

**Consultation on proposed amendments to the Banking Ordinance (CAP.155)
for the implementation of recovery planning and new exposure limits**

A. Background

Recovery Planning

- 1 The financial crises in recent years have pointed to the inadequacy of banks in preparing for severe stress events. To address this, the Financial Stability Board¹ (“FSB”) re-issued in 2014 the latest set of standards relating to recovery planning and resolution planning in its “Key Attributes of Effective Resolution Regimes for Financial Institutions”. The Key Attributes require that recovery and resolution plans be put in place, at a minimum, for any financial institutions that could be systemically important or critical if they fail (Key Attributes 11.1 and 11.2). All member jurisdictions of the FSB, including Hong Kong, are expected to implement these standards to ensure that financial institutions are sufficiently prepared to respond to risk events.
- 2 In respect of recovery planning, the Monetary Authority (MA) has to date relied on information gathering powers (section 63(2)) to implement recovery planning for Authorized Institutions (AIs). Pursuant to the Banking Ordinance (section 7(3)), guidance for AIs on the key elements of effective recovery planning is set out in the HKMA’s Supervisory Policy Manual RE-1, Recovery Planning (“SPM RE-1”).²
- 3 To achieve greater certainty and transparency, the Monetary Authority considers it preferable and appropriate at this time to establish a more explicit legal basis for recovery planning. This will also help align the framework with the relevant FSB standards³, which provide that relevant authorities should have the requisite

¹ The FSB is an international body established by the G20 in 2009. It seeks to assess the vulnerabilities in the global financial system and propose actions to address them.

² Accessible at:
<http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/RE-1.pdf>

³ Moreover, the proposed approach of incorporating recovery planning requirements into the Banking Ordinance reflects the approach adopted in other jurisdictions where their recovery planning requirements are incorporated in the primary legislation. For example the European Union where the Bank Recovery and Resolution Directive contains specific provisions on recovery planning (Article 5 to Article 9) and early intervention measures, which require authorities to have powers to

powers to mandate the implementation of recovery measures with speed and legal certainty to avoid failure and preserve financial stability.

Exposure Limits

- 4 Under the Banking Ordinance, Authorized Institutions (AIs) are subject to the prescribed limits on exposures which seek to prevent their exposures from becoming overly concentrated in certain aspects. Part XV of the Banking Ordinance prescribes restrictions on advances made by AIs against the security of its own shares; limits on exposures of AIs to counterparties and their directors or employees; and other restrictions on shareholding, acquisition of share capital in companies and holding of interest in land etc. by AIs.
- 5 The current limits on large exposures under the Banking Ordinance follow the international standards promulgated by the Basel Committee on Banking Supervision (“BCBS”) in 1991⁴. In April 2014, the BCBS issued a new “supervisory framework for measuring and controlling large exposures”⁵ to replace the existing standards of 1991, which is scheduled to take effect from 1 January 2019. The new large exposures framework is designed to improve measurement of exposures to better reflect a bank’s economic loss when its counterparties default. The new framework is also more comprehensive than the 1991 standards in terms of coverage and provides more detailed guidance in relation to the treatment of exposures arising from specific instruments.
- 6 Implementing the new BCBS large exposures framework locally requires amendments to Part XV of the Banking Ordinance to remove obsolete provisions and institute replacement rules. The opportunity is also taken to update certain provisions in Part XV of the Banking Ordinance in light of market developments in recent years. In view of the technical nature of the new BCBS large exposures framework, and considering that such provisions need to be amended from time to time to reflect changes in international standards, it will be more effective to remove the relevant provisions from the main body of the Banking Ordinance and to replace it by a power for the Monetary Authority (MA) to prescribe exposure limits by way of making subsidiary legislation (i.e. issuing rules subject to

require banks in rapidly deteriorating financial conditions to implement one or more of the actions set out in the banks’ recovery plans (Article 27).

⁴ <http://www.bis.org/publ/bcbssc121.pdf>

⁵ <http://www.bis.org/publ/bcbs283.pdf>

negative vetting by the Legislative Council). The existing provisions rendered obsolete by the new rules will be repealed at the same time when the subsidiary legislation commences operation.

- 7 The approach of relegating the more technical rules to subsidiary legislation made by the MA is in line with that adopted for implementing the BCBS capital, disclosure and liquidity standards. This approach has been proved effective in enabling the MA to implement new international standards locally in a timely manner.

