LEGISLATIVE COUNCIL BRIEF

The Secretary for Financial Services and the Treasury submits the following note for Members' information:

Title of the Note	Date of ExCo	Date of Gazette
Banking Ordinance (Chapter 155) – Banking (Capital) (Amendment) Rules 2011 and Banking (Disclosure) (Amendment) Rules 2011	-	21 October 2011

19 October 2011 **Financial Services and the Treasury Bureau**

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LEGISLATIVE COUNCIL BRIEF

BANKING ORDINANCE (CHAPTER 155)

BANKING (CAPITAL) (AMENDMENT) RULES 2011

AND BANKING (DISCLOSURE) (AMENDMENT) RULES 2011

INTRODUCTION

The Hong Kong Monetary Authority ("HKMA") will publish in the Gazette on 21 October 2011 the Banking (Capital) (Amendment) Rules 2011 ("B(C)(A)R") (at **Annex 1**) and the Banking (Disclosure) (Amendment) Rules 2011 ("B(D)(A)R") (at **Annex 2**) principally to implement in Hong Kong the enhancements to the Basel II regulatory capital framework issued by the Basel Committee on Banking Supervision ("BCBS") in July 2009 (referred to as "Basel 2.5" in this brief).

JUSTIFICATIONS

Basel II capital framework and lessons from the global financial crisis

2. Basel II is an international regulatory framework for the capital adequacy of banks originally introduced by the BCBS in 2006. It is composed of three pillars: (i) minimum capital requirements for a bank's credit, market and operational risks ("Pillar 1"); (ii) supervisory review process to evaluate and monitor the bank's capital adequacy in relation to its overall risk profile ("Pillar 2"); and (iii) disclosure requirements to allow market participants to access key pieces of information on the capital adequacy of banks ("Pillar 3").

3. Hong Kong implemented the Basel II capital framework on 1 January 2007 through the enactment of the Banking (Capital) Rules ("B(C)R") and Banking (Disclosure) Rules ("B(D)R"). The B(C)R prescribe how the capital adequacy ratios ("CAR") of locally-incorporated authorized institutions ("AIs") are to be calculated, while the B(D)R prescribe what information on state of

affairs, profit and loss, and CAR is to be publicly disclosed by AIs, in line with the requirements under Pillars 1 and 3 respectively of the Basel II capital framework. HKMA has developed and undertaken a supervisory review process under Pillar 2 since 1 January 2007.

4. A key lesson drawn from the global financial crisis in 2008 was that the Basel II capital framework had not adequately captured the risks of trading book activities of banks. The specific weaknesses in the Basel II market risk framework, which governs the trading book, relate to -

(a) Treatment of securitization exposures

The capital treatment for securitization exposures in the trading book is more lenient than that for similar exposures booked in the banking book and has thus opened up an opportunity for regulatory arbitrage by banks.

(b) Inadequate risk coverage

The market risk framework does not adequately capture the risk of losses of credit-sensitive trading exposures (e.g. debt securities and credit derivatives) due to price changes arising from the default of issuers, and/or downgrades in the credit ratings.

(c) Inclusion of illiquid exposures in the trading book

During the crisis, illiquid exposures in the trading book (and in the banking book where they were measured at fair value) caused unexpectedly large losses (both realised and unrealised) for some banks, which left negative impacts on those banks' capital base.

(d) Model limitations

The value-at-risk ("VaR") models used by some banks to calculate market risk capital charges are subject to inherent limitations (e.g. reliance on historical data which does not cater well for stressed conditions), which have not been sufficiently recognised and addressed.

5. Although the Basel II credit risk framework governing exposures booked in the banking book levies higher capital charges for securitization exposures, the crisis has demonstrated the insufficiency of such charges to cater for the more risky "re-securitization" activities (such as collateralised debt

obligations backed by mortgage-backed securities) that have developed rapidly in recent years. In addition, it has become clear that some banks rely unduly on external credit ratings for assessing the risks of securitization products without conducting their own rigorous due diligence.

6. In order to address the weaknesses mentioned in paragraphs 4 and 5 above, the BCBS issued the Basel 2.5 package in July 2009, covering the following areas -

(a) *Revisions to the Basel II market risk framework*[1] (Pillar 1), supported by *Guidelines for computing capital for incremental risk in the trading book*, which address those weaknesses pertaining to the trading book and the fair valuation of exposures, particularly illiquid exposures, that are measured at fair value; and

(b) *Enhancements to the Basel II framework* (Pillars 1, 2 and 3), which address the additional risk observed with respect to re-securitization exposures in the banking book (Pillar 1); prescribe supplemental Pillar 2 guidance for improving the governance and risk management practices of banks; and require additional disclosure regarding banks' exposures to market risk and securitization activities and the related capital requirements (Pillar 3).

7. The timetable set by the BCBS in respect of Basel 2.5 was for the supplemental guidance under Pillar 2 to be implemented immediately, and for the enhancements to Pillars 1 and 3 to be implemented by 31 December 2011.

8. We consider that Basel 2.5 should be implemented in Hong Kong so that we, as a member of the BCBS, can stay in line with the established practice of subscribing to the supervisory standards recommended by the BCBS. To this end, HKMA has already implemented the Pillar 2 enhancements through the issuance of a revised module in HKMA's supervisory policy manual since June 2010. In addition, we have made the necessary legislative amendments, as set out in the B(C)(A)R and B(D)(A)R, for the purposes of implementing the abovementioned enhancements to Pillar 1 (capital) and Pillar 3 (disclosure). The implementation of Basel 2.5 will ensure that the capital framework for AIs in Hong Kong is consistent with international standards and in a better capacity to address the risks to which AIs are exposed.

[1] The BCBS published a revised version of this document in February 2011, and the changes introduced therein have been incorporated into the B(C)(A)R.

MAJOR AMENDMENTS INTRODUCED BY B(C)(A)R

9. The B(C)(A)R (at **Annex 1**), developed in accordance with the requirements set out in Basel 2.5, primarily cover -

(a) Enhancements to the **market risk framework**, which are incorporated into Parts 2 and 8 of, and Schedules 3 and 5 to, the B(C)R, so as to:

(i) align the capital treatment for securitization (including re-securitization) exposures in the trading book with the higher and enhanced capital requirements applicable to banking book securitization exposures (e.g. sections 128 and 140 of the B(C)(A)R);

(ii) subject those banks which use VaR models for market risk calculations to more stringent modelling requirements such as more frequent update of data inputs and greater use of stress-testing (e.g. section 146(2) and (5) of the B(C)(A)R), and additional market risk capital charges (e.g. sections 139 and 146(10) of the B(C)(A)R) to better capture price changes due to issuer defaults and changes in credit ratings of credit-sensitive products as well as incorporate some stress elements into the market risk calculations based on historical stress experience; and

(iii) strengthen the prudent valuation requirements to ensure prudent and reliable valuation of fair-valued exposures held in both the trading book and the banking book, taking account of the liquidity of the exposures (e.g. sections 4 and 27 of the B(C)(A)R).

(b) Enhancements to the **securitization framework for the banking book**, which are incorporated into Part 7 of, and Schedule 5 to, the B(C)R, in order to:

(i) impose higher risk-weights for re-securitization exposures to address the additional risk observed with respect to such exposures (e.g. sections 97 and 111 of the B(C)(A)R);

(ii) increase the capital requirements of liquidity facilities provided to securitization transactions (e.g. sections 99 and 120 of the B(C)(A)R);

(iii) limit banks' ability to rely on credit ratings where the ratings are based on guarantees provided by the banks themselves (e.g. section 95 of the B(C)(A)R); and

(iv) require banks to conduct adequate credit analysis for securitization exposures rather than relying blindly on credit ratings (failure to do so will lead to harsher capital treatment) (e.g. sections 94, 96 and 104 of the B(C)(A)R).

10. In addition, the opportunity is taken to make amendments to the B(C)R -

(a) to introduce refinements and clarifications to address some practical issues and ambiguities identified in the implementation of the B(C)R in Hong Kong to date (e.g. sections 20, 23 to 26, 37 to 40(3), 41 to 42, 54 to 60, 62, 69, 72 and 76 of the B(C)(A)R); and

(b) to recognise four credit rating agencies, namely, Japan Credit Rating Agency, Ltd., ICRA Limited, Credit Analysis and Research Limited and CRISIL Limited, for the purposes of calculating CAR. The necessary changes are mainly made to Part 4 of, and Schedules 6, 7, 11 and 14 to, the B(C)R (see sections 3(4) to (7), (9) and (19), 28(4), 29 to 35, 40(4), 44, 51 to 52, 63(2), 81, 127(13), 149, 150, 154 and 155 of the B(C)(A)R).

MAJOR AMENDMENTS INTRODUCED BY B(D)(A)R

11. The amendments to the B(D)R to be introduced by the B(D)(A)R (at **Annex 2**) reflect the following enhanced disclosure requirements as set out in Basel 2.5 -

(a) Disclosure policy

emphasising that a bank's disclosure policy should set out the approach used by it to ensure that the information it discloses is relevant and adequate to convey an accurate impression of the bank's actual risk profile to market participants (i.e. section 4 of the B(D)(A)R).

(b) Securitization exposures

(i) requiring additional disclosure in respect of a bank's

securitization exposures, aligning the disclosure required in respect of securitization exposures booked in the trading book with that required in respect of securitization exposures in the banking book, and requiring disclosure of exposures in the trading book separately from those in banking book (i.e. sections 6, 8 and 12 of the B(D)(A)R);

(ii) requiring disclosure of the nature of risks, other than credit risk, inherent in a bank's securitized assets as well as an explanation of the role played by the bank in the securitization process such as originator, investor, servicer, provider of credit enhancement, sponsor and liquidity provider (i.e. sections 60(1)(b) and (c), 69(1)(a), and 82(1)(b) and (c) of the B(D)R as amended by sections 6(1), 8(1) and 12(1) of the B(D)(A)R);

(iii) mandating a description of a bank's risk management of securitization exposures, including its policy governing the use of credit risk mitigation to mitigate the risks of retained exposures (i.e. sections 60(1)(f) and (g), 69(1)(c), and 82(1)(f) and (g) of the B(D)R as amended by sections 6(1), 8(1) and 12(1) of the B(D)(A)R);

(iv) requiring further information to be disclosed regarding the valuation of securitization exposures, including the methods and key assumptions applied in valuation and any changes in the methods and key assumptions from the previous reporting period and the impact of the changes (i.e. sections 60(1)(e)(iii), 69(1)(b) and 82(1)(e)(iii) of the B(D)R inserted/amended by sections 6(1), 8(1) and 12(1) of the B(D)(A)R); and

(v) requiring additional information to be disclosed regarding valuation of assets intended to be securitized and the aggregate amount of such assets, broken down by exposure type (i.e. new sections 60(1)(e)(v) and 82(1)(e)(v) of the B(D)R inserted by sections 6(1) and 12(1) of the B(D)(A)R).

(c) Market risk framework

(i) requiring additional disclosure regarding capital requirements for banks' trading book positions in interest rate exposures (particularly their securitization and re-securitization exposures and credit-sensitive trading products) as calculated under Pillar 1 (i.e. sections 7(1), 9(1) and 13(1) of the B(D)(A)R); and

(ii) mandating disclosure of the approach and methodologies used for computing the new market risk capital charges introduced by Basel 2.5 (i.e. sections 7(3), 9(3) and 13(3) of the B(D)(A)R).

LEGISLATIVE TIMETABLE

12. The B(C)(A)R and B(D)(A)R will be published in the Gazette on 21 October 2011 and tabled at the Legislative Council on 26 October 2011 for negative vetting. The B(C)(A)R and B(D)(A)R will come into operation on 1 January 2012, in line with the BCBS' timetable.

IMPLICATIONS OF THE RULES

13. The B(C)(A)R and B(D)(A)R are in conformity with the Basic Law, including the provisions concerning human rights. They have no financial, civil service, productivity, environmental or sustainability implications.

14. On economic implications, the implementation of Basel 2.5 through the enactment of the B(C)(A)R and B(D)(A)R will keep the capital framework of Hong Kong in line with international standards, which is important to Hong Kong both as an international financial centre and a member of the international regulatory standard-setting bodies, i.e. the BCBS and the Financial Stability Board. Moreover, the enhanced capital framework will ensure that the risks inherent in AIs' exposures (including securitization and trading book exposures) are better captured in their minimum regulatory capital requirements; and the enhanced disclosure requirements will enable investors, creditors, regulators and counterparties of AIs to have a clearer picture of the risk profile and capital adequacy of the AIs for the purposes of conducting their own investment or risk assessments. On the whole, the implementation of Basel 2.5 would make the banking system in Hong Kong more resilient, thereby contributing to the robustness and competitiveness of Hong Kong's financial markets and economy.

PUBLIC CONSULTATION

15. HKMA consulted the banking industry in September 2009 and August 2010 on the substance of its proposed amendments to the B(C)R and B(D)R and its intention to put the amendments into effect starting 1 January 2012. The banking industry was generally supportive of the proposed enhancements and

the implementation timetable.

16. In May 2011, a preliminary consultation was conducted to seek the views of The Hong Kong Association of Banks ("HKAB") and The DTC Association ("DTCA") on the details of the draft amendments to the B(C)R and B(D)R. The comments received were mostly to seek clarifications on a number of technical issues and where appropriate, these were addressed in preparing the drafts for the statutory consultation conducted in August 2011 on the two sets of Rules pursuant to sections 98A and 60A of the Banking Ordinance ("BO") (Cap. 155) (please see paragraph 17 below).

17. In accordance with sections 98A and 60A of the BO, HKMA conducted statutory consultation with the Financial Secretary, the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, HKAB and DTCA on the two sets of amendment rules in August 2011. All of them were supportive of the objectives of the amendments, with the majority of comments being requests for clarification on some technical points. All comments have been appropriately addressed in finalising the B(C)(A)R and B(D)(A)R. HKMA's responses to the comments received from the statutory consultation are attached at **Annex 3** for reference.

18. In addition, we briefed the Legislative Council Panel on Financial Affairs ("FA Panel") on the implementation of Basel 2.5 on 9 June 2011. A couple of questions were raised about the possible impacts of Basel 2.5 on the business development and competitiveness of AIs (in terms of costs particularly) and their customers (especially small- and medium-sized enterprises). We explained that Basel 2.5 sought to enhance the resilience and risk management capability of AIs, which might potentially help reduce AIs' funding costs and hence borrowing costs of their customers. In any case, Basel requirements were only part of a host of others factors (e.g. market competition) that might affect the pricing of banking products and AIs' profitability. AIs might be put in a disadvantageous position vis-à-vis their peers overseas for not following international practices and the latest banking supervisory requirements.

PUBLICITY

19. Following the publication of the B(C)(A)R and B(D)(A)R in the Gazette on 21 October 2011, HKMA will issue a letter to all AIs, informing them of the gazettal of the amendment rules. HKMA will also keep the AIs informed upon the completion of the negative vetting process in due course.

ENQUIRIES

20. For any enquiries relating to the brief, please contact Miss Natalie Li, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) at 2529 0121 or Mr Richard Chu, Acting Head (Banking Policy) of HKMA at 2878 8276.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
19 October 2011

Banking (Capital) (Amendment) Rules 2011

Contents

Banking (Capital) (Amendment) Rules 2011

(Made by the Monetary Authority under section 98A of the Banking Ordinance (Cap. 155) after consultation with the Financial Secretary, the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, The Hong Kong Association of Banks and The DTC Association)

1. Commencement

These Rules come into operation on 1 January 2012.

2. Banking (Capital) Rules amended

The Banking (Capital) Rules (Cap. 155 sub. leg. L) are amended as set out in sections 3 to 155.

3. Section 2 amended (interpretation)

(1) Section 2(1), definition of ***comprehensive approach***—

Repeal

"section 51"

Substitute

"section 51(1)".

(2) Section 2(1), definition of ***credit conversion factor***—

Repeal

"section 51" (wherever appearing)

Substitute

"section 51(1)".

(3) Section 2(1)—

Repeal the definition of *delivery-versus-payment basis*

Substitute

"***delivery-versus-payment basis*** (貨銀對付形式)—

(a) in relation to a transaction that is not a foreign exchange transaction, means that the delivery of a thing under the transaction and the payment for the thing occur simultaneously; or

(b) in relation to a foreign exchange transaction, means that the transfer of all the currencies under the transaction occur simultaneously;".

(4) Section 2(1)—

Repeal the definition of *ECAI issue specific rating*

Substitute

"***ECAI issue specific rating*** (ECAI 特定債項評級), in relation to an exposure—

(a) except in sections 51, 52, 59, 60, 61, 62, 69, 74 and 79, Part 7, section 287 and Schedule 7, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the exposure by an ECAI, and is for the time being neither withdrawn nor suspended by that ECAI;

(b) in section 51, has the meaning given by section 51(2);

(c) in section 52, has the meaning given by section 52(4);

(d) in sections 59, 60, 61, 74 and 79 and Part 7, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the exposure by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in this section, and is for the time being neither withdrawn nor suspended by that ECAI;

(e) in section 62, has the meaning given by section 62(4);

(f) in section 69, has the meaning given by section 69(11);

(g) in section 287, has the meaning given by section 287(11); and

(h) in Schedule 7, has the meaning given by section 2(g) of that Schedule;".

(5) Section 2(1)—

Repeal the definition of *ECAI issuer rating*

Substitute

"***ECAI issuer rating*** (ECAI 發債人評級), in relation to any person (however described)—

(a) except in sections 51, 55, 57, 59, 60, 61, 69 and 287, means a long-term credit assessment rating that is assigned to the person by an ECAI, and is for the time being neither withdrawn nor suspended by that ECAI;

(b) in section 51, has the meaning given by section 51(2);

(c) in sections 55, 57, 59, 60 and 61, means a long-term credit assessment rating that is assigned to the person by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in this section, and is for the time being neither withdrawn nor suspended by that ECAI;

(d) in section 69, has the meaning given by section 69(11); and

(e) in section 287, has the meaning given by section 287(11);".

(6) Section 2(1), definition of ***external credit assessment institution***, paragraph (c)—

Repeal

"or".

(7) Section 2(1), definition of ***external credit assessment institution***, after paragraph (d)—

Add

"(e) Japan Credit Rating Agency, Ltd.;

(f) Credit Analysis and Research Limited;

(g) CRISIL Limited; or

(h) ICRA Limited;".

(8) Section 2(1), definition of ***first-to-default credit derivative contract***, paragraph (a)—

Repeal

"held by it".

(9) Section 2(1)—

Repeal the definition of *long-term ECAI issue specific rating*

Substitute

"***long-term ECAI issue specific rating*** (長期 ECAI 特定債項評級), in relation to an exposure—

(a) except in sections 55, 59, 60, 61, 69 and 79(e), (i) and (j), Part 7 and Schedule 7, means an ECAI issue specific rating assigned to the exposure by an ECAI that is a long-term credit assessment rating;

(b) in sections 55, 59, 60, 61 and 79(e), (i) and (j) and Part 7, means an ECAI issue specific rating assigned to the exposure by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in this section that is a long-term credit assessment rating;

(c) in section 69, has the meaning given by section 69(11); and

(d) in Schedule 7, has the meaning given by section 2(h) of that Schedule;".

(10) Section 2(1), definition of ***main index***—

Repeal

"section 51"

Substitute

"section 51(1)".

(11) Section 2(1), definition of ***minimum holding period***—

Repeal

"section 51"

Substitute

"section 51(1)".

(12) Section 2(1), definition of ***past due exposure***—

Repeal

"section 51"

Substitute

"section 51(1)".

(13) Section 2(1), definition of ***positive current exposure***—

Repeal

"section 51"

Substitute

"section 51(1)".

(14) Section 2(1), definition of ***potential exposure***—

Repeal

"section 51"

Substitute

"section 51(1)".

(15) Section 2(1), definition of ***recognized credit risk mitigation***—

Repeal

"section 51" (wherever appearing)

Substitute

"section 51(1)".

(16) Section 2(1), definition of ***risk-weighted amount***, paragraph (c)—

Repeal

"Part 8;"

Substitute

"Part 8; or".

(17) Section 2(1), definition of ***second-to-default credit derivative contract***, paragraph (a)—

Repeal

"held by it".

(18) Section 2(1)—

Repeal the definition of *securitization exposure*

Substitute

"***securitization exposure*** (證券化類別風險承擔), in relation to an authorized institution, means the institution's exposure to a securitization transaction, and includes such an exposure arising from—

(a) the purchase or repurchase of securitization issues;

(b) the provision of credit protection or credit enhancement to any of the parties to the transaction;

(c) the retention of one or more than one securitization position;

(d) the provision of a liquidity facility or servicer cash advance facility for the transaction; and

(e) the obligation to acquire any investors' interest in the transaction if the transaction is subject to an early amortization provision;".

(19) Section 2(1)—

Repeal the definition of *short-term ECAI issue specific rating*

Substitute

"***short-term ECAI issue specific rating*** (短期ECAI特定債項評級), in relation to an exposure—

(a) except in sections 59, 60, 61 and 79(k), (l) and (m) and Part 7, means an ECAI issue specific rating assigned to the exposure by an ECAI that is a short-term credit assessment rating; and

(b) in sections 59, 60, 61 and 79(k), (l) and (m) and Part 7, means an ECAI issue specific rating assigned to the exposure by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in this section that is a short-term credit assessment rating;".

(20) Section 2(1), definition of ***sovereign foreign public sector entity***—

Repeal

"section 51"

Substitute

"section 51(1)".

(21) Section 2(1), definition of ***standard supervisory haircut***—

Repeal

"section 51"

Substitute

"section 51(1)".

(22) Section 2(1)—

Repeal the definition of *underlying exposures*

Substitute

"***underlying exposures*** (組成項目)—

(a) in relation to a securitization transaction, has the meaning given by section 227(1); or

(b) subject to paragraph (a), in relation to a derivative contract (including a credit derivative contract) for the calculation of an authorized institution's market risk, has the meaning given to the definition of ***underlying exposure*** by section 281;".

(23) Section 2(1)—

Add in alphabetical order

"***Basel Committee on Banking Supervision*** (巴塞爾銀行監管委員會) means the committee, whose secretariat is hosted by the Bank for International Settlements in Basel, Switzerland, that seeks to promote sound standards of banking supervision worldwide;

comprehensive risk charge (綜合風險資本要求) has the meaning given by section 281;

correlation trading portfolio (相關交易組合) has the meaning given by section 281;

Credit Analysis and Research Limited means the company incorporated in India under that name;

CRISIL Limited means the company incorporated in India under that name;

ICRA Limited means the company incorporated in India under that name;

incremental risk charge (遞增風險資本要求) has the meaning given by section 281;

incremental risks (遞增風險) has the meaning given by section 281;

investors' interest (投資者權益) has the meaning given by section 227(1);

Japan Credit Rating Agency, Ltd. (日本格付研究所株式會社) means the company incorporated in Japan under that name;

loss given default (違責損失率) has the meaning given by section 139(1);

mark-to-model (按模式計值) means an approach to valuing an exposure, or a portfolio of exposures, where the value is benchmarked, extrapolated or calculated from an internal model based on a set of market data;

nth-to-default credit derivative contract (nth違責者信用衍生工具合約) has the meaning given by section 281;

probability of default (違責或然率) has the meaning given by section 139(1);

Rating and Investment Information, Inc. (評級及投資資料有限公司) means the company incorporated in Japan under that name;

re-securitization exposure (再證券化類別風險承擔) has the meaning given by section 227(1);

re-securitization transaction (再證券化交易) has the meaning given by section 227(1);

securitization position (證券化持倉) has the meaning given by section 227(1);

stressed VaR (受壓風險值) has the meaning given by section 281;

tranche (份額) has the meaning given by section 227(1);

valuation adjustment (估值調整), in relation to an exposure of an authorized institution that is measured at fair value, means an adjustment made in accordance with section 4A;".

(24) Section 2(5), English text—

Repeal

"section" (wherever appearing)

Substitute

"provision".

(25) Section 2—

Repeal subsection (7).

4. Section 4A added

Part 2, Division 1, after section 4—

Add

"4A. Valuation of exposures measured at fair value

(1) Where the exposures of an authorized institution are measured at fair value, for the purposes of calculating the risk-weighted amount of the exposures under Part 4, 5, 6, 7 or 8, the institution must establish and maintain valuation systems, controls and procedures that are effective to ensure that the valuation of its exposures is prudent and reliable.

(2) For the purposes of subsection (1), an authorized institution must make adjustments, where appropriate, to the valuation of its exposures that are measured at fair value to account for—

(a) the limitations of the valuation model or methodology and the data used by the institution in the valuation process;

(b) the liquidity of the institution's exposures; and

(c) other relevant factors that might reasonably be expected to affect the prudence and reliability of the valuation of the institution's exposures.

(3) To avoid doubt, adjustments made by an authorized institution in accordance with this section may exceed

adjustments made by the institution in accordance with the financial reporting standards adopted by the institution.".

5. Section 5 amended (authorized institution shall only use STC approach, BSC approach or IRB approach to calculate its credit risk for non-securitization exposures)

Section 5(2), English text—

Repeal

"section"

Substitute

"provision".

6. Section 10 amended (measures which may be taken by Monetary Authority if authorized institution using BSC approach or IRB approach no longer satisfies specified requirements)

(1) Section 10(1)—

Repeal paragraph (b)

Substitute

"(b) the Monetary Authority is satisfied that—

(i) if the institution were to make a fresh application under section 6(1) for approval to use the BSC approach to calculate its credit risk for non-securitization exposures, the approval would be refused by virtue of section 6(3); or

(ii) the institution has contravened a condition attached under section 33A(1) or (2) to its approval granted under section 6(2)(a),".

(2) Section 10(4)—

Repeal paragraph (b)

Substitute

"(b) the Monetary Authority is satisfied that—

(i) if the institution were to make a fresh application under section 8(1) for approval to use the IRB approach to calculate its credit risk for non-securitization exposures, the approval would be refused by virtue of section 8(3) (but, insofar as Schedule 2 is concerned, only section 1 of that Schedule is to be taken into account); or

(ii) the institution has contravened a condition attached under section 33A(1) or (2) to its approval granted under section 8(2)(a),".

7. Section 12 amended (exemption for exposures)

Section 12(1)—

Repeal

"uses"

Substitute

"has made an application under section 8(1) to use, or which uses,".

8. Section 14 amended (transitional arrangements)

Section 14(2), Chinese text, Table 1—

Repeal

"公司" (wherever appearing)

Substitute

"法團".

9. Section 15 amended (authorized institution shall only use STC(S) approach or IRB(S) approach to calculate its credit risk for securitization exposures)

(1) Section 15(1)—

Repeal paragraph (b)

Substitute

"(b) the underlying exposures in the securitization transaction are of a class that would fall within—

(i) section 54, 108 or 142; or

(ii) the definition of ***securitization exposure*** in section 2(1),

(referred to in this section as ***relevant class***) if the institution were to classify those underlying exposures as if they were not securitized through that transaction,".

(2) Section 15(1)(c)—

Repeal

"or BSC approach"

Substitute

", BSC approach or STC(S) approach".

(3) Section 15(1)(d), after "IRB approach"—

Add

"or IRB(S) approach".

(4) Section 15(2)(c)—

Repeal

"and IRB approach"

Substitute

", IRB approach, STC(S) approach and IRB(S) approach".

(5) Section 15(2)(d)(i)—

Repeal

"or BSC approach"

Substitute

", BSC approach or STC(S) approach".

(6) Section 15(2)(e), after "the IRB approach"—

Add

"or IRB(S) approach".

(7) Section 15(4)(a)(i)—

Repeal

"or BSC approach"

Substitute

", BSC approach or STC(S) approach".

(8) Section 15(4)(a)(ii), after "the IRB approach"—

Add

"or IRB(S) approach".

10. Section 17 amended (authorized institution shall only use STM approach, IMM approach or approach used by parent bank to calculate its market risk)

Section 17(2), English text—

Repeal

"section"

Substitute

"provision".

11. Section 18 amended (authorized institution may apply for approval to use IMM approach to calculate its market risk)

(1) After section 18(1)—

Add

"(1A) The Monetary Authority must not determine under subsection (2) an application from an authorized institution—

(a) for any relevant charge specified in column 2 of Table 1A opposite a risk category specified in column 1 of Table 1A unless—

(i) the application is made in respect of both the VaR and stressed VaR and covers the same positions for that risk category; or

(ii) the application is made in respect of the stressed VaR only, the institution has a deemed approval for the VaR specified in column 2 of Table 1A opposite that risk category, and that stressed VaR and that deemed approval cover the same positions;

(b) for any relevant charge specified in column 3 of Table 1A opposite the risk category, interest rate exposures or equity exposures, as the case may be, specified in column 1 of Table 1A unless—

(i) either—

(A) the application is made in respect of both the VaR and stressed VaR and covers the same positions for that risk category; or

(B) the application is made in respect of the stressed VaR only, the institution has a deemed approval for the VaR specified in column 3 of Table 1A opposite that risk category, and that deemed approval includes the positions covered by that stressed VaR; and

(ii) either—

(A) the institution has also made another application that falls within paragraph (a) for that risk category and that includes the positions covered by the application that falls within subparagraph (i); or

(B) the institution already has the approval in respect of that other application;

(c) for the incremental risk charge specified in column 4 of Table 1A opposite the risk category, interest rate exposures, specified in column 1 of Table 1A unless—

(i) either—

(A) the institution has also made another application that falls within paragraph (a) for that risk category and that includes the positions covered by the application that falls within this paragraph; or

(B) the institution already has the approval in respect of that other application; and

(ii) either—

(A) the institution has also made another application that falls within paragraph (b)(i) for that risk category and that includes the positions covered by the application that falls within this paragraph; or

(B) the institution already has the approval in respect of that other application;

(d) for the comprehensive risk charge specified in column 4 of Table 1A opposite the risk category, interest rate exposures, specified in column 1 of Table 1A unless—

(i) either—

(A) the institution has also made another application that falls within paragraph (a) for that risk category and that includes the positions covered by the application that falls within this paragraph; or

(B) the institution already has the approval in respect of that other application; and

(ii) either—

(A) the institution has also made another application that falls within paragraph (b)(i) for that risk category and that includes the positions covered by the application that falls within this paragraph; or

(B) the institution already has the approval in respect of that other application; and

(e) for the incremental risk charge specified in column 4 of Table 1A opposite the risk category, equity exposures, specified in column 1 of Table 1A unless—

(i) either—

(A) the institution has also made another application that falls within paragraph (a) for that risk category and that includes the positions covered by the application that falls within this paragraph; or

(B) the institution already has the approval in respect of that other application;

(ii) either—

(A) the institution has also made another application that falls within paragraph (b)(i) for that risk category and that includes the positions covered by the application that falls within this paragraph; or

(B) the institution already has the approval in respect of that other application; and

(iii) either—

(A) the institution has also made another application (or other applications) that falls (or fall) within paragraphs (a), (b)(i) and (c) in respect of the risk category, interest rate exposures, specified in column 1 of Table 1A; or

(B) the institution already has the approval in respect of that other application (or those other applications).".

