Submission to the Consultation Paper on "An Effective Resolution Regime for Financial Institutions in Hong Kong"

Josephine Chung
Director, CompliancePlus Consulting Limited

Tom Ng, Research Assistant
March 2014

For enquiries on this submission, please contact Josephine Chung at jchung@complianceplus.hk. CompliancePlus Consulting Limited understands and agrees that our name and/or submission may be published to the public.

Introduction

Our approach

This submission responds to the 34 questions raised by the Consultation Document. In doing so, we assess the proposal against (1) the Financial Stability Board ("FSB") Key Attributes and (2) the draft European Resolution Directive.

Scope of the Regime

Question 1

Do you agree that a common framework for resolution through a single regime (albeit with some sector-specific provisions) offers advantages over establishing different regimes for FIs operating in different sectors of the financial system? If not, please explain the advantages of separate regimes and how it can be ensured that these operate together effectively in the resolution of cross-sectoral groups.

We agree that a common framework for resolution via a single regime, with appropriate sector-specific provisions, is to be preferred. This is similar to the Special Resolution Regime recently adopted in the United Kingdom which is applicable to banks, investment firms and central counterparties.

A common regime would also ensure that all sectors receive equal treatment. Favoritism is to be avoided.

Question 2

Do you agree that it is appropriate for all LBs to be within the scope of the regime (given it would only be used where a non-viable LB also posed a threat to financial stability)? If not, what other approaches to the setting of the scope of the regime, which ensure that all relevant LBs are covered, should be considered?

We agree that all Licensed Banks should be included in light of the importance of the role played by banks in the Hong Kong economy. We stress that including Licensed Banks in the regime does not mean that all Banks would be automatically

covered by the regime. The resolution regime would only come into play if the relevant decision criteria are satisfied.

Question 3

Do you agree that it is appropriate for all RLBs and DTCs to be within the scope of the regime (given it would only be used where a non-viable RLB or DTC posed a threat to financial stability)? If not, what other approaches, which would ensure that all relevant RLBs and DTCs are covered, should be considered?

We disagree with this suggestion. Restricted Licensed Banks and Deposit Taking Companies play a less important role in the Hong Kong economy. Moreover, Restricted Licensed Banks and Deposit Taking Companies are usually not the major liquidity providers.

Restricted Licensed Banks and Deposit Taking Companies (in particular Deposit Taking Companies) usually lend to debtors with poor credit profile. They have voluntarily assumed the relevant credit risk. In light of the business nature of Restricted Licensed Banks and Deposit Taking Companies, they should not be covered by the regime. Otherwise, moral hazard will be created.

The justification offered by the Consultation Document is that often the Restricted Licensed Banks and Deposit Taking Companies are connected to the Licensed Banks. This is true, but the Consultation Document also recognizes that the regime can also cover wholly-owned Restricted Licensed Banks and Deposit Taking Companies. A better approach is to perfect the regime as applicable to Licensed Banks. Extending the regime to Restricted Licensed Banks and Deposit Taking Companies solely on this ground is unconvincing.

Question 4

Do you agree that it would be appropriate to extend the scope of the proposed resolution regime to FMIs which are designated to be overseen by the MA under the CSSO (other than those which are owned and operated by the MA) and those that are recognized as clearing houses under the SFO?

We agree with the proposal.

Question 5

Do you agree that it is appropriate to set the scope of the regime to extend to some LCs?

We agree that not all Licensed Corporations should be covered. The businesses of Licensed Corporations differ markedly according to their licensed activities. They are also of different size.

In particular, for securities firms it is recognized that the firms hold cash, shares and securities on trust for the investor-customers (*Re CA Pacific Finance Ltd* [1999] 2 HKLRD 1). Their failure poses little systematic risk to the financial market and they should not be covered.