B. Overview of the proposed amendments under the Banking (Amendment) Bill 2017

- 8 Details of the proposed amendments to be introduced by the Bill are set out in Part C. Major changes are summarised as follows:
- 9 **First** - Building on the requirements set out in SPM RE-1, it is proposed that the provisions related to recovery planning be incorporated as a new Part in the Banking Ordinance.
- 10 The proposed new Part will contain the following provisions:–
 - 10.1 An AI must prepare, maintain and submit a recovery plan to the MA containing a range of recovery options which could be deployed by the AI's management to stabilise and restore the financial resources and the viability of the AI should it encounter circumstances of stress that might pose a significant threat to its financial soundness or viability.
 - 10.2 An AI must notify the MA of the occurrence of any trigger event specified in its recovery plan or any deployment of a recovery action under the AI's recovery plan.
 - 10.3 The MA may give directions to an AI in relation to its recovery plan (i) to ensure that the plan is fit for its purpose; (ii) to require changes to the recovery plan to address any deficiency or impediment identified by the MA; and (iii) as a last resort, to require an AI to implement its recovery plan when the MA considers that the AI is delaying the implementation,

which is imperilling the viability of the AI and the MA considers implementation necessary to stabilise and restore the financial resources and viability of the AI. The power of direction under point (iii) will be accompanied by the right for the AI to make representations and be heard before any such direction could be given.

- 10.4 The MA may require a locally incorporated holding company of an AI to prepare and maintain a recovery plan where relevant and where the MA considers this appropriate for the purposes of promoting the soundness of the AI.
- 10.5 As with other provisions under the Banking Ordinance, offence provisions will apply if the AI (or holding company), as well as the directors, chief executive and manager of the AI (or holding company), do not comply without a reasonable excuse with the requirements to notify the MA or the requirements in respect of recovery plans.
- 11 **Second** - Amend Part XV of the Banking Ordinance (Limitations on Loans by and Interests of Authorized Institutions) so that the specification of various limits and restrictions on AIs' exposures or interests is removed from the body of the Ordinance and replaced by a rule-making power, permitting the MA to prescribe limits on AIs' exposures or interests that are applicable to AIs. The scope of the limits to be prescribed under these rules (exposure limits rules) will be the same as that under the current Part XV of the Banking Ordinance at least initially.
- 12 As with the existing arrangements for the Banking (Liquidity) Rules, Banking (Capital) Rules and the Banking (Disclosure) Rules, the MA will only be able to make the exposure limit rules after consultation with the Financial Secretary ("FS"), the two advisory bodies (i.e. the Banking Advisory Committee and the Deposit-taking Companies Advisory Committee) and the two industry associations (i.e. the Hong Kong Association of Banks and the DTC Association).
- 13 The revised Part XV will specify the MA's power to vary, in accordance with any procedure set out in the rules and in circumstances set out in the rules, exposure limits applicable to an AI.
- 14 The exposure limit rules to be made will specify the matters (e.g. failure to comply with a particular exposure limit) that an AI needs to notify the MA. The

revised Part XV will specify the MA's power, by notice in writing serving on an AI, to require the AI to take remedial action with respect to a breach of an exposure limit.

- 15 Under the current provisions in Part XV of the BO, every director, every chief executive and every manager of an AI contravening the relevant limits or restrictions commits an offence. Taking into account the increased complexity of the new rules to be introduced in accordance with the relevant BCBS standards, and that an AI could contravene the limits or restrictions inadvertently (e.g. due to market factor moves beyond its control or a sudden link-up of two previously unrelated individual counterparties), it is proposed that it should be an offence only when the AI fails to comply with a notification requirement under the rules or a requirement under a remedial action notice served on it. This approach is similar to that in respect of contraventions of the Banking (Capital) Rules and the Banking (Liquidity) Rules. Moreover, drawing reference from the Financial Institutions (Resolution) Ordinance (FIRO), if an AI fails to comply with a notification requirement under the rules or a requirement under a remedial action notice served on it, not only will every director, every chief executive and every manager of the AI commit an offence, but the AI itself will also commit an offence.
- 16 **Third** - Amend Part XVIC (Code of Practice for Rules Made under Section 60A(1), 97C(1) or 97H(1) so that the MA may also approve and issue code of practice for providing guidance to the exposure limit rules to be made.
- 17 **Fourth** - Amend Part XVIIIA (Banking Review Tribunal) to widen the review remit of the Banking Review Tribunal in relation to a decision made by the Monetary Authority under the exposure limit rules.

