

LEGISLATIVE COUNCIL BRIEF

Financial Institutions (Resolution) Ordinance (Chapter 628)

FINANCIAL INSTITUTIONS (RESOLUTION) (CONTRACTUAL RECOGNITION OF SUSPENSION OF TERMINATION RIGHTS – BANKING SECTOR) RULES

INTRODUCTION

Pursuant to section 92 of the Financial Institutions (Resolution) Ordinance (Cap. 628) (“FIRO”), the Monetary Authority (“MA”) has made the Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights – Banking Sector) Rules (“the Rules”), at **Annex**, to require that entities subject to the Rules must ensure that certain contracts contain a provision to the effect that the parties will be bound by any suspension of termination rights in relation to those contracts imposed by the MA as a resolution authority under section 90(2) of the FIRO.

BACKGROUND

2. The FIRO, which came into force on 7 July 2017, establishes a cross-sectoral resolution regime for within scope financial institutions (“within scope FIs”)¹ and is designed to meet the international standards set by the Financial Stability Board (“FSB”)² in its “Key Attributes of Effective Resolution Regimes for Financial Institutions” (“Key

¹ Within scope FIs include all Authorized Institutions (“AIs”), certain licensed corporations, certain authorized insurers, certain settlement institutions and system operators of designated clearing and settlement systems, and recognized clearing houses. The scope of the FIRO also extends to holding companies and affiliated operational entities of within scope FIs.

² The FSB is an international body established by the G20 in 2009 in the aftermath of the global financial crisis. It monitors and makes recommendations about the global financial system and promotes international financial stability by coordinating national financial authorities and international standard-setting bodies as they work toward developing regulatory, supervisory and other financial sector policies.

Attributes”³. Under the FIRO, the MA, the Insurance Authority and the Securities and Futures Commission are the resolution authorities for those within scope FIs operating under their respective purviews. The FIRO provides resolution authorities with various powers, which include the powers to apply stabilization options by making one or more Part 5 instruments⁴ to resolve a non-viable within scope FI the non-viability of which poses risks to the stability and effective working of the financial system of Hong Kong, including to the continued performance of critical financial functions.

JUSTIFICATIONS

3. In a resolution where one or more stabilization options are applied by a resolution authority to a non-viable within scope FI, it is important that the contractual counterparties to the FI cannot terminate and close out their positions solely as a result of the FI’s entry into resolution. Disorderly termination of contracts on a mass scale could frustrate resolution actions taken with respect to a non-viable within scope FI, thus causing significant contagion effects to the financial markets and posing wider risks to the stability and effective working of the financial system. Should a termination right of a counterparty to a qualifying contract⁵ become exercisable, section 90(2) of the FIRO empowers a resolution authority to temporarily suspend, for up to two business days, the termination right of a counterparty (other than a counterparty that is a financial market infrastructure⁶) to a qualifying contract, by way of provision in a Part 5 instrument.

³ Key Attributes of Effective Resolution Regimes for Financial Institutions, first issued in 2011 and updated in 2014.

⁴ A Part 5 instrument means a securities transfer instrument, a property transfer instrument or a bail-in instrument.

⁵ A qualifying contract is a contract entered into by a within scope FI or a group company of a within scope FI (each a “qualifying entity” under the FIRO) under which the obligations for payment and delivery and for provision of collateral continue to be performed.

⁶ A financial market infrastructure is a multilateral system among participating financial institutions used for clearing, settling or recording payments, securities, derivatives or other financial transactions and includes any payment system, central securities depository, securities settlement system, central counterparty and trade repository.

4. Notwithstanding the above, where the relevant contracts are governed by non-Hong Kong law, there are uncertainties as to whether a court in a non-Hong Kong jurisdiction would give effect to a suspension of termination rights imposed by a resolution authority under section 90(2) of the FIRO unless the law of such jurisdiction expressly recognizes the resolution authority's action. Further, 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 fashion in order to best achieve the resolution objectives in Hong Kong. To address the issue of ensuring cross-border effectiveness of a suspension of termination rights imposed under local rules or laws with respect to contracts governed by laws of other jurisdictions, the FSB has set out certain principles in its "Principles for Cross-border Effectiveness of Resolution Actions" ("FSB Principles")⁷. The FSB Principles support, amongst others, contractual approaches to giving effect to cross-border resolution actions, which complement and support statutory frameworks.

