

Subcommittee on Financial Institutions (Resolution) (Protected Arrangements) (Regulation) and Financial Institutions (Resolution) Ordinance (Commencement) Notice 2017

Response to follow-up actions arising from the discussion at the meeting on 2 June 2017

This paper sets out the Government's response to the matters raised by Members in relation to the Financial Institutions (Resolution) Ordinance (Cap.628) ("FIRO") at the Subcommittee ("SC") meeting on 2 June 2017:

- (a) how would deposits, in particular the protected deposits as defined by section 2(1) of the Deposit Protection Scheme Ordinance (Cap. 581) ("DPSO"), be protected under the resolution regime, including whether the deposits, after transferring to a bridge institution, an asset management vehicle ("AMV") or a temporary public ownership ("TPO") company can still be protected by DPSO (the Administration is requested to provide the relevant provisions in FIRO and DPSO in its response); and
- (b) the Administration's response to members' views on the need to introducing amendments to DPSO to explicitly provide for the protection of deposits maintained by a bridge institution, an AMV or a TPO company, when such companies become non-viable.

2. According to the FIRO, there are five stabilization options that a resolution authority may apply to a within scope financial institution ("FI") in resolving the institution. These options are transfer to a purchaser, transfer to a bridge institution, transfer to an AMV, bail-in, and transfer to a TPO company.

Protections for deposits under the FIRO

3. The FIRO confers on the resolution authorities ("RAs") a range

of tools necessary to facilitate the orderly resolution of a non-viable, systemically important within scope FI in a manner that meets the resolution objectives under section 8 of the FIRO. One of those resolution objectives is to seek to protect deposits of a within scope FI to no less an extent than they would be protected under the Deposit Protection Scheme (“DPS”) on a winding up of the FI (section 8(1)(b) of the FIRO).

4. Further specific protections for deposits are provided under the FIRO, recognising the importance placed on securing continuity of access of the FI’s retail customers and counterparties to the critical financial function of deposit-taking in the event of an FI’s non-viability. These protections include that:

- (a) all deposits (irrespective of amount) falling within the definition of “protected deposit” under the DPSO are excluded from bail-in (section 2(b) of Schedule 5 to the FIRO). All deposits held by restricted licence banks (“RLBs”) or deposit-taking companies (“DTCs”), which would be a “protected deposit” if the relevant RLB or DTC was a DPS member, are also excluded from bail-in (section 2(c) of Schedule 5 to the FIRO);
- (b) certain obligations to pay certain deposit liabilities¹ are excluded from a suspension of obligations that may be imposed by an RA under section 83(1) of the FIRO (section 84(1)(a) and (b) of the FIRO); and
- (c) in case a deposit transfer is made from a DPS member to another, the protection afforded to pre-existing protected deposits with a transferee would not be affected and a transferred protected deposit from the transferor would continue to be a protected deposit for six months or until its original maturity date (if later than six months of the transfer date)

¹ Section 84(1)(a) excludes from any suspension of obligations imposed by an RA under section 83(1) an obligation to pay the whole or any part of a protected deposit; whilst section 84(1)(b) excludes from the same, for a FI that is exempt from section 12(1) of the DPSO, an obligation to pay a deposit covered by a deposit protection scheme, or other scheme of a similar nature, that protects deposits taken by it at its Hong Kong offices.

(section 12(2)-(6) of Schedule 4 to the FIRO). Upon the transfer of a protected deposit, along with any accrued interest up to the date of transfer inclusive, which amounts altogether to say HKD X, there will be a temporary increase in the amount of protected deposits under the DPS at the transferee for that deposit account from HKD 500,000 to HKD (500,000 + X) but capped at a maximum of HKD 1,000,000 (section 12(7) and (8) of Schedule 4 to the FIRO).

Continued coverage under the DPSO for protected deposits transferred

5. Pursuant to section 12(1) of the Banking Ordinance (Cap. 155) (“BO”) “[n]o business of taking deposits shall be carried on in Hong Kong except by an authorized institution (other than an authorized institution the authorization of which is for the time being suspended under section 24 or 25)”.

6. There are three types of authorized institution, namely (a) banks; (b) RLBs; and (c) DTCs. Only banks may operate current and savings accounts, and accept deposits of any size and maturity from the public and pay or collect cheques drawn by or paid in by customers. RLBs are principally engaged in merchant banking and capital market activities. They may take deposits of any maturity of HK\$500,000 and above. DTCs are mostly owned by, or otherwise associated with, banks. These companies engage in a range of specialised activities, including consumer finance and securities business. They may take deposits of HK\$100,000 or above with an original term of maturity of at least three months. Banks are members of the DPS. RLBs and DTCs are not members of the DPS.

7. In the event that an RA were to transfer the deposit book of a bank, given the restrictions under section 12(1) of the BO and the limitations of deposits that may be taken by an RLB or DTC, the transferee would also be a bank. This could be a private sector purchaser that is already authorized as a bank or a bridge institution established to receive the transfer of deposits, backed by the non-viable FIs’ good assets, which is likely to have been authorized as a bank under

the BO. Under a stabilisation option of a transfer to a TPO company, only the securities of a within scope FI may be transferred (section 67 of the FIRO). Therefore, a TPO company would not be a transferee of any deposits of a within scope FI, given that the TPO company would actually be a transferee of the securities issued by the within scope FI. With the within scope FI remaining in place after a transfer of its securities to a TPO company, the within scope FI would continue to be authorized under the BO and therefore would continue to be covered by the DPS. AMVs are not generally considered an appropriate stabilization option for protecting or maintaining continuity of access to deposits in the event of FI failure. Instead, AMVs are intended to be used for maximizing the value of transferred assets through eventual sale or orderly wind down (section 52 of the FIRO).

8. Section 12 of the DPSO provides that every bank is a member of the DPS. Since a transferee would likely need to be authorized as a bank to receive a transfer of deposits from a bank, then the transferee would be a member of the DPS given section 12 of the DPSO. Furthermore, and as mentioned in the response above, recognising the possible risk that a transfer from one DPS member to another could inadvertently push the balance of a depositor with deposits in both banks over the HKD 500,000 insured limit, section 12 of Schedule 4 to the FIRO provides for a temporary increase in the protection afforded to protected deposits under the DPS in the event that a deposit transfer is made from one DPS member to another (to a maximum of HKD 1,000,000 for six months).

9. Given the explanation above and the continuity of coverage by the DPSO for deposits transferred by an RA from a non-viable bank, the Administration does not consider that any amendment to the DPSO is necessary.

**Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
Securities and Futures Commission
Office of the Commissioner of Insurance
June 2017**