AN EFFECTIVE RESOLUTION REGIME FOR FINANCIAL INSTITUTIONS IN HONG KONG

FINANCIAL INSTITUTIONS (RESOLUTION) ORDINANCE (Chapter 628)

REGULATION ON PROTECTED ARRANGEMENTS

CONSULTATION CONCLUSION

Jointly published by the Financial Services and the Treasury Bureau, the Hong Kong Monetary Authority, the Securities and Futures Commission and the Insurance Authority

6 April 2017

Introduction

1. The Financial Services and the Treasury Bureau of the Government of the Hong Kong Special Administrative Region, in conjunction with the Hong Kong Monetary Authority ("HKMA"), the Securities and Futures Commission and the Insurance Authority (together "the authorities"), issued a consultation paper ("CP") on 22 November 2016 on their proposals for the regulation on protected arrangements ("PAR") to be made as subsidiary legislation under section 75 of the Financial Institutions (Resolution) Ordinance (Cap. 628) ("FIRO").[1] The PAR is designed to provide certainty in respect of the treatment of specified protected arrangements in resolution whilst affording a resolution authority ("RA") a sufficient degree of flexibility to execute an orderly resolution.

2. This paper concludes the consultation on the authorities' approach to the PAR and summarises the key comments received from respondents to the CP ("respondents"), our responses to those comments and proposals for taking forward the PAR.

Consultation Feedback

3. The two-month consultation period on the PAR ended on 21 January 2017. A total of 11 submissions were received from a variety of sources including industry associations, professional bodies and financial market infrastructures ("FMIs"). The names of the respondents (other than those who requested anonymity) are listed in **Annex 1**.

4. The consultation responses indicated broad support for the authorities' policy intent under the PAR and provided constructive and technical input to the questions posed in the CP. The major comments received and our responses are discussed below together with the latest policy stance. **Annex 2** addresses the comments received and our responses in more detailed tabular form for ease of reference.

5. Our current target is to submit the draft PAR into the Legislative Council ("LegCo") in Q2 2017 with a view to bringing the FIRO and the PAR into operation shortly after completion of the negative vetting procedure within 2017.

---

[1] The CP can be found under the following link: http://www.fstb.gov.hk/fsb/ppr/consult/doc/consult_par_e.pdf.

PAR - Major Comments and Authorities' Responses

General comments

6. The majority of responses broadly supported the policy intent set out in the CP. One respondent asked whether the authorities intended to consult on the text of the PAR before introducing it into LegCo. Our view is that the policy intent has already been set out clearly in the CP and, as set out in this consultation conclusion, has since been refined to reflect comments received during the consultation period as appropriate.

7. In relation to our intention to bring the FIRO into force once negative vetting of the PAR has completed, certain respondents remarked that the authorities should provide within scope financial institutions ("FIs") with legal certainty and understanding of the full impact of the FIRO when determining its effective date. Although the FIRO does not mandate any specific consultation process, we intend to consult stakeholders on the proposed approach to rules, regulations and the Code of Practice to be made under the FIRO that impact FIs directly. In addition, we also intend to include lead-in or transitional arrangements for implementation of any requirements that affect FIs directly, as appropriate in the circumstances. Accordingly, the HKMA has already consulted the industry on its proposed requirements for core resolution planning information, which are expected to be issued once the FIRO comes into force with appropriate timeframes for submission of information.[2]

8. Certain respondents sought clarification on the nature and timing of implementation of any possible future requirements related to the management, collation and provision of information regarding protected arrangements. As explained on page 29 of the CP, the gathering of appropriate information, quickly and accurately, is crucial to enabling an RA to act consistently with the resolution

[2] The requirements will set standards on the scope and content of core information to be submitted by authorized institutions ("AIs") in the initial stage of resolution planning, covering four main constituent parts, namely: (i) relevant entities and material entities; (ii) core business lines and operating model; (iii) dependencies and (iv) financial functions. The initial submission of core information by an AI, which will be expected to be submitted within six months of notification by the Monetary Authority ("MA"), will enable the MA to determine a preferred resolution strategy. The MA may subsequently require more detailed "supplementary" information necessary to make the preferred resolution strategy operational. The version of the requirements consulted on can be found under the following link, http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/RE-2.pdf.

objectives by being able to promptly and decisively execute an orderly resolution over a short period of time. As and when each of the RAs develops resolution planning requirements under different resolution strategies for individual or classes of within scope FIs under their respective purviews, as appropriate, they will determine the precise form of any additional information reporting capabilities that may be required to be maintained in order to facilitate implementation of the resolution strategy, including for the purposes of facilitating an RA's ability to act in accordance with the objectives of the PAR.

Safeguards in a partial property transfer ("PPT")

Clearing and settlement systems arrangements

9. Most respondents were generally supportive of the provision of a broad scope of protection to clearing and settlement systems arrangements (as defined in paragraph 12 of the CP) in a PPT by restricting an RA from transferring some but not all of the assets, rights or liabilities of an entity in resolution under a PPT in a way that will disrupt the operation of a recognized clearing house ("RCH") under the Securities and Futures Ordinance (Cap. 571) ("SFO") or a designated clearing and settlement system ("DCSS") under the Payment Systems and Stored Value Facilities Ordinance (Cap. 584) ("PSSVFO").

10. A few respondents proposed expanding the scope of the definition of clearing and settlement systems arrangement in order to extend the protection under the PAR to clearing arrangements with a clearing house that is not an RCH but is authorized as an automated trading service under the SFO. We have carefully considered respondents' suggestions, but concluded that this is not necessary. Given an RA's objectives under the FIRO, including to promote and seek to maintain the stability and effective working of the financial system in Hong Kong, it will be highly incentivised not to disrupt the effective functioning of FMI functions such as payments, clearing and settlement during the resolution of a participant, irrespective of whether or not those functions are provided by an RCH or DCSS. Furthermore, we consider that the broad definitions of set-off arrangement, netting arrangement and secured arrangement in effect extend to a wide range of key relationships between FMIs and their participants and thus provide certainty that these arrangements will benefit from the protections afforded by the PAR. We also consider that this approach to the scope of protection to be provided to clearing and settlement systems arrangements under the PAR is consistent with

the practice adopted in other jurisdictions with well evolved resolution frameworks, for example, the United Kingdom ("UK").[3]

11. One respondent observed that it was not clear from the CP whether the initiation of resolution or application of stabilization options to a within scope entity under the FIRO would fall within section 45 of the SFO and thus whether resolution proceedings would be overridden by the proceedings of the RCH, including its default rules under section 45(1)(e) of the SFO. Our intention, as explained in the CP and consistent with the resolution objective under the FIRO of promoting, and seeking to maintain, the stability and effective working of the financial system of Hong Kong, remains not to disrupt the operation of clearing and settlement systems arrangements or introduce uncertainty through the taking of resolution actions. Having considered the respondent's views, we are minded to further consider conferring override protections to RCHs and their operations so that resolution actions taken by RAs under the FIRO will not affect or invalidate or render unenforceable transactions and actions (including default proceedings) undertaken by RCHs. However, such protection would require an amendment to section 45 of the SFO, which may also have wider impact on other sections of the SFO. Consequently, we propose to undertake this exercise separately having considered the range of possible implications and knock-on effects.

12. In light of respondents' comments, we will also, for clarity and certainty, provide in the PAR the specific arrangements of an RCH or DCSS, collectively defined as clearing and settlement systems arrangements, which an RA should seek not to disrupt in transferring assets, rights or liabilities under a PPT. In respect of an RCH, in line with section 45(1) of the SFO, the arrangements that an RA is to seek not to disrupt are: (a) a market contract; (b) the rules of an RCH relating to the settlement of a market contract; (c) any proceedings or other action taken under the rules of an RCH relating to the settlement of a market contract; (d) a market charge; (e) the provision of market collateral; (f) the default rules of an RCH; and (g) any default proceedings. In respect of a DCSS, in line with section 20(1) of the PSSVFO, the arrangements that an RA is to seek not to disrupt are: (a) a transfer order; (b) any disposition of property in pursuance of a transfer order; (c) the default arrangements of a DCSS; (d) the operating rules of a DCSS as to the settlement of transfer orders not dealt with under its default arrangements; and (e)

---

[3] See article 7 of the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 (S.I. 2009/322), http://www.legislation.gov.uk/uksi/2009/322/pdfs/uksi_20090322_en.pdf, as amended by, amongst others, The Banking Act 2009 (Restriction of Partial Property Transfers) (Amendment) Order 2009 (S.I. 2009/1826), http://www.legislation.gov.uk/uksi/2009/1826/pdfs/uksi_20091826_en.pdf.

a contract for the purpose of realizing collateral security in connection with participation in a DCSS otherwise than pursuant to its default arrangements.

