HONG KONG MONETARY AUTHORITY
香港金融管理局

HKMA Resolution Stay Implementation Review Report

EXECUTIVE SUMMARY

The Hong Kong Monetary Authority ("HKMA") Resolution Office conducted a review of implementation of the Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights – Banking Sector) Rules (Cap. 628C)[1] ("Stay Rules"). The review is based on its engagement with domestic systemically important banks and other large authorized institutions ("AIs") (together "relevant AIs") in Hong Kong with active bilateral resolution planning programmes in place in 2021-2025. This report outlines key observations on AI's financial contracts, the AIs' compliance approaches, implementation challenges and good practices, as well as future priorities for further enhancing resolvability.

Purpose of the Stay Rules

In the resolution of a financial institution, it is important that the contractual counterparties to the financial institution do not terminate and close out their positions solely as a result of the financial institution's entry into resolution. A disorderly termination of contracts on a mass scale could frustrate the resolution actions taken with respect to a financial institution, causing significant contagion effects to the financial markets and posing broader risks to the stability and effective working of the financial system.

The Financial Institutions (Resolution) Ordinance ("FIRO") empowers the Monetary Authority ("MA") as a resolution authority to temporarily suspend, for up to two business days, the termination right ("temporary stay") of a counterparty (other than a counterparty that is a financial market infrastructure ("FMI"), government, or central bank) to certain financial contracts. Considering majority of the financial contracts of AIs are governed by non-Hong Kong laws, the MA has established the Stay Rules to facilitate the cross-border effectiveness of its temporary stay power under the FIRO.

Under the Stay Rules, AIs incorporated in Hong Kong and certain of their group companies are required to ensure that the parties to the in-scope covered contract agree to be bound by any temporary stay power that a resolution authority may impose under the FIRO, by way of including contractual recognition provisions in the covered contracts.

Key observations

Through bilateral resolution planning programmes, the HKMA has been closely engaging with the relevant AIs to monitor their progress in implementing the Stay Rules. The efforts by AIs in this regard cover cross-border client outreach, development of systems of control, as well as updates of the relevant financial contracts. As of 31 December 2024, financial contracts of notional value exceeding HKD60 trillion have been remediated by the relevant AIs, which included securities, commodities, and derivatives contracts entered into with more than 5,700 counterparties. Majority of them are derivative trades entered under English law governed International Swaps and Derivatives Association ("ISDA") Master Agreements.

1 https://www.elegislation.gov.hk/hk/cap628C. Unless otherwise stated, terms used in this report have the meanings given to them in the FIRO (https://www.elegislation.gov.hk/hk/cap628) and the Stay Rules, as the case may be.

In terms of the approach to remediating covered contracts, counterparties that are banks or non-bank financial institutions ("NBFIs") are generally more receptive of remediation through adherence to the ISDA Hong Kong Jurisdictional Module to the ISDA Resolution Stay Jurisdictional Modular Protocol[2] ("ISDA Hong Kong Jurisdictional Protocol"), while other counterparties typically opt for bilateral amendments. Furthermore, the negotiation with non-FI counterparties typically require more time, prompting the relevant AIs to step up their outreach efforts to remediate the contracts.

AIs have adopted various good practices in meeting the Stay Rules requirements and addressing the early termination risk. These include establishing robust record-keeping capabilities and systems of control to ensure ongoing compliance, conducting proactive internal assessments to holistically evaluate early termination risk in resolution, as well as putting in place resolution stay playbook or manual to facilitate resolution execution. These good practices could serve as useful references for the other AIs in considering further enhancements to their resolution stay capabilities.

Next steps

Moving forward, AIs are encouraged to adopt the good practices outlined in this report to more effectively manage the risk of early termination in resolution. This includes implementing robust systems of control to ensure compliance with the Stay Rules, and developing effective reporting capabilities that facilitate the timely identification of financial contracts and counterparty information in resolution scenarios. AIs should also ensure their capabilities to monitor and meet intraday liquidity needs that may arise from trading activities, thereby reducing the risk of disorderly close-out of trades during periods of market volatility. Having readily deployable communication plans tailored to resolution stay will further support execution readiness. As development of these capabilities mature, AIs should implement comprehensive testing and assurance programmes to validate the effectiveness of their resolution stay capabilities.

