

立法會
Legislative Council

LC Paper No. CB(1)1251/20-21
(These minutes have been seen
by the Administration)

Ref : CB1/SS/17/20

**Subcommittee on Financial Institutions (Resolution) (Contractual
Recognition of Suspension of Termination Rights – Banking Sector) Rules**

**Minutes of the first meeting on
Tuesday, 13 July 2021, at 2:30 pm
in Conference Room 1 of the Legislative Council Complex**

Members present : Hon Holden CHOW Ho-ding (Chairman)
Hon Starry LEE Wai-king, SBS, JP
Hon Christopher CHEUNG Wah-fung, SBS, JP
Hon CHAN Chun-ying, JP
Hon CHEUNG Kwok-kwan, JP

Public Officers attending : Agenda Item II
Financial Services and the Treasury Bureau

Ms May CHAN, JP
Deputy Secretary (Financial Services)1

Ms Candy LAU
Principal Assistant Secretary (Financial Services)3

Hong Kong Monetary Authority

Ms Olivia CHENG
Senior Manager (Resolution Office) (Policy)1

Ms Melissa TSANG
Acting Senior Manager (Resolution Office) (Policy)2

Department of Justice

Ms Leonora IP
Senior Assistant Law Draftsman

Ms Carmen CHAN
Senior Government Counsel

Clerk in attendance : Mr Derek LO
Chief Council Secretary (1)5

Staff in attendance : Miss Joyce CHAN
Assistant Legal Adviser 1

Mr Hugo CHIU
Senior Council Secretary (1)4

Ms Michelle NIEN
Legislative Assistant (1)5

Action

I. Election of Chairman

Ms Starry LEE, the member with the highest precedence in the Legislative Council ("LegCo") among those who were present at the meeting, presided over the election of the Chairman of the Subcommittee on Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights – Banking Sector) Rules ("the Subcommittee") and invited nominations for the chairmanship of the Subcommittee.

2. Mr CHAN Chun-ying nominated Mr Holden CHOW and the nomination was seconded by Ms Starry LEE. Mr CHOW accepted the nomination. There being no other nomination, Mr Holden CHOW was declared Chairman of the Subcommittee. Mr CHOW then took the chair.

3. Members agreed that it was not necessary to elect a Deputy Chairman.

II. Meeting with the Administration

- (L.N. 106 of 2021 — Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights – Banking Sector) Rules
- File Ref.: B&M/2/1/29/4/4C(2021) — Legislative Council Brief Pt.4
- LC Paper No. LS86/20-21 — Legal Service Division Report
- LC Paper No. CB(1)1105/20-21(01) — Background brief prepared by the Legislative Council Secretariat)

Discussion

4. The Subcommittee deliberated (index of proceedings in the **Appendix**).

Invitation of views

5. The Subcommittee agreed to invite the public to submit written views on the Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights - Banking Sector) Rules ("the Rules"), and the submissions received would be referred to the Administration for response.

(Post-meeting note: An invitation for public submissions on the Rules was uploaded onto the website of the LegCo on 13 July 2021. Letters were also issued to the 18 District Councils on 14 July 2021 to notify them of the invitation. No submission was received by the deadline of 22 July 2021.)

III. Any other business

Legislative timetable

6. The Chairman concluded that the Subcommittee had completed the scrutiny of the Rules.

7. Members agreed that the Chairman should move a motion on behalf of the Subcommittee at the Council meeting of 21 July 2021 to extend the scrutiny period of the Rules to the Council meeting of 25 August 2021 ("the extension motion"). If the scrutiny period was extended, the deadline for giving notice of amendment to the Rules would be 18 August 2021. The Chairman would report the deliberations of the Subcommittee at the House Committee meeting on 13 August 2021.

(Post-meeting note: The Chairman moved the extension motion at the Council meeting of 21 July 2021 and reported the deliberations of the Subcommittee at the House Committee meeting on 13 August 2021.)