13. In relation to the consequence of an RA inadvertently transferring assets, rights and liabilities in a PPT in a way that disrupts the operation of a clearing and settlement systems arrangement (i.e. in a manner inconsistent with the objectives sought to be achieved by the PAR), a few respondents expressed the view that attempts to reverse actions already performed by an FMI or FMI participants in reliance on a PPT may be impracticable. We recognise these concerns and they underscore the importance of *ex ante* resolution planning to minimise the risk of taking action that is inconsistent with the objectives of the PAR, e.g. through ensuring that within scope FIs' Management Information Systems ("MIS") are capable of producing, with adequate speed and accuracy, information on assets, rights and liabilities related to an FI's positions as far as clearing and settlement systems arrangements are concerned. Given the potential negative consequences that could otherwise arise in respect of achieving the resolution objectives, an RA is strongly incentivised, and will undertake *ex ante* resolution planning action, to enhance certainty that resolution actions will not inadvertently result in the treatment of a protected arrangement in a manner inconsistent with the objectives of the PAR.

14. Notwithstanding the above, we remain of the view that it is appropriate to provide a backstop mechanism should an RA inadvertently act in a manner inconsistent with the objectives of the PAR (e.g. because an FI's MIS are not able to identify, with adequate speed and certainty, the constituent parts of a protected arrangement). The intention is that the operations of the clearing and settlement systems arrangement could continue as if the purported transfer had not taken place. In such circumstances, the PAR provides that the transfer is void *ab initio* to the extent that it disrupts the operation of specified elements of a clearing and settlement systems arrangement (see paragraph 12 for the specific arrangements that an RA is to seek not to disrupt), which is consistent with our understanding of the approach adopted in the UK.[4] This approach was designed to provide a self-executing remedy which could be relied upon by the affected RCH or DCSS to continue to clear and settle as appropriate despite the purported transfer. The outcome is that the transfer is deemed by law to have never taken place. The consequence of the purported transfer of the relevant assets, rights or liabilities being void is intended to remove legal uncertainty at a later stage.

---

[4] See article 10 of the Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 (S.I. 2009/322), as amended by, amongst others, The Banking Act 2009 (Restriction of Partial Property Transfers) (Amendment) Order 2009 (S.I. 2009/1826). See Footnote 3 for reference.

15. We appreciate that, as suggested by one respondent, advance notification to an FMI about potential resolution action being taken in respect of an FMI participant could offer benefits in achieving continuity of access to the FMI by the resolved entity or a successor. However, it is also important to recognise that an RA has to balance this against other factors (e.g. confidentiality concerns around the failing FI). This is consistent with the Financial Stability Board ("FSB")'s *Key Attributes of Effective Resolution Regimes for Financial Institutions* ("Key Attributes"), which state at paragraph 5.1 of Appendix II-Annex 1 on the *Resolution of Financial Market Infrastructures (FMIs) and FMI participants* that (emphasis added) "[r]esolution authorities should inform FMIs as soon as possible of the resolution of a participant, and **if possible** in advance of the firm's entry into resolution".[5] That said, the RAs' current intention is to work with FMIs *ex ante* in order to develop non-firm specific cooperation frameworks or agreed upon procedures so as to have a greater *ex ante* understanding of the actions that could be taken by both sides in the resolution of an FMI participant. This should give greater confidence and certainty around continuity in member access to FMI services to avoid disrupting the operation of an FMI whilst achieving the orderly resolution of a participant.

Secured arrangements

16. Respondents agreed with the proposed approach to protecting secured arrangements in a PPT.

17. One respondent sought clarification in relation to the drafting of "legitimate" secured arrangements and how it interfaces with foreign security and legal / regulatory requirements. The fundamental policy objective is for the PAR to cover those secured arrangements which would have been recognised by a liquidator in ordinary insolvency proceedings in Hong Kong and which have not been made in contravention of any local legislative restriction. As such, we intend to provide in the PAR that "secured arrangements" made in contravention of any restriction imposed by or under a Hong Kong Ordinance would not fall within the definition of secured arrangement under the PAR.

Structured finance arrangements

18. Respondents agreed with the proposed approach to protecting structured finance arrangements in a PPT.

---

[5] For reference, see: http://www.fsb.org/wp-content/uploads/r_141015.pdf.

19. Whilst no specific comment was received in relation to the question asked in the CP, we intend to clarify that the PAR applies to the class of structured finance arrangements that are securitizations, including both true sale securitizations and synthetic securitizations.

Set-off arrangements, netting arrangements and title transfer arrangements

20. Respondents generally agreed with the overall approach to protecting set-off, netting and title transfer arrangements in a PPT, i.e. offering a broad protection with specified exclusions to provide certainty for counterparties and an appropriate degree of flexibility for an RA to secure orderly resolution.

21. One respondent expressed a preference for adopting an approach similar to that in the United States ("US") which, as explained in the CP, explicitly lists out a narrower group of "qualified financial contracts" ("QFC") for protection in resolution on the ground of higher predictability and certainty.[6] Others supported the approach advocated in the CP. We had previously considered these alternatives and set out in the CP[7] our views on the pros and cons of the approach proposed in the PAR against that adopted in the US. Having revisited the issue in light of respondents' comments, we remain of the view that the approach proposed in the CP, which is broadly similar to that in the UK, is on balance more appropriate for Hong Kong.

22. Two respondents sought further explanation around the proposal that the restrictions under the PAR would only extend to rights and liabilities entitled to be set off or netted under set-off, netting or title transfer arrangements set out in written contracts. Having considered the matter further, it is now our intent that the PAR will apply to set-off, netting and title transfer arrangements that are documented or otherwise evidenced in writing (including where held electronically). This is intended to protect those rights and liabilities under set-off, netting or title transfer arrangements that have a nexus or link *inter se* and are clearly specified so as to avoid disproportionately constraining the possible use of resolution tools, which could otherwise be the case with a broader protection for rights of set-off of all mutual debits and credits arising by operation of law. Furthermore, this approach offers greater clarity for an RA in identifying the relevant protected arrangements quickly and decisively, which will be crucial to enabling the RA to exercise resolution powers effectively without acting

[6] See paragraph 38 of the CP. See Footnote 1 for reference.

[7] See paragraphs 38 to 41 of the CP. See Footnote 1 for reference.

inconsistently with the objectives of the PAR. Respondents did not identify any specific, significant financial market arrangements that could potentially be disrupted by this approach (i.e. which were not reduced to writing).

23. Two respondents sought clarification of the authorities' proposed approach to "sweeper clauses", as set out in paragraph 32 of the CP. In particular, the respondents sought to clarify whether the proposal could affect the status of the International Swaps and Derivatives Association ("ISDA") Master Agreement or the Global Master Securities Lending Agreement ("GMSLA") as a protected arrangement given that those agreements include wider set-off clauses that extend beyond the core netting sets under the agreement (e.g. section 6(f) of the 2002 ISDA Master Agreement; and paragraph 11.8 of the 2010 GMSLA). We recognise the criticality of maintaining the integrity of the close-out netting sets for transactions entered into under a master agreement given reliance upon them for regulatory capital calculation and therefore confirm that it is not the intention of the PAR to affect the fundamental operation of such arrangements. However, wider set-off clauses which permit the set-off / netting of any and all rights and liabilities between an entity in resolution and its counterparty, including those unrelated to transactions entered into under core close-out netting sets under a master agreement, could severely constrain an RA's ability to carry out a PPT quickly and decisively in a manner consistent with the resolution objectives. Therefore, we intend to provide that such broad set-off rights do not benefit from protection under the PAR, but without affecting core netting sets for transactions entered into pursuant to master agreements that are relied upon for regulatory capital calculation.

24. One respondent sought clarification on the approach to "walk–away" clauses, as set out in paragraph 35 of the CP, and specifically whether the "flawed asset" provision in the ISDA Master Agreement would be considered a "walk-away" clause and thus impact on the protection given to ISDA Master Agreements under the PAR. We confirm that the policy intent is not to unpick provisions of any master agreement such that the "flawed asset" provision under section 2(a)(iii) of the 2002 ISDA Master Agreement would oust the protection to be afforded to the core close-out netting sets under those agreements, recognising the material use of such agreements across financial markets as a fundamental tool for managing exposures and liquidity needs.

