



**Resolution Regime – Code of Practice**

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## **Purpose**

Section 196 of the Financial Institutions (Resolution) Ordinance (Cap. 628) (“FIRO”) empowers the Monetary Authority (“MA”) as resolution authority in relation to banking sector entities (“Resolution Authority”) to issue a code of practice (“Code of Practice”) about any matter relating to the functions given to the MA as a resolution authority by the FIRO.

This publication is a chapter of the Code of Practice. The purpose of this chapter is to provide guidance on how the Resolution Authority intends to exercise certain discretionary powers under, and on the operation of certain provisions in, the Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights – Banking Sector) Rules (“Stay Rules”). This chapter does not seek to provide a comprehensive overview of requirements under the Stay Rules.

Unless otherwise defined herein, terms used in this chapter have the same meaning as defined in the FIRO and the Stay Rules. Unless otherwise stated, references to rules in this chapter are to those of the Stay Rules.

## **Application**

Entities which are subject to requirements under the Stay Rules are: (a) authorized institutions (“AIs”) incorporated in Hong Kong; (b) HK holding companies; and (c) related companies of AIs incorporated in Hong Kong<sup>1</sup>. Each of these entities is a covered entity in the Stay Rules.

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<sup>1</sup> Under the Stay Rules, an HK holding company means an entity that is a holding company incorporated in Hong Kong of an AI incorporated in Hong Kong, but is not itself an AI; whereas a related company, in relation to an AI incorporated in Hong Kong, means a group company of the AI that is not itself an AI incorporated in Hong Kong or an HK holding company.



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### **1. Introduction**

- 1.1 The FIRO was enacted by the Legislative Council in June 2016<sup>2</sup>, with its main provisions coming into operation on 7 July 2017<sup>3</sup>. The FIRO establishes a cross-sectoral resolution regime for within scope financial institutions in Hong Kong and is designed to meet the international standards set by the Financial Stability Board in its “Key Attributes of Effective Resolution Regimes for Financial Institutions”<sup>4</sup>.
- 1.2 Whilst the FIRO provides the legal framework for resolution, it is only the first step in ensuring that the failure of within scope financial institutions can be managed in an orderly way. In particular, resolution planning is recognised as an essential pre-requisite to orderly resolution.
- 1.3 Resolution planning involves gathering information from the relevant AI and its group companies, setting a preferred resolution strategy, developing a resolution plan, assessing resolvability, and addressing firm-specific impediments to the effective implementation of the strategy and plan. The disorderly early termination of financial contracts is a potential impediment to orderly resolution. In this regard, section 90(2) of the FIRO provides for a resolution authority, by way of provision in a Part 5 instrument<sup>5</sup>, to suspend for up to two business days<sup>6</sup> a termination right of a counterparty (other than a counterparty that is a

<sup>2</sup> Gazetted version of the FIRO: <http://www.gld.gov.hk/egazette/pdf/20162026/es12016202623.pdf>

<sup>3</sup> Commencement notice of the FIRO: <http://www.gld.gov.hk/egazette/pdf/20172119/es22017211977.pdf>

<sup>4</sup> First issued by the Financial Stability Board in 2011 and updated in 2014. For the latest version see: [http://www.fsb.org/wp-content/uploads/r\\_141015.pdf](http://www.fsb.org/wp-content/uploads/r_141015.pdf)

<sup>5</sup> A Part 5 instrument is an instrument through which a stabilization option is applied, and is defined in section 2(1) of the FIRO as a securities transfer instrument, a property transfer instrument, or a bail-in instrument.

<sup>6</sup> Section 90(4) of the FIRO provides that a suspension begins when the Part 5 instrument providing for the suspension is first published; and ends at the end of the suspension specified in the Part 5 instrument, being no later than the expiry of the first business day following the day on which the Part 5 instrument is published.



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financial market infrastructure) that becomes exercisable under a qualifying contract (“temporary stay”).