5. Section 92 of the FIRO provides that a resolution authority may make rules to require that the terms and conditions of a contract entered into by a qualifying entity contain a provision to the effect that the parties to the contract agree to be bound by any suspension of termination rights in relation to the contract imposed under section 90(2) of the FIRO.

THE RULES

6. The Rules are made by the MA under section 92 of the FIRO, in his capacity as the resolution authority for banking sector entities⁸ under the FIRO. In developing the legislative proposals for the Rules, the MA has taken into account relevant international standards (in particular the FSB Principles) and approaches taken in other jurisdictions on similar requirements. The Rules adopt the contractual approach, as supported by the FSB, to recognize a suspension of termination rights under section 90(2) of the FIRO.

⁷ Principles for Cross-border Effectiveness of Resolution Actions, November 2015.

⁸ Banking sector entities include all AIs, and certain settlement institutions and system operators.

7. The main provisions of the Rules are as follows –
- (a) Part 1 provides for the commencement of the Rules and sets out definitions of terms used in the Rules (rules 1 and 2). The most important terms are –
 - (i) covered entity: an authorized institution incorporated in Hong Kong (“HKAI”), an HK holding company (being a holding company incorporated in Hong Kong of an HKAI) or a related company of an HKAI;
 - (ii) covered contract: a financial contract that is governed by non-Hong Kong law and contains a termination right exercisable by a counterparty other than an excluded counterparty⁹. However, for a covered entity that is a related company of an HKAI, a contract is only a covered contract if it also contains an obligation of the covered entity that is guaranteed or otherwise supported by an HKAI, or an HK holding company, that is a group company of the covered entity; and
 - (iii) suspension of termination rights provision: a term or condition (made, or evidenced, in writing) of a covered contract to the effect that the parties agree in a legally enforceable manner that the parties (other than an excluded counterparty) will be bound by a suspension of a termination right in relation to the contract imposed by the MA under section 90(2) of the FIRO.
 - (b) Part 2 deals with the requirement for covered contracts to contain a suspension of termination rights provision and it includes the following –
 - (i) provisions that require a covered entity to ensure that covered contracts entered into by it contain a suspension of termination rights provision when the

⁹ Under the Stay Rules, an excluded counterparty means, in relation to a contract, a counterparty that is a financial market infrastructure; the MA; the Government; or the central bank or government of a non-Hong Kong jurisdiction.

covered contract is entered into (or, as regards covered contracts entered into before the Rules come into operation, when the covered contract is renewed or materially amended, as the case requires) and to continue to so comply throughout the term or remaining term of the contract (rules 3 and 4);

- (ii) a provision that provides for an initial period for compliance. For a covered contract entered into by a covered entity during the initial period, where there are no counterparties other than an authorized institution, or a financial institution (other than an authorized institution) that is a global systemically important bank on the initial day, the initial period by the end of which the covered entity must comply with the requirement for a suspension of termination rights provision will be 24 months. For any other covered contracts, the initial period will be 30 months (rule 5); and
 - (iii) provisions that empower the MA to extend the initial period for a covered contract or a class of covered contract (rule 6) and to exempt a covered entity from compliance with the requirement for covered contracts to contain a suspension of termination rights provision for a covered contract or a class of covered contract (rule 7).
- (c) Part 3 sets out provisions relating to compliance requirement and enforcement of the Rules. It includes the following –
- (i) a provision that requires a covered entity to have adequate systems of control in place to ensure compliance with the requirement for covered contracts to contain a suspension of termination rights provision and for covered entities to keep sufficient records to demonstrate compliance (rule 8);
 - (ii) a provision that empowers the MA to require a covered

entity to provide a legal opinion that a suspension of termination rights provision contained in a covered contract is legally enforceable (rule 9);