Question 6

If so, and in order to capture those LCs which could be critical or systemic, should the scope be set with reference to the regulated activities undertaken by LCs? Are the regulated activities identified in paragraph 144 those that are most relevant? Is there a case for further narrowing the scope through the use of a minimum size threshold?

We agree that the scope should be set with reference to the regulated activities, and we agree that they should include (i) asset management; and (ii) dealing in OTC derivatives or acting as a clearing agent for OTC derivatives (to be created). We however disagree with the suggestion that dealing in securities or future contracts (type 1 and type 2) should be included.

As explained above, the securities and funds will be held on trust for the clients (*Re CA Pacific Finance Ltd* [1999] 2 HKLRD 1). The failure of such firms will not cause any risk to financial stability, since the customers' assets (i.e. funds and shares) are generally protected. The court has developed a comprehensive procedure to deal with these assets. For example, if the securities are unclaimed, the liquidator can apply to the court under section 62 of the Trustee Ordinance: see *Re New Japan Securities International (HK) Ltd* [2007] 3 HKLRD 54. The unclaimed assets will be paid into the court. These procedures ensure that the firms can be wound down in an orderly

manner. The Consultation Document should articulate the justifications for including type 1 and type 2 licensees.

There need not be a minimum size threshold: otherwise Licensed Corporations satisfying the threshold may be encouraged to take more risky business decisions, and potentially gain an advantage over those that do not meet the threshold. After all, the regime would only be triggered if the failure of the Licensed Corporations will cause systematic risk to financial stability.

Question 7

Do you agree that the scope should extend to LCs which are branches or subsidiaries of G-SIFIs? Do you see a need for the scope to extend to LCs which are part of wider financial services groups, other than G-SIFIs, whether those operate only locally or cross-border?

Paragraph 1.1 of the Key Attributes states that the resolution regime should extend to:

… (iii) branches of foreign firms.

In light of this provision, we agree that branches of Globally Systematically Important Financial Institutions should also be included.

Question 8

Do you agree that it would be appropriate to extend the scope of the proposed resolution regime to the local operations of insurers designated as G-SIIs and/or IAIGs as well as those insurers which it is assessed could be critical or systemically important locally were they to fail?

We agree that insurers should also be covered. In fact, it seems that the Key Attributes require us to extend the regime to insurers, since paragraph 3.7 of the Key Attributes states that:

In the case of insurance firms, resolution authorities should also have powers to:

> *(i) undertake a portfolio transfer moving all or part of the insurance business to another insurer without the consent of each and every policyholder; and*
>
> *(ii) discontinue the writing of new business by an insurance firm in resolution while continuing to administer existing contractual policy obligations for in-force business (run-off).*

In light of this paragraph, it seems that the Key Attributes implicitly assume that insurers are covered.

Question 9

Do you agree that branches of foreign FIs should be within the scope of the local resolution regime such that the powers made available might be used to: (i) facilitate resolution being undertaken by a home authority; or (ii) support local resolution?

Paragraph 1.1 of the Key Attributes states that the resolution regime should extend to:

> *… (iii) branches of foreign firms.*

Thus we agree with the proposal. This is also in line with Article 1 of the draft European Resolution Directive, which includes:

> *… branches of institutions that are established outside the Union in accordance with the specific conditions laid down in this Directive.*

Question 10

Do you see any particular issues that need to be taken into consideration in ensuring that the regime can be deployed effectively in relation to branches of foreign FIs where necessary?

We believe that information sharing and cross-border cooperation would be critical. Please refer to questions 32-34 below.

Question 11

Do you agree that extending the scope of the proposed resolution regime to cover locally-incorporated holding companies is appropriate such that the powers available might be used where, and to the extent, appropriate to support resolution of one or more FIs?

Paragraph 1.1 of the Key Attributes states that the resolution regime should extend to:

(i) holding companies of a firm …

In view of this provision we agree that the regime should also cover local holding companies.

