

## RECOVERY AND RESOLUTION REGIME

ONE STEP FORWARD FOR FINANCIAL INSTITUTIONS TO SAFEGUARD THEMSELVES  
AGAINST FINANCIAL INSTABILITY

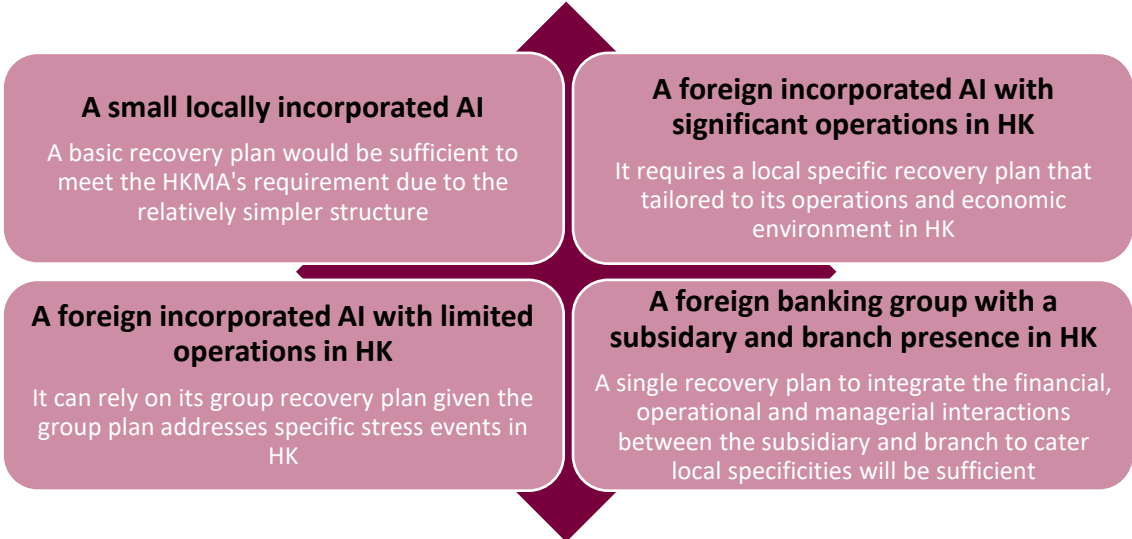


The Hong Kong Monetary Authority (“HKMA”) issued the latest guidelines on the rules Supervisory Policy Manual RE-1 (“SPM RE-1”) and Financial Institutions (Resolution) Ordinance (“FIRO”) for business recovery and resolution planning (“RRP”) respectively in July 2017. These guidelines are established to meet the “Key Attributes of Effective Resolution Regimes for Financial Institutions” set by the Financial Stability Board and will allow financial institutions to effectively manage the challenges arising from financial crisis. Upon the successful implementation of the RRP, this will strengthen the resilience of the financial system in Hong Kong.




## The “third wave” recovery planning

As an extension of the SPM RE-1 introduced in 2014, the HKMA issued a further guideline on 6 July 2017 to include the **third wave institutions**: overseas-incorporated AIs with branch operations in Hong Kong and smaller locally incorporated AIs. This guideline will prepare financial institutions to effectively respond to risk events and shocks arising from financial instability while limiting the financial reliance from the local government.

Who will be affected?



What are the key elements in a recovery plan?

<ul style="list-style-type: none"> <li>•To integrate the recovery plan into the <b>risk management framework</b></li> <li>•<b>Local management should take ownership</b> for the development, review, approval and ongoing maintenance of the recovery plan with oversight from regional or head office</li> <li>•Obtain management buy-in and support with <b>the board's review for the recovery plan</b>, where appropriate/if required</li> </ul> <p><b>Governance and oversight</b> </p>	<ul style="list-style-type: none"> <li>•To include options that may have <b>permanent structural or strategic implications</b>, such as partial / full disposal of the AIs' businesses and assets</li> <li>•While AIs can rely on the group recovery options, the branches with significant operations in Hong Kong should <b>determine if a local recovery option is preferred and be more effective</b> to address the local specificities</li> </ul> <p><b>Menu of recovery options</b> </p>	<ul style="list-style-type: none"> <li>•To establish a <b>trigger framework</b> for prompt recovery actions when triggering events occur</li> <li>•To develop <b>recovery triggers</b> based on existing internal early warning indicators</li> <li>•For branches, <b>quantitative triggers</b> would be sufficient whereas both qualitative and quantitative triggers are required for other AIs</li> <li>• Any <b>trigger events</b> should be reported to the HKMA</li> </ul> <p><b>Recovery triggers</b> </p>
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- The branch needs to **test whether the existing group recovery framework can support recovery planning at the local level**. At least one stress scenario should be developed to sufficiently test the branch’s stress response ability
- For smaller AIs, they may **conduct one stress test that is most relevant to their risk profile and operations**, only if limited capacity is available for a full range of scenarios

Stress scenario and testing



- To design a **communication strategy** for the deployment of recovery options
- The branch should maintain **smooth coordination with the group** if the group recovery plan is adopted

Communication plan



What would also be assessed in each recovery option? What is the implementation timeline?