8. There being no other business, the meeting ended at 3:45 pm.

Council Business Division 1
Legislative Council Secretariat
25 August 2021

**Proceedings of the first meeting of the
Subcommittee on Financial Institutions (Resolution) (Contractual Recognition of
Suspension of Termination Rights - Banking Sector) Rules
on Tuesday, 13 July 2021, at 2:30 pm
in Conference Room 1 of the Legislative Council Complex**

Time Marker	Speaker	Subject(s)	Action Required
Agenda item I — Election of Chairman			
000402 – 000525	Ms Starry LEE Mr Holden CHOW Mr CHAN Chun-ying	Election of Chairman	
Agenda item II — Meeting with the Administration			
Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights - Banking Sector) Rules			
000526 – 001003	Chairman Administration	Briefing by the Administration on the Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights - Banking Sector) Rules ("the Rules")	
001004 – 002334	Chairman Mr CHAN Chun-ying Administration	<p>Mr CHAN Chun-ying raised enquiries and views as follows –</p> <p>(a) how the scope of financial market infrastructure as one of the five types of excluded counterparties was determined, and whether the scope would be set out in the Rules or the relevant Code of Practice ("CoP") to be issued by the Monetary Authority ("MA");</p> <p>(b) what transitional arrangements would be in place to facilitate compliance by entities subject to the Rules (i.e. covered entities);</p> <p>(c) what measures would be in place to prevent a covered entity from circumventing the Rules by signing a financial contract with an excessively long period before the commencement of the Rules given that the Rules did not have any retrospective effect;</p> <p>(d) Hong Kong Monetary Authority ("HKMA") should avoid adopting a stringent approach in enforcing the Rules;</p> <p>(e) details of measures HKMA might require a covered entity failing to comply with the Rules to take before it decided to impose sanctions on the entity; and</p>	

Time Marker	Speaker	Subject(s)	Action Required
		<p>(f) the percentage of financial contracts governed by non-Hong Kong law among the total number of financial contracts entered into by authorized institutions ("AIs") in Hong Kong.</p> <p>The Administration responded as follows –</p> <p>(a) in general, the same rationale applied in determining the five types of excluded counterparties (i.e. they might be relatively less likely to terminate contracts in a disorderly manner which could pose risk to the orderly resolution of a non-viable within scope financial institution ("FI")). More specifically, the provision of a financial market infrastructure as an excluded counterparty in Rule 2 of the Rules was in line with the exclusion in the applicability of section 90(2) of the Financial Institutions (Resolution) Ordinance (Cap. 628) ("FIRO"), which was also consistent with the "Key Attributes of Effective Resolution Regimes for Financial Institutions" promulgated by the Financial Stability Board;</p> <p>(b) the definition of "financial market infrastructure" was set out in section 2 of FIRO, the meaning of which was not limited to the location or jurisdiction of incorporation of a financial market infrastructure;</p> <p>(c) the Rules would not have any retrospective effect. A covered contract entered into before the commencement of the Rules would only be required to comply with the Rules when it was renewed or materially amended. For covered contracts entered into by a covered entity on or after the commencement of the Rules (i.e. 27 August 2021), an initial period for compliance of 24 months or 30 months beginning on the initial day (depending on the types of counterparties involved) would be provided to facilitate compliance by covered entities;</p>	

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		<p>(d) should a covered entity fail to comply with the Rules by the end of the initial period, MA might require the covered entity to propose and implement a rectification plan pursuant to Rule 11 of the Rules. The covered entity would only commit an offence if it failed to propose or implement such plan without reasonable excuse; and</p> <p>(e) according to the responses received by HKMA in its industry engagement, the majority of the financial contracts entered into by AIs in Hong Kong were governed by non-Hong Kong law. However, the Administration did not have the precise statistics on covered contracts in Hong Kong.</p>	
002335 – 003404	Chairman Mr Christopher CHEUNG Administration	<p>Mr Christopher CHEUNG supported the Rules which could help strengthen Hong Kong's financial stability. He enquired about the proportion of overseas jurisdictions that had enacted legislation similar to the Rules.</p> <p>The Administration responded that many jurisdictions including the United States, the United Kingdom, Japan, Switzerland, Germany and Italy had enacted legislation similar to the Rules.</p> <p>The Chairman supported the Rules and raised enquiries as follows –</p> <p>(a) the conditions under which a covered contract entered into before the commencement of the Rules would be required to contain a provision to the effect that the parties to the contract agreed that the parties (other than an excluded counterparty) would be bound by a suspension of termination rights in relation to the contract imposed by MA under section 90(2) of FIRO ("suspension of termination rights provision"); and</p> <p>(b) the factors that the Administration had taken into account when formulating the length of initial period for compliance.</p>	

