

**AN EFFECTIVE RESOLUTION REGIME FOR FINANCIAL  
INSTITUTIONS IN HONG KONG**

**FINANCIAL INSTITUTIONS (RESOLUTION) ORDINANCE  
(Chapter 628)**

**RULES ON CONTRACTUAL STAYS ON  
TERMINATION RIGHTS IN FINANCIAL CONTRACTS  
FOR AUTHORIZED INSTITUTIONS**

**CONSULTATION CONCLUSION**

**Hong Kong Monetary Authority**

**31 December 2020**

## Introduction

1. The Monetary Authority ('MA') issued a consultation paper ('CP')<sup>1</sup> on 22 January 2020 on proposals for making rules under section 92 of the Financial Institutions (Resolution) Ordinance (Cap. 628) ('FIRO'). Section 92 of the FIRO provides the power for a resolution authority to make rules requiring the adoption of an appropriate provision in a contract of a qualifying entity, to the effect that parties to the contract agree to be bound by a resolution authority's exercise of power to temporarily suspend (or 'stay') termination rights under section 90 of the FIRO ('Stay Rules').
2. This paper sets out the conclusion of the consultation on the MA's approach to the Stay Rules. It summarises the key comments received from respondents to the CP, the responses of the MA to those comments, and proposals for taking forward the development of the Stay Rules. The terms defined in the CP have the same meanings as used in this paper, although the terms may be modified or replaced when relevant proposals are implemented in the form of legislation. Note that the proposals set out in this paper remain subject to modification and should not be taken to represent the MA's fixed or final policy position.
3. The two-month consultation period on the Stay Rules ended on 22 March 2020. A total of 14 submissions were received from a variety of sources comprising industry associations, professional associations, banks, an accounting firm and law firms. The names of the respondents (except for those who requested for their names not to be disclosed) are listed in **Annex 1**. A summary of the major comments received and the MA's responses thereto are discussed below, set out in a structure which follows that of the CP. A fuller consideration of comments received and the MA's responses thereto are set out in **Annex 2** in tabular form for ease of reference.

## General comments

4. All respondents indicated broad support for the proposed approach to the Stay Rules. In particular, there was overall support for the approach to the scope of the covered entities under the Stay Rules. The majority of the respondents also

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<sup>1</sup> <https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/resolution/Stay-rules-CP-for-consultation.pdf>

generally agreed with the proposed definition of ‘covered financial contract’, with a number of respondents seeking clarity on whether certain types of financial contracts may or may not fall within the scope of the Stay Rules. In addition, respondents supported the proposed exclusion of certain counterparties, with some suggesting a wider consideration of excluded counterparties.

5. On the concept of material amendment in relation to pre-existing contracts, respondents generally agreed with the proposed approach, with several respondents asking for further guidance on what constitutes a ‘material amendment’.
6. A number of respondents mentioned the prevalence of non-Hong Kong law as the governing law of financial contracts for certain trading and markets businesses, and suggested that the number of contracts subject to the requirements under the Stay Rules may consequently be relatively higher than under similar contractual stay requirements in other key jurisdictions. On the proposed approach to phasing in the implementation of the Stay Rules, the respondents’ views were somewhat mixed, with some expressing broad support for the proposed phased-in timetable, while a few others called for the implementation of the Stay Rules as soon as possible. Three respondents suggested a third phase to the phase-in implementation timetable be added and elaborated their suggestion with details.
7. Regarding the proposed requirements for internal capabilities, reporting and information to assist the MA’s work in monitoring compliance and support resolvability more generally, a number of respondents sought more clarity and details on the requirements, and suggested a further industry consultation to understand the MA’s requirements.
8. Whilst not formally a part of the proposals for the Stay Rules to be made under the current legislative timetable, the MA also invited views on a potential requirement to include a contractual provision to give effect to not only the temporary stay provision, but also the ongoing stay provision, subject to appropriate amendments being made to the empowering provision in section 92 of the FIRO. All respondents who expressed a view supported extending the coverage of the Stay Rules to the ongoing stay provision. While some respondents did not have any views on extending the coverage, they suggested that any contractual recognition requirement for the temporary stay provision should be implemented together with any contractual recognition requirement for the ongoing stay provision to

reduce operational burden, similar to the approaches taken in other jurisdictions.

## **Entities to be covered by the Stay Rules**

9. The vast majority of the respondents expressed support for the MA's approach to setting the scope of covered entities under the Rules as comprising: (i) a Hong Kong incorporated authorized institution ('AI'); (ii) a Hong Kong incorporated holding company of a Hong Kong incorporated AI; and (iii) a group company of a Hong Kong incorporated AI, but only to the extent that the covered financial contracts entered into by the group company contain obligations that are guaranteed or otherwise supported by the AI or the Hong Kong incorporated holding company of the AI.
10. A few respondents sought further clarification concerning the contracts entered into by group companies which are guaranteed or otherwise supported by the first two groups of covered entities mentioned above, in particular regarding the term 'guaranteed or otherwise supported' under limb (iii) of the proposed definition of 'covered entities'. Two respondents noted the reference to 'otherwise supported' is quite broad.
11. The MA's policy intent as regards the term 'support' is to capture support that is relevant in the context of early termination risks of financial contracts in a resolution. Given that the Stay Rules concern only financial contracts, we generally expect that relevant 'support' in this context would be credit related primarily. As set out in the CP, we would emphasise that the policy focus is on guarantee or other support provided in respect of the obligations of a group company under a covered financial contract (as opposed to general support on an entity basis that is not relevant to the group company's obligations under the contract), by a Hong Kong incorporated AI and/or a Hong Kong incorporated holding company of a Hong Kong incorporated AI within the same group of companies as the group company that entered into the contract.
12. Certain respondents suggested that the MA consider an express carve-out of entities that are not covered entities in the Stay Rules. In view of the relatively narrow scoping of covered entities, the MA considers it appropriate to set out the scope of covered entities, and does not see the need for explicit carve-outs in the Stay Rules.
13. Some respondents suggested that the MA should be provided with a power to

include additional entities in the scope of the Stay Rules from time to time on a need basis. The MA is mindful of the importance of providing certainty as regards the definition of 'covered entities' to the market so as to ensure transparency of the applicability of the Stay Rules, and there is therefore no intention to provide flexibility under the Stay Rules for the MA to include additional entities in the 'covered entities' definition under the Stay Rules.

14. In a similar vein to provide clarity and certainty regarding the scope of covered entities, the formulation of the 'covered entities' definition in the Stay Rules will be refined in relation to limb (iii) concerning group company. The element of 'guaranteed or otherwise supported' will be omitted from limb (iii) of the definition of 'covered entities' but will be incorporated in the definition of a 'within scope contract' instead. This approach not only has the operational advantage of a more 'static' definition of 'covered entities' which underpins the applicability of the Stay Rules, but should also more clearly reflect the policy intent to capture the guarantee or support provided at a contract level, as discussed in paragraph 11. It should be noted that this change in the formulation of the definitions does not affect the coverage of contracts entered into by a group company under the Stay Rules; the overall effect of the Stay Rules in relation to contracts entered into by group companies remains the same as that proposed in the CP.

### **Types of contracts to be covered by the Stay Rules**

15. Respondents expressed general support for the scope of covered financial contracts. A number of specific questions were raised, seeking clarification as to whether certain types of contracts will be covered by the Stay Rules. Some respondents also expressed views regarding certain specific types of contracts which they believe should (or should not) be scoped in.
16. In formulating the definition of 'covered financial contract' under the Stay Rules, a broad approach was taken, similar to that taken by a number of jurisdictions in devising their regulatory measures to implement contractual stays. It is not our intention for the Stay Rules to take a prescriptive approach of setting out all possible classes of financial contracts that may fall within the scope of the Stay Rules, as it is neither practicable nor possible to provide an exhaustive list under the Stay Rules. Whether a contract is a within scope contract will depend whether it meets all of the components under the definition of a 'within scope

contract', and the onus is on the covered entity to identify contracts that fall within the scope of the Stay Rules.