- 1.4 For ensuring the effective implementation of section 90 of the FIRO, section 92(1) of the FIRO empowers a resolution authority to make rules that impose a requirement on a within scope financial institution or a group company of a within scope financial institution to ensure that the terms and conditions of a contract entered into by it contain a provision to the effect that the parties to the contract agree to be bound by any temporary stay which a resolution authority may impose in relation to the contract under section 90(2) of the FIRO. It is under section 92(1) of the FIRO that the Resolution Authority has made the Stay Rules, which came into operation on [date].
- 1.5 Each section of this chapter corresponds to, and provides guidance in relation to, a particular provision of the Stay Rules. The guidance in this chapter is intended to be general and does not take into account the particular circumstances of any individual covered entity. In case of any conflict between this chapter and the Stay Rules, the Stay Rules prevail. As such, covered entities must read this chapter in conjunction with the Stay Rules and not in place of them.
- 1.6 This chapter should not be regarded as, or be considered as a substitute for obtaining, independent professional advice. A covered entity should consider obtaining such advice before taking action on any matters covered by this chapter, particularly if it has any doubt as to how any aspect of the Stay Rules might apply to it.
- 1.7 The Resolution Authority will keep under review the implementation of the Stay Rules and, where necessary, consider the need to update this



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chapter as circumstances require.

### ***Compliance with the Stay Rules in the context of resolution planning and resolvability assessment***

- 1.8 The risk of early termination of financial contracts in resolution by counterparties is a potential barrier to the orderly resolution of an AI or its holding company. Consistent with the objectives of the Resolution Authority under the FIRO, which include promoting and seeking to maintain the continued performance of critical financial functions, AIs are therefore expected to assess and manage such risk, regardless of whether they are subject to the Stay Rules or their contracts are covered contracts. As part of the Resolution Authority's bilateral resolution planning programme, the Resolution Authority expects an AI to be able to demonstrate that it has assessed such risk holistically and that appropriate arrangements to mitigate such risk have been, or are being, put in place.
- 1.9 The Stay Rules are designed to mitigate the risk of early termination in resolution and form part of the resolution standards set by the Resolution Authority for AIs to achieve resolvability and enable orderly resolution. For an AI incorporated in Hong Kong or an HK holding company, its compliance with the Stay Rules is a relevant consideration in assessing its resolvability and it is therefore expected to be able to demonstrate its compliance with the Stay Rules to the Resolution Authority.
- 1.10 Compliance with the Stay Rules by a covered entity that is a related company is also relevant to the resolvability assessment of an AI incorporated in Hong Kong and/or an HK holding company within the same group of companies, to the extent that the obligations of the related



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company under its covered contracts are guaranteed or supported by the AI and/or the HK holding company. As non-compliance with the Stay Rules by the related company may have an adverse impact on the resolvability of the AI and/or the HK holding company and constitute a significant impediment to orderly resolution, the Resolution Authority expects the AI and/or the HK holding company (as applicable) to coordinate with the related company to: (a) ensure that the related company is in compliance with the Stay Rules; and (b) provide, on request, information and records to the Resolution Authority to demonstrate such compliance in a timely manner<sup>7</sup>.

- 1.11 For the avoidance of doubt, the expectation on an AI incorporated in Hong Kong as described in paragraph 1.10 does not absolve its related company of the responsibility for complying with the Stay Rules. The related company is equally expected to be able to demonstrate its compliance with the Stay Rules to the Resolution Authority.
- 1.12 A covered entity may have entered into financial contracts that are not covered contracts subject to the Stay Rules. Nevertheless, to support resolvability, the covered entity should have a clear understanding of any risk of early termination of these “out of scope” financial contracts in resolution. This understanding is important in order for the covered entity to identify whether any “out of scope” financial contract may become a covered contract in the future (as envisaged by rule 3(2)), any significant risk of early termination in relation to such contracts in resolution, and the implications for resolvability and the application of stabilization options to, as applicable, an AI incorporated in Hong Kong

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<sup>7</sup> The Resolution Authority expects to be able to obtain access to the information and records on the related company’s covered contracts and legal opinions, as well as records kept by the related company for the purpose of rule 8(b), via the AI and/or the HK holding company which guarantees or supports the obligations of the related company under its covered contracts.



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or an HK holding company. A covered entity should therefore be able to identify these financial contracts and assess the risk of early termination in resolution in a timely manner.

- 1.13 If the Resolution Authority is of the opinion that a failure to comply<sup>8</sup> with the Stay Rules (including by a related company) constitutes a significant impediment to the orderly resolution of an AI incorporated in Hong Kong (or its holding company) in accordance with a resolution plan, the Resolution Authority may direct the AI (or its holding company) to take any measures in relation to its structure (including group structure), operations (including intra-group dependencies), assets, rights or liabilities that are, in the opinion of the Resolution Authority, reasonably required to remove or mitigate the effect of the impediment<sup>9</sup>.