(iii) a provision that requires a covered entity to notify the MA if it fails to comply with the requirement for covered contracts to contain a suspension of termination rights provision (rule 10); and

(iv) a provision that empowers the MA to require a covered entity that fails to comply with the requirement for covered contracts to contain a suspension of termination rights provision to propose and implement a plan to rectify the failure. A failure without reasonable excuse to comply with the MA's requirement to propose or implement a rectification plan is an offence. A covered entity which commits an offence is liable on conviction to a fine at level 2. An officer who authorizes, permits or is knowingly concerned in any way (whether by act or omission) in the commission of the offence by the covered entity commits an offence and is liable on conviction to a fine at level 2 and to imprisonment for 6 months (rule 11).

(d) the Schedule lists the types of contracts that are financial contracts for the purposes of the Rules.

LEGISLATIVE TIMETABLE

8. The Rules will be published in the Gazette on 25 June 2021 and tabled at the Legislative Council ("LegCo") at its sitting on 30 June 2021. Subject to the negative vetting by LegCo, the Rules will come into operation on 27 August 2021.

IMPLICATIONS OF THE RULES

9. The Rules are in conformity with the Basic Law, including the

provisions concerning human rights, and will not affect the current binding effect of the existing provisions of the FIRO. The Rules have no financial or civil service implications to the Government, and no environmental, productivity, family and gender implications. The Rules have no sustainability implications other than economic implications set out in paragraph 10 below.

10. On economic implications, the Rules are designed to facilitate the operationalization of the resolution regime in Hong Kong that is consistent with the international standards set out in the FSB’s Key Attributes and FSB Principles by reducing the risk of disorderly termination of contracts in resolution on a mass scale, thereby strengthening the resilience and stability of our financial system.

PUBLIC CONSULTATION

11. The Hong Kong Monetary Authority (“HKMA”) conducted a public consultation from January to March 2020 on the policy proposals for the Rules. A range of stakeholders were engaged during the consultation period and 14 submissions were received from industry associations, professional associations, banks and others. Respondents indicated broad support for the proposed approach to the Rules whilst providing comments or seeking clarifications in relation to some technical aspects of the proposals. The consultation conclusion, released on 31 December 2020, explained appropriate refinements to the proposals as reflected in the legislative proposals set out in this paper. The HKMA conducted an industry consultation on the draft text of the Rules from December 2020 to January 2021. Respondents provided technical comments on the draft text of the Rules and indicated areas where further guidance is required from the MA. The HKMA would provide further implementation details in a Code of Practice to be issued in the future.

12. We briefed the LegCo Panel on Financial Affairs on the Rules at its meeting on 1 March 2021. Members indicated general support for the Rules.

PUBLICITY

13. We will issue a press release upon the gazettal of the Rules. A government spokesperson will be available to answer enquiries.

ENQUIRIES

14. Enquiries relating to this brief can be addressed to Ms Candy LAU, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) at 2810 2150, or Ms Olivia CHENG, Senior Manager (Resolution Office) (Policy) of the HKMA, at 2878 1266.

**Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
June 2021**

Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights—Banking Sector) Rules

Contents

Rule	Page
Part 1	
Preliminary	
1. Commencement	1
2. Interpretation.....	1
Part 2	
Requirement for Covered Contracts to Contain Suspension of Termination Rights Provision	
3. Requirement on covered entity for covered contracts to contain suspension of termination rights provision.....	5
4. When covered entity must comply.....	7
5. Initial period for compliance.....	7
6. Resolution authority may extend initial period	8
7. Resolution authority may exempt covered entity from requirements.....	9

Rule	Page
Part 3	
Compliance and Enforcement	
8. Systems of control and record keeping	12
9. Resolution authority may require covered entity to provide legal opinion.....	12
10. Requirement to notify resolution authority of failure to comply.....	13
11. Rectification plans.....	13
Schedule Financial Contracts	16

Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights—Banking Sector) Rules

(Made by the Monetary Authority under section 92 of the Financial Institutions (Resolution) Ordinance (Cap. 628))

Part 1

Preliminary

1. Commencement

These Rules come into operation on 27 August 2021.