Question 12

Do you have any initial views on whether it is appropriate to extend the scope of the regime to affiliated operational entities to help ensure that they can continue to provide critical services to any FIs which are being resolved?

It is true that paragraph 1.1 of the Key Attributes states that the resolution regime should extend to:

non-regulated operational entities within a financial group or conglomerate that are significant to the business of the group or conglomerate …

Nevertheless, this paragraph does not directly support the proposal. The Key Attributes refer to entities "within a financial group or conglomerate": this is a far from "affiliated" (as proposed). It is also not immediately clear why an entity providing critical services must be "significant to the business of the group". (Conversely, an entity not providing critical services may nonetheless be significant to the business, so the proposal undue restricts the scope of the regime).

We are therefore of the view that the proposal must be modified to reflect the exact wording of the Key Attributes.

Triggering and Creating the Regime

Question 13

Do you agree that the conditions proposed for initiating resolution are appropriate in that they will support the use of the regime in relevant circumstances?

In principle the first non-viability condition and the second financial stability condition would ensure that the regime could only be trigger if (1) the institution is no longer viable, and (2) such failure would cause systematic risk to financial stability. In terms of principle the proposal is to be supported.

Nevertheless, as the Consultation Document points out, more concrete guidelines must be issued by the resolution authorities.

There is however one critical point that was not raised too clearly in the Consultation Documents. The two conditions focus on the necessity and benefit of resolution. They however fail to consider the cost of such intervention. Such an approach fails to safeguards the interests of the general public and creates moral hazard. The resolution authority must also take into account the facts that public funds are to be used cautiously. To this end, Article 13 of the draft European Resolution Directive provides a viable reference point:

> *Member States shall ensure that the resolution authority, after consultation with the competent authority and the resolution authorities of the jurisdictions in which significant branches are located insofar as is relevant to the significant branch,, assesses the extent to which an institution is resolvable without the assumption of extraordinary public financial support besides the use of the financing arrangements established in accordance with Article 91. An institution shall be deemed resolvable if it is feasible and credible for the resolution authority to either liquidate it under normal insolvency proceedings or to resolve it by applying the different resolution tools and powers to the institution without giving rise to significant adverse consequences for financial systems, including circumstances of broader financial instability or system wide events, of the Member State in which the institution is situated, or other*

Member States, or the Union and with a view to ensuring the continuity of critical functions carried out by the institution.(Emphasis added)

The European approach focuses on both the cost and benefit of intervention. Similar approach should also be adopted in Hong Kong.

In the same vein, the Preamble of the Key Attributes states that a suitable regime should "not rely on public solvency support and not create an expectation that such support will be available". The proposal, however, creates an impression that once the two conditions are satisfied, the resolution authority will automatically intervene with public funds (without regard to whether it is "worth" doing so). This is precisely the approach to be avoided.

Question 14

In particular, do you agree that it is appropriate that the first condition recognizes that non-viability could arise on financial and non-financial grounds (noting that resolution could occur only if the second financial stability condition is also met)?

We agree that a financial institution may fail on non-financial grounds, e.g. loss of licence.

Question 15

Are the objectives which it is proposed should be set for resolution suitable to guide the delivery of the desired outcomes?

The following objectives are proposed in the Consultation Document:

(i) promote and seek to maintain the general stability and effective working of the financial system in Hong Kong, including by securing continued provision of critical financial services, including payment, clearing and settlement functions;

(ii) seek an appropriate degree of protection for depositors, investors and policyholders;

> *(iii) subject to pursuing resolution objectives (i) and (ii), seek to contain the costs of resolution and, in so doing, to protect public funds.*

The phrase "subject to" is deliberately chosen to reflect the fact that cost is "a subordinate or supplementary objective" (paragraph 185).

This is, in our view, a flawed approach. This is not to deny the importance of maintaining financial stability. But this does not mean that financial stability has to be maintained at all cost.