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<sup>8</sup> It is important to note that, in respect of each covered entity, the Resolution Authority may pursuant to section 158(1) of the FIRO require the provision or production of information, records and documents, such those demonstrating the covered entity's compliance with the Stay Rules.

<sup>9</sup> See section 14 of the FIRO.



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## 2. Obligation of a related company under a financial contract that is guaranteed or otherwise supported by an AI incorporated in Hong Kong or an HK holding company in the same group of companies (rule 2)

2.1 Rule 2 provides the following definition of covered contract in relation to a covered entity that is a related company of an AI incorporated in Hong Kong:

### ***covered contract—***

...

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

2.2 The purpose of paragraph (b)(iii) of the definition is to delineate financial contracts of a related company that have a nexus to an AI incorporated in Hong Kong or an HK holding company within the same group of companies, the early termination of which in resolution could impact the financial condition of the AI or the HK holding company. A deterioration in the financial condition of the AI or the HK holding company could potentially frustrate resolution actions taken with respect to the AI or the HK holding company, and pose significant risks to the stability and





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effective working of the financial system of Hong Kong, including to the continued performance of critical financial functions.

### ***Illustrative examples of “support”***

- 2.3 For the purpose of the definition of covered contract, “support” is that which is relevant in the context of early termination risk of financial contracts in a resolution. Given that the Stay Rules are concerned with financial contracts, the Resolution Authority generally expects that “support” would be financial in nature, though support is not confined to such in the Stay Rules.
- 2.4 The criterion of “guaranteed or otherwise supported” in the definition of covered contract in relation to a related company reflects the Resolution Authority’s policy intent to capture support that is provided in respect of an obligation of a related company under a financial contract, as opposed to general support provided to the related company on an entity level that is not relevant to the related company’s obligation under the contract. However, the “support” provided need not be exclusively for a financial contract. In other words, so long as an obligation of a related company under a financial contract is supported by an AI incorporated in Hong Kong, or an HK holding company, that is in the same group of companies as the related company, the financial contract would be a covered contract (assuming that the other criteria of a covered contract are met) regardless of whether obligations of the related company under any other contracts are also supported by the AI or the HK holding company in the same arrangement.
- 2.5 For illustration, “support” may include, but is not limited to, any of the following undertaken by an AI incorporated in Hong Kong, or an HK



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holding company, that is in the same group of companies as a related company which has the effect of supporting a contractual obligation of the related company under a financial contract:

- (a) indemnification or the making of any loan or advance;
- (b) provision of collateral; or
- (c) contractual obligation to provide any other financial assistance.

2.6 Where support is provided for less than the full term (i.e. duration) of a financial contract of a related company, subject to the other criteria of a covered contract being met, the contract should still be considered a covered contract for the period of time during which the support is provided.



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### 3. Covered contracts entered into before the initial day (rule 3)

3.1 Rule 3(1)(b) and (4) provides as follows:

(1) *A covered entity must ensure that a suspension of termination rights provision is contained in a covered contract that is—*

...

(b) *entered into by the covered entity before the initial day but—*

(i) *renewed on expiry of its term on or after that day (irrespective of whether the renewal is automatic or requires any action on the part of the covered entity or any counterparty to the contract); or*

(ii) *materially amended on or after that day (irrespective of whether the amendment is automatic or requires any action on the part of the covered entity or any counterparty to the contract).*

...

(4) *For the purposes of subrule (1)(b)(ii) but without limiting that subrule, a covered contract is materially amended if an amendment is made to the contract to create a new right or obligation of a party to the contract.*

3.2 Under the Stay Rules, a covered contract that is entered into by a covered entity before the initial day (referred to in this chapter as a “pre-existing contract”) may continue under its existing terms and conditions for its remaining term (i.e. duration) and need not contain a suspension of termination rights provision unless: (a) it is renewed on expiry of its term on or after the initial day; or (b) it is materially amended on or after



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the initial day, in each case irrespective of whether it is done automatically or requires any action on the part of the covered entity or any counterparty to the contract.

- 3.3 Such requirement is designed to prevent a covered entity from avoiding compliance with the Stay Rules by continually renewing a pre-existing contract, or by changing the commercial parameters of a pre-existing contract to enable an ongoing commercial relationship to be maintained without entering into a new contract.