C. Legislative proposals

[Please note that the description which follows reflects the MA's thinking as at the date of the launch of this consultation. Changes may be made as the process of drafting the Banking (Amendment) Bill progresses, ideas are developed and comments are received.]

New Part XIIA to the Banking Ordinance (Recovery Planning)

18 For the purposes of incorporating recovery planning provisions into the Banking Ordinance we propose that a new part to the Banking Ordinance, “Part XIIA - Recovery Planning”, be added to follow the existing section 68 of the Ordinance. We propose Part XIIA to contain the following provisions:-

18.1 Under the new Part XIIA, a “recovery plan” is defined as a plan required by the MA (see paragraph 18.3 below) or the revised plan as may be required by the MA (see paragraph 18.5 below).

18.2 The provisions in the new Part XIIA will apply to AIs incorporated in Hong Kong and an AI incorporated outside of Hong Kong and operating in Hong Kong through a branch. *(The provision reflects section 1.4 of SPM RE-1)*

18.3 The MA may, by notice in writing given to an AI, require the AI to prepare and maintain a recovery plan and submit, including periodically submit, the recovery plan to the MA. *(The provision reflects section 2.1 and paragraph 3.2.2 of SPM RE-1)*

18.3.1 The recovery plan will set out measures that the AI may take to stabilise and restore its financial resources and viability in the event that it comes under stress.

18.3.2 The MA may specify the form and standards applicable to the recovery plan, including the elements to be included in the plan. For example, this could include the framework of recovery triggers to support the timely implementation of the recovery plan; a range of material and feasible recovery options; a process for activating the recovery plan and a communication plan.

18.4 In the event of an AI coming under stress and if the MA considers it expedient or necessary to do so, the MA may, by notice in writing, impose requirements on the AI in relation to the AI’s recovery plan to ensure that the recovery plan and accompanying measures are fit for purpose of stabilizing and restoring the financial resources and viability of the AI in the event that it comes under stress.

18.4.1 The requirements may apply to the frequency of review of the recovery plan; the information to be maintained by the AI for recovery planning and the AI’s governance arrangements for

recovery planning.

18.4.2 In imposing the requirements, the MA may have regard to the nature, scale and complexity of the AI's operations.

18.5 The MA may require an AI to revise the recovery plan if the MA is of the view that there are deficiencies or impediments in the AI's recovery plan or the measures proposed in the AI's recovery plan. *(The provision reflects paragraph 3.3.1 of SPM RE-1)*

18.5.1 If the MA intends to impose a requirement on an AI, the MA must by notice in writing notify the AI of its intention to do so and specify the deficiencies or impediments in the recovery plan.

18.5.2 If the AI fails to submit a revised recovery plan within the period specified in the above notice, or the MA considers that the deficiencies or impediments in the plan have not been adequately addressed in the revised recovery plan, the MA may, by notice in writing, direct the AI to make specific revisions to the recovery plan within a period specified in the notice.

18.5.3 The period specified in the notices as stated in the paragraphs above must be reasonable in the circumstances.

18.6 The MA may require an AI to implement one or more measures in the AI's recovery plan.

18.6.1 The MA may require the AI to implement its recovery plan if it considers that the AI is delaying implementation of one or more measures in the AI's recovery plan; the delay is detrimental to the continuing viability of the AI and the implementation of one or more of the measures is necessary to stabilise and restore the financial resources and viability of the AI. In addition, the MA must also consider that directing the AI to implement such measures will also avoid unacceptable risk to the stability and effective working of the banking system in Hong Kong.

18.6.2 If the MA intends to impose such a requirement, it must notify the AI of that intention, give reasons for the direction and specify the measure(s) that the MA intends to require the AI to implement. The AI may, within a period specified in the notice, make representations in writing to the MA as to why the MA should not impose the requirement. If the MA then decides to impose the requirement, it must notify the AI in writing of that intention, give