That objective (ii) overrides objective (iii) is a classic scenario in which moral hazard arises. The resolution regime encourages risky investment by providing a resolution "safety net".

A better approach is adopted by Article 26 of the draft European Resolution Directive:

> *1. When applying the resolution tools and exercising the resolution powers, resolution authorities shall have regard to the resolution objectives, and choose the tools and powers that, in their view, best achieve the objectives that are relevant in the circumstances of the case.*
>
> *2. The resolution objectives referred to in paragraph 1 are:*
>
> > *(a) to ensure the continuity of critical functions;*
> >
> > *(b) to avoid significant adverse effects on financial stability, including to prevent contagion, and maintain market discipline;*
> >
> > *(c) to protect public funds by minimising reliance on extraordinary public financial support; and*
> >
> > *(d) to protect depositors covered by Directive 94/19/EC and investors covered by Directive 97/9/EC and to protect client funds and client assets.*

> *When pursuing the above objectives, the resolution authority shall seek to avoid the unnecessary destruction of value and to minimise the cost of resolution.*
>
> *3. Subject to different provisions of this Directive, the resolution authority shall balance the objectives mentioned in paragraph 2 as appropriate to the nature and circumstances of each case. (Emphasis added)*

The European approach does not "subordinate" cost consideration. It recognizes that public funds are to be used wisely. The Hong Kong proposal should consider the European model.

Question 16

Do you agree that, in line with their existing statutory responsibilities and supervisory intervention powers, the MA, SFC and IA should be appointed to act as resolution authorities for the FIs under their respective purviews?

We agree that the MA, the SFC and the IA should be appointed to act as resolution authorities. This is an approach permissible under Article 3 of the draft European Resolution Directive:

> *Each Member State shall designate one or more resolution authorities that are empowered to apply the resolution tools and exercise the resolution powers.*

This approach is in line with existing local legislation. The MA, the SFC and the IA are respectively responsible for regulating banks, intermediates and insurers. Thus, section 7(1) of the Banking Ordinance provides that "The principal function of the Monetary Authority under this Ordinance shall be to promote the general stability and effective working of the banking system". Section 4 of the Securities and Futures Ordinance provides that the SFC should "assist the Financial Secretary in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industry". Section 4A(1) of the Insurance Companies Ordinance provides that "The principal function of the Insurance Authority shall be to regulate and supervise the insurance industry for the promotion of the general stability of the insurance industry and for the protection of existing and potential policy holders".

When there are multiple authorities, paragraph 2.2 of the Key Attributes states should be observed:

> *Where there are multiple resolution authorities within a jurisdiction their respective mandates, roles and responsibilities should be clearly defined and coordinated.*

Paragraph 2.3 of the Key Attributes also states that:

> *Where different resolution authorities are in charge of resolving entities of the same group within a single jurisdiction, the resolution regime of that jurisdiction should identify a lead authority that coordinates the resolution of the legal entities within that jurisdiction.*

The lead authority should be given greater decision-making power. This is because individual resolution authority may have its own interests (e.g. to conceal regulatory gaps). The lead authority should review the decisions made by the resolution authorities to ensure impartiality.

Resolution Options

Question 17

Do you have any views on how a resolution option allowing compulsory transfer of all or part of a failing FI's business could most effectively be structured and used?

When a failing financial institution sells part of its business (in the form of assets rather than shares) to an acquirer, it seems that the Transfer of Businesses (Protection of Creditors) Ordinance may apply.

Under section 3, the transferee would be liable to all the debts previously owed by the transferor (notwithstanding any agreement to the contrary). This can defeat the purpose of the acquisition (and deter such acquisition). There may be a need to create an exception to section 3 of the Transfer of Businesses (Protection of Creditors) Ordinance.

Question 18

Do you have any views on how a resolution option allowing compulsory transfer of part of a failing FI's business to a bridge institution could most effectively be structured and used?