17. That said, we would take this opportunity to provide more clarity in response to the questions raised by respondents on a number of specific contract types that are understood to be 'out of scope' and 'in scope'. For contracts understood to be 'out of scope' by some respondents, clarity was sought regarding contracts that are typically of a short term nature, including spot FX, FX forwards, transactions settled within a single settlement cycle and contracts settled on a delivery-versus-payment/receipt-versus-payment basis. Respondents added that short-dated contracts often do not contain default rights or transfer restrictions, and hence do not give rise to a risk of early termination in a resolution. Clarification was also sought as to whether covered financial contracts that do not contain any transfer restrictions or default rights would be subject to the Stay Rules.
18. In response to the above comments, we confirm that to the extent a contract does not contain a termination right, it would not fall under the definition of a 'within scope contract'. As for transfer restrictions, it should be noted that the Stay Rules are only concerned with contractual recognition of suspension of termination rights, pursuant to section 92 of the FIRO.
19. In line with the proposal under the CP, the Stay Rules will clearly provide that 'covered financial contract' is only one of the components of the 'within scope contract' definition. A contract will be required to contain a provision to the effect that the parties to the contract agree to be bound by a suspension of termination rights that may be imposed by the MA as a resolution authority under section 90(2) of the FIRO ('**suspension of termination rights provision**') under the Stay Rules only if it meets all the components under the 'within scope contract' definition, including the existence of a termination right (as defined by section 86 of the FIRO) that is exercisable by a counterparty (other than an excluded counterparty) and the contract being non-Hong Kong law governed. We believe this should render a large portion of the contracts that respondents were concerned with out of scope of the Stay Rules.
20. Moreover, it should be noted that the inclusion of the suspension of termination rights provision in a contract does not itself impose a stay on the contract; it merely acknowledges the parties' agreement to be bound if the MA imposes a temporary stay on the termination rights of the contract in the future.

21. Respondents provided some comments on the five classes of covered financial contracts under the proposed definition in the CP, namely securities contracts, commodities contracts, futures and forwards contracts, swap agreements, and master agreements. In relation to swap agreements, one respondent commented that it is not clear whether the scope should be understood to include not only the swap agreement itself but also a standalone guarantee, security or credit enhancement supporting such swap agreement. Another respondent commented on the inclusion of 'spot or other foreign exchange agreements' under 'swap agreements' in the CP, which may create uncertainty as to whether 'swap agreements' are intended to cover spot FX contracts themselves, or only swaps on spot FX contracts.
22. In relation to spot FX transactions, one respondent expressed the view that even where spot FX transactions provide for contractual early termination default rights, it is unlikely that these rights could be exercised effectively before the covered entity's obligations fall due. Another respondent shared a similar view, citing that spot contracts are low risk transactions with a short settlement cycle. These respondents suggested excluding spot FX transactions on this basis. Another respondent observed that it was not certain whether spot FX contracts are caught under the proposed definition of 'covered financial contract'.
23. In light of the comments received, to provide better clarity regarding the scope of covered financial contracts under the Stay Rules, the definition will be slightly modified, taking reference from the approach adopted for the definition of 'financial contract' in section 2(1) of the Financial Institutions (Resolution) (Protected Arrangements) Regulation (Cap. 628A) (**'Protected Arrangements Regulation'**). The 'futures and forwards contracts' limb and the 'swap agreements' limb that were proposed in the CP will be replaced by the following in the Stay Rules:
- (a) a limb to cover contracts for the purchase, sale or delivery of Hong Kong currency or any other currency. Under this limb, it should be clearer that spot FX transactions are covered; and
  - (b) a 'derivatives contracts' limb which includes forwards contracts, futures contracts, options contracts and swap agreements.
24. Regarding a standalone guarantee, security or credit enhancement that supports

a swap agreement (or that supports a covered financial contract more generally), to the extent that such arrangements relate to a covered financial contract, they are also intended to be caught by the last limb of the 'covered financial contract' definition. For clarity, the wording of the last limb of the 'covered financial contract' definition will be refined to make clear that master or other agreements, in so far as they relate to a 'covered financial contract' listed in any of the other limbs of the definition, are also considered as a 'covered financial contract' under the Stay Rules.

25. In relation to securities contracts, one respondent commented that the meaning of 'securities contract' or 'securities' is not clearly defined and could cause the market to (erroneously) refer to the broad definition of 'securities' under the securities regulation. Our policy intent is that securities, irrespective of whether they are cash settled or physically settled and irrespective of whether or not they are dealt in or negotiable on the financial markets, are included in the scope of 'securities contracts'. This will be reflected through the definition of 'transferable securities' in the Stay Rules, which is to be given the same meaning as under section 2(1) of the Protected Arrangements Regulation.
26. Some respondents considered that certain types of agreements may be less likely to have termination rights exercised on a mass scale, and argued for their exclusion from the Stay Rules. One such example given by a respondent was underwriting agreements relating to investment banking transactions, citing the distinct nature of these transactions where counterparties to such agreements are less likely to create a disorderly rush for the exits. Given these agreements are not different from other securities contracts by nature as they may also involve the purchase and sale of an issuer's securities, such that there is still a potential for a mass disorderly termination which may adversely affect the financial market in Hong Kong, and also considering the importance of the capital markets in Hong Kong, the MA does not intend to exclude underwriting agreements from the definition of 'covered financial contract'.
27. Having further considered the definition of 'covered financial contract', we are minded to include an additional limb, to capture contracts of a similar nature to four broad classes of contracts currently in the 'covered financial contract' definition. The policy intention for this limb is to prevent circumvention of the Stay Rules and to 'future-proof' the evolution of financial contract construction and related developments in the market more generally. This addition is not



intended to broaden the scope of the application of the Stay Rules, but rather it is designed to ensure that the definition would remain relevant with the evolution of financial contracts over time.

28. To provide flexibility for refining the coverage of contracts as appropriate in view of the broad definition of ‘covered financial contract’, we are minded to provide in the Rules a power for the MA to exempt a covered entity from complying with the Stay Rules in respect of one or more within scope contracts or classes of within scope contracts, if the MA is satisfied that it is prudent to do so. The MA may attach conditions to the exemption as appropriate. In considering whether it is prudent to grant an exemption, the MA may take into account the resolution strategy(ies) for the relevant Hong Kong incorporated AI or a Hong Kong incorporated holding company of the Hong Kong incorporated AI; risks that may be posed by the non-viability of the Hong Kong incorporated AI (if the AI is the covered entity or, in the case of other covered entities, the Hong Kong incorporated AI in the same group of companies) including to the continued performance of the AI’s critical financial functions; and any other matters that the MA considers relevant.

### **Rights to be bound by the Stay Rules**

29. A few comments were received in relation to the rights to be bound by the Stay Rules, with some respondents suggesting a narrower definition of ‘termination right’ under the Rules, such that it focuses on contracts which, if terminated, would give rise to resolvability issues.
30. As mentioned in the CP, the policy intent of the MA in adopting the same definition of ‘termination right’ under section 86 of the FIRO in the Stay Rules is to avoid any discrepancies in that regard between the primary and the subsidiary legislation, where the latter seeks to address the contractual recognition of a temporary stay under the former. In the case of a resolution, disorderly termination of financial contracts on a mass scale would impact resolvability, hence a broad adoption of the contractual recognition of suspension of termination rights of contracts is considered prudent.

### **Counterparties to be excluded from the Stay Rules**

31. In line with the exclusion under the temporary stay provision, the CP proposed the

exclusion of a counterparty that is a financial market infrastructure ('FMI'), including a central counterparty ('CCP'). In addition, the CP invited views on whether excluded counterparties should also cover central banks, with an initial proposal of not excluding central banks as counterparties from the scope of the Stay Rules.

32. All respondents who expressed a view on this agreed with the proposed exclusion of counterparties that are FMIs in line with the temporary stay provision. Regarding the term 'financial market infrastructure', some respondents sought clarity on whether the term under the FIRO includes those from a third country. In response to this comment, we confirm the intention is for the Rules to adopt the definition of 'financial market infrastructure' under the FIRO, the meaning of which is not limited by the location or jurisdiction of incorporation of an FMI.
33. Several respondents also urged the MA to consider excluding central banks and governments from the Stay Rules. One respondent noted that in practice there may be considerable overlap between contracts with FMIs and with certain other governmental and quasi-governmental entities (in particular central banks), while another reasoned that many of these entities are themselves sensitive to financial stability concerns and the goals of resolvability, and may therefore not exhibit counterparty behaviour that would undermine an orderly resolution.
34. With respect to central banks and governments, having considered views received and the implications for the overall objective of the Stay Rules, we intend to extend the definition of excluded counterparties to cover central banks and governments, in Hong Kong and non-Hong Kong jurisdictions.
35. One respondent sought guidance on agreements entered into with multiple counterparties, and whether the existence of an excluded counterparty as one of the parties to an agreement would exclude that agreement from the scope of the Stay Rules entirely.
36. The policy intent is that if excluded counterparties are the only counterparties to a within scope contract entered into by a covered entity, the contract will not be required to include the suspension of termination rights provision under the Stay Rules. However, for a within scope contract that is entered into with more than one counterparty comprising both an excluded counterparty (for example, an FMI) and a non-excluded counterparty, the Stay Rules would still require the contract to

include the suspension of termination rights provision. In the case of an FMI for instance, a contract would not be excluded solely because an FMI is one of the parties (assuming that there are other counterparties which are not excluded counterparties) to the contract, or because the contract is settled by an FMI.

