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3 December 2018

Honourable James To Kun-sun
Room 909
Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong

Dear Honourable To,

**Follow-up questions on
Financial Institutions (Resolution) (Loss-absorbing Capacity
Requirements – Banking Sector) Rules (“the Rules”)**

Thank you for your letter of 30 November 2018 seeking further clarifications on the Rules. Having consulted the Hong Kong Monetary Authority, please see our response as set out at Annex.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Estrella Cheung'.

(Estrella Cheung)

for Secretary for Financial Services
and the Treasury

c.c.

Honourable Chan Chun-ying, JP, Chairman of Subcommittee on
Financial Institutions (Resolution) (Loss-absorbing Capacity
Requirements – Banking Sector) Rules
Hong Kong Monetary Authority (Attn: Mr Eamonn White)

Response to questions raised by Honourable James To Kun-sun on Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules (“the Rules”)

This paper sets out the Government’s response to the questions raised by Honourable James To Kun-sun in his letter of 30 November 2018 seeking further clarifications on the Government’s response to the list of follow-up actions arising from the discussion at the meeting of the Subcommittee on Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules on 28 November 2018 (“Government’s Response” (Ref.: LC Paper No. CB(1)/244/18-19(01))).

(1) What is the change in number of authorized institutions (“AIs”) covered by the loss-absorbing capacity (“LAC”) requirements if the threshold is raised from HKD150 billion to HKD300 billion?

2. The number of AIs with total consolidated assets above HKD150 billion and above HKD300 billion will vary over time, as AIs’ balance sheets change. Based on returns to the Hong Kong Monetary Authority (“HKMA”) in December 2017, 17 AIs have total consolidated assets above HKD150 billion and 12 AIs have total consolidated assets above HKD300 billion, so a change of 5.

(2) Re. paragraph 4 of the Government’s Response that “[a]ll AIs with total consolidated assets above HKD300 billion have around 200,000 depositors, or more”, could HKMA provide the number (or percentage) of depositors that have over HKD500,000 of deposits in a certain AI?

3. According to statistics of the Hong Kong Deposit Protection Board, about 90% of depositors of the member banks of the Deposit Protection Scheme (“DPS”) are fully protected by the DPS¹. It follows from this that around 10% of such depositors are not fully protected.

¹ See Hong Kong Deposit Protection Board Annual Report 2017-2018: http://www.dps.org.hk/en/download/pdf/annual_report_2018/e_annual_report_2018.pdf.

(3) Re. para. 6 of the Government’s Response that “[i]t 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” –

(a) Does it mean that if an AI’s total consolidated assets is below HKD300 billion, it will not be subject to LAC requirement?

4. Yes, to improve *ex ante* resolvability of AIs, the intention of the Monetary Authority, as the resolution authority (“RA”) for AIs, is only to require AIs with HKD300 billion or above to meet LAC requirements. The RA recognises that the calibration of threshold is a matter of judgement and that a number of subcommittee Members have expressed concern that the original threshold of HKD150 billion proposed by the RA may have a disproportionate impact on some smaller AIs, with adverse cost and competitiveness implications. In light of these feedback to date, the HKMA confirmed at the subcommittee meeting on 28 November 2018 that the RA intends to raise this threshold from HKD150 billion to HKD 300 billion when finalising the LAC Code of Practice chapter².

(b) What are the guidelines / rules / regulations that the RA will follow to determine whether the failure of an AI will pose a risk to financial stability such that it would be subject to LAC requirements?

5. The draft LAC Code of Practice chapter that is currently undergoing consultation provides guidance on how the RA expects to exercise its powers in classifying entities to be subject to the LAC requirements³. A basis for the classification is whether the failure of an AI would be anticipated to pose a risk to the stability and effective working of the financial system of Hong Kong, including to the continued

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.

³ See sections 2, 3 and 4 of the draft LAC Code of Practice chapter.

performance of critical financial functions, through considering a range of institution-specific characteristics such as total assets, total volume of deposits and total number of deposits of an AI which are generally correlated to its consolidated asset threshold. The RA will also take into account likely consequences of the failure of the AI, including the likely consequences of that AI going into liquidation. A key issue for this assessment will be whether the nature and scale of the relevant AI's deposit-taking activities are such that they constitute a critical financial function.

During the scrutiny of the Financial Institutions (Resolution) Ordinance (Cap. 628) (“FIRO”), the Government said that the FIRO would only be applicable to global systemically important banks. Hence, the current scope of the Rules is inconsistent with the objective of the FIRO.

6. All AIs are “banking sector entities”, and thus all AIs are within the scope of the FIRO. The rule-making power of the RA under section 19 of the FIRO to prescribe LAC requirements covers, *inter alia*, all banking sector entities (which include all AIs) and their group companies. However, under the FIRO it is only where the non-viability of an 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, that it can be put into resolution.

7. Consequently, it is only where the failure of an AI is expected to pose risks to financial stability, including to the continued performance of critical financial functions, 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.

**Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
3 December 2018**