It is important to highlight any firm-specific and market-specific impacts from the deployment of an option, potential key risks during deployment and the ownership for each option. This is to ensure the responsibilities are properly allocated. The HKMA will notify individual AIs the timeline for submitting their recovery plans.






## The Resolution Regime

**The resolution regime established under the FIRO commenced operation on the 7 July 2017.** The HKMA Resolution Office issued the “CI-1: Core information submission requirements”, “RA-1: HKMA’s code of conduct” and “RA-2: HKMA’s approach to resolvability assessments and stabilization options” to provide guidance on the implementation process. This regime aims to ensure AIs can adopt in an orderly manner and to limit disruption of the financial system in Hong Kong.

Who will be affected?

This is a cross-sector legislation, covering the within scope financial institutions in the banking, insurance, securities and futures sectors. The HKMA is the resolution authority for all AIs in the banking sector, acting alongside with the Securities and Futures Commission and the Insurance Authority to exercise relevant power authorized by the FIRO.

What are the core information requested in a resolution plan?

	<b>Governance and oversight</b> <ul style="list-style-type: none"><li>• Define the roles and responsibilities for the collection, review and approval of the core information requested by the HKMA and obtain approval from the Hong Kong management team assigned by the AI</li><li>• Notify the HKMA regarding significant changes in the business operations or group</li></ul>
	<b>Relevant and material entities</b> <ul style="list-style-type: none"><li>• Describe activities for all relevant and material entities and provide key information on the corporate structure along with financial information</li></ul>
	<b>Business lines and operating model</b> <ul style="list-style-type: none"><li>• Provide an overview of the business model of each of the material entity and map them to the AI's core business lines</li><li>• Provide business and financial information for each of the core business line to the HKMA</li></ul>
	<b>Dependencies</b> <ul style="list-style-type: none"><li>• Highlight key internal (e.g. legal, financial and operational) and external dependencies (e.g. external service providers) of the material entities</li><li>• Govern the contractual arrangement to manage dependencies and to prevent any serious impediment to its financial performance in case of dependencies failure</li></ul>
	<b>Financial functions</b> <ul style="list-style-type: none"><li>• Provide a detailed list of all financial functions for the AI and its material entities in Hong Kong such as deposits, lending &amp; loan servicing, and wholesale funding markets, etc</li></ul>

What is the implementation timeline?

Als are required to provide the core information outlined above within 6 months after the date of the HKMA's notification in order for the HKMA to assess a preferred resolution strategy for each of the AI. Furthermore, the core information should be updated at least every 2 years after each submission. The HKMA will adopt a similar "wave" approach used in the recovery regime to request core information from all of the in scope entities. Upon the assessment of the core information provided, the HKMA may request for supplementary information, relating to the partial transfer strategies (e.g. asset valuation capabilities, asset and liability packages, etc.) and bail-in strategies (e.g. capital and liability structure and valuation capabilities, etc.).

**For more information, please contact our risk and regulatory team for a detailed discussion.**

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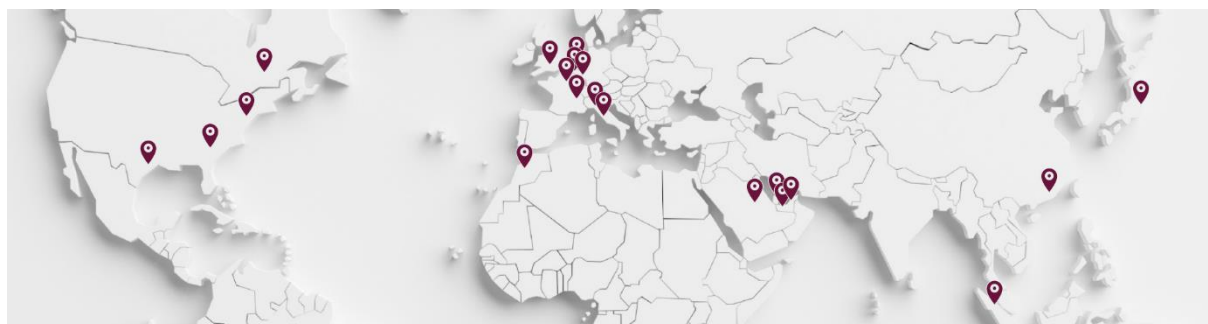
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