(2) Section 18—

Repeal subsections (2), (3), (4), (5), (6) and (7)

Substitute

"(2) Subject to subsections (1A), (3), (5) and (8), the Monetary Authority must determine an application from an authorized institution by—

(a) granting approval to the institution to use the IMM approach to calculate all the relevant charges that fall within a group of relevant charges to which the application relates; or

(b) refusing to grant the approval.

(3) Without prejudice to the generality of subsection (2)(b), the Monetary Authority must refuse to grant approval to an authorized institution to use the IMM approach to calculate its market risk if any one or more of the requirements specified in Schedule 3 applicable to or in relation to the institution are not satisfied with respect to the institution.

(4) Where an authorized institution uses the IMM approach to calculate its market risk, the institution must not, without the prior consent of the Monetary Authority, make any significant change to any internal model that is

the subject of the approval granted to the institution under subsection (2)(a).

(5) The Monetary Authority may grant an approval under subsection (2)(a) to an authorized institution to use the IMM approach to calculate its market risk in respect of general market risk or specific risk, or both, for any risk categories, or any local or overseas business of the institution, specified in the approval, beginning on any date, or the occurrence of any event, specified in the approval.

(6) Subject to sections 18A(3), 19(2)(a) and 317A, where an authorized institution is granted an approval under subsection (2)(a) and uses the IMM approach to calculate its market risk in respect of general market risk or specific risk, or both, for its positions in all or any risk categories or business, it must not, in respect of those positions, use the STM approach to calculate its market risk except with the prior consent of the Monetary Authority.

(7) To avoid doubt, subject to section 18A(3), an authorized institution that has an approval under subsection (2)(a) must use the STM approach to calculate its market risk for any risk category or business that is not the subject of the approval.".

(3) After section 18(7)—

Add

"(8) To avoid doubt, where an application falls within a combination of 2 or more paragraphs of subsection (1A), the Monetary Authority may, for the purposes of determining under subsection (2) the application, separately apply each of the paragraphs concerned.

(9) In this section—

application (申請) means an application under subsection (1);

approval (批准) means an approval under subsection (2)(a);

deemed approval (當作批准) has the meaning given by section 18A(1)(a);

group of relevant charges (一組有關資本要求) in relation to an authorized institution's use of the IMM approach to calculate market risk—

(a) in respect of general market risk, means the institution's relevant charges that fall within subsection (1A)(a);

(b) in respect of specific risk for interest rate exposures—

(i) for specific risk interest rate exposures that fall within paragraph (a) of the definition of ***incremental risk charge*** in section 281, means the institution's relevant charges that fall within subsection (1A)(b) and (c); and

(ii) for specific risk interest rate exposures that fall within a correlation trading portfolio and where the institution seeks to calculate the comprehensive risk charge for that portfolio, means the institution's relevant charges that fall within subsection (1A)(b) and (d); and

(c) in respect of specific risk for equity exposures—

(i) subject to subparagraph (ii), means the institution's relevant charges that fall within subsection (1A)(b); and

(ii) for equity exposures that fall within paragraph (b) of the definition of ***incremental risk charge*** in section 281 and where the institution seeks to calculate the incremental risk charge for those exposures, means the institution's relevant charges that fall within subsection (1A)(b) and (e);

relevant charge (有關資本要求) means a market risk capital charge under the IMM approach specified in column 2, 3 or 4 of Table 1A.

Table 1A

Market Risk Capital Charge under IMM Approach

Risk category	General market risk	Specific risk	
Column 1	Column 2	Column 3	Column 4
1. Interest rate exposures	VaR	VaR	Incremental risk charge
	Stressed VaR	Stressed VaR	Comprehensive risk charge
2. Equity exposures	VaR	VaR	Incremental risk charge
	Stressed VaR	Stressed VaR	
3. Foreign exchange (including gold) exposures	VaR	—	—
	Stressed VaR		
4. Commodity exposures	VaR	—	—".
	Stressed VaR		

12. Section 18A added

After section 18—

Add

"18A. Transitional provisions applicable to approvals granted under section 18 as in force immediately before commencement date of Banking (Capital) (Amendment) Rules 2011

(1) Subject to subsections (2) and (4), where an authorized institution has in force, immediately before 1 January 2012, an approval under section 18(2)(a) to use the IMM approach to calculate the VaR for general market risk or specific risk, or both, for any risk category or business of the institution specified in the approval (referred to in this section as ***former approval***), then, on and after 1 January 2012—

(a) the former approval is deemed to be an approval granted under section 18(2)(a) to the institution (referred to in this section as ***deemed approval***) to use the IMM approach to calculate the relevant charge for any risk category or business that is the subject of the former approval; and

(b) the other provisions of these Rules (including the definition of ***approval*** in section 18(9)), with all necessary modifications, apply to and in relation to the institution and its deemed approval accordingly.

(2) The application of subsection (1) to an authorized institution does not affect the operation of a notice under section 19(2)(a) that is—

(a) given to the institution before 1 January 2012; and

(b) in force immediately before 1 January 2012.

(3) Where an authorized institution has a deemed approval for a relevant charge specified in column 2 or 3 of Table

1A that is a VaR, the institution must, on and after 1 January 2012, use the STM approach to calculate its market risk for any risk category or business that is the subject of the former approval unless the following applications, where applicable, have been made under section 18(1) to the Monetary Authority and the Monetary Authority has granted the approval in respect of the applications under section 18(2)(a)—

(a) for a deemed approval relating to the VaR for general market risk for any risk category or business, an application that falls within section 18(1A)(a)(ii) in respect of the stressed VaR for general market risk for the positions covered in the deemed approval;

(b) for a deemed approval relating to the VaR for specific risk for the interest rate exposures referred to in paragraph (b)(i) of the definition of ***group of relevant charges*** in section 18(9)—

(i) an application that falls within section 18(1A)(a)(ii) in respect of the stressed VaR for general market risk;

(ii) an application that falls within section 18(1A)(b)(i)(B) in respect of the stressed VaR for specific risk; and

(iii) an application that falls within section 18(1A)(c) in respect of the incremental risk charge,

for the applicable positions covered in the deemed approval;

(c) for a deemed approval relating to the VaR for specific risk for the interest rate exposures referred to in paragraph (b)(ii) of the definition of ***group of relevant charges*** in section 18(9)—

(i) an application that falls within section 18(1A)(a)(ii) in respect of the stressed VaR for general market risk;

(ii) an application that falls within section 18(1A)(b)(i)(B) in respect of the stressed VaR for specific risk; and

(iii) an application that falls within section 18(1A)(d) in respect of the comprehensive risk charge,

for the applicable positions covered in the deemed approval;

(d) for a deemed approval relating to the VaR for specific risk for the interest rate exposures referred to in section 317A(1)(a) and (b) and which the institution seeks to include in its calculation of the VaR and stressed VaR for specific risk for interest rate exposures in accordance with section 317A(2)—

(i) an application that falls within section 18(1A)(a)(ii) in respect of the stressed VaR for general market risk; and

(ii) an application that falls within section 18(1A)(b)(i)(B) in respect of the stressed VaR for specific risk,

for the applicable positions covered in the deemed approval;

(e) for a deemed approval relating to the VaR for specific risk for the equity exposures referred to in paragraph (c)(i) of the definition of ***group of relevant charges*** in section 18(9)—

(i) an application that falls within section 18(1A)(a)(ii) in respect of the stressed VaR for general market risk; and

(ii) an application that falls within section 18(1A)(b)(i)(B) in respect of the stressed VaR for specific risk,

for the applicable positions covered in the deemed approval; and

(f) for a deemed approval relating to the VaR for specific risk for the equity exposures referred to in paragraph (c)(ii) of the definition of ***group of relevant charges*** in section 18(9)—

(i) an application that falls within section 18(1A)(a)(ii) in respect of the stressed VaR for general market risk;

(ii) an application that falls within section 18(1A)(b)(i)(B) in respect of the stressed VaR for specific risk; and

(iii) an application that falls within section 18(1A)(e) in respect of the incremental risk charge,

for the applicable positions covered in the deemed approval.

(4) An authorized institution's deemed approval is deemed to be revoked—

(a) subject to paragraph (b), on 1 July 2012 unless, before that date, the institution has obtained the Monetary Authority's approval under section 18(2)(a) to use the IMM approach to calculate the applicable relevant charge or charges referred to in subsection (3) in respect of that deemed approval; or

(b) if the institution has, before 1 July 2012, made an application under section 18(1) for approval to use the IMM approach to calculate the applicable relevant charge or charges referred to in subsection

(3) in respect of that deemed approval but the application has not been—

(i) determined under section 18(2); or

(ii) finally determined under section 18(2) as read with sections 101B, 101C, 101D, 101E, 101F, 101G, 101H and 101I of the Ordinance,

on the final determination of the application where the Monetary Authority has refused to grant the approval and there is no further step that the institution can take to appeal against that refusal.

(5) In this section—

relevant charge (有關資本要求) has the meaning given by section 18(9).".

13. Section 19 amended (measures which may be taken by Monetary Authority if authorized institution using IMM approach no longer satisfies specified requirements)

Section 19(1)—

Repeal paragraph (b)

Substitute

"(b) the Monetary Authority is satisfied that—

(i) if the institution were to make a fresh application under section 18(1) for approval to use the IMM approach to calculate its market risk, the approval would be refused by virtue of section 18(3); or

(ii) the institution has contravened a condition attached under section 33A(1) or (2) to its approval granted under section 18(2)(a),".

14. Section 21 amended (measures which may be taken by Monetary Authority if authorized institution using approach used by parent bank no longer satisfies specified requirements)

(1) Section 21(1)—

Repeal paragraph (b)

Substitute

"(b) the Monetary Authority is satisfied that—

(i) if the institution were to make a fresh application under section 20(1) for approval to use that approach to calculate its market risk, the approval would be refused—

(A) by virtue of section 20(3); or

(B) because the entity that was the parent bank of the institution has ceased to be the parent bank of the institution; or

(ii) the institution has contravened a condition attached under section 33A(1) or (2) to its approval granted under section 20(2)(a),".

(2) Section 21(1), after "as specified in the notice"—

Add

"or, if the institution falls within paragraph (b)(ii) but does not also fall within paragraph (b)(i), take one or more of the measures set out in subsection (3)".

(3) After section 21(2)—

Add

"(3) The measures referred to in subsection (1) are that—

(a) the Monetary Authority may, by notice in writing given to the institution, require the institution to—

(i) submit to the Monetary Authority a plan, within the period specified in the notice (being a period that is reasonable in all the circumstances of the case), that satisfies the Monetary Authority that, if it were implemented by the institution, the institution would cease to fall within subsection

(1)(b)(ii) within a period that is reasonable in all the circumstances of the case; and

(ii) implement the plan;

(b) the Monetary Authority may, by notice in writing given to the institution, advise the institution that the Monetary Authority is considering exercising the Monetary Authority's power under section 101 of the Ordinance to vary the capital adequacy ratio of the institution by increasing it;

(c) the Monetary Authority may, by notice in writing given to the institution, require the institution to calculate its market risk capital charge by the use of such higher multiplication factor as specified in the notice in accordance with section 319(3); and

(d) the Monetary Authority may, by notice in writing given to the institution, require the institution to reduce its market risk exposures in such manner, or to adopt such measures, specified in the notice that, in the opinion of the Monetary Authority, will cause the institution to cease to fall within subsection (1)(b)(ii) within a period that is reasonable in all the circumstances of the case, or will otherwise mitigate the effect of the institution falling within that subsection.

(4) An authorized institution must comply with the requirements of a notice given to it under subsection (3)(a), (c) or (d).

(5) To avoid doubt, subsection (3)(b) does not operate to prejudice the generality of the circumstances in respect of which the Monetary Authority may exercise the power under section 101 of the Ordinance in the case of an authorized institution to which that subsection applies.".

15. Section 22 amended (exemption from section 17)

(1) Section 22(1)—

Repeal

"institution demonstrates to the satisfaction of the Monetary Authority"

Substitute

"Monetary Authority is satisfied".

(2) Section 22(2)(b)(i)—

Repeal

"section 51"

Substitute

"section 51(1)".

(3) Section 22—

Repeal subsection (3)

Substitute

"(3) The date in relation to which an authorized institution's market risk positions are assessed for the purposes of subsection (1) is—

(a) subject to paragraphs (b) and (c), the calendar quarter end date of each of the 4 consecutive calendar quarters of the same calendar year;

(b) subject to paragraph (c), the calendar quarter end date of the consecutive calendar quarters, being not more than 4 consecutive calendar quarters, specified by the Monetary Authority by notice in writing given to the institution; or

(c) the date specified by the Monetary Authority by notice in writing given to the institution.".

16. Section 23 amended (revocation of exemption under section 22)

Section 23(1)—

Repeal paragraph (b)

Substitute

"(b) either—

(i) the Monetary Authority is satisfied that, if the institution were not already so exempted, the exemption would be refused by virtue of the institution failing to satisfy the Monetary Authority as specified in section 22(1); or

(ii) the institution has given the Monetary Authority a notice referred to in section 22(4)(b),".

17. Sections 23A and 23B added

Part 2, Division 5, after section 23—

Add

"**23A. Exemption from section 18 in respect of portfolio of market risk positions that fall within risk category**

(1) An authorized institution that has made an application under section 18(1) to use, or that uses, the IMM approach to calculate its market risk (referred to in this section as ***relevant calculation***) may apply to the Monetary Authority to have a portfolio of its market risk positions that fall within a risk category (referred to in this section as ***relevant portfolio***), as specified in the application, exempted from inclusion in the relevant calculation.

(2) The Monetary Authority is to determine an application under subsection (1) from an authorized institution by—

(a) exempting from inclusion in the relevant calculation the relevant portfolio if the institution demonstrates to the satisfaction of the Monetary Authority that—

(i) it is not practicable for the institution to include the relevant portfolio in the relevant calculation;

(ii) all the market risk positions that fall within the relevant portfolio have identical or substantially similar transaction characteristics; and

(iii) the exemption will not materially prejudice the calculation of the institution's regulatory capital for market risk; or

(b) refusing to grant the exemption.

(3) An authorized institution to which an exemption under subsection (2)(a) is granted must use the STM approach to calculate its market risk for the relevant portfolio to which the exemption relates.

(4) Where—

(a) an authorized institution is granted an exemption (referred to in this subsection as ***existing exemption***) under subsection (2)(a); and

(b) the institution is at any time thereafter satisfied that if it were to make a fresh application under subsection (1) for an exemption (referred to in this subsection as ***new exemption***) in respect of the relevant portfolio to which the existing exemption relates, the new exemption would be, or may be, refused by virtue of subsection (2),

the institution must, as soon as is practicable after it is so satisfied, give notice in writing to the Monetary Authority of the case.

23B. Revocation of exemption under section 23A

(1) Where—

(a) an authorized institution uses the STM approach to calculate its market risk for a relevant portfolio to which an exemption under section 23A(2)(a) relates; and

(b) the Monetary Authority is satisfied that, if the institution were to make a fresh application under section 23A(1) for an exemption in respect of that portfolio, the exemption would be refused by virtue of section 23A(2),

the Monetary Authority may take either of the measures set out in subsection (2).

(2) The measures referred to in subsection (1) are that—

(a) the Monetary Authority may, by notice in writing given to the institution, require the institution to—

(i) submit to the Monetary Authority a plan, within the period specified in the notice (being a period that is reasonable in all the circumstances of the case), that satisfies the Monetary Authority that, if it were implemented by the institution, the institution would be able to use the IMM approach to calculate its market risk for the relevant portfolio within a period that is reasonable in all the circumstances of the case; and

(ii) implement the plan; and

(b) the Monetary Authority may, by notice in writing given to the institution, revoke the exemption as of the date, or on the occurrence of the event, specified in the notice.

(3) An authorized institution must comply with the requirements of a notice given to it under subsection (2)(a).

(4) To avoid doubt, an authorized institution's compliance with a requirement referred to in subsection (2)(a) does not prejudice the generality of the Monetary Authority's power under subsection (2)(b).

(5) In this section—

relevant portfolio (有關組合) has the meaning given by section 23A(1).".

18. Section 24 amended (authorized institution shall only use BIA approach, STO approach or ASA approach to calculate its operational risk)

Section 24(2), English text—

Repeal

"section"

Substitute

"provision".

19. Section 26 amended (measures which may be taken by Monetary Authority if authorized institution using STO approach or ASA approach no longer satisfies specified requirements)

Section 26(1)—

Repeal paragraph (b)

Substitute

"(b) the Monetary Authority is satisfied that—

(i) if the institution were to make a fresh application under section 25(1) for approval to use the STO approach or ASA approach to calculate its operational risk, the approval would be refused by virtue of section 25(3); or

(ii) the institution has contravened a condition attached under section 33A(1) or (2) to its approval granted under section 25(2)(a),".

20. Section 33 amended (exceptions to section 27)

(1) Section 33(1), after "that subsidiary"—

Add

"specified in the application (which may be all those exposures or a class thereof)".

(2) Section 33(2)(a), after "in the application"—

Add

", or those exposures specified by the Monetary Authority in the approval,".

(3) Section 33(2)(b), after "approval"—

Add

"(whether in whole or in part)".

21. Part 2, Division 7A added

Part 2, after section 33—

Add

"Division 7A—Attachment of Conditions to Approvals Granted under Section 6(2)(a), 8(2)(a), 18(2)(a), 20(2)(a) or 25(2)(a)

33A. Attachment of conditions to approvals granted under section 6(2)(a), 8(2)(a), 18(2)(a), 20(2)(a) or 25(2)(a)

(1) Where the Monetary Authority grants an approval under section 6(2)(a), 8(2)(a), 18(2)(a), 20(2)(a) or 25(2)(a) to an authorized institution, the approval may be granted subject to any conditions that the Monetary Authority thinks proper to attach to the approval in any particular case.

(2) Without limiting the generality of subsection (1), the Monetary Authority may at any time, by notice in writing served on an authorized institution in respect of

which the Monetary Authority has granted an approval under section 6(2)(a), 8(2)(a), 18(2)(a), 20(2)(a) or 25(2)(a) (whether before, on or after 1 January 2012), attach to the institution's approval any conditions (including attach by way of amending conditions already attached to the approval), or cancel any conditions attached to the approval, that the Monetary Authority thinks proper, with effect from—

(a) subject to paragraph (b), the date of service of the notice; or

(b) such later date (if any) as is specified in the notice.".

22. Section 34 substituted

Section 34—

Repeal the section

Substitute

"**34. Reviewable decisions**

(1) Subject to subsection (2), a decision made by the Monetary Authority under section 6(2), 8(2), 18(2), 25(2) or 33A(1) or (2) is a decision to which section 101B(1) of the Ordinance applies.

(2) Subsection (1) does not apply to any decision made by the Monetary Authority under section 33A(1) or (2) to the extent that the decision relates to an approval granted under section 20(2)(a) to an authorized institution.".

23. Section 35 amended (interpretation of Part 3)

(1) Section 35, definition of ***available-for-sale***, paragraph (b)(iii)—

Repeal

"investments;"

Substitute

"investments; or".

(2) Section 35, Chinese text, definition of *綜合規定*, paragraph (b)—

Repeal

"計算。"

Substitute

"計算；".

(3) Section 35—

Add in alphabetical order

"***related company*** (關連公司), in relation to an authorized institution, means a holding company of the institution, or a company in which the institution or a holding company of the institution is entitled to exercise, or control the exercise of, more than 20% of the voting power at any general meeting of the company;".

24. Section 37 amended (essential characteristics of core capital and supplementary capital)

(1) Section 37(2)(c), before "where the"—

Add

"subject to subsection (2A),".

(2) After section 37(2)—

Add

"(2A) Subsection (2)(c) does not apply to an authorized institution's capital items that fall within section 42(1)(g) or (h).".

(3) Section 37—

Repeal subsection (3)

Substitute

"(3) To avoid doubt, an authorized institution must not include in the institution's core capital or supplementary capital any capital instrument issued by it that is covered by a guarantee or other type of contingent liability of the institution (or covered by a guarantee or other type of contingent liability of a related company of the institution) that legally or in any other way enhances the seniority (in terms of the order of repayment of claims) of the holders of the instrument.".

25. Section 42 amended (supplementary capital of authorized institution)

(1) Section 42(1)(f)(ii)—

Repeal

"trading; and"

Substitute

"trading;".

(2) After section 42(1)(f)(ii)—

Add

"(iia) the institution is entitled to defer the payment of dividends on the shares where its profitability will not support such payment; and".

26. Section 44 amended (provisions supplementary to section 42(1)(b))

(1) Section 44(2)—

Repeal paragraphs (a) and (b)

Substitute

"(a) must deduct from its core capital cumulative unrealized losses of the institution that arise from the institution's holdings of available-for-sale equities and debt securities; and

(b) must not, for the purposes of paragraph (a), set-off any impairment losses in respect of the institution's holdings of available-for-sale equities and debt securities against any unrealized gains in respect of those securities.".

(2) Section 44—

Repeal subsection (3).

27. Section 48 amended (deductions from core capital and supplementary capital)

(1) Section 48(1)(d)—

Repeal

"institution; and"

Substitute

"institution;".

(2) Section 48(1)(e)—

Repeal

"(5)."

Substitute

"(5); and".

(3) After section 48(1)(e)—

Add

"(f) the amount of any valuation adjustment made in respect of an exposure of the institution that gives rise to a reduction in the value of the exposure, except—

(i) where that exposure is—

(A) any loan that falls within section 38(d)(i) or (e)(i);

(B) any hedged item or hedging instrument that falls within section 38(d)(ii); or

(C) any hedging instrument that falls within section 38(d)(iii); or

(ii) any part of that amount that has been taken into account in the calculation of—

(A) the amount of reserves (or that part thereof) that falls within section 38(d) or 42(1)(b) or (c); or

(B) the amount of the institution's unaudited profit or loss referred to in section 38(e) in respect of its current financial year, or the amount of the institution's profit or loss pending audit completion referred to in section 38(e) in respect of its immediately preceding financial year.".

28. Section 51 amended (interpretation of Part 4)

(1) Section 51—

Renumber the section as section 51(1).

(2) Section 51(1), English text, definition of ***attributed risk-weight***, paragraph (b)—

Repeal

"peron"

Substitute

"person".

(3) Section 51(1), definition of ***principal amount***—

Repeal paragraph (a)

Substitute

"(a) in relation to an on-balance sheet exposure of an authorized institution—

(i) if the exposure is measured at fair value, means the value of the exposure determined in accordance with section 4A; or

(ii) if the exposure is not measured at fair value, means the book value (including accrued interest) of the exposure; or".

(4) After section 51(1)—

Add

"(2) In subsection (1), for the purposes of the definition of ***attributed risk-weight***—

ECAI issue specific rating (ECAI 特定債項評級)—

(a) in relation to any debt obligation of a person that is not a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the debt obligation by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in section 2(1), and is for the time being neither withdrawn nor suspended by that ECAI; or

(b) in relation to any debt obligation of a person that is a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the debt obligation by an ECAI, and is for the time being neither withdrawn nor suspended by that ECAI;

ECAI issuer rating (ECAI 發債人評級)—

(a) in relation to a person that is not a corporate incorporated in India, means a long-term credit assessment rating that is assigned to the person by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in section 2(1), and is for the time being neither withdrawn nor suspended by that ECAI; or

(b) in relation to a person that is a corporate incorporated in India, means a long-term credit assessment rating that is assigned to the person by an ECAI, and is for the time being neither withdrawn nor suspended by that ECAI.".

29. Section 52 amended (calculation of risk-weighted amount of exposures)

After section 52(3)—

Add

"(4) In subsections (2)(c) and (3)(c)—

ECAI issue specific rating (ECAI 特定債項評級)—

(a) in relation to an exposure to a person that is not a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the exposure by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in section 2(1), and is for the time being neither withdrawn nor suspended by that ECAI;

(b) in relation to an exposure to a collective investment scheme, has the meaning given by section 62(4); or

(c) in relation to an exposure to a person that is a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the exposure by an ECAI, and is for the time being neither withdrawn nor suspended by that ECAI.".

30. Section 55 amended (sovereign exposures)

(1) Section 55—

Repeal subsection (1)

Substitute

"(1) Where a sovereign has an ECAI issuer rating, or a long-term ECAI issue specific rating assigned to a debt obligation issued or undertaken by the sovereign, an authorized institution must map the ECAI issuer rating or long-term ECAI issue specific rating, as the case may be, to a scale of credit quality grades represented by the numerals 1, 2, 3, 4, 5 and 6 in accordance with Table A in Schedule 6.".

(2) Section 55(3)—

Repeal

"an ECAI issue specific rating"

Substitute

"a long-term ECAI issue specific rating".

31. Section 59 amended (bank exposures)

Section 59(6), before "Table E"—

Add

"Part 1 of".

32. Section 60 amended (securities firm exposures)

Section 60(6), before "Table E"—

Add

"Part 1 of".

33. Section 61 amended (corporate exposures)

(1) Section 61(1), before "Table C"—

Add

"Part 1 of".

(2) Section 61(3)—

Repeal

everything after "in accordance with"

Substitute

"Part 1 of Table C in Schedule 6.".

(3) Section 61(6), before "Table E"—

Add

"Part 1 of".

(4) Section 61(7)—

Repeal

everything after "in accordance with"

Substitute

"Part 1 of Table E in Schedule 6.".

34. Section 61A added

After section 61—

Add

"61A. Application of section 61

(1) Section 61—

(a) applies to a corporate incorporated outside India; and

(b) subject to the modifications described in subsection (2), applies to a corporate incorporated in India.

(2) The modifications mentioned in subsection (1)(b) are that—

(a) the references in section 61 to "ECAI issue specific rating" are construed as having the meaning given by paragraph (a) of the definition of ***ECAI issue specific rating*** in section 2(1);

(b) the references in section 61 to "ECAI issuer rating" are construed as having the meaning given by paragraph (a) of the definition of ***ECAI issuer rating*** in section 2(1);

(c) the references in section 61 to "long-term ECAI issue specific rating" are construed as having the meaning given by paragraph (a) of the definition of ***long-term ECAI issue specific rating*** in section 2(1);

(d) the references in section 61 to "short-term ECAI issue specific rating" are construed as having the meaning given by paragraph (a) of the definition of ***short-term ECAI issue specific rating*** in section 2(1);

(e) the references in section 61 to "Part 1 of Table C in Schedule 6" are construed as "Part 1 or 2 of Table C in Schedule 6";

(f) the references in section 61 to "Part 1 of Table E in Schedule 6" are construed as "Part 1 or 2 of Table E in Schedule 6"; and

(g) the reference in section 61 to "the numerals 1, 2, 3 and 4 in accordance with Part 1 of Table E in Schedule 6" is construed as "the numerals 1, 2, 3 and 4 in accordance with Part 1 of Table E in Schedule 6 or the numerals 1, 2, 3, 4 and 5 in accordance with Part 2 of that Table".".

35. Section 62 amended (collective investment scheme exposures)

After section 62(3)—

Add

"(4) In this section—

ECAI issue specific rating (ECAI特定債項評級), means a short-term credit assessment rating or long-term credit assessment rating—

(a) that is assigned by an ECAI within the meaning of paragraph (a), (b), (c) or (d) of the definition of ***external credit assessment institution*** in section

2(1) to a collective investment scheme that only holds cash or fixed income assets;

(b) that is assigned to the scheme by that ECAI based on the credit quality of the cash held or the fixed income assets held, as the case may be; and

(c) that is for the time being neither withdrawn nor suspended by that ECAI.".

36. Section 63 amended (cash items)

Section 63—

Repeal

"section 51" (wherever appearing)

Substitute

"section 51(1)".

37. Section 65 amended (residential mortgage loans)

Section 65(1)—

Repeal paragraph (e)

Substitute

"(e) after the loan is drawn by the borrower or purchased by the institution, as the case may be, the loan-to-value ratio of the loan does not exceed 100% at the time of the allocation of the risk-weight to the loan; and".

38. Section 66 amended (other exposures which are not past due exposures)

(1) Section 66(1)(a)—

Repeal

"section 62; and"

Substitute

"section 62;".

(2) Section 66(1)(b)—

Repeal

"is applicable)."

Substitute

"is applicable); and".

(3) After section 66(1)(b)—

Add

"(c) instruments that—

(i) fall within the definition of ***other regulatory capital instrument*** in section 35; and

(ii) are not subject to deduction from an authorized institution's core capital and supplementary capital under section 48(2).".

(4) Section 66(5)—

Repeal

"on-balance sheet".

39. Section 68 substituted

Section 68—

Repeal the section

Substitute

"**68. Credit-linked notes**

Where an authorized institution has an exposure in respect of a credit-linked note held by the institution—

(a) if the note has an ECAI issue specific rating, the institution must, subject to paragraphs (b) and (c)—

(i) classify the exposure, in accordance with the issuer or reference entity of the note, into that class of exposures specified in section 54 that will result in the highest risk-weight; and

(ii) determine the risk-weight of the note by mapping the ECAI issue specific rating to a scale of credit quality grades applicable to the rating in accordance with section 55, 56, 57, 58, 59, 60 or 61, as the case requires, or, if the note does not fall within any ECAI ratings based portfolio (within the meaning of section 70(8)) of the institution, by applying section 66, or treat the note as not having an ECAI issue specific rating if, for the class of exposures within which the note falls, there is no scale of credit quality grades applicable to the rating;

(b) if the note falls within paragraph (a) and is a past due exposure, the institution must determine the risk-weight of the note in accordance with section 67;

(c) if the note falls within paragraph (a) and it—

(i) is a first-to-default, second-to-default or n^{th}-to-default note; or

(ii) provides credit protection proportionately to a basket of reference obligations,

the institution must assign a risk-weight to the exposure, or deduct the exposure from its core capital and supplementary capital, in accordance with section 237 as if that exposure were a securitization exposure;

(d) if the note does not have an ECAI issue specific rating, the institution must, subject to paragraph (e), allocate a risk-weight to the exposure that is the greater of—

(i) the risk-weight attributable to the reference obligation of the note as determined in accordance with sections 55, 56, 57, 58, 59,

60, 61, 62, 63, 64, 65, 66 and 67 as if the institution had a direct exposure to the reference obligation; and

(ii) the attributed risk-weight of the issuer of the note; and

(e) if the note falls within paragraph (d) and it—

(i) is a first-to-default, second-to-default or n^{th}-to-default note; or

(ii) provides credit protection proportionately to a basket of reference obligations,

the institution must determine the risk-weight attributable to the pool of reference obligations of the note in accordance with section 74(3)(b), (4)(b), (5) or (6), as the case requires, as if the institution had a direct exposure to the credit default swap embedded in the note.".

40. Section 69 amended (application of ECAI ratings)

(1) Section 69(9)(a)—

Repeal

"shall".

(2) Section 69(9)(a)—

Repeal subparagraphs (i) and (ii)

Substitute

"(i) must use ECAI ratings applicable to foreign currency, if available, to the extent that the exposure is denominated in foreign currency;

(ii) must use ECAI ratings applicable to local currency, if available, to the extent that the exposure is denominated in local currency; and".

(3) After section 69(9)(a)(ii)—

Add

"(iii) may use ECAI issuer ratings applicable to foreign currency, if available, to the extent that—

(A) the exposure is denominated in local currency; and

(B) there is not available an ECAI rating applicable to local currency;".