- reasons for the direction and specify the measures that the MA requires the AI to implement within a reasonable period specified in the notice.
- 18.6.3 The period specified in the notices set out in the above paragraph must be reasonable in the circumstances.
- 18.6.4 If an AI is aggrieved by the MA's decision to exercise this power, a right of appeal would be provided to the Banking Review Tribunal under section 101B of the Banking Ordinance.
- 18.7 AIs are required to notify the MA if an event that requires an AI to implement a measure in the AI's recovery plan occurs or is likely to occur. *(The provision reflects paragraph 2.2.11 of SPM RE-1)*
- 18.7.1 In such circumstances, the AI must as soon as practicable after it has become aware of the matter notify the MA and provide the MA with any particulars of the matter that the MA requires.
- 18.7.2 If the AI decides to implement a measure in its recovery plan, it must notify the MA as soon as practicable and provide the MA with any particulars of the matter that the MA requires.
- 18.8 If the MA considers it necessary or expedient to do so for promoting the (i) financial soundness and viability of the AI or the general stability and effective working of financial system, the MA may exercise the powers outlined above in respect of holding companies if the holding company is incorporated in Hong Kong or under the Companies Ordinance (CAP. 622), a former Companies Ordinance (CAP. 622) or any other Ordinance.
- 18.9 If an AI or holding company fails to comply with the requirements set out in the paragraphs above without reasonable excuse, offence provisions would apply.
- 18.9.1 For an AI, or holding company, that commits an offence, it is liable (i) on conviction on indictment to a fine at tier 9 and in the case of a continuing offence to a further fine at tier 5 for every day during which the offence continues or (ii) on summary conviction to a fine at tier 5, and in the case of a continuing offence to a further fine at tier 2 for every day during which the offence continues.
- 18.9.2 In addition, every director, every chief executive and every manager of an AI, or officer of the holding company, that fails to

comply without reasonable excuse will commit an offence and be liable (i) on conviction on indictment to a fine at tier 9 and to imprisonment for 5 years and in the case of a continuing offence to a further fine at tier 5 for every day the offence continues or (ii) on summary conviction to a fine at tier 5 and to imprisonment for 2 years and in the case of a continuing offence, to a further fine at tier 2 for every day during which the offence continues.

Amendments to Part XV (Limitations on Loans by and Interests of Authorized Institutions)

19 For the purposes of replacing the limits and restrictions on AIs' exposures and interests in this Part by the new exposure limit rules, we propose that: -

19.1 Part XV will be renamed as "Limitations on Exposure of Authorized Institutions" to better reflect the coverage of this part;

19.2 A new section 81A will be introduced before section 82 to empower the MA to make rules prescribing limits and restrictions in respect of exposures incurred by AIs. The rules may:

- prescribe limits on the exposure incurred by an AI, including
 - exposures to a counterparty or a group of counterparties;
 - exposures to a party connected to the institution;
 - exposures to an employee of the institution;
 - exposures incurred against the security of the institution's own shares and other instruments that are capital in nature issued by the institution; and
 - exposures incurred against the security of shares and other instruments that are capital in nature issued by a holding company or subsidiary of the institution, or by any other subsidiary of a holding company of the institution;
- prescribe limits on exposures of an AI to, or the holding by the institution of interests in, certain assets or classes of assets, including,
 - direct or indirect exposures to the equity of any other company; and
 - the holding of interests in land (whether situation in or outside Hong Kong);
- prescribe aggregate limits on any combination of exposures and holding of interests mentioned above;

- be for connected purposes;
- make different provisions for different classes of AIs, taking into account the risks associated with the institutions belonging to each class;
- give effect to relevant banking supervisory standards issued by the BCBS, with modifications where necessary having regard to the prevailing circumstances in Hong Kong;
- specify the MA's power to apply any exposure limit or restriction (i) to the AI on an unconsolidated basis, (ii) to the AI and one or more of its subsidiaries on a consolidated basis, or (iii) to the AI on an unconsolidated basis and to the AI and one or more of its subsidiaries on a consolidated basis (*this provision will replace section 79A of the Banking Ordinances*);
- in respect of an AI incorporated outside Hong Kong, specify that an exposure limit or restriction is applicable only to the Hong Kong business of the AI in Hong Kong;
- specify the matters (e.g. failure to comply with a particular exposures limit) that an AI needs to notify the MA ("prescribed notification requirement");
- provide for the MA, on application made by an AI aggrieved by a decision of the MA made in relation to it under the rules, to review the decision;
- prescribe limits in the form of a range with upper and lower limits, and the circumstances under which the MA may determine specific limits within that range to apply to an AI;
- empower the MA to consent, subject to any conditions the MA thinks fit, to the incurring of specified exposures or the acquisition of specified interests such that the exposures or interests need not be taken into account in calculating whether an AI has reached any applicable limits under the rules;
- empower the MA to vary, in accordance with any procedure set out in the rules and in circumstances set out in the rules, limits applicable to an AI;
- provide that a decision made by the MA under the rules is a decision to which the appeal mechanism under section 101B(1) applies; and
- contain incidental, supplementary, consequential, transitional or savings provisions that may be necessary or expedient in consequence of the rules;