37. Two respondents asked whether exchange traded contracts are excluded. Similar to the case of FMIs described above, a contract would not be excluded solely because it is traded on an exchange. However, to the extent that the counterparties to such contracts include excluded counterparties, the exclusions apply in the same way as described in paragraph 36 above in relation to FMIs.
38. One respondent suggested excluding 'customer cleared transactions', meaning transactions between a clearing member of a CCP (or any intermediate clearing firm) and its customer (including an intermediate clearing firm) in respect of which a clearing member has entered into a related cleared transaction with the CCP substantially contemporaneously with entry into the customer transaction. In accordance with the temporary stay provision under the FIRO, the policy intention for the Stay Rules is to only exclude FMIs (including CCPs), but not the clearing members of a CCP.
39. One respondent suggested that intra-group financial contracts should be excluded, on the basis that an intra-group counterparty is, broadly speaking, less likely to seek a disruptive termination of contract, as the group entities should generally be supportive of the resolution action. Having considered a number of factors including level-playing field and the importance of securing better contractual certainty in a resolution from a group resolvability perspective, we are of the view that intra-group entities should not be treated as excluded counterparties under the Stay Rules.

## **Material amendments**

40. Respondents generally agreed with the proposed approach in respect of 'material amendments' to pre-existing contracts. Several respondents stressed the importance of clarity on what constitutes a 'material amendment', and sought further guidance.
41. In light of the respondents' comments and in addition to what was set out in the CP, we would note that, as a matter of policy, a 'material amendment' of a pre-

existing contract is not expected to be solely concerned with whether the amendment or alteration itself is material, and the nature of the obligation or right under the pre-existing contract that may be affected by the amendment is also expected to be taken into account when considering what constitutes a 'material amendment'. If an obligation or a right that is being amended is itself a trivial one, the amendment is unlikely from the policy perspective to be considered a 'material amendment' for the purpose of the Stay Rules. On the other hand, if an amendment itself is minor but has the effect of changing the economic terms of a contract, such amendment may still be considered a 'material amendment'.

42. In view of the desire for more clarity on the meaning of 'material amendments' from the industry, the MA will look to provide guidance on the policy intent by way of examples in due course.

43. Three respondents sought clarification on the potential interface between the Stay Rules and certain policies and regulatory requirements to which AIs are also subject, with a view to ensuring that compliance with the Stay Rules does not inadvertently or prematurely trigger the application of other regulatory initiatives. Some of these respondents also suggested that amendments to pre-existing contracts which are implemented as a result of regulatory requirements should not be considered material amendments for the purposes of the Stay Rules.

44. While we acknowledge the existence of potential interface as highlighted by the respondents, this is outside the scope of the Stay Rules in that it relates to requirements established under other pieces of legislation. We will continue to liaise with the relevant authorities concerned in the administration of such legislation regarding the potential impact of the Stay Rules so that the need for any further clarity can be assessed and reflected as appropriate, whether in the relevant requirements or through guidance. As regards the operation of the Stay Rules, our policy intent is that amendments to pre-existing contracts for the sole purpose of, and to the extent necessary for, compliance with other regulatory requirements should not be considered material amendments for the purposes of the Stay Rules.

## **Implementation timetable**

45. The respondents' views on the proposed implementation timetable were somewhat mixed. Two respondents expressed disagreement with the timetable

and phasing in the implementation of the Stay Rules by counterparties, on the basis that the risks of dealing with bank or non-bank counterparties are the same. These respondents see more reasons to implement these rules as soon (and as widely) as possible. On the other hand, four respondents including those representing the banking sector and the derivatives and financial markets participants agreed with the implementation timelines in principle and broadly supported the MA's proposed implementation approach. Those respondents supported the prioritisation of global systemically important banks ('G-SIBs') in the first stage, noting that this population corresponds to large providers of liquidity to which the covered entities may have the largest exposure. Three respondents in this latter group suggested adding a third phase to the transitional timetable and provided detailed proposals, taking into consideration that some counterparties (e.g. small to medium corporate counterparties) may require a longer time period for phased-in implementation as they may not be familiar with the policy objectives of the Stay Rules.

46. With a view to reducing the compliance burden for covered entities, one respondent asked the MA to be mindful of the timing of other compliance obligations on AIs, while a few other respondents suggested the MA to align implementation timetable with other Asian jurisdictions where possible.

47. In light of the comments received, we have narrowed down the types of counterparty to the within scope contracts in respect of which the covered entities will be required to comply with the Stay Rules by the end of the first phase of the transitional timetable, as well as extending the transitional period for the first phase. The revised transitional timetable is as follows:

- Phase 1: for a within scope contract where the only counterparties (ignoring any excluded counterparties for this purpose) are (a) AIs; and/or (b) financial institutions (other than AIs) that are, or are part of, G-SIBs on the commencement date of the Stay Rules, 24 months from the date of the commencement of the Stay Rules; and
- Phase 2: for all other within scope contracts, 30 months from the date of the commencement of the Rules.

## **Compliance and enforcement of the Stay Rules**

48. While a third phase has not been added to the revised transitional timetable, taking into consideration the responses to the CP, the policy proposals have been refined in relation to compliance and enforcement to provide for the following powers for the MA under the Rules: (i) to require a covered entity to propose and implement a rectification plan should it fail to comply with the Stay Rules after the expiry of the transitional period; and (ii) to extend the transitional period for a covered entity with respect to certain covered financial contracts entered into by the covered entity, if the MA is satisfied that it is prudent to do so.
49. In relation to (i), the rectification plan to be proposed and implemented by the covered entity must be acceptable to the MA as the resolution authority.
50. In relation to (ii), in determining whether it is prudent to extend the transitional period, the MA may take into account the resolution strategy(ies) for the relevant Hong Kong incorporated AI or a Hong Kong incorporated holding company of the Hong Kong incorporated AI and any other matters that the MA considers relevant. In order to allow the MA to reflect consideration of the entity's particular circumstances in any extension to be granted, the MA may attach conditions to an extension. In addition, the MA may vary an extension taking into account the same factors.
51. We believe these additional provisions under the Stay Rules would serve to address the industry's concerns in a targeted manner as needed, while at the same time keeping up the momentum with the overall implementation of the Stay Rules.

## **Internal capabilities, periodic reporting and information requests in relation to the Stay Rules**

52. Respondents generally recognised that the MA would need visibility on the financial contracts in order to facilitate the monitoring of compliance with the Stay Rules. A number of respondents sought more clarity and details on reporting requirements regarding compliance with the Rules.
53. It is acknowledged that covered entities will need more clarity and details on reporting requirements regarding compliance with the Stay Rules. The intention is for the Stay Rules to require a covered entity to have adequate systems of control

and keep sufficient records to establish the status of its ongoing compliance with respect to covered financial contracts entered into by it. It is however not the intention for the Rules to prescribe the nature or frequency of periodic reporting; the MA intends to provide further guidance on reporting requirements and consult industry on the proposed guidance in due course.

54. On the legal enforceability and effectiveness of the contractual provisions for effecting suspension of termination rights, several respondents agreed that the onus is on the covered entity to ensure its compliance with the Rules, and that the MA should not request sight of legal opinions as a matter of course. Some respondents further submitted that covered entities should be allowed to come to their own conclusions on legal enforceability of the suspension of termination rights provision.
55. It is our intention for the Stay Rules to provide the MA with a power to request a covered entity to provide, with respect to a covered financial contract the entity has entered into, a legal opinion that the requirement to include the suspension of termination rights provision is being complied with. The policy intent in this regard remains unchanged, in that the MA does not intend to routinely perform due diligence on the legal enforceability or the effectiveness of the contractual provisions for effecting suspension of termination rights, as the onus is on the covered entity to ensure its compliance with the Stay Rules.

### **Ongoing stay provision**

56. Whilst not formally a part of the proposals for the Stay Rules to be made under the current legislative timetable, the CP also invited views on the potential inclusion of a contractual provision to give effect to not only the temporary stay provision, but also the ongoing stay provision, subject to appropriate amendments being made to the empowering provision in section 92 of the FIRO. All of the respondents who expressed a view on this supported extending the coverage of the Stay Rules to the ongoing stay provision. While some respondents did not have any views on extending the coverage, they suggested that any contractual recognition requirement for the temporary stay provision should be implemented together with any contractual recognition requirement for the ongoing stay provision to reduce operational burden, similar to the approaches taken in other jurisdictions.

57. The MA will consider the appropriate amendments to the FIRO in due course, taking into account the comments received.

### **Next steps**

58. Our current intention, subject to legislative priorities, is for the draft Stay Rules to be tabled in the Legislative Council within the current legislative year of 2020/2021. Closer to the time of the tabling of the draft Stay Rules in the Legislative Council, it is also our intention to consult industry on a FIRO Code of Practice chapter to provide guidance on certain operational aspects of the Stay Rules, including those mentioned in this paper. Our aim is to issue a final FIRO Code of Practice chapter around the time when the Stay Rules come into operation.