(4) After section 69(9)—

Add

"(10) An authorized institution, in complying with the requirements under subsection (3), (4), (5), (6) or (7) or section 59(8), (9) or (10), 60(8) or (9) or 61(8) or (9), must not use an ECAI issue specific rating allocated to a debt obligation that has ceased to be outstanding.

(11) In this section—

ECAI issue specific rating (ECAI 特定債項評級)—

(a) in relation to an exposure to a sovereign, a bank, a securities firm or a corporate incorporated outside India, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the exposure by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in section 2(1), and is for the time being neither withdrawn nor suspended by that ECAI;

(b) in relation to an exposure to a collective investment scheme, has the meaning given by section 62(4); or

(c) in relation to an exposure to a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the exposure by an ECAI, and is for the time being neither withdrawn nor suspended by that ECAI;

ECAI issuer rating (ECAI 發債人評級)—

(a) in relation to a sovereign, a bank, a securities firm or a corporate incorporated outside India, means a long-term credit assessment rating that is assigned to the sovereign, bank, securities firm or corporate by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in section 2(1), and is for the time being neither withdrawn nor suspended by that ECAI; or

(b) in relation to a corporate incorporated in India, means a long-term credit assessment rating that is assigned to the corporate by an ECAI, and is for the time being neither withdrawn nor suspended by that ECAI;

long-term ECAI issue specific rating (長期ECAI特定債項評級)—

(a) in relation to an exposure to a sovereign, a bank, a securities firm or a corporate incorporated outside India, means an ECAI issue specific rating assigned to the exposure by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in section 2(1) that is a long-term credit assessment rating; or

(b) in relation to an exposure to a corporate incorporated in India, means an ECAI issue specific rating assigned to the exposure by an ECAI that is a long-term credit assessment rating.".

41. Section 72 amended (provisions supplementary to section 71)

(1) Section 72(e)—

Repeal

"commitment."

Substitute

"commitment;".

(2) After section 72(e)—

Add

"(f) in the case of an off-balance sheet exposure that is a credit derivative contract where—

(i) the contract is a credit default swap, the institution is the protection seller and a regulatory capital calculated in accordance with section 74 has been provided in respect of the credit risk of the reference obligation underlying the swap; or

(ii) the institution is the protection buyer and the credit risk mitigation effect of the contract has been recognized and taken into account, in accordance with Divisions 9 and 10, for the purposes of the calculation of the risk-weighted amount of the exposure to which credit protection is provided by the contract,

the institution must treat the credit equivalent amount of the exposure as zero.".

42. Section 73 substituted

Section 73—

Repeal the section

Substitute

"**73. Calculation of credit equivalent amount of other off-balance sheet exposures not specified in Table 10 or 11**

An authorized institution must, in calculating the risk-weighted amount of an off-balance sheet exposure that is not specified in Table 10 or 11—

(a) subject to paragraph (c), if the exposure is not specified in Table 10 and is neither an OTC derivative transaction nor a credit derivative

contract, calculate the credit equivalent amount of the exposure by applying a CCF of 100% in accordance with section 71(1) with all necessary modifications;

(b) subject to paragraph (c), if the exposure is an OTC derivative transaction or credit derivative contract that is not specified in Table 11, calculate the credit equivalent amount of the exposure by treating the exposure as if it fell within item 5 of Table 11 and applying the relevant CCF specified in that item in accordance with section 71(2) with all necessary modifications; or

(c) calculate the credit equivalent amount of the exposure by applying the CCF applicable to the exposure pursuant to Part 2 of Schedule 1 in accordance with section 71(1) or (2), as the case requires, with all necessary modifications.".

43. Section 77 amended (recognized collateral)

Section 77(i)—

Repeal

"(k), (l),"

Substitute

"(ja), (k), (l), (la),".

44. Section 79 amended (collateral which may be recognized for purposes of section 77(i)(i))

(1) Section 79—

Repeal paragraph (j)

Substitute

"(j) debt securities issued by a corporate incorporated outside India that have a long-term ECAI issue specific rating that, if mapped to the scale of credit quality grades

in Part 1 of Table C in Schedule 6, would result in the debt securities being assigned a credit quality grade of 1, 2 or 3;".

(2) After section 79(j)—

Add

"(ja) debt securities issued by a corporate incorporated in India that have a long-term ECAI issue specific rating that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the debt securities being assigned a credit quality grade of 1, 2 or 3 or, if mapped to the scale of credit quality grades in Part 2 of that Table, would result in the debt securities being assigned a credit quality grade of 1, 2, 3 or 4;".

(3) Section 79(k), before "Table E"—

Add

"Part 1 of".

(4) Section 79—

Repeal paragraph (l)

Substitute

"(l) debt securities issued by a bank, a securities firm or a corporate incorporated outside India that have a short-term ECAI issue specific rating that, if mapped to the scale of credit quality grades in Part 1 of Table E in Schedule 6, would result in the debt securities being assigned a credit quality grade of 1, 2 or 3;".

(5) After section 79(l)—

Add

"(la) debt securities issued by a corporate incorporated in India that have a short-term ECAI issue specific rating that, if mapped to the scale of credit quality grades in Part 1 of Table E in Schedule 6, would result in the debt securities being assigned a credit quality grade of 1, 2 or

3 or, if mapped to the scale of credit quality grades in Part 2 of that Table, would result in the debt securities being assigned a credit quality grade of 1, 2, 3 or 4;".

(6) Section 79(m)(iii), before "Table E"—

Add

"Part 1 of".

(7) Section 79(m)(iv), before "Table E"—

Add

"Part 1 of".

45. Section 80 amended (collateral which may be recognized for purposes of section 77(i)(ii))

Section 80(a)—

Repeal

"(k), (l),"

Substitute

"(ja), (k), (l), (la),".

46. Section 82 amended (determination of risk-weight to be allocated to recognized collateral under simple approach)

(1) Section 82(1)—

Repeal paragraph (a)

Substitute

"(a) subject to paragraph (b)—

(i) must, subject to subparagraph (ii), determine the risk-weight to be allocated to the collateral in accordance with sections 55, 56, 57, 58, 59, 60, 61, 62, 63, 66 and 68 as if the collateral were an on-balance sheet exposure; and

(ii) if the collateral is a securitization issue, must determine the risk-weight to be allocated to the

collateral in accordance with section 237 as if the collateral were an on-balance sheet exposure; and".

(2) Section 82(4)(c)—

Repeal

"section 51"

Substitute

"section 51(1)".

(3) Section 82(5), definition of ***cash***, paragraph (a)—

Repeal

"transaction;"

Substitute

"transaction; or".

47. Section 84 amended (calculation of risk-weighted amount of off-balance sheet exposures other than OTC derivative transactions)

(1) Section 84, heading, after "**transactions**"—

Add

"**or credit derivative contracts**".

(2) Section 84—

Repeal

"not an OTC derivative transaction"

Substitute

"neither an OTC derivative transaction nor a credit derivative contract".

48. Section 85 amended (calculation of risk-weighted amount of OTC derivative transactions)

(1) Section 85, heading, after "**transactions**"—

Add

"and credit derivative contracts".

(2) Section 85—

Renumber the section as section 85(1).

(3) After section 85(1)—

Add

"(2) Subsection (1), with all necessary modifications, applies to the calculation of the risk-weighted amount of each of an authorized institution's off-balance sheet exposures that is a credit derivative contract as it applies to the calculation of the risk-weighted amount of each of the institution's off-balance sheet exposures that is an OTC derivative transaction.".

49. Section 96 amended (netting of repo-style transactions)

(1) Section 96(2)(b)(ii), after "trading book"—

Add

"where the arrangements for the provision of collateral in respect of the transactions satisfy all the requirements of section 77 (other than the requirements of section 77(g) and (i)(i))".

(2) Section 96(5)(b), Chinese text—

Repeal

"賬"

Substitute

"帳".

50. Section 97 amended (use of value-at-risk model instead of Formula 9)

(1) Section 97(4)—

Repeal paragraph (c)

Substitute

"(c) the quality of the model has proved acceptable pursuant to a back-testing of the model—

(i) using data covering at least a one-year period; and

(ii) that covers representative counterparty portfolios that have been chosen based on the sensitivity of the portfolios to the material risk factors and correlations to which the institution is exposed.".

(2) Section 97(6), Formula 10—

Repeal

"x multiplier".

(3) Section 97(6), Formula 10, after "as collateral;"—

Add

"and".

(4) Section 97(6), Formula 10—

Repeal

"business day; and"

Substitute

"business day.".

(5) Section 97(6), Formula 10—

Repeal

"multiplier = the relevant multiplier derived in accordance with subsection (7) and Table 13.".

(6) Section 97(6)—

Repeal Table 13.

(7) Section 97—

Repeal subsections (7) and (8).

51. Section 98 amended (recognized guarantees)

(1) Section 98(a)(v)—

Repeal

"or".

(2) Section 98(a)—

Repeal subparagraph (vi)

Substitute

"(vi) a corporate incorporated outside India that has an ECAI issuer rating that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1 or 2; or".

(3) After section 98(a)(vi)—

Add

"(vii) a corporate incorporated in India that has an ECAI issuer rating that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1 or 2 or, if mapped to the scale of credit quality grades in Part 2 of that Table, would result in the corporate being assigned a credit quality grade of 1, 2 or 3,".

52. Section 99 amended (recognized credit derivative contracts)

(1) Section 99(1)(b)(v)—

Repeal

"or".

(2) Section 99(1)(b)—

Repeal subparagraph (vi)

Substitute

"(vi) a corporate incorporated outside India that has an ECAI issuer rating that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1 or 2; or".

(3) After section 99(1)(b)(vi)—

Add

"(vii) a corporate incorporated in India that has an ECAI issuer rating that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1 or 2 or, if mapped to the scale of credit quality grades in Part 2 of that Table, would result in the corporate being assigned a credit quality grade of 1, 2 or 3,".

53. Section 105 amended (interpretation of Part 5)

Section 105, definition of ***principal amount***—

Repeal paragraph (a)

Substitute

"(a) in relation to an on-balance sheet exposure of an authorized institution—

(i) if the exposure is measured at fair value, means the value of the exposure determined in accordance with section 4A; or

(ii) if the exposure is not measured at fair value, means the book value (including accrued interest) of the exposure; or".

54. Section 109 amended (sovereign exposures)

(1) Section 109—

Repeal subsections (5), (6), (10) and (11).

(2) Section 109(12)—

Repeal

", (9), (10) or (11)"

Substitute

"or (9)".

55. Section 116 amended (other exposures)

(1) Section 116(1)(a)—

Repeal

"and".

(2) Section 116(1)(b)—

Repeal

"is applicable).".

Substitute

"is applicable); and".

(3) After section 116(1)(b)—

Add

"(c) instruments that—

(i) fall within the definition of ***other regulatory capital instrument*** in section 35; and

(ii) are not subject to deduction from an authorized institution's core capital and supplementary capital under section 48(2).".

(4) Section 116(5)—

Repeal

"on-balance sheet".

56. Section 117 amended (credit-linked notes)

Section 117—

Repeal paragraph (a)

Substitute

"(a) the risk-weight attributable to—

(i) subject to subparagraph (ii), the reference obligation of the note as determined in accordance with sections 109, 110, 111, 112, 113, 114, 115 and

116 as if the institution had a direct exposure to the reference obligation;

(ii) if the note—

(A) is a first-to-default, second-to-default or n^{th}-to-default note; or

(B) provides credit protection proportionately to a basket of reference obligations,

the pool of reference obligations of the note as determined in accordance with section 121(3), (4), (5) or (6), as the case requires, as if the institution had a direct exposure to the credit default swap embedded in the note; and".

57. Section 119 amended (provisions supplementary to section 118)

(1) Section 119(e)—

Repeal

"commitment."

Substitute

"commitment;".

(2) After section 119(e)—

Add

"(f) in the case of an off-balance sheet exposure that is a credit derivative contract where—

(i) the contract is a credit default swap, the institution is the protection seller and a regulatory capital calculated in accordance with section 121 has been provided in respect of the credit risk of the reference obligation underlying the swap; or

(ii) the institution is the protection buyer and the credit risk mitigation effect of the contract has been recognized and taken into account, in accordance with Divisions 7 and 8, for the purposes of the

calculation of the risk-weighted amount of the exposure to which credit protection is provided by the contract,

the institution must treat the credit equivalent amount of that exposure as zero.".

58. Section 120 substituted

Section 120—

Repeal the section

Substitute

"**120. Calculation of credit equivalent amount of other off-balance sheet exposures not specified in Table 14 or 15**

An authorized institution must, in calculating the risk-weighted amount of an off-balance sheet exposure that is not specified in Table 14 or 15—

(a) subject to paragraph (c), if the exposure is not specified in Table 14 and is neither an OTC derivative transaction nor a credit derivative contract, calculate the credit equivalent amount of the exposure by applying a CCF of 100% in accordance with section 118(1) with all necessary modifications;

(b) subject to paragraph (c), if the exposure is an OTC derivative transaction or credit derivative contract that is not specified in Table 15, calculate the credit equivalent amount of the exposure by treating the exposure as if it fell within item 5 of Table 15 and applying the relevant CCF specified in that item in accordance with section 118(2) with all necessary modifications; or

(c) calculate the credit equivalent amount of the exposure by applying the CCF applicable to the exposure pursuant to Part 2 of Schedule 1 in

accordance with section 118(1) or (2), as the case requires, with all necessary modifications.".

59. Section 128 amended (calculation of risk-weighted amount of off-balance sheet exposures other than OTC derivative transactions)

(1) Section 128, heading, after "**transactions**"—

Add

"**or credit derivative contracts**".

(2) Section 128—

Repeal

"not an OTC derivative transaction"

Substitute

"neither an OTC derivative transaction nor a credit derivative contract".

60. Section 129 amended (calculation of risk-weighted amount of OTC derivative transactions)

(1) Section 129, heading, after "**transactions**"—

Add

"**and credit derivative contracts**".

(2) Section 129—

Renumber the section as section 129(1).

(3) After section 129(1)—

Add

"(2) Subsection (1), with all necessary modifications, applies to the calculation of the risk-weighted amount of each of an authorized institution's off-balance sheet exposures that is a credit derivative contract as it applies to the calculation of the risk-weighted amount of each of the

institution's off-balance sheet exposures that is an OTC derivative transaction.".

61. Section 130 amended (on-balance sheet netting)

Section 130(2), English text, Formula 14, heading—

Repeal

"EXPOSE"

Substitute

"EXPOSURE".

62. Section 134 amended (capital treatment of recognized guarantees and recognized credit derivative contracts)

Section 134—

Repeal subsection (3)

Substitute

"(3) Where a guarantor referred to in subsection (1) is a sovereign, then, for the purposes of that subsection, the risk-weight attributable to the guarantor is that attributable under—

(a) if the institution's exposure covered by the guarantee concerned is to a debt security, section 109(3), (4), (8) or (9), as the case requires; or

(b) if the institution's exposure covered by the guarantee concerned is not to a debt security, section 109(2) or (7), as the case requires.".

63. Section 139 amended (interpretation of Part 6)

(1) Section 139(1), definition of ***cash items***, paragraph (h)(ii)—

Repeal

"transaction; or"

Substitute

"transaction;".

(2) Section 139(1)—

Repeal the definition of *financial firm*

Substitute

"***financial firm*** (金融商號), in relation to the recognition of a guarantee or credit derivative contract in respect of an exposure of an authorized institution under the double default framework, means—

(a) a bank;

(b) a securities firm;

(c) an insurance firm;

(d) a corporate incorporated outside India that has an ECAI issuer rating that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1, 2 or 3; or

(e) a corporate incorporated in India that has an ECAI issuer rating that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1, 2 or 3 or, if mapped to the scale of credit quality grades in Part 2 of that Table, would result in the corporate being assigned a credit quality grade of 1, 2, 3 or 4,

that—

(f) has provided, in the normal course of business, credit protection for the exposure where the credit protection concerned is not the subject of any counter-guarantee given by a sovereign;

(g) has had an exposure to it assigned by the institution, at the time the credit protection was first provided, to an obligor grade with an estimate of PD that—

(i) if mapped to the scale of credit quality grades for banks and securities firms in Table B in Schedule 6, would result in the entity being assigned a credit quality grade of 1 or 2;

(ii) if mapped to the scale of credit quality grades for corporates in Part 1 of Table C in Schedule 6, would result in the entity being assigned a credit quality grade of 1 or 2; or

(iii) if mapped to the scale of credit quality grades for corporates incorporated in India in Part 2 of Table C in Schedule 6, would result in the entity being assigned a credit quality grade of 1, 2 or 3;

(h) currently has an exposure to it assigned by the institution to an obligor grade with an estimate of PD that—

(i) if mapped to the scale of credit quality grades for banks and securities firms in Table B in Schedule 6, would result in the entity being assigned a credit quality grade of 1, 2 or 3;

(ii) if mapped to the scale of credit quality grades for corporates in Part 1 of Table C in Schedule 6, would result in the entity being assigned a credit quality grade of 1, 2 or 3; or

(iii) if mapped to the scale of credit quality grades for corporates incorporated in India in Part 2 of Table C in Schedule 6, would result in the entity being assigned a credit quality grade of 1, 2, 3 or 4; and

(i) has not had, at any time since the credit protection was first provided, an exposure to it assigned by the institution to an obligor grade with an estimate of PD that—

(i) if mapped to the scale of credit quality grades for banks and securities firms in Table B in Schedule 6 or corporates in Part 1 of Table C in Schedule 6, as the case may be, would result in the entity being assigned a credit quality grade of 4 or 5; or

(ii) if mapped to the scale of credit quality grades for corporates incorporated in India in Part 2 of Table C in Schedule 6, would result in the entity being assigned a credit quality grade of 5;".

(3) Section 139(1), definition of ***maturity***, paragraph (a)—

Repeal

"requires;"

Substitute

"requires; or".

(4) Section 139(1), definition of ***principal amount***—

Repeal paragraph (a)

Substitute

"(a) in relation to an on-balance sheet exposure of an authorized institution—

(i) if the exposure is measured at fair value, means the value of the exposure determined in accordance with section 4A; or

(ii) if the exposure is not measured at fair value, means the book value (including accrued interest) of the exposure; or".

(5) Section 139(1), definition of ***recognized collateral***, paragraph (a)—

Repeal

"collateral;" (wherever appearing)

Substitute

"collateral; or".

(6) Section 139(1), definition of ***recognized credit derivative contract***, paragraph (a)—

Repeal

"requires;"

Substitute

"requires; or".

(7) Section 139(1)—

Repeal the definition of *recognized financial collateral*

Substitute

"***recognized financial collateral*** (認可財務抵押品) means any collateral (except collateral in the form of real property)—

(a) that falls within the description of section 80(a), (b), (c) or (d); and

(b) that satisfies the requirements under section 77(a), (b), (c), (d), (e) and (f);".

(8) Section 139(1), definition of ***recognized guarantee***, paragraph (a)—

Repeal

"requires;"

Substitute

"requires; or".

64. Section 140A added

After section 140—

Add

"140A. Calculation of exposure at default

(1) Subject to subsection (2), an authorized institution must estimate the EAD of exposures under this Part in accordance with section 163, 164, 165, 166, 179, 180, 181, 182, 183, 195, 196, 197, 201 or 202, as appropriate.

(2) For the purposes of subsection (1), for estimating the EAD of on-balance sheet exposures that are measured at fair value—

(a) in respect of sections 163 and 164, a reference to current drawn amount is a reference to the value determined in accordance with section 4A; and

(b) in respect of section 183, an authorized institution must determine the EAD of an equity exposure of the institution as the value of the equity exposure determined in accordance with section 4A.".

65. Section 146 amended (other exposures)

(1) Section 146(1)—

Repeal

"For"

Substitute

"Subject to subsection (2), for".

(2) Section 146—

Repeal subsection (2)

Substitute

"(2) For the purposes of section 142(1) as read with Table 16, an authorized institution must classify under the IRB subclass of other items—

(a) any of the institution's other exposures that do not fall within the IRB subclass of cash items; and

(b) any of the institution's exposures that—

(i) fall within the definition of ***other regulatory capital instrument*** in section 35; and

(ii) are not subject to deduction from the institution's core capital and supplementary capital under section 48(2).".

66. Section 149 amended (default of obligor)

(1) Section 149(1)—

Repeal

"For"

Substitute

"Subject to subsection (4), for".

(2) Section 149(2)—

Repeal paragraph (a)

Substitute

"(a) subject to paragraph (b), an authorized institution—

(i) must treat the exposure as being in default; and

(ii) may treat all other outstanding credit obligations of the obligor to the institution (or to any member of the consolidated group of the institution) as being in default;".

(3) After section 149(5)—

Add

"(5A) Subject to subsection (5B), an authorized institution must treat its exposures to all individual obligors in a connected group as being in default if—

(a) a default of an obligor (referred to in this subsection as ***defaulting obligor***) in the connected group has—

(i) without prejudice to subsection (2), occurred in respect only of—

(A) one exposure that is a retail exposure; or

(B) 2 or more exposures that include at least one retail exposure; or

(ii) occurred in respect only of one or more than one exposure that is not a retail exposure; and

(b) the defaulting obligor has been rated substantially on the basis of the economic or financial interdependence between the members in the connected group pursuant to section 154(c) and (d).

(5B) An authorized institution must disregard subsection (5A) in respect of—

(a) any obligor in the connected group that has been rated on a basis that reflects the specific circumstances of the obligor and without regard to any economic or financial support available to that obligor by any other member in the connected group; and

(b) any other obligor in the connected group if the institution demonstrates, to the satisfaction of the Monetary Authority, that—

(i) that other obligor has not been rated as referred to in subsection (5A)(b); and

(ii) disregarding subsection (5A) in respect of that other obligor—

(A) is neither imprudent nor unreasonable; and

(B) will not materially prejudice the calculation of the institution's regulatory capital for credit risk.".

(4) Section 149—

Repeal subsection (9)

Substitute

"(9) In this section—

prescribed default criteria (訂明違責準則) means the criteria specified in subsection (1);

rated (受評級), in relation to an obligor of an authorized institution, means that the institution's corporate, sovereign or bank exposures to the obligor have been assigned to obligor grades by using the IRB approach.".

67. Section 154 amended (rating coverage)

(1) Section 154(a)—

Repeal

"approvals; and"

Substitute

"approvals;".

(2) Section 154(b)—

Repeal

"exposure."

Substitute

"exposure;".

(3) After section 154(b)—

Add

"(c) subject to paragraph (d), rate on an individual basis each legal entity to which the institution is exposed; and

(d) for the purposes of paragraph (c), demonstrate, to the satisfaction of the Monetary Authority, that its policy and practices regarding the assignment of exposures to obligor grades in respect of individual obligors in a connected group—

(i) are prudent and reasonable;

(ii) set out, at the least—

(A) the circumstances under which the institution may or may not assign the same obligor grade in respect of exposures to separate obligors in a connected group; and

(B) the definition of a connected group for the purposes of rating assignment; and

(iii) are applied in a consistent manner.".

68. Section 155 amended (integrity of rating process)

(1) Section 155(e)—

Repeal subparagraphs (i) and (ii)

Substitute

"(i) identifying, documenting, reviewing and updating the circumstances in which it is appropriate for officers of the institution to override the inputs to, or the outputs of, the institution's rating system;

(ii) ensuring that such circumstances are prudent;".

(2) After section 155(e)(ii)—

Add

"(iii) ensuring that all permissible overrides are approved by officers of the institution having delegated credit authority and are applied in a consistent manner; and

(iv) monitoring the nature and performance of such overrides following approval.".

69. Section 166 amended (exposure at default under foundation IRB approach or advanced IRB approach—other off-balance sheet exposures not specified in Table 11 or 20)

Section 166—

Repeal

everything after "of the exposure"

Substitute

"—

(a) subject to paragraph (c), if the exposure is not specified in Table 20 and is neither an OTC derivative transaction nor a credit derivative contract, by applying a CCF of 100%, and in accordance with section 163 or 164, as the case requires, with all necessary modifications;

(b) subject to paragraph (c), if the exposure is an OTC derivative transaction or credit derivative contract that is not specified in Table 11, by treating the exposure as if it fell within item 5 of Table 11 and applying the relevant CCF specified in that item, and in accordance with section 165 with all necessary modifications; or

(c) by applying the CCF applicable to the exposure pursuant to Part 2 of Schedule 1, and in accordance with section 163, 164 or 165, as the case requires, with all necessary modifications.".

70. Section 175 amended (integrity of rating process)

(1) Section 175(c)—

Repeal subparagraphs (i) and (ii)

Substitute

"(i) identifying, documenting, reviewing and updating the circumstances in which it is appropriate for officers of the institution to override the inputs to, or the outputs of, the institution's rating system;

(ii) ensuring that such circumstances are prudent;".

(2) After section 175(c)(ii)—

Add

"(iii) ensuring that all permissible overrides are approved by officers of the institution having delegated credit authority and are applied in a consistent manner; and

(iv) monitoring the nature and performance of such overrides following approval.".

71. Section 178 amended (loss given default)

Section 178(1)—

Repeal paragraph (c)

Substitute

"(c) subject to paragraph (d), the estimate of the LGD of a retail exposure that falls within the IRB subclass of residential mortgages to individuals or residential mortgages to property-holding shell companies is not less than 10%;".

72. Section 182 amended (exposure at default—other off-balance sheet exposures not specified in Table 11 or 20)

Section 182—

Repeal

everything after "of the exposure"

Substitute

"—

(a) subject to paragraph (c), if the exposure is not specified in Table 20 and is neither an OTC derivative transaction nor a credit derivative contract, by applying a CCF of 100%, and in accordance with section 180 with all necessary modifications;

(b) subject to paragraph (c), if the exposure is an OTC derivative transaction or credit derivative contract that is not specified in Table 11, by treating the exposure as if it fell within item 5 of Table 11 and applying the relevant CCF specified in that item, and in accordance with section 181 with all necessary modifications; or

(c) by applying the CCF applicable to the exposure pursuant to Part 2 of Schedule 1, and in accordance with section 180 or 181, as the case requires, with all necessary modifications.".

73. Section 193 amended (PD/LGD approach—integrity of rating process)

(1) Section 193(e)—

Repeal subparagraphs (i) and (ii)

Substitute

"(i) identifying, documenting, reviewing and updating the circumstances in which it is appropriate for officers of the institution to override the inputs to, or the outputs of, the institution's rating system;

(ii) ensuring that such circumstances are prudent;".

(2) After section 193(e)(ii)—

Add

"(iii) ensuring that all permissible overrides are approved by officers of the institution having delegated credit authority and are applied in a consistent manner; and

(iv) monitoring the nature and performance of such overrides following approval.".

74. Section 201 amended (leasing arrangements)

Section 201(1)(b), Chinese text—

Repeal

"信用風險減低效果"

Substitute

"減低信用風險效果".

75. Section 202 amended (repo-style transactions)

(1) Section 202(a)—

Repeal

"falls; and"

Substitute

"falls;".

(2) After section 202(a)—

Add

"(aa) the institution must determine, by reference to Part 8, the risk-weight to be allocated to its exposure under a repo-style transaction booked in the institution's trading book, that falls within paragraph (a) or (b) of the definition of ***repo-style transaction*** in section 2(1), or paragraph (d) of that definition where the collateral provided by the institution is in the form of securities; and".

76. Section 202A added

Part 6, Division 9, after section 202—

Add

"202A. Credit-linked notes

(1) Subject to subsection (2), an authorized institution that has an exposure in respect of a credit-linked note held by the institution must allocate a risk-weight, as determined by the applicable risk-weight function, to the exposure that is the greater of—

(a) the risk-weight attributable to the reference obligation or basket of reference obligations of the note, as the case may be, as if the institution had a direct exposure to the reference obligation or the basket of reference obligations; and

(b) the risk-weight attributable to the note.

(2) An authorized institution is not required to provide regulatory capital for its exposure in respect of a credit-

linked note held by the institution in excess of the institution's maximum liability under the note.".

77. Section 204 amended (recognized collateral)

Section 204, Chinese text—

Repeal

"信用風險減低效果"

Substitute

"減低信用風險效果".

78. Section 208 amended (leased assets may be recognized as collateral)

Section 208(e), Chinese text—

Repeal

"信用風險減低效果"

Substitute

"減低信用風險效果".

79. Section 209 amended (recognized netting)

(1) Section 209(3)(a)(ii)—

Repeal

"requires;"

Substitute

"requires; or".

(2) Section 209, Chinese text—

Repeal

"信用風險減低效果" (wherever appearing)

Substitute

"減低信用風險效果".

80. Section 210 amended (recognized guarantees and recognized credit derivative contracts)

Section 210, Chinese text—

Repeal

"信用風險減低效果" (wherever appearing)

Substitute

"減低信用風險效果".

81. Section 211 amended (recognized guarantees and recognized credit derivative contracts under substitution framework for corporate, sovereign and bank exposures under foundation IRB approach and for equity exposures under PD/LGD approach)

Section 211—

Repeal subsection (2)

Substitute

"(2) For the purposes of subsection (1), sections 98(a)(vi) and (vii) and 99(1)(b)(vi) and (vii) are deemed to read as—

"(vi) a corporate incorporated outside India that—

(A) has an ECAI issuer rating that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1 or 2; or

(B) has an exposure assessed under the institution's rating system with an estimate of PD that is equivalent to the PD of an exposure with a credit quality grade of 1 or 2 in Part 1 of Table C in Schedule 6; or

(vii) a corporate incorporated in India that—

(A) has an ECAI issuer rating that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the

corporate being assigned a credit quality grade of 1 or 2 or, if mapped to the scale of credit quality grades in Part 2 of that Table, would result in the corporate being assigned a credit quality grade of 1, 2 or 3; or

(B) has an exposure assessed under the institution's rating system with an estimate of PD that is equivalent to the PD of an exposure with a credit quality grade of 1 or 2 in Part 1 of Table C in Schedule 6 or a credit quality grade of 1, 2 or 3 in Part 2 of that Table,".".

82. Section 213 amended (recognized guarantees and recognized credit derivative contracts under double default framework)

Section 213(c)—

Repeal subparagraph (i)

Substitute

"(i) the first-to-default credit derivative contract up to and including the $(n-1)^{th}$-to-default credit derivative contract (each of which is a recognized credit derivative contract) in respect of the reference obligations within the basket have also been entered into; or".

83. Section 214 amended (capital treatment of recognized guarantees and recognized credit derivative contracts)

(1) After section 214(2)—

Add

"(3) To avoid doubt, if—

(a) a recognized guarantee is provided to an authorized institution or a recognized credit derivative contract is entered into by the institution; and

(b) the institution does not use the IRB approach to calculate its credit risk for exposures to the guarantor or counterparty, as the case may be,

the institution must not take into account the credit risk mitigating effect of the guarantee or contract, as the case may be, in calculating, under the IRB approach, the risk-weighted amount of the exposure that is covered by the guarantee or contract, as the case may be.".

(2) Section 214, Chinese text—

Repeal

"信用風險減低效果" (wherever appearing)

Substitute

"減低信用風險效果".

84. Section 215 amended (provisions supplementary to section 214(1)—substitution framework (general))

Section 215, Chinese text—

Repeal

"信用風險減低效果" (wherever appearing)

Substitute

"減低信用風險效果".