25. Having reviewed the proposed provisions, we are also minded to add a further exclusion to those set out in paragraph 33 of the CP. This addition will be designed to ensure that receivables owed by depositors, unless related to a

financial contract, will be excluded from protection afforded to set-off, netting and title transfer arrangements. This is intended to be similar to the concept of "retail liability" under the relevant UK legislation.[8] The purpose of this exclusion is to facilitate the transfer of assets related to deposits and to be clear that deposits can be transferred independently of any lending to the same counterparty, and vice versa, where otherwise part of a set-off, netting or title transfer arrangement. This is important because there needs to be certainty that deposits and related receivables of the same counterparty (e.g. in relation to a mortgage) can, if appropriate to meet the resolution objectives, be transferred independently of each other to achieve continuity, including continued access to deposits for depositors.

Safeguards in bail-in

Set-off, netting and title transfer arrangements

26. Most respondents agreed with the proposed approach to protecting set-off arrangements, netting arrangements and title transfer arrangements in bail-in.

27. One respondent expressed concern that in the event that an RA did not act in a manner consistent with the objectives of the PAR (i.e. that bail-in of rights and liabilities under these arrangements should be on a "net" basis), subsequent measures to restore an affected party's position would create legal, contractual and regulatory capital uncertainties. To mitigate the need for such subsequent measures, the RAs will take *ex ante* steps through resolution planning, to avoid the risk of taking resolution action that is inconsistent with the objectives of the PAR through ensuring that a within scope entity has MIS capable of promptly and accurately identifying rights and liabilities that are subject to set-off, netting and title transfer arrangements. Furthermore, future loss-absorbing capacity requirements (to be made by an RA under section 19 of the FIRO) will be specifically designed to require an FI to have available dedicated loss-absorbing capacity. This dedicated resource will be expected to have appropriate characteristics (e.g. a vanilla structure, long tenor, subordinated to operating liabilities), to ensure that it can feasibly and credibly be subject to loss without the need to consider other factors such as whether it should be subject to bail-in on a net basis because it may be part of a set-off, netting or title transfer arrangement. This will mean that in practice an RA will seek to rely primarily on the dedicated

[8] See definition of "excluded rights" in article 1(3) of the The Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 (S.I. 2009/322), as amended by, amongst others, The Banking Act 2009 (Restriction of Partial Property Transfers) (Amendment) Order 2009 (S.I. 2009/1826). See Footnote 3 for reference.

loss-absorbing capacity when undertaking a bail-in and avoid seeking to bail in, for example, derivative liabilities which may be subject to set-off or netting rights.

28. Nevertheless, we recognise the potential of inadvertent action resulting in inconsistent treatment of protected arrangements due to, e.g. deficiencies in an FI's MIS capabilities or definitional legal uncertainty in a transfer instrument. Therefore, we consider it important that the PAR should provide for a mechanism that enables an affected party's position to be restored as if a bail-in had not been effected in a manner inconsistent with the objectives of the PAR. The approach adopted in the PAR is modelled on that adopted in the relevant UK legislation.[9]

29. A respondent sought clarification on how an RA would close out the position of an FI within a short period to create a net debt to subject to bail-in. The resolution regime under the FIRO contains a range of legal tools necessary to resolve failing, systemically important FIs, including compulsory transfer and bail-in powers. However, further work is required to refine the processes and procedures to effectively implement those tools and to make FIs resolvable in practice. Work at the international level is ongoing to develop principles and procedures underpinning bail-in execution. We will continue to monitor relevant international developments and standards, and seek to develop a process reflecting these as appropriate in Hong Kong. As noted above, the development of loss-absorbing capacity requirements for within scope FIs will be designed such that FIs have in issue sufficient credible alternative sources of loss-absorbing capacity that is subordinated to liabilities which are operationally very difficult to bail in – such as those which may be subject to complex valuations before being closed out in order to be bailed in on a net basis pursuant to the PAR.

Definitions of "derivative contract" and "financial contract"

30. Some respondents provided comments on the interaction between the proposed definitions of the terms "derivative contract", "financial contract" and "qualifying master agreement", and offered some suggestions for refining these. We are grateful for the constructive comments. In particular, it appears that mutually exclusive definitions of "financial contract" and "derivative contract" may not be necessary for the purposes of the PAR given that the ultimate intended treatment of both is the same, i.e. to bail in on a net basis where they are constituent parts of a set-off arrangement, netting arrangement or title transfer arrangement. We will

[9] See paragraphs 49 to 51 of the CP (see Footnote 1 for reference) and article 6 of the The Banking Act 2009 (Restriction of Special Bail-in Provision, etc.) Order 2014 (S.I. 2014/3350), http://www.legislation.gov.uk/uksi/2014/3350/pdfs/uksi_20143350_en.pdf.

therefore adapt the definitions to be more precise as to the population of contracts that are covered by the PAR in relation to bail-in without excessively constraining an RA's ability to execute a resolution within a short period of time.

Next steps

31. Our intention is for the PAR to be tabled in LegCo in Q2 2017 with a view to bringing the FIRO and the PAR into operation shortly after completion of the negative vetting procedure within 2017. Thereafter, we will continue the development of resolution rules, regulations, standards and guidance, on which we intend to consult with stakeholders, with the objective of enhancing the resolvability of within scope FIs such that they can be resolved in an orderly manner should resolution ever need to be initiated under the FIRO.

Annex 1

List of respondents

1. CLS Bank International
2. CompliancePlus Consulting Limited
3. CME Group
4. DLA Piper Hong Kong
5. The Hong Kong Association of Banks
6. The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies
7. The Hong Kong Federation of Insurers
8. International Swaps and Derivatives Association, Inc. (ISDA) and Asia Securities Industry & Financial Markets Association (ASIFMA)
9. The Law Society of Hong Kong

** Two respondents asked not to be identified*

Annex 2

Summary of Comments and the Authorities' Responses

Respondents' comments	Authorities' responses
GENERAL	
1. Text of the regulation relating to PAR	
a. One respondent asked whether market participants will be consulted on the text of the PAR.	Our approach to the PAR, as set out in the CP, builds on the thinking set out in our previous two consultation papers ("CP1" and "CP2") and the consultation conclusions on "An Effective Resolution Regime for Financial Institutions in Hong Kong"[10] and is intended to be consistent with the standards set by the FSB's Key Attributes. The approach set out in the CP largely follows that adopted in the UK and that required by the European Union ("EU")'s Bank Recovery and Resolution Directive ("BRRD"), which are both considered to align with the standards set by the Key Attributes. Given this, respondents were generally supportive of the broad policy directions and this consultation conclusion confirms our latest policy position after carefully taking into account the constructive, technical comments raised by respondents and making suitable adjustments to the proposals as discussed in this paper.
2. Effective date of the FIRO and its scope relating to FMIs	
a. One respondent was of the view that an effective date of the FIRO within the first half of 2017 would not provide within scope entities with the legal certainty and understanding of the full impact of the FIRO and any related subsidiary legislation for them to get ready for the FIRO. The same respondent submitted that more clarity on the form and substance of future regulations to be made under the FIRO should be provided to the industry before the	While the FIRO has not yet been brought into force following its enactment in June 2016 pending the passage of the PAR through the legislative process, it provides the statutory basis for a resolution regime in Hong Kong that is designed to meet the standards set by the Key Attributes. The PAR will seek to constrain the manner in which an RA may exercise certain of the powers conferred on it by the FIRO. Please see paragraph 7 of this paper for a discussion of the proposed approach to bringing the FIRO into force, the rationale therefor and the proportionate consequences that we anticipate for within scope FIs over time. In respect of the form and substance of future regulations to be made under the FIRO, the respective empowering provisions in the Ordinance provide that such regulations will be made as subsidiary legislation

[10] The previous consultation papers and consultation response on the FIRO can be found under the following links: CP1: http://www.fstb.gov.hk/fsb/ppr/consult/resolution.htm; CP2: http://www.fstb.gov.hk/fsb/ppr/consult/resolutionregime.htm; and Consultation Response: http://www.fstb.gov.hk/fsb/ppr/consult/doc/resolutionregime_conclu_e.pdf.

