



By email < [resolution@fstb.gov.hk](mailto:resolution@fstb.gov.hk) > and by post

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Resolution Regime Consultation  
Financial Services Branch  
Financial Services and the Treasury Bureau  
24/F Central Government Offices  
2 Tim Mei Avenue, Tamar  
Hong Kong

Dear Sirs,

### **An Effective Resolution Regime for Financial Institutions in Hong Kong Consultation Paper**

The Restructuring and Insolvency Faculty Executive Committee of the Hong Kong Institute of Certified Public Accountants ("the Institute") has considered the above consultation paper, which seeks views and comments on the proposals for a resolution regime for certain financial institutions ("FIs") operating in the banking, securities and futures and insurance sectors, as well as for certain financial market infrastructures, in Hong Kong. We note that this is only the first stage consultation on the regulatory structure and principles that would be required to establish an effective resolution regime for FIs in Hong Kong and that more specific details regarding the operation of the resolution regime will be elaborated in a further consultation due to be carried out later this year. Some of the information to be considered later will be important, such as the areas listed in paragraph 14 of the consultation paper. Other important issues would include the interface between the deposit protection scheme and the proposed resolution regime and powers to be given to regulators to require FIs to take action to improve resolvability. In fact, many of the details of when and how the system would be deployed, including the very important issues surrounding the operation of international co-operation when, for example, a multinational banking institution is subject to the regime, are not clear at this stage. At this stage, therefore, it would be difficult to take a holistic view of the proposed regime and its likely efficacy.

Broadly speaking, given Hong Kong's status as an international financial centre and a major hosting jurisdiction of many global and regional FIs, identified by the Financial Stability Board ("FSB") as systemically important FIs, we would support the introduction of a resolution regime to bring Hong Kong into line with the standards set in the key attributes issued by the FSB. This will help to preserve confidence in the Hong Kong market and to reinforce Hong Kong's standing internationally.

At the same time, the resolution regime advocates very extensive powers being given to resolution authorities to, for example, override the rights of shareholders in FIs that, by definition, have not failed at the point of taking action and which, if left to their own devices, might not fail. Inevitably, judgment will need to be exercised and it is important that there be as much certainty as possible about the regime and how it will operate. If a high degree of uncertainty remains, this could precipitate the very



outcome that resolution seeks to prevent, i.e., loss of confidence in the financial system or a systemic part of it.

Our comments on the proposals, which are high-level commentaries on the principles and the proposed framework for a resolution regime for FIs, modelled on the key attributes set by the FSB, are provided below.

A. Scope and coverage of the proposed resolution regime

On balance, we would support a fairly broad scope for the regime, covering a wide spectrum of FIs. A wider scope provides greater flexibility in determining whether or not to apply the regime to particular FIs that have been identified as systemically significant or critical to Hong Kong's financial system, the failure of which could pose a risk to financial stability and the wider economy. In adopting this position, we are taking the view that, in addition to considering the characteristics of specific FIs themselves, the economic climate at the time, both locally and globally, could also be a factor to be taken into consideration when deciding whether or not to initiate resolution action.

However, having said that, the proposed scope of coverage of the regime to, among other FIs, all authorised institutions ("AIs") within the banking system in Hong Kong, including all restricted licenced banks and deposit-taking companies ("DTCs"), as explained in paragraph 124-133 of the consultation paper, is very wide. It is difficult to envisage the circumstances in which the failure of a small DTC, which is not part of a larger financial group, could be systemically significant. While it is also explained (e.g., in paragraphs 129 and 133) that including a particular FI or category of FIs within the scope of the regime does not mean that the regime would be deployed routinely in all cases of non-viability, such a wide scope could, on the one hand, result in a high degree of uncertainty in individual cases and, on the other hand, could also increase the risk of "moral hazard", in which smaller FIs might be encouraged to act less prudently, believing that they will be bailed out if anything goes wrong. This would not be healthy for the financial system. At the same time, we appreciate that, if some AIs are excluded while others in the same category are covered by the resolution regime, this could make them appear less attractive to depositors.

To address concerns about providing for an overly wide discretion, which could result from a very broad scope of coverage, we would suggest that the criteria for deploying the regime in any given circumstances be clearly and transparently defined. The merits of covering all AIs, however small and segregated, should also be considered carefully.

International co-ordination and co-operation is very important, in particular in relation to the potential failure of multinational FIs, which could affect the financial stability of several jurisdictions. The international element is particularly important for Hong Kong, given the number of international banks to which Hong Kong plays host.

