

# **Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights— Banking Sector) Rules**

*Note: These draft Rules are prepared to assist in explaining the relevant policy proposals. They are not the final version for the legislative process if legislation is introduced for giving effect to the proposals.*

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# **Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights—Banking Sector) Rules**

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# **Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights—Banking Sector) Rules**

(Made by the Monetary Authority under section 92 of the Financial Institutions (Resolution) Ordinance (Cap. 628))

## **Part 1**

### **Preliminary**

#### **1. Commencement**

These Rules come into operation on [date to be added].

#### **2. Interpretation**

In these Rules—

***covered contract*** ()—

- (a) in relation to a covered entity that is an authorized institution incorporated in Hong Kong or an HK holding company, means a financial contract entered into by the covered entity that—
  - (i) is governed by non-Hong Kong law; and
  - (ii) contains a termination right exercisable by a counterparty other than an excluded counterparty; or
- (b) in relation to a covered entity that is a related company of an authorized institution incorporated in Hong Kong, means a financial contract entered into by the covered entity that—
  - (i) is governed by non-Hong Kong law;

- (ii) contains a termination right exercisable by a counterparty other than an excluded counterparty; and
- (iii) contains one or more obligations of the covered entity that are guaranteed or otherwise supported by an authorized institution incorporated in Hong Kong, or an HK holding company, that is a member of the same group of companies as the covered entity;

***covered entity*** () means—

- (a) an authorized institution incorporated in Hong Kong;
- (b) an HK holding company; or
- (c) a related company of an authorized institution incorporated in Hong Kong;

***excluded counterparty*** (), in relation to a contract, means a counterparty to the contract that is—

- (a) a financial market infrastructure;
- (b) the Monetary Authority;
- (c) the Government;
- (d) the government of a non-Hong Kong jurisdiction; or
- (e) the central bank of a non-Hong Kong jurisdiction;

***financial accommodation*** () has the meaning given by section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571);

***financial contract*** () means a contract listed in the Schedule or any combination of such contracts;

***HK holding company*** () means an entity that is a holding company incorporated in Hong Kong of an authorized institution

incorporated in Hong Kong, but is not itself an authorized institution;

***initial day*** (), in relation to a covered entity, or a covered contract entered into by it, means—

- (a) the day on which these Rules come into operation; or
- (b) if it is not a covered entity on that day, the later day on which it becomes a covered entity;

***initial period*** (), in relation to a covered contract, means the period set out in rule 5(3);

***related company*** (), in relation to an authorized institution incorporated in Hong Kong, means a body corporate that is a member of the same group of companies as the authorized institution, but is not itself an authorized institution incorporated in Hong Kong or an HK holding company;

***resolution authority*** () means the resolution authority in relation to a banking sector entity;

**Note—**

Under section 2(1) of the Ordinance, the resolution authority in relation to a banking sector entity is the Monetary Authority.

***suspension of termination rights provision*** () means a term or condition (made, or evidenced, in writing) of a covered contract to the effect that the parties to the contract agree in a legally enforceable manner that, despite any other term or condition of the contract or any other agreement, arrangement or understanding, they will be bound by a suspension of a termination right in relation to the contract imposed by the resolution authority under section 90(2) of the Ordinance;

***termination right*** (), in relation to a covered contract, means—

- (a) a right to terminate the contract;

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- (b) a right to accelerate, close out, set off or net obligations, or any similar right that suspends, modifies or extinguishes an obligation of a party to the contract; or
  - (c) a right to prevent an obligation from arising under the contract;

***transferable securities*** () has the meaning given by section 2(1) of the Financial Institutions (Resolution) (Protected Arrangements) Regulation (Cap. 628 sub. leg. A).

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## **Part 2**

### **Requirement for Covered Contracts to Contain Suspension of Termination Rights Provision**

#### **3. Requirement on covered entity for covered contracts to contain suspension of termination rights provision**

- (1) A covered entity must ensure that a suspension of termination rights provision is contained in a covered contract that is—
  - (a) entered into by the covered entity on or after the initial day; or
  - (b) entered into by the covered entity before the initial day but—
    - (i) renewed on expiry of its term on or after that day (irrespective of whether the renewal is automatic or requires any action on the part of the covered entity or any counterparty to the contract); or
    - (ii) materially amended on or after that day (irrespective of whether the amendment is automatic or requires any action on the part of the covered entity or any counterparty to the contract).
- (2) If a contract is not a covered contract when it is entered into but becomes a covered contract on or after the initial day, the contract is taken for the purposes of this rule to be a covered contract entered into when it becomes a covered contract.
- (3) If an amendment of a covered contract creates a new right or obligation of a party to the contract, the amendment is taken for the purposes of subrule (1)(b)(ii) to be a material amendment of the contract.