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		<p>The Administration responded as follows –</p> <p>(a) the Rules would not have any retrospective effect. A covered contract entered into before the commencement of the Rules would only be required to comply with the Rules when it was renewed or materially amended; and</p> <p>(b) the duration of the initial period for compliance was determined having regard to the feedback received in HKMA's public consultation on the Rules from January to March 2020. As respondents indicated that time was needed to comply with the Rules, the minimum duration of the initial period for compliance had been lengthened from 18 months as proposed in HKMA's earlier proposal during its public consultation to 24 months in the final version of the Rules.</p> <p>Mr CHEUNG enquired how HKMA would enforce the Rules, particularly in the case where the counterparty to a covered contract was in a jurisdiction that had not enacted any legislation to enable cross-border resolution actions. The Chairman made a similar enquiry.</p> <p>The Administration responded as follows –</p> <p>(a) the Rules covered three types of covered entities: an AI incorporated in Hong Kong ("HKAI"), an HK holding company (being a holding company incorporated in Hong Kong of an HKAI) or a related company of an HKAI. The first two categories must by definition be entities incorporated in Hong Kong. While entities in the last category might be cross-border entities, the contract of the related company of an HKAI would only be a covered contract if it also contained an obligation of the covered entity that was guaranteed or otherwise supported by an HKAI, or an HK holding company, that was a group company of the covered entity. As such, HKMA could follow up with the relevant HKAI or HK holding company on non-compliance issues as necessary;</p>	

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		<p>(b) the international community had arrived at a consensus on the establishment and implementation of a resolution regime. HKMA would liaise with the relevant authorities of non-Hong Kong jurisdictions on the implementation of the Rules as appropriate; and</p> <p>(c) if an AI failed to comply with the relevant requirements under the Rules and, in the opinion of MA, such failure posed a significant impediment to an orderly resolution of the AI, MA might serve a written notice on the AI pursuant to section 14 of FIRO requiring it to take measures that were in the opinion of MA reasonably required to remove the impediment.</p>	
003405 – 003731	Chairman Mr CHAN Chun-ying Administration	<p>Mr CHAN Chun-ying enquired about –</p> <p>(a) whether HKMA would, similar to its existing arrangement for the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements — Banking Sector) Rules (Cap. 628B), review certain provisions in the Rules on a regular basis; and</p> <p>(b) whether the Administration planned to table further subsidiary legislation under FIRO before the Legislative Council ("LegCo").</p> <p>The Administration responded as follows –</p> <p>(a) while the Administration did not expect the need to review the Rules regularly, HKMA issued a draft CoP on the Rules for industry consultation and might update it as necessary; and</p> <p>(b) FIRO covered the banking, insurance and securities sectors. As far as the banking sector was concerned, there was no plan for HKMA to table further subsidiary legislation made under FIRO before LegCo for the time being.</p>	

