

Subcommittee on Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements — Banking Sector) Rules - Meeting on 23rd November, 2018 (Friday)

Good morning, Chairman and fellow members.

Thank you for inviting The Bank of East Asia to give our view on the Rules Prescribing Loss-Absorbing Capacity for Authorised Institutions in Hong Kong.

I take this opportunity to state that our Bank is fully supportive of the development and implementation of a recovery and resolution framework to safeguard the stability of the financial system of Hong Kong.

In respect of the proposed LAC Rules and the LAC Code of Practice Consultation, our Bank has two major comments.

Firstly, while we understand the rationale to have the minimum debt requirement aiming for the AI to be recapitalised without an external source of funds, we opine that the loss absorbency debt qualification should be determined by the instrument's legal form instead of by its accounting classification. According to the LAC Code of Practice Consultation set out by the HKMA, it further clarifies that the instrument accounted for as equity on the AI's balance sheet, such as AT1 instruments, will not be considered as a debt component for LAC .

I would like to bring out the fact that those AT1 instruments being classified as equity under the accounting rules are actually available for loss absorption during the resolution situation as they are not subject to any hard trigger thresholds for writing off during the pre-resolution period. Our Bank proposes therefore that for those AT1 instruments, though accounted for as equity, they should be considered and included in the debt component for the minimum debt calculations for LAC requirement.

Secondly, we noted that it is a general concern of the industry that the proposed implementation timeline of LAC for non-G-SIB AIs for meeting the LAC requirements in 24 months is rather too tight, the reason being that all such AIs may need to raise significant amount of LAC instruments in the market for fulfilling the required LAC position in a relatively short period of time. Given the volatile economic condition and tightening market appetite for primary bond supply, fund raising through the debt capital markets will be a big challenge for all of us, and the resultant high funding cost is going to put further pressure on the banks' profitability.

As such, our Bank suggests that the HKMA should formulate the implementation timeline in a more flexible manner. In order to achieve a smooth implementation for LAC, the Authority should review the proposed deadline for meeting the LAC requirements for each individual AI according to its specific situation and its actual gap position of the LAC compliance. The HKMA may consider introduce a phase-in approach for implementation starting from year 2022.

I hope the Authority could consider our Bank's comments and suggestions.

Thank you very much.

23rd November, 2018