

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

Responses to list of follow-up actions arising from the discussion at the meeting on 28 November 2018

This paper sets out the Government’s response to the matters raised by Members in relation to the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules (“Rules”) at the subcommittee meeting on 28 November 2018.

(1) Clarification is sought on the objectives of the Financial Institutions (Resolution) Ordinance (Cap. 628) (“the Ordinance”), in particular relating to protection of depositors

2. In exercising his power under the Ordinance, the Monetary Authority (“MA”) as resolution authority (“RA”) under the Ordinance for all banking sector entities must have regard to the objectives as set out in section 8(1) of the Ordinance which include:

- (a) promoting and seeking to maintain the stability and effective working of the financial system of Hong Kong, including the continued performance of critical financial functions; and
- (b) seeking to contain the costs of resolution and, in so doing, protect public money¹.

3. In addition, the initiation of resolution in respect of any authorized institution (“AI”) is subject to a number of conditions set out in section 25 of the Ordinance, including that the failure of the AI **poses risks to the stability and effective working of the financial system of Hong Kong, including to the continued performance of critical financial functions (i.e. if the failure of an AI will not pose risks to the stability and effective working of the financial system of Hong Kong, resolution cannot be initiated).**

¹ Subject to the other resolution objectives set out in sections 8(1)(a), (b) and (c) of the Ordinance.

4. All AIs are banking sector entities, and are thus within the scope of, the Ordinance. The draft loss-absorbing capacity (“LAC”) Code of Practice chapter² sets out the RA’s intention that AIs with total consolidated assets above a certain threshold would likely be subject to LAC requirements under the Rules. At the subcommittee meeting on 28 November, the Hong Kong Monetary Authority (“HKMA”) confirmed that the RA intends to raise this threshold from the originally proposed HKD 150 billion to HKD 300 billion when finalising the LAC Code of Practice chapter. All AIs with total consolidated assets above HKD 300 billion have around 200,000 depositors, or more.

5. Bearing in mind the objectives set out in the Ordinance, it is considered that:

- (a) allowing any of these AIs to go into insolvency on failure would likely undermine the general confidence of participants in the financial market in Hong Kong and give rise to contagion within the financial system of Hong Kong, thereby affecting the stability and effective working of the financial system of Hong Kong; and
- (b) to avoid (a), resolution is likely to be the only realistic alternative to a publicly funded bail-out, and could minimise the risk to public money and protect the interests of Hong Kong taxpayers.

6. It should be noted that no AI will be automatically subject to LAC requirements under the Rules or LAC Code of Practice chapter. **It is only where the failure of an AI, assessed on a case-by-case basis, is expected to pose a risk to financial stability that it would be subject to LAC requirements.** As a result, where an AI could demonstrate to the RA that its failure could be managed via insolvency without posing such a risk, it would not be subject to LAC requirements.

² The draft Code of Practice chapter in relation to the Rules was published for consultation on 19 October 2018. The consultation will close on 3 December 2018.

(2) Clarification is sought on the appointment process for independent non-executive directors of banks, and any training and assistance provided to them by the HKMA on various compliance issues relating to banks

7. The MA has the power to approve directors, including independent non-executive directors (“INEDs”), of an AI under section 71 of the Banking Ordinance (Cap. 155) (“BO”). The MA also needs to be satisfied, on an ongoing basis, with the fitness and propriety of the directors of an AI as it is an authorization criterion under the Seventh Schedule to the BO³. An AI should notify the HKMA of the names of directors who are considered to be independent (i.e. INEDs) and the criteria supporting this judgement. In assessing the independence of such directors, the HKMA will take account of various factors such as their direct and indirect financial or other interest in the business of the AI, the length of their service on the board, their family ties, etc.⁴

8. The HKMA engages on an ongoing basis with banking practitioners generally, and with INEDs of AIs more specifically, on the key developments in the banking industry. For example, the HKMA presented at a Regulator’s Dialogue organised by an industry body in Hong Kong in December 2017, and will do so again next month, on the latest policies and regimes for prudential regulation and resolution. Another example is a conference for INEDs which the HKMA has been organising on an annual basis since 2017. When it comes to resolution planning, including implementation of the LAC requirements, for specific AIs, the HKMA has detailed bilateral engagements with the relevant AIs

³ See Chapter 4 of the HKMA’s Guide to Authorization (<https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/guide-authorization/Chapter-4.pdf>) and the HKMA’s Supervisory Policy Manual CG-1 “Corporate Governance of Locally Incorporated Authorized Institutions” (<https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/CG-1.pdf>).

⁴ See the HKMA’s Supervisory Policy Manual CG-1 “Corporate Governance of Locally Incorporated Authorized Institutions”, and HKMA’s guidance entitled “Empowerment of Independent Non-Executive Directors (INEDs) in the Banking Industry in Hong Kong” issued on 14 December 2016 (<https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2016/20161214e1.pdf>).

to ensure that the expectations of the HKMA are clearly understood, and to ensure that any issues raised by the AIs can be discussed.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
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