85. Section 216 amended (provisions supplementary to section 214(1)—substitution framework for corporate, sovereign and bank exposures under foundation IRB approach and for equity exposures under PD/LGD approach)

Section 216(1), Chinese text—

Repeal

"信用風險減低效果"

Substitute

"減低信用風險效果".

86. Section 217 amended (provisions supplementary to section 214(1)—substitution framework for corporate, sovereign and bank exposures under advanced IRB approach and for retail exposures under retail IRB approach)

Section 217(1), Chinese text—

Repeal

"信用風險減低效果"

Substitute

"減低信用風險效果".

87. Section 218 amended (provisions supplementary to section 214(2)—double default framework)

Section 218, Chinese text—

Repeal

"信用風險減低效果" (wherever appearing)

Substitute

"減低信用風險效果".

88. Section 219 amended (capital treatment of recognized guarantees and recognized credit derivative contracts in respect of purchased receivables)

Section 219, Chinese text—

Repeal

"信用風險減低效果" (wherever appearing)

Substitute

"減低信用風險效果".

89. Section 220 amended (calculation of expected losses and eligible provisions for corporate, sovereign, bank and retail exposures)

(1) Section 220(3), after "EL"—

Add

"amount".

(2) Section 220(4), Table 22, heading, after "EL"—

Add

"AMOUNT".

(3) Section 220(5), after "EL"—

Add

"amount".

90. Section 225 amended (application of Division 13)

(1) Section 225(1)—

Repeal

"subsection (2)"

Substitute

"subsections (2), (3), (4) and (5)".

(2) Section 225—

Repeal subsection (2)

Substitute

"(2) Where an authorized institution fails to fully comply with the provisions of this Part that are applicable to it, the Monetary Authority may, for the purposes of mitigating the effect of that failure, exercise, in relation to the institution, any of the Monetary Authority's powers under subsection (5).".

(3) After section 225(2)—

Add

"(3) Where the Monetary Authority is satisfied that an internal rating system or model used by an authorized institution for the purposes of this Part causes, or could reasonably be construed as potentially causing, whether by itself or in conjunction with any other event, the institution to cease to have adequate financial resources

(whether actual or contingent) for the nature and scale of its operations, the Monetary Authority may, for the purposes of assisting in ensuring that the institution does not cease to have those financial resources, exercise, in relation to that institution, any of the Monetary Authority's powers under subsection (5).

(4) Where the Monetary Authority is satisfied that there exists a material prudential concern in respect of an authorized institution that causes, or could reasonably be construed as potentially causing, whether by itself or in conjunction with any other event, the financial soundness of the institution to be put at risk in prevailing, or likely prevailing, market conditions, the Monetary Authority may, for the purposes of assisting in ensuring that the financial soundness of the institution is not put at risk, exercise, in relation to that institution, any of the Monetary Authority's powers under subsection (5).

(5) The Monetary Authority may, by notice in writing given to an authorized institution that falls within subsection (2), (3) or (4)—

(a) extend the period for which the institution is subject to this Division for any period, or until the occurrence of any event, specified in the notice;

(b) again apply this Division to the institution for any period, or until the occurrence of any event, specified in the notice; or

(c) specify, in the notice, an adjustment factor (but neither, in any case, lower than the adjustment factor applicable to the institution by virtue of Table 23 as read with section 226(6) nor exceeding 100%) that is to be used by the institution for the purposes of calculating the capital floor in accordance with section 226.".

91. Section 226 amended (calculation of capital floor)

Section 226(6)—

Repeal

"section 225(2)"

Substitute

"section 225(5)(c)".

92. Section 227 amended (interpretation of Part 7)

(1) Section 227(1), definition of ***clean-up call***, paragraph (a)—

Repeal

"transaction;"

Substitute

"transaction; or".

(2) Section 227(1), definition of ***credit equivalent amount***, paragraph (a)—

Repeal

"section 51"

Substitute

"section 51(1)".

(3) Section 227(1), definition of ***credit equivalent amount***, paragraph (c)—

Repeal

"section 245(1)(b);"

Substitute

"section 245(1)(b); or".

(4) Section 227(1), definition of ***investment grade***, paragraph (a)—

Repeal

"Schedule 11;"

Substitute

"Schedule 11; or".

(5) Section 227(1), definition of ***look-through treatment***—

Repeal

"or BSC approach"

Substitute

", BSC approach or STC(S) approach".

(6) Section 227(1), definition of ***principal amount***—

Repeal paragraph (a)

Substitute

"(a) in relation to an on-balance sheet exposure of an authorized institution—

(i) in the case of the STC(S) approach—

(A) if the exposure is measured at fair value, means the value of the exposure determined in accordance with section 4A; or

(B) if the exposure is not measured at fair value, means the book value of the exposure; or

(ii) in the case of the IRB(S) approach, means the book value of the exposure; or".

(7) Section 227(1)—

Repeal the definition of *securitization exposure*.

(8) Section 227(1)—

Repeal the definition of *underlying exposures*

Substitute

"***underlying exposures*** (組成項目)—

(a) in relation to a securitization transaction that is not a re-securitization transaction, means one or more than one on-balance sheet or off-balance sheet non-securitization exposure in respect of which credit risk is transferred to one or more than one person by the originator in the transaction; or

(b) in relation to a re-securitization transaction—

(i) either—

(A) means one or more than one on-balance sheet or off-balance sheet securitization exposure being re-securitized through the transaction; or

(B) means one or more than one on-balance sheet or off-balance sheet securitization exposure being re-securitized through the transaction and one or more than one on-balance sheet or off-balance sheet non-securitization exposure being securitized through the transaction; and

(ii) does not include the underlying exposures in respect of the original securitization transaction that gave rise to the securitization exposure referred to in subparagraph (i)(A) or (B);".

(9) Section 227(1)—

Add in alphabetical order

"***re-securitization exposure*** (再證券化類別風險承擔) means a securitization exposure that is an exposure to a re-securitization transaction;

re-securitization transaction (再證券化交易) means a securitization transaction in respect of which not less than one of the underlying exposures of the transaction is a securitization exposure;".

(10) After section 227(2)—

Add

"(3) Unless otherwise expressly stated, a reference in this Part to a securitization exposure of an authorized

institution (howsoever expressed) means a securitization exposure booked in the institution's banking book.".

93. Section 229 amended (treatment to be accorded to securitization transaction by originating institution)

(1) Section 229(1)(a)—

Repeal

"or 6"

Substitute

", 6 or 7".

(2) Section 229(3)—

Repeal

"or 6"

Substitute

", 6 or 7".

(3) Section 229(5)(a)—

Repeal

"or 6"

Substitute

", 6 or 7".

94. Section 230A added

After section 230—

Add

"230A. Criteria authorized institutions must meet to use STC(S) approach or IRB(S) approach

An authorized institution must have—

(a) a comprehensive understanding, on a continuous basis, of the risk characteristics of—

(i) the institution's securitization exposures (whether on-balance sheet or off-balance sheet); and

(ii) the pools of underlying exposures of the securitization transactions that gave rise to those securitization exposures;

(b) an ability to access, on a continuous basis and in a timely manner—

(i) in relation to a securitization transaction that is not a re-securitization transaction, performance information on the underlying exposures (including issuer name and credit quality); and

(ii) in relation to a securitization transaction that is a re-securitization transaction—

(A) performance information on the underlying exposures (including issuer name and credit quality); and

(B) information on the risk characteristics and performance of the underlying exposures of the original securitization transaction being re-securitized through the re-securitization transaction; and

(c) a thorough understanding of each structural feature of a securitization transaction that has the potential to materially affect the performance of the institution's securitization exposures to the transaction.".

95. Section 232 amended (provisions applicable to ECAI issue specific ratings in addition to those applicable under Part 4)

(1) Section 232(f)(ii)—

Repeal

"exposure."

Substitute

"exposure;".

(2) After section 232(f)—

Add

"(g) if an ECAI issue specific rating assigned to a securitization exposure of the institution is wholly or partly based on unfunded support (including a liquidity facility or credit enhancement) provided by the institution, the institution must treat that securitization exposure as unrated.".

96. Section 236 amended (deductions from core capital and supplementary capital)

(1) Section 236(1)(d)(iv)—

Repeal

"facility; and"

Substitute

"facility;".

(2) After section 236(1)(d)—

Add

"(da) any securitization exposure of the institution in any case where the institution is not in compliance, whether in whole or in part, with section 230A in respect of that exposure; and".

97. Section 237 amended (determination of risk-weights)

(1) Section 237(1)(b), after "subsections (2) and (3)"—

Add

"(in the case of securitization exposures that are not re-securitization exposures) and subsections (4) and (5) (in the case of re-securitization exposures)".

(2) Section 237(2)—

Repeal

"which have"

Substitute

"that are not re-securitization exposures and have".

(3) Section 237(2), Table 24, heading, after "APPROACH"—

Add

"(EXCLUDING RE-SECURITIZATION EXPOSURES)".

(4) Section 237(3)—

Repeal

"which have"

Substitute

"that are not re-securitization exposures and have".

(5) Section 237(3), Table 25, heading, after "APPROACH"—

Add

"(EXCLUDING RE-SECURITIZATION EXPOSURES)".

(6) After section 237(3)—

Add

"(4) For the purposes of subsection (1)(b), an authorized institution must allocate risk-weights to, or deduct from the institution's core capital and supplementary capital, securitization exposures that are re-securitization exposures and have long-term ECAI issue specific ratings in accordance with Table 25A such that—

(a) for those securitization exposures that map to a credit quality grade of 4, the institution must—

(i) allocate a risk-weight of 650% to the exposures if the institution is an investing institution; or

(ii) deduct the exposures from the institution's core capital and supplementary capital if the institution is the originating institution; and

(b) for those securitization exposures that do not fall within paragraph (a), the institution must apply the treatment specified in Table 25A to the exposures regardless of whether the institution is an originating institution or investing institution.

Table 25A

Risk-weights or Deductions Applicable to Long-term Credit Quality Grades under STC(S) Approach (Re-securitization Exposures)

Long-term credit quality grade	Risk-weight	Deduction
1	40%	not applicable
2	100%	not applicable
3	225%	not applicable
4	650% (for investing institutions)	deduction from core capital and supplementary capital (for originating institutions)
5	not applicable	deduction from core capital and supplementary capital

(5) For the purposes of subsection (1)(b), an authorized institution must allocate risk-weights to, or deduct from the institution's core capital and supplementary capital, securitization exposures that are re-securitization exposures and have short-term ECAI issue specific ratings in accordance with Table 25B.

Table 25B

Risk-weights or Deductions Applicable to Short-term Credit Quality Grades under STC(S) Approach (Re-securitization Exposures)

Short-term credit quality grade	Risk-weight	Deduction
1	40%	not applicable
2	100%	not applicable
3	225%	not applicable
4	not applicable	deduction from core capital and supplementary capital".

98. Section 239 amended (securitization positions which are in second loss tranche or better in ABCP programmes)

Section 239(f)—

Repeal

"or 5"

Substitute

", 5 or 7, as the case requires,".

99. Section 240 amended (treatment of liquidity facilities and servicer cash advance facilities)

(1) Section 240(1)—

Repeal

", (3)".

(2) Section 240(2)—

Repeal

"Subject to subsection (3), an"

Substitute

"An".

(3) Section 240(2)(a)(i)—

Repeal

"Table 24 or 25"

Substitute

"Table 24, 25, 25A or 25B".

(4) Section 240(2)(b)(i)—

Repeal

"or 5"

Substitute

", 5 or 7".

(5) Section 240(2)(b)—

Repeal subparagraph (ii)

Substitute

"(ii) apply to the undrawn portion of the facility a CCF of 50% for the purposes of calculating the credit equivalent amount of that undrawn portion; and".

(6) Section 240—

Repeal subsection (3).

(7) Section 240(6)—

Repeal

", (3)".

100. Section 241 substituted

Repeal the section

Substitute

"241. Treatment of overlapping facilities and exposures

(1) Where an authorized institution provides 2 or more facilities that may be drawn in respect of the same securitization transaction such that—

(a) duplicate coverage is provided in respect of the same underlying exposure (referred to in this section as ***overlapping portion A***); and

(b) a drawing on one such facility precludes the drawing, whether in whole or in part, on another such facility,

the institution must—

(c) calculate the risk-weighted amount of the overlapping portion A on the basis of—

(i) if the facilities are subject to the same CCF, attributing the overlapping portion A to any one of the facilities;

(ii) if the facilities are subject to different CCFs, attributing the overlapping portion A to the facility with the highest CCF; and

(d) calculate the risk-weighted amount of that portion of each of the facilities that is not the overlapping portion A.

(2) Where overlapping facilities are provided by different authorized institutions, each institution must calculate

the risk-weighted amount for the maximum amount of the facility provided by it.

(3) Subject to subsection (4), where—

(a) an authorized institution provides one or more than one facility that may be drawn in respect of the same securitization transaction and, at the same time, holds an on-balance sheet securitization exposure in the transaction (including any such exposure booked in the trading book of the institution); and

(b) the on-balance sheet securitization exposure will benefit from any drawdown of the facility such that the institution has duplicate exposure to the same underlying exposures (referred to in this section as ***overlapping portion B***),

the institution must—

(c) calculate the regulatory capital for the overlapping portion B by attributing the overlapping portion B to the securitization exposure (that is, the facility or the on-balance sheet securitization exposure) that will result in a higher regulatory capital for the overlapping portion B; and

(d) calculate the regulatory capital for that portion of each of the exposures that is not the overlapping portion B.

(4) An authorized institution must not apply subsection (3) to the overlapping portion B between securitization exposures booked in the institution's banking book and securitization exposures booked in the institution's trading book in respect of the same securitization transaction unless it is able to calculate and compare the regulatory capital for the exposures concerned such that it can determine to which of those exposures the

overlapping portion B should be attributed for the purposes of subsection (3)(c).

(5) To avoid doubt—

(a) the regulatory capital calculated as required by subsection (3)(c) for the overlapping portion B that has been attributed to a securitization exposure booked in the trading book of an authorized institution; and

(b) the regulatory capital calculated as required by subsection (3)(d) for a securitization exposure booked in the trading book of an authorized institution,

must be included in the total market risk capital charge for specific risk calculated under Part 8.

(6) In subsections (3), (4) and (5)—

regulatory capital (監管資本), in relation to—

(a) a securitization exposure booked in the trading book of an authorized institution; and

(b) the overlapping portion B that has been attributed to such a securitization exposure,

means the market risk capital charge for specific risk determined in accordance with the provisions applicable to securitization exposures set out in Part 8.".

101. Section 242 amended (maximum regulatory capital for originating institution)

Section 242(1), after "been securitized"—

Add

"through the transaction".

102. Section 243 amended (treatment of underlying exposures of originating institution in synthetic securitization transactions)

(1) Section 243(2)(b)(i), before "Part 4"—

Add

"this Division, Division 2 and".

(2) Section 243(2)(b)(ii), before "Part 5"—

Add

"this Division, Division 2 and".

103. Section 245 amended (calculation of risk-weighted amount of investors' interest for securitization exposures of originating institution subject to early amortization provision)

(1) Section 245(2)(c), after "were not securitized"—

Add

"through the transaction".

(2) Section 245(3)(f)—

Repeal

"accumulated"

Substitute

"average".

(3) Section 245(3)—

Repeal paragraph (g)

Substitute

"(g) in any case where the transaction does not require excess spread to be trapped, treat the trapping point as 4.5%.".

(4) Section 245(4)(f)—

Repeal

"accumulated"

Substitute

"average".

(5) Section 245(4)—

Repeal paragraph (g)

Substitute

"(g) in any case where the transaction does not require excess spread to be trapped, treat the trapping point as 4.5%.".

104. Section 251 amended (deductions from core capital and supplementary capital)

(1) Section 251(1)(e)—

Repeal

"institution; and"

Substitute

"institution;".

(2) After section 251(1)(e)—

Add

"(ea) any securitization exposure of the institution in any case where the institution is not in compliance, whether in whole or in part, with section 230A in respect of that exposure; and".

105. Section 253 substituted

Repeal the section

Substitute

"253. Treatment of overlapping facilities and exposures

(1) Where an authorized institution provides 2 or more facilities that may be drawn in respect of the same securitization transaction such that—

(a) duplicate coverage is provided in respect of the same underlying exposure (referred to in this section as ***overlapping portion A***); and

(b) a drawing on one such facility precludes the drawing, whether in whole or in part, on another such facility,

the institution must—

(c) calculate the risk-weighted amount of the overlapping portion A on the basis of—

(i) if the facilities are subject to the same CCF, attributing the overlapping portion A to any one of the facilities;

(ii) if the facilities are subject to different CCFs, attributing the overlapping portion A to the facility with the highest CCF; and

(d) calculate the risk-weighted amount of that portion of each of the facilities that is not the overlapping portion A.

(2) Where overlapping facilities are provided by different authorized institutions, each institution must calculate the risk-weighted amount for the maximum amount of the facility provided by it.

(3) Subject to subsection (4), where—

(a) an authorized institution provides one or more than one facility that may be drawn in respect of the same securitization transaction and, at the same time, holds an on-balance sheet securitization exposure in the transaction (including any such exposure booked in the trading book of the institution); and

(b) the on-balance sheet securitization exposure will benefit from any drawdown of the facility such that the institution has duplicate exposure to the same

underlying exposures (referred to in this section as ***overlapping portion B***),

the institution must—

(c) calculate the regulatory capital for the overlapping portion B by attributing the overlapping portion B to the securitization exposure (that is, the facility or the on-balance sheet securitization exposure) that will result in a higher regulatory capital for the overlapping portion B; and

(d) calculate the regulatory capital for that portion of each of the exposures that is not the overlapping portion B.

(4) An authorized institution must not apply subsection (3) to the overlapping portion B between securitization exposures booked in the institution's banking book and securitization exposures booked in the institution's trading book in respect of the same securitization transaction unless it is able to calculate and compare the regulatory capital for the exposures concerned such that it can determine to which of those exposures the overlapping portion B should be attributed for the purposes of subsection (3)(c).

(5) To avoid doubt—

(a) the regulatory capital calculated as required by subsection (3)(c) for the overlapping portion B that has been attributed to a securitization exposure booked in the trading book of an authorized institution; and

(b) the regulatory capital calculated as required by subsection (3)(d) for a securitization exposure booked in the trading book of an authorized institution,

must be included in the total market risk capital charge for specific risk calculated under Part 8.

(6) In subsections (3), (4) and (5)—

regulatory capital (監管資本), in relation to—

(a) a securitization exposure booked in the trading book of an authorized institution; and

(b) the overlapping portion B that has been attributed to such a securitization exposure,

means the market risk capital charge for specific risk determined in accordance with the provisions applicable to securitization exposures set out in Part 8.".

106. Section 254 amended (maximum regulatory capital for originating institution)

Section 254(1), after "been securitized"—

Add

"through the transaction".

107. Section 255 amended (treatment of underlying exposures of originating institution in synthetic securitization transactions)

Section 255(2)(b), after "Part 4"—

Add

"and section 247(1)".

108. Section 257 amended (calculation of risk-weighted amount of investors' interest for securitization exposures of originating institution subject to early amortization provision)

(1) Section 257(3)(f)—

Repeal

"accumulated"

Substitute

"average".

(2) Section 257(3)—

Repeal paragraph (g)

Substitute

"(g) in any case where the transaction does not require excess spread to be trapped, treat the trapping point as 4.5%.".

(3) Section 257(4)(f)—

Repeal

"accumulated"

Substitute

"average".

(4) Section 257(4)—

Repeal paragraph (g)

Substitute

"(g) in any case where the transaction does not require excess spread to be trapped, treat the trapping point as 4.5%.".

109. Section 258 amended (treatment of interest rate contracts and exchange rate contracts)

Section 258—

Repeal

"Part 4"

Substitute

"Part 6".

110. Section 260A added

After section 260—

Add

"**260A. Reduction in risk-weighted amount**

Where an authorized institution has made a valuation adjustment or specific provision, in respect of a securitization

exposure, the institution must, in calculating the risk-weighted amount of the exposure, reduce it by an amount equal to the risk-weight of the exposure (determined in accordance with section 262) multiplied by the aggregate amount of any valuation adjustment and specific provision made in respect of the exposure.".

111. Section 262 amended (determination of risk-weights)

(1) Section 262(1)(b)—

Repeal

"and (9)"

Substitute

", (9), (10), (11), (12) and (13)".

(2) Section 262(4)—

Repeal

"have".

(3) Section 262(4)—

Repeal paragraphs (a) and (b)

Substitute

"(a) are not re-securitization exposures and have a long-term ECAI issue specific rating; or

(b) are not re-securitization exposures and have a long-term inferred rating.".

(4) Section 262(4), Table 26, heading, after "METHOD"—

Add

"(EXCLUDING RE-SECURITIZATION EXPOSURES)".

(5) Section 262(6)—

Repeal

everything from "subsection (5)" to "by using Formula 24."

Substitute

"subsection (5) and subject to subsection (7), an authorized institution must calculate the effective number of underlying exposures by using Formula 24 and treating multiple exposures to one obligor as one exposure.".

(6) Section 262(6), Formula 24—

Repeal

"N = effective number of underlying exposures (in the case of a re-securitization transaction as specified in subsection (7), the effective number of securitization exposures which have been securitized); and"

Substitute

"N = effective number of underlying exposures; and".

(7) Section 262—

Repeal subsection (7)

Substitute

"(7) Where the portfolio share of the largest exposure (referred to in this subsection as C_1) (being the amount of the largest exposure in the pool of underlying exposures in a securitization transaction as a percentage of the total amount of the pool) of an authorized institution is available, the institution may, for the purposes of Formula 24, calculate N in that formula as $1/C_1$.".

(8) Section 262(8)—

Repeal

"have".

(9) Section 262(8)—

Repeal paragraphs (a) and (b)

Substitute

"(a) are not re-securitization exposures and have a short-term ECAI issue specific rating; or

(b) are not re-securitization exposures and have a short-term inferred rating.".

(10) Section 262(8), Table 27, heading, after "METHOD"—

Add

"(EXCLUDING RE-SECURITIZATION EXPOSURES)".

(11) After section 262(9)—

Add

"(10) For the purposes of subsection (1)(b), an authorized institution must allocate risk-weights to, or deduct from the institution's core capital and supplementary capital, securitization exposures in accordance with Table 27A if the exposures—

(a) are re-securitization exposures and have a long-term ECAI issue specific rating; or

(b) are re-securitization exposures and have a long-term inferred rating.

Table 27A

Risk-weights or Deductions Applicable to Long-term Credit Quality Grades under Ratings-based Method (Re-securitization Exposures)

Long-term credit quality grade	Risk-weight of senior re-securitization exposures A	Risk-weight of non-senior re-securitization exposures B	Deduction
1	20%	30%	not applicable
2	25%	40%	not applicable
3	35%	50%	not applicable
4	40%	65%	not applicable

Long-term credit quality grade	Risk-weight of senior re-securitization exposures A	Risk-weight of non-senior re-securitization exposures B	Deduction
5	60%	100%	not applicable
6	100%	150%	not applicable
7	150%	225%	not applicable
8	200%	350%	not applicable
9	300%	500%	not applicable
10	500%	650%	not applicable
11	750%	850%	not applicable
12	not applicable	not applicable	deduction from core capital and supplementary capital

(11) For the purposes of subsection (1)(b), an authorized institution must allocate risk-weights to, or deduct from the institution's core capital and supplementary capital, securitization exposures in accordance with Table 27B if the exposures—

(a) are re-securitization exposures and have a short-term ECAI issue specific rating; or

(b) are re-securitization exposures and have a short-term inferred rating.

Table 27B

Risk-weights or Deductions Applicable to Short-term Credit Quality Grades under Ratings-based Method (Re-securitization Exposures)

Short-term credit quality grade	Risk-weight of senior re-securitization exposures A	Risk-weight of non-senior re-securitization exposures B	Deduction
1	20%	30%	not applicable
2	40%	65%	not applicable
3	150%	225%	not applicable
4	not applicable	not applicable	deduction from core capital and supplementary capital

(12) An authorized institution must, in the case of a securitization exposure that falls within subsection (10) or (11) and is not a liquidity facility—

(a) allocate the applicable risk-weight specified in column A of Table 27A or 27B, as the case may be, if—

(i) the exposure is a senior position as referred to in subsection (2); and

(ii) none of the underlying exposures of the exposure is a re-securitization exposure; or

(b) allocate the applicable risk-weight specified in column B of Table 27A or 27B, as the case may be, if any of the conditions set out in paragraph (a) is not fulfilled.

(13) An authorized institution must, in the case of a securitization exposure that is a liquidity facility—

(a) allocate the applicable risk-weight specified in column A of Table 26, 27, 27A or 27B, as the case may be, only if—

(i) the facility covers all of the outstanding debts (including debts that are senior) supported by the pool of underlying exposures in the securitization transaction concerned; and

(ii) repayment of the facility has seniority over the outstanding debts referred to in subparagraph (i),

such that no moneys from that pool of underlying exposures may be applied towards the repayment of other creditors until all drawings under the liquidity facility are repaid in full; or

(b) allocate the applicable risk-weight specified in column B of Table 26, 27, 27A or 27B, as the case may be, if any of the conditions set out in paragraph (a) is not fulfilled.".

112. Section 263 amended (use of inferred ratings)

After section 263(c)—

Add

"(ca) the reference securitization exposure has not ceased to exist;".

113. Section 264 amended (calculation of risk-weighted amount of liquidity facilities)

Section 264(1)(a)—

Repeal

"Table 26 or 27"

Substitute

"Table 26, 27, 27A or 27B".

114. Section 265 amended (recognized credit risk mitigation)

(1) Section 265—

Repeal paragraph (b)

Substitute

"(b) in the case of credit protection in the form of a recognized guarantee (within the meaning of section 51(1)) or recognized credit derivative contract (within the meaning of section 51(1))—

(i) adopt the substitution framework in accordance with sections 214(1), 215 and 216;

(ii) multiply the EAD of the exposure by the risk-weight of the credit protection provider derived in section 216(3) in respect of the portion covered by the credit protection; and

(iii) multiply the EAD of the exposure by the risk-weight of the securitization exposure concerned in accordance with section 262 in respect of the portion not covered by the credit protection;".

(2) After section 265(b)—

Add

"(c) in the case of credit protection in the form of recognized netting—

(i) take into account the credit risk mitigating effect of the recognized netting in calculating the EAD of the exposure in accordance with section 209(1), (2) and (4), where applicable, in offsetting the credit risk of the securitization exposure held by the institution; and

(ii) multiply the EAD of the exposure by the risk-weight determined in accordance with section 262.".

115. Section 268A added

After section 268—

Add

"268A. Reduction in risk-weighted amount

Where an authorized institution has made a valuation adjustment or specific provision, in respect of a securitization exposure, the institution must, in calculating the risk-weighted amount of the exposure, reduce it by an amount equal to the risk-weight of the exposure (determined in accordance with section 270(4) or 277(3)(a), as the case requires) multiplied by the aggregate amount of any valuation adjustment and specific provision made in respect of the exposure.".

116. Section 270 amended (use of supervisory formula)

(1) Section 270(1)(a)—

Repeal

"if those underlying exposures had not been securitized"

Substitute

"as if those exposures were directly held by the institution".

(2) Section 270(2)(b)(i), after "T"—

Add

"in the case of a securitization exposure that is not a re-securitization exposure and the product of 0.016 multiplied by T in the case of a re-securitization exposure".

(3) Section 270(4)—

Repeal

"securitization exposure"

Substitute

"securitization position held by it in a given tranche of a securitization transaction".

(4) Section 270(4)—

Repeal paragraph (a)

Substitute

"(a) 7% in the case of a securitization exposure that is not a re-securitization exposure and 20% in the case of a re-securitization exposure; or".

(5) Section 270(4)(b)—

Repeal

"exposure calculated by the use of Formula 25 by 12.5"

Substitute

"position calculated by the use of Formula 25 by 12.5 and then dividing it by T".

117. Section 271 amended (capital charge factor for underlying exposures under IRB approach)

(1) Section 271(a)—

Repeal

"capital charge"

Substitute

"sum of the capital charge and the EL amount".

(2) Section 271(c)(ii), after "price discount"—

Add

"in respect of the underlying exposures".

118. Section 274 amended (effective number of underlying exposures)

(1) Section 274(a), after "section 262"—

Add

", and pursuant to section 276,".

(2) Section 274(a), after "transaction;"—

Add

"and".

(3) Section 274—

Repeal paragraph (b).

(4) Section 274—

Repeal paragraph (c)

Substitute

"(c) if the transaction is a re-securitization transaction, take into account, in respect of the underlying exposures that are securitization exposures in that transaction, the number of those securitization exposures instead of the number of underlying exposures in the original pools in the securitization transactions creating those first-mentioned underlying exposures.".

119. Section 275 amended (exposure-weighted average LGD)

(1) Section 275(b)—

Repeal

"relevant"

Substitute

"securitization".

(2) Section 275(b), Chinese text—

Repeal

"再度證券化" (wherever appearing)

Substitute

"再證券化".

120. Section 277 amended (calculation of risk-weighted amount of liquidity facilities)

(1) Section 277(1)—

Repeal paragraph (b)

Substitute

"(b) apply a CCF of 100% to the undrawn portion of the facility for the purposes of calculating the credit equivalent amount of that undrawn portion; and".

(2) Section 277(1)—

Repeal paragraph (c).

(3) Section 277(1)(d)—

Repeal

"or (c), as the case may be".

(4) Section 277(3)—

Repeal paragraph (b)

Substitute

"(b) apply a CCF of 100% to the undrawn portion of the facility for the purposes of calculating the credit equivalent amount of the undrawn portion of the facility;".

(5) Section 277(3)(c)—

Repeal

"(i) or (ii), as the case may be".

(6) Section 277(6), after "unrated"—

Add

"eligible".

(7) After section 277(6)—

Add

"(6A) Where—

(a) an unrated liquidity facility provided by an authorized institution is not an eligible liquidity facility; and

(b) the institution uses the supervisory formula method to calculate its credit risk for securitization exposures,

the institution must determine the risk-weight to be allocated to the drawn portion of the facility, or whether that drawn portion is to be deducted from the institution's core capital and supplementary capital, in accordance with subsections (1)(a) and (2).".

(8) Section 277(7), after "subsection (6)"—

Add

"or (6A)".

121. Section 278 amended (treatment of recognized credit risk mitigation—full credit protection)

(1) Section 278(a), after "section 270(4)"—

Add

"or 277(3)(a), as the case requires".

(2) Section 278(b)—

Repeal

"section 51" (wherever appearing)

Substitute

"section 51(1)".

(3) Section 278(b)(ii)—

Repeal

"216(3)."

Substitute

"216(3);".

(4) After section 278(b)—

Add

"(c) in the case of credit protection in the form of recognized netting—

(i) take into account the credit risk mitigating effect of recognized netting in calculating the EAD of the exposure in accordance with section 209(1), (2) and (4), where applicable, in offsetting the credit risk of the securitization exposure held by the institution; and

(ii) multiply the EAD of the exposure by the risk-weight determined in accordance with section 270(4) or 277(3)(a), as the case requires.".

122. Section 279 amended (treatment of recognized credit risk mitigation—partial credit protection)

(1) Section 279(1)(a)—

Repeal

"section 51) or a recognized credit derivative contract (within the meaning of section 51)"

Substitute

"section 51(1)), a recognized credit derivative contract (within the meaning of section 51(1)) or recognized netting".