Respondents' comments	Authorities' responses
FIRO becomes effective.	through negative vetting by the LegCo and we would continue to engage with the relevant stakeholders in the process.
b. A couple of respondents commented that given the inter-related nature of FIs and FMIs, there is a potential need to reconsider the timeline for bringing the FIRO into force given international standards on recovery and resolution of FMIs are still under development. It was also submitted that certain resolution powers contained in the FIRO are inappropriate or will require further amendments further to international standards development on central counterparties ("CCP") recovery and resolution. One respondent stated that these standards should be considered in determining the timeline for bringing the FIRO into force and revisiting whether any amendments to the FIRO would be required. One respondent also urged the authorities to take into account international developments in the area of FMI resolution when finalizing and implementing the resolution regime in Hong Kong. One respondent also questioned whether the authorities had considered the appropriateness of implementing a PPT in respect of a CCP.	The scope of the regime under the FIRO goes beyond the CP on the PAR. However, in CP1 and CP2 on providing for an effective resolution regime for financial institutions in Hong Kong (see Footnote 10 for reference), we explained that the scope of the regime was designed to meet the expectation of the FSB's Key Attributes that all FIs that could be systemically significant or critical on failure should be subject to a resolution regime that is consistent with the Key Attributes. The Key Attributes set out the fundamental powers that should be available to authorities to resolve a within scope FI, supplemented by the sector-specific guidance set out in the Annexes to the Key Attributes. The FIRO provides for a resolution regime in Hong Kong that is designed to implement these international standards. Ultimately, it is important for the Hong Kong authorities to have available the resolution powers necessary to be able to respond to the failure of a systemically important FI, including FMI, consistent with the resolution objectives of the FIRO. Any guidance from the FSB concerning resolution of CCPs will inform the relevant RA's consideration of how the powers provided for under the FIRO will be exercised in relation to CCPs. An RA may also issue a Code of Practice under section 196 of the FIRO, which could be used to set out more detail in this regard in the future.
3. Choice of stabilization options	
a. One respondent requested that the authorities provide clarity on the considerations an RA would take into account when choosing which stabilization options (e.g. PPT or bail-in) to apply.	Whilst not directly relevant to the content of the PAR, the identification of appropriate stabilization options to be applied to an entity in the event of its failure is a decision for an RA bound by the parameters set out in the FIRO and well-established administrative law principles. As part of the resolution planning process, well in advance of any potential failure, an RA would expect to determine a preferred resolution strategy so

Respondents' comments	Authorities' responses
	as to effectively identify, and require an FI to remove, any impediments to the orderly implementation of the preferred strategy in the event of the FI's failure. Guidance and standards in relation to each RA's approach to resolution planning are expected to be published in due course under the Code of Practice (which it is expected will cover, amongst others, considerations an RA would take into account when determining a preferred resolution strategy for a within scope FI under its purview).
4. Information requests	
a. Two respondents sought to clarify: (i) whether the information requirements discussed in the CP are to be on an *ad hoc* basis or through regular reporting to RAs; and (ii) the time allowed for within scope entities to respond to such requests. In addition, the respondents suggested that the authorities engage with the industry through a formal consultation on the detail of such information reporting requirements and provide market participants with adequate time for implementation.	Effective resolution planning requires consistent, regular reporting of information such that an RA has adequate information to plan for, and if necessary, implement an orderly resolution. Section 158 of the FIRO provides the necessary information gathering powers. As explained in the CP, as the RAs develop their resolution planning requirements, further thought will be given to the precise form of the information and reporting capabilities which will need to be maintained by FIs for the purposes of facilitating an RA's compliance with the PAR on use of stabilization options in the event of FI failure. Within scope entities will be expected to be able to produce the information required by an RA: (i) as part of business-as-usual resolution planning information requirements; and (ii) on an *ad hoc* basis sufficiently promptly and accurately for an RA to be able to execute an orderly resolution over a short period of time, e.g. over a "resolution weekend". On the former, the HKMA conducted a 2-month industry consultation on proposed resolution planning core information requirements for AIs from April to June 2016 and, as mentioned above, will publish the final requirements once the FIRO is in force.[11] In the context of the PAR, the additional information required by an RA could depend on the preferred resolution strategy. Therefore, the RAs will each consider the most appropriate approach to the implementation of information and reporting requirements relating to the PAR. Whilst the FIRO does not mandate any specific consultation process, our intention is to consult stakeholders on the proposed approach to rules, regulations and the Code of Practice to be made under the FIRO that impact within scope entities directly.

[11] See Footnote 2 for reference.

Respondents' comments	Authorities' responses
Q1: CLEARING AND SETTLEMENT SYSTEMS ARRANGEMENTS IN A PPT	
5. Scope of definition of clearing and settlement systems arrangement	
a. One respondent suggested that the scope of the definition of clearing and settlement systems arrangement under the PAR should extend to FMIs which have their clearing systems authorized as an automated trading service under the SFO ("ATS CCPs") with the same level of protection as RCHs. The respondent submits that negative impacts may arise where ATS CCPs lack clear protection from the application of FIRO provisions: (1) uncertainty around a CCP's rights *versus* clearing member ("CM") positions or collateral creates substantial litigation risk for the CCP and; (2) add-on risk management costs for Hong Kong participants. The respondent is of the view that it is unfair to draw a distinction between RCHs (local securities and futures market clearing systems) and CCP authorized as ATS (overseas securities and futures market clearing systems). Two other respondents expressed similar comments.	We consider that the approach adopted in this regard in the PAR is consistent with that adopted in other jurisdictions with well evolved resolution frameworks, including for example the UK.[12] As explained in paragraph 10 of this paper, we do not consider it necessary to extend the definition of clearing and settlement systems arrangements beyond RCHs and DCSSs. However, this does not mean that there is no protection for an ATS CCP under the PAR. Indeed, the broad definitions of set-off arrangement, netting arrangement and secured arrangement in the PAR should go a long way to capturing the key relationships between an entity in resolution and an FMI (including an ATS CCP). This should serve to provide greater legislative certainty about the types of protected arrangements entered into between an entity in resolution and an FMI (including an ATS CCP) that will benefit from the constraints imposed on an RA by the PAR in resolving a participant.

[12] See the definition of "recognized clearing house" used in article 7 of The Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 (S.I. 2009/322), as amended by, amongst others, The Banking Act 2009 (Restriction of Partial Property Transfers) (Amendment) Order 2009 (S.I. 2009/1826). See Footnote 3 for reference.

Respondents' comments	Authorities' responses
6. Disruption to clearing and settlement systems arrangements	
a. One respondent sought to clarify the policy intention behind a narrower definition (i.e. "that will disrupt…") than UK approach (i.e. "have the effect of modifying the operation of or rendering unenforceable…") in relation to protection of clearing and settlement systems arrangements.	We do not consider the scope of protection proposed to be extended to clearing and settlement systems arrangements in the PAR to be narrower than that adopted in the UK legislation.[13] The proposed approach set out in the CP was to establish a relatively broad constraint that an RA should not take action under a PPT that disrupts the operation of a clearing and settlement systems arrangement (e.g. by affecting the operation of its rules). However, having considered the matter further and taken into account respondents' views, we are of the view that greater clarity could be achieved by specifying the specific elements of a clearing and settlement systems arrangement that an RA would be required to seek not to disrupt under the PAR. Please see paragraph 12 of this paper for more details on the proposed approach.
b. One respondent, while agreeing in principle to the proposed approach in the CP, sought more prescriptive guidance or/and examples of what will disrupt the operation of a clearing and settlement systems arrangement.	The policy intent is to provide a broad protection such that there is legislative provision that seeks to constrain an RA from taking action that may disrupt the operation of an FMI critical to financial stability in Hong Kong, namely a DCSS or an RCH. The objective is to provide certainty that clearing and settlement can continue with minimal, if any, disruption given the criticality of certainty in maintaining confidence in their operations. An RA would seek to take *ex ante* steps through resolution planning to mitigate the potential of taking action that is inconsistent with the objectives of the PAR. However, as noted in item 6.a in the table above, having considered the matter further and taken into account respondents' views, we are of the view that greater clarity could be achieved by specifying the specific elements of a clearing and settlement systems arrangement that an RA would be required to seek not to disrupt under the PAR when transferring assets, rights and liabilities of an entity in resolution. Please see paragraph 12 of this paper for the proposed approach.
c. One respondent proposed that the PAR should offer protection to clearing and settlement systems in absolute terms such that RAs shall not be able to disrupt any arrangements in any scenarios.	As explained in the CP, our view is that any disruption to the operation of a clearing and settlement systems arrangement in resolution is most likely to happen in a PPT whereby some, but not all, of the assets, rights and liabilities of an entity in resolution are transferred to a third party. Were a whole business transfer or share transfer conducted in resolution, the likelihood of disruption would not arise because the balance sheet of the entity would remain intact as an RA seeks to deliver continuity for the entire business transferred. In the context of bail-in, the following, amongst others, are excluded from bail-in pursuant to sections 2(r) and

[13] See article 7 of The Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 (S.I. 2009/322), as amended by, amongst others, The Banking Act 2009 (Restriction of Partial Property Transfers) (Amendment) Order 2009 (S.I. 2009/1826). See Footnote 3 for reference.