Maintaining resolution preparedness for banks that could be critical or systemic upon failure is vital for financial stability. It is a continuous journey that necessitates ongoing efforts to ensure that capabilities remain robust and up-to-date. The HKMA Resolution Office will continue to engage closely with AIs to enhance their resolvability and resilience.

2 https://www.isda.org/protocol/hong-kong-jurisdictional-module-to-the-isda-resolution-stay-jurisdictional-modular-protocol/

1. INTRODUCTION

The FIRO empowers the MA as a resolution authority to exercise temporary stay power over certain financial contracts. However, where the relevant contracts are governed by non-Hong Kong law, uncertainties arise as to whether a court in a non-Hong Kong jurisdiction would give effect to a suspension of termination rights imposed by the MA under the FIRO, unless the law of such jurisdiction expressly recognises the MA's action.

Furthermore, even if a court in a non-Hong Kong jurisdiction were to give effect to the suspension imposed under the FIRO, it could be challenging to effect such recognition in a timely manner in order to achieve the resolution objectives in Hong Kong effectively.

To address these challenges, the Stay Rules came into effect in August 2021, supporting the contractual approach to enhancing cross-border effectiveness of suspending termination rights as advocated by the Financial Stability Board ("FSB")[3]. The Stay Rules require AIs incorporated in Hong Kong and certain of their group companies to ensure that certain financial contracts governed by non-Hong Kong law contain a term or condition to the effect that the parties agree in a legally enforceable manner to be bound by any suspension of termination rights in relation to the contract that may be imposed by the MA under the FIRO, except in the case of an excluded counterparty[4].

To provide guidance on the operation of certain provisions in the Stay Rules, the MA issued the Code of Practice chapter ST-1 *Resolution Planning – Contractual Recognition of Suspension of Termination Rights*[5] in December 2021.

3 FSB has set out certain principles in its *Principles for Cross-border Effectiveness of Resolution Actions* (https://www.fsb.org/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf)

4 As defined in rule 2(1) of the Stay Rules, "excluded counterparty" means a FMI, the MA, the HKSAR Government, and the government or central bank of a non-Hong Kong jurisdiction.

5 https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/resolutions/ST-1_Contractual_Recognition_of_Suspension_of_Termination_Rights_ENG.pdf

2. REQUIREMENTS UNDER THE STAY RULES

Under the Stay Rules, covered entities are required to comply with the contractual recognition requirements for covered contracts, namely that the counterparties agree to be bound by the temporary stay power that may be imposed by a resolution authority under FIRO. The definitions of covered entity, financial contract, and covered contract under the Stay Rules are summarised in Table 1 – 3 below.

Furthermore, a covered entity is required to maintain adequate systems of control to ensure its compliance with the Stay Rules and that accurate, complete and up-to-date information regarding the entity's financial contracts can be produced and provided to the resolution authority as required in a timely manner[6]. In this regard, a covered entity is expected to develop record-keeping capabilities which enable it to readily identify, gather, aggregate, and report key information about its financial contracts in a timely manner. Also, there should be proper oversight and regular review of the systems to ensure the integrity and reliability of the information.

Table 1 **Covered entity under the Stay Rules**

A covered entity means:

(a) An AI incorporated in Hong Kong ("HK AI");

(b) A Hong Kong incorporated holding company of an HK AI (that is not itself an AI) ("HK holding company"); or

(c) A group company of an HK AI (that is not itself an HK AI or an HK holding company) ("related company of an HK AI").

Table 2 **Financial contract under the Stay Rules**

A contract or combination of contracts listed below:

(a) a securities contract;

(b) a commodities contract;

(c) a derivatives contract;

(d) a currency contract;

(e) a contract of a similar nature to a contract in point (a), (b), (c) or (d); or

(f) a master or other agreement in so far as it relates to a contract in point (a), (b), (c), (d) or (e).

[6] Paragraphs 1.1 and 4.4 of ST-1.

