

(Reform) too big to fail? Hong Kong puts in place resolution regime to meet international standards

30 months after the first public consultation of a resolution regime for financial institutions in Hong Kong, the Government published the much anticipated Financial Institutions (Resolution) Ordinance (the "Ordinance") in the Gazette on 30 June 2016.

Background

Given Hong Kong's status as an international financial centre and Financial Stability Board ("FSB") member jurisdiction, the Government originally planned to enact legislation before the end 2015 deadline set by the FSB to meet its "Key Attributes of Effective Resolution Regimes for Financial Institutions"¹ ("KAs"). An effective resolution regime is also much needed to complement the other prudential regulatory mechanisms adopted by Hong Kong to strengthen the resilience of its financial system.

To see how the consultation process has evolved to pave way for the Ordinance, please refer to our briefings² on the first stage and

second stage consultations and conclusions.

With a view to establishing a regime for the orderly resolution of systemically important financial institutions in Hong Kong the Government published its Financial Institutions (Resolution) Bill (the "**Bill**") in the Gazette on 20 November 2015. Taking into account the views of the Bills Committee and the public, the Government clarified certain provisions, incorporated other technical amendments to the Bill but made no major changes to the proposals made at the conclusion of the consultation exercise.

Bill vs. Ordinance

The most noticeable changes to the legislation following the passage of the Bill are summarised in the following table.

Key issues

- The Ordinance is designed to comply with the latest international standards set by the Financial Stability Board.
- No major changes to proposals made at the conclusion of the consultation exercise.
- Will commence operation on a date appointed by the Secretary for Financial Services and the Treasury.
- Now pending Legislative Council's passing of certain essential regulations which need to be made as subsidiary legislation.

¹ Published by the FSB in October 2011 and subsequently re-issued in October 2014.

² More detail on the scope of the regime can be found in our briefings on the [Second Consultation Conclusions](#), [Second Consultation](#) and [First Consultation](#).

Areas of change	Government response
Removal of directors	Any revocation of a person's appointment to a post as a director, chief executive officer ("CEO") or deputy chief executive officer ("DCEO") by a resolution authority ("RA") will not affect that person's rights under their employment contract with the financial institution, the Employment Ordinance and other application legislation.
Effect of an instrument	There is no intention for the regime to exclude the ability of any person affected by an RA to seek judicial review regarding the effect of a securities, property transfer instrument or a bail-in instrument.
Resolution Compensation Tribunal and Resolvability Review Tribunal	The Chief Executive may establish additional tribunals should he consider it appropriate to do so.
Power for the RA to retain senior officers' variable remuneration	The purpose for which an RA may give directions in the run-up to resolution has been widened. This allows the RA to also give directions if it is of the opinion that such directions will facilitate future application of a power conferred on the RA or the Court by the Ordinance. This could include a direction not to pay an inappropriate bonus in the run-up to resolution.
Coordination between the powers of the RA and those of the relevant regulators	Before initiating resolution the RA must liaise with Hong Kong Monetary Authority ("HKMA"), Securities Futures Commission ("SFC") or Insurance Authority ("IA") as appropriate in order to ensure coordination of their exercise of any supervisory powers under the Banking Ordinance, Securities and Futures Ordinance and Insurance Companies Ordinance respectively and the exercise of powers by an RA.
Clawback orders	A Court is not required to take into account the financial circumstances of the officer when making a clawback order. However the discretion of the Court to take into account such factors and circumstances as it may see fit in making a clawback order are not fettered. The Limitation Ordinance does not apply to an application for a clawback order.
Confidentiality requirements	A new added gateway expressly empowers the RA to disclose information where it is of the opinion that doing so is in the interests of promoting and maintaining the stability and effective working of the financial system of Hong Kong.
Chinese term for "bail-in instruments"	An amendment "內部財務調整文書" to "內部財務重整文書" to reflect the urgency and seriousness of "bail-in instruments".
Definition of CEO and DCEO	Amendment of the definitions of CEO and DCEO as being the persons responsible for the implementation of the general strategy of the entity and for the general management of the business of the entity (as opposed to the management of the whole of the business of the entity as previously stated).
Appointment criteria for entities to assist an RA and independent valuer	Recognition of the fact that the requirement for the relevant persons not to have an interest in common or conflict with any shareholder as well as any creditor is not workable in practice and therefore this criteria has been removed.
Mistakes in a valuation made by an independent valuer	Recognition that the correction of a clerical mistake, or error arising from an accidental slip or omission, in the valuation decision or the assessment on which the decision is made should not be capable of affecting the valuation decision or the level of compensation payable as a result of the correction.

Areas of change	Government response
Employees employed by entities to assist the RA or an independent valuer to be covered by the confidentiality requirement	Made explicit that the members, employees and agents of, and the consultants and advisors to, an entity assisting on RA or an independent valuer should be covered by confidentiality requirements.
Code of practice	Clarification that codes of practice to be issued by an RA about the performance of its functions will not be through subsidiary legislation. Widened scope to enable RAs to issue codes of practice about any matter relating to the functions given to them, including providing guidance on the operation of any provision of the Ordinance.

Next steps

The Ordinance will commence operation on a date to be appointed by the Secretary for Financial Services and the Treasury pending the Legislative Council's passing of certain essential regulations which need to be made as subsidiary legislation in order to supplement the basic framework established under the Ordinance.

The Government, along with the HKMA, the IA and the SFC will maintain close liaison with the industry and the relevant stakeholders in the formulation of regulations, rules and codes of practice. The Government and the regulators will post on their respective websites information about the work being undertaken to make the resolution regime operational and the implications of resolution for relevant stakeholders.

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