(2) Section 279(1)—

Repeal paragraph (b)

Substitute

"(b) calculate the risk-weighted amount of the portion covered by a recognized guarantee or recognized credit derivative contract by applying section 278(b) to that portion;".

(3) Section 279(1)(c), after "section 270(4)"—

Add

"or 277(3)(a), as the case requires,".

123. Section 281 amended (interpretation of Part 8)

(1) Section 281—

Repeal the definition of *investment grade*

Substitute

"***investment grade*** (投資等級) means—

(a) a credit quality grade of 1, 2 or 3 derived from mapping the ECAI issuer rating assigned to an issuer, being a sovereign, of any debt security to a scale of credit quality grades in Table A in Schedule 6;

(b) a credit quality grade of 1, 2 or 3 derived from mapping the ECAI issue specific rating assigned to any debt security issued by a bank or securities firm to a scale of credit quality grades in Table B in Schedule 6 or Part 1 of Table E in that Schedule;

(c) a credit quality grade of 1, 2 or 3 derived from mapping the ECAI issue specific rating assigned to any debt security issued by a corporate (within the meaning of section 51(1) or 139(1), as the case requires) to a scale of credit quality grades in Part 1 of Table C in Schedule 6 or Part 1 of Table E in that Schedule; or

(d) a credit quality grade of 1, 2, 3 or 4 derived from mapping the ECAI issue specific rating assigned to any debt security issued by a corporate (within the meaning of section 51(1) or 139(1), as the case requires) incorporated in India to a scale of credit quality grades in Part 2 of Table C in Schedule 6 or Part 2 of Table E in that Schedule;".

(2) Section 281—

Repeal the definition of *mark-to-model*.

(3) Section 281, Chinese text, definition of ***簡化計算法***—

Repeal

"計算法。"

Substitute

"計算法；".

(4) Section 281—

Add in alphabetical order

"***comprehensive risk charge*** (綜合風險資本要求), in relation to an authorized institution, means the market risk capital charge for specific risk calculated by the institution using the IMM approach under section 317(1)(f) to capture not only the incremental risks but also all material factors affecting market risk inherent in the institution's correlation trading portfolio;

correlation trading portfolio (相關交易組合), in relation to an authorized institution, means—

(a) a portfolio of securitization exposures or n^{th}-to-default credit derivative contracts, or both—

(i) that are not—

(A) re-securitization exposures; or

(B) derivatives of securitization exposures that do not provide a pro-rata share in the proceeds of a securitization tranche;

(ii) where the underlying exposures of the securitization exposures, or the reference obligations of the n^{th}-to-default credit derivative contracts, are not—

(A) a regulatory retail exposure within the meaning of section 51(1);

(B) an exposure that is subject to the IRB approach for retail exposures under section 144;

(C) a credit facility secured on one or more than one residential property for the purposes of financing or re-financing the purchase of the property or properties concerned; or

(D) a credit facility secured on one or more than one commercial property for the purposes of financing or re-financing the purchase of the property or properties concerned;

(iii) that do not reference a claim on a special purpose entity; and

(iv) where all reference obligations, in the case of the n^{th}-to-default credit derivative contracts, are single-name products (including single-name credit derivative contracts and commonly traded indices based on single-name products) for which a liquid two-way market exists; and

(b) any positions that hedge the securitization exposures or n^{th}-to-default credit derivative contracts referred to in paragraph (a) where—

(i) the positions are not securitization exposures or n^{th}-to-default credit derivative contracts; and

(ii) a liquid two-way market exists for the positions and the underlying exposures of the positions;

credit migration risk (信用遷移風險), in relation to an exposure of an authorized institution, means the potential for direct and indirect losses to the institution if there were an internal or external rating downgrade or upgrade;

default risk (違責風險), in relation to an exposure of an authorized institution, means the potential for direct and indirect losses to the institution if the obligor were to default or a default event were to occur;

incremental risk charge (遞增風險資本要求), in relation to an authorized institution, means the market risk capital charge for specific risk calculated by the institution using the IMM approach under section 317(1)(e) to capture the incremental risks in respect of its trading book positions in—

(a) specific risk interest rate exposures, other than—

(i) securitization exposures;

(ii) n^{th}-to-default credit derivative contracts; and

(iii) other specific risk interest rate exposures that fall within paragraph (b) of the definition of ***correlation trading portfolio*** in this section; and

(b) listed equities and equity-related derivative contracts based on listed equities;

incremental risks (遞增風險), in relation to an authorized institution, means the default risk and credit migration risk that are incremental to those that have been captured by the institution's VaR-based calculations under section 317(1)(c) and (d);

n^{th}-to-default credit derivative contract (n^{th}違責者信用衍生工具合約) means a credit derivative contract under which—

(a) the protection buyer obtains credit protection for a basket of exposures; and

(b) the n^{th} default among the obligations specified in the contract for the purposes of determining whether a credit event has occurred triggers the credit protection and terminates the contract;

special purpose entity (特定目的實體), in relation to an authorized institution's correlation trading portfolio, means a company, trust or other entity—

(a) organized for a specific purpose;

(b) the activities of which are limited to those appropriate to accomplish that purpose; and

(c) the structure of which is intended to isolate the obligations of the company, trust or other entity, as the case may be, from the credit risk of an originator or a seller of exposures;

specific risk interest rate exposures (特定風險利率風險承擔), in relation to an authorized institution, means the interest rate exposures of the institution that are subject to market risk capital charge for specific risk;

stressed VaR (受壓風險值), in relation to a portfolio of exposures held by an authorized institution, means a VaR calculated by the institution under the IMM approach with model inputs calibrated to historical data from, subject to section 317(2)(a), a stressed VaR relevant period;

stressed VaR relevant period (受壓風險值有關期間), in relation to an authorized institution and the definition of ***stressed VaR*** in this section, means a continuous 12-month period of significant financial stress relevant to the portfolio of exposures concerned held by the institution;

transitional period (securitization) (過渡期(證券化)) means the period from and including 1 January 2012 to and including 31 December 2013;

two-way market (雙向市場) means a market where there are independent bona fide offers to buy or sell such that—

(a) a price reasonably related to the last sales price or current bona fide competitive bid and offer

quotations can be determined within one business day; and

(b) transactions can be settled at such price within a relatively short time in accordance with trade custom;".

124. Section 283 amended (positions to be used to calculate market risk)

(1) Section 283(2)(a)—

Repeal

"section 51"

Substitute

"section 51(1)".

(2) Section 283—

Repeal subsections (3), (4) and (5).

125. Section 284 amended (calculation of market risk capital charge for each risk category)

Section 284(1)—

Repeal

"this Part"

Substitute

"Divisions 2, 3, 4, 5, 6, 7, 8, 9 and 10".

126. Section 286 amended (calculation of market risk capital charge)

(1) Section 286—

Repeal paragraph (a)

Substitute

"(a) calculate the market risk capital charge for specific risk for each of its trading book positions (whether long or

short) in debt securities and debt-related derivative contracts—

(i) in accordance with section 287 if those positions arise from non-securitization exposures that do not fall within subparagraph (iii) or (iv);

(ii) in accordance with section 287A if those positions arise from securitization exposures that do not fall within subparagraph (iii);

(iii) in accordance with section 287B if those positions fall within a correlation trading portfolio; or

(iv) in accordance with section 287 and Division 10 if those positions arise from credit derivative contracts that do not fall within subparagraph (ii) or (iii);".

(2) Section 286(b)—

Repeal

"calculate"

Substitute

"subject to paragraph (c), calculate".

(3) Section 286(b), English text—

Repeal

"general market risk of"

Substitute

"general market risk for".

(4) Section 286(b)(iii)—

Repeal

"contracts."

Substitute

"contracts; and".

(5) After section 286(b)—

Add

"(c) calculate in accordance with section 288 and Division 10 the market risk capital charge for general market risk for the interest rate exposures arising from its trading book positions (whether long or short) in credit derivative contracts.".

127. Section 287 amended (calculation of market risk capital charge for specific risk)

(1) Section 287, heading, after "**specific risk**"—

Add

"**for interest rate exposures that fall within section 286(a)(i) or (iv)**".

(2) Section 287(1), after "(9)"—

Add

", (9A)".

(3) Section 287(1), English text—

Repeal

"specific risk of" (wherever appearing)

Substitute

"specific risk for".

(4) Section 287(1), after "debt-related derivative contracts"—

Add

"arising from its interest rate exposures that fall within section 286(a)(i) or (iv)".

(5) Section 287(1)(c)—

Repeal

"calculate"

Substitute

"subject to subsection (1A), calculate".

(6) After section 287(1)—

Add

"(1A) For the purposes of subsection (1), the total market risk capital charge for specific risk for n^{th}-to-default credit derivative contracts that fall within section 286(a)(iv) must, during the transitional period (securitization), be calculated as the higher of—

(a) the total market risk capital charge for specific risk for the long positions; or

(b) the total market risk capital charge for specific risk for the short positions.".

(7) Section 287(2)(a)—

Repeal

"with the same issuer, coupon, currency and maturity".

(8) After section 287(4)(a)—

Add

"(aa) debt securities issued by public sector entities, and debt-related derivative contracts where the underlying debt securities are issued by public sector entities, where—

(i) subject to subparagraphs (ii) and (iii), the debt securities or the underlying debt securities, as the case may be, are assigned a credit quality grade of 2 or 3;

(ii) for the purposes of subparagraph (i), the credit quality grade is determined as one grade below that assigned to the sovereign, pursuant to subsection (3)(b) and (c), of the jurisdiction in which the public sector entity concerned is incorporated or, if there is no such lower credit quality grade, the credit quality grade assigned to that sovereign pursuant to that subsection; and

(iii) the institution treats as unrated any of those debt securities, or any of those underlying debt securities, as the case may be, where—

(A) they do not have an ECAI issue specific rating; or

(B) the sovereign of the jurisdiction in which the public sector entity is incorporated does not have an ECAI issuer rating;".

(9) Section 287(4)—

Repeal paragraph (b)

Substitute

"(b) debt securities, not falling within paragraph (a) or (aa), that are rated investment grade and debt-related derivative contracts where the underlying debt securities, not falling within paragraph (a) or (aa), that are rated investment grade; and".

(10) Section 287(5)(b)—

Repeal

"(4)."

Substitute

"(4);".

(11) After section 287(5)(b)—

Add

"(c) include any debt securities issued by public sector entities, and any debt-related derivative contracts where the underlying debt securities are issued by public sector entities, in the non-qualifying class in Table 28 that assigns a credit quality grade of 5 if the application of subsection (4)(aa)(ii) to the debt securities or the underlying debt securities, as the case may be, results in the debt securities or underlying debt securities, as the case may be, being assigned a credit quality grade of 6.".

(12) After section 287(9)—

Add

"(9A) For the purposes of subsection (1)—

(a) subject to paragraph (b), the market risk capital charge for specific risk for an authorized institution's positions in a credit derivative contract (other than an n^{th}-to-default credit derivative contract) may be capped at the maximum possible loss arising from the contract calculated for each individual position as—

(i) if the institution is a protection buyer, the change in the value of the contract in the event that all the reference obligations specified in the contract were to become immediately default risk-free; or

(ii) if the institution is a protection seller, the change in the value of the contract in the event that all the reference obligations specified in the contract were to default immediately with zero recoveries; and

(b) for each position an authorized institution has in an n^{th}-to-default credit derivative contract or n^{th}-to-default credit-linked note, irrespective of whether the institution is a protection buyer or a protection seller—

(i) the market risk capital charge for specific risk for the contract or note, where n is equal to 1, is to be the lesser of—

(A) the sum of the market risk capital charge for specific risk for the individual reference obligations in the basket of reference obligations specified in the contract or note, as the case may be; or

(B) the institution's maximum liability under the contract or the fair value of the note, as the case may be; and

(ii) the market risk capital charge for specific risk for the contract or note, where n is greater than 1, is to be the lesser of—

(A) the sum of the market risk capital charge for specific risk for the individual reference obligations in the basket of reference obligations specified in the contract or note, as the case may be, but disregarding the (n-1) obligation with the lowest market risk capital charge for specific risk; or

(B) the institution's maximum liability under the contract or the fair value of the note, as the case may be.".

(13) Section 287(11), Chinese text, definition of ***官方實體***—

Repeal

"單位。"

Substitute

"單位；".

(14) Section 287(11)—

Add in alphabetical order

"***ECAI issue specific rating*** (ECAI 特定債項評級)—

(a) in relation to a debt security or, in the case of a debt-related derivative contract, the underlying debt security, issued by an issuer that is not a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the debt security or underlying debt security, as the case may be, by an ECAI within the meaning of

paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in section 2(1), and is for the time being neither withdrawn nor suspended by that ECAI; or

(b) in relation to a debt security or, in the case of a debt-related derivative contract, the underlying debt security, issued by a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the debt security or underlying debt security, as the case may be, by an ECAI, and is for the time being neither withdrawn nor suspended by that ECAI;

ECAI issuer rating (ECAI 發債人評級)—

(a) in relation to the issuer of a debt security or, in the case of a debt-related derivative contract, the underlying debt security, that is not a corporate incorporated in India, means a long-term credit assessment rating that is assigned to the issuer by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in section 2(1), and is for the time being neither withdrawn nor suspended by that ECAI; or

(b) in relation to the issuer of a debt security or, in the case of a debt-related derivative contract, the underlying debt security, that is a corporate incorporated in India, means a long-term credit assessment rating that is assigned to the issuer by an ECAI, and is for the time being neither withdrawn nor suspended by that ECAI;".

128. Sections 287A and 287B added

After section 287—

Add

"287A. **Calculation of market risk capital charge for specific risk for interest rate exposures that fall within section 286(a)(ii)**

(1) Subject to subsections (2), (3), (4), (5), (6), (7), (8), (9), (10) and (11), an authorized institution must apply Part 7, with all necessary modifications, to calculate the market risk capital charge for specific risk arising from its positions (whether long or short) in securitization exposures held in the trading book that fall within section 286(a)(ii).

(2) For the purposes of subsection (1), an authorized institution must apply section 15 to determine whether the STC(S) approach or the IRB(S) approach applies to securitization exposures referred to in that subsection.

(3) Subject to subsections (4), (5), (6), (7), (8), (9), (10) and (11), an authorized institution must calculate the market risk capital charge for specific risk interest rate exposures referred to in subsection (1)—

(a) subject to paragraph (b), by calculating the total market risk capital charge for specific risk as—

(i) subject to paragraph (ii), the sum of the market risk capital charge for specific risk for each of those positions (long and short); or

(ii) during the transitional period (securitization), the higher of—

(A) the total market risk capital charge for specific risk for the long positions; or

(B) the total market risk capital charge for specific risk for the short positions; and

(b) by capping the market risk capital charge for specific risk for the institution's positions in a securitization exposure at the maximum possible loss arising from the positions, which is to be calculated for each individual position as—

(i) for a short position, the change in the value of the position in the event that all the underlying exposures were to become immediately default risk-free; or

(ii) for a long position, the change in the value of the position in the event that all the underlying exposures were to default immediately with zero recoveries.

(4) For the purposes of subsection (3), an authorized institution must not offset between positions except as provided for in section 287(2)(a).

(5) For the purposes of subsection (3), an authorized institution must, subject to subsections (6), (7), (8) and (9), calculate the market risk capital charge for its positions (whether long or short) in rated securitization exposures to which a credit quality grade has been assigned in accordance with Part 7, by—

(a) multiplying the positions by the appropriate market risk capital charge factors; or

(b) deducting the positions from the institution's core capital and supplementary capital,

as specified in subsection (6), (7), (8) or (9), as appropriate.

(6) For the purposes of subsection (3), an authorized institution must, in respect of its positions in rated securitization exposures that are not re-securitization exposures and are subject to the STC(S) approach, apply Division 3 of Part 7 as if—

(a) a reference in that Division to Table 24 were a reference to Table 28A;

(b) a reference in that Division to Table 25 were a reference to Table 28B; and

(c) a reference in that Division to risk-weight were a reference to market risk capital charge factor.

Table 28A

Market Risk Capital Charge Factors for Specific Risk or Deductions Applicable to Long-term Credit Quality Grades under STC(S) Approach (Excluding Re-securitization Exposures)

Long-term credit quality grade	Market risk capital charge factor	Deduction
1	1.6%	not applicable
2	4.0%	not applicable
3	8.0%	not applicable
4	28% (for investing institutions)	deduction from core capital and supplementary capital (for originating institutions)
5	not applicable	deduction from core capital and supplementary capital

Table 28B

Market Risk Capital Charge Factors for Specific Risk or Deductions Applicable to Short-term Credit Quality Grades under STC(S) Approach (Excluding Re-securitization Exposures)

Short-term credit quality grade	Market risk capital charge factor	Deduction
1	1.6%	not applicable
2	4.0%	not applicable
3	8.0%	not applicable
4	not applicable	deduction from core capital and supplementary capital

(7) For the purposes of subsection (3), an authorized institution must, in respect of its positions in rated securitization exposures that are re-securitization exposures and are subject to the STC(S) approach, apply Division 3 of Part 7 as if—

(a) a reference in that Division to Table 25A were a reference to Table 28C;

(b) a reference in that Division to Table 25B were a reference to Table 28D; and

(c) a reference in that Division to risk-weight were a reference to market risk capital charge factor.

Table 28C

Market Risk Capital Charge Factors for Specific Risk or Deductions Applicable to Long-term Credit Quality Grades under STC(S) Approach (Re-securitization Exposures)

Long-term credit quality grade	Market risk capital charge factor	Deduction
1	3.2%	not applicable

Long-term credit quality grade	Market risk capital charge factor	Deduction
2	8.0%	not applicable
3	18.0%	not applicable
4	52% (for investing institutions)	deduction from core capital and supplementary capital (for originating institutions)
5	not applicable	deduction from core capital and supplementary capital

Table 28D

Market Risk Capital Charge Factors for Specific Risk or Deductions Applicable to Short-term Credit Quality Grades under STC(S) Approach (Re-securitization Exposures)

Short-term credit quality grade	Market risk capital charge factor	Deduction
1	3.2%	not applicable
2	8.0%	not applicable
3	18.0%	not applicable
4	not applicable	deduction from core capital and supplementary capital

(8) For the purposes of subsection (3), an authorized institution must, in respect of its positions in rated securitization exposures that are not re-securitization

exposures and are subject to the IRB(S) approach, apply Divisions 4 and 5 of Part 7 as if—

(a) a reference in those Divisions to Table 26 were a reference to Table 28E;

(b) a reference in those Divisions to Table 27 were a reference to Table 28F; and

(c) a reference in those Divisions to risk-weight were a reference to market risk capital charge factor.

Table 28E

Market Risk Capital Charge Factors for Specific Risk or Deductions Applicable to Long-term Credit Quality Grades under Ratings-based Method in IRB(S) Approach (Excluding Re-securitization Exposures)

Long-term credit quality grade	Market risk capital charge factor			
	A	B	C	Deduction
1	0.56%	0.96%	1.60%	not applicable
2	0.64%	1.20%	2.00%	not applicable
3	0.80%	1.44%	2.80%	not applicable
4	0.96%	1.60%	2.80%	not applicable
5	1.60%	2.80%	2.80%	not applicable
6	2.80%	4.00%	4.00%	not applicable

Long-term credit quality grade	Market risk capital charge factor			
	A	B	C	Deduction
7	4.80%	6.00%	6.00%	not applicable
8	8.00%	8.00%	8.00%	not applicable
9	20.00%	20.00%	20.00%	not applicable
10	34.00%	34.00%	34.00%	not applicable
11	52.00%	52.00%	52.00%	not applicable
12	not applicable	not applicable	not applicable	deduction from core capital and supplementary capital

Table 28F

Market Risk Capital Charge Factors for Specific Risk or Deductions Applicable to Short-term Credit Quality Grades under Ratings-based Method in IRB(S) Approach (Excluding Re-securitization Exposures)

Short-term credit quality grade	Market risk capital charge factor			
	A	B	C	Deduction
1	0.56%	0.96%	1.60%	not applicable

Short-term credit quality grade	Market risk capital charge factor			
	A	B	C	Deduction
2	0.96%	1.60%	2.80%	not applicable
3	4.80%	6.00%	6.00%	not applicable
4	not applicable	not applicable	not applicable	deduction from core capital and supplementary capital

(9) For the purposes of subsection (3), an authorized institution must, in respect of its positions in rated securitization exposures that are re-securitization exposures and are subject to the IRB(S) approach, apply Divisions 4 and 5 of Part 7 as if—

(a) a reference in those Divisions to Table 27A were a reference to Table 28G;

(b) a reference in those Divisions to Table 27B were a reference to Table 28H; and

(c) a reference in those Divisions to risk-weight were a reference to market risk capital charge factor.

Table 28G

Market Risk Capital Charge Factors for Specific Risk or Deductions Applicable to Long-term Credit Quality Grades under Ratings-based Method in IRB(S) Approach (Re-securitization Exposures)

Long-term credit quality grade	Market risk capital charge factor: Senior re-securitization positions A	Non-senior re-securitization positions B	Deduction
1	1.60%	2.40%	not applicable
2	2.00%	3.20%	not applicable
3	2.80%	4.00%	not applicable
4	3.20%	5.20%	not applicable
5	4.80%	8.00%	not applicable
6	8.00%	12.00%	not applicable
7	12.00%	18.00%	not applicable
8	16.00%	28.00%	not applicable
9	24.00%	40.00%	not applicable
10	40.00%	52.00%	not applicable
11	60.00%	68.00%	not applicable
12	not applicable	not applicable	deduction from core capital and supplementary capital

Table 28H

Market Risk Capital Charge Factors for Specific Risk or Deductions Applicable to Short-term Credit Quality Grades under Ratings-Based Method in IRB(S) Approach (Re-securitization Exposures)

Short-term credit quality grade	Market risk capital charge factor: Senior re-securitization positions A	Non-senior re-securitization positions B	Deduction
1	1.60%	2.40%	not applicable
2	3.20%	5.20%	not applicable
3	12.00%	18.00%	not applicable
4	not applicable	not applicable	deduction from core capital and supplementary capital

(10) For the purposes of subsection (3), an authorized institution may, subject to subsection (11) and with the Monetary Authority's prior consent, in respect of its positions in unrated securitization exposures subject to the IRB(S) approach, use and consistently apply—

(a) if the institution has obtained the Monetary Authority's approval to use the IRB approach to calculate the credit risk capital charge for the IRB subclass into which the underlying exposures of the positions are classified, the supervisory formula method; or

(b) if the institution has obtained the Monetary Authority's approval to use the IMM approach to calculate the incremental risk charge for the underlying exposures of the positions, the supervisory formula method but applying the estimates for the probability of default and loss

given default for the purposes of calculating K_{IRB} under the supervisory formula method that are produced by the internal model that the institution uses to calculate the incremental risk charge.

(11) The market risk capital charge for specific risk for a position calculated under subsection (10) must not be lower than the market risk capital charge for specific risk applicable to a rated and more senior tranche.

287B. Calculation of market risk capital charge for specific risk for interest rate exposures that fall within section 286(a)(iii)

(1) Subject to subsection (2), an authorized institution must calculate the market risk capital charge for specific risk for its positions that fall within section 286(a)(iii)—

(a) in accordance with section 287A in respect of positions (whether long or short) in securitization exposures that fall within paragraph (a) of the definition of ***correlation trading portfolio*** in section 281;

(b) in accordance with section 287 and Division 10 in respect of positions (whether long or short) in n^{th}-to-default credit derivative contracts that fall within paragraph (a) of the definition of ***correlation trading portfolio*** in section 281; and

(c) in accordance with section 287 in respect of positions (whether long or short) that fall within paragraph (b) of the definition of ***correlation trading portfolio*** in section 281.

(2) The market risk capital charge for specific risk for an authorized institution's positions in a correlation trading portfolio is the higher of—

(a) the total market risk capital charge for specific risk that applies to long positions as calculated in accordance with subsection (1); or

(b) the total market risk capital charge for specific risk that applies to short positions as calculated in accordance with subsection (1).".

129. Section 289 amended (construction of maturity ladder)

Section 289(4)(b), after "of that bond"—

Add

"as determined in accordance with section 4A as if measured at fair value".

130. Section 291 amended (calculation of market risk capital charge)

(1) Section 291(a), English text—

Repeal

"specific risk of"

Substitute

"specific risk for".

(2) Section 291(b), English text—

Repeal

"general market risk of"

Substitute

"general market risk for".

131. Section 293 amended (calculation of market risk capital charge for specific risk)

Section 293, English text—

Repeal

"specific risk of"

Substitute

"specific risk for".

132. Section 294 amended (calculation of market risk capital charge for general market risk)

Section 294(1), English text—

Repeal

"general market risk of"

Substitute

"general market risk for".

133. Section 297 amended (preliminary steps to calculating market risk capital charge)

After section 297(2)—

Add

"(3) In this section—

current market price (現行市場價格) means the current market price as determined in accordance with section 4A as if measured at fair value.".

134. Section 307 amended (specific risk)

Section 307—

Repeal subsections (5), (6), (7) and (8)

Substitute

"(5) Subject to subsection (6), an authorized institution must, for the purposes of calculating the market risk capital charge for specific risk for n^{th}-to-default credit derivative contracts that fall within section 286(a)(iv)—

(a) subject to paragraph (b), apply section 287 and Division 10; and

(b) if the n^{th}-to-default credit derivative contract has an ECAI issue specific rating, in respect of positions in which the institution is the protection seller,

assign a market risk capital charge factor to the position, or deduct the position from the core capital and supplementary capital of the institution, in accordance with section 287A(6) or (8), as determined by the operation of section 15 as if that contract were a securitization exposure.

(6) Subject to subsection (7), for the purposes of subsection (5)—

(a) subject to paragraph (b), where an authorized institution has a position in one of the reference obligations underlying a first-to-default credit derivative contract and the contract hedges that position, the institution may offset with respect to the hedged amount—

(i) the market risk capital charge for specific risk for its position in the reference obligation; and

(ii) that part of the market risk capital charge for specific risk for the credit derivative contract that relates to the reference obligation in which the institution has that position; and

(b) where an authorized institution has multiple positions in the reference obligations underlying a first-to-default credit derivative contract, the offsetting of market risk capital charge otherwise allowed under paragraph (a) is allowed only for its positions in the underlying reference obligation having the lowest market risk capital charge for specific risk.

(7) For the purposes of subsection (6), an authorized institution—

(a) must offset the long and short positions in identical first-to-default credit derivative contracts before applying that subsection; and

(b) must not offset the market risk capital charge for specific risk for its position in any n^{th}-to-default credit derivative contract, where n is greater than 1, with the market risk capital charge for its position in any underlying reference obligation.".

135. Section 308 amended (use of credit derivative contracts to offset specific risk)

Section 308(1), after "subsection (2)"—

Add

"and section 307(6)".

136. Section 310 amended (offsetting by 80%)

Section 310(1), English text—

Repeal

"specific risk of"

Substitute

"specific risk for".

137. Section 311 amended (other offsetting)

Section 311(1) , English text—

Repeal

"specific risk of"

Substitute

"specific risk for".

138. Section 316 amended (positions to be used to calculate market risk)

(1) Section 316(1), after "subsection (2)"—

Add

"and section 23A".

(2) Section 316(2)(a)—

Repeal

"section 51"

Substitute

"section 51(1)".

(3) Section 316—

Repeal subsections (3), (4) and (5).

139. Section 317 substituted

Section 317—

Repeal the section

Substitute

"317. Calculation of risk-weighted amount for market risk

(1) Subject to section 317A(1), an authorized institution must calculate the risk-weighted amount for market risk as the sum of—

(a) the market risk capital charge for general market risk calculated by the institution's internal model expressed as VaR;

(b) the market risk capital charge for general market risk calculated by the institution's internal model expressed as stressed VaR;

(c) where applicable, the market risk capital charge for specific risk calculated by the institution's internal model expressed as VaR (except that the institution need not capture the default risk and credit migration risk of positions that are subject to the incremental risk charge);

(d) where applicable, the market risk capital charge for specific risk calculated by the institution's internal model expressed as stressed VaR (except that the

institution need not capture the default risk and credit migration risk of positions that are subject to the incremental risk charge);

(e) where applicable, the incremental risk charge calculated by the institution's internal model;

(f) where applicable, the comprehensive risk charge calculated by the institution's internal model; and

(g) where applicable, the supplemental capital charge referred to in section 318(3) in respect of specific risk interest rate exposures that fall within a correlation trading portfolio,

multiplied by 12.5.

(2) The institution must, for the purposes of calculating stressed VaR under subsection (1)(b) or (d)—

(a) obtain the prior consent of the Monetary Authority for the use of a stressed VaR relevant period in respect of any portfolio of exposures included in the calculation; and

(b) if such prior consent is obtained, regularly review, on at least an annual basis, the appropriateness of such period.

(3) Where an authorized institution uses one internal model to calculate both the market risk capital charge for general market risk under subsection (1)(a) and the market risk capital charge for specific risk under subsection (1)(c), the institution must, in that calculation, use the higher of—

(a) the institution's VaR for all risk categories as at the last trading day; or

(b) the average VaR for the last 60 trading days multiplied by a multiplication factor, m_c, determined under section 319(1).

(4) Where an authorized institution uses one internal model to calculate both the market risk capital charge for general market risk under subsection (1)(b) and the market risk capital charge for specific risk under subsection (1)(d), the institution must, in that calculation, use the higher of—

(a) the institution's latest available stressed VaR for all risk categories; or

(b) the average stressed VaR for the last 60 trading days multiplied by a multiplication factor, m_s, determined under section 319(4).

(5) Where an authorized institution uses one internal model to calculate the incremental risk charge under subsection (1)(e), the institution must, in that calculation, apply a scaling factor, S_i, determined under section 319(5), to the higher of—

(a) the institution's latest available incremental risk charge; or

(b) the average incremental risk charge for the last 12 weeks.

(6) Where an authorized institution uses one internal model to calculate the comprehensive risk charge under subsection (1)(f), the institution must, in that calculation, use the higher of—

(a) the comprehensive risk charge calculated in accordance with subsection (7); or

(b) 8% of the market risk capital charge for specific risk calculated in accordance with section 287B under the STM approach.

(7) An authorized institution must, for the purposes of subsection (6), apply a scaling factor, S_c, determined under section 319(6), to the higher of—

(a) the institution's latest available comprehensive risk charge; or

(b) the average comprehensive risk charge for the last 12 weeks.

(8) Where an authorized institution uses more than one internal model to calculate the market risk capital charge for general market risk and the market risk capital charge for specific risk, the institution must comply with subsections (3), (4), (5), (6) and (7), as the case requires, except that it must apply the subsection or subsections concerned separately to the relevant market risk capital charge generated from each model.".

140. Sections 317A, 317B and 317C added

After section 317—

Add

"**317A. Provisions supplementary to section 317—calculation of market risk capital charge for interest rate exposures**

(1) An authorized institution must use the STM approach to calculate the market risk capital charge for specific risk for its trading book positions (whether long or short) in—

(a) n^{th}-to-default credit derivative contracts that fall within section 286(a)(iv);

(b) securitization exposures that fall within section 286(a)(ii); and

(c) exposures within a correlation trading portfolio that fall within section 286(a)(iii) but for which portfolio the institution does not have the approval of the Monetary Authority to calculate a comprehensive risk charge.