REQUIREMENTS UNDER THE STAY RULES

Table 3 Covered contract under the Stay Rules

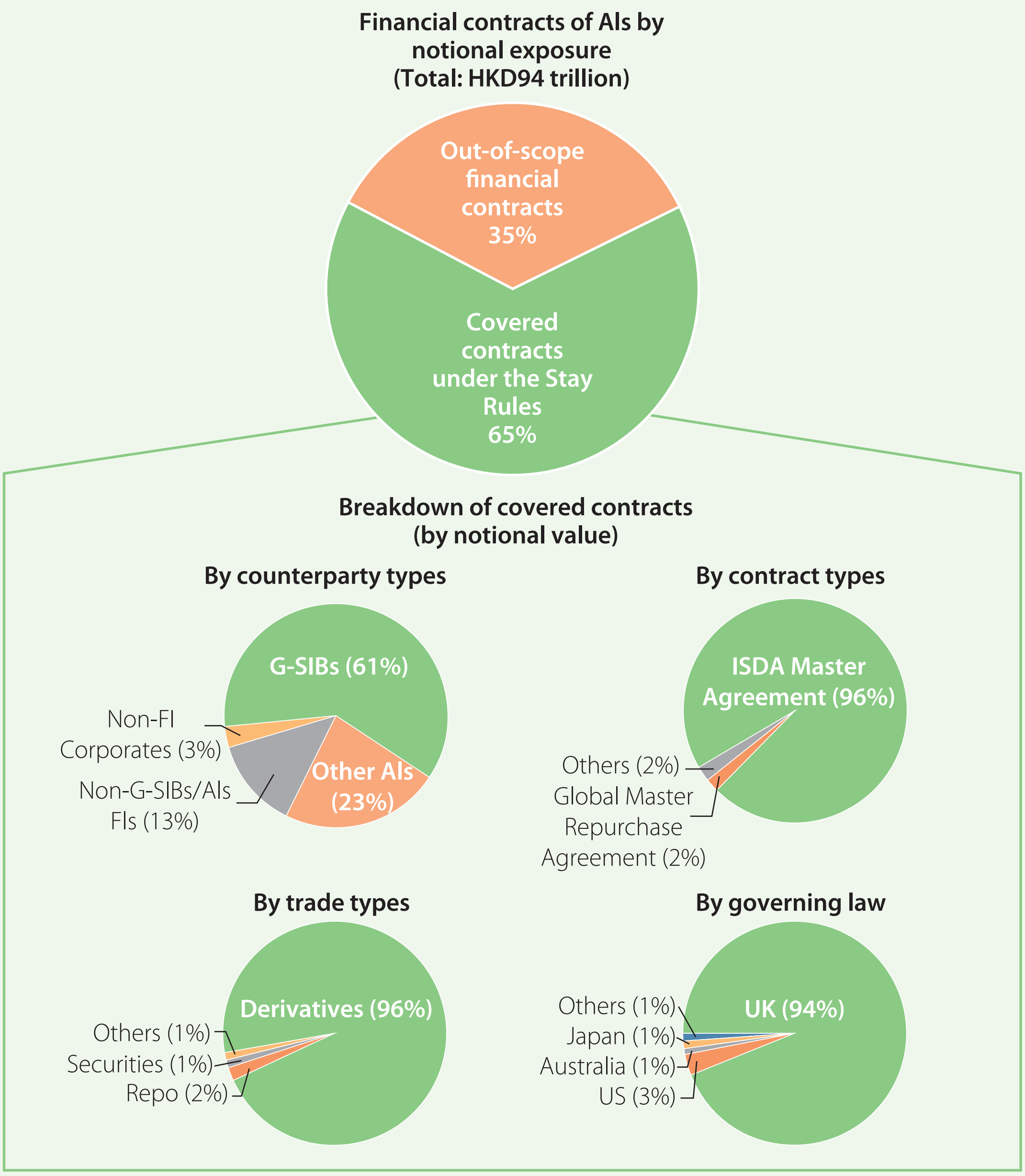
If a covered entity is:	
An HK AI or an HK holding company –	A related company of an HK AI –
A covered contract means a financial contract entered into by the covered entity that: (i) is governed by non-Hong Kong law; and (ii) contains a termination right exercisable by a counterparty other than an excluded counterparty.	An additional criterion of a covered contract is that it: (iii) contains an obligation of the covered entity that is guaranteed or otherwise supported by an HK AI, or an HK holding company, that is a group company of the covered entity

3. FINANCIAL CONTRACTS OF RELEVANT AIs

Covered contracts

As of 31 December 2024, the total notional value of financial contracts entered into by the relevant AIs was appropriately HKD94 trillion, of which 65% comprised covered contracts under the Stay Rules. The vast majority of these covered contracts consisted of derivative trades entered into under English law governed ISDA Master Agreements. Over 84% of the counterparties were globally systemically important banks or other AIs, while the remaining 16% of counterparties were primarily NBFI and non-financial institution corporates.