***Illustrative examples in relation to material amendments***

- 3.4 What constitutes a material amendment of a pre-existing contract will vary depending on the nature of the contract and the particular facts. Whether a contract has been materially amended is expected to involve consideration not only of the amendment itself but also the nature of the right or obligation that may be affected by the amendment. For example, if an amendment appears minor on its face but has the effect of substantially changing the commercial terms and conditions of a contract, such amendment may still be considered a “material amendment”. Another consideration is the architecture of the contract, including its relationship with other contracts, documents and provisions. For example, where certain master provisions are incorporated by reference into a pre-existing contract, amendments to such master provisions may result in a material amendment of the pre-existing contract. A covered entity is therefore expected, as part of its responsibility to ensure compliance with the Stay Rules, to assess whether an amendment is material for the purposes of rule 3(1)(b)(ii) on a case-by-case basis.



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- 3.5 An amendment that creates a new right or obligation of a party to a pre-existing contract is a material amendment of the contract under rule 3(4)<sup>10</sup> and an amendment that constitutes a material alteration of an existing right or obligation of a party to a pre-existing contract would generally be considered to be material for the purposes of rule 3(1). On the contrary, changes of a minor and administrative nature are not expected to be considered material.
- 3.6 However, an amendment to a pre-existing contract for the sole purpose of, and to the extent necessary for, compliance with other regulatory requirements (such as the benchmark rate reform and margin requirements) is not typically expected to be considered a material amendment for the purposes of the Stay Rules. The Resolution Authority will keep in view the potential interface between the Stay Rules and other regulatory requirements as appropriate.
- 3.7 Although an amendment to a pre-existing contract for compliance with other regulatory requirements may not be a material amendment, a covered entity should nevertheless take the opportunity to consider adding a suspension of termination rights provision into the contract at the same time, as this would enhance: (a) the resolvability of the covered entity (where it is an AI incorporated in Hong Kong or an HK holding company); or (b) if the covered entity is a related company, the resolvability of the AI and/or the HK holding company in the same group of companies that guarantees or otherwise supports an obligation of the related company under the pre-existing contract.
- 3.8 For illustration, a non-exhaustive list of examples of amendments likely

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<sup>10</sup> For the avoidance of doubt, material amendments under the Stay Rules are not limited to those which create new rights or obligations in a pre-existing contract.



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to be considered material is provided below:

- (a) a change in the parties to the contract;
- (b) a change in the scope of the contract, such as its nature or type, or the size of transactions covered thereunder;
- (c) a change in the term (i.e. duration) of the contract (other than a renewal on expiry, which would come under rule 3(1)(b)(i));
- (d) a change in a determinant of the payout or risk profile of a transaction under the contract, such as a reference rate (but excluding any necessary amendment in light of the benchmark rate reform), underlying asset, or payment date or mechanism;
- (e) a material alteration in the rights or obligations of a party to the contract, such as provisions on events of default, termination events, or netting or set-off arrangements; or
- (f) a change in the governing law of the contract, or in the provisions related to dispute resolution.

3.9 Examples of amendments likely to be considered non-material include changes to address or payment account details, clarification of definitions, or other similar technical or administrative amendments that do not affect the commercial terms or conditions of a pre-existing contract.

3.10 An amendment to correct an error in relation to a commercial term or condition in a pre-existing contract is not likely to be considered material if the purpose of the amendment is to reflect what the parties initially agreed and which should have been set out in the contract prior to such amendment but for the error. A covered entity should be able to demonstrate with sufficient records that the amendment is a technical amendment for properly reflecting the initial agreement among the



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parties rather than an act of changing, or attempting to change, a commercial parameter of the initial agreement.



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### 4. Systems of control and record keeping (rule 8)

4.1 Rule 8 provides as follows:

*A covered entity must at all times—*

*(a) have adequate systems of control in place to ensure compliance by it with—*

*(i) rule 3(1); and*

*(ii) any conditions of an extension under rule 6 or of an exemption under rule 7; and*

*(b) keep sufficient records to demonstrate compliance by it with—*

*(i) rule 3(1);*

*(ii) any conditions of an extension under rule 6 or of an exemption under rule 7; and*

*(iii) paragraph (a).*

4.2 A covered entity is required to have adequate systems of control to ensure, and is required to keep sufficient records to demonstrate, its compliance with the requirement under rule 3(1), and any conditions of an extension or an exemption granted by the Resolution Authority under the Stay Rules. Sufficient records must also be kept to demonstrate its compliance with the aforesaid requirement of having adequate systems of control. These requirements apply to a covered entity at all times, i.e. not limited to in business-as-usual (“BAU”) but also in crisis situations, including the lead up to and during resolution.