## **Annex 1 – List of respondents**

1. Clifford Chance
2. Global Financial Markets Association
3. Hong Kong Bar Association
4. Hong Kong Institute of Certified Public Accountants
5. International Swaps and Derivatives Association, Inc.
6. Norton Rose Fulbright Hong Kong
7. ONC Lawyers
8. PricewaterhouseCoopers Advisory Services Limited
9. Royal Bank of Canada
10. The DTC Association
11. The Hong Kong Association of Banks
12. The Law Society of Hong Kong

## Annex 2 – Summary of respondents’ comments and the MA’s responses

Respondents’ comments	MA’s response
<b>A. Scope of the Stay Rules: Entities to be covered by the Stay Rules</b>	
<p>1. One respondent observed that a Hong Kong incorporated holding company can also be captured by the third limb of the definition of ‘covered entity’ as set out in paragraph 3.4(iii) of the CP.</p>	<p>The Stay Rules will make clear that the third limb of the ‘covered entity’ definition does not include a Hong Kong incorporated holding company of an AI.</p>
<p>2. Some respondents suggested that the MA explicitly provides in the Stay Rules that non-Hong Kong incorporated entities (e.g. AIs incorporated outside Hong Kong), including their respective branches registered in Hong Kong (even if the branch is an AI or is regarded as a non-Hong Kong company), are excluded from the definition of ‘covered entity’ (unless such entities fall within the third limb of the definition as set out in paragraph 3.4(iii) of the CP).</p> <p>One respondent submitted that offshore branches of a Hong Kong incorporated AI and a Hong Kong incorporated holding company, or certain group companies of the aforementioned two types of covered entities (e.g. group companies incorporated in Hong Kong that are part of a non-Hong Kong incorporated group of companies), are understood to be within the scope of the Stay Rules.</p>	<p>In view of the relatively narrow scoping of covered entities, the MA considers it appropriate to set out the scope by defining covered entities, and does not see the need for explicit carve-outs under the Stay Rules.</p> <p>For a group company in the same group of companies as a Hong Kong incorporated AI (that is not a Hong Kong incorporated holding company of a Hong Kong incorporated AI), the group company’s covered financial contract could be in scope, but only to the extent that it contains one or more obligations of the covered entity that are guaranteed or otherwise supported by the Hong Kong incorporated AI and/or the Hong Kong incorporated holding company of the Hong Kong incorporated AI.</p>
<p>3. Two respondents submitted that the Stay Rules should, notwithstanding the proposed scope of covered entities, also empower the MA to include entities from time to time on a need basis.</p>	<p>The MA is mindful of the importance of providing certainty as regards the definition of ‘covered entities’ so as to ensure transparency to the applicability of the Stay Rules. The MA thus has no intention to provide flexibility under the Stay Rules for the MA to include additional entities in the ‘covered entities’ definition under the Stay Rules.</p>

Respondents' comments	MA's response
<p>4. One respondent suggested a threshold on the size of AIs to exclude smaller AIs from the application of the Stay Rules.</p>	<p>Having considered various factors including the intended objectives of the Stay Rules and the specificities of the banking sector in Hong Kong, the MA does not intend to introduce a threshold on the size of AIs for determining the scope of covered entities under the Stay Rules. However, it should be noted that the MA has taken proportionality into account in the scoping of the Stay Rules, by focusing on the Hong Kong incorporated AIs and their Hong Kong incorporated holding companies.</p>
<p>5. One respondent sought more clarity on the precise definition of terms used for qualifying whether an entity is within the scope of the Stay Rules (e.g. 'group company', 'holding company' and 'Hong Kong incorporated AI'), and suggested that the MA consider making reference to terms such as those defined in the Companies Ordinance (Cap. 622).</p>	<p>The term 'covered entity' will be defined in the Stay Rules. In formulating the definition, reference has been taken from various sources, in particular from the FIRO under which the Stay Rules are to be made.</p>
<p>6. Several respondents expressed that while the meaning of 'guarantee' is relatively well-understood, they sought more clarity on the kinds or types of arrangements that would constitute the provision of 'support' by a Hong Kong incorporated AI or a Hong Kong incorporated holding company to its group company's obligations under a covered financial contract, for the purpose of determining whether such a financial contract entered into by the group company will be subject to the Stay Rules.</p> <p>Certain respondents submitted that contracts entered into by a group company of a Hong Kong incorporated AI (which is itself not a Hong Kong incorporated AI or a Hong Kong incorporated holding company) should not fall under the scope of the Stay Rules if the</p>	<p>The MA's policy intent for the term 'support' is to capture support that is relevant in the context of early termination risks of financial contracts in a resolution. Given that the Stay Rules concern only financial contracts, we generally expect that relevant 'support' in this context would be credit related primarily.</p> <p>To provide better clarity and certainty, the formulation of the 'covered entities' definition in the Stay Rules in relation to limb (iii) as set out in paragraph 3.4(iii) of the CP concerning group company will be refined, where the element of 'guaranteed or otherwise supported' will be omitted from limb (iii) of the definition of 'covered entities' but will be incorporated in the definition of a 'within scope contract' instead. For details please see paragraph 14 of the main</p>

Respondents' comments	MA's response
<p>support is of an operational or compliance nature, unless the support provided is material to the continued performance of the contract and the failure to provide such non-financial support to the group company entitles the counterparty to trigger default or similar provisions in the contract. A respondent suggested the term 'guaranteed or credit-enhanced' in place of 'guaranteed or otherwise supported'.</p>	<p>text.</p> <p>On the term 'guaranteed or otherwise supported', we remain of the view that 'otherwise supported' is preferable to 'credit-enhanced' as suggested by the respondent. Even though credit enhancement generally constitutes a type of support that would be caught under the Stay Rules, support is not necessarily limited to credit enhancement.</p>
<p>7. Two respondents commented that the reference to 'otherwise supported' was quite broad, and asked whether support that does not constitute a legal obligation would be caught under the Stay Rules, e.g. a comfort letter. The same respondent also suggested that a credit support relationship should only be covered by the Stay Rules if it is established by way of documentation.</p>	<p>With the policy focus on guarantee or other support provided at a contract level (as opposed to general support on an entity basis that is not relevant to the group company's obligations under the contract) as explained in paragraph 11 of the main text, we would like to draw attention to the term 'contract', which is a defined term under the FIRO and is intended to bear the same meaning under the Stay Rules. Under the FIRO, the term 'contract' includes an arrangement of any kind (made, or evidenced, in writing) that imposes obligations on, or creates rights for, a party to it that are intended to be legally enforceable.</p> <p>A guarantee or other support provided by a Hong Kong incorporated AI and/or Hong Kong incorporated holding company of the AI in respect of the obligations of its group company under the contract, should likewise be intended to be legally enforceable. It is therefore expected that a credit support relationship made, or evidenced, in writing may be covered by the Stay Rules if the other components of a within scope contract are met. However the MA does not intend to specifically prescribe the form of documentation</p>

Respondents' comments	MA's response
	of a support relationship in the Stay Rules.
<p>8. One respondent was of a view that to the extent that material support (as opposed to immaterial support, such as limited indemnification or representation) is provided by an AI incorporated in Hong Kong or a Hong Kong incorporated holding company in respect of its group company's obligations under a covered financial contract, it is reasonable for such guarantee or security document itself to constitute a covered financial contract and hence be subject to the Stay Rules.</p>	<p>We do not consider it necessary to establish a materiality threshold in the Stay Rules for the level of support provided by a Hong Kong incorporated AI or a Hong Kong incorporated holding company in respect of its group company's obligations under a covered financial contract.</p>
<p>9. Two respondents submitted that a group company of an AI incorporated in Hong Kong (which is itself not a Hong Kong incorporated AI or a Hong Kong incorporated holding company) should only fall under the Stay Rules if the covered financial contract it enters into, being guaranteed or otherwise supported by the AI or a Hong Kong incorporated holding company, includes termination rights related to the guarantor or support provider that can be suspended under the FIRO.</p>	<p>We understand that it is a common practice for termination rights in respect of a contract to relate to the parties who guarantee or otherwise support the contractual obligations therein. As such, we do not consider a need to specifically provide for such a link under the Stay Rules.</p>

Respondents' comments	MA's response
<p><b>B. Scope of the Stay Rules: Types of contracts to be covered by the Stay Rules</b></p>	
<p>10. One respondent sought clarification on the reason for not covering non-financial contracts in the scope of the Stay Rules, noting the <i>Consultation Response and Certain Further Issues on an Effective Resolution Regime for Financial Institutions in Hong Kong</i> issued on</p>	<p>As explained in paragraph 2.8 of the CP, the commitment made by Financial Stability Board ('FSB') members (including Hong Kong) 'to act in a concerted manner to promote, by way of regulation or other enforceable measures, the broad adoption of the contractual approach to cross-border effectiveness of temporary stays of early termination rights in financial contracts', as set out in the FSB's</p>