(2) An authorized institution to which subsection (1) applies may, in addition to complying with that subsection, also

make an application under section 18(1) to the Monetary Authority that complies with section 18(1A)(b) in respect of the VaR and stressed VaR for specific risk for the institution's interest rate exposures referred to in subsection (1)(a) and (b).

(3) To avoid doubt, subject to section 18A(3), where—

(a) an authorized institution uses the IMM approach;

(b) the Monetary Authority is satisfied that the institution is in compliance with the requirements set out in sections 1 and 2 of Schedule 3; and

(c) in any case in which the institution has positions that are subject to the incremental risk charge or comprehensive risk charge, or both, the Monetary Authority is satisfied that the institution is in compliance with the requirements set out in—

(i) section 3 or 4 of Schedule 3; or

(ii) sections 3 and 4 of Schedule 3,

as appropriate,

the institution is not required to calculate the market risk capital charge for specific risk under the STM approach for interest rate exposures other than for the positions referred to in subsection (1).

317B. Provisions supplementary to section 317—calculation of market risk capital charge for equity exposures

Where an authorized institution has equity exposures that fall within paragraph (b) of the definition of ***incremental risk charge*** in section 281, the institution may, at its discretion, make an application under section 18(1) to the Monetary Authority that complies with section 18(1A)(e) to calculate an incremental risk charge for such exposures.

317C. Provisions supplementary to section 317—calculation of market risk capital charge for foreign exchange (including gold) exposures

An authorized institution must not exclude, for the purposes of calculating the market risk capital charge for its positions in foreign exchange (including gold) and exchange rate-related derivative contracts, any of its structural positions (within the meaning of section 295(3)) from the calculation except after consultation with the Monetary Authority.".

141. Section 318 substituted

Section 318—

Repeal the section

Substitute

"318. Capital treatment for trading book positions subject to incremental risk charge or comprehensive risk charge

(1) Subject to subsection (2), an authorized institution may calculate an incremental risk charge, or a comprehensive risk charge, in respect of its trading book positions to which either one of the charges is applicable, using an internally-developed approach.

(2) For the calculation of the incremental risk charge or comprehensive risk charge, an authorized institution—

(a) must comply with the requirements specified in Schedule 3 applicable to or in relation to the institution;

(b) must incorporate those positions in the institution's calculation of VaR and stressed VaR; and

(c) must not make any adjustment for double-charging of capital between the incremental risk charge and comprehensive risk charge, or among those 2 capital charges and other market risk capital charges, applicable to those positions.

(3) The Monetary Authority may, by notice in writing given to an authorized institution, impose a supplemental capital charge against a correlation trading portfolio of the institution, to be added to the institution's capital requirement calculated under its internally-developed approach, if the Monetary Authority is satisfied that the stress-testing results referred to in section 4(g) and (h) of Schedule 3 indicate a material shortfall in its comprehensive risk charge.

(4) To avoid doubt, an authorized institution must use the STM approach to calculate—

(a) the market risk capital charge for general market risk and the market risk capital charge for specific risk in respect of any positions that fall within paragraph (a) of the definition of ***incremental risk charge*** in section 281 but for which the institution does not have the approval of the Monetary Authority to calculate an incremental risk charge; and

(b) the market risk capital charge for specific risk in respect of any positions that fall within a correlation trading portfolio but for which the institution does not have the approval of the Monetary Authority to calculate a comprehensive risk charge.".

142. Section 319 amended (multiplication factor)

(1) Section 319, heading—

Repeal

"factor"

Substitute

"and scaling factors".

(2) Section 319(1)—

Repeal

"multiplication factor to be used by an authorized institution"

Substitute

"multiplication factor, m_c, to be used by an authorized institution for the purposes of section 317(3)".

(3) After section 319(2)—

Add

"(2A) An authorized institution must not, without the prior consent of the Monetary Authority, make any significant change to the approach it uses to determine the number of back-testing exceptions under subsection (1)(b).".

(4) After section 319(3)—

Add

"(4) The multiplication factor, m_s, to be used by an authorized institution for the purposes of section 317(4) is to be the sum of—

(a) the value of 3;

(b) a plus factor determined in accordance with subsection (1)(b); and

(c) any additional plus factor assigned to the institution pursuant to subsection (3).

(5) The scaling factor, S_i, to be used by an authorized institution for the purposes of section 317(5) is to be 1 or any other value the Monetary Authority may specify in a notice in writing given to the institution.

(6) The scaling factor, S_c, referred to in section 317(7), to be used by an authorized institution for the purposes of section 317(6) is to be 1 or any other value the Monetary Authority may specify in a notice in writing given to the institution.".

143. Section 324 amended (meaning of "loans and advances in the standardized business line of commercial banking")

Section 324(1)(b)(ii)—

Repeal

"(3)(a) and (b);"

Substitute

"(3)(a) and (b); or".

144. Section 325 amended (meaning of "loans and advances in the standardized business line of retail banking")

Section 325(1)(b)(ii)—

Repeal

"(3)(a) and (b);"

Substitute

"(3)(a) and (b); or".

145. Schedule 2 amended (minimum requirements to be satisfied for approval under section 8 of these Rules to use IRB approach)

Schedule 2, section 1(i)—

Repeal subparagraph (v)

Substitute

"(v) reviewing any proposed development of, or any proposed significant change to, the institution's rating system to assess whether the rating system will function effectively as intended if the proposed development is implemented or the proposed change made, as the case may be; and".

146. Schedule 3 amended (minimum requirements to be satisfied for approval under section 18 of these Rules to use IMM approach)

(1) Schedule 3, after "[ss. 18, 19, 97, 317,"—

Add

"317A,".

(2) Schedule 3, section 1(n)—

Repeal subparagraphs (i), (ii), (iii), (iv) and (v)

Substitute

"(i) VaR is computed on a daily basis and stressed VaR is computed at least on a weekly basis;

(ii) a one-tailed 99% confidence interval is used in calculating VaR (including stressed VaR);

(iii) the minimum holding period used by, or assumed by, the relevant models is 10 trading days for the institution's portfolio of exposures but, where VaR (including stressed VaR) is calculated according to shorter holding periods scaled up to 10 days, the institution must demonstrate periodically the reasonableness of that approach to the satisfaction of the Monetary Authority;

(iv) subject to subparagraph (vi), the historical observation period for calculating VaR (including stressed VaR) is not less than 250 trading days;

(v) if the institution applies a weighting scheme to the historical observations for the calculation of VaR (excluding stressed VaR), a higher weighting is assigned to recent observations;".

(3) Schedule 3, after section 1(n)(v)—

Add

"(va) the institution does not apply a weighting scheme to the historical observations for the calculation of stressed VaR;

(vb) if the institution calculates VaR (excluding stressed VaR) using a weighting scheme that is not fully consistent with the requirements of subparagraphs (iv) and (v), that scheme results in a market risk capital

charge that is not lower than that which would be calculated by the use of a scheme that fully complies with the requirements of those subparagraphs;".

(4) Schedule 3, section 1(n)(vi), after "VaR"—

Add

"(excluding stressed VaR)".

(5) Schedule 3, section 1(n)—

Repeal subparagraph (vii)

Substitute

"(vii) data used are updated at least once every month and are reassessed whenever market prices are subject to material change, and the updating process is flexible enough to allow for more frequent updates where necessary;".

(6) Schedule 3, section 1(n)(ix)(B), after "VaR"—

Add

"(including stressed VaR)".

(7) Schedule 3, section 2(a)(v)—

Repeal

"(referred to in this Schedule as "event risk")".

(8) Schedule 3, section 2—

Repeal paragraph (b).

(9) Schedule 3, section 2—

Repeal paragraph (e)

Substitute

"(e) where applicable, the institution has an internally-developed approach or approaches for calculating the incremental risk charge or comprehensive risk charge, or both, for the institution's trading book positions; and".

(10) Schedule 3, after section 2—

Add

"3. **Additional requirements relating to internally-developed approach for calculation of incremental risk charge**

Without prejudice to sections 1 and 2, an authorized institution must demonstrate to the satisfaction of the Monetary Authority that, if the institution uses the relevant models to calculate an incremental risk charge—

(a) the relevant models capture and adequately reflect, on a continuing basis, the incremental risks inherent in the institution's relevant positions as specified in paragraph (a), or paragraphs (a) and (b), as the case requires, of the definition of ***incremental risk charge*** in section 281;

(b) the relevant models do not capture any positions in securitization exposures or n^{th}-to-default credit derivative contracts, even when such positions are viewed as hedging the underlying exposures held in the trading book;

(c) the incremental risk charge is measured at a 99.9% confidence interval over a capital horizon (being the time period over which default risk and credit migration risk are measured) of one year, taking into account the liquidity horizons (being the time required to sell the position, or to hedge all material risks covered by the internal model that the institution uses to calculate the incremental risk charge, in a stressed market) applicable to individual positions or sets of positions;

(d) the liquidity horizon for a position or set of positions is subject to a floor of 3 months;

(e) the relevant models adopt, consistently and across all of the positions subject to the incremental risk charge—

(i) the assumption of a constant level of risk over the one-year capital horizon, incorporating, for those individual positions that have experienced default or credit migration over their liquidity horizons, the effect of rebalancing those positions at the end of their liquidity horizons so as to achieve the institution's initial level of risk; or

(ii) a one-year constant position assumption over the capital horizon;

(f) the relevant models incorporate correlation effects among the risk factors modelled, including the impact of a clustering of default and credit migration events but excluding the impact of diversification between default or credit migration events and other market variables;

(g) the relevant models reflect—

(i) issuer and market concentration; and

(ii) concentrations that may arise within and across product classes under stressed conditions;

(h) positions are netted only when long and short positions refer to the same underlying exposure, otherwise the positions are captured on a gross basis;

(i) the relevant models only recognize the hedging or diversification effects associated with long and short positions—

(i) involving different instruments or different underlying exposures of the same obligor; or

(ii) in different issuers,

by capturing and modelling separately the gross long and gross short positions in those instruments or underlying exposures and incorporating any basis risks and residual risks involved;

(j) the relevant models reflect the nonlinear impact of options and other positions with material nonlinear behaviour with respect to price changes, taking account of model risk inherent in the valuation and estimation of price risks associated with such positions;

(k) the incremental risk charge is computed at least once a week, or more frequently as required by the Monetary Authority;

(l) where the institution chooses to include equity exposures in the calculation pursuant to section 317B of these Rules—

(i) the inclusion of such exposures in the calculation is consistent with how the institution internally measures and manages the default risk and credit mitigation risk of those exposures;

(ii) such exposures are included in the incremental risk charge calculation in a consistent manner; and

(iii) the institution applies section 149 of these Rules in determining whether a default has occurred; and

(m) the institution satisfies the minimum requirements comparable to those set out in section 1 of Schedule 2 for the use of the IRB approach for the calculation of credit risk, using the assumption of a constant level of risk and with any necessary adjustments to reflect the impact of liquidity,

concentrations and hedging on, and the option characteristics of, the institution's market risk exposures.

4. Additional requirements relating to internally-developed approach for calculation of comprehensive risk charge

Without prejudice to sections 1 and 2, an authorized institution must demonstrate to the satisfaction of the Monetary Authority that, if the institution uses an internally-developed approach to calculate the comprehensive risk charge for its correlation trading portfolio—

(a) the institution is active in trading positions that fall within the correlation trading portfolio (having regard to market perception and the institution's own judgement of the significance of such activities to itself and to the markets in which it operates);

(b) the institution applies, consistently and with any necessary modifications, section 3(c), (d), (e), (f), (g), (h), (i), (j) and (m) of this Schedule in its calculation of comprehensive risk charge as in its calculation of incremental risk charge;

(c) the relevant models capture and adequately reflect, on a continuing basis, not only the incremental risks but also all material risk factors affecting market risk inherent in the institution's correlation trading portfolio;

(d) the institution has sufficient market data to ensure that its relevant models fully capture the material risks of its correlation trading portfolio;

(e) the comprehensive risk charge calculated by the institution is able to provide a justification for the historical price variation of its positions in the correlation trading portfolio;

(f) the institution is able to segregate those positions for which it has the Monetary Authority's approval to incorporate into its calculation of comprehensive risk charge from those positions for which it does not hold such an approval;

(g) the institution regularly applies a set of specific, predetermined stress scenarios to its correlation trading portfolio, having regard to the guidance specified in the Annex to the document entitled "Revisions to the Basel II market risk framework" published by the Basel Committee on Banking Supervision in July 2009, or in that document as amended or updated from time to time, to examine the implications of stresses to—

(i) default rates;

(ii) recovery rates;

(iii) credit spreads; and

(iv) correlations on the correlation trading portfolio's profit or loss;

(h) in respect of compliance with paragraph (g), the institution—

(i) applies the stress scenarios at least weekly, and reports the results, including comparisons with the comprehensive risk charge calculated using the institution's internally-developed approach, to the Monetary Authority within 6 weeks after the end of each quarter, or within such a period and on such a shorter interval as advised by the Monetary Authority; and

(ii) reports to the Monetary Authority any instances where the stress tests indicate a material shortfall of the comprehensive risk charge as soon as reasonably practicable in all the circumstances of the case; and

(i) in respect of the relevant model, comprehensive risk charge is computed at least weekly, or more frequently as required by the Monetary Authority.".

147. Schedule 4 amended (minimum requirements to be satisfied for approval under section 25 of these Rules to use STO approach or ASA approach)

Schedule 4, section 2(c)(ix), after "board of directors"—

Add

"(or a committee designated by the board)".

148. Schedule 5 amended (other deductions from core capital and supplementary capital)

(1) Schedule 5, paragraph (d), after "(c), (d)"—

Add

", (da)".

(2) Schedule 5, paragraph (e), after "(d), (e)"—

Add

", (ea)".

(3) Schedule 5, paragraph (e)—

Repeal

"Rules."

Substitute

"Rules;".

(4) Schedule 5, after paragraph (e)—

Add

"(f) in relation to an authorized institution that is subject to Part 8 of these Rules, the amount of the sum of the exposures in the trading book that are subject to deduction under—

(i) section 236(1)(a), (c), (d), (da) or (e) or 251(1)(a), (c), (d), (e), (ea) or (f) of these Rules by virtue of the operation of section 287A of these Rules; and

(ii) section 307(5) of these Rules;

(g) in relation to an authorized institution that uses the STC approach, the amount of the institution's exposure that is subject to deduction under section 68(c) or 74(3)(a) or (4)(a) of these Rules.".

149. Schedule 6 amended (credit quality grades)

(1) Schedule 6—

Repeal

"[ss. 55, 59, 60, 61, 62, 79, 98, 99, 139, 211, 281 & 287]"

Substitute

"[ss. 55, 59, 60, 61, 61A, 62, 79, 98, 99, 139, 211, 281 & 287 & Sch. 7]".

(2) Schedule 6—

Repeal Table A

Substitute

"Table A

Sovereign Exposures

Credit quality grade (sovereigns)	Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.
1	AAA	Aaa	AAA	AAA	AAA
	AA+	Aa1	AA+	AA+	AA+

Credit quality grade (sovereigns)	Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.
	AA	Aa2	AA	AA	AA
	AA-	Aa3	AA-	AA-	AA-
2	A+	A1	A+	A+	A+
	A	A2	A	A	A
	A-	A3	A-	A-	A-
3	BBB+	Baa1	BBB+	BBB+	BBB+
	BBB	Baa2	BBB	BBB	BBB
	BBB-	Baa3	BBB-	BBB-	BBB-
4	BB+	Ba1	BB+	BB+	BB+
	BB	Ba2	BB	BB	BB
	BB-	Ba3	BB-	BB-	BB-
5	B+	B1	B+	B+	B+
	B	B2	B	B	B
	B-	B3	B-	B-	B-
6	CCC+	Caa1	CCC	CCC+	CCC
	CCC	Caa2	CC	CCC	CC
	CCC-	Caa3	C	CCC-	C
	CC	Ca	D	CC	D".
	C	C		C	
	D			D	

(3) Schedule 6—

Repeal Table B

Substitute

"Table B

Bank and Securities Firm Exposures

Credit quality grade (banks and securities firms)	Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.
1	AAA	Aaa	AAA	AAA	AAA
	AA+	Aa1	AA+	AA+	AA+
	AA	Aa2	AA	AA	AA
	AA-	Aa3	AA-	AA-	AA-
2	A+	A1	A+	A+	A+
	A	A2	A	A	A
	A-	A3	A-	A-	A-
3	BBB+	Baa1	BBB+	BBB+	BBB+
	BBB	Baa2	BBB	BBB	BBB
	BBB-	Baa3	BBB-	BBB-	BBB-
4	BB+	Ba1	BB+	BB+	BB+
	BB	Ba2	BB	BB	BB
	BB-	Ba3	BB-	BB-	BB-

Credit quality grade (banks and securities firms)	Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.
	B+	B1	B+	B+	B+
	B	B2	B	B	B
	B-	B3	B-	B-	B-
5	CCC+	Caa1	CCC	CCC+	CCC
	CCC	Caa2	CC	CCC	CC
	CCC-	Caa3	C	CCC-	C
	CC	Ca	D	CC	D".
	C	C		C	
	D			D	

(4) Schedule 6—

Repeal Table C

Substitute

"Table C

Corporate Exposures

Part 1

Credit quality grade (corporates)	Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Rating	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.	Risk-weight
1	AAA	Aaa	AAA	AAA	AAA	20%
	AA+	Aa1	AA+	AA+	AA+	
	AA	Aa2	AA	AA	AA	
	AA-	Aa3	AA-	AA-	AA-	
2	A+	A1	A+	A+	A+	50%
	A	A2	A	A	A	
	A-	A3	A-	A-	A-	
3	BBB+	Baa1	BBB+	BBB+	BBB+	100%
	BBB	Baa2	BBB	BBB	BBB	
	BBB-	Baa3	BBB-	BBB-	BBB-	
4	BB+	Ba1	BB+	BB+	BB+	100%
	BB	Ba2	BB	BB	BB	
	BB-	Ba3	BB-	BB-	BB-	
5	B+	B1	B+	B+	B+	150%
	B	B2	B	B	B	
	B-	B3	B-	B-	B-	
	CCC+	Caa1	CCC	CCC+	CCC	
	CCC	Caa2	CC	CCC	CC	
	CCC-	Caa3	C	CCC-	C	
	CC	Ca	D	CC	D	

Credit quality grade (corporates)	Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Rating	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.	Risk-weight
	C	C		C		
	D			D		

Part 2

Credit quality grade (corporates)	Credit Analysis and Research Limited	CRISIL Limited	ICRA Limited	Risk-weight
1	CARE AAA	CRISIL AAA	[ICRA]AAA	20%
	CARE AAA (Is)		IrAAA	
2	CARE AA+	CRISIL AA+	[ICRA]AA+	30%
	CARE AA	CRISIL AA	[ICRA]AA	
	CARE AA-	CRISIL AA-	[ICRA]AA-	
	CARE AA+ (Is)		IrAA+	
	CARE AA (Is)		IrAA	
	CARE AA- (Is)		IrAA-	
3	CARE A+	CRISIL A+	[ICRA]A+	50%
	CARE A	CRISIL A	[ICRA]A	
	CARE A-	CRISIL A-	[ICRA]A-	
	CARE A+ (Is)		IrA+	
	CARE A (Is)		IrA	
	CARE A- (Is)		IrA-	

Credit quality grade (corporates)	Credit Analysis and Research Limited	CRISIL Limited	ICRA Limited	Risk-weight
4	CARE BBB+	CRISIL BBB+	[ICRA]BBB+	100%
	CARE BBB	CRISIL BBB	[ICRA]BBB	
	CARE BBB-	CRISIL BBB-	[ICRA]BBB-	
	CARE BBB+ (Is)		IrBBB+	
	CARE BBB (Is)		IrBBB	
	CARE BBB- (Is)		IrBBB-	
5	CARE BB+	CRISIL BB+	[ICRA]BB+	150%".
	CARE BB	CRISIL BB	[ICRA]BB	
	CARE BB-	CRISIL BB-	[ICRA]BB-	
	CARE B+	CRISIL B+	[ICRA]B+	
	CARE B	CRISIL B	[ICRA]B	
	CARE B-	CRISIL B-	[ICRA]B-	
	CARE C+	CRISIL C+	[ICRA]C+	
	CARE C	CRISIL C	[ICRA]C	
	CARE C-	CRISIL C-	[ICRA]C-	
	CARE D	CRISIL D	[ICRA]D	
	CARE BB+ (Is)		IrBB+	
	CARE BB (Is)		IrBB	
	CARE BB- (Is)		IrBB-	
	CARE B+ (Is)		IrB+	
	CARE B (Is)		IrB	
	CARE B- (Is)		IrB-	
	CARE C+ (Is)		IrC+	
	CARE C (Is)		IrC	

Credit quality grade (corporates)	Credit Analysis and Research Limited	CRISIL Limited	ICRA Limited	Risk-weight
	CARE C- (Is)		IrC-	
	CARE D (Is)			

(5) Schedule 6, Table D, column 5—

Repeal

"CCC+
CCC
CCC-
CC
C
D"

Substitute

"CCC
CC
C
D".

(6) Schedule 6—

Repeal Table E

Substitute

"Table E

Short-term Exposures (Banks, Securities Firms and Corporates)

Part 1

Short-term credit quality grade (banks, securities firms and corporates)	Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.	Risk-weight
1	A-1+	P-1	F1+	a-1+	J-1+	20%
	A-1		F1	a-1	J-1	
2	A-2	P-2	F2	a-2	J-2	50%
3	A-3	P-3	F3	a-3	J-3	100%
4	B	NP	B	b	NJ	150%
	B-1		C	c	D	
	B-2		D			
	B-3					
	C					
	D					

Part 2

Short-term credit quality grade (corporates)	Credit Analysis and Research Limited	CRISIL Limited	ICRA Limited	Risk-weight
1	CARE A1+	CRISIL A1+	[ICRA]A1+	20%

Short-term credit quality grade (corporates)	Credit Analysis and Research Limited	CRISIL Limited	ICRA Limited	Risk-weight
2	CARE A1	CRISIL A1	[ICRA]A1	30%
3	CARE A2+	CRISIL A2+	[ICRA]A2+	50%
	CARE A2	CRISIL A2	[ICRA]A2	
4	CARE A3+	CRISIL A3+	[ICRA]A3+	100%
	CARE A3	CRISIL A3	[ICRA]A3	
5	CARE A4+	CRISIL A4+	[ICRA]A4+	150%".
	CARE A4	CRISIL A4	[ICRA]A4	
	CARE D	CRISIL D	[ICRA]D	

150. Schedule 7 amended (standard supervisory haircuts for comprehensive approach to treatment of recognized collateral)

(1) Schedule 7, section 1, Table—

Repeal Part 1

Substitute

"Part 1

Standard Supervisory Haircuts for Debt Securities

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Standard supervisory haircuts: Sovereign issuers	Standard supervisory haircuts: Other issuers
1.	Debt securities with ECAI issue specific ratings	grade 1 (in relation to Table A, Table B, Part 1 of Table C or Part 1 of Table E in Schedule 6, or Table A or Table B in Schedule 11) and grades 1 and 2 (in relation to Part 2 of Table C or Part 2 of Table E in Schedule 6)	(a) not more than 1 year	0.5%	1%
			(b) more than 1 year but not more than 5 years	2%	4%
			(c) more than 5 years	4%	8%
2.	Recognized collateral that falls within any of section 79(e) to (la) of these Rules	grade 1 (in relation to Table A, Table B, Part 1 of Table C or Part 1 of Table E in Schedule 6,	(a) not more than 1 year	0.5%	1%
			(b) more than 1 year but not	2%	4%

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Standard supervisory haircuts: Sovereign issuers	Standard supervisory haircuts: Other issuers
		or Table A or Table B in Schedule 11) and grades 1 and 2 (in relation to Part 2 of Table C or Part 2 of Table E in Schedule 6)	more than 5 years		
			(c) more than 5 years	4%	8%
3.	Debt securities with ECAI issue specific ratings	grades 2 and 3 (in relation to Table A, Table B, Part 1 of Table C or Part 1 of Table E in Schedule 6, or Table A or Table B in Schedule 11) and grades 3 and 4 (in relation to Part 2 of Table C or Part 2 of	(a) not more than 1 year	1%	2%
			(b) more than 1 year but not more than 5 years	3%	6%
			(c) more than 5 years	6%	12%

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Standard supervisory haircuts: Sovereign issuers	Standard supervisory haircuts: Other issuers
		Table E in Schedule 6)			
4.	Recognized collateral that falls within any of section 79(e) to (la) of these Rules	grades 2 and 3 (in relation to Table A, Table B, Part 1 of Table C or Part 1 of Table E in Schedule 6, or Table A or Table B in Schedule 11) and grades 3 and 4 (in relation to Part 2 of Table C or Part 2 of Table E in Schedule 6)	(a) not more than 1 year	1%	2%
			(b) more than 1 year but not more than 5 years	3%	6%
			(c) more than 5 years	6%	12%
5.	Debt securities with long-term ECAI issue specific ratings	grade 4	All	15%	not applicable

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Standard supervisory haircuts: Sovereign issuers	Standard supervisory haircuts: Other issuers
6.	Recognized collateral that falls within section 79(e), (f) or (h) of these Rules	grade 4	All	15%	not applicable
7.	Debt securities without ECAI issue specific ratings issued by banks or securities firms, that satisfy the criteria set out in section 79(m) of these Rules	not applicable	(a) not more than 1 year	not applicable	2%
			(b) more than 1 year but not more than 5 years	not applicable	6%
			(c) more than 5 years	not applicable	12%

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Standard supervisory haircuts: Sovereign issuers	Standard supervisory haircuts: Other issuers
8.	Recognized collateral, that falls within section 79(m) of these Rules	not applicable	(a) not more than 1 year	not applicable	2%
			(b) more than 1 year but not more than 5 years	not applicable	6%
			(c) more than 5 years	not applicable	12%".

(2) Schedule 7, section 2(d)—

Repeal

"section 51"

Substitute

"section 51(1)".

(3) Schedule 7, section 2(e)—

Repeal

"section 51"

Substitute

"section 51(1)".

(4) Schedule 7, section 2(f)—

Repeal

"entities."

Substitute

"entities;".

(5) Schedule 7, after section 2(f)—

Add

"(g) ***ECAI issue specific rating*** (ECAI 特定債項評級)—

(i) in relation to a debt security issued by a bank, a securities firm, a corporate incorporated outside India, or any other issuer that is not a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the debt security by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in section 2(1) of these Rules, and is for the time being neither withdrawn nor suspended by that ECAI; or

(ii) in relation to a debt security issued by a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that is assigned to the debt security by an ECAI, and is for the time being neither withdrawn nor suspended by that ECAI;

(h) ***long-term ECAI issue specific rating*** (長期 ECAI 特定債項評級), in relation to a debt security issued by a sovereign, a sovereign foreign public sector entity, or a multilateral development bank, means an ECAI issue specific rating assigned to the debt security by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in section 2(1) of these Rules that is a long-term credit assessment rating.".

151. Schedule 8 amended (credit quality grades for specialized lending)

Schedule 8, column 4—

Repeal

"CCC+

CCC

CCC-

CC

C"

Substitute

"CCC

CC

C".

152. Schedule 9 amended (requirements to be satisfied for using section 229(1)(a) of these Rules)

Schedule 9, paragraph (g)—

Repeal subparagraph (ii)

Substitute

"(ii) obliges the institution to repurchase any of the underlying exposures, at any time, except where—

(A) the obligation arises from a claim arising from a representation or warranty given by the institution to another person in the documentation solely in respect of the status of any underlying exposure at the time of the transfer and that is capable of being verified at that time; or

(B) the obligation is accepted by and imposed on the institution for legitimate and sound commercial reasons and does not expose the institution to excessive credit risk;".

153. Schedule 10 amended (requirements to be satisfied for using section 229(1)(b) of these Rules)

Schedule 10, section 1(b)(i)—

Repeal

"section 51"

Substitute

"section 51(1)".

154. Schedule 11 amended (mapping of ECAI issue specific ratings into credit quality grades under STC(S) approach)

(1) Schedule 11—

Repeal

"[ss. 227, 236, 237, 239 & 240]"

Substitute

"[ss. 227, 236, 237, 239 & 240 & Sch. 7]".

(2) Schedule 11—

Repeal Table A

Substitute

"Table A

Long-term Credit Quality Grades

Long-term credit quality grade	Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.
1	AAA	Aaa	AAA	AAA	AAA
	AA+	Aa1	AA+	AA+	AA+

Long-term credit quality grade	Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.
	AA	Aa2	AA	AA	AA
	AA-	Aa3	AA-	AA-	AA-
2	A+	A1	A+	A+	A+
	A	A2	A	A	A
	A-	A3	A-	A-	A-
3	BBB+	Baa1	BBB+	BBB+	BBB+
	BBB	Baa2	BBB	BBB	BBB
	BBB-	Baa3	BBB-	BBB-	BBB-
4	BB+	Ba1	BB+	BB+	BB+
	BB	Ba2	BB	BB	BB
	BB-	Ba3	BB-	BB-	BB-
5	B+	B1	B+	B+	B+
	B	B2	B	B	B
	B-	B3	B-	B-	B-
	CCC+	Caa1	CCC	CCC+	CCC
	CCC	Caa2	CC	CCC	CC
	CCC-	Caa3	C	CCC-	C
	CC	Ca	D	CC	D".
	C	C		C	
	D				

(3) Schedule 11—

Repeal Table B

Substitute

"Table B

Short-term Credit Quality Grades

Short-term credit quality grade	Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.
1	A-1+	P-1	F1+	a-1+	J-1+
	A-1		F1	a-1	J-1
2	A-2	P-2	F2	a-2	J-2
3	A-3	P-3	F3	a-3	J-3
4	B	NP	B	b	NJ
	B-1		C	c	D".
	B-2		D		
	B-3				
	C				
	D				

155. Schedule 14 amended (mapping of ECAI issue specific ratings into credit quality grades under ratings-based method)

(1) Schedule 14—

Repeal Table A

Substitute

"Table A

Long-term Credit Quality Grades

Long-term credit quality grade	Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.
1	AAA	Aaa	AAA	AAA	AAA
	AA+	Aa1	AA+	AA+	AA+
2	AA	Aa2	AA	AA	AA
	AA-	Aa3	AA-	AA-	AA-
3	A+	A1	A+	A+	A+
4	A	A2	A	A	A
5	A-	A3	A-	A-	A-
6	BBB+	Baa1	BBB+	BBB+	BBB+
7	BBB	Baa2	BBB	BBB	BBB
8	BBB-	Baa3	BBB-	BBB-	BBB-
9	BB+	Ba1	BB+	BB+	BB+
10	BB	Ba2	BB	BB	BB
11	BB-	Ba3	BB-	BB-	BB-

Long-term credit quality grade	Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.
12	B+	B1	B+	B+	B+
	B	B2	B	B	B
	B-	B3	B-	B-	B-
	CCC+	Caa1	CCC	CCC+	CCC
	CCC	Caa2	CC	CCC	CC
	CCC-	Caa3	C	CCC-	C
	CC	Ca	D	CC	D".
	C	C		C	
	D				

(2) Schedule 14—

Repeal Table B

Substitute

"Table B

Short-term Credit Quality Grades

Short-term credit quality grade	Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.
1	A-1+	P-1	F1+	a-1+	J-1+
	A-1		F1	a-1	J-1

Short-term credit quality grade	Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.
2	A-2	P-2	F2	a-2	J-2
3	A-3	P-3	F3	a-3	J-3
4	B	NP	B	b	NJ
	B-1		C	c	D".
	B-2		D		
	B-3				
	C				
	D				

Monetary Authority

2011

Explanatory Note

These Rules are made by the Monetary Authority under section 98A of the Banking Ordinance (Cap. 155) and amend the Banking (Capital) Rules (Cap. 155 sub. leg. L) (***principal Rules***).