Chart 1: Breakdown of financial contracts and covered contracts by notional value[7]



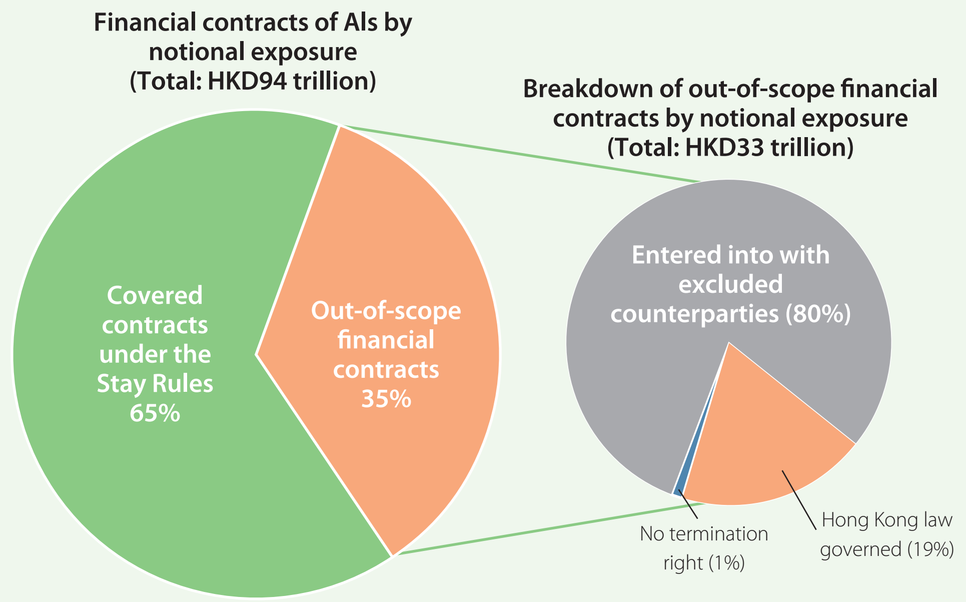
[7] Unless otherwise specified, the charts included in this report comprise information of financial contracts that were reported by the relevant AIs as of 31 December 2024.

Out-of-scope financial contracts

Certain financial contracts entered into by the covered entities are not subject to the contractual recognition requirements under the Stay Rules, namely "out-of-scope financial contracts". Amongst all financial contracts entered into by the relevant AIs, 35% of contracts by notional value are out-of-scope financial contracts.

Within this group, 80% of contracts by notional value are entered into with excluded counterparties. Additionally, 19% of contracts by notional value are governed by Hong Kong law, which are bound by the temporary stay power that may be imposed by a resolution authority under FIRO. The remaining out-of-scope financial contracts (approximately 1% by notional value) do not contain a termination right.

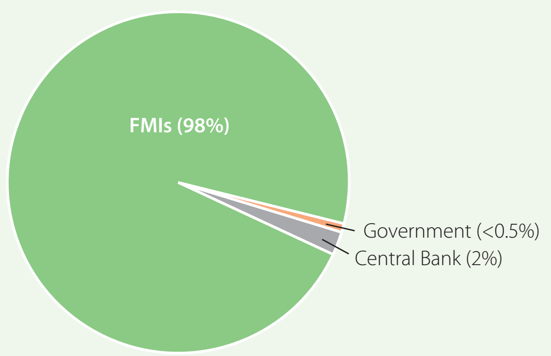
Chart 2: Breakdown of out-of-scope financial contracts by notional value



Among the out-of-scope financial contracts that are entered into with excluded counterparties, a significant majority, approximately 98% of the notional value, are entered into with FMIs such as derivatives clearing houses and exchanges. The remaining financial contracts, which account for approximately 2% of the notional value, are trades entered into with central banks or governments.