Respondents' comments	MA's response
<p>9 October 2015<sup>2</sup>, which states that the authorities determined that 'the scope of temporary stay should be extended to <i>all</i> contracts whose early termination could hinder the ability of the resolution authority to achieve the resolution objectives'.</p>	<p><i>Principles for Cross-border Effectiveness of Resolution Actions</i> <sup>3</sup> concerns financial contracts only. As such, we are taking steps to implement the contractual approach for financial contracts.</p>
<p>11. One respondent sought clarification on the reason for excluding 'inter-bank borrowing agreements where the term of the borrowing is three months or less' from the scope of covered financial contracts in the CP, which was originally included in the scope of financial contracts covered by the temporary stay in the <i>Second Consultation Paper on an Effective Resolution Regime for Financial Institutions in Hong Kong</i> issued on 21 January 2015<sup>4</sup> (<b>January 2015 Resolution Regime Consultation Paper</b>).</p>	<p>The list referred to by the respondent in the January 2015 Resolution Regime Consultation Paper was based on the EU's Bank Recovery and Resolution Directive in substance. It was noted in the January 2015 Resolution Regime Consultation Paper that 'the authorities are further considering whether this would be appropriate for the local regime'. Since the January 2015 Resolution Regime Consultation Paper, 'inter-bank borrowing of three months or less' was carved out from the regulatory contractual stay measures in certain EU member states due to concerns about disrupting the inter-bank market. The MA shares a similar view and considers it appropriate to not include such contracts under the Stay Rules.</p>
<p>12. In relation to securities contracts, one respondent commented that the meaning of 'securities contract' or 'securities' is not clearly defined and could cause the market to (erroneously) refer to the broad definition of 'securities' under the securities regulation.</p>	<p>Our policy intent is that securities, irrespective of whether they are cash settled or physically settled and irrespective of whether or not they are dealt in or negotiable on the financial markets, are included in the scope of 'securities contracts'. This will be reflected through the definition of 'transferable securities' in the Stay Rules, which is to be given the meaning of the same term under section 2(1) of the Protected Arrangements Regulation.</p>
<p>13. In relation to spot FX transactions, one respondent expressed the</p>	<p>In light of the comments received, to provide better clarity regarding</p>

<sup>2</sup> [https://www.fstb.gov.hk/fsb/ppr/consult/doc/resolutionregime\\_conclu\\_e.pdf](https://www.fstb.gov.hk/fsb/ppr/consult/doc/resolutionregime_conclu_e.pdf)

<sup>3</sup> <https://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf>

<sup>4</sup> [https://www.fstb.gov.hk/fsb/ppr/consult/doc/resolutionregime\\_e.pdf](https://www.fstb.gov.hk/fsb/ppr/consult/doc/resolutionregime_e.pdf)

Respondents' comments	MA's response
<p>view that even where spot FX transactions provide for contractual early termination default rights, it is unlikely that these rights could be exercised effectively before the covered entity's obligations fall due. One respondent shared a similar view, citing that spot contracts and other similar short-dated contracts are low risk transactions with a short settlement cycle or settled on a delivery-versus-payment/receipt-versus-payment basis. These respondents suggested excluding spot FX transactions on this basis. Another respondent observed that there can be some uncertainty as to whether spot FX contracts are caught under the proposed definition of 'covered financial contract'.</p>	<p>the scope of covered financial contracts under the Stay Rules, the definition will be slightly modified, taking reference from the approach adopted for the 'financial contract' definition under section 2(1) of the Protected Arrangements Regulation. The 'futures and forwards contracts' limb and the 'swap agreements' limb proposed in the CP will be replaced by two new limbs on derivatives and currencies. For details please see paragraph 23 of the main text.</p>
<p>14. In relation to swap agreements, one respondent commented that it is not clear whether the scope should be understood to include not only the swap agreement itself but also a standalone guarantee, security or credit enhancement supporting such swap agreement (or supporting a class of covered financial contract). The same respondent was of the view that 'pure' credit and guarantee contracts (i.e. contracts which contain no standalone payments and collateral provisions) should be excluded from the scope of covered financial contracts. Another respondent commented on the inclusion of 'spot or other foreign exchange agreements' under 'swap agreements' proposed in the CP, which may create uncertainty as to whether 'swap agreements' are intended to cover spot FX contracts themselves, or only swaps on spot FX contracts.</p>	<p>Regarding a standalone guarantee, security or credit enhancement that supports a swap agreement (or that supports a covered financial contract more generally), to the extent that such arrangements relate to a covered financial contract, they are also intended to be caught by the last limb of the 'covered financial contract' definition. For clarity, the wording of the last limb of the 'covered financial contract' definition will be refined. For details please see paragraph 24 of the main text.</p> <p>That said, whether a covered financial contract is a within scope contract will depend whether it meets all of the components under the definition of a 'within scope contract', as explained in paragraph 16 of the main text. For example, contracts that do not contain termination rights exercisable by a counterparty which may be suspended by the MA as a resolution authority under section 90(2) of the FIRO, would not be subject to the requirements under the Stay Rules.</p>
<p>15. One respondent gave a specific example of derivative contracts</p>	<p>It should be noted that the inclusion of the suspension of termination</p>

Respondents' comments	MA's response
<p>under the contractual architecture of the International Swaps and Derivatives Association, Inc. ('ISDA') which contain automatic early termination provisions, and noted that should the covered entity be subject to the Stay Rules, the counterparty will not be able to apply the automatic early termination provisions and would be at a significant disadvantage as close-out netting would not be possible given the suspension.</p>	<p>rights provision in a contract does not itself impose a stay on the contract; it merely acknowledges the parties' agreement to be bound if the MA imposes a temporary stay on the termination rights of the contract in the future.</p> <p>On the imposition of a temporary stay by the MA, it may be helpful to note that before imposing a temporary stay under the FIRO, the MA must have regard to the impact a suspension might have on the orderly functioning of the financial market in Hong Kong pursuant to section 90(3) of the FIRO. In addition, as noted in paragraph 2.4 of the CP, any suspension to be imposed must have a specified duration, which can be up to two business days, i.e. the effect of such a suspension is temporary. Close-out netting would be possible after the expiry of the suspension, subject to the limitations on suspension under section 91 of the FIRO.</p>
<p>16. Two respondents suggested that underwriting or subscription agreements relating to investment banking transactions (e.g. initial public offerings, follow-on transactions) involving the purchase of securities should be excluded from the scope of covered financial contracts under the Stay Rules because these contracts are unlikely to pose resolvability concerns.</p>	<p>Given these agreements are not different from other securities contracts by nature as they may also involve the purchase and sale of an issuer's securities so there is still a potential for a mass disorderly termination which may adversely affect the financial market in Hong Kong, and also considering the importance of the capital markets in Hong Kong, the MA does not intend to exclude capital markets underwriting or subscription agreements from the definition of 'covered financial contract'.</p>
<p>17. One respondent understood that margin loans or agreements to provide securities margin financing activities, or financial accommodations for acquiring or holding listed securities to clients are out of scope under the Rules and suggested that the Rules</p>	<p>Given these agreements are not different from other securities contracts by nature as they may also involve the purchase and sale of securities so there is still a potential for a mass disorderly termination which may adversely affect the financial market in Hong</p>



Respondents' comments	MA's response
<p>explicitly exclude these types of contracts for the avoidance of doubt.</p>	<p>Kong, the MA does not intend to exclude these types of contracts.</p>
<p>18. One respondent asked whether a bond or loan containing an embedded derivative could become the subject of a contractual stay, which could result in the covered entity itself being unable to accelerate the bond or loan and recover its debt.</p>	<p>Bonds and loans may generally be considered as a form of 'transferable securities' which fall under the securities contract limb of the definition of 'covered financial contract'. In addition, a derivatives contract is proposed to be a class of 'covered financial contracts' under the Stay Rules.</p> <p>Recognising a vast range of constructions and arrangements for financial contracts exists in the market and the possibility that a financial contract may fit the description of more than one class of contract under the definition of 'covered financial contract', the term 'covered financial contract' will be defined in a way such that the term may capture a contract that is a combination of different classes of financial contracts which fits the description of more than one limb of the definition. As such, contracts for bonds or loans containing an embedded derivative are generally expected to fall within the definition of a 'covered financial contract'.</p> <p>It should be noted that the inclusion of the suspension of termination rights provision in a contract does not itself impose a stay on the contract; it merely acknowledges the parties' agreement to be bound if the MA imposes a temporary stay on the termination rights of the contract in the future. Before imposing a temporary stay under the FIRO, the MA must have regard to the impact a suspension might have on the orderly functioning of the financial market in Hong Kong pursuant to section 90(3) of the FIRO.</p>