- (4) A failure of a covered entity to comply with subrule (1) in relation to a covered contract does not affect any power of the resolution authority under section 90(2) of the Ordinance to suspend a termination right under the contract.

**4. When covered entity must comply**

Subject to rule 5, a covered entity must—

- (a) comply with rule 3(1) in relation to a covered contract when the contract is entered into, renewed or amended (as the case requires); and
- (b) continue to comply with that rule throughout the term or remaining term of the contract (as the case requires), including the term or remaining term of the contract as renewed or amended.

**5. Initial period for compliance**

- (1) This rule applies if, in the following period, a covered entity enters into a covered contract, or a covered contract entered into by a covered entity is renewed or amended—
  - (a) the initial period for the contract; or
  - (b) if the initial period is extended under rule 6(1)—subject to any variation under rule 6(2) or any condition imposed under rule 6(3), the initial period so extended.
- (2) The covered entity must—
  - (a) comply with rule 3(1) in relation to the covered contract by the end of the period specified in subrule (1); and
  - (b) continue to comply with that rule throughout the term or remaining term of the contract (as the case requires), including the term or remaining term of the contract as renewed or amended.

- (3) The initial period for a covered contract is—
  - (a) the period of 24 months beginning on the initial day, for a contract where there are no counterparties other than—
    - (i) an authorized institution; or
    - (ii) a financial institution (other than an authorized institution) that is, or is a member of a group of companies that is, a global systemically important bank on the initial day; or
  - (b) the period of 30 months beginning on the initial day, for any other contract.
- (4) Any excluded counterparties to a covered contract are to be ignored for the purposes of subrule (3)(a).

**6. Resolution authority may extend initial period**

- (1) The resolution authority may, by written notice served on a covered entity, extend the initial period for a covered contract or a class of covered contract, if satisfied that it is prudent to do so.
- (2) The resolution authority may, by written notice served on a covered entity, vary or revoke an extension under subrule (1), if satisfied that it is prudent to do so.
- (3) The resolution authority may, if satisfied that it is prudent to do so—
  - (a) in a written notice under subrule (1) or (2) impose conditions on an extension; and
  - (b) by written notice served on a covered entity, vary or revoke any conditions of, or impose further conditions on, an extension.
- (4) In determining whether it is prudent to extend the initial period, vary or revoke an extension, impose a condition on an

extension or vary or revoke a condition of an extension, the resolution authority may take into account—

- (a) any strategies devised by the resolution authority under section 13(1)(a) or (2)(a) of the Ordinance for securing an orderly resolution of—
  - (i) if the covered entity is an authorized institution incorporated in Hong Kong—the covered entity or an HK holding company of the covered entity;
  - (ii) if the covered entity is an HK holding company—the covered entity or an authorized institution incorporated in Hong Kong that is a subsidiary of the covered entity; or
  - (iii) if the covered entity is a related company of an authorized institution incorporated in Hong Kong—an authorized institution incorporated in Hong Kong, or an HK holding company, that is a member of the same group of companies as the covered entity; and
- (b) any other matters the resolution authority considers relevant.

**7. Resolution authority may exempt covered entity from requirements**

- (1) The resolution authority may, by written notice served on a covered entity, exempt the covered entity from compliance with rule 3(1) for a covered contract or a class of covered contract, if satisfied that it is prudent to do so.
- (2) The resolution authority may, by written notice served on a covered entity, vary or revoke an exemption under subrule (1), if satisfied that it is prudent to do so.

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- (3) The resolution authority may, if satisfied that it is prudent to do so—
- (a) in a written notice under subrule (1) or (2) impose conditions on an exemption; and
  - (b) by written notice served on a covered entity, vary or revoke any conditions of, or impose further conditions on, an exemption.
- (4) In determining whether it is prudent to exempt a covered entity, vary or revoke an exemption, impose a condition on an exemption or vary or revoke a condition of an exemption, the resolution authority may take into account—
- (a) any strategies devised by the resolution authority under section 13(1)(a) or (2)(a) of the Ordinance for securing an orderly resolution of—
    - (i) if the covered entity is an authorized institution incorporated in Hong Kong—the covered entity or an HK holding company of the covered entity;
    - (ii) if the covered entity is an HK holding company—the covered entity or an authorized institution incorporated in Hong Kong that is a subsidiary of the covered entity; or
    - (iii) if the covered entity is a related company of an authorized institution incorporated in Hong Kong—an authorized institution incorporated in Hong Kong, or an HK holding company, that is a member of the same group of companies as the covered entity;
  - (b) any risks to the stability and effective working of the financial system of Hong Kong, including to the

continued performance of critical financial functions, that may be posed by the non-viability of—