Respondents' comments	Authorities' responses
	2(s) of Schedule 5 to the FIRO respectively: liabilities arising from participation in DCSSs and owed to such systems or to the operators of, or participants in, such systems; and liabilities arising from participation in the services provided by an RCH and owed to the RCH or to its clearing participants. Additionally, as explained in item 5.a above, the broad definitions of set-off arrangement, netting arrangement and secured arrangement should cover a range of key relationships between an FMI and an entity in resolution. Therefore, it is considered not necessary to provide any additional protection for these arrangements in the context of other stabilization options under the PAR, given that those stabilization options are not predicated on the "splitting" of a balance sheet as is the case in a PPT.
7. Precedence of proceedings of RCHs	
a. One respondent commented that it is not clear from the CP whether the initiation of resolution or application of stabilization options to a within scope entity under the FIRO would fall within section 45 of the SFO (which provides for proceedings of an RCH to take precedence, amongst others, over insolvency proceedings) and thus would be overridden by the proceedings, including default rules under section 45(1)(e) of the SFO, of an RCH.	Our intention has always been not to affect the effective operation of payment, clearing and settlement systems or introduce uncertainty through resolution actions. Having considered the matter further and taken into account the respondent's views, we are minded to consider amendment of the SFO, in a future amendment exercise, to confer protections on an RCH and its operations in resolution in a manner similar to the insolvency override protections provided in section 45 of the SFO. Please see paragraph 11 of this paper for the approach we intend to adopt to achieve this.
8. Consequences of inadvertent action taken by an RA inconsistent with the objectives of the PAR	
a. Commenting on the proposed consequences of any inadvertent action by an RA under a PPT which disrupts a clearing and settlement system arrangement, one respondent opined that an attempt to reverse actions already performed by an FMI or FMI participants in reliance on such a PPT would likely be impracticable. The respondent therefore suggested that an RA should rather take steps to pre-empt the potential occurrence of disruptions to the arrangement in the first instance, such as through	The CP proposed that the intention was for the PAR to provide that a transfer is void to the extent that it splits property, rights and liabilities that are part of a clearing and settlement systems arrangement. This approach was designed to provide a self-executing remedy which could be relied upon by the affected RCH or DCSS to continue to clear and settle as appropriate despite the purported transfer. However, we also fully recognise that pre-emptive action should be taken to reduce further the risk of inconsistent action by an RA occurring. An RA will need to undertake a substantial amount of *ex ante* resolution planning, well in advance of any potential failure, to determine the preferred resolution strategy for a within scope FI and make it feasible and operational in order to facilitate achievement of the resolution objectives. We appreciate that, as suggested by one respondent, advance notification to an FMI about potential

Respondents' comments	Authorities' responses
an RA's advance notice to, and early engagement with, the relevant FMIs and their regulators, which is consistent with the Key Attributes and FSB guidance set out in the consultative document *Guidance on Continuity of Access to FMIs for a Firm in Resolution*.	resolution action being taken in respect of an FMI participant could offer benefits in achieving continuity of access to the FMI by the resolved entity or a successor. However, it is important to recognise that an RA has to balance this against other factors (e.g. confidentiality concerns around the failing FI). This is consistent with the Key Attributes, which state that RAs should inform FMIs as soon as possible of the resolution of a participant, and **if possible** in advance of the firm's entry into resolution. That said, the RAs' current intention is to work with FMIs *ex ante* in order to develop non-firm specific cooperation frameworks or agreed upon procedures so as to have a greater *ex ante* understanding of the actions that could be taken by both sides in the resolution of an FMI participant. Please refer to paragraph 15 of this paper for the proposed approach.
b. One respondent suggested amendments to the drafting in relation to the consequences of a PPT which disrupts a clearing and settlement systems arrangement to allow greater flexibility. The suggested amendment concerns adding a qualification that the PPT is void "to the extent that it splits property, rights and liabilities that are part of the arrangement insofar as such split contributes to the disruption."	As noted above in this paper (see paragraph 12), we now intend to specify more precisely the areas of disruption to a clearing and settlements systems arrangement to be constrained. Following on from this, the consequence of the PPT being void will be triggered by reference to it disrupting the specified operations of the clearing and settlement systems arrangement. This should be sufficient to reflect the concept of what is proposed whilst seeking to reduce any prospect of challenge based on any measure of contribution to the disruption.
Q2: SECURED ARRANGEMENTS IN A PPT	
9. Scope of definition of secured arrangement	
a. One respondent commented that if the definition of "clearing and settlement systems arrangement" under PAR is not extended to also cover ATS CCPs, as well as DCSSs and RCHs, then "secured arrangement" should be interpreted in such a way so as to protect in a PPT any liability owed to an ATS CCP for which the ATS CCP holds collateral, irrespective of whether the person who owes the liability is the same as the equitable owner of the collateral held by the ATS	As explained in paragraph 10 of this paper and item 5.a of the table above, we consider that the broad definition of secured arrangement would extend to such relationships between an FMI (including an ATS CCP) and a participant in resolution and thus provide certainty of treatment over these relationships in resolution. One clarification will be made to clarify that to be a class of secured arrangement that is protected by the PAR, the arrangement must not be made in contravention of any legal restriction imposed by or under any Hong Kong legislation (see paragraph 17 of the CP and item 12.a in the table below). This clarification does not materially affect the broad scope of the definition set out in section 74 of the FIRO and will provide legal clarity that an arrangement that purports to be a secured arrangement, but which is created in contravention of a law preventing its creation, does not benefit from the protections under the PAR.

Respondents' comments	Authorities' responses
CCP to cover such liability. The respondent noted that the definition of "secured arrangement" under the FIRO is broad enough to accommodate such an interpretation.	
10. Mitigation of proliferation of floating charges	
a. One respondent agreed with the proposed protections to be afforded to secured arrangements under the PAR, but doubted the practicality of mitigating incentives to proliferate floating charges through resolution planning given the freedom of contract in Hong Kong and the unduly heavy burden on RA.	In undertaking resolution planning and resolvability assessments, an RA will seek to identify potential impediments, which could be wide-ranging, to the preferred resolution strategy for a within scope FI (or its holding company). Whilst the FSB has identified a number of common impediments to resolvability across the global systemically important bank population, these are not exhaustive. Where an RA identified an impediment to resolvability locally, it would be empowered to direct the removal of that impediment (should the FI not take action itself to address the identified impediment) pursuant to section 14 of the FIRO. This could include addressing the granting of security in a way that represents a significant impediment to resolvability. Our current intention is to set out in due course the resolvability assessment process that an RA may undertake.
11. Form of a transfer	
a. One respondent suggested that the authorities should give consideration to the form of the transfer and how that might impact transferred rights and particularly whether an assignment or novation is appropriate in these circumstances and how any requirement for consent can be overcome.	Section 4(3) of Schedule 4 to the FIRO provides explicitly that a transfer effected under a property transfer instrument, amongst other things, takes effect despite any restriction arising under contract or legislation or in any other way. Such provision is necessary in order to enable an RA to act with the necessary speed and certainty. The precise structure and form of a transfer would be determined through resolution planning and finalised at the point of failure depending upon the circumstances at the time. Section 7(1) of Schedule 4 to the FIRO provides that a property transfer may be, or be treated as, a succession and for a transferee be treated for any purpose connected with the transfer as the same person as the transferor.
12. "Legitimate" secured arrangement	
a. One respondent suggested that the authorities should give consideration to the drafting of "legitimate" secured arrangement and how it interfaces with foreign security and legal/regulatory requirements.	The fundamental objective of extending protection under the PAR to "legitimate" secured arrangements is to respect those secured arrangements which would have been recognised by a liquidator in ordinary insolvency proceedings (since the reliance on that expected recognition supports the effectiveness of such an arrangement in a going concern context) and to further clarify that such protection does not extend to cases where the arrangement has been made inconsistently with any restriction imposed by Hong Kong law (for example, s.119A(2) of the Banking Ordinance (Cap. 155)). Therefore, we will provide in the PAR that an