- 19.3 A new section 81B will be introduced to specify the MA's power, by notice in writing served on an AI, to require the AI to take remedial action if the AI has breached an exposure limit under the rules ("remedial action requirement");
- 19.4 A new section 81C will be introduced to provide that failing to comply with the prescribed notification requirement or remedial action requirement is an offence:
- The institution commits an offence and is liable –
 - (i) on conviction on indictment to a fine at tier 8 and, in the case of a continuing offence, to a further fine at tier 3 for every day during which the offence continues; or
 - (ii) on summary conviction to a fine at tier 5 and, in the case of a continuing offence, to a further fine at tier 2 for every day during which the offence continues; and
 - Every director, every chief executive and every manager of the institution also commits the offence and is liable:
 - (i) on conviction on indictment to a fine at tier 8 and to imprisonment for 5 years, and in the case of a continuing offence, to a further fine at tier 3 for every day during which the offence continues; or
 - (ii) on summary conviction to a fine at tier 5 and to imprisonment for 2 years, in the case of a continuing offence, to a further fine at tier 2 for every day during which the offence continues,whether or not the institution is charged with or convicted of the offence;
- (The tariffs have been proposed primarily with reference to similar tariffs in sections 97D/E/I/J of the BO (in relation to the Banking (Capital) Rules and the Banking (Liquidity) Rules) and the FI(R)O for the sake of consistency.)*
- 19.5 Sections 79A, 80, 81, 83, 85, 87, 87A, 88, 90 will be repealed upon the commencement of the rules made under the new section 81A; and
- 19.6 Section 91 will be amended to the effect that the MA may call upon an AI to produce proof of compliance with the exposure limit rules to be made.

Amendments to Part XVIC (codes of practice for rules made under section 60A(1), 97C(1) or 97H(1))

- 20 We propose to amend Part XVIC so that MA will be empowered to approve and issue codes of practices for providing guidance on the exposure limit rules made under the new section 81A.

Amendments to Part XVIIIA (Banking Review Tribunal)

- 21 We propose to amend section 101B by adding cross reference to the relevant provisions under the revised Part XV such that the review remit of the Banking Review Tribunal will be widened to cover decisions made by the MA under the exposure limit rules.

Consequential amendments

- 22 As a result of the above proposed amendments, we propose the following consequential amendments to the Banking Ordinance:-

22.1 Section 79(1), (2), (3) and (5) (*in relation to definitions and applications of Part XV*) will be repealed and replaced by the new rules.

22.2 The definition of value given by section 79(1) will be explicitly stated under section 119A. The current cross reference of this term to the definition in section 79(1) will become invalid when section 79(1) is repealed.

22.3 The following outdated transitional provisions will be repealed: Section 148 (transitional provision in relation to certain letters of comfort), section 148A (transitional provisions in relation to section 87) and subsections (9) and (10) of section 150 (transitional provisions in relation to amendments made by Banking (Amendment) (No.2) Ordinance 1991).

(Any transitional arrangement rendered necessary by the new exposure limit rules will be provided in the rules)

22.4 Section 8 of Schedule 7 (minimum criteria for authorization) will be amended so that the authorization criteria will include compliance with the new rules made under Part XV.

22.5 A definition of “banking or other financial services” will be explicitly stated in Schedule 14. The current cross reference of this term to “financial exposure mentioned in section 81(2)” will become invalid when section 81 is repealed. The proposed definition is as follows:-

“banking or other financial services includes –

- (a) the taking of deposits;
- (b) the provision of payment and remittance services;
- (c) the issuance of credit cards, debit cards or stored value facilities;
- (d) the provision of facilities for the purchase or sale of foreign currencies, securities or other financial instruments;
- (e) the provision of financial advice;
- (f) the incurring of exposures in connection with –
 - (i) the extension of credit;
 - (ii) the provision of guarantees; or
 - (iii) the undertaking of other off balance sheet exposures; and
- (g) the entry into of contracts of a financial nature.”

22.6 Specification of Factors (Financial Exposure of Authorized Institution) Notice 2007 (Cap 155P) will be repealed. This notice was made pursuant to section 81, which is to be repealed. Depending on how the calculation of off-balance sheet exposure will be cast in the new exposure limit rules, a replacement notice may or may not be required. A decision will be made during the course of the drafting of the new rules.

Repeals

23 Taking the opportunity, we propose to repeal Banking (Specification of Public Sector Entity in Hong Kong) Notice (Cap155O). Following the repeal of Schedule 4 to the BO in 2015, this notice is no longer needed.