The purpose of a bridge institution is to facilitate the ultimate sale of the business to a third-party acquirer. The most important issue is what should be done if such acquirer cannot be found.

The bridge institution must be given the power to transfer the business back to the financial institution. Article 34 of the draft European Resolution Directive therefore provides:

> *5. Following an application of the bridge institution tool, the resolution authority may:*
>
> *(b) transfer rights, assets or liabilities back from the bridge institution to the institution under resolution, or the shares or other instruments of ownership back to their original owners, and the institution under resolution or original owners shall be obliged to take back any such assets, rights or liabilities, or shares or other instruments of ownership, provided that the conditions specified in paragraph 6 are met …*
> *6. Resolution authorities may transfer shares or other instruments of ownership or assets, rights or liabilities back from the bridge institution in one of the following circumstances:*
>
> *(a) the possibility that the specific shares or other instruments of ownership, assets, rights, or liabilities might be transferred back is stated expressly in the order by which the transfer was made.*
>
> *(b) the specific shares or other instruments of ownership, assets, rights, or liabilities do not in fact fall within the classes of, or meet the conditions for transfer of shares or other instruments of ownership, assets, rights, or liabilities specified in the order by which the transfer was made.*

Such a transfer back may be made within any time period and shall comply with any other conditions stated in that order for the relevant purpose.

This is a sensible approach. The power to re-sell the business back to the financial institutions must be expressly provided.

Question 19

Do you have any views on the factors which should be taken into account in drawing up proposals for the provision of a bail-in option for the resolution regime in Hong Kong?

The most important principle in this regard is that financial institutions benefiting from bail-in should accept the business reorganization plan proposed by the resolution authority.

This should include "removal of problem assets, replacement of senior management and adoption of a new business plan" as provided by paragraph 3.6 of the Key Attributes.

A business reorganization plan should always be prepared in case of bail-in under Article 46 of the draft European Resolution Directive. Similar provision should be adopted in Hong Kong.

Similarly, the power to write down claim and the power to convert loan into equity are expressly recognized by the Key Attributes and the draft European Resolution Directive.

Question 20

Do you agree that there is a case for including a TPO option in the proposed regime?

The Preamble of the Key Attributes states that the regime should include:

> *(i) stabilisation options that achieve continuity of systemically important functions by way of a sale or transfer of the shares in the firm or of all or parts of the firm's business to a third party, either directly or through a bridge institution, and/or an officially mandated creditor-financed recapitalisation of the entity that continues providing the critical functions …*

As the Consultation Document recognizes, TPO is not a mandatory option. And as the Consultation Document rightly points out, there is a risk that public funds would be used to finance the financial institutions and such a drastic measure should only be used as a last resort. In the circumstances, we do not believe that TPO should be made an available option.

Question 21

Do you have any views on when it would be appropriate to make temporary use of an AMV in order to manage the residual parts of an FI in resolution?

We agree that the use of an AMV may sometimes be beneficial. The draft European Resolution Directive requires all member states to allow their resolution authorities to create AMVs.

As provided by Article 36 of the draft European Resolution Directive, the purpose of an AMV is to "[maximize the assets' value] through eventual sale or orderly wind down". Therefore, an AMV can be used if such use preserves the value of the assets (by avoiding "fire sale" or a sudden increase in the supply of the assets).

Question 22

Do you have any views on how best to provide for a stay of early termination rights where these might otherwise be exercisable on the grounds of an FI entering resolution or as a result of the use of certain resolution options?

The set-off rights or early termination rights are inserted by commercial parties to protect their own interests in case of default or insolvency on the part of their counterparties. Any stay of such rights may potentially upset the careful contractual balance intended and created by the parties.

We note that such rights are frequently included in standard precedent commercial contracts. For example, a set-off right is invariably provided in derivative contracts (see e.g. the International Swaps and Derivatives Association's Master Agreement). In the context of bank loan, an acceleration clause is very common feature (see e.g. the Loan Market Association's standard loan agreement). Similar clauses can also be found in securities agreements (e.g. the automatic crystallization clause in a floating charge agreement). The power to stay such rights must be carefully checked and sparingly exercised.