Respondents' comments	MA's response
<p>19. Three respondents suggested that short term debt and commercial paper be included in the scope of covered financial contracts.</p>	<p>Short term debt and commercial paper may be considered as types of 'transferable securities' and therefore may generally fall under the 'securities contract' limb in the definition of 'covered financial contract'.</p>
<p>20. One respondent suggested excluding cash equities transactions-related agreements (e.g. general relationship documents or terms between the parties, customer on-boarding documentation, brokerage agreements, dealer or distribution agreements, warrants and similar securities). Another respondent sought confirmation on its understanding that a 'master agreement' is within the scope of the Stay Rules to the extent it relates to transactional framework agreement, rather than more general 'umbrella' terms covering the overall relationship between an AI and its counterparty. Another respondent suggested excluding custody agreements and trust deeds from the scope of the Stay Rules.</p>	<p>Cash equities transactions may generally be considered a form of 'transferable securities' under the 'securities contract' limb. As the agreements described by the respondent relate to the cash equity transactions, they fall under the last limb of the definition of 'covered financial contract', which will be refined to capture the master or other agreements in so far as they relate to a contract listed in the other limbs of the 'covered financial contract' definition. Similarly, for general relationship documents or terms, custody agreements and trust deeds, to the extent they relate to a contract listed in the other limbs of the 'covered financial contract' definition, they may also fall under the last limb of the refined definition of 'covered financial contract'.</p> <p>That said, whether a contract is a within scope contract will depend whether it meets all of the components under the definition of a 'within scope contract', as explained in paragraph 16 of the main text. For example, contracts that do not contain termination rights exercisable by a counterparty which may be suspended by the MA as a resolution authority under section 90(2) of the FIRO, would not be subject to the requirement to include the suspension of termination rights provision under the Stay Rules.</p> <p>As regards general 'umbrella' terms, they are unlikely to fall under</p>

Respondents' comments	MA's response
	the 'covered financial contract' definition if they do not relate to a covered financial contract.

Respondents' comments	MA's response
<b>C. Scope of the Stay Rules: Rights to be bound by the Stay Rules</b>	
<p>21. Three respondents suggested a narrower definition of 'termination right' under the Stay Rules, such that it focuses on contracts which, if terminated, would give rise to resolvability issues. These respondents proposed specific suggestions for narrowing the termination rights to those that can be exercised by the counterparty to a contract entered into by a covered entity; and that is triggered by resolvability-related conditions (e.g. deteriorating financial condition, entry into resolution proceedings, use of resolution powers).</p>	<p>As mentioned in the CP, the policy intent of the MA in adopting the same definition of 'termination right' under section 86 of the FIRO in the Stay Rules, is to avoid any discrepancies in that regard between the primary and the subsidiary legislation, where the latter seeks to address the contractual recognition of a temporary stay under the former. In the case of a resolution, disorderly termination of financial contracts on a mass scale would impact resolvability, hence a broad adoption of the contractual recognition of suspension of termination rights of contracts is considered prudent.</p> <p>Having considered respondents' comments, we remain of the view that the same definition of 'termination right' under section 86 of the FIRO should be adopted in the Stay Rules. However, it should be noted that one of the components under the 'within scope contract' definition is that the contract should contain a termination right exercisable by a counterparty (other than an excluded counterparty).</p>
<p>22. One respondent suggested that the MA might consider scoping in cross-default rights exercisable against an affiliated operating entity ('AOE') of an AI incorporated in Hong Kong, as a result of entry into resolution of the AI that acts as a guarantor or a credit support provider in relation to the AOE.</p>	<p>As mentioned above, we remain of the view that the same definition of 'termination right' under section 86 of the FIRO should be adopted in the Stay Rules. In relation to AOE's, as set out in paragraph 3.10 of the CP, AOE's were not specifically proposed to be scoped in as covered entities considering they would unlikely be entering into</p>

Respondents' comments	MA's response
	significant volumes of financial contracts that fall within the scope of the Stay Rules.
23. One respondent suggested that unilateral termination rights exercisable without having to show cause and upon notice to the other counterparty, upon a prescribed notice period (e.g. 30 - 60 days), or termination at will, or at no fault, or not triggered by performance or default conditions, should not be subject to the Stay Rules. The respondent also suggested excluding termination rights that relate to same-day payment netting or arise solely from a change in the underlying economic variables.	As mentioned above, we remain of the view that the same definition of 'termination right' under section 86 of the FIRO should be adopted in the Stay Rules.
24. One respondent suggested that the MA consider limiting restriction on transferability of covered financial contracts to the extent required to facilitate the transfer of those contracts to bridge entities or purchasers from the institution in resolution.	The Stay Rules are only concerned with the contractual recognition of suspension of termination rights pursuant to the rulemaking power under section 92 of the FIRO, and are not intended to cover transfer restriction.

Respondents' comments	MA's response
<b>D. Scope of the Stay Rules: Counterparties to be excluded from the Stay Rules</b>	
25. Five respondents submitted that central banks should be excluded under the Stay Rules because it would be practically difficult for covered entities to negotiate and amend a covered financial contract with central banks in line with the Rules. The respondents also submitted that central banks tend to be sensitive to financial stability concerns and may not behave in a manner which undermines the resolvability of a covered entity; and some central banks may be subject to legal immunity from contractual protections.	Having considered comments received and implications for the overall objective of the Stay Rules, we intend to extend the 'excluded counterparties' definition to cover central banks and governments, in Hong Kong and in non-Hong Kong jurisdictions.

Respondents' comments	MA's response
<p>Three respondents further suggested that central governments, sovereign entities, other governmental and quasi-governmental entities and international financial institutions (including multilateral development banks), as well as agencies or branches of central governments, should be excluded from the Rules, in addition to central banks.</p>	
<p>26. Certain respondents sought clarity on the definition of FMI under the Stay Rules and whether the definition of FMI under FIRO covers those from a third country.</p>	<p>The intention is for the Rules to adopt the definition of 'financial market infrastructure' under the FIRO, the meaning of which is not limited by the location or jurisdiction of incorporation of an FMI.</p>
<p>27. One respondent suggested excluding 'customer cleared transactions', meaning transactions between a clearing member of a CCP (or any intermediate clearing firm) and its customer (including an intermediate clearing firm) in respect of which a clearing member has entered into a related cleared transaction with the CCP substantially contemporaneously with entry into the customer transaction.</p>	<p>In accordance with the temporary stay provision under the FIRO, the policy intention for the Stay Rules is to exclude FMIs (including CCPs) as counterparties, but not the clearing members of a CCP.</p>
<p>28. One respondent queried whether the Rules can be effectively implemented when the termination rights of a financial institution are suspended while such rights can be exercised immediately by a CCP (e.g. clearing houses) during resolution.</p>	<p>Any imposition of a stay of a counterparty's termination rights, pursuant to section 90 of the FIRO, is a matter for the discretion of a resolution authority, ultimately with a view to achieving the resolution objectives. In line with the temporary stay provision under the FIRO, we consider it appropriate to exclude contracts entered into by a covered entity to which FMIs (including CCPs) are the only counterparties.</p> <p>Securing the continued access of an AI in resolution to FMIs including CCPs is important to ensuring that the AI's critical financial functions</p>

Respondents' comments	MA's response
	<p>can be continued without interruption. In this regard, the FSB published its <i>Guidance on Continuity of Access to Financial Market Infrastructures for a Firm in Resolution</i><sup>5</sup> in 2017, which sets out a range of arrangements to support continued access to FMIs by a firm in resolution. One such arrangement relates to the contractual rights and obligations of an FMI that would be triggered by entry into resolution of an FMI participant, its parent or affiliate. The MA has started working with a number of FMIs with a view to have a greater <i>ex ante</i> common 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. An example of this work is the update of the Clearing House Automated Transfer System (or 'CHATS') and Central Moneymarkets Unit (or 'CMU') scheme rules to support continuity of access for AIs in resolution.</p>
<p>29. Two respondents asked whether exchange traded contracts are excluded.</p>	<p>Similar to the case of FMIs as described in paragraph 36 of the main text, a contract would not be excluded solely because it is traded on an exchange. However, to the extent that the counterparties to such contracts comprise excluded counterparties, the exclusions apply in the same way as described in paragraph 36 of the main text.</p>
<p>30. Certain respondents suggested that the MA limit the application of the Stay Rules to covered financial contracts which are entered into with certain categories of counterparties by adopting thresholds with respect to contract notional amount or size / types of counterparties.</p>	<p>The MA considers a threshold with respect to contract notional amount or counterparty size may be susceptible to regulatory arbitrage and can pose significant risks to resolvability and the effective application of a temporary stay in a resolution. In the interest of maintaining a level-playing field, the MA does not intend</p>