#### **Systems of control**

4.3 As part of its capabilities for compliance, and for demonstrating continued compliance with the requirement under rule 3(1) and any





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conditions of an extension or an exemption granted by the Resolution Authority under the Stay Rules, a covered entity should establish and maintain adequate systems of control which enable it to readily identify, gather, aggregate, and report in a timely manner key information about its financial contracts and compliance with any conditions relating to an extension or an exemption.

4.4 A covered entity's systems of control pertinent to ensuring its compliance with requirements under the Stay Rules should be commensurate with the nature, scale and complexity of the covered entity's business activities, especially those relating to covered contracts entered into by the entity. Generally, the systems are expected:

- (a) to be capable of capturing, aggregating and reporting in a timely manner key information of the entity's financial contracts on a range of bases, such as those listed in paragraph 4.9, as well as producing other records for complying with requirement under rule 8(b); and
- (b) to be adequate and operate effectively to ensure 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, not only in BAU but also in crisis situations, including the lead up to and during resolution.

4.5 Governance and assurance processes are critical to ensuring a covered entity's systems of control are adequate. There should be proper oversight and regular review of the systems to ensure integrity and reliability of the information. A covered entity should be able to explain to the Resolution Authority how its governance and assurance processes



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ensure that it complies with the requirement under rule 3(1), as well as any conditions of an extension or an exemption granted by the Resolution Authority under the Stay Rules. For the effective implementation of the Stay Rules, an AI incorporated in Hong Kong is expected to assign an officer of appropriate seniority with accountability for overseeing, as well as ensuring that the board of directors of the AI is kept adequately informed of, the effective implementation of and compliance with the Stay Rules.

- 4.6 More broadly, an AI incorporated in Hong Kong is expected to ensure that its governance and assurance processes enable the ongoing effectiveness of its implementation of the Stay Rules and are embedded into its overarching governance and organisational arrangements in place to support the HKMA’s resolution planning process pursuant to the Code of Practice chapter RA-2, “The HKMA’s Approach to Resolution Planning”<sup>11</sup>. To this end, the relevant processes and arrangements should also support effective, forward-looking decision making and timely action by senior management, the board of directors or relevant authorities in the lead up to and during resolution.

### ***Record keeping***

- 4.7 A covered entity should keep sufficient records to demonstrate that it has in place adequate systems of control as required under rule 8(a). Examples of records that should be kept include an inventory and description of the relevant management information systems used by the covered entity; a description and operational documentation of the governance and assurance processes as well as the oversight and

<sup>11</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)



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review arrangements; and evidence of and findings from ongoing testing and regular review, lessons learned and remedial actions taken.

- 4.8 In addition to the records expected to be kept to demonstrate compliance with the requirement to maintain adequate systems of control as explained in paragraph 4.7, a covered entity should maintain on an ongoing basis sufficient records to demonstrate compliance with the requirement under rule 3(1) and any conditions of an extension or an exemption granted by the Resolution Authority under the Stay Rules. This should include sufficient records to establish that the covered entity has identified all covered contracts for the purpose of complying with rule 3(1), such as information which explains why other financial contracts are not considered covered contracts and, in the case of an amendment to a pre-existing contract, why the amendment is not considered material.
- 4.9 By way of example, records that a covered entity is expected to keep include (as applicable):
- (a) position-level data with respect to each covered contract to which it is a party, e.g. notional amount, mark-to-market value, valuation type or method, trade date, maturity date, payment date, delivery date, and value of collateralisation;
  - (b) counterparty-level data with respect to each covered contract to which it is a party, e.g. Legal Entity Identifier, legal name, and jurisdiction of incorporation of counterparty(ies);
  - (c) agreement-level information with respect to each covered contract to which it is a party, e.g. contract type, governing law, and date of entering into legal agreements;



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- (d) documents that govern transactions under a covered contract between the covered entity and its counterparties to the contract, including master agreements, master confirmation agreements, and annexes, schedules, netting agreements, supplements or other modifications with respect to the agreements, confirmation or acknowledgement for each covered contract transaction, credit support documents, and any assignment or novation documents;
- (e) information related to termination rights with respect to each covered contract to which it is a party, e.g. parties with a termination right, and conditions under which a termination right becomes exercisable; and
- (f) information related to suspension of termination rights provision with respect to each covered contract to which it is a party, including presence or otherwise of a suspension of termination rights provision, and documents that evidence the agreement of parties to the contract to be bound by a temporary stay imposed by the Resolution Authority under section 90(2) of the FIRO, including legal opinions.

