

# THE FINANCIAL INSTITUTIONS (RESOLUTION) (CONTRACTUAL RECOGNITION OF SUSPENSION OF TERMINATION RIGHTS - BANKING SECTOR) RULES

On 25 June 2021, the HKSAR government published the Financial Institutions (Resolution) (Contractual Recognition of Suspension of Termination Rights - Banking Sector) Rules (the “**Stay Rules**”) in the Gazette. The Stay Rules were tabled before the Legislative Council for negative vetting on 7 July 2021 and has come into operation on 27 August 2021.

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## I. Background

The Hong Kong Monetary Authority (“**HKMA**”) made the Stay Rules under section 92 of the Financial Institutions (Resolution) Ordinance (Cap. 628, Laws of Hong Kong) (“**FIRO**”), in its capacity as the resolution authority for banking sector entities under the FIRO. The Stay Rules adopt the contractual approach, as supported by the Financial Stability Board, to recognize a suspension of termination rights under section 90(2)<sup>1</sup> of the FIRO. By incorporating a suspension of termination rights clause (the “**Suspension Clause**”) in a Covered Contract (as defined hereinafter), disorderly termination of contracts on a mass scale may be avoided which could ensure the stability and effective working of the financial system.

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## II. Affected Entities under the Stay Rules

Entities that fall within the definition of “Covered Entity” will be affected by the Stay Rules. Pursuant to section 2 of Part 1 of the Stay Rules, the “Covered Entity” means:

- (a) an authorised institution incorporated in Hong Kong (“**AI**”);
- (b) a Hong Kong holding company, which 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 (“**HK Holding Company**”); or
- (c) a related company, which means in relation to an authorised institution incorporated in Hong Kong, a group company of the authorised institution that is not itself an authorised institution incorporated in Hong Kong or a Hong Kong holding company (“**Related Company**”).

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<sup>1</sup> Under section 90(2) of the FIRO, a resolution authority may, by way of provision in a Part 5 instrument, suspend for a specified period the termination right of a counterparty to the contract (other than a counterparty that is a financial market infrastructure).

### III. Covered Contracts under the Stay Rules

In accordance with section 2 of Part 1 of the Stay Rules, the following contracts are regarded as the “Covered Contracts” which must include the Suspension Clause within the prescribed time:

- (a) in relation to an AI or an HK Holding Company, means a financial contract entered into by such AI or HK Holding Company that—
  - (i) is governed by non-Hong Kong law; and
  - (ii) contains a termination right exercisable by a counterparty other than an excluded counterparty<sup>2</sup>; or
- (b) in relation to a Related Company, means a financial contract entered into by such Related Company 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 Related Company that is guaranteed or otherwise supported by an AI, or an HK Holding Company, that is a group company of the Related Company.

Different types of financial contracts are set out in the Schedule of the Stay Rules. Below are some examples thereof:

- (a) securities contracts;
- (b) commodities contracts;
- (c) derivatives contracts;
- (d) contracts for the purchase, sale or delivery of Hong Kong currency or any other currency.



<sup>2</sup> Under section 2 of Part 1 of the Stay Rules, an excluded counterparty, in relation to a contract, means a counterparty to the contract that is (a) a financial market infrastructure; (b) the HKMA; (c) the Government; (d) the government of a non-Hong Kong jurisdiction; or (e) the central bank of a non-Hong Kong jurisdiction.

#### **IV. Implementation Timeline**

Depending on the type of Covered Contract, Covered Entity must ensure that the Suspension Clause is contained in Covered Contract in accordance with the timeline as follows:

<b>Types of covered contract</b>	<b>Implementation timeline</b>
For (a) Covered Contract entered into by a Covered Entity on or after the initial day <sup>3</sup> or (b) pre-existing Covered Contract that is renewed or materially amended on or after such day, and where the counterparty is either (i) an AI; or (ii) a financial institution (other than an AI) that is a global systemically important bank on the initial day	By the end of the period of 24 months beginning on the initial day
For any other Covered Contract (a) entered by a Covered Entity on or after the initial day or (b) pre-existing Covered Contract that is renewed or materially amended on or after such day	By the end of the period of 30 months beginning on the initial day

#### **V. Consequences of Non-Compliance**

If a Covered Entity fails to include the Suspension Clause in a Covered Contract, HKMA may, by written notice served on Covered Entity, require Covered Entity to:

- (a) propose, within the period specified in the notice, a plan acceptable to HKMA to rectify the failure; and
- (b) implement the plan.

If Covered Entity, without reasonable excuse, fails to comply with either (a) or (b) above, it commits an offence and is liable on conviction to a fine at level 2 (i.e. HK\$5,000).

It is worth noting that if a Covered Entity commits the above offence, an officer<sup>4</sup> of the Covered Entity also commits an offence if the officer:

- (a) authorised 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.

<sup>3</sup> Pursuant to Rule 2 of Part 1 of the Stay Rules, initial day mean, in relation to a covered entity, or a covered contract entered into it, (a) the day on which the Stay 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.

<sup>4</sup> Pursuant to section 2 of the FIRO, an officer, in relation to an entity, means a person who is (a) a director of the entity; (b) the chief executive officer or deputy chief executive officer of the entity; or (c) a person who is employed by, or acts for or on behalf of or under an arrangement with, the entity and is principally responsible, alone or jointly with others, for (i) the management of part of the business of the entity; or (ii) the performance of one of more of the control functions of the entity.

An officer who commits such an offence is liable on conviction to a fine at level 2 (i.e. HK\$5,000) and to imprisonment for 6 months.

Should you have any question, please contact our Mr. Lawrence Yeung on (852) 2854 3070 or by email at [lawrence.yeung@ycylawyers.com.hk](mailto:lawrence.yeung@ycylawyers.com.hk).

*This explanatory note is not, and should not be regarded as, legal advice. Should you have any enquiries, please seek specific advice from legal advisers.*

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