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LEGISLATIVE COUNCIL BRIEF

BANKING ORDINANCE (CHAPTER 155)

BANKING (AMENDMENT) ORDINANCE 2012 (COMMENCEMENT) NOTICE 2012

BANKING (CAPITAL) (AMENDMENT) RULES 2012

BANKING (SPECIFICATION OF MULTILATERAL DEVELOPMENT BANK) (AMENDMENT) NOTICE 2012

INTRODUCTION

To implement the revised regulatory capital standards as promulgated by the Basel Committee on Banking Supervision ("BCBS") for the banking sector -

(a) the Secretary for Financial Services and the Treasury has made the Banking (Amendment) Ordinance 2012 (Commencement) Notice 2012 (**Annex A**) to appoint 1 January 2013 as the date on which relevant provisions of the Banking (Amendment) Ordinance 2012 ("BAO 2012") will come into operation;

(b) the Monetary Authority ("MA"[1]) has made the Banking (Capital) (Amendment) Rules 2012 (**Annex B**) to prescribe the revised capital requirements for locally incorporated authorized institutions[2] ("AIs"); and

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[1] In this paper, MA refers to "Monetary Authority" or "Hong Kong Monetary Authority", as the context so requires.

[2] Authorized institutions refer to licensed banks, restricted licence banks, and deposit-taking companies authorized under the Banking Ordinance.

(c) the MA has made the Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2012 (**Annex C**) to update the list of "multilateral development banks" for the purposes of the revised capital standards.

JUSTIFICATIONS

2. The Legislative Council enacted the BAO 2012 on 29 February 2012 to provide for the legal framework for implementation in Hong Kong of the revised regulatory capital and liquidity standards promulgated by the BCBS (known as "Basel III"). Building upon an earlier package dubbed "Basel 2.5", Basel III is designed to further enhance the resilience of banks and banking systems and address weaknesses observed in the recent global financial crisis.

3. Basel III was endorsed by the G20 Leaders in November 2010, and they committed to implementing Basel III fully in line with the BCBS transitional timeline. This means that implementation should begin in January 2013, with the standards being phased-in over the subsequent six years to achieve full implementation by 1 January 2019.

4. It is incumbent upon Hong Kong, a major international financial centre and a member of the BCBS[3], to adopt the internationally agreed timeline. This will ensure that the capital and liquidity frameworks for AIs in Hong Kong are consistent with international standards, and that our AIs will not be disadvantaged vis-à-vis their counterparts outside of Hong Kong[4]. Therefore, relevant provisions of the BAO 2012 should come into operation on 1 January 2013 to align with the international implementation timetable for Basel III.

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[3] The BCBS is committed to monitoring the global implementation of the Basel III standards through a vigorous assessment process. Status reports on the compliance of BCBS member jurisdictions will be issued to the G20 and published on the website of the Bank for International Settlements.

[4] Major jurisdictions such as Australia, Singapore, Japan, Mainland China, New Zealand, Switzerland, and the European Union will all commence implementation of Basel III from January 2013. Some have elected to implement in advance of the BCBS transitional timeline in certain aspects, and some have opted for a certain degree of "gold-plating" of the Basel III standards (i.e. increasing levels compared to Basel minimum requirements) to address their own prudential concerns.

5. To this end, the BAO 2012 has introduced, among other things, a new section 97C to empower the MA to prescribe detailed capital requirements applicable to AIs. The Banking (Capital) (Amendment) Rules 2012 seek to amend the Banking (Capital) Rules (Cap. 155 sub. leg. L) in order to implement the first phase[5] of Basel III capital requirements scheduled to take effect in January 2013.

6. In essence, the new Basel III capital framework increases the level, quality and transparency of banks' capital base, as well as the risk coverage of the capital framework. It seeks to improve the banking sector's ability to absorb shocks arising from financial and economic stress, and to reduce the risks of any spillover from the banking sector to the real economy. The relevant requirements are broadly described in paragraphs 7 to 10 below.

