening of the deposit franchise

The LAC Rules proposed that at least 1/3 of the external LAC requirement be constituted by LAC debt. This may cause the smaller banks to increase their reliance on wholesale LAC debts which will come at a higher cost than deposits when LAC debts are used to replace deposits. This would weaken the deposit franchise of institutions that are already of small market share.

(5) Robust banking regulatory system in Hong Kong

Hong Kong banking industry is well regulated to a high standard, with banks generally maintaining capital well in excess of minimum regulatory capital requirements. They are also subject to rigorous stress testing requirements, close supervisory oversight and processes that allow for timely intervention during stress. This reduces the need of imposing LAC requirements (which were originally designed for G-SIBs and D-SIBs) on smaller banks.

(6) Other resolution tools are available

Bail-in is not the only resolution tool. Regulators have a number of other tools in their resolution toolkit such as sale of business, bridge bank and asset management vehicles. Therefore, the use of bail-in should be balanced with its impact on the banks' competitiveness, costs of funding and profitability as well as the overall efficiency of the economy. Moreover, bail-in does not sufficiently address liquidity in resolution which should be the priority during a crisis.

(7) Possible contagion risks

A contagion impact to the financial system and the broader economy could arise from the bail-in of a bank as losses are imposed on creditors of the bailed-in bank. When certain liabilities (e.g. interbank liabilities) are bailed-in and there is no repayment, essential services may be disrupted, causing widespread and disruptive contagion to other parts of the financial system.