<sup>5</sup> <https://www.fsb.org/wp-content/uploads/P060717-2.pdf>

Respondents' comments	MA's response
	to specifically exclude or exempt counterparties based on the contract notional amount or counterparty size / types.
31. One respondent suggested that intra-group financial contracts should be excluded, on the basis that an intra-group counterparty is, broadly speaking, less likely to seek a disruptive termination of contract, as the group entities should generally be supportive of the resolution action.	Having considered a number of factors including level-playing field and the importance of securing better contractual certainty in a resolution from a group resolvability perspective, we are of the view that intra-group entities should not be treated as excluded counterparties under the Stay Rules.
32. One respondent suggested the MA should ensure flexibility where a fund manager executes a contract on behalf of multiple funds, to ensure that the fund manager and its counterparty to a within scope contract are able to implement the requirements under the Stay Rules either on an individual fund level or a fund manager level. Another respondent suggested that, with reference to the approach taken in certain jurisdictions, a party acting merely as an agent or in the capacity as a trustee, such as those defined as trust companies under the Companies Ordinance (Cap. 622) read with the Trustee Ordinance (Cap. 29), should be excluded from the scope of covered entities under the Rules.	The MA does not consider it necessary to distinguish in the Stay Rules whether a contract is entered into by another party (e.g. fund manager, agent, trustee) on behalf of a covered entity, or by the covered entity in its proprietary capacity. In any case, the onus is always on a covered entity to identify contracts that fall under the scope of the Stay Rules and ensure compliance accordingly.
33. One respondent sought guidance on agreements entered into with multiple counterparties, and whether the existence of an excluded counterparty as one of the parties to an agreement would exclude that agreement from the scope of the Stay Rules entirely.	The policy intent is that if excluded counterparties are the only counterparties to a within scope contract entered into by a covered entity, the contract will not be required to include the suspension of termination rights provision under the Stay Rules. However, for a within scope contract that is entered into with more than one counterparty comprising both an excluded counterparty (for example, an FMI) and a non-excluded counterparty, the Stay Rules would still require the contract to include the suspension of termination rights provision. In the case of an FMI for instance, a

Respondents' comments	MA's response
	contract would not be excluded solely because an FMI is one of the parties (assuming that there are other counterparties which are not excluded counterparties) to the contract, or because the contract is settled by an FMI.

Respondents' comments	MA's response
<b>E. Operation of the Stay Rules: Material amendments</b>	
<p>34. A number of respondents requested the MA to provide more examples and guidance on what kind of changes to contracts constitute or do not constitute 'material amendments'. Some of the respondents made specific queries on whether certain specific scenarios may be regarded as 'immaterial amendment', for examples changes that occur automatically under rollover, renewal or extension, or amendment to contracts solely for the purpose of correcting a material error.</p>	<p>As a matter of policy, a 'material amendment' of a pre-existing contract is not expected to be solely concerned with whether the amendment or alteration itself is material, and the nature of the obligation or right under the pre-existing contract that may be affected by the amendment is also expected to be taken into account when considering what constitutes a 'material amendment'. For details please see paragraph 41 of the main text.</p> <p>In relation to renewal, the Stay Rules will provide that a within scope contract that is renewed upon expiry of its term, irrespective of whether the renewal is automatic or requires any action on the part of the covered entity or any counterparty to the contract, must include the suspension of termination rights provision in the contract.</p> <p>In view of the desire for more clarity on the meaning of 'material amendments' from the industry, the MA will look to provide guidance on the policy intent by way of examples in due course.</p>
35. One respondent requested the MA to clarify that amendments to	The amendments described by the respondent do not appear to be



Respondents' comments	MA's response
<p>the terms of an agreement covered by the relevant ISDA protocols to contractually recognise the cross-border application of special resolution regimes applicable to certain financial companies under ISDA 2015 Universal Resolution Stay Protocol published by ISDA ('ISDA UP') (or similar initiatives) will not be considered a material amendment for the purpose of the Rules.</p>	<p>amending any substantive obligations or rights under the pre-existing agreement. On this basis it seems unlikely for such amendments to be considered material for the purpose of the Stay Rules.</p>

Respondents' comments	MA's response
<b>F. Operation of the Stay Rules: Internal capabilities, periodic reporting and information requests</b>	
<p>36. Three respondents submitted that sufficient time should be allowed for entities to acquire, test and set up the relevant internal systems (including reporting system) before the actual implementation.</p>	<p>The MA understands that a covered entity may have varying system setups with different levels of maturity. To allow more time for covered entities to establish internal system capabilities to support resolvability, the minimum transitional period for compliance with the Stay Rules will be lengthened from 18 months to 24 months. The MA intends to provide guidance on adequate internal systems of control for covered entities to demonstrate ongoing compliance with the Rules. We intend to consult industry on the proposed guidance in due course.</p>
<p>37. Two respondents opined that reporting should not be periodic but on an ad-hoc and request basis so as to lower the operational burden. On the other hand, a respondent held the view that periodic reporting based on broad categories and features relating to contract types is acceptable, but raised concern on requiring entities to flexibly capture and report certain information. Some respondents submitted that some of the information required to be reported appear to be peripheral or onerous, and suggested</p>	<p>The MA intends to provide guidance on reporting requirements and consult industry on the proposed guidance in due course.</p>

Respondents' comments	MA's response
consultation take place to clarify the requirements and to avoid the reporting of excessive, instead of sufficient, information.	
38. Five respondents requested for clear delineation and definition of information required in each report, level of details, expected report frequency, response time and availability of standardised template. One respondent sought clarity on whether MA can accept reporting with sensitive information redacted.	
39. One respondent sought more examples (other than pre-existing contracts) on the types of contract that fall under one of the broad categories required to be reported with reference to paragraph 4.13 of the CP (i.e. covered financial contracts of Hong Kong incorporated AIs and their Hong Kong incorporated holding companies that are assessed to be out of the scope of the Stay Rules).	

Respondents' comments	MA's response
<b>G. Operation of the Stay Rules: Implementation timetable and related matters</b>	
40. A few respondents expressed disagreement with the transitional timetable and phasing in the implementation of the Stay Rules by counterparties, on the basis that the risks of dealing with bank or non-bank counterparties are the same. These respondents see more reasons to implement these rules as soon (and as widely) as possible. On the other hand, four respondents including those representing the banking sector and the derivatives and financial markets participants agreed with the implementation timelines in principle and broadly supported the MA's proposed implementation approach. Those respondents supported the	In light of the comments received, the types of counterparties to the within scope contracts in respect of which the covered entities will be required to comply in the first phase of the transitional timetable has been narrowed down. The transitional period for the first phase has also been extended. For details please see paragraph 47 of the main text.

Respondents' comments	MA's response
<p>prioritisation of G-SIBs in the first stage, noting that this population corresponds to large providers of liquidity to which the covered entities may have the largest exposure.</p>	
<p>41. Three respondents suggested a third phase to the phase-in implementation timetable be added and elaborated their suggestion with details, out of the concern that some counterparties (e.g. small to medium corporate counterparties) may require a longer time period for phased-in implementation as they may not be familiar with the policy objectives of the Stay Rules.</p>	<p>While a third phase has not been added to the revised transitional timetable, taking into consideration the responses to the CP, the policy proposals have been refined in relation to compliance and enforcement to provide for the following powers for the MA under the Stay Rules: (i) to require a covered entity to propose and implement a rectification plan should it fail to comply with the Stay Rules after the expiry of the transitional period; and (ii) to extend the transitional period for a covered entity with respect to certain covered financial contracts entered into by the covered entity, if the MA is satisfied that it is prudent to do so. For details please see paragraphs 49 and 50 of the main text.</p>
<p>42. A number of respondents requested the MA to align the timing with other regulatory initiatives or implementation milestones in Hong Kong or requirements on contractual stays of other jurisdictions and provide a reasonable window of time to comply with the Rules' requirements.</p>	<p>We are conscious of the need to provide a reasonable window of time for implementation and have been coordinating with relevant parties in this regard. In refining the revised transitional timetable, the timing of relevant regulatory initiatives has been considered where known.</p>
<p>43. A respondent suggested that MA establish an exemption application mechanism for covered entities to apply for exemptions under the Rules on certain types of contracts on an ad-hoc basis.</p>	<p>It is intended that the Stay Rules will provide a power for the MA to exempt a covered entity from complying with the requirement to include the suspension of termination rights provision in respect of one or more within scope contracts or classes of within scope contracts, if the MA is satisfied that it is prudent to do so. For details please see paragraph 28 of the main text.</p>