Respondents' comments	Authorities' responses
	arrangement purporting to be a "secured arrangement", but which has been made in contravention of any restriction imposed by, or pursuant to, a provision restricting the creation of such an arrangement under a Hong Kong Ordinance would not fall within the definition of "secured arrangement" under the PAR.
13. Foreign property – remainder of constituent parts of secured arrangement	
a. One respondent sought clarification on the definition and scope of the remainder of the constituent parts of the secured arrangement (particularly for foreign property not effectively transferred under a secured arrangement).	We remain of the view that the provision made in respect of foreign property is necessary to enable a transfer to be completed swiftly. Subsequent to the initial transfer, steps should be taken by the transferor and the transferee, pursuant to sections 13(2) and (3) of Schedule 4 to the FIRO, to perfect a transfer which transfers foreign property. However, where it is not possible to do so, e.g. because the governing law of a non-Hong Kong jurisdiction presents an insurmountable barrier, the transfer is to be treated as being consistent with the objectives of the PAR. The likelihood for such a scenario should be mitigated over time through the undertaking of cross-border resolution planning for within scope FIs in Hong Kong as well as the development and implementation of effective cross-border regimes for the recognition of foreign resolution actions.
Q3: STRUCTURED FINANCE ARRANGEMENTS IN A PPT	
14. Inclusion of additional protection/powers mirroring EU BRRD provisions	
a. For the respondents which provided comments, the vast majority agreed in principle to the proposed approach to protecting structured finance arrangements in PPT. One respondent suggested evaluating the possibility of including the prevention of termination or modification of the assets, rights and liabilities through the use of ancillary powers (as stated under Art 79(1)(b) of the BRRD) in the scope of protection; and allowing transfer of some (but not all) of the assets, rights and liabilities of a structured finance arrangement when such a PPT will not, or within a predetermined range, affect the risk parameters, cash flow and structure of the arrangement.	We do not consider that this point is directly applicable to the context of the PAR as the FIRO was not drafted as a direct equivalent of the BRRD, but seeks to implement a resolution regime in Hong Kong that is designed to be consistent with the standards set out in the Key Attributes. It is therefore considered that the approach to the PAR described in the CP sufficiently addresses those situations in which the exercise of resolution powers could undermine the economic effect of a protected arrangement and that it is not be necessary to make specific provision in relation to ancillary powers in light of the powers available to the RAs under the FIRO.

Respondents' comments	Authorities' responses
Q4: SET-OFF ARRANGEMENTS, NETTING ARRANGEMENTS AND TITLE TRANSFER ARRANGEMENTS IN A PPT	
15. Scope of definition of set-off and netting arrangements	
a. One respondent commented that if the definition of "clearing and settlement systems arrangement" under PAR is not extended to cover ATS CCPs, in addition to DCSSs and RCHs, then the definitions of "set-off arrangement" and "netting arrangement" should each be interpreted under the PAR in such a way so as to protect from a PPT any liability owing to an ATS CCP for which the ATS CCP holds collateral, irrespective of whether the liabilities being set off and netted by the ATS CCP are owed to and by the within scope FI itself or to and by the within scope FI on behalf its underlying clients or affiliates. The respondent noted that the definitions of "set-off arrangement" and "netting arrangement" under the FIRO are both broad enough to accommodate such an interpretation.	As explained in paragraph 10 of this paper and item 5.a of the table above, we consider that the broad definition of set-off arrangement and netting arrangement under the PAR would extend to the key relationships between an entity in resolution and an FMI (including an ATS CCP) and thus provide certainty of treatment over these relationships in resolution. One clarification made in respect of the definition of set-off arrangement and netting arrangement in the PAR, compared with the FIRO definition, is that the PAR clarifies that those arrangements are protected to the extent that are agreed under a written contract or otherwise evidenced in writing (see paragraphs 32, 36 and 37 of the CP and item 16.a in the table below), with the objective of providing certainty to the types of arrangement captured by the PAR whilst providing an RA with an appropriate degree of flexibility.
16. "Written" contractual set-off, netting or title transfer arrangements	
a. Two respondents sought to understand the rationale behind limiting the scope of the PAR to rights to set-off and net under set-off, netting and title transfer arrangements that are agreed by written contract. One of these respondents noted that the proposed approach is different to that in the UK and requested that Hong Kong should adopt an approach that is consistent with the international standards.	As explained in paragraph 32 of the CP, our view was that focusing the protections under the PAR on set-off arrangements, netting arrangements and title transfer arrangements agreed by written contract is appropriate because we primarily seek to protect the significant close-out netting sets under the market standard contracts, such as the ISDA Master Agreement on which large numbers of market participants rely and which are recognised, for instance, in the calculation of regulatory capital. Accordingly, we seek to focus the PAR on rights and liabilities that have a nexus or link *inter se* and are clearly specified. To afford broader protection for any rights of set-off which could arise by operation of law would risk disproportionately constraining the use of resolution tools beyond what is necessary to ensure financial market participants have certainty with respect to the credit risk mitigation and funding arrangements on which they, and the wider funding market, rely. The proposed approach also provides greater clarity for an

Respondents' comments	Authorities' responses
	RA in identifying the relevant arrangements given that they should be effectively documented and recorded. Having considered respondents' views, we are, however, minded to clarify that the protections under the PAR will apply to set-off, netting and title transfer arrangements that are documented or otherwise evidenced in writing (including where held electronically). We consider that this provides a clear, predictable level of minimum protection under the PAR.
17. "Catch-all" or "sweeper" clauses	
a. Two respondents sought confirmation that the approach to "catch-all" or "sweeper" provisions, as set out in paragraph 32 of the CP, will not affect the status of master agreements, such as the ISDA Master Agreement and the GMSLA, as protected arrangements given that those agreements have long-standing clauses relating to the right to set-off other non-master agreement related rights and liabilities in the event of a counterparty default (see clause 6(f) of the 2002 ISDA Master Agreement; and paragraph 11.8 of the 2010 GMSLA).	We consider it important that the objectives of the PAR do not undermine established financial market arrangements, such as the ISDA Master Agreement and the GMSLA. In particular, it is important from the perspective of market stability that an RA, in effecting a PPT, should seek not to disrupt close-out netting sets under master agreements. However, we remain of the view that broader set-off provisions (i.e. catch-all or sweeper provisions) which can extend to any and all other rights or liabilities between the counterparties (whether arising under the master agreement or not) could pose a material impediment to the orderly resolution of a failed FI under a PPT. We therefore do not intend to extend the protections under the PAR to "catch-all" or "sweeper" provisions which could apply to any and all of the rights and liabilities between the entity in resolution and a counterparty. To reiterate, the policy intent is not to affect the fundamental operation of arrangements for core close-out netting sets under established master agreements, such as the ISDA master agreement which are relied upon for regulatory capital calculation.
18. "Walk-away" clauses	
a. One respondent sought clarification that the "flawed asset" provision in the ISDA Master Agreement would not have an impact on the protections given to ISDA Master Agreements under the PAR (as a result of the policy intent expressed in paragraph 35 of the CP in relation to "walk-away" clauses).	"Walk–away" clauses are not regarded as valid bilateral netting agreements under the Banking Capital Rules (Cap. 155L) ("BCRs") (see sub-clause (g) of the definition of valid bilateral netting agreement under section 2(1) of the BCRs) because essentially they allow a non-defaulting party to make limited payments only, or no payments at all, to the estate of the defaulting party, even if the defaulting party is a net creditor. It is therefore considered that such clauses should not receive protection under the PAR. It is however not the policy intent that the provision would seek to affect the "flawed asset" provision as established under section 2(a)(iii) of the 2002 ISDA Master Agreement.
19. Exclusion of "deposits" from protection	
a. One respondent noted that the proposal to exclude "deposits" from the scope of set-off, netting and title transfer arrangements in a PPT goes further than the	We have previously considered the approach to identifying limited, specific exclusions from the protections under the PAR in undertaking a PPT in the context of a set-off, netting or title transfer arrangement and explained our approach in paragraph 33 of the CP. As highlighted by the respondent, and as explained in

Respondents' comments	Authorities' responses
BRRD and allows for the RA to split off deposits of unlimited value. Whilst the respondent agreed that this gives greater flexibility to the RA, in the context of an insolvent bank the respondent sought to understand whether the RA would advocate (i) transferring deposits that are in excess of the scope of the Deposit Protection Scheme ("DPS") at an early stage; or (ii) risk losing the benefit of set-off or netting claims which are in excess of the DPS.	paragraph 33(i) of the CP, our view is that flexibility for an RA in the context of deposits is of particular importance to achieving orderly resolution in a PPT, especially in the context of the population of AIs for whom a PPT might be a preferred resolution strategy. As such, we remain of the view that deposits, as defined in section 2(1) of the FIRO, should be excluded from the protections under the PAR in the context of set-off, netting and title transfer arrangements in a PPT. This exclusion is crucial in the context of a PPT because a PPT may be an appropriate resolution strategy for smaller, less complex AIs for whom it might be expected that the main critical financial function performed would be deposit-taking. In structuring a resolution transaction, however, an RA may seek to transfer as many matching, good assets as possible alongside any transfer of a deposit book. This may include, where practical in the circumstances and timeframe available, transferring assets and deposits of a single counterparty together, thus retaining any set-off or netting rights.
20. Definition of "financial activity"	
a. One respondent sought more clarity in respect of the definition of "financial activity".	We intend to adopt a definition of financial activity for the purpose of items to be included in the PAR as outlined in paragraphs 33(iv) and 33(v) of the CP along the lines of the following: "financial activity" means an activity that relates to securities, transferable securities, financial contracts (including derivatives contracts), deposits or loans. The policy intent behind the definition, as explained in paragraph 33(iv) in the CP, is to capture rights and liabilities arising as a result of what would be considered the ordinary course business of an FI which then informs certain "exclusions" from the protections under the PAR in respect of set-off, netting and title transfer arrangements in the context of a PPT.
21. Other approaches – in the EU and US	
a. One respondent opined that the approach in the US and EU of protecting all QFC would provide greater predictability and certainty. Alternatively, this section could adopt the definition for the term "financial contract" to describe those arrangements protected. Another respondent acknowledged the objections to the creation of a list of QFCs as had been set out in paragraph 38 of the CP, but suggested that it would be helpful for a reasonable level of	As explained in paragraphs 38 to 41 of the CP, we have considered the pros and cons of the potential approaches to setting the scope of protection in the context of set-off arrangements, netting arrangements and title transfer arrangements. We remain of the view that the broad approach, with specified exclusions, as proposed in the CP, is more appropriate for Hong Kong. Given that the approach adopted in the PAR is relatively broad – i.e. extending to set-off, netting and title transfer arrangements that are documented or otherwise evidenced in writing (see also paragraph 22 of this paper and item 16.a in the table above) – and the concerns about a more specific approach expressed in paragraph 38 of the CP, we are not convinced of the need to provide greater specificity. We will work with FIs, through resolution planning, to better understand their adoption of set-off, netting and title transfer