In the premises, we stress that the stay can only be exercised if "the substantive obligations under the contract continue to be performed" (paragraph 4.2 of the Key Attributes). If a financial institution is no longer able to honour its contractual undertaking, there is no reason why the resolution authority can deprive the counterparties of their contractual protection.

Question 23

Do you have any views on how best to provide the supervisory or resolution authorities with powers to require that FIs remove substantial barriers to resolution?

The FSB recognizes in the FSB's Thematic Review on Resolution Regimes: Peer Review Report (page 31) that such measures are "intrusive" in nature. In our view, the powers can only be exercised if the benefit from removing the barriers outweighs the cost of removing the barriers.

In assessing the benefit, the first non-viability condition and the second financial stability condition must be satisfied. In assessing the cost, the resolution authority must bear in mind the importance of safeguarding public monies.

This is broadly in line with the test articulated by Article 14 of the draft European Resolution Directive:

> *These measures must be necessary and proportionate to reduce or remove the impediments to resolvability in question, taking into account the threat to financial stability of those impediments to resolvability and the effect of the*

measures on the business of the institution, its stability and its ability to contribute to the economy.

Question 24

Is the proposed approach to ensuring that third parties cannot act to pre-empt the resolution of a non-viable FI (including by means of a petition to initiate a winding up) appropriate?

We agree with the proposal, save that we believe that if the winding up is based on (1) member's voluntary winding up or (2) winding up on just and equitable ground: see section 177 of the Companies Ordinance.

The shareholders' right to wind up their companies must be respected, however strategically important the companies are. That the voluntary winding up may later be overtaken by the court or the creditors (if the companies are insolvent) does not detract from the fact that the winding up is what the shareholders intended. We therefore take the view that shareholders should not be regarded as third parties.

Equally, if a petition is based on the just and equitable ground, it is likely that the petition is filed by dis-satisfied shareholders. This is an important mechanism to protect minority shareholders. The just and equitable winding up mechanism should not be interfered with.

Question 25

Do you have any views on how provision might be made to ensure that the residual part of an FI could be called on to temporarily support a transfer of business to another FI or bridge institution (in the manner described in paragraph 266)?

We do not see the necessity of such a provision. If an acquirer cannot be immediately found, the assets can be transferred to the bridge institution temporarily. If the assets do not belong to the financial institution under resolution, the resolution authority should not be given the power to deal (indirectly) with these assets.

The proposal also contradicts the following principle articulated in paragraph 3.9 of the Key Attributes:

> *In applying resolution powers to individual components of a financial group located in its jurisdiction, the resolution authority should take into account the impact on the group as a whole and on financial stability in other affected jurisdictions, and undertake best efforts to avoid taking actions that could reasonably be expected to trigger instability elsewhere in the group or in the financial system.*

We therefore expect the authority to provide further justifications in the second public consultation.

Question 26

Do you attach any priority to pursuing reforms designed to ensure that the claims of protected parties (particularly those of depositors and investors) can be transferred out of liquidation proceedings, alongside those reforms being pursued to establish an effective resolution regime?

We do not see this as a priority: in the first place the depositors and investors assume the credit risk of the financial institutions. Moreover, as aforesaid the courts often take the view that the assets are held by the financial institutions on trust for the clients: there is no need to establish a separate statutory regime.

Safeguards

Question 27

Do you agree that a compensation mechanism is a necessary safeguard to ensure that shareholders and creditors are no worse off under resolution than they would have been in liquidation? Do you have any views on the factors which should be taken into account in designing such a compensation mechanism?

The Preamble of the Key Attributes states that a suitable regime should "allocate losses to firm owners (shareholders) and unsecured and uninsured creditors in a manner that respects the hierarchy of claims".