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003732 – 004125	Chairman Administration	<p>In respect of the offence under the Rules, the Chairman enquired about –</p> <p>(a) whether the reluctance of the counterparty to a covered contract to agree to the incorporation of a suspension of termination rights provision (due to, for example, the lack of relevant legislation in the counterparty's jurisdiction) could be a reasonable excuse for non-compliance; and</p> <p>(b) whether HKMA would issue warning to a covered entity before it decided to impose sanctions on it.</p> <p>The Administration responded as follows –</p> <p>(a) HKMA would review non-compliant cases having regard to individual circumstances. In general, the officer of a covered entity would only commit an offence if he/she authorized, permitted or was knowingly concerned in the act or omission that constituted the relevant offence; and</p> <p>(b) a covered entity would not commit an offence unless it failed, without reasonable excuse, to propose or implement a rectification plan, having been required to do so by MA. Thus, the covered entity would first have had an opportunity to rectify a failure to comply with the Rules.</p>	
004126 – 004746	Chairman Ms Starry LEE Administration	<p>Ms Starry LEE enquired about –</p> <p>(a) how the implementation of a resolution regime and the Rules in Hong Kong could strengthen its financial stability; and</p> <p>(b) whether the international community planned to implement further measures to enhance the global financial stability having regard to the relevant developments in recent years (like the launch of quantitative easing by many major economies).</p> <p>The Administration responded as follows –</p> <p>(a) MA would only initiate the resolution of a within scope FI if it was satisfied that three conjunctive conditions were met.</p>	

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		<p>Condition one was that the FI had ceased, or was likely to cease, to be viable. Condition two was that there was no reasonable prospect that private sector action (outside of resolution) would result in the FI again becoming viable within a reasonable period. Condition three was that the non-viability of the FI posed risks to the stability and effective working of the financial system in Hong Kong, including to the continued performance of critical financial functions, and resolution would avoid or mitigate those risks;</p> <p>(b) in a resolution where one or more stabilization options were applied by a resolution authority ("RA") to a non-viable within scope FI, it was important that the contractual counterparties to the FI could not terminate and close out their positions solely as a result of the FI's entry into resolution. Disorderly termination of contracts on a mass scale could frustrate resolution actions taken with respect to a non-viable within scope FI, thus causing significant contagion effects to the financial markets and posing wider risks to the stability and effective working of the financial system. As such, FIRO empowered RA to temporarily suspend termination rights of counterparties to qualifying contracts. Where the relevant contracts were governed by non-Hong Kong law, there were uncertainties as to whether a court in a non-Hong Kong jurisdiction would give effect to a suspension of termination rights imposed by an RA under section 90(2) of FIRO unless the law of such jurisdiction expressly recognized the RA's action. To ensure effectiveness of cross-border resolution actions involving suspension of termination rights imposed pursuant to section 90(2) of FIRO with respect to relevant contracts governed by non-Hong Kong law, the purpose of the Rules was to give effect to resolution actions via a contractual approach, i.e. by stipulating that relevant financial contracts governed by non-Hong Kong law must contain a suspension of termination rights provision; and</p>	

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		(c) the international community was currently focusing on implementing the resolution regime.	
004747 – 005051	Chairman Administration	<p>The Chairman pointed out that the recent default of the Archegos Capital Management on the margin calls of its leveraged transactions had led to massive losses of a number of foreign banks, and enquired whether the resolution regime and the Rules could curb the contagion effects should a similar incident occur in Hong Kong.</p> <p>The Administration responded that the Rules mainly covered HKAI's given their importance to Hong Kong's financial system. It was envisaged that similar contagion effects caused by a disorderly termination of contracts on a mass scale could be addressed in Hong Kong with the implementation of the Rules.</p>	
Section-by-section examination of the Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights — Banking Sector) Rules			
005052 – 005355	Chairman Administration	<p>Part 1: Preliminary</p> <p><u>Rule 1 – Commencement</u></p> <p><u>Rule 2 – Interpretation</u></p> <p>In response to the Chairman's enquiry about the applicability of the Rules to contracts entered into by a covered entity which was a related company of an HKAI, the Administration confirmed that the contract of the related company of an HKAI would only be a covered contract if it also contained an obligation of the covered entity that was guaranteed or otherwise supported by an HKAI, or an HK holding company, that was a group company of the covered entity.</p>	
005356 – 011151	Chairman Ms Starry LEE Mr Christopher CHEUNG Administration	<p>Part 2: Requirement for Covered Contracts to Contain Suspension of Termination Rights Provision</p> <p><u>Rule 3 – Requirement on covered entity for covered contracts to contain suspension of termination rights provision</u></p>	