- (i) if the covered entity is an authorized institution incorporated in Hong Kong—the covered entity;
  - (ii) if the covered entity is an HK holding company—an authorized institution incorporated in Hong Kong that is a subsidiary of the covered entity; or
  - (iii) if the covered entity is a related company of an authorized institution incorporated in Hong Kong—an authorized institution incorporated in Hong Kong that is a member of the same group of companies as the covered entity; and
- (c) any other matters the resolution authority considers relevant.
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## **Part 3**

### **Compliance and Enforcement**

#### **8. Systems of control and record keeping**

A covered entity must at all times—

- (a) have adequate systems of control in place to ensure compliance by it with—
  - (i) rule 3(1); and
  - (ii) any conditions of an extension under rule 6 or an exemption under rule 7; and
- (b) keep sufficient records to demonstrate compliance by it with—
  - (i) rule 3(1);
  - (ii) any conditions of an extension under rule 6 or an exemption under rule 7; and
  - (iii) paragraph (a).

**Note—**

Under section 158 of the Ordinance, the resolution authority may require a controlled entity or a third party entity to provide information or produce records or documents that the resolution authority reasonably requires in connection with the performance of its functions under the Ordinance. Section 159 of the Ordinance provides for related offences. A covered entity is a controlled entity within the meaning of those sections (see sections 2(1) and 154 of the Ordinance).

#### **9. Resolution authority may require covered entity to provide legal opinion**

The resolution authority may require a covered entity to provide to the resolution authority an opinion acceptable to the resolution

authority from counsel or a solicitor that a suspension of termination rights provision contained in a covered contract in compliance with rule 3(1) is legally enforceable.

**10. Requirement to notify resolution authority of failure to comply**

- (1) If, in relation to a covered contract, a covered entity fails to comply with rule 3(1) in accordance with rule 4 or 5(2) (as the case requires), the covered entity must—
  - (a) as soon as practicable notify the resolution authority in writing; and
  - (b) provide particulars to the resolution authority on request.
- (2) A covered entity that, without reasonable excuse, fails to comply with subrule (1) commits an offence and is liable on conviction to a fine at level 2.
- (3) If a covered entity commits an offence under subrule (2), an officer of the covered entity also commits an offence under that subrule if the officer—
  - (a) authorized or permitted the commission of the offence by the covered entity; or
  - (b) was knowingly concerned in any way (whether by act or omission) in the commission of the offence by the covered entity.
- (4) An officer who commits an offence under subrule (2) is liable on conviction to a fine at level 2 and to imprisonment for 6 months.
- (5) An officer of a covered entity may commit an offence under subrule (2) whether or not the covered entity has been prosecuted for, or found guilty of, an offence under that subrule.

## **11. Rectification plans**

- (1) If, in relation to a covered contract, a covered entity fails to comply with rule 3(1) in accordance with rule 4 or 5(2) (as the case requires), the resolution authority may, by written notice served on the covered entity, require the covered entity to—
  - (a) propose, within the period specified in the notice, a plan acceptable to the resolution authority to rectify the failure; and
  - (b) implement the plan.
- (2) A covered entity must specify in a plan proposed in response to a notice served on it under subrule (1) a period within which it proposes to rectify the failure.
- (3) The service of a notice on a covered entity under subrule (1) does not affect any power of the resolution authority under section 14 of the Ordinance in relation to—
  - (a) if the covered entity is an authorized institution incorporated in Hong Kong—the covered entity or an HK holding company of the covered entity;
  - (b) if the covered entity is an HK holding company—the covered entity or an authorized institution incorporated in Hong Kong that is a subsidiary of the covered entity; or
  - (c) if the covered entity is a related company of an authorized institution incorporated in Hong Kong—an authorized institution incorporated in Hong Kong, or an HK holding company, that is a member of the same group of companies as the covered entity.
- (4) A covered entity commits an offence and is liable on conviction to a fine at level 2 if the covered entity, without reasonable excuse, fails to—



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- (a) propose a plan in compliance with a requirement imposed on the covered entity under subrule (1)(a); or
    - (b) implement a plan proposed in compliance with that requirement within the period specified in the plan.
  - (5) If a covered entity commits an offence under subrule (4), an officer of the covered entity also commits an offence under that subrule if the officer—
    - (a) authorized or permitted the commission of the offence by the covered entity; or
    - (b) was knowingly concerned in any way (whether by act or omission) in the commission of the offence by the covered entity.
  - (6) An officer who commits an offence under subrule (4) is liable on conviction to a fine at level 2 and to imprisonment for 6 months.
  - (7) An officer of a covered entity may commit an offence under subrule (4) whether or not the covered entity has been prosecuted for, or found guilty of, an offence under that subrule.
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## Schedule