While the out-of-scope financial contracts entered into with FMIs are not subject to the contractual recognition requirements under the Stay Rules, AIs should have a clear understanding of the risk of early termination of these out-of-scope financial contracts in resolution and implement appropriate mitigation measures to support resolvability[8]. In this regard, ex-ante engagement by AIs with critical FMI service providers will be helpful in reducing the risk of early termination of financial contracts entered into with FMIs and to ensuring continuity of access ("CoA") to FMIs in a resolution scenario.

Chart 3: Breakdown of out-of-scope financial contracts entered into with excluded counterparties by notional value



The MA issued the Code of Practice chapter FMI-1 *Resolution Planning – Continuity of Access to Financial Market Infrastructure Services*[9] in February 2024. This chapter sets out the MA's expectations in relation to the ex-ante capabilities and arrangements an AI should put in place to maintain, in a resolution scenario, the CoA to critical FMI services. These expectations include the assessment of requirements and conditions and development of measures for maintaining CoA to critical FMI services in resolution. AIs are also encouraged to engage with critical FMI service providers to negotiate the inclusion of "resolution-proof" terms in their FMI service agreements.

8 Paragraph 1.12 of ST-1.
9 https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2024/FMI-1_Resolution_Planning-Continuity_of_Access_to_Financial_Market_Infrastructure_Services_ENG.pdf

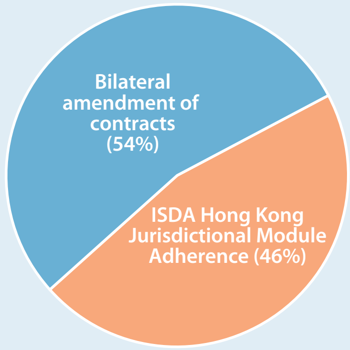
4. IMPLEMENTATION OBSERVATIONS AND GOOD PRACTICES

Compliance approach

The relevant AIs have primarily adopted two approaches to remediate the covered contracts in meeting the Stay Rules requirements. The first approach, which involves adherence to the ISDA Hong Kong Jurisdictional Protocol by all parties involved in a trade, has been adopted by the AIs and their counterparties to remediate 46% of the covered contracts by notional value. The second approach, which entails remediating the covered contract via bilateral amendment with the counterparties, has been utilised by the AIs and their counterparties to remediate the remaining 54% of the covered contracts.

Counterparties that are banks or NBFIs are generally more receptive of remediation through adherence to the ISDA Hong Kong Jurisdictional Protocol, given their experience in adhering to similar ISDA protocols to meet the resolution stay requirements in other jurisdictions, while other counterparties typically opt for bilateral amendments. For certain smaller counterparties, the cost of adhering to the ISDA Hong Kong Jurisdictional Protocol may be a factor to consider when determining the remediation approach. To facilitate the bilateral contractual remediation process with counterparties, certain AIs have developed an in-house template to streamline bilateral amendment of the covered contracts.

Chart 4: Breakdown of compliance approach by notional values



Engagement and negotiation with counterparties

Throughout the Stay Rules implementation process, the HKMA has maintained active dialogue with the relevant AIs to review their contractual remediation progress, understand challenges they face in the implementation, and discuss the remediation plan for the relevant AIs to achieve full compliance.

The complexity of the contractual remediation progress is influenced by the types of counterparties involved, market specificities, as well as the volume of counterparties and contracts that require remediation. Certain AIs have encountered difficulties in remediating the covered contracts in the course of negotiating with corporate and institutional clients, small and medium enterprises, as well as FI counterparties in jurisdictions that do not have local resolution stay requirements. These counterparties often require additional time to fully comprehend and absorb the requirements under the Stay Rules, leading to a prolonged negotiation process. To address this issue, some AIs have stepped up their

10 A one-time fee of USD 500 will be incurred for each adherence to the ISDA Hong Kong Jurisdictional Protocol. https://www.isda.org/protocol/hong-kong-jurisdictional-module-to-the-isda-resolution-stay-jurisdictional-modular-protocol/

outreach efforts, for example, by developing podcast and FAQs for the counterparties, as well as proactively engaging with the counterparties' management to explain the resolution stay concept and the requirements of the Stay Rules.