4.10 For a covered entity that is a related company of an AI incorporated in Hong Kong, records to be kept should also extend to information on guarantees or other support provided by an AI incorporated in Hong Kong or an HK holding company in respect of obligations of the related company under its covered contracts (such as type, duration and identity of the provider of guarantee or support, and documents that govern the provision of guarantee or support). In this regard, capabilities to track and identify financial contracts which are guaranteed or otherwise



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supported by an AI incorporated in Hong Kong and/or an HK holding company, as backed by adequate systems of control and sufficient records, are fundamental for determining the scope of contracts subject to the requirement under rule 3(1).

- 4.11 Paragraphs 4.7 to 4.10 provide examples of records and information that should be maintained by a covered entity to demonstrate compliance with the requirements under the Stay Rules. In performing his functions under the FIRO such as conducting resolution planning and resolvability assessment, the Resolution Authority may however require additional information from a covered entity as appropriate.
- 4.12 The Stay Rules do not require a covered entity to make regular reports to the Resolution Authority of the records it is required to keep. However, the Resolution Authority does expect a covered entity to be able to provide such records and be able to demonstrate compliance with the Stay Rules when requested to do so, and within the timeframe specified by the Resolution Authority. The Resolution Authority may also require a covered entity to provide the information in a prescribed template or format as the Resolution Authority considers appropriate. In this regard, it would be open to the Resolution Authority to exercise his power under section 158(1) of the FIRO to require the provision or production of information, records and documents from a within scope financial institution and its group companies, which would include all covered entities under the Stay Rules. A failure, without reasonable excuse, to comply with a requirement under section 158(1) of the FIRO is an offence pursuant to section 159 of the FIRO.
- 4.13 It should be noted that under paragraph 2 of the Eighth Schedule to the Banking Ordinance (Cap. 155) (“BO”), the failure of an AI to meet the



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criterion set out in paragraph 10 of the Seventh Schedule to the BO, that is, to have adequate systems of control, is a ground on which the MA may revoke the AI's authorization. Under the Guideline on Minimum Criteria for Authorization issued by the MA, which sets out the manner in which the MA will interpret the licensing criteria set out in the Seventh Schedule to the BO, the MA expects that an AI will put in place and maintain adequate management information systems and adequate systems of control with a view to providing the MA with timely information as required for resolution planning as well as managing an orderly failure of the AI<sup>12</sup>. Depending on the circumstances, an AI's failure to meet the requirement under the Stay Rules to have adequate systems of control might call into question whether the AI is continuing to fulfil the authorization criterion under the BO to have adequate systems of control.

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<sup>12</sup> See paragraph 85 of the Guideline on Minimum Criteria for Authorization, which can be accessed here: <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/guideline/g15.pdf>



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**5. Legal opinion (rule 9)**

5.1 Rule 9 provides as follows:

*The resolution authority may require a covered entity to provide to the resolution authority an opinion acceptable to the resolution authority from counsel or a solicitor that a suspension of termination rights provision contained in a covered contract in compliance with rule 3(1) is legally enforceable.*

5.2 A covered entity is required to ensure the legal enforceability of a suspension of termination rights provision that is contained in a covered contract for complying with the requirement under rule 3(1) and, for that purpose, should undertake an assessment which may be supported by a legal opinion as appropriate.

5.3 In performing his functions under the FIRO such as undertaking resolution planning and resolvability assessment, the Resolution Authority may require a covered entity to provide a written legal opinion in respect of a covered contract. The Resolution Authority would generally expect a legal opinion to cover at least the following matters under all applicable laws (taking into account applicable conflicts of laws principles) for it to be considered acceptable:

- (a) the compliance of the proposed suspension of termination rights provision with the definition of suspension of termination rights provision in rule 2;
- (b) the absence of conflict between the suspension of termination rights provision and (i) the constitutional documents of any party to the covered contract and (ii) applicable laws; and



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(c) the suspension of termination rights provision being legal, valid, binding and enforceable in accordance with its terms before the courts in the parties' chosen jurisdiction.