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### Financial contracts

1. Securities contracts, that is—
  - (a) contracts for the purchase, sale or loan of a transferable security or a group or index of transferable securities;
  - (b) repurchase or reverse purchase transactions on a transferable security or a group or index of transferable securities; or
  - (c) securities margin financing transactions, that is, transactions for providing financial accommodation in order to facilitate—
    - (i) the acquisition of transferable securities; or
    - (ii) (if applicable) the continued holding of those securities,whether or not those or other securities are pledged as security for the accommodation.
2. Commodities contracts, that is—
  - (a) contracts for the purchase, sale or loan of a commodity or a group or index of commodities for future delivery; or
  - (b) repurchase or reverse purchase transactions on a commodity or a group or index of commodities.
3. Derivatives contracts, that is, financial instruments the value of which is determined by reference to the price or value of, or changes

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- in the price or value of, at least one underlying asset, financial instrument, index, rate or thing of any kind designated in the instrument and includes forwards contracts, futures contracts, options contracts and swap agreements.
4. Contracts for the purchase, sale or delivery of Hong Kong currency or any other currency.
  5. Contracts of a similar nature to a contract listed in item 1, 2, 3 or 4.
  6. Master or other agreements in so far as they relate to a contract listed in item 1, 2, 3, 4 or 5.

Monetary Authority

[date]

  

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## Explanatory Note

A resolution authority may suspend termination rights in relation to certain contracts under section 90(2) of the Financial Institutions (Resolution) Ordinance (Cap. 628) (*Ordinance*). The main objective of these Rules is to require authorized institutions incorporated in Hong Kong (*HKAI*s) and certain holding companies and other group companies of *HKAI*s to ensure that certain contracts contain a provision to the effect that the parties agree to be bound by such a suspension of termination rights.

2. The Rules are divided into 3 Parts.

### Part 1—Preliminary

3. Rule 1 provides for commencement and rule 2 sets out definitions of terms used in the Rules. The most important terms are—
  - (a) *covered entity*—an authorized institution 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*;
  - (b) *covered contract*—a financial contract that is governed by non-Hong Kong law and contains a termination right exercisable by a non-excluded counterparty (however, for a covered entity that is a related company of an *HKAI*, a contract is only a covered contract if it also contains one or more obligations of the covered entity that are guaranteed or otherwise supported by an *HKAI*, or an HK holding company, that is a member of the same group of companies as the covered entity); and
  - (c) *suspension of termination rights provision*—a contractual term or condition (made, or evidenced, in writing) to the effect that the parties agree in a legally

enforceable manner to be bound by a suspension of a termination right in relation to the contract imposed by the resolution authority for banking sector entities (that is, the Monetary Authority) under section 90(2) of the Ordinance.

**Part 2—Requirement for Covered Contracts to Contain Suspension of Termination Rights Provision**

4. Rule 3 requires a covered entity to ensure that covered contracts entered into by it contain a suspension of termination rights provision. This applies to covered contracts entered into on or after the initial day (which is the day on which the Rules come into operation or the later day on which an entity becomes a covered entity). For covered contracts entered into before the initial day, the requirement applies if the contracts are renewed or materially amended on or after that day.
5. Rule 4 provides that a covered entity must comply with rule 3 when the covered contract is entered into (or renewed or amended, as the case requires) and to continue to so comply throughout the term or remaining term of the contract.
6. Rule 4 is subject to rule 5, which provides for an initial period for compliance. For covered contracts entered into (or renewed or amended, as the case requires) during the initial period, or the initial period as extended under rule 6, a covered entity must comply with rule 3 by the end of that period, and continue to so comply throughout the term or remaining term of the contract.
7. Rule 6 empowers the Monetary Authority to extend the initial period for a covered contract or a class of covered contract.
8. Rule 7 empowers the Monetary Authority to exempt a covered entity from compliance with rule 3 for a covered contract or a class of covered contract.

### **Part 3—Compliance and Enforcement**

9. Rule 8 requires a covered entity to have adequate systems of control in place to ensure compliance with rule 3 and any conditions of an extension or exemption. That rule also requires a covered entity to keep sufficient records to demonstrate compliance.
10. Rule 9 empowers the Monetary Authority to require a covered entity to provide a legal opinion that a suspension of termination rights provision in a covered contract is legally enforceable.
11. Rule 10 requires a covered entity to notify the Monetary Authority if the covered entity fails to comply with rule 3. That rule also provides for offences for non-compliance.
12. Rule 11 empowers the Monetary Authority to require a covered entity that fails to comply with rule 3 to propose and implement a plan to rectify the failure. That rule also provides for offences for non-compliance.

### **Schedule**

13. The Schedule lists the types of contracts that are financial contracts for the purposes of the Rules.