The scope of the local resolution regime is proposed to be extended to branches or subsidiaries of FIs incorporated outside Hong Kong that are in resolution, on the condition that the home authority's resolution will deliver an outcome that is assessed as being consistent with the objectives set for resolution in Hong Kong and will not disadvantage local creditors relative to foreign creditors. In this regard, we should like

to seek further clarification as to the criteria to be used to determine whether local creditors would be worse off than foreign creditors. What, for example, would have been the outcome in Hong Kong had a resolution regime been in place when the Bank of Credit and Commerce ("BCC") collapsed internationally? Under a winding up procedure in Hong Kong, creditors received a dividend exceeding one hundred percent from the liquidation of BCC (Hong Kong). We note that relevant issues and concerns are raised in chapter 8 of the consultation paper. However, the approach to be adopted in cross border resolutions and the way in which the procedures are expected to work in practice will need to be further elaborated. We hope that, in the second stage consultation, there will be more specifics.

In view of the above, it would be appropriate to have regard to other jurisdictions in determining the scope of the proposed regime in Hong Kong. As Hong Kong has, for historical reasons, favoured the establishment of branches of foreign banks rather than separately-capitalised subsidiaries, it would be relevant to look at what has been done, or is being done, in relation to resolution arrangements in other jurisdictions that host many branches of international FIs. The treatment of branches under a resolution regime may be different from the treatment of subsidiaries and this may have implications for depositors.

#### B. Resolution framework, options and resolution authorities

We generally support the provision of the range of resolution options to be made available under the proposed regime. It is suggested, in paragraph 210 of the consultation paper, that resolution authorities should be able to decide which of the options (as outlined in Box G) to draw upon and how to deploy them, based on the specific circumstances of each case and what approach would best fulfil the objectives set for resolution. This needs to be read in conjunction with the general statement, in paragraph 262, that whenever there are significant doubts about the viability of an FI covered by the regime, the resolution authority should be given the opportunity to consider whether resolution should be carried out.

As indicated above, unfettered discretion could result in doubts and uncertainty on the part of stakeholders, which would be counterproductive to the objective of maintaining financial stability. Some general criteria should be developed and made publicly available as to which options or combinations of options would be used in what circumstances. As a minimum, information should be made available as to the factors that would be considered by the resolution authority before coming to a decision on the most appropriate resolution option(s) in any particular case.

We support the proposal to establish a common framework for resolution through a single cross-sectoral regime, with some sector-specific provisions, and that each of the existing regulators, the Hong Kong Monetary Authority, the Securities and Futures Commission and the Insurance Authority, should be designated as resolution authorities responsible for exercising the powers available under the regime in relation to the FIs subject to their regulatory authority.

On the failure of a financial services group which operates across multiple sectors of the financial industry and is subject to regulation by more than one regulator, we concur that there would be a need to appoint a lead resolution authority to oversee and co-ordinate the resolution process so as to avoid supervisory conflict. However, it



is not clear as to how a lead resolution authority would be appointed and how, in practice, supervisory overlap or conflict could be avoided or mitigated if the failure of the financial services group were brought about by the non-viability of more than one sector of the business. This would suggest that the lead resolution authority would need to be more than a coordinator and be invested with some decision-making power. Such issues will need to be addressed in the second stage consultation.

We note that the proposals in the consultation paper do not include empowering the resolution authority to investigate the causes of failure in respect of FIs covered by the resolution regime. However, possible threats to the viability of a systemically significant FI would include fraud, corruption and accounting irregularities, within or affecting the business (e.g., the cases of BCC and Barings). Criminal activities could have a significant impact on an FI and impose barriers to the application of various resolution options by the resolution authority. For example, it would be more difficult to transfer a failing FI in its entirety, or to transfer some or all of its business, to another FI where, potentially, criminal irregularities were involved, because the extent of such activities and their impact on business might not be known without further investigation. We suggest that this issue needs to be further considered.

As mentioned above, the powers of the supervisory authorities or resolution authority in relation to requiring FIs to take action to improve their "resolvability" is an important area that also needs to be spelled out in greater detail, as this could involve the relevant authority substituting its own judgment for the business judgment of the management of FIs.

### C. Safeguards

We agree that it is important that directors and officers of FIs covered by the regime should be protected in law from civil liability when acting in good faith in compliance with the decisions and instructions of the resolution authority. Otherwise, they may not be willing to support the resolution authority in the execution of the resolution.

Given the potential interface that the proposed regime will have with corporate insolvency law and the Deposit Protection Scheme, we would suggest that the Official Receiver and the Deposit Protection Board also be invited to comment on the proposals if they have not already done so.

The above reflects our preliminary views on the principles and proposed framework and regulatory structure for a resolution regime for FIs in Hong Kong. If you have any questions on this submission or wish to discuss it further, please contact me at the Institute on 2287 7084.

Yours faithfully,

Peter Tisman  
Director, Specialist Practices

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