2. The principal Rules, which were made in 2006, prescribe the manner in which the capital adequacy ratio of an authorized institution incorporated in Hong Kong is to be calculated. The principal Rules have now been in operation for over 4 years.

3. The main purpose of the Rules is to incorporate into the principal Rules—

(a) amendments relating to external credit assessment institutions, the risk-weighting scales for such institutions and the use of credit assessment ratings issued by such institutions (which revisions arise, in particular, from recognizing, for the purposes of the principal Rules, 4 new credit rating agencies as external credit assessment institutions);

(b) amendments relating to the capital requirements for the credit risk activities of an authorized institution as contained in the paper entitled "Enhancements to the Basel II Framework", released by the Basel Committee on Banking Supervision (***BCBS***) in July 2009;

(c) amendments relating to the capital requirements for the market risk activities of an authorized institution as contained in the paper mentioned in subparagraph (b), the paper entitled "Revisions to the Basel II market risk framework", released by the BCBS in July 2009 and updated in February 2011, and the paper entitled "Guidelines for computing capital for incremental risk in the trading book", released by the BCBS in July 2009;

(d) amendments necessitated by problems and ambiguities identified by the Monetary Authority in the operation of the principal Rules to date; and

(e) technical amendments for achieving internal consistency in terminology and consistency between the Chinese and English texts of the principal Rules.

4. The Rules come into operation on 1 January 2012.

Banking (Disclosure) (Amendment) Rules 2011

Contents

Banking (Disclosure) (Amendment) Rules 2011

(Made by the Monetary Authority under section 60A of the Banking Ordinance (Cap. 155) after consultation with the Financial Secretary, the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, The Hong Kong Association of Banks and The DTC Association)

1. Commencement

These Rules come into operation on 1 January 2012.

2. Banking (Disclosure) Rules amended

The Banking (Disclosure) Rules (Cap. 155 sub. leg. M) are amended as set out in sections 3 to 13.

3. Section 2 amended (interpretation)

Section 2(1)—

Add in alphabetical order

"***exposure type*** (風險承擔類型), in relation to the underlying exposures in securitization transactions, or the outstanding exposures held by an authorized institution with the intention of transferring those exposures into securitization transactions, includes—

(a) credit card receivables, home equity loans and auto loans; and

(b) residential mortgage-backed securities, commercial mortgage-backed securities, asset-backed securities and collateralized debt obligations;

protection provider (保障提供者), in relation to a securitization transaction, means the provider of protection against the credit risk in respect of an exposure to the securitization transaction, whether by

means of any of the following or any combination of the following—

(a) insurance;

(b) a guarantee;

(c) a credit derivative contract;".

4. Section 5 amended (disclosure policy)

Section 5(a)—

Repeal subparagraph (i)

Substitute

"(i) the approach used by the institution—

(A) to determine the content, appropriateness and frequency of the information it discloses to the general public relating to its state of affairs, profit and loss or capital adequacy ratio; and

(B) to ensure that such information it discloses is relevant and adequate to convey an accurate impression of the institution's actual risk profile; and".

5. Section 59 amended (credit risk mitigation)

Section 59—

Repeal subsection (3)

Substitute

"(3) An authorized institution—

(a) is not required to make disclosures under this section in respect of credit risk mitigation that is treated as part of securitization transactions; and

(b) must make disclosures under section 60 in respect of such credit risk mitigation.".

6. Section 60 amended (asset securitization)

(1) Section 60—

Repeal subsections (1) and (2)

Substitute

"(1) Subject to subsection (2), an authorized institution must disclose, in respect of securitization transactions to which it is a party and in respect of securitization exposures assumed by it—

(a) the institution's objectives in relation to securitizing the underlying exposures in the securitization transactions, including—

(i) the extent to which the securitization transactions transfer credit risk in respect of the underlying exposures away from the institution to other parties to the transactions; and

(ii) the types of risks assumed and retained through re-securitization transactions;

(b) the nature of risks, other than credit risk, inherent in the underlying exposures that have been securitized by the institution;

(c) the roles played by the institution in the securitization transactions (including as originator, investor, servicer, provider of credit enhancement, sponsor, liquidity provider, swap provider or protection provider) and the extent of the institution's involvement in each of them;

(d) the regulatory capital approaches that the institution uses for its securitization exposures assumed or retained through the roles played by the institution in the securitization transactions and the type of exposures to which each approach applies;

(e) a summary of the institution's accounting policies for the securitization transactions, including—

(i) whether the transactions are treated as sales or financings;

(ii) recognition of gain-on-sale;

(iii) the methods and key assumptions applied for valuing the securitization exposures assumed by the institution (including the methods and key assumptions applied for valuing the re-securitization exposures assumed by the institution if these differ from those applied for valuing the securitization exposures assumed by the institution, and any significant changes since the immediately preceding annual reporting period and the impact of those changes);

(iv) the treatment of synthetic securitization transactions if this is not covered by other accounting policies;

(v) the methods and key assumptions applied for valuing exposures that the institution holds with the intention of transferring them into securitization transactions and an indication of whether the exposures are booked in the institution's banking book or trading book; and

(vi) the policies for recognizing liabilities on the balance sheet of the institution for arrangements that could require the institution to provide financial support for the underlying exposures that have been securitized by the institution;

(f) a description of the processes in place to monitor changes in the credit risk and market risk for

securitization exposures assumed by the institution (including a description of the processes to monitor how the behaviour of the underlying exposures in the securitization transactions impacts the institution's securitization exposures and, if those processes differ for re-securitization exposures assumed by the institution, a description of how they differ);

(g) a description of the institution's policy governing the use of credit risk mitigation to mitigate the risks of securitization exposures retained (including the institution's policy governing the use of credit risk mitigation to mitigate the risks of re-securitization exposures retained if this differs from its policy governing the use of credit risk mitigation to mitigate the risks of securitization exposures retained);

(h) a list of the types of special purpose entities, if any, that the institution has used to securitize exposures acquired from third parties and an indication of the extent and type of the institution's exposures, both on-balance sheet exposures and off-balance sheet exposures, to those special purpose entities;

(i) a list of the related companies (within the meaning of section 35 of the Capital Rules) that the institution manages or advises and that invest in the securitization exposures issued by—

(i) the institution; or

(ii) the special purpose entities of which the institution is a sponsor;

(j) the names of the ECAIs the institution used in relation to the securitization exposures in respect of which the institution uses the STC(S) approach during the annual reporting period and the types of

securitization exposures for which each such ECAI was so used;

(k) an explanation of significant changes to any of the quantitative disclosures (including an explanation of those related to the amounts of exposures that the institution holds with the intention of transferring them into securitization transactions and the movements of exposures between the institution's banking book and trading book) since the last reporting period;

(l) the total outstanding amount of underlying exposures in securitization transactions (regardless of whether the exposures in a traditional securitization transaction have been excluded from the calculation of the risk-weighted amount of the institution's credit exposures under Part 4, 5, 6 or 7 of the Capital Rules in accordance with section 229(1)(a) of those Rules and regardless of whether the risk-weighted amount of the exposures in a synthetic securitization transaction have been calculated in accordance with sections 229(1)(b) and 243, or sections 229(1)(b) and 255, of those Rules), broken down into traditional securitization transactions and synthetic securitization transactions and then broken down by exposure type;

(m) the total outstanding amount of underlying exposures in securitization transactions of which the institution is a sponsor, broken down into traditional securitization transactions and synthetic securitization transactions and then broken down by exposure type;

(n) in the case of underlying exposures in securitization transactions (regardless of whether the exposures in a traditional securitization

transaction have been excluded from the calculation of the risk-weighted amount of the institution's credit exposures under Part 4, 5, 6 or 7 of the Capital Rules in accordance with section 229(1)(a) of those Rules and regardless of whether the risk-weighted amount of the exposures in a synthetic securitization transaction have been calculated in accordance with sections 229(1)(b) and 243, or sections 229(1)(b) and 255, of those Rules)—

(i) the amount of impaired or overdue exposures securitized, broken down by exposure type; and

(ii) the losses recognized by the institution during the annual reporting period, broken down by exposure type;

(o) the amount of outstanding exposures that the institution holds with the intention of transferring them into securitization transactions, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(p) a summary of the securitization transactions the institution has entered into during the annual reporting period, including—

(i) the amount of underlying exposures that have been securitized, broken down by exposure type; and

(ii) the amount of recognized gain or loss on sale of underlying exposures that have been securitized, broken down by exposure type,

and shown separately for the exposures booked in the institution's banking book and trading book;

(q) the total outstanding amount of the institution's on-balance sheet securitization exposures, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(r) the total outstanding amount of the institution's off-balance sheet securitization exposures, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(s) the total amount of securitization exposures (excluding re-securitization exposures) in respect of which the institution uses the STC(S) approach and the capital requirements for those exposures, broken down into the respective risk-weight bands of those exposures determined by reference to the capital requirements calculation for those exposures;

(t) the total amount of re-securitization exposures in respect of which the institution uses the STC(S) approach and the capital requirements for those exposures, broken down into the respective risk-weight bands of those exposures determined by reference to the capital requirements calculation for those exposures;

(u) the securitization exposures that have been fully deducted from the institution's core capital, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(v) the credit-enhancing interest-only strips and other exposures that have been deducted from the institution's core capital and supplementary capital, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(w) in the case of securitization transactions that are subject to an early amortization provision and in which the institution is the originating institution—

(i) the total principal amount of the drawn balances of the underlying exposures attributed to the originator's and investors' interests, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(ii) the total capital requirements, in respect of which the institution uses the STC(S) approach, incurred by the institution against the originator's retained shares of the principal amount of the drawn balances and undrawn balances of the underlying exposures, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book; and

(iii) the total capital requirements, in respect of which the institution uses the STC(S) approach, incurred by the institution against the investors' shares of the principal amount of the drawn balances and undrawn balances of the underlying exposures, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(x) the total amount of re-securitization exposures of the institution, broken down into—

(i) exposures to which credit risk mitigation is applied and those to which it is not applied; and

(ii) exposures to guarantors, broken down by credit-worthiness categories or names of the guarantors,

each shown separately for the exposures booked in the institution's banking book and trading book;

(y) the total outstanding amount of underlying exposures in securitization transactions in relation to which the institution has retained some securitization exposures and calculates the risk-weighted amount of those exposures under Part 8 of the Capital Rules, broken down into traditional securitization transactions and synthetic securitization transactions and then broken down by exposure type;

(z) the total amount of the institution's securitization exposures booked in the institution's trading book that are subject to the comprehensive risk charge, the amount of comprehensive risk charge for those exposures as calculated under Part 8 of the Capital Rules, and a breakdown of that amount of comprehensive risk charge into default risk, credit migration risk, correlation risk and other material risk factors;

(za) the total amount of the institution's securitization exposures that are subject to Part 8 of the Capital Rules for the calculation of the specific risk for the exposures (but excluding securitization positions booked in the institution's trading book that fall within a correlation trading portfolio and are subject to the comprehensive risk charge under the internal models approach for market risk), broken down into the respective market risk capital charge factors of those exposures for each regulatory capital approach; and

(zb) the capital requirements for the securitization exposures of the institution that are subject to Part 8 of the Capital Rules (but excluding securitization positions booked in the institution's trading book that fall within a correlation trading portfolio and are subject to the comprehensive risk charge under the internal models approach for market risk), broken down into the respective market risk capital charge factors of those exposures for each regulatory capital approach.

(2) The disclosures required under subsection (1)(a), (b), (c), (d), (e), (f), (g), (h) and (i) must, for information purposes, be shown separately in relation to the authorized institution's securitization exposures booked in the institution's banking book and trading book.".

(2) Section 60—

Repeal subsections (3), (4) and (5).

7. Section 61 amended (market risk)

(1) Section 61(2)(b)—

Repeal subparagraph (i)

Substitute

"(i) interest rate exposures (including options exposures if applicable), including the separate disclosure of the capital requirements incurred by the institution against securitization positions and non-securitization positions;".

(2) Section 61(3)(d)(iii)—

Repeal

"processes; and"

Substitute

"processes;".

(3) Section 61(3)—

Repeal paragraph (e)

Substitute

"(e) in respect of the incremental risk charge and the comprehensive risk charge calculated by the institution using internal models, disclose a description of the methodologies used and the risks measured through the use of the internal models, including—

(i) the approach used by the institution to determine liquidity horizons;

(ii) the methodologies used to achieve a capital assessment for market risk that is consistent with a soundness standard comparable to that for the IRB approach for credit risk; and

(iii) the approaches used in the validation of the models; and".

(4) After section 61(3)(e)—

Add

"(f) for each position covered by the approach and for each internal model used by the institution for the position, separately disclose—

(i) the institution's average, high and low VaR for the annual reporting period and the VaR as at the last trading day of the annual reporting period;

(ii) the institution's average, high and low stressed VaR for the annual reporting period and the stressed VaR as at the last trading day of the annual reporting period;

(iii) the institution's average, high and low incremental and comprehensive risk charges for the annual reporting period and the incremental and

comprehensive risk charges as at the last trading day of the annual reporting period; and

(iv) a comparison of VaR estimates with actual gains or losses experienced by the institution and a breakdown of important exceptions in back-test results.".

8. Section 69 amended (asset securitization)

(1) Section 69—

Repeal subsection (1)

Substitute

"(1) Subject to subsection (1A), an authorized institution must disclose, in respect of securitization transactions to which it is a party and in respect of securitization exposures assumed by it—

(a) the roles played by the institution in the securitization transactions (including as investor, servicer, provider of credit enhancement, sponsor, liquidity provider, swap provider or protection provider) and the extent of the institution's involvement in each of them;

(b) a summary of the institution's accounting policies for securitization transactions, including the methods and key assumptions applied for valuing the securitization exposures assumed by the institution (including the methods and key assumptions applied for valuing the re-securitization exposures assumed by the institution if these differ from those applied for valuing the securitization exposures assumed by the institution, and any significant changes since the immediately preceding annual reporting period and the impact of those changes);

(c) a description of the processes in place to monitor changes in the credit risk and market risk for securitization exposures assumed by the institution (including a description of the processes to monitor how the behaviour of the underlying exposures in the securitization transactions impacts the institution's securitization exposures and, if those processes differ for re-securitization exposures assumed by the institution, a description of how they differ);

(d) the names of the ECAIs the institution used in relation to the securitization exposures in respect of which the institution uses the STC(S) approach during the annual reporting period and the types of securitization exposures for which each such ECAI was so used;

(e) an explanation of significant changes to any of the quantitative disclosures (including an explanation of those related to the movements of exposures between the institution's banking book and trading book) since the last reporting period;

(f) the total outstanding amount of the institution's on-balance sheet securitization exposures, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(g) the total outstanding amount of the institution's off-balance sheet securitization exposures, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(h) the total amount of securitization exposures (excluding re-securitization exposures) in respect of which the institution uses the STC(S) approach and the capital requirements for those exposures,

broken down into the respective risk-weight bands of those exposures determined by reference to the capital requirements calculation for those exposures;

(i) the total amount of re-securitization exposures in respect of which the institution uses the STC(S) approach and the capital requirements for those exposures, broken down into the respective risk-weight bands of those exposures determined by reference to the capital requirements calculation for those exposures;

(j) the total amount of re-securitization exposures of the institution, broken down into—

(i) exposures to which credit risk mitigation is applied and those to which it is not applied; and

(ii) exposures to guarantors, broken down by credit-worthiness categories or names of the guarantors,

each shown separately for the exposures booked in the institution's banking book and trading book;

(k) the securitization exposures that the institution has deducted from its core capital and supplementary capital, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(l) the total amount of the institution's securitization exposures booked in the institution's trading book that are subject to the comprehensive risk charge, the amount of comprehensive risk charge for those exposures as calculated under Part 8 of the Capital Rules, and a breakdown of that amount of comprehensive risk charge into default risk, credit

migration risk, correlation risk and other material risk factors;

(m) the total amount of the institution's securitization exposures that are subject to Part 8 of the Capital Rules for the calculation of the specific risk for the exposures (but excluding securitization positions booked in the institution's trading book that fall within a correlation trading portfolio and are subject to the comprehensive risk charge under the internal models approach for market risk), broken down into the respective market risk capital charge factors of those exposures for each regulatory capital approach; and

(n) the capital requirements for the securitization exposures of the institution that are subject to Part 8 of the Capital Rules (but excluding securitization positions booked in the institution's trading book that fall within a correlation trading portfolio and are subject to the comprehensive risk charge under the internal models approach for market risk), broken down into the respective market risk capital charge factors of those exposures for each regulatory capital approach.".

(2) After section 69(1)—

Add

"(1A) The disclosures required under subsection (1)(a), (b) and (c) must, for information purposes, be shown separately in relation to the authorized institution's securitization exposures booked in the institution's banking book and trading book.".

9. Section 70 amended (market risk)

(1) Section 70(2)(b)—

Repeal subparagraph (i)

Substitute

"(i) interest rate exposures (including options exposures if applicable), including the separate disclosure of the capital requirements incurred by the institution against securitization positions and non-securitization positions;".

(2) Section 70(3)(d)(iii)—

Repeal

"processes; and"

Substitute

"processes;".

(3) Section 70(3)—

Repeal paragraph (e)

Substitute

"(e) in respect of the incremental risk charge and the comprehensive risk charge calculated by the institution using internal models, disclose a description of the methodologies used and the risks measured through the use of the internal models, including—

(i) the approach used by the institution to determine liquidity horizons;

(ii) the methodologies used to achieve a capital assessment for market risk that is consistent with a soundness standard comparable to that for the IRB approach for credit risk; and

(iii) the approaches used in the validation of the models; and".

(4) After section 70(3)(e)—

Add

"(f) for each position covered by the approach and for each internal model used by the institution for the position, separately disclose—

(i) the institution's average, high and low VaR for the annual reporting period and the VaR as at the last trading day of the annual reporting period;

(ii) the institution's average, high and low stressed VaR for the annual reporting period and the stressed VaR as at the last trading day of the annual reporting period;

(iii) the institution's average, high and low incremental and comprehensive risk charges for the annual reporting period and the incremental and comprehensive risk charges as at the last trading day of the annual reporting period; and

(iv) a comparison of VaR estimates with actual gains or losses experienced by the institution and a breakdown of important exceptions in back-test results.".

10. Section 78 amended (credit risk: disclosures on risk assessment)

Section 78(3)(a), Chinese text—

Repeal

"根據"

Substitute

"根據第".

11. Section 81 amended (credit risk mitigation)

Section 81—

Repeal subsection (3)

Substitute

"(3) An authorized institution—

(a) is not required to make disclosures under this section in respect of credit risk mitigation that is treated as part of securitization transactions; and

(b) must make disclosures under section 82 in respect of such credit risk mitigation.".

12. Section 82 amended (asset securitization)

(1) Section 82—

Repeal subsections (1) and (2)

Substitute

"(1) Subject to subsection (2), an authorized institution must disclose, in respect of securitization transactions to which it is a party and in respect of securitization exposures assumed by it—

(a) the institution's objectives in relation to securitizing the underlying exposures in the securitization transactions, including—

(i) the extent to which the securitization transactions transfer credit risk in respect of the underlying exposures away from the institution to other parties to the transactions; and

(ii) the types of risks assumed and retained through re-securitization transactions;

(b) the nature of risks, other than credit risk, inherent in the underlying exposures that have been securitized by the institution;

(c) the roles played by the institution in the securitization transactions (including as originator, investor, servicer, provider of credit enhancement, sponsor, liquidity provider, swap provider or protection provider) and the extent of the institution's involvement in each of them;

(d) the regulatory capital approaches that the institution uses for its securitization exposures assumed or retained through the roles played by the institution in the securitization transactions and the type of exposures to which each approach applies;

(e) a summary of the institution's accounting policies for the securitization transactions, including—

(i) whether the transactions are treated as sales or financings;

(ii) recognition of gain-on-sale;

(iii) the methods and key assumptions applied for valuing the securitization exposures assumed by the institution (including the methods and key assumptions applied for valuing the re-securitization exposures assumed by the institution if these differ from those applied for valuing the securitization exposures assumed by the institution, and any significant changes since the immediately preceding annual reporting period and the impact of those changes);

(iv) the treatment of synthetic securitization transactions if this is not covered by other accounting policies;

(v) the methods and key assumptions applied for valuing exposures that the institution holds with the intention of transferring them into securitization transactions and an indication of whether the exposures are booked in the institution's banking book or trading book; and

(vi) the policies for recognizing liabilities on the balance sheet of the institution for arrangements that could require the institution

to provide financial support for the underlying exposures that have been securitized by the institution;

(f) a description of the processes in place to monitor changes in the credit risk and market risk for securitization exposures assumed by the institution (including a description of the processes to monitor how the behaviour of the underlying exposures in the securitization transactions impacts the institution's securitization exposures and, if those processes differ for re-securitization exposures assumed by the institution, a description of how they differ);

(g) a description of the institution's policy governing the use of credit risk mitigation to mitigate the risks of securitization exposures retained (including the institution's policy governing the use of credit risk mitigation to mitigate the risks of re-securitization exposures retained if this differs from its policy governing the use of credit risk mitigation to mitigate the risks of securitization exposures retained);

(h) a list of the types of special purpose entities, if any, that the institution has used to securitize exposures acquired from third parties and an indication of the extent and type of the institution's exposures, both on-balance sheet exposures and off-balance sheet exposures, to those special purpose entities;

(i) a list of the related companies (within the meaning of section 35 of the Capital Rules) that the institution manages or advises and that invest in the securitization exposures issued by—

(i) the institution; or

(ii) the special purpose entities of which the institution is a sponsor;

(j) the names of the ECAIs the institution used in relation to the securitization exposures in respect of which the institution uses the STC(S) approach or IRB(S) approach, or both, during the annual reporting period and the types of securitization exposures for which each such ECAI was so used;

(k) an explanation of significant changes to any of the quantitative disclosures (including an explanation of those related to the amount of exposures that the institution holds with the intention of transferring them into securitization transactions and the movements of exposures between the institution's banking book and trading book) since the last reporting period;

(l) the total outstanding amount of underlying exposures in securitization transactions (regardless of whether the exposures in a traditional securitization transaction have been excluded from the calculation of the risk-weighted amount of the institution's credit exposures under Part 4, 5, 6 or 7 of the Capital Rules in accordance with section 229(1)(a) of those Rules and regardless of whether the risk-weighted amount of the exposures in a synthetic securitization transaction have been calculated in accordance with sections 229(1)(b) and 243, or sections 229(1)(b) and 255, of those Rules), broken down into traditional securitization transactions and synthetic securitization transactions and then broken down by exposure type;

(m) the total outstanding amount of underlying exposures in securitization transactions of which the institution is a sponsor, broken down into traditional securitization transactions and synthetic securitization transactions and then broken down by exposure type;

(n) in the case of underlying exposures in securitization transactions (regardless of whether the exposures in a traditional securitization transaction have been excluded from the calculation of the risk-weighted amount of the institution's credit exposures under Part 4, 5, 6 or 7 of the Capital Rules in accordance with section 229(1)(a) of those Rules and regardless of whether the risk-weighted amount of the exposures in a synthetic securitization transaction have been calculated in accordance with sections 229(1)(b) and 243, or sections 229(1)(b) and 255, of those Rules)—

(i) the amount of impaired or overdue exposures securitized, broken down by exposure type; and

(ii) the losses recognized by the institution during the annual reporting period, broken down by exposure type;

(o) the amount of outstanding exposures that the institution holds with the intention of transferring them into securitization transactions, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(p) a summary of the securitization transactions the institution has entered into during the annual reporting period, including—

(i) the amount of underlying exposures that have been securitized, broken down by exposure type; and

(ii) the amount of recognized gain or loss on sale of underlying exposures that have been securitized, broken down by exposure type,

and shown separately for the exposures booked in the institution's banking book and trading book;

(q) the total outstanding amount of the institution's on-balance sheet securitization exposures, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(r) the total outstanding amount of the institution's off-balance sheet securitization exposures, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(s) the total amount of securitization exposures (excluding re-securitization exposures) in respect of which the institution uses the STC(S) approach or IRB(S) approach, or both, and the capital requirements for those exposures, broken down into the respective risk-weight bands of those exposures determined by reference to the capital requirements calculation for those exposures;

(t) the total amount of re-securitization exposures in respect of which the institution uses the STC(S) approach or IRB(S) approach, or both, and the capital requirements for those exposures, broken down into the respective risk-weight bands of those exposures determined by reference to the capital requirements calculation for those exposures;

(u) the securitization exposures that have been fully deducted from the institution's core capital, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(v) the credit-enhancing interest-only strips and other exposures that have been deducted from the institution's core capital and supplementary capital,

broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(w) in the case of securitization transactions that are subject to an early amortization provision and in which the institution is the originating institution—

(i) the total principal amount of the drawn balances of the underlying exposures attributed to the originator's and investors' interests, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(ii) the total capital requirements, in respect of which the institution uses the STC(S) approach or IRB(S) approach, or both, incurred by the institution against the originator's retained shares of the principal amount of the drawn balances and undrawn balances of the underlying exposures, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book; and

(iii) the total capital requirements, in respect of which the institution uses the STC(S) approach or IRB(S) approach, or both, incurred by the institution against the investors' shares of the principal amount of the drawn balances and undrawn balances of the underlying exposures, broken down by exposure type, and shown separately for the exposures booked in the institution's banking book and trading book;

(x) the total amount of re-securitization exposures of the institution, broken down into—

(i) exposures to which credit risk mitigation is applied and those to which it is not applied; and

(ii) exposures to guarantors, broken down by credit-worthiness categories or names of the guarantors,

each shown separately for the exposures booked in the institution's banking book and trading book;

(y) the total outstanding amount of underlying exposures in securitization transactions in relation to which the institution has retained some securitization exposures and calculates the risk-weighted amount of those exposures under Part 8 of the Capital Rules, broken down into traditional securitization transactions and synthetic securitization transactions and then broken down by exposure type;

(z) the total amount of the institution's securitization exposures booked in the institution's trading book that are subject to the comprehensive risk charge, the amount of comprehensive risk charge for those exposures as calculated under Part 8 of the Capital Rules, and a breakdown of that amount of comprehensive risk charge into default risk, credit migration risk, correlation risk and other material risk factors;

(za) the total amount of the institution's securitization exposures that are subject to Part 8 of the Capital Rules for the calculation of the specific risk for the exposures (but excluding securitization positions booked in the institution's trading book that fall within a correlation trading portfolio and are subject to the comprehensive risk charge under the internal models approach for market risk), broken down into the respective market risk capital charge

factors of those exposures for each regulatory capital approach; and

(zb) the capital requirements for the securitization exposures of the institution that are subject to Part 8 of the Capital Rules (but excluding securitization positions booked in the institution's trading book that fall within a correlation trading portfolio and are subject to the comprehensive risk charge under the internal models approach for market risk), broken down into the respective market risk capital charge factors of those exposures for each regulatory capital approach.

(2) The disclosures required under subsection (1)(a), (b), (c), (d), (e), (f), (g), (h) and (i) must, for information purposes, be shown separately in relation to the authorized institution's securitization exposures booked in the institution's banking book and trading book.".

(2) Section 82—

Repeal subsections (3), (4) and (5).

13. Section 83 amended (market risk)

(1) Section 83(1)(b)—

Repeal subparagraph (i)

Substitute

"(i) interest rate exposures (including options exposures if applicable), including the separate disclosure of the capital requirements incurred by the institution against securitization positions and non-securitization positions;".

(2) Section 83(2)(d)(iii)—

Repeal

"processes; and"

Substitute

"processes;".

(3) Section 83(2)—

Repeal paragraph (e)

Substitute

"(e) in respect of the incremental risk charge and the comprehensive risk charge calculated by the institution using internal models, disclose a description of the methodologies used and the risks measured through the use of the internal models, including—

(i) the approach used by the institution to determine liquidity horizons;

(ii) the methodologies used to achieve a capital assessment for market risk that is consistent with a soundness standard comparable to that for the IRB approach for credit risk; and

(iii) the approaches used in the validation of the models; and".

(4) After section 83(2)(e)—

Add

"(f) for each position covered by the approach and for each internal model used by the institution for the position, separately disclose—

(i) the institution's average, high and low VaR for the annual reporting period and the VaR as at the last trading day of the annual reporting period;

(ii) the institution's average, high and low stressed VaR for the annual reporting period and the stressed VaR as at the last trading day of the annual reporting period;

(iii) the institution's average, high and low incremental and comprehensive risk charges for the annual reporting period and the incremental and

comprehensive risk charges as at the last trading day of the annual reporting period; and

(iv) a comparison of VaR estimates with actual gains or losses experienced by the institution and a breakdown of important exceptions in back-test results.".

Monetary Authority

2011

Explanatory Note

These Rules are made by the Monetary Authority under section 60A of the Banking Ordinance (Cap. 155) and amend the Banking (Disclosure) Rules (Cap. 155 sub. leg. M) (***principal Rules***).

2. The main purpose of the Rules is to incorporate into the principal Rules—

   (a) changes to the disclosure requirements for securitization transactions as contained in the paper entitled "Enhancements to the Basel II framework", released by the Basel Committee on Banking Supervision (***BCBS***) in July 2009; and

   (b) changes to the disclosure requirements for market risk as contained in the paper entitled "Revisions to the Basel II market risk framework", released by the BCBS in July 2009 and updated in February 2011.