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		<p>The Chairman enquired how the beginning of the initial period for compliance would be determined for a covered entity's financial contract, which became a covered contract after the commencement of the Rules, and whether the covered entity concerned would have sufficient time to make relevant preparations.</p> <p>The Administration responded as follows –</p> <p>(a) the initial period for compliance for the relevant covered contracts of covered entities would begin on the commencement date of the Rules, i.e. 27 August 2021; and</p> <p>(b) it was envisaged that covered entities would have sufficient preparation time as they should start assessing whether their contracts had to contain the suspension of termination rights provision upon the commencement of the Rules.</p> <p><u>Rule 4 – When covered entity must comply</u></p> <p>In response to Ms Starry LEE's enquiry about the requirements and coverage of the Rules, the Administration advised that: (a) all covered contracts of covered entities would be required to contain the suspension of termination rights provision; (b) the Rules sought to deal with contracts governed by non-Hong Kong law; and (c) relevant contracts governed by Hong Kong law were already effectively bound by section 90 of FIRO.</p> <p>The Chairman enquired why contracts entered into by a covered entity which was a related company of an HKAI would not be covered by the Rules if they did not contain any obligation that was guaranteed or otherwise supported by an HKAI, or an HK holding company, that was a group company of the covered entity. The Administration advised that the termination of such contracts would unlikely have significant adverse effect on resolution actions taken in Hong Kong.</p> <p><u>Rule 5 – Initial period for compliance</u></p>	

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		<p><u>Rule 6 – Resolution authority may extend initial period</u></p> <p>In response to the Chairman's enquiry, the Administration confirmed that the extension made by MA under Rule 6 applied to individual cases only.</p> <p>Ms LEE enquired about the factors considered by MA in determining the duration of initial period for compliance.</p> <p>The Administration reiterated that the duration concerned was determined having regard to the feedback received in the public consultation on the Rules, including the need for sufficient preparation time. There was no international standard on the duration of initial period for compliance.</p> <p><u>Rule 7 – Resolution authority may exempt covered entity from requirements</u></p> <p>Mr Christopher CHEUNG was concerned whether the exemptions set out in Rule 7 would be abused, which might adversely affect the financial stability of Hong Kong. He requested the Administration to elaborate on how MA would exercise his power to grant exemptions.</p> <p>The Administration responded as follows –</p> <p>(a) the power of exemption under Rule 7 provided for flexibility in exceptional cases where non-compliance of a contract might not adversely affect the strategy devised for securing an orderly resolution or pose risks to the stability and effective working of the financial system of Hong Kong. MA might only exercise such power if it was satisfied that it was prudent to do so. It was envisaged that exemptions would rarely be granted in practice;</p> <p>(b) the factors that MA would take into account in granting exemptions were set out in Rule 7(4); and</p>	

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		(c) under Rule 7(2), MA could revoke an exemption if satisfied that it was prudent to do so.	
011152 – 011620	Chairman Administration	<p>Part 3: Compliance and Enforcement</p> <p><u>Rule 8 – Systems of control and record keeping</u></p> <p><u>Rule 9 – Resolution authority may require covered entity to provide legal opinion</u></p> <p><u>Rule 10 – Requirement to notify resolution authority of failure to comply</u></p> <p><u>Rule 11 – Rectification plans</u></p> <p>In response to the Chairman's enquiry, the Administration advised that the definition of the term "officer" (高級人員) was set out in section 2 of FIRO.</p> <p><u>Schedule – Financial Contracts</u></p> <p>Members did not raise questions on the Schedule.</p>	
011621 – 011722	Chairman Assistant Legal Adviser 1 ("ALA1")	<p>ALA1 said that no difficulties had been identified in relation to the legal and drafting aspects of the English version of the Rules.</p> <p>Invitation of views</p>	
Agenda item III — Any other business			
011723 – 011909	Chairman	Legislative timetable, extension of scrutiny period and way forward	