Similarly, Article 29 of the draft European Resolution Directive outlines the following general principles:

> *(a) the shareholders of the institution under resolution bear first losses;*
>
> *(b) creditors of the institution under resolution bear losses after the shareholders in accordance with the order of priority of their claims under normal insolvency proceedings, save as expressly provided otherwise in this Directive…*

These passages focus on allocating loss to the creditors. The Consultation Document however puts more emphasis on compensating the creditors, highlighting the section 265 of the Companies Ordinance.

Two crucial statutory provisions deserve more attention. The first is the liquidator's power to avoid a floating charge under section 267 of the Companies Ordinance (floating charge created within 1 year of winding up can be avoided if (1) the charge secures existing debts and (2) the company was insolvent at the time of winding up). The second is the provision relating to unfair preference: section 266 of the Companies Ordinance.

The argument here is that the resolution regime should not benefit the creditors. Had there been a winding up petition, the creditors would have lost their protection by virtue of sections 266 and 267. In assessing whether they are "worse off" as a result of the resolution taking place, one must also consider the possibility that their securities would have been avoided had there been a winding up petition.

Question 28

Do you consider that any adjustments are needed to the existing framework for protecting client assets for the purposes of resolution?

As we have repeatedly emphasized, we are of the view that the existing framework provides adequate protection to client assets. In particular, we have seen that firms usually hold funds and securities on trust for their customers. We therefore do not see any need for adjustments.

Question 29

What types of "financial arrangements" do you consider as important to protect in resolution? Why is it important that those arrangements be protected?

We agree with the Consultation Document that secured arrangements should be protected: such arrangements are usually embodied in the Loan Market Association's standard loan agreements.

We also agree that contractual netting off or set off should be protected: such provisions are incorporated in the International Swaps and Derivatives Association's Master Agreement.

It may be argued that securities agreements created for the sole purpose of securing pre-existing debts should not be protected. This is because the subsequent securities agreements and the pre-existing debts do not form a composite arrangement. We stress that an all-monies securities agreement will still be valid if it also secure "new monies".

Question 30

Do you agree that, in order to ensure resolution can be effected as swiftly as needed, there should be protection from civil liability for: (a) officers, employees and agents of the resolution authority, and (b) directors and officers of FIs acting in compliance with the instructions of the resolution authority, limited to cases where these parties are acting in good faith?

Paragraph 2.6 of the Key Attributes states that:

The resolution authority and its staff should be protected against liability for actions taken and omissions made while discharging their duties in the exercise of resolution powers in good faith, including actions in support of foreign resolution proceedings.

In view of this paragraph we agree with the proposal. This is also consistent with Article 3 of the draft European Resolution Directive:

> *Without prejudice to Article 78, Member States may limit the liability of the resolution authority, the competent authority and their respective staff in accordance with national law for acts and omissions in the course of discharging their functions under this Directive.*

Question 31

What provisions should be made under the regime to fund resolution, with a view to ensuring that any call on public funds is no more than temporary?

The Preamble of the Key Attributes states that a suitable regime should "not rely on public solvency support and not create an expectation that such support will be available".

We believe that the best way to ensure that any call on public funds would be no more than temporary is to insist that the resolution authority must always bear in mind the importance of public interest. We have repeatedly criticized the Consultation Document for failing to highlight such a principle.

To this end we once again refer to the draft European Resolution Directive. Article 27 provides:

> *1. Member States shall ensure that resolution authorities shall take a resolution action in relation to an institution referred to in Article 1(a) if the resolution authority considers that all of the following conditions are met:*
>
> *…*
>
> *(c) a resolution action is necessary in the public interest pursuant to paragraph 3.*
>
> *3. For the purposes of point (c) of paragraph 1, a resolution action shall be treated as in the public interest if it is necessary for the achievement of, and is proportionate to one or more of the resolution objectives as specified in Article 26 and winding up of the institution under normal insolvency proceedings would not meet those resolution objectives to the same extent.*

The resolution authority should always use public funds wisely. In particular, we cannot disagree more with the proposition that cost is merely "a subordinate or supplementary objective" (paragraph 185 of the Consultation Document).