New trades under pre-existing covered contracts

Under the Stay Rules, a covered contract that is entered into before the initial day ("pre-existing covered contract") would not be subject to remediation, unless it has been renewed or materially amended on or after that day. Certain AIs have encountered challenges in the timely identification and remediation of pre-existing covered contracts that become subject to the remediation requirement when inactive clients re-activate trading activities under the pre-existing covered contracts and new trades are transacted.

To address this issue, some AIs have taken a prudent approach by remediating all pre-existing covered contracts, regardless of whether they are subject to the contractual remediation requirements under the Stay Rules. Additionally, some AIs have implemented pre-trade and post-trade controls into their business-as-usual risk management processes, which are designed to detect trades that are not compliant with the Stay Rules. These measures aim to mitigate potential risks associated with non-compliance and ensure ongoing compliance with the Stay Rules.

Systems of control and reporting capabilities

Under the Stay Rules, a covered entity should establish and maintain adequate systems of control to ensure compliance with the Stay Rules. In addition, the entity is required to ensure that accurate, complete and up-to-date information regarding its financial contracts can be produced and provided to the HKMA as required in a timely manner.

The relevant AIs have been working to put in place reporting capabilities to support timely reporting of financial contract information, which is crucial for informed decision-making in resolution scenarios. For instance, some AIs have deployed automated trade monitoring systems that summarise trade details, such as their compliance status with the Stay Rules, notional and mark-to-market values, and counterparty information, into centralized platform. These systems are accompanied by compliance tools to that support effective monitoring of compliance and identification of early termination risk.

To demonstrate the effectiveness of their reporting capabilities, the relevant AIs were requested to submit to the HKMA summarised information regarding their financial contracts, covering metrics on covered contracts versus out-of-scope financial contracts, exposure distributions across contracts nature, and counterparty type information. Through this process, certain weaknesses in the AIs' reporting capabilities were identified and subsequently addressed. In one case, an AI adopted the infrastructure of the parent group without tailoring it to the Stay Rules requirements or local product specificities, resulting in the need for manual workarounds and data inaccuracies. Furthermore, areas for enhancement were identified for a number of AIs regarding the timeliness, accuracy and completeness in consolidating and summarising the relevant financial contract information, particularly given multiple departments or business lines of an AI may trade financial contracts for various purposes.

Proactive holistic assessment on early termination risk in resolution

Some AIs have adopted a proactive approach to assessing early termination risks that may arise from financial contracts in resolution. The risk assessment covers the evaluation of residual risks associated with pre-existing covered contracts and out-of-scope financial contracts that are not subject to the contractual recognition requirements under the Stay Rules.

To facilitate the risk assessment, some AIs have established an internal risk assessment matrix that categorises the risk level based on the trade types and financial contract types. Based on the risk assessment outcome, the AIs have implemented the corresponding measures and arrangements to mitigate the residual risks entailed in these financial contracts. This holistic risk assessment enables the AIs to better understand and manage early termination risks in resolution.

Execution manual

Some AIs have developed resolution stay playbooks to facilitate continuity of financial contracts. The playbooks outline specific actions and coordination steps that AIs undertake in resolution scenarios, including procedures for identifying financial contracts' positions and exposures, communicating with the key counterparties and stakeholders, and managing the residual early termination risks from the out-of-scope financial contracts. Furthermore, some AIs have conducted testing exercises based on their resolution stay playbook, in which participants executed the outlined steps under a simulated resolution scenario. These exercises enhance the AIs' preparedness for effective resolution execution.

5. FORWARD PRIORITIES

Going forward, the HKMA Resolution Office will continue to engage closely with relevant AIs on the implementation of resolution stay requirements. The priorities will be on assessing the effectiveness of the AIs' resolution stay capabilities, focusing on systems of control and record-keeping capabilities, intraday liquidity management in the context of early termination risk in resolution, execution and communication arrangements, as well as testing and assurance activities.

Systems of control and reporting capabilities

In terms of systems of control, AIs are expected to demonstrate the effectiveness of their pre-trade or post-trade control processes to ensure compliance with the Stay Rules. It is essential for AIs to embed these capabilities into business-as-usual processes and put in place appropriate governance arrangements for conducting ongoing reviews.