Respondents' comments	MA's response
<p>44. One respondent submitted that the Rules should expressly permit new covered financial contracts to be made compliant through incorporation by reference of the terms in ISDA UP and ISDA Resolution Stay Jurisdictional Modular Protocol published by ISDA ('ISDA JMP'). On the other hand, another respondent sought clarity on whether covered entities and their contractual counterparties will be required to adhere to the ISDA Jurisdictional Module for Hong Kong. This respondent also sought more details on the timing of publication of the ISDA Jurisdictional Module for Hong Kong and the alignment of timing with the implementation of the Stay Rules.</p>	<p>The MA does not intend to prescribe the manner in which covered entities include the suspension of termination rights provision in the contract under the Stay Rules, whether through adherence to ISDA JMP or bilateral amendment, so long as the contractual parties agree to be bound by a suspension of a termination right in relation to the contract imposed by the MA, in a legally enforceable manner.</p> <p>Regarding the ISDA Jurisdictional Module for Hong Kong, as noted in paragraph 5.3 of the CP, the MA intends to liaise with ISDA closely with a view to putting in place an ISDA Jurisdictional Module for Hong Kong in due course. In refining our proposals we have been in touch with ISDA, and our latest expectation regarding the legislative timetable for the Stay Rules has been communicated to ISDA, with a view to facilitating the development and the publication of the ISDA Jurisdictional Module for Hong Kong following the finalisation of the Stay Rules.</p>
<p>45. Two respondents suggested that the MA develop industry bilateral templates, standardised or template terms/wordings to be incorporated in new contracts or pre-existing contracts with material amendments, as well as a webpage or explanatory documents for counterparties' information concerning the compliance with the Rules.</p>	<p>We are supportive of industry efforts to develop a standardised approach and documentation to facilitate compliance with the Rules and the provision of more information to the relevant parties. However, it is not our policy intent to prescribe the precise content of the contractual terms required to comply with the Stay Rules, nor to provide standardised or template terms for the amendment. The suspension of termination rights provision may take a form that is appropriate to the specific contract, so long as the provision has the effect of a legally enforceable agreement with the counterparty.</p>

Respondents' comments	MA's response
<b>H. Operation of the Stay Rules: Legal enforceability</b>	
<p>46. Three respondents agreed that the onus is on a covered entity to ensure its compliance with the Stay Rules but were of a view that the MA should not request sight of legal opinions as a matter of course. Covered entities should be allowed to demonstrate legal enforceability of the suspension of termination rights provision by alternative means, internally or relying on external documentation (e.g. industry-wide terms, industry legal opinions on standardised agreements).</p> <p>On a related note, one respondent sought more clarity on evidence that is regarded as satisfactory or required by the MA for confirming whether a suspension of termination rights provision is legally enforceable. As an example, the respondent asked whether an AI will need to obtain an independent legal opinion in the relevant jurisdiction, or if it is sufficient for the AI to obtain confirmation from the counterparty.</p>	<p>Covered entities may adopt any appropriate means, including but not limited to adhering to industry protocols, for meeting the requirement to include the suspension of termination rights provision under the Stay Rules, so long as the provision included in the contract is legally enforceable. It is not the MA's intent to prescribe the specific form or manner in which the covered entities should incorporate the provision in their contracts.</p> <p>For monitoring compliance and implementation of the Stay Rules, the MA may request a covered entity to provide written evidence, which includes but is not limited to the provision of a legal opinion acceptable to the MA, for establishing enforceability of the agreement and substantiating its compliance with the Stay Rules. However, the MA does not intend to routinely perform due diligence on the enforceability of the relevant contractual provision in the covered financial contracts as the onus is on the covered entity to ensure compliance with the Stay Rules.</p>
<p>47. One respondent suggested that one-way contractual amendment without a written agreement from the counterparty should be regarded as acceptable for complying with the Stay Rules, provided that the covered entity has given due notice to its counterparty on the proposed amendment; made reasonable and repeated efforts to obtain the counterparty's consent to the changes; and the counterparty has continued to deal with the covered entity.</p>	<p>As noted above, the MA does not intend to prescribe the manner in which a covered entity may achieve compliance with the Stay Rules. It is the obligation of the covered entity to comply with the Stay Rules and to ensure that the parties to a within scope contract agree to be bound by the exercise of suspension of termination rights by the MA under section 90(2) of the FIRO in a legally enforceable manner.</p> <p>As regards an amendment without a written agreement, in</p>

Respondents' comments	MA's response
	accordance with the meaning of the term 'contract', which is a defined term under the FIRO and is intended to bear the same meaning under the Stay Rules, a contract (and any amendment to it) is one that is made, or evidenced, in writing. In other words, while an agreement with a counterparty may not always be in a written form, any non-written agreement (and any amendment to it) should be evidenced in writing.
48. Two respondents sought clarity on whether the mere non-compliance with the Stay Rules for a within scope contract will automatically render the contract legally unenforceable.	The Stay Rules are intended to ensure the effective implementation of suspension of termination rights under section 90 of the FIRO, pursuant to the rulemaking power under section 92 of the FIRO. As such, the MA's Stay Rules are not designed to have any broader impact on the legal enforceability of the contract beyond the contractual recognition of the suspension of termination rights that may be imposed by the MA.

Respondents' comments	MA's response
<b>I. Others</b>	
49. A number of respondents commented on the relationship between the implementation of the Stay Rules and other regulatory initiatives. Two respondents suggested that amendments to pre-existing contracts which are implemented as a result of regulatory requirements should not be considered a material amendment for the purposes of the Stay Rules or, if otherwise, AIs should be made specifically aware. Several respondents requested the MA to clarify that amendments made in order to comply with the Stay Rules would not trigger the application of other regulatory	While we acknowledge the existence of potential interface as highlighted by the respondents, this is outside the scope of the Stay Rules in that it relates to requirements established under other pieces of legislation. We will continue to liaise with the relevant authorities concerned in the administration of such legislation regarding the potential impact of the Stay Rules so that the need for any further clarity can be assessed and reflected as appropriate, whether in the relevant requirements or through guidance. As regards the operation of the Stay Rules, our policy intent is that

Respondents' comments	MA's response
initiatives.	amendments to pre-existing contracts for the sole purpose of, and to the extent necessary for, compliance with other regulatory requirements should not be considered material amendments for the purposes of the Stay Rules.
50. One respondent asked about the treatment of non-Hong Kong incorporated AIs in resolution, and the possible impact of not scoping in those AIs under the Stay Rules. Another respondent asked whether there may be any potential conflict in the application of temporary stays in Hong Kong in the situation of a covered financial contract entered into by a group company of a Hong Kong incorporated AI, which has its home jurisdiction outside Hong Kong.	<p>In proposing the scope of covered entities under the Stay Rules, a range of factors were considered by the MA, including the possible impact of focusing the scope on Hong Kong incorporated AIs and their Hong Kong incorporated holding companies. As mentioned in the CP, the MA considers it a proportionate approach to propose a narrower range of contracts as well as entities to fall within the scope of the Stay Rules.</p> <p>The MA recognises the importance of close consultation and cooperation with the AI's home resolution authority in respect of an AI that is part of a cross-border group. As described in the FIRO Code of Practice chapter on <i>The HKMA's Approach to Resolution Planning (RA-2)</i><sup>6</sup>, for an AI that is part of a cross-border group, the MA intends to develop a preferred resolution strategy that has been devised on a group-wide basis in consultation with the home resolution authority (and if applicable, with the group's Crisis Management Group, for AIs that are part of groups that are designated as G-SIBs).</p>
51. One respondent commented that the application of the Stay Rules can impact an AI's ability to protect its own interests and drive a pattern of behaviour to trade with entities not covered by the Stay	We have not observed much evidence of contractual stay measures in other jurisdictions that had a significant effect of driving away trades to entities not subject to contractual stay measures. We are

<sup>6</sup> [https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/resolutions/RA-2\\_The\\_HKMA\\_approach\\_to\\_resolution\\_planning.pdf](https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/resolutions/RA-2_The_HKMA_approach_to_resolution_planning.pdf)

Respondents' comments	MA's response
<p>Rules of Hong Kong or similar contractual stay requirements in other jurisdictions. The respondent requested for details on the impact of the Stay Rules on covered entities which are AIs, and whether guidance or tools would be provided to AIs on how to manage risks and liquidity issues when an AI is temporarily suspended from terminating a financial contract.</p>	<p>however aware that contractual stay measures have been implemented in the vast majority of G-SIB home jurisdictions and by the vast majority of G-SIBs<sup>7</sup>. We also understand from one of the respondents that G-SIBs correspond to large providers of liquidity to which the covered entities may have the largest exposure.</p> <p>As regards the management of risks and liquidity issues when an AI is temporarily suspended from terminating a financial contract, it may be worth noting that the inclusion of the suspension of termination rights provision in a contract does not itself impose a stay on the contract. Moreover, as noted in paragraph 2.4 of the CP, a temporary stay may only be imposed when the conditions for triggering a resolution have been met and a resolution is being initiated, for a specified duration of up to two business days. AIs are encouraged to consider the management of risk and liquidity issues they may experience in the event of an imposition of a temporary stay by the MA against this backdrop.</p>

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<sup>7</sup> See Annex 3 of the *2020 Resolution Report: 'Be prepared'* issued by the FSB, accessible at: <https://www.fsb.org/wp-content/uploads/P181120.pdf>