2. Interpretation

In these Rules—

covered contract (受涵蓋合約)—

- (a) in relation to a covered entity that is an authorized institution incorporated in Hong Kong or an HK holding company, 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; or
- (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;

covered entity (受涵蓋實體) means—

- (a) an authorized institution incorporated in Hong Kong;
- (b) an HK holding company; or
- (c) a related company of an authorized institution incorporated in Hong Kong;

excluded counterparty (獲豁免對手方), 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;

financial contract (金融合約) 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;

group company (集團公司), in relation to a covered entity, means a body corporate that is a member of the same group of companies as the covered entity;

HK holding company (香港控權公司) means an entity that is a holding company incorporated in Hong Kong of an authorized

institution incorporated in Hong Kong, but is not itself an authorized institution;

initial day (起始日), in relation to a covered entity, or a covered contract entered into by it, means—

- (a) the day on which these Rules come into operation; or
- (b) if it is not a covered entity on that day—the later day on which it becomes a covered entity;

initial period (起始期間), in relation to a covered contract, means the period set out in rule 5(3);

related company (關連公司), in relation to an authorized institution incorporated in Hong Kong, means a group company of the authorized institution that is not itself an authorized institution incorporated in Hong Kong or an HK holding company;

resolution authority (處置機制當局) means the resolution authority in relation to a banking sector entity;

Note—

Under section 2(1) of the Ordinance, the resolution authority in relation to a banking sector entity is the Monetary Authority.

suspension of termination rights provision (暫停終止權條文) means a term or condition (made, or evidenced, in writing) of a covered contract to the effect that the parties to the contract agree in a legally enforceable manner that, despite any other term or condition of the contract or any other agreement, arrangement or understanding, the parties (other than an excluded counterparty) will be bound by a suspension of a termination right in relation to the contract imposed by the resolution authority under section 90(2) of the Ordinance;

termination right (終止權), in relation to a covered contract, means—

- (a) a right to terminate the contract;

- (b) a right to accelerate, close out, set off or net obligations, or any similar right that suspends, modifies or extinguishes an obligation of a party to the contract; or
- (c) a right to prevent an obligation from arising under the contract.

Part 2

Requirement for Covered Contracts to Contain Suspension of Termination Rights Provision

3. Requirement on covered entity for covered contracts to contain suspension of termination rights provision

- (1) A covered entity must ensure that a suspension of termination rights provision is contained in a covered contract that is—
 - (a) entered into by the covered entity on or after the initial day; or
 - (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).
- (2) Subject to subrule (3), if a contract is not a covered contract when it is entered into but becomes a covered contract at a time on or after the initial day (*relevant time*), the contract is taken for the purposes of this rule to be a covered contract entered into when it becomes a covered contract.
- (3) Subrule (2) does not apply—
 - (a) if—

- (i) the contract becomes a covered contract falling within paragraph (a) of the definition of *covered contract* in rule 2, because a party to the contract becomes an authorized institution incorporated in Hong Kong or an HK holding company; and
 - (ii) immediately before the relevant time, the contract would have been a covered contract falling within paragraph (a) of that definition, but for the party not being an authorized institution incorporated in Hong Kong or an HK holding company; or
- (b) if—
- (i) the contract becomes a covered contract falling within paragraph (b) of that definition, because—
 - (A) the entity (*Entity A*) that guarantees or otherwise supports an obligation of a party to the contract (*Entity B*) becomes an authorized institution incorporated in Hong Kong, or an HK holding company, that is a group company of Entity B; or
 - (B) in the case that Entity A is, immediately before the relevant time, an authorized institution incorporated in Hong Kong or an HK holding company—Entity B becomes a related company of Entity A, or becomes a related company of an authorized institution incorporated in Hong Kong that is a group company of Entity A; and
 - (ii) immediately before the relevant time, the contract would have been a covered contract falling within paragraph (b) of that definition, but for the absence of the circumstance mentioned in subparagraph (i).

