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Newsletter

Finance & Insolvency

13 May 2020

What's inside?

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HKMA's Pre-approved Principal Payment Holiday Scheme

To provide immediate relief for cash flow pressures faced by corporate borrowers (in particular small and medium sized corporates) during the Covid-19 pandemic, the Hong Kong Monetary Authority (**HKMA**) together with the Banking Sector SME Lending Corporation Mechanism (**SME Lending Mechanism**) launched a novel Pre-approved Principal Payment Holiday Scheme (**Scheme**) on 1 May 2020. The Scheme applies to corporate borrowers that have an annual sales turnover of HK$800 million or less, have had no outstanding loan payments overdue for more than 30 days and are not in the process of liquidation or bankruptcy (**Eligible Borrowers**). The Scheme is expected to cover more than 80% of all corporate borrowers in Hong Kong.

Under the Scheme, all loan principal payments of Eligible Borrowers falling due within a 6-month period between 1 May 2020 to 31 October 2020 will be pre-approved for deferment. Principal payments of loans (including revolving facilities) will generally be deferred by 6 months. Trade facilities will be deferred by 3 months, due to their short-term nature.
Eligible Borrowers are not required to apply for the Scheme. Following the circular issued by the HKMA in April 2020, participating banks should have started informing Eligible Borrowers about the Scheme, with priority given to customers with principal payments falling due soon after 1 May 2020. Eligible Borrowers are only required to contact the participating bank to confirm the detailed arrangements of the principal payment holiday within 14 days of receipt of the bank's notice. The Scheme has received support from all 11 major lenders in the SME Lending Mechanism. All authorised institutions are expected to participate in the Scheme.

Execution of documents – Recent development in the UK

In the recent English case of *Signature Living Hotel Ltd* v *Sulyok [2020] EWHC 257 (Ch)*, the High Court held that a deed of guarantee that was not executed properly due to absence of a witness's signature could nevertheless take effect as a simple, binding contract.

On 3 March 2020, the UK Lord Chancellor and Secretary of State for Justice issued a written ministerial statement (**Statement**) in response to the UK Law Commission's 2019 report on electronic execution of documents. The Statement confirmed that, in most cases, electronic signatures are legally capable of executing a document (including a deed) provided that intention to enter into contract and certain execution formalities (e.g. the requirement of a witness) are satisfied. The Statement also endorsed the Law Commission's conclusion that electronic signatures can be used in confidence in commercial and consumer documents but noted that reforms regarding electronic signatures may be needed to ensure sufficient protection is afforded to vulnerable people. The English Law Society has also just issued an updated "note" on virtual execution and use of e-signatures: https://www.lawsociety.org.uk/support-services/advice/articles/position-on-virtual-execution-e-signature-during-coronavirus-covid-19-pandemic/.

In Hong Kong, documents can be executed by electronic means and this is often done by way of a virtual signing process or by electronic signature. The virtual signing process (often termed the "Mercury" process after the English case of *Mercury Tax Group v HMRC [2008] EWHC 2721*), which, if agreed by the parties, involves the "wet-ink" signing of a 'hard copy' paper document, and sending a scanned PDF version of that document with the signed signature page(s) by email to the other party will not always be feasible during the pandemic when people are working from home and may not have access to a printer and/or scanner. Some organisations may also have strict security policies to prohibit printing work documents outside their office. Subject to certain limitations, the Electronic Transactions Ordinance (Cap. 553) allows for the execution of documents (except for certain documents such as wills, powers of attorney, documents or deeds involving land interests, etc.) by affixing an electronic signature to an electronic record/contract. There are a number of uncertainties presented by this execution method. For security documents that are registrable with the Hong Kong Companies Registry (**Companies Registry**), a certified true copy of that document is required to be submitted. However, the Companies Registry has not published any official guidance on registration of documents that are executed by electronic signatures. Given that such documents technically only exist in electronic form, some practical issues e.g. whether a document bearing electronic signatures can be certified as a true copy, thus registered successfully, remain unclear.

In the light of the recent legal development in the UK, as well as the practical difficulties and uncertainties presented by the current regime, a reform and clarification of the laws governing electronic execution of documents in Hong Kong would be very helpful.

Asia Securities Industry & Financial Markets Association (ASIFMA) launches Hong Kong Common Practices for Client Onboarding and Refresh

ASIFMA has published a paper documenting common Know Your Customer practices across 15 financial institutions in Hong Kong. ASIFMA aims to demonstrate that adoption of streamlined and consistent KYC measures by different financial institutions can improve monitoring measures for banks and also reduce banks' friction with clients during the on-boarding process. These are common practices where there are no Anti-Money Laundering (AML) red flags associated with the client, the client is a low risk domestic client and corporate clients are owned by only a single layer of legal entities, which are in turn owned by natural persons.

The paper covers KYC practices for taking on the following types of clients:

1. Privately owned entities and relevant associated individuals
2. Funds regulated by an approved regulator and relevant individuals associated with them
3. Trusts and relevant associated individuals
4. Individuals
5. Financial institutions regulated by approved regulators and relevant associated individuals
6. Non-Bank Financial Institutions (NBFIs) regulated by approved regulators and relevant associated individuals
7. Public listed entities from approved jurisdictions and relevant associated individuals
8. Partnerships

For details, please see: ASIFMA Hong Kong Common Practices for Client Onboarding and Refresh

Basel Committee on Banking Supervision Discussion paper on “Designing a Prudential Treatment for Crypto-Assets” and industry response

As exposure to crypto-assets is becoming more and more relevant to banks, the Basel Committee on Banking Supervision (**Basel Committee**) issued a timely discussion paper in December 2019 inviting an industry response on the topic of crypto-assets. The paper formed part of the Basel Committee’s broader plan to monitor market and regulatory developments revolving around crypto-assets in the banking system, the qualification of banks’ direct and indirect crypto-asset exposures through periodic data-collection exercises, and assessment of appropriate prudential treatment for banks’ exposures to crypto-assets.