Cross-Border Cooperation and Information Sharing

Question 32

Do you agree that it is important that the resolution regime in Hong Kong supports, and is seen to support, cooperative and coordinated approaches to the resolution of cross-border groups given Hong Kong's status as a major financial centre playing host to a significant number of global financial services groups?

We agree with this observation in light of paragraph 12 of the Key Attributes which highlights these aspects.

Question 33

Do you agree that the model outlined in paragraphs 331 to 333 to support and give effect to resolution actions being carried out by a foreign home resolution authority would be effective in supporting coordinated approaches to resolution where it is in the interests of Hong Kong to do so?

Page 29 of the FSB's Thematic Review on Resolution Regimes: Peer Review Report states:

> *To facilitate cooperation, jurisdictions should provide for transparent and expedited processes to give effect to foreign resolution measures, either by way of procedures for mutual recognition or by using powers under the domestic framework to take measures that support and complement the foreign resolution in relations to local operations of the firm.*

We believe that mutual recognition is the preferred approach. This ensures that other jurisdictions will also support the resolution work carried out in Hong Kong.

When it comes to us supporting the resolution of other jurisdictions, we agree that the Hong Kong resolution authority must ensure that local creditors would not be prejudiced.

We disagree with the proposal that the Hong Kong resolution authority should also consider the financial stability of other jurisdictions. As the FSB's Thematic Review on Resolution Regimes: Peer Review Report states (page 30 – the only exception is that Australia provided limited protection to New Zealand):

> *No jurisdiction has comprehensive obligations for domestic authorities to avoid taking resolution actions that may have an adverse effect on the financial stability of other jurisdictions.*

Therefore we do not feel that our authority should be constrained by foreign factors.

Question 34
Do you consider that the powers proposed regarding information sharing strike an appropriate balance in terms of facilitating information sharing for resolution in both in a domestic and cross-border context?

In the FSB's Thematic Review on Resolution Regimes: Peer Review Report, Hong Kong was doing quite well in this area. We are one of the eight jurisdictions allowing cross-border information sharing (page 32).

In the circumstances, we believe that the existing framework satisfies the requirements specified in the Key Attributes. When it comes to the HKMA, the Banking Ordinance provides in section 121:

> *(1) Subject to subsection (3), and notwithstanding section 120, the Monetary Authority may disclose information to an authority in a place outside Hong Kong where-*
>
> *(a) that authority exercises functions in that place corresponding to the functions of-*
> *(i) the Monetary Authority; or*

(ii) an authorized statutory office within the meaning of section 120(5A); and
(b) in the opinion of the Monetary Authority-
(i) that authority is subject to adequate secrecy provisions in that place; and
(ii) it is desirable or expedient that information should be so disclosed in the interests of depositors or potential depositors or the public interest; or
(iii) such disclosure will enable or assist the recipient of the information to exercise his functions and it is not contrary to the interests of depositors or potential depositors or the public interest that the information should be so disclosed.

As one can see, the provision allows disclosure provided that the receiving authorities are bound by confidentiality obligations. This strikes a right balance between disclosure and confidentiality.

As regards the SFC, similar provision has been provided by section 378 of the Securities and Futures Ordinance. Similar disclosure powers can also be found in Part VIIIA of the Insurance Companies Ordinance.

We are therefore of the view that the existing regime strikes a balance between disclosure and secrecy.

Conclusion

Our principal criticism is that the proposal fails to emphasize the importance of using public funds wisely. Contrary to the suggestion of the Consultation Document, costs should not be merely regarded as subsidiary considerations. To this end the European approach is to be preferred.

END