- (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.
- (5) A failure of a covered entity to comply with subrule (1) in relation to a covered contract does not affect any power of the resolution authority under section 90(2) of the Ordinance to suspend a termination right under the contract.

4. When covered entity must comply

Subject to rule 5, a covered entity must—

- (a) comply with rule 3(1) in relation to a covered contract when the contract is entered into, renewed or materially amended (as the case requires); and
- (b) continue to comply with that rule throughout the term or remaining term of the contract (as the case requires), including the term or remaining term of the contract as renewed or materially amended.

5. Initial period for compliance

- (1) This rule applies if, in the following period, a covered entity enters into a covered contract, or a covered contract entered into by a covered entity is renewed or materially amended—
 - (a) the initial period for the contract; or
 - (b) if the initial period is extended under rule 6(1)—subject to any variation under rule 6(2) or any condition imposed under rule 6(3), the initial period so extended.
- (2) The covered entity must—
 - (a) comply with rule 3(1) in relation to the covered contract by the end of the period specified in subrule (1); and

- (b) continue to comply with that rule throughout the term or remaining term of the contract (as the case requires), including the term or remaining term of the contract as renewed or materially amended.
- (3) The initial period for a covered contract is—
 - (a) the period of 24 months beginning on the initial day, for a contract where there are no counterparties other than—
 - (i) an authorized institution; or
 - (ii) a financial institution (other than an authorized institution) that is a global systemically important bank on the initial day; or
 - (b) the period of 30 months beginning on the initial day, for any other contract.
- (4) Any excluded counterparties to a covered contract are to be ignored for the purposes of subrule (3)(a).

6. Resolution authority may extend initial period

- (1) The resolution authority may, by written notice served on a covered entity, extend the initial period for a covered contract or a class of covered contract, if satisfied that it is prudent to do so.
- (2) The resolution authority may, by written notice served on a covered entity, vary or revoke an extension under subrule (1), if satisfied that it is prudent to do so.
- (3) The resolution authority may do the following, if satisfied that it is prudent to do so—
 - (a) in a notice under subrule (1) or (2), impose conditions on an extension;

- (b) by written notice served on a covered entity, vary or revoke any conditions of, or impose further conditions on, an extension.
- (4) In determining whether it is prudent to extend the initial period, vary or revoke an extension, impose a condition on an extension or vary or revoke a condition of an extension, the resolution authority may take into account—
 - (a) any strategies devised by the resolution authority under section 13(1)(a) or (2)(a) of the Ordinance for securing an orderly resolution of—
 - (i) if the covered entity is an authorized institution incorporated in Hong Kong—the covered entity or an HK holding company of the covered entity;
 - (ii) if the covered entity is an HK holding company—the covered entity or an authorized institution incorporated in Hong Kong that is a subsidiary of the covered entity; or
 - (iii) if the covered entity is a related company of an authorized institution incorporated in Hong Kong—an authorized institution incorporated in Hong Kong, or an HK holding company, that is a group company of the covered entity; and
 - (b) any other matters the resolution authority considers relevant.

7. Resolution authority may exempt covered entity from requirements

- (1) The resolution authority may, by written notice served on a covered entity, exempt the covered entity from compliance with rule 3(1) for a covered contract or a class of covered contract, if satisfied that it is prudent to do so.

- (2) The resolution authority may, by written notice served on a covered entity, vary or revoke an exemption under subrule (1), if satisfied that it is prudent to do so.
- (3) The resolution authority may do the following, if satisfied that it is prudent to do so—
 - (a) in a notice under subrule (1) or (2), impose conditions on an exemption;
 - (b) by written notice served on a covered entity, vary or revoke any conditions of, or impose further conditions on, an exemption.
- (4) In determining whether it is prudent to exempt a covered entity, vary or revoke an exemption, impose a condition on an exemption or vary or revoke a condition of an exemption, the resolution authority may take into account—
 - (a) any strategies devised by the resolution authority under section 13(1)(a) or (2)(a) of the Ordinance for securing an orderly resolution of—
 - (i) if the covered entity is an authorized institution incorporated in Hong Kong—the covered entity or an HK holding company of the covered entity;
 - (ii) if the covered entity is an HK holding company—the covered entity or an authorized institution incorporated in Hong Kong that is a subsidiary of the covered entity; or
 - (iii) if the covered entity is a related company of an authorized institution incorporated in Hong Kong—an authorized institution incorporated in Hong Kong, or an HK holding company, that is a group company of the covered entity;