In the paper, the Basel Committee called for industry responses in relation to the following topics:

1. A common understanding on the features and risk characteristics of crypto-assets that should be taken into consideration when designing prudential treatment for banks’ exposures to crypto-assets; and
2. General principles that should guide the design of prudential treatment by banks to their crypto-assets exposures.

The industry’s response was coordinated by the Global Financial Markets Association (**GFMA**) and was published in the GFMA’s response paper dated March 2020. Points of interest include:

1. Basel Committee: **Definition of “crypto-asset”** includes where the following features can be identified– digital/virtual nature, reliance on cryptography and use of distributed ledger technology.
   GFMA’s response: there is no wide-spread agreement on the definition of “crypto-assets”, but the GFMA identified types of crypto-assets in its proposed approach to classification and understanding of crypto-assets in Annex A of the response paper.
2. Basel Committee: **General principle of prudential treatment: “Same risk, same activity, same treatment”**
   GFMA’s response: Highly supportive of the above risk-based principle, but did not encourage an overly simplistic framework. GFMA thinks although there are unique risks associated with high risk crypto-assets, banks can leverage existing frameworks to tackle these risks, as seen in their proposed framework in Annex B of the response paper.
3. Basel Committee: **Channels of bank exposures to crypto-assets and framework for identifying corresponding risk and prudential treatment**
   GFMA: the GFMA has made a list of potential channels of bank exposures to crypto-assets, with the corresponding assessment of whether the exposure is direct or indirect, overall risks related to banks’ exposure to the activity for determining the prudential treatment and recommended prudential treatment should banks engage in activity with “high risk” crypto-assets (see Annex B to the response paper).

For the complete Basel Committee discussion paper, please see here. For the complete GFMA response paper, please see here.

Global Stablecoin Initiatives: Regulatory challenges ahead

Whilst crypto-assets are customarily associated with high volatility, a low-volatility crypto-asset, the so-called “stablecoin”, has emerged recently. Stablecoin initiatives typically aim to create a store of value backing the crypto-asset and means of exchange. In view of the increasing discussion of such initiatives, in particular with global technology firms contemplating the issuance of their own stablecoin (e.g Facebook’s “Libra”), regulators and the market should be ready for the regulatory challenges of stablecoin.

The International Organization of Securities Commissions (**IOSCO**) recently published a report (**Report**) on global stablecoin initiatives, in which it highlighted the risks and the corresponding regulations required to tackle such risks through a case study of a stablecoin (**Coin**) proposed to be issued by a private entity (**Entity**). In the hypothetical case, the Entity designs a platform using distributed ledger technology to issue the Coin which is intended to be used as a means of exchange on the Entity’s platform and accessible to third parties, whereas the price of the Coin is determined by the value of the assets backing the Coin (**Reserve Fund**) and the ongoing trading activities of the Coin. Such a scheme poses challenges for both financial and securities regulators.

From a financial regulatory perspective, if users can make payments using the Coin, regulations on the “front-end” are likely to be required as it could amount to the provision of banking, payment system or other types of financial infrastructure services. The potential anonymity of transactions which use stablecoin, as with any other crypto-assets, gives rise to the risk of financial crime. If the Coin were to be used on a large scale, it could even become systemically important mandating scrutiny from regulators.

From a “back-end” perspective, the Reserve Fund backing the Coin could mean that the Coin would need to be classified as a collective investment scheme, securitised product or other type of security. The participants who provide or facilitate the trading of the Coin could as such be deemed to be carrying on “regulated activities” for the purposes of the Securities and Futures Ordinance (Cap. 571). Therefore, regulators may wish to impose requirements concerning pre- and post-trade obligations, financial promotions, disclosure and regular and trigger-based reporting requirements on market participants such as trading platforms or intermediaries facilitating the trading or subscription of the Coin. These requirements would be necessary to protect the interests of customers and investors.

Given the significant impact which a widely adopted global stablecoin could have on market participants or even the financial markets generally, the Report stated that the IOSCO was ready to work with other international bodies to facilitate understanding of stablecoin proposals and risks, and would seek to provide a venue for regulators to discuss issues relevant to the supervision of a stablecoin ecosystem.

"Replacement of Screen Rate Language" in Asia Pacific Loan Market Association (APLMA) standard form loan facility agreements

The APLMA has now formally adopted the Loan Market Association (**LMA**)’s "Replacement of Screen Rate Language" into the body of the APLMA recommended template documents along with a number of consequential and related changes. This language was introduced to facilitate transition to a new benchmark from LIBOR following discrediting of the rate when it became clear that certain banks had been providing purported interest rate figures which did not truly reflect the rate at which they could borrow. The amended documents have just been posted to the APLMA website for APLMA members. The APLMA decided to adopt the "Replacement of Screen Rate Language" in its templates in March this year, in response to announcements made by various regulators (including the Bank of England, the Federal Reserve in the US and the Financial Conduct Authority in the UK) and working groups, indicating that LIBOR would “definitely” cease to exist by, at the latest, the end of 2021 and be replaced by risk free rates such as SONIA or SOFRA.

Recent Publications

Hong Kong's Resolution Regime for Financial Institutions - Some Key Issues

Corporate Insolvency and Restructuring Technical Guide

Corporate Insolvency and Restructuring – A Creditor's Perspective

A Guide to Hong Kong Security and Receivership

Closing the Operations of a Solvent Company in Hong Kong

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