5.4 Where applicable, the legal opinion should also address matters in relation to the mechanism by which the suspension of termination rights provision is incorporated into a pre-existing contract<sup>13</sup>, including the due capacity and authority of the parties to enter into the mechanism and the matters referred to in paragraph 5.3(b) and (c) above in respect of the mechanism.

5.5 In considering whether the legal opinion is acceptable, the Resolution Authority will also consider whether it has been issued by a person who is duly qualified to advise on the matters therein and whether the legal opinion is sufficiently independent (an external opinion is preferable). Where relevant, opinions obtained on an industry-wide basis by industry associations may be acceptable, subject to the matters set out in paragraphs 5.3 and (as applicable) 5.4 being addressed.

5.6 The Resolution Authority will consider adopting a flexible approach to the scope of a legal opinion where appropriate in the particular circumstances. This may include the situation where the Resolution Authority considers it sufficient on the particular facts for the opinion sought to be confined to confirming that a legal opinion previously issued in respect of one covered contract applies equally to another covered contract.

5.7 The Resolution Authority does not intend to require the submission of

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<sup>13</sup> The suspension of termination rights provision may, for example, be incorporated by way of an amendment agreement or through adherence to an industry protocol.





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legal opinions as a matter of course or to routinely check that a covered entity has conducted due diligence with respect to the legal enforceability of a suspension of termination rights provision contained in a covered contract. However, the Resolution Authority expects a covered entity to conduct its own assessment on the legal enforceability of a suspension of termination rights provision and satisfy itself that it is in compliance with the requirement under rule 3(1) with respect to a covered contract. In this regard, the covered entity is expected to be able to demonstrate its compliance, including through the provision of a relevant legal opinion, upon request by the Resolution Authority. If a legal opinion is yet to be obtained, the covered entity may be required to procure and provide it to the Resolution Authority.



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### 6. Financial contracts (rule 2 and Schedule)

6.1 Rule 2 provides the following definition of financial contract:

***financial contract** means a contract listed in Part 2 of the Schedule or any combination of such contracts, other than a contract or combination of contracts for short-term inter-bank borrowing with an original maturity of 3 months or less;*

6.2 Part 2 of the Schedule to the Stay Rules provides as follows:

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



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*index, rate or thing of any kind designated in the instrument and includes forwards contracts, futures contracts, options contracts and swap agreements.*

- 4. Contracts for the purchase, sale or delivery of Hong Kong currency or any other currency.*
- 5. Contracts of a similar nature to a contract listed in item 1, 2, 3 or 4.*
- 6. Master or other agreements in so far as they relate to a contract listed in item 1, 2, 3, 4 or 5.*

6.3 The financial contracts listed in the Schedule to the Stay Rules reflect the Resolution Authority's policy intention to adopt a broad approach to the scoping of financial contracts under the Stay Rules. These financial contracts, irrespective of the mode of settlement (e.g. cash or physical settlement) or trading venue (e.g. exchange or over-the-counter), will be within the scope of the Stay Rules if they meet the other criteria of a covered contract under rule 2.

6.4 A contract of a similar nature to a contract for securities, commodities, derivatives or currency is a financial contract under the Stay Rules. The policy intention is not to broaden the scope of the application of the Stay Rules but to prevent their circumvention and anticipate future market developments in financial contracts, such that the scope of financial contracts under the Stay Rules remains relevant as the types of financial contracts continue to evolve over time.

6.5 A master or other agreement which relates to any of the four broad classes of financial contracts (or those of a similar nature to these contracts), is a financial contract under the Stay Rules regardless of whether the agreement relates to a specific contract, or a combination of contracts, listed in the Schedule to the Stay Rules; and regardless of



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whether the agreement relates to a contract listed in the Schedule as well as another contract outside the scope of the Stay Rules (e.g. a contract for short-term inter-bank borrowing with an original maturity of 3 months or less, or a contract providing for operational services). As long as the agreement relates to one or more financial contracts, a covered entity is expected to assess whether the agreement meets the other criteria under the definition of covered contract to determine the need to comply with the requirement under rule 3(1).

- 6.6 For a master or other agreement relating to a pre-existing contract which falls within the four broad classes of financial contracts (or those of a similar nature to these contracts) and which is renewed or materially amended on or after the initial day, whether or not a suspension of termination rights provision should be included in the pre-existing contract only, or in the master or other agreement relating to the contract, or both, should be considered in the context of the architecture of the contract and the requirement that the suspension of termination rights provision be legally enforceable.