Respondents' comments	Authorities' responses
detail to be provided as regards identifying "*bona fide* financial arrangements" considering there to be a need to provide clarity at the margins.	arrangements to facilitate their treatment in a manner consistent with the protections under the PAR in resolution.
22. Consequences of inadvertent actions taken by an RA that are inconsistent with the objectives of the PAR	
a. One respondent considered that the proposed remedial action of allowing affected counterparty to continue to set-off after an inadvertent splitting of the rights and liabilities under set-off, netting or title transfer arrangement would create legal, contractual and regulatory capital uncertainties.	The approach adopted to allow a counterparty to continue to set-off or net was designed to reflect comments received in earlier consultations that any "remedy" should be self-executing. Given that a self-executing remedy is proposed, we do not consider it necessary to include a specific rectification mechanism akin to those provided in the context of secured arrangements and structured finance arrangements. However, where necessary, an RA could still issue a supplemental property transfer instrument or reverse property transfer instrument to restore the constituent parts of the affected set-off, netting or title transfer arrangement, should to do so be consistent with the resolution objectives. The proposed approach is also considered to be consistent with that adopted in the UK legislation.[14]
Q5 & Q6: SET-OFF ARRANGEMENTS, NETTING ARRANGEMENTS AND TITLE TRANSFER ARRANGEMENTS IN BAIL-IN	
23. Scope of the definition of set-off and netting arrangements	
a. One respondent commented that if the PAR do not explicitly provide that any regulated Part 5 instrument that contains a bail-in provision cannot apply to any liabilities arising from participation in a clearing system provided by an ATS CCP and owed to such clearing systems or to the operators of, or participants in, such clearing systems then "set-off arrangement" and "netting arrangement" should each be interpreted under the PAR in such a way so as to ensure that only the final net liability owing to an ATS CCP, by a clearing member that is a within scope FI can be subject to a bail-in, irrespective of	As explained in paragraph 10 of this paper and item 5.a of the table above, we consider that the broad definition of set-off arrangement and netting arrangement under the PAR would extend to the key relationships between an entity in resolution and an FMI (including an ATS CCP) and thus provide certainty of treatment over these relationships in resolution. One clarification intended to be made in respect of the definition of set-off arrangement and netting arrangement in the PAR, compared with the FIRO definition, is that the PAR will be drafted to clarify that those arrangements are protected to the extent that they are documented or otherwise evidenced in writing (see paragraphs 32, 36 and 37 of the CP, paragraph 22 of this paper and item 16.a in the table above), with the objective of providing certainty to the types of arrangement captured by the PAR whilst providing an RA with an appropriate degree of flexibility. However, as such arrangements between a within scope FI and an ATS CCP would be expected to be reduced to writing, we consider that the protections under the PAR would apply as suggested by the respondent.

[14] See article 10 of The Banking Act 2009 (Restriction of Partial Property Transfers) Order 2009 (S.I. 2009/322), as amended by, amongst others, The Banking Act 2009 (Restriction of Partial Property Transfers) (Amendment) Order 2009 (S.I. 2009/1826). See Footnote 3 for reference.

Respondents' comments	Authorities' responses
whether such liability is a mixture of its own liabilities and those of its underlying clients or affiliates. The definitions of "set-off arrangement" and "netting arrangement" under the FIRO are both broad enough to accommodate such an interpretation.	In practice, given the importance of securing continuity in payment, clearing and settlement systems, an RA is unlikely to consider such unsecured liabilities to be a credible source of loss-absorbing capacity. Loss-absorbing capacity requirements for within scope FIs will be developed to specify the categories of capital and unsecured debt liabilities which will be considered eligible loss-absorbency, with consideration given to an appropriate form of their subordination to operating liabilities, including liabilities relating to participation in payment, clearing and settlement systems.
24. Mechanism for closing out position of an FI in resolution	
a. One respondent sought elaboration on how an RA would close out the position of an FI under a set-off, netting or title transfer arrangement within a short period in order to subject it to bail-in on a net basis.	The resolution regime provided for under the FIRO establishes a range of legal tools necessary to resolve failing systemically important FIs (i.e. it makes resolution "feasible"). Further work is however required to refine the processes and procedures for the deployment of these tools. One area of such further refinement will be that of "bail-in mechanics", mapping out how an RA will carry out bail-in in practice. Work is ongoing at the international level to develop principles underpinning bail-in execution and we will continue to monitor, and contribute to, this in developing bail-in mechanics locally.[15] We recognise that converting set-off, netting and title transfer arrangements to create a net debt, claim or obligation will present challenges, particularly in the context of valuation when dealing with derivatives under such arrangements. Furthermore, closing out the arrangements may not be conducive to securing continuity of critical financial functions and indeed could potentially be value destructive given close out and replacement costs. As explained in paragraph 29 of this paper, over time the development of loss-absorbing capacity requirements for within scope FIs should materially reduce the need for an RA to have to consider the bail-in of liabilities under such arrangements, as an FI should have in issue sufficient amounts of subordinated loss-absorbing instruments, that can feasibly and credibly absorb loss without the need to close out positions under derivatives and other arrangements to create a net position. This should support both speed of application of the bail-in and enhance the ability to secure continuity.
25. Exclusion of deposits from protection	
a. One respondent commented that, in relation to paragraph 45(vi) of the CP, the Hong Kong	The proposal in paragraph 45(vi) of the CP is to the effect that an RA should not be constrained from bailing-in, on a gross basis, any liabilities which might be considered deposits but which are not excluded

[15] See, in particular, section 2.4 of the FSB's 2016 Progress Report on Resolution to the G20: "Resilience through resolvability – moving from policy design to implementation", http://www.fsb.org/wp-content/uploads/Resilience-through-resolvability-%E2%80%93-moving-from-policy-design-to-implementation.pdf.

Respondents' comments	Authorities' responses
authorities appear to be proposing a different approach in respect of the bail-in of deposits that do not fall within the definition of protected deposits compared to the equivalent UK regime. The respondent would like to understand the policy consideration behind the proposed Hong Kong approach.	from bail-in under the FIRO (see, in this context, sections 2(b) and 2(c) in Schedule 5 to the FIRO). This ensures that those deposits which have features more akin to issued, medium- to longer-term debt, e.g. long-term deposits, certificates of deposit, and which might be expected to represent effective loss-absorbing capacity, can be subject to bail-in on a gross basis to support the absorption of losses in and recapitalisation of the entity in resolution.
26. Consequence of inadvertent action by an RA	
a. One respondent considered that subsequent measures to restore an affected party's position after an inadvertent bail-in on a "gross" rather than "net" basis would necessarily create legal, contractual and regulatory capital uncertainties.	An RA would expect to take *ex ante* steps to mitigate the risks of taking resolution action that is inconsistent with the PAR. However, recognising that inadvertent action could potentially result in inconsistent treatment of protected arrangements (e.g. due to deficiencies in FIs' MIS capabilities or inadvertent definitional legal uncertainty), it is considered important that the PAR provide for a mechanism that enables a party directly affected by such inadvertent treatment to have their position restored to the one they would have been in if the bail-in had been conducted on a "net" basis consistent with the PAR. The approach to be adopted is considered consistent with that adopted in the UK legislation.[16]
27. Definition of "derivative contracts", "financial contracts" and "qualifying contracts"	
a. One respondent commented that the fundamental issue to definition of both "derivative contract" and "financial contract" is whether the right contracts are excluded from bail-in without catching contracts which are not important for the daily functioning of regulated financial markets whilst other respondents indicated that there did not seem to be a need for the two terms to be mutually exclusive.	We are grateful for the constructive comments and, in particular, it appears that mutually exclusive definitions of "financial contract" and "derivative contract" may not be necessary for the purposes of the PAR given that the ultimate treatment of both is the same – i.e. to be bailed-in on a net basis where they are constituent parts of a set-off arrangement, netting arrangement or title transfer arrangement. We will therefore adapt the definitions in the PAR to be more precise in the population of contracts that are covered by the protection under the PAR in bail-in without excessively constraining an RA's ability to execute a resolution within a short period of time.
b. Financial contract: One respondent made specific comments on the definition of commodities contracts for the definition of "financial contract":	On (i), for clarity we are minded to retain the wording "of a financial nature", particularly having observed practice in other jurisdictions. To retain flexibility, we are minded to retain the word "transfer" and note that is has been adopted in similar

[16] See article 6 of The Banking Act 2009 (Restriction of Special Bail-in Provision, etc.) Order 2014. See Footnote 3 for reference.