7. First, Basel III reduces the "tiers" of banks' regulatory capital from potentially three tiers to two[6], and increases the minimum regulatory capital requirements (expressed as a percentage of banks' risk-weighted assets). In this regard –

(a) Tier 1 capital is set at a minimum of 6%, comprising Common Equity Tier 1 ("CET1", principally ordinary shares, retained earnings and reserves) of at least 4.5% of risk-weighted assets, and Additional Tier 1 ("AT1", covering non-cumulative preference shares and perpetual subordinated debt instruments);

(b) Tier 2 capital is supplementary capital covering cumulative preference shares and dated subordinated debt instruments; and

(c) total capital (combining both Tiers 1 and 2) must be at least 8%, which is the same as the current requirement prescribed under the Banking Ordinance.

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[5] The first phase of Basel III implementation focuses principally on the introduction of a strengthened capital framework, notably, the three minimum risk-weighted capital ratios (as elaborated in paragraph 7 of this paper), which will take effect starting from 1 January 2013, with the levels of the ratios progressively increasing until 2015. The new capital buffers, the leverage ratio, and the liquidity standards to be introduced under Basel III will be phased-in gradually thereafter.

[6] In Hong Kong, Tier 3 capital is not currently made available as a constituent of banks' capital base. There will remain two tiers of capital for locally incorporated AIs after the introduction of Basel III.

8. Secondly, Basel III tightens the criteria for instruments to qualify for inclusion in the capital base to ensure that capital instruments are genuinely loss-absorbing. In particular, both AT1 and Tier 2 capital instruments are required to be capable of being converted into ordinary shares or written off at a point when the relevant regulatory authority determines the issuing banks to be non-viable.

9. Thirdly, Basel III restricts recognition of minority interest (i.e. capital issued by banks' consolidated subsidiaries and held by third parties) in banks' consolidated capital base. It also harmonises the deductions and exclusions for calculating the regulatory capital base, and requires these to be applied mostly to CET1 capital.

10. Fourthly, Basel III enhances the risk coverage of the capital framework (i.e. the risk-weighted asset measure in the calculation of the regulatory capital ratios), by introducing measures to strengthen the capital requirements for counterparty credit risk ("CCR") exposure[7].

11. In addition, the MA has taken the opportunity to introduce a technical amendment to the Banking (Specification of Multilateral Development Bank) Notice (Cap. 155 sub. leg. N) to implement a decision of the BCBS to include the Multilateral Investment Guarantee Agency ("MIGA"), which is a member of the World Bank Group[8], in the list of "multilateral development banks" for the purposes of the Basel capital framework. The effect of this inclusion is that banks' exposures to MIGA will be afforded the same preferential treatment for capital calculation purposes as is currently available to exposures to other recognised multilateral development banks, under the Banking Ordinance and the Banking (Capital) Rules.

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[7] CCR exposure means the risk of loss when a counterparty to a derivatives or securities financing transaction defaults before the cash flows for the transaction are finally settled.

[8] MIGA was established to encourage the flow of investments for productive purposes among member countries, particularly developing member countries, by providing political risk insurance for investments in these countries. MIGA can issue insurance coverage against the risks of convertibility and transfer restrictions, expropriation, war and civil disturbance, breach of contract and the non-honoring of sovereign financial obligations.

THE SUBSIDIARY LEGISLATION

Banking (Amendment) Ordinance 2012 (Commencement) Notice 2012

12. This Commencement Notice seeks to bring certain provisions of the BAO 2012 into operation with effect from 1 January 2013. These amendment provisions in essence amend the powers of the MA to make rules to prescribe capital and disclosure requirements[9] for AIs incorporated in Hong Kong, and confer new powers on the MA to approve and issue codes of practices to provide guidance in respect of those rules. The amendment provisions also prescribe the procedure for remedial action to be taken upon any contravention by an AI of these requirements, as well as providing for the Banking Review Tribunal to review certain decisions made by MA in this connection.

Banking (Capital) (Amendment) Rules 2012

13. The major provisions of the amendments to the Banking (Capital) Rules are set out below.

Revisions to the minimum capital ratio requirements and the definition of regulatory capital

14. New **sections 3A and 3B** under new **Part 1A** are added to redefine the term "capital adequacy ratio", and to prescribe the three new minimum capital adequacy ratios applicable to AIs (i.e. the CET1 capital ratio, Tier 1 capital ratio and Total capital ratio) from year 2013 onwards. New **sections 38, 39 and 40 and Schedules 4A, 4B and 4C** are added to tighten the qualifying criteria for CET1, AT1, and Tier 2 capital.