- (b) any risks to the stability and effective working of the financial system of Hong Kong, including to the continued performance of critical financial functions, that may be posed by the non-viability of—
 - (i) if the covered entity is an authorized institution incorporated in Hong Kong—the covered entity;
 - (ii) if the covered entity is an HK holding company—an authorized institution incorporated in Hong Kong that is a subsidiary of the covered entity; or
 - (iii) if the covered entity is a related company of an authorized institution incorporated in Hong Kong—an authorized institution incorporated in Hong Kong that is a group company of the covered entity; and
 - (c) any other matters the resolution authority considers relevant.
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Part 3

Compliance and Enforcement

8. Systems of control and record keeping

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).

Note—

Under section 158 of the Ordinance, the resolution authority may require a controlled entity or a third party entity to provide information or produce records or documents that the resolution authority reasonably requires in connection with the performance of its functions under the Ordinance. Section 159 of the Ordinance provides for related offences. A covered entity is a controlled entity within the meaning of those sections (see sections 2(1) and 154 of the Ordinance).

9. Resolution authority may require covered entity to provide legal opinion

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.

10. Requirement to notify resolution authority of failure to comply

If, in relation to a covered contract, a covered entity fails to comply with rule 3(1) in accordance with rule 4 or 5(2) (as the case requires), the covered entity must—

- (a) as soon as practicable notify the resolution authority in writing; and
- (b) provide particulars to the resolution authority on request.

11. Rectification plans

(1) If, in relation to a covered contract, a covered entity fails to comply with rule 3(1) in accordance with rule 4 or 5(2) (as the case requires), the resolution authority may, by written notice served on the covered entity, require the covered entity to—

- (a) propose, within the period specified in the notice, a plan acceptable to the resolution authority to rectify the failure; and
 - (b) implement the plan.
- (2) The covered entity must specify in a plan proposed in response to a notice served on it under subrule (1) a period within which it proposes to rectify the failure.
- (3) The resolution authority may, by written notice served on the covered entity, extend the period for the covered entity to rectify the failure, if satisfied that it is prudent to do so.
- (4) The service of a notice on a covered entity under subrule (1) or (3), does not affect any power of the resolution authority under section 14 of the Ordinance in relation to—

- (a) if the covered entity is an authorized institution incorporated in Hong Kong—the covered entity or an HK holding company of the covered entity;
 - (b) if the covered entity is an HK holding company—the covered entity or an authorized institution incorporated in Hong Kong that is a subsidiary of the covered entity; or
 - (c) if the covered entity is a related company of an authorized institution incorporated in Hong Kong—an authorized institution incorporated in Hong Kong, or an HK holding company, that is a group company of the covered entity.
- (5) A covered entity commits an offence and is liable on conviction to a fine at level 2 if the covered entity, without reasonable excuse, fails to—
- (a) propose a plan in compliance with a requirement imposed on the covered entity under subrule (1)(a); or
 - (b) implement a plan proposed in compliance with that requirement within the period specified in the plan or, if the period is extended under subrule (3), within the period so extended.
- (6) If a covered entity commits an offence under subrule (5), an officer of the covered entity also commits an offence under that subrule if the officer—
- (a) authorized or permitted the commission of the offence by the covered entity; or
 - (b) was knowingly concerned in any way (whether by act or omission) in the commission of the offence by the covered entity.
- (7) An officer who commits an offence under subrule (5) is liable on conviction to a fine at level 2 and to imprisonment for 6 months.