Respondents' comments	Authorities' responses
i. in (b) [on page 34 of the CP], "of a financial nature" does not add much to the definition; asked that what is intended to be captured through reference to "transfer" beyond what is already captured though "purchase, sale… or loan"; and whether spot commodities transactions ought to be included; and ii. in (d), the respondent questioned whether "the swaps or derivatives markets" should be interpreted as being only those in Hong Kong, or also international markets.	legislation adopted in other jurisdictions. In relation to spot commodities transactions, for completeness, we are minded to update the definition of "financial contract" to also cover contracts for the purchase, sale or delivery of Hong Kong or foreign currency (which it is considered would cover all forms of currency contract both spot and contracts for future delivery). On (ii), we will take this into account in considering whether to fine-tune the definitions of "financial contract" and "derivative contract" as discussed in item 27.a in the table above, but consider that the location of the market on which a contract is traded should not affect the protection afforded by the PAR such that where the contract is entitled to be set-off or netted under a set-off, netting or title transfer arrangement an RA should convert the contract to a net debt, claim or obligation before subjecting it to bail-in.
c. One respondent suggested that a definition of financial contract similar to QFC under the Dodd-Frank Act in the US should be adopted to broaden the definition.	As explained above, we have considered an approach similar to that adopted in the US, but given that the Hong Kong PAR, as well as the FIRO, is more akin to the European, and particularly UK, legislation we considered it appropriate to retain a similar approach to the UK legislation in relation to the relevant definitions for "financial contract" rather than adopting definitions developed under a different system.
d. Qualifying master agreement: One respondent considered the definition inaccurately defined and inconsistent with the generally understood definition of a master agreement. The respondent suggested adopting the definition in s210(c)(8)(D)(viii) of the Dodd-Frank Act.	The policy intent of the definition is to ensure that master agreements covering "financial contracts", "derivative contracts" and "currency contracts" fall within the protection under the PAR. We will keep this in mind in considering whether to refine the definitions of "financial contract" and "derivative contract" as discussed in item 27.a in the table above.
e. Creation of an additional term: One respondent suggested adding an additional term of "currency contract", which contains the meaning of "a contract for the sale, purchase or delivery of the currency of Hong Kong or any other country, territory or monetary union"	For completeness, we are considering, as explained in item 27.b in the table above, to refine the definition of "financial contract" to also cover a broader range of currency contracts.

Respondents' comments	Authorities' responses
28. Exclusion of liabilities owed to clearing and settlement systems from bail-in	
a. One respondent referred to Article 55 of BRRD and suggested that, according to the Article, the liabilities from clearing and settlement systems arrangements are not included in bail-in. The respondent then suggested that liabilities from the clearing and settlement systems arrangements are related and should be included for the protection of the counterparties and the stability of the financial markets.	Under the FIRO, liabilities arising from participation in: (i) DCSSs and owed to such systems or to the operators of, or participants in, such systems; and (ii) the services provided by an RCH and owed to the RCH or to its clearing participants, are excluded from bail-in as they are "excluded liabilities" under sections 2(r) and (s) of Schedule 5 to the FIRO and so may not be subject to bail-in pursuant to section 58(4) of the FIRO. Article 55 of the BRRD relates to the requirement for institutions to include provisions in contracts creating liabilities through which the holder agrees to be subject to bail-in. This helps ensure the relevant liabilities have the necessary loss-absorbing characteristics required to enable an RA to feasibly and credibly write down or convert the liabilities through bail-in in the event of failure. Article 55 provides that such provision need not be made in a contract creating a liability that is excluded from bail-in pursuant to Article 44(2) of the BRRD. "Liabilities with a remaining maturity of less than seven days, owed to systems or operators of systems designated according to Directive 98/26/EC or their participants and arising from the participation in such a system" are excluded from bail-in under Article 44(2). This is similar to the provision described above under the FIRO. We will consider the approach to requiring such contractual recognition provisions in contracts creating liabilities in the context of the future exercise of the rule-making powers under section 19 and section 60 of the FIRO, and would intend to consult on this in due course.
29. Treatment of a contract between a CM and its client ("CM-Client Contract") in bail-in	
a. One respondent sought clarification as to whether a "CM-Client Contract" is an "excluded liability" pursuant to section 2(s) of Schedule 5 to the FIRO and therefore not subject to bail-in. The respondent considered this important as assuming that a CM-Client Contract is subject to bail-in this will result in a mismatch between the contract between a CM and the CCP and the CM and its client.	Fundamentally, it is our intention that an RA should not disrupt the effective operation of payments, clearing and settlement services through the exercise of resolution powers, given the importance of continuity and certainty in these services to the stability and effective working of the financial system of Hong Kong. The liabilities excluded from bail-in, as listed in Schedule 5 to the FIRO, were intended to reflect this policy intent and were modelled on the approaches adopted in the relevant UK legislation and the EU BRRD. In the example given, we consider that a CM-Client Contract is likely to be a mirror of the contract between the CM and the RCH. In a simple example, if a CM in resolution is due to make a payment to an RCH in respect of a client, then the relevant client is likely to have the same liability *vis a vis* the CM. Therefore, there would be no liability of the CM in resolution to bail-in as the liability of the client would be an asset of the CM and the client should continue to make payments to the entity as appropriate under its contractual arrangements. Notwithstanding the above, as part of resolution planning, and work to achieve continuity

Respondents' comments	Authorities' responses
	of access to FMI for entities in resolution, be they direct or indirect participants in the FMI, as discussed in item 29.b below, the RAs will consider how best a resolution transaction can take into account the different relationships of an entity in resolution as they relate to FMIs such that resolution can be executed in a manner consistent with the resolution objectives.
b. The same respondent sought clarification on whether a temporary stay on early termination rights and payment/delivery obligations applies to a CM-Client Contract. If not, a mismatch may potentially arise where a CCP terminates the trade with the CM which is in resolution but the client is unable to do so.	Any imposition of a temporary suspension ("stay") of a counterparty's termination rights, pursuant to section 90 of the FIRO, is to be made at the discretion of an RA, ultimately with a view to achieving the resolution objectives. To ensure certainty in the clearing and settlement of transactions, we considered it appropriate to make explicit provision that such a temporary suspension could not be imposed on a counterparty that is an FMI. Before applying a stay, an RA must also, pursuant to section 90(3) of the FIRO, have regard to the impact a suspension might have on the orderly functioning of the financial market in Hong Kong and must always act in a manner consistent with achieving the resolution objectives. Securing the continued access of an FI in resolution to clearing, payment, securities settlement through direct or indirect participation is important to ensuring that the firm's critical functions can be continued without interruption. The FSB has recently completed its consultation on its "*Guidance on Continuity of Access to Financial Market Infrastructures for a Firm in Resolution*". The Guidance proposes a set of arrangements to support continued access to FMIs by a firm in resolution. One such arrangement relates to the contractual rights and obligations of a FMI that would be triggered by entry into resolution of an FMI participant, its parent or affiliate. As mentioned in item 8.a above in this table, the RAs plan to work with FMIs *ex ante* to develop cooperation frameworks or agreed upon procedures as appropriate in order to have a greater *ex ante* understanding of the actions that could be taken in the resolution of an FMI participant so as to have confidence and certainty around continuity of the participant's access to the FMI whilst achieving orderly resolution. FSB's finalised "*Guidance on Continuity of Access to Financial Market Infrastructures for a Firm in Resolution*" will be an important resource in informing the development of these frameworks or procedures.