Furthermore, AIs should establish robust reporting capabilities to facilitate the timely identification and reporting of financial contract information in accordance with the Stay Rules requirements. To achieve this, AIs are encouraged to consider enhancing their reporting capabilities, such as implementing automated reporting processes and tools, which can facilitate rapid generation of necessary information for decision-making in resolution scenarios.

Intraday liquidity needs from trading activities

In a resolution scenario, trading counterparties may exercise their right to close out trades (to the extent that these are not subject to resolution stay powers or provision) or impose heightened intraday liquidity requirements, particularly during periods of market volatility when they seek to mitigate exposure to potential losses by calling collateral, demanding additional margin, or accelerating settlement timelines.

Therefore, AIs are expected to put in place capabilities to monitor and project their intraday liquidity needs, accounting for contractual obligations in financial contracts (e.g., margin agreements, collateral triggers, and close-out clauses embedded in financial contracts such as derivatives or repos), and ensure the ability to secure sufficient liquidity to meet the relevant requests by counterparties.

Resolution execution and communications capabilities

AIs should be equipped with the capabilities to promptly identify the financial contract positions and exposures, as well as the associated counterparties in times of crisis. It is also crucial for AIs to deliver consistent and accurate communication to these counterparties in a timely and coordinated manner. In this regard, AIs can benefit from developing a resolution stay playbook that provides structured guidance on the execution protocols. The playbook should clearly define the roles and responsibilities of all parties involved and detail the coordination steps required for effective execution. For communication specifically, it should outline the necessary steps for identifying and prioritising key counterparties and stakeholders, specify the communication channels to be used, and incorporate pre-approved message templates for rapid deployment at different stages of a resolution scenario. By developing these capabilities, AIs can enhance their resolution execution readiness.

Testing and assurance

When the development of resolution stay capabilities are mature, AIs are expected to implement testing and assurance programmes to validate the effectiveness of their overall resolution stay capabilities, including communications and intraday liquidity reporting and projection capabilities, to facilitate orderly resolution. In the course of designing the testing and assurance activities, AIs are encouraged to involve second and third lines of defence as appropriate.

Resolution planning is an ongoing process. The HKMA is committed to continuing the close engagement with relevant AIs to develop and put in place capabilities and arrangements to mitigate early termination risk in resolution. AIs and their stakeholders are encouraged to reference the observations and good implementation practices outlined in this report as appropriate.

ANNEX: GLOSSARY

Term	Definition
AI	Authorized institution
CoA	Continuity of Access
Excluded counterparty	Excluded counterparty in relation to a contract, means a counterparty to the contract that is – (a) a financial market infrastructure; (b) the Monetary Authority; (c) the Government; (d) the government of a non-Hong Kong jurisdiction; or (e) the central bank of a non-Hong Kong jurisdiction;
FI	Financial institution
FIRO	Financial Institutions (Resolution) Ordinance (Cap. 628)
FMI	Financial Market Infrastructure
FSB	Financial Stability Board
HK AI	An AI incorporated in Hong Kong
HK holding company	A Hong Kong incorporated holding company of an HK AI (that is not itself an AI)
HKMA	Hong Kong Monetary Authority
ISDA	International Swaps and Derivatives Association
ISDA Hong Kong Jurisdictional Protocol	Hong Kong Jurisdictional Module to the ISDA Resolution Stay Jurisdictional Modular Protocol
MA	Monetary Authority as resolution authority under the FIRO
NBFI	Non-bank financial institution
Out-of-scope financial contracts	Financial contracts entered into by the covered entities are not subject to the contractual recognition requirements under the Stay Rules
Pre-existing covered contract	a covered contract that is entered into by a covered entity before the initial day i.e. 27 August 2021
Related company of an HK AI	A group company of an HK AI (that is not itself an HK AI or an HK holding company)
Relevant AIs	Domestic systemically important banks and other large authorized institutions in Hong Kong with which active bilateral resolution planning programmes have been conducted
ST-1	Code of Practice chapter ST-1 "Resolution Planning – Contractual Recognition of Suspension of Termination Rights"
Stay Rules	Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights – Banking Sector) Rules (Cap. 628C)
Temporary stay	Section 90(2) of the FIRO provides for a resolution authority to suspend for up to two business days a termination right of a counterparty (other than a counterparty that is a financial market infrastructure) that becomes exercisable under a qualifying contract

Published in April 2025

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