3. The Rules come into operation on 1 January 2012.

Annex 3

Statutory consultation in August 2011 on draft Banking (Capital) (Amendment) Rules 2011 ("B(C)(A)R 2011") conducted by HKMA

	Section no. of draft B(C)(A)R 2011	Existing / new section no. Banking (Capital) Rules ("BCR")	Industry Comments	HKMA's Responses (The B(C)(A)R section numbers quoted in this column correspond to those in the version of draft B(C)(A)R 2011 issued for statutory consultations in August 2011)
1.	Section 11	Section 18A added	Section 18A added for transitional provisions applicable to IMM approvals under section 18. It appears that the new transitional provisions require AIs to summit the STM approach for market risk even though a HKMA deemed approval on IMM had been obtained. Could the HKMA provide: – An example on what market risk items would require HKMA new approval – any expected application period and any expected timeline for approval – any grace period for AI to enhance the system for STM reporting in case the new approval cannot be obtained before 1 Jan 2 012	When the B(C)(A)R 2011 comes into effect on 1 January 2012, authorized institutions ("AIs") that have obtained the approval of the Monetary Authority ("MA") under section 18(2)(a) of the BCR to use the internal models approach ("IMM approach") to calculate market risk prior to 1 January 2012, and that wish to continue using the IMM approach on and after 1 January 2012, will be required to have sought and obtained the MA's approval in respect of any new market risk capital charge applicable to them. These AIs may make use of a 6-month grace period, mentioned below, for obtaining such approval. In relation to this, an IMM approval existing before 1 January 2012 will be deemed to remain in force on and after 1 January 2012, but the "deemed approval" will be deemed to be revoked on 1 July 2012 if the requisite approval for any new charge applicable to an IMM AI is not obtained before 1 July 2012. Broadly speaking, the new market risk capital charges include – • in the case of an AI having a deemed approval relating to the value-at-risk ("VaR") for general market risk, the stressed VaR for general market risk for the positions covered in the deemed approval; and • in the case of an AI having a deemed approval relating to

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				the VaR for specific risk, (i) the stressed VaR for specific risk for the positions covered in the deemed approval; and (ii) the incremental risk charge and/or comprehensive risk charge, where there are positions covered in the deemed approval that are subject to these charges. If the requisite approval for any new charge related to a deemed approval has not been obtained upon the commencement of the B(C)(A)R 2011, the IMM AI concerned will be required to use the standardized (market risk) approach ("STM approach") to calculate market risk for the positions covered in that deemed approval on and after 1 January 2012, until such requisite approval is obtained no later than 30 June 2012. If such approval is not obtained in time, the deemed approval will be deemed to be revoked on 1 July 2012. This 6-month grace period and the "deemed approval" provisions effectively allow an IMM AI six more months (i.e. until 30 June 2012) to obtain the requisite approval without having to re-apply for the MA's approval for calculation of the relevant charge that constitutes the deemed approval (e.g. VaR for general market risk, or VaR for general market risk and specific risk). Please refer to section 18A(3) in section 11 of the B(C)(A)R 2011 for full and exact details of the requisite approval(s) that an IMM AI should obtain in respect of the new charge(s) applicable to it, and section 18A(4) for the "deemed" revocation of a deemed approval.

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				As an illustration, take an IMM AI that currently calculates general market risk in respect of its foreign exchange ("FX") exposures in the form of a VaR ("original VaR measure"). Pursuant to section 18A(3), the AI has to use the STM approach to calculate general market risk in respect of its FX exposures on and after 1 January 2012, unless and until it has obtained the MA's approval to calculate a stressed VaR related to the original VaR measure concerned. If such approval is obtained before 1 July 2012 while the "deemed approval" in respect of the original VaR measure is still in force, there will be no need to re-apply for the MA's approval in respect of the original VaR measure. If, however, the approval is obtained after 1 July 2012, then the AI will have to re-apply for approval for the original VaR measure. Since early 2010, the HKMA has been closely working with individual IMM AIs with a view to facilitating their application for the requisite approvals as soon as practicable upon the commencement of the B(C)(A)R 2011. Generally, there has been good progress. Barring any unforeseen circumstances, it is currently envisaged that, to the extent that (i) the outstanding issues can be satisfactorily resolved between the AIs and the HKMA before the end of 2011, and (ii) the AIs submit the required applications in the manner specified in section 18(1A) expeditiously, it is likely that the MA will be in a position to make his determination under section 18(2) very shortly after receipt of the applications.

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				There is no grace period for an existing IMM AI to adopt, where necessary, the STM approach for the positions covered in the deemed approval upon the commencement of the B(C)(A)R 2011. This reflects the fact that AIs were already fully informed of the HKMA's intention to implement Basel 2.5 and reminded to prepare for compliance as early as in 2009[1]. Moreover, such a grace period for adopting the STM approach is not technically feasible in that those IMM AIs planning to obtain the requisite approval for any new market risk capital charge applicable to them within the aforesaid 6-month grace period can only use the STM approach as the default approach during the interim. There is no other alternative approach that such AIs can use before the requisite approval is obtained. Any IMM AI that has reasonable grounds to believe that it may likely fail to procure the requisite approval from the MA for it to continue using the IMM approach for market risk in January 2012 should, as soon as possible if it has not already done so, implement a contingency plan that will enable it to revert to the use of the STM approach for market risk immediately after the

[1] Paragraph 35 of Annex 2 of the consultation package issued by the HKMA on 9 September 2009 on implementation of Basel 2.5 states that "As the HKMA intends to follow closely the requirements of the Trading Book Proposals, AIs which plan to apply, or are in the process of applying, for approval from the MA to use the IMM approach for calculation of market risk capital charge should ensure that their internal models can fully comply with the revised market risk capital framework. Similarly, AIs which are using, or have received the MA's approval under the existing framework to use, the IMM approach should start implementing the necessary changes to their internal models as soon as practicable to ensure that their models can fully comply with the revised framework by 1 January 2011." The effective date was revised to 1 January 2012 following the decision of the Basel Committee on Banking Supervision ("BCBS") in June 2010 to extend the implementation of the Trading Book Proposal for one year.

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				commencement of the B(C)(A)R 2011. The AI should keep its usual supervisory contact at the HKMA updated on the issues and impact on its regulatory capital requirements, and the plans for, and progress in, its rectification actions.
2.	Section 36	Section 65 amended (Residential mortgage loan)	Clarification is requested from the HKMA on "… at the time of the allocation of the risk-weight to the loan".	Under the existing BCR, a residential mortgage loan ("RML") which meets all the requirements stated in section 65(1) can be assigned a preferential risk-weight of 35%. The two major requirements stated in section 65(1) are that (i) the loan-to-value ("LTV") ratio of the loan does not exceed 70% at the time a commitment to extend the loan was made (section 65(1)(d)) and (ii) the LTV ratio of the loan does not exceed 100% <u>at any time</u> after the loan is drawn by the borrower (section 65(1)(e)). The latter is considered by some AIs to be unduly stringent in cases where the current LTV ratio of a RML is well below 100%, but where the loan was once a negative-equity loan. The policy intent of the 100% LTV requirement is really to ensure that the preferential risk-weight of 35% is not applied to a loan which is in negative equity at the time of calculating the capital adequacy ratio subsequent to the loan drawdown. However, the drafting of section 65(1)(e) has an unintended effect of extending the restriction to cover all historical LTV ratios of the loan after its drawdown. The proposed amendment to section 65(1)(e) is intended to address the above issue. The phrase in question refers to the time when an AI allocates the 35% risk-weight to a RML for the

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				purpose of calculating its latest capital adequacy ratio.
3.	Section 65(3)	New sections 149(5A) and 149(5B)	It is both prudent and reasonable to assess the risk profile of each individual obligor in the case that the economic or financial support in the connected group is no longer available or insufficient. Under such circumstances, instead of treating all exposures under the connected group automatically as being defaulted, AIs should conduct their own risk assessment taking into consideration the rating on the specific circumstances of the obligor to determine an appropriate rating. Therefore we interpret Section 149(5B) as the AIs need not treat its exposures to all individual obligors in a connected group as being in default, when subsequent to a default of an obligor in the connected group the other exposures in such connected group are re-assessed on the basis that reflects the specific circumstances of the other obligors. Please advise if our interpretation is correct.	The stated interpretation of section 149(5B) is not entirely correct. To the extent that members of a connected group are treated on a group basis for the purposes of rating assignment and have, as a result, been assigned with more favourable ratings based on the available group support than if they were rated on a standalone basis, it is only prudent and logical that such members be treated consistently on the same basis (i.e. as a group) for the purposes of the recognition of default within the group as provided for under section 149(5A). That is, AIs that adopt the group support policy in rating assignment should be obliged to accept both the benefit of allowing more favourable ratings to be assigned to members of a connected group on the strength of available group support pursuant to section 154(c) and (d) as well as the adverse impact on members' ratings when section 149(5A) becomes applicable. It would amount to cherry-picking if AIs were allowed to rate favourably the members of a connected group on a group basis when there is no default among the members, and yet as soon as the group support so recognized in those ratings fails to prevent the default of a member, to revert to rating the other members on a standalone basis and essentially then ignore the inter-dependencies among the group members that had been recognized and relied on before the default occurred. Other major jurisdictions (e.g. UK and Singapore) have adopted a

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				similar approach to that in the B(C)(A)R 2011 in the recognition of default relating to obligor ratings in a connected group. The HKMA does not, however, intend to mandate AIs to automatically regard the default of any one member of a connected group as a default of all the group members in all circumstances, and has therefore set out in section 149(5B) the circumstances under which section 149(5A) will not apply.
4.	Section 70	Section 178 amended (Loss given default)	This change is about permanently maintaining the 10% LGD floor for residential mortgages. Whilst it is acknowledged that the amendment was a result of BCBS changes, consideration should be given as to its appropriateness, given that Downturn LGDs are already used for regulatory capital calculations. Furthermore, as additional capital buffers will be imposed under Basel 3, this is akin to another buffer on buffer, unless the HKMA (or BCBS) is planning to remove the LGD floor when Basel 3 is implemented in 2013.	Other than implementing the decision of the BCBS, the HKMA also considers that it would be in the interest of the financial stability of Hong Kong to maintain the 10% loss given default ("LGD") floor for RML, taking into account the market events since the adoption of the BCR, the significance of RML to the Hong Kong banking sector, and the potential systemic stability issues that such exposures may engender for the sector as a whole. The HKMA will nevertheless keep in view the appropriateness of this LGD floor over time, having regard to international and local developments.
5.	Section 73	Section 202 amended	Subsection (aa) added for Repo-style transactions. The new subsection requires institution to determine the risk-weight by	Section 202(aa) mainly mirrors the corresponding provision under the standardized (credit risk) approach and the basic approach for credit risk (see sections 76(a) and 123(a) of the

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			reference to Part 8 Market Risk on its trading book repo-style transactions where the collateral provided is in the form of securities. However, the new subsection is unclear whether it is applicable only when the underlying securities are regarded as the institution's assets as per Section 202(a). Clarification is required from the HKMA on this.	BCR respectively). Therefore, AIs' primary consideration should be whether those trading book exposures fall within the specified paragraphs of the definition of "repo-style transaction" in section 2(1) of the BCR, and not section 202(a) which applies to banking book exposures.
6.	Section 77	Section 214 amended (Capital Treatment of recognised guarantees and recognized credit derivative contracts)	This issue was raised in the June consultation and the response from the HKMA was to avoid cherry picking. Whilst we acknowledged the HKMA's intention, there are other provisions to stop cherry picking: (1) the IRB approval from the HKMA, which clearly specified the assets that must be booked under the different approaches; and (2) the minimum IRB coverage ratio of 85%. Again, we would like to emphasis the need to differentiate a credit risk mitigant based on the approach (i.e. IRB vs Standardised) instead of the real credit risk mitigating effect of the	We agree that there are existing provisions in the BCR to prevent or discourage cherry-picking. Section 11(3) of the BCR stipulates that, unless exempted by the MA under section 12, "where an authorized institution uses the IRB approach[2] to calculate its credit risk for an IRB class or an IRB subclass of retail exposures, the institution shall use the IRB approach to calculate its credit risk for all exposures which fall within that class or subclass, as the case may be". The proposed amendment to section 214 therefore does not introduce a new requirement but merely serves to reinforce the requirement of section 11(3). The proposed amendment to section 214 of the BCR also does not conflict with the industry's belief that the personal guarantee in its example should be worth something from a risk

[2] "IRB approach" stands for internal ratings-based approach, which is a prescribed approach in the BCR for calculating regulatory capital for credit risk.

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			guarantee/collateral. For example, if we are lending to a large corporation/group (which is an IRB customer) but also accepted a personal guarantee from its Chairman (who may have a very high profile and standing in the country but may be a Standardised customer from a reporting perspective), the guarantee would be worth some value from risk management's perspective.	management perspective. The HKMA allows IRB AIs the flexibility of not using exactly the same ratings or estimates for both regulatory capital calculation and internal purposes, as long as the differences are justified (see paragraphs 5.4.3 to 5.4.5 of the Supervisory Policy Manual ("SPM") module CA-G-4, *Validating Risk Rating Systems under the IRB Approaches*). Such flexibility is provided in light of the fact that regulatory capital requirements may not always align with the specific day-to-day risk management systems and practices of individual AIs, which have different risk profiles and risk tolerance levels. For instance, for the sake of prudence and harmonisation with international standards, the BCR only recognize the risk-mitigating effects of those guarantees that can meet the requirements specified in the applicable credit risk mitigation framework (Division 10 of Part 6 of the BCR applies to the IRB approach). However, the HKMA does not expect AIs to ignore any available credit protection that is not recognized for regulatory capital purposes in their day-to-day management of credit risk.
7.	Section 81	Section 227 amended	According to Subsection 4, securitisation exposure is an "exposure to a securitisation transaction", implying that it is applicable for both the banking and trading books. Subsection 7 then clarified that "Unless otherwise expressly stated, a reference in this Part to a securitization	It is correct that the revised definition of "securitization exposure" will apply to both the banking and trading books. Accordingly, it is more appropriate to move the revised definition from Part 7 of the BCR, which deals with banking book exposures only, to section 2 of the BCR for interpretation of the Rules more generally.

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			exposure of an authorized institution (howsoever expressed) means a securitization exposure booked in the institution's banking book." Clarification is required from the HKMA on this.	After the definitional change, the definition of "securitization exposure" will no longer have the effect of limiting the scope of application of Part 7 to banking book exposures. Hence, there is a need to clarify in subsection 7 that the capital treatments set out in Part 7 are applicable to banking book exposures only.
8.	Section 124	Section 317A(1) & (2) on Provisions supplementary to section 317	The new section requires AIs to use STM approach on (a) nth-to-default CDS (b) trading book securitisation or to get an IMM approval. Clarification is required on the following: • Section 317A(2) refers to approval on Section 18(1A)(b). Is it by default that once approval on Section 18(1A)(b) is obtained, the exposures related to section 317A(1)(a) and (b) will be automatically covered by the approval? • Whether an AI obtained HKMA approval on Section 18(1A)(b) can be	There would appear to be some misinterpretation regarding the relevant market risk capital treatment for n^{th}-to-default credit derivative contracts and securitization exposures under Basel 2.5[3], and the B(C)(A)R 2011 provisions that implement this treatment – • In line with the Basel 2.5 requirement, section 317A(2) allows IMM AIs, if they so choose, to calculate the specific risk VaR and stressed VaR for the n^{th}-to-default credit derivative contracts and securitization exposures specified in section 317A(1)(a) and (b) <u>in addition to</u> their standardized specific risk charge calculated pursuant to section 317A(1). In other words, for these market risk exposures, calculating a specific risk charge using the STM approach is a mandatory requirement, while calculating a

[3] Extract from paragraph 718(Lxxxvii-1-) on page 19 of the BCBS document, *Revisions to the Basel II market risk framework* (Feb 2011) [underlining and elaboration (in italics and square brackets) added by the HKMA for emphasis or ease of understanding] –
"The bank is allowed to include its securitisation exposures and n-th-to-default credit derivatives in its value-at-risk measure. Notwithstanding, <u>it is still required to hold additional capital for these products according to the standardised measurement methodology</u>, with the exceptions noted in paragraphs 718(xcv) to 718(xcviii) below [*i.e. unless these interest rate exposures fall within a correlation trading portfolio and to which the comprehensive risk charge applies*]."

	Section no. of draft B(C)(A)R 2011	Existing / new section no. Banking (Capital) Rules ("BCR")	Industry Comments	HKMA's Responses (The B(C)(A)R section numbers quoted in this column correspond to those in the version of draft B(C)(A)R 2011 issued for statutory consultations in August 2011)
			exempt to report STM approach on Section 317(1)(a) and (b) positions? • Whether an AI should exclude the position in related to section 317A(1)(a) and (b) from the VaR model in case approval from Section 18(1A)(b) does not cover exposures related to Section 317A(1)(a) and (b)?	specific risk charge using the IMM approach is an optional decision for the AI and this charge should be calculated on top of the standardized charge applicable to these exposures under the STM approach. • It remains unchanged that the MA's approval for an AI to use the IMM approach for market risk is to be granted under section 18(2)(a) of the BCR. As explained above, having the MA's approval to use the IMM approach to calculate the specific risk VaR and stressed VaR for an AI's exposures referred to in section 317A(1)(a) and (b) does not obviate the AI's obligation to calculate the specific risk for these exposures using the STM approach. Section 18(1A) serves to stipulate the manner in which an application under section 18(1) should be made. For example, an AI seeking to calculate the VaR and stressed VaR for specific risk for its interest rate exposures pursuant to section 317A(2) must submit to the MA an application under section 18(1) that complies with section 18(1A)(b). An AI must exclude the interest rate exposures referred to in section 317A(1)(a) and (b) from the VaR model if it does not have the MA's approval under section 18(2)(a) to use the IMM approach to calculate the market risk capital charge for such exposures.

	Section no. of draft B(C)(A)R 2011	Existing / new section no. Banking (Capital) Rules ("BCR")	Industry Comments	HKMA's Responses (The B(C)(A)R section numbers quoted in this column correspond to those in the version of draft B(C)(A)R 2011 issued for statutory consultations in August 2011)
9.	Other	Section 224	This is an issue that was not raised during the June consultation but we thought it should be raised given the amendment. Currently, the 6% scaling factor is applicable to all IRB exposures, including "other exposures" as per Section 224 of the BCR. The 6% was a best estimate by the BCBS as a model calibration factor. Given that the exposures included in "other exposures" are simply 100% risk weighted and not driven by internal models (such as property), consideration should be given by the HKMA as to the whether the 6% should be applicable to "other exposures" under IRB.	The BCBS has stipulated the IRB scaling factor of 1.06, based on global quantitative impact study data, with a view to broadly maintaining the aggregate level of minimum capital requirements while also providing incentives for banks to adopt the more advanced approach. We believe the BCBS has made this determination by taking a holistic view of the aggregate credit risk capital requirement generated under the IRB approach, and there is no intention to calibrate separate scaling factors for individual IRB classes or subclasses. Consistent with the BCBS approach, the scaling factor applies broadly to an IRB AI's exposures under section 224 of the BCR. As such, we do not see the need to revise the existing requirement.
10.		48(1)	Under 48(1)(c), an AI shall deduct from its core capital the amount of net deferred tax assets. We would like to clarify if the deferred tax on AFS debt securities and equities are excluded when deriving the net deferred tax amount.	The HKMA's preferred approach is that in deriving the amount of net deferred tax assets ("DTAs") to be deducted under section 48(1)(c), any deferred tax provisions relating to available-for-sale ("AFS") debt securities and equities should not be included. The intention is that deferred tax liabilities or DTAs associated with unrealized gains or losses of AFS equities and debt securities should be dealt with under sections 42 or 44 of the BCR respectively. However, we are aware that the current drafting of section 48 may create ambiguity because it does not specifically exclude

	Section no. of draft B(C)(A)R 2011	Existing / new section no. Banking (Capital) Rules ("BCR")	Industry Comments	HKMA's Responses (The B(C)(A)R section numbers quoted in this column correspond to those in the version of draft B(C)(A)R 2011 issued for statutory consultations in August 2011)
				DTAs relating to AFS equities and debt securities and may appear inconsistent with sections 42 and 44. The interplay between sections 42 and 44 also raises the question as to whether deduction of cumulative unrealized losses from core capital should be on a "pre-tax" basis (HKMA preferred approach) or "post-tax" basis. In view of the ambiguity mentioned above, the HKMA has not objected to the alternative interpretation of section 48(1)(c) adopted by certain AIs as including DTAs relating to cumulative unrealized losses on AFS equities and debt securities. We propose to remove this ambiguity in the course of implementing Basel III in Hong Kong which will necessitate amendment of Part 3 of the BCR.
11.	64(2)	146	According to section 146, other exposures include exposures that fall within definition of other regulatory capital instrument and are not subject to deduction from the institution's core capital and supplementary capital. We would like to clarify for subordinated debt issued by other banks, such exposures should be grouped under IRB bank asset class or report under other exposures and risk weight at 100%?	If the "subordinated debt issued by other banks" in question falls within the definition of "other regulatory capital instrument" in section 35 of the BCR, and that exposure is not subject to deduction from an AI's core capital and supplementary capital under section 48(2), then the exposure must be classified under the IRB subclass of "other items" under the IRB class of "other exposures" as required by section 146(2)(b) (instead of as a bank exposure). The applicable risk-weight is 100%, or higher if section 196(2) applies to the exposure concerned.

	Section no. of draft B(C)(A)R 2011	Existing / new section no. Banking (Capital) Rules ("BCR")	Industry Comments	HKMA's Responses (The B(C)(A)R section numbers quoted in this column correspond to those in the version of draft B(C)(A)R 2011 issued for statutory consultations in August 2011)
12.	65(3) and (4)	149	We wish to seek clarifications on whether an indirect controller would be included as connected groups and would appreciate some examples from the HKMA to illustrate.	AIs are expected to determine and define what constitutes a "connected group" for the purposes of the proposed section 154(c) and (d). An indirect controller who does not make available any form of economic or financial support to other members of a group would not be regarded as meaningful for group support purposes. If, however, the indirect controller provides economic or financial support on which individual group members can rely to reduce their risk of default (such support may be in various forms, e.g. formal guarantee, letter of comfort, provision of supporting collateral, commitment to provide capital or liquidity, etc), AIs will have to determine whether and how such support should be "recognized" for the purposes of section 154(c) and (d). Further information, including key considerations that AIs may take into account, is contained in our response of 2 August 2011 to the industry's comment on section 154(d) under the preliminary consultation on the B(C)(A)R 2011.
13.		240 – Treatment of liquidity facilities and service cash advance facilities Subsection (2)(b)(ii)	In the case of an unrated eligible liquidity facility, "apply to the undrawn portion of the facility a CCF of 50%" regardless of the duration of original maturity. Repeal "An AI may apply a CCF of 0% to the undrawn portion of an eligible liquidity facility provided by the institution"	The treatment set out in section 240 of the BCR and the amendments made to such section only apply to an AI which uses the standardized (securitization) approach to calculate its credit risk for securitization exposures. The corresponding section of the BCR for the internal ratings-based (securitization) approach is section 277 and the amendments to be made to that section are set out in section 109 of the B(C)(A)R.

	Section no. of draft B(C)(A)R 2011	Existing / new section no. Banking (Capital) Rules ("BCR")	Industry Comments	HKMA's Responses (The B(C)(A)R section numbers quoted in this column correspond to those in the version of draft B(C)(A)R 2011 issued for statutory consultations in August 2011)
		(Amended) Subsection (3) (Repealed)	Clarify if this applies to IRB, STC, or both.	
14.	126(3)	319(2A)	We would seek further elaboration on 'An AI must not, without the prior consent of the MA, make any <u>significant change</u> to the <u>approach</u> it uses to determine the number of back-testing exception under subsection(1)(b)'.	An IMM AI must operate a regular back-testing programme to verify the accuracy and reliability of its market risk internal models. The HKMA uses the number of "exceptions" identified through back-testing (i.e. where the daily losses in the value of a portfolio of exposures of the AI are above the daily VaR generated from the AI's internal model applicable to that portfolio) as the basis for supervisory action. Such action may include, for example, a mandatory scaling up of the VaR measures generated by the AI's internal model by a plus factor pursuant to section 319(1)(b) of the BCR, and the conduct of on-site examinations. In serious cases, the supervisory action may involve the imposition of additional capital by means of the supervisory review process or even withdrawal of permission for the AI to continue using the IMM approach to calculate its market risk. The supervisory guidance on the framework for incorporating back-testing into the IMM approach, and the supervisory approach to interpreting an AI's back-testing results, are detailed in section 4.3 of, and Annex B to, the SPM module CA-G-3, *Use of Internal Models Approach to Calculate Market Risk*. As reflected from the above, the determination of the number of back-testing exceptions is important to the assessment of IMM

	Section no. of draft B(C)(A)R 2011	Existing / new section no. Banking (Capital) Rules ("BCR")	Industry Comments	HKMA's Responses (The B(C)(A)R section numbers quoted in this column correspond to those in the version of draft B(C)(A)R 2011 issued for statutory consultations in August 2011)
				AIs' calculations of their market risk capital and supervision in respect of the adequacy of their capital. While the HKMA acknowledges that an AI may perform different types of back-testing comparison and use different standards to interpret the comparison results, it is reasonable to require that an AI must not, without the prior consent of the MA, make any significant change to the approach it uses to determine the number of back-testing exceptions. As to what constitutes "significant" change in these circumstances, AIs are expected to exercise their own judgment on a case-by-case basis in a prudent and consistent manner. Nevertheless, in determining whether a change is "significant", AIs should bear in mind the possibility that a series of "minor" changes over time may, in aggregate, result in a "significant" change to that approach.
15.		319(1)	Does it allow different plus factor on same multiplication factor, at consolidated level and solo level of a banking group due to different number of back-testing exceptions?	Yes, a different plus factor may be applicable to an AI on a solo or consolidated basis, depending on the number of back-testing exceptions identified under the respective basis.
16.		S77, 139(1)	Regarding the correlation between the credit quality of the obligor and relevant collateral, can the property with high liquidity be regarded as eligible collateral under condition that the correlation of the property and its holder, is of "one-way"	The objective of section 77(f) is to ensure that the collateral will remain an effective credit risk mitigant when there is a material deterioration in the credit quality of the obligor concerned. If the credit quality of the obligor changes with the market value of the collateral, apparently, a correlation exists. An AI which intends to recognize the collateral as eligible collateral has to

	Section no. of draft B(C)(A)R 2011	Existing / new section no. Banking (Capital) Rules ("BCR")	Industry Comments	HKMA's Responses (The B(C)(A)R section numbers quoted in this column correspond to those in the version of draft B(C)(A)R 2011 issued for statutory consultations in August 2011)
			nature, i.e. The credit quality of the property holder changes with the market value of the collateral while the market value is not influenced by the credit quality of the obligor?	establish that such correlation is neither positive nor material. AIs should note that high correlation can exist between two factors even though they have no causal relationship (i.e. one factor influencing the other factor or vice versa), and section 77(f) is intended to cover any material positive correlation, regardless of whether the change in collateral value is caused by changes in the obligor's financial condition or vice versa. AIs using the IRB approach should also note the following requirements: • Under the foundation IRB approach, only properties that fall within sections 206 (re recognized commercial real estate and recognized residential real estate) or 208 (re leased assets) of the BCR can be recognized for credit risk mitigation ("CRM") purposes. One of the recognition criteria is that "the institution's credit risk to the obligor in respect of the exposure is not materially dependent on the performance of the underlying property or project constituting the collateral … but on the capacity of the obligor to repay the exposures …" (see section 206(a) of the BCR). • In the context of the retail IRB approach or the advanced IRB approach, "recognized collateral" is defined in section 139(1) of the BCR as any collateral which (a) is recognized by the AI for CRM in accordance with its policies and procedures; and (b) satisfies the requirements under section

	Section no. of draft B(C)(A)R 2011	Existing / new section no. Banking (Capital) Rules ("BCR")	Industry Comments	HKMA's Responses (The B(C)(A)R section numbers quoted in this column correspond to those in the version of draft B(C)(A)R 2011 issued for statutory consultations in August 2011)
				77(a) to (f). A property that is determined to be in compliance with the aforesaid requirements is eligible for CRM purposes under the retail IRB approach or advanced IRB approach.
17.	126 [should be 127]	Schedule 2	We proposed a revision in the comments dated 14 June 2011 to achieve clearer and consistent minimum requirements conducted for regulatory recognition of IRB approach. We understand this proposed revision would not narrow down any scope of AI's internal validation but help to avoid ambiguity in interpretation of validation principles. From the practical perspective, the proposed term "accuracy of risk quantification" is more precise and is not deviated from the original "accuracy of internal rating system" the difference between but is more precise. Recognizing that "risk management purposes" cover such wide scope, which ranges from risk identification, risk measurement, risk monitoring to risk control in association with various use scopes of pricing, provisioning, budgeting	Compared to the industry's proposed revision to the chapeau to, and subparagraph (v) of, section 1(i) of Schedule 2 to the BCR of June 2011, it is noted that, other than the relocation of the bracketed text in the chapeau, the only other difference in this version is the addition of the word "accurate" before the phrase "calculation of regulatory minimum capital requirement". These relatively minor changes do not affect the substance of the HKMA's response on the subject dated 2 August 2011, i.e. the industry's proposed version would narrow considerably the scope of AIs' internal validation of their rating systems, such as confining the scope to checking accuracy of system outputs for regulatory capital purposes, which is not in line with the 2006 Basel II framework. As such, it remains our view that no further change to section 1(i) of Schedule 2 to the BCR is necessary. The industry commented that "risk management purposes" cover a wide scope ranging from risk identification, risk measurement, risk monitoring to risk control … etc. While we agree with the comment, the suitability of an AI's rating system for such wide-ranging risk management purposes is precisely the requirement under section 1(b)(i) of Schedule 2, in addition to other minimum requirements relating to the use of the rating system

	Section no. of draft B(C)(A)R 2011	Existing / new section no. Banking (Capital) Rules ("BCR")	Industry Comments	HKMA's Responses (The B(C)(A)R section numbers quoted in this column correspond to those in the version of draft B(C)(A)R 2011 issued for statutory consultations in August 2011)
			and planning etc., the criteria, measurement and acceptable accuracy level of risk component could be different. In the specific circumstance of the Capital Rules, which is formulated for capital calculation on the basis of risk components, it is necessary to explicitly define the accuracy of the validation exercises should aim at, rather than imply a general and wide purpose of "risk management purposes." Also we don't think this specification would lead to any exclusion of rating process or use of rating/risk quantification results from validation scope since they are already included by "validating regularly the consistency of the institution's rating system" and other sub-sections.	for calculating credit risk capital (see section 1(b)(ii))[4]. This consideration further supports our above assessment that no change be made to section 1(i) of Schedule 2 such that the internal validation conducted by an IRB AI can serve the purpose of reviewing the AI's rating system, or any related proposed development or proposed significant change, to assess whether the system will function effectively as intended (i.e. not confined to its use for regulatory capital purposes).

[4] Extract from section 1 of Schedule 2 to the BCR:

"(b) the institution's rating system—

(i) is suitable for the purposes of identifying, measuring and controlling the institution's credit risk taking into account the characteristics and extent of the institution's exposures;

(ii) is capable of generating reasonably accurate, consistent and verifiable credit risk components and of calculating the institution's regulatory capital for credit risk;".

	Section no. of draft B(C)(A)R 2011	Existing / new section no. Banking (Capital) Rules ("BCR")	Industry Comments	HKMA's Responses (The B(C)(A)R section numbers quoted in this column correspond to those in the version of draft B(C)(A)R 2011 issued for statutory consultations in August 2011)
			Accepting the rating use and employment of rating system are emphasized in IRB validation because it creates an incentive to risk quantification, we would accordingly suggest a better defined requirement for validation as: **Section 1 (i):** **The institution has a reliable system for validating regularly the consistency of the institution's rating system <u>and accuracy of risk quantification for purposes of accurate calculation of regulatory minimum capital requirement</u>, (including models used as referred to in paragraph (g))** **Section 1 (i), paragraph (v):** **reviewing any proposed development of, or any proposed significant change to, the institution's rating system to assess whether the rating system will function effectively <u>enough for accurate calculation of regulatory minimum capital requirement</u> if the proposed development is implemented or the proposed change is made**	

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