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IMPLEMENTATION OF BASEL III

Phase One - implemented 1 Jan 2013

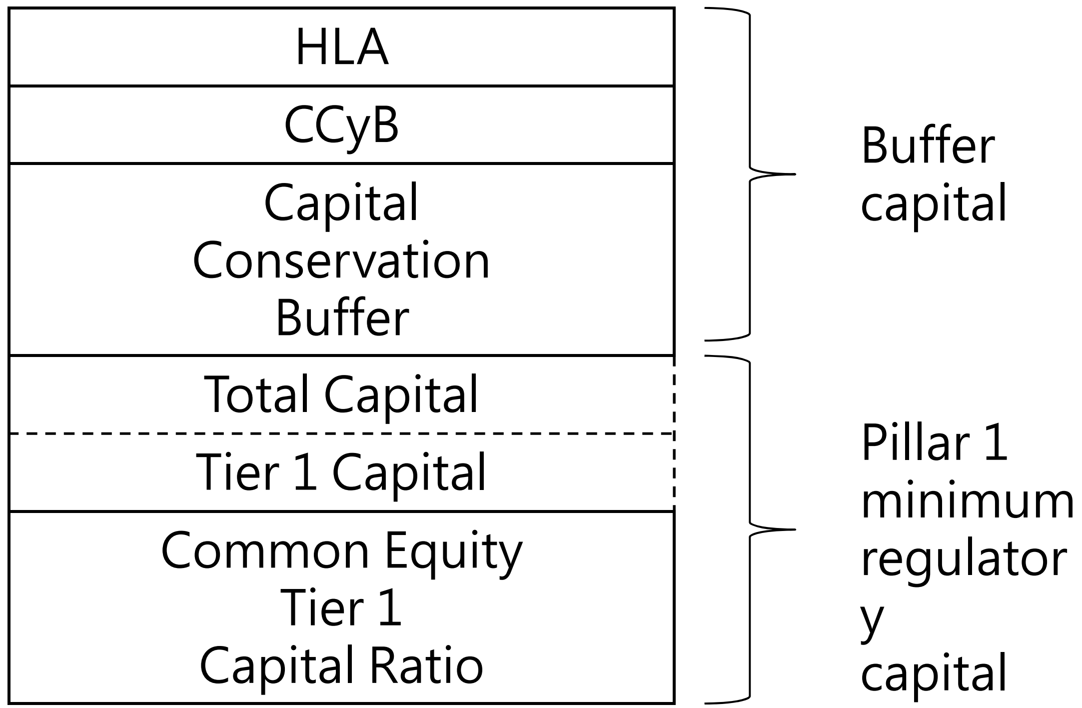
Phase Two - beginning 1 Jan 2015

- capital : buffers
  higher loss absorbency requirements (HLA) for systemically important banks (SIBs) (phase-in from 2016)
- liquidity coverage ratio (LCR)
- disclosure requirements

CAPITAL STANDARDS

Buffers	- capital conservation buffer
	- countercyclical capital buffer (CCyB)
	➡ jurisdictional CCyB
	➡ AI-specific CCyB
HLA	- identification of G-SIBs & D-SIBs
	- application of HLA - “bucketing” approach

“CAPITAL STACK”



CAPITAL CONSERVATION BUFFER

Basel III - "designed to ensure that banks build-up capital buffers outside periods of stress which can be drawn down as losses are incurred"

- buffers, once drawn down, to be rebuilt

➡ restrictions on discretionary distributions applied on sliding scale

CCyB

Basel Committee	– "aim is to ensure that the banking sector in aggregate has the capital on hand to help maintain the flow of credit in the economy without its solvency being questioned, when the broader financial system experiences stress after a period of excess credit growth"
Jurisdictional buffer decisions	– "monitor credit growth and make assessments of whether such growth is excessive and is leading to the build-up of system-wide risk"

CCyB

<u>Reference indicators for Hong Kong CCyB decisions</u>

Two primary gap indicators

- Basel Committee common reference guide (aggregate private sector credit/GDP ratio gap vs. trend)
- property price/rent ratio gap vs. trend

Two primary stress indicators

- interbank risk spread
- loan quality indicator

Comprehensive Reference indicators

SIBs

G-SIBs - Basel Committee Methodology
FSB publishes list: currently 29 banks

D-SIBs - Basel Committee Principles
Proposed Assessment Factors

- size
- interconnectedness
- substitutability
- complexity

HLA - proposed buckets from 1% to 3.5% (3.5% empty bucket) by reference to systemic importance

CAPITAL CONSERVATION

- CCyB & HLA extend capital conservation buffer
- restrictions on distributions:-

CET1	Conservation Ratio as % of earnings
Within first quartile of buffer	100%
Within second quartile of buffer	80%
Within third quartile of buffer	60%
Within fourth quartile of buffer	40%
Above top of buffer	0%

LIQUIDITY STANDARDS

Liquidity Coverage Ratio (LCR) :

$$\frac{\text{High quality liquid assets}}{\text{Net cash outflows over 30 calendar days}} \geq 100\%$$

Liquidity Maintenance Ratio (LMR) :

$$\frac{\text{Liquefiable assets}}{\text{Qualifying liabilities (after deductions) for each calendar month}} \geq 25\%$$

LIQUIDITY STANDARDS

Two tier approach:-

LCR - Category 1 AIs

- internationally active
- significant to the stability & effective working of the banking system
- material liquidity risk
- connected to Category 1 AI

LMR - all other AIs

DISCLOSURE STANDARDS

- corresponding disclosure re buffers/HLA/LCR/LMR

- Leverage Ratio – disclosed from 1 Jan 2015 prior to migrating to minimum standard on 1 Jan 2018