- (8) An officer of a covered entity may commit an offence under subrule (5) whether or not the covered entity has been prosecuted for, or found guilty of, an offence under that subrule.
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Schedule

[r. 2]

Financial Contracts

Part 1

Interpretation

1. Interpretation

In this Schedule—

financial accommodation (財務通融) has the meaning given by section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571);

transferable securities (可轉讓證券) has the meaning given by section 2(1) of the Financial Institutions (Resolution) (Protected Arrangements) Regulation (Cap. 628 sub. leg. A).

Part 2

Financial Contracts

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, 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.

Monetary Authority

2021

Explanatory Note

A resolution authority may suspend termination rights in relation to certain contracts under section 90(2) of the Financial Institutions (Resolution) Ordinance (Cap. 628) (*Ordinance*). The main objective of these Rules is to require authorized institutions incorporated in Hong Kong (*HKAI*s) and certain holding companies and other group companies of HKAI s to ensure that certain contracts contain a provision to the effect that the parties (other than an excluded counterparty) will be bound by such a suspension of termination rights.

2. The Rules are divided into 3 Parts.

Part 1—Preliminary

3. Rule 1 provides for commencement and rule 2 sets out definitions of terms used in the Rules. The most important terms are—
 - (a) *covered entity*—an authorized institution incorporated in Hong Kong (*HKAI*), an HK holding company (being a holding company incorporated in Hong Kong of an HKAI) or a related company of an HKAI;
 - (b) *covered contract*—a financial contract that is governed by non-Hong Kong law and contains a termination right exercisable by a non-excluded counterparty (however, for a covered entity that is a related company of an HKAI, a contract is only a covered contract if it also contains an obligation of the covered entity that is guaranteed or otherwise supported by an HKAI, or an HK holding company, that is a group company of the covered entity); and
 - (c) *suspension of termination rights provision*—a contractual term or condition (made, or evidenced, in

writing) to the effect that the parties agree in a legally enforceable manner that the parties (other than an excluded counterparty) will be bound by a suspension of a termination right in relation to the contract imposed by the resolution authority for banking sector entities (that is, the Monetary Authority) under section 90(2) of the Ordinance.

Part 2—Requirement for Covered Contracts to Contain Suspension of Termination Rights Provision

4. Rule 3 requires a covered entity to ensure that covered contracts entered into by it contain a suspension of termination rights provision. This applies to—
 - (a) covered contracts entered into on or after the initial day (which is the day on which the Rules come into operation or the later day on which an entity becomes a covered entity); and
 - (b) covered contracts entered into before the initial day, if the contracts are renewed or materially amended on or after that day.
5. Rule 4 provides that a covered entity must comply with rule 3 when a covered contract is entered into (or renewed or materially amended, as the case requires), and continue to so comply throughout the term or remaining term of the contract.
6. Rule 4 is subject to rule 5, which provides for an initial period for compliance. For a covered contract entered into (or renewed or materially amended, as the case requires) during the initial period, or the initial period as extended under rule 6, a covered entity must comply with rule 3 by the end of that period, and continue to so comply throughout the term or remaining term of the contract.

7. Rule 6 empowers the Monetary Authority to extend the initial period for a covered contract or a class of covered contract.
8. Rule 7 empowers the Monetary Authority to exempt a covered entity from compliance with rule 3 for a covered contract or a class of covered contract.

Part 3—Compliance and Enforcement

9. Rule 8 requires a covered entity to have adequate systems of control in place to ensure compliance with rule 3 and any conditions of an extension of an initial period or exemption. Rule 8 also requires a covered entity to keep sufficient records to demonstrate compliance.
10. Rule 9 empowers the Monetary Authority to require a covered entity to provide a legal opinion that a suspension of termination rights provision contained in a covered contract is legally enforceable.
11. Rule 10 requires a covered entity to notify the Monetary Authority if the covered entity fails to comply with rule 3.
12. Rule 11 empowers the Monetary Authority to require a covered entity that fails to comply with rule 3 to propose and implement a plan to rectify the failure. Rule 11 also provides for offences for non-compliance.

Schedule

13. The Schedule lists the types of contracts that are financial contracts for the purposes of the Rules.