15. New **sections 43 to 48 and Schedules 4E, 4F and 4G** are added to prescribe the regulatory deductions to be made in determining the capital base of an AI. Deductions can be broadly classified into two categories –

[9] The MA intends to make the Banking (Disclosure) (Amendment) Rules 2013, in the form of subsidiary legislation, in the first quarter of 2013 to prescribe the disclosure requirements associated with the new capital requirements. The relevant disclosure requirements will take effect from 30 June 2013 to align with the latest implementation timetable promulgated by the BCBS.

(a) items that ultimately may not provide a bank with loss absorbent capital to the extent of their accounting value, including: (i) goodwill and other intangibles; (ii) deferred tax assets; (iii) shortfalls in the stock of provisions relative to expected losses; (iv) gains on sale related to securitization transactions; and (v) defined benefit pension fund assets; and

(b) items that inflate regulatory capital within the financial system by virtue of their double-gearing effect, including (i) investments in own capital instruments; (ii) reciprocal cross-holdings in the capital of financial institutions; and (iii) investment in the capital of financial institutions outside the scope of regulatory capital consolidation.

16. New **Schedule 4H** sets out the transitional arrangements for the phasing-in of the above requirements.

Enhancements to the CCR framework

17. New **Part 6A** is added to prescribe the rules on the calculation of counterparty credit risk. Key elements include –

(a) introduction of an approach that allows use of internal models to calculate CCR exposures (new **sections 10A to 10D and 226C to 226M and Schedule 2A**);

(b) a new capital charge for potential loss when the mark-to-market value of a derivative contract changes due to changes in the credit quality of the counterparty (new **sections 226N to 226T**);

(c) strengthened collateral management standards (amendments to **sections 77, 79, 80, 124, 125 and 139**);

(d) a revised capital framework for exposures to central counterparties (including lower risk weights for certain exposures to central counterparties that meet specified

eligibility criteria) (new **sections 16A, and 226U to 226ZE**);

(e) higher risk weights for exposures to unregulated financial institutions and large regulated financial institutions (new **section 157A**); and

(f) stricter treatment for transactions with "wrong-way risk" (i.e. cases in which the exposure increases when the credit quality of the counterparty deteriorates) (new **section 226J**).

Other Technical Amendments

18. **Section 59** is amended to reduce the capital charge for certain trade financing activities, in line with the standards set out in the document "Treatment of Trade Finance under the Basel Capital Framework" issued by the BCBS in October 2011, to better reflect the self-liquidating nature of these activities.

19. **Sections 69, 98, 99 and 211** are amended, and new **section 232A** added, to address potential "cliff effects" (i.e. where the capital requirement for an exposure increases suddenly and substantially when the obligor's credit rating is downgraded) associated with the use of external credit ratings.

20. **Sections 75, 76, 122, 123 and 202** are amended, and new **sections 76A and 123A** added, to refine the capital treatment for securities financing transactions, in order to clarify the requirements in respect of the CCR exposures arising from margin lending, securities lending, and repurchase transactions.

21. **Sections 77, 88, 89, 100, 124, 134, 149, 216, 217, 225, 226, 272, 273 and 318** are amended to further clarify the policy intent of those provisions, address any ambiguity in the existing rules, and align more closely with the banking supervisory standards relating to capital issued by the BCBS.

Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2012

22. The list of "multilateral development banks" is updated to reflect a decision of the BCBS in May 2010 to include MIGA in the list, so that supervisors may allow banks to apply a 0% risk-weight to claims on MIGA.

LEGISLATIVE TIMETABLE

23. The subsidiary legislation set out in paragraph 1 above will be published in the Gazette on 19 October 2012, and tabled at the Legislative Council at its sitting of 24 October 2012. Subject to negative vetting by the Legislative Council, the relevant provisions will come into operation on 1 January 2013.

IMPLICATIONS OF THE PROPOSALS

24. The MA is monitoring the capital positions of local banks and their process of planning for the implementation of Basel III. Local banks are generally well-capitalised (the average capital adequacy ratio was 15.9% and the average Tier 1 ratio was 13.0%, as at end-June 2012). They have traditionally placed significant reliance on common equity to meet regulatory capital requirements (with common equity accounting for around 89% of Tier 1 capital overall). Furthermore, many of the Basel III regulatory deductions are already required to be deducted from Tier 1 capital under the existing Banking (Capital) Rules. In the MA's assessment, local banks should be relatively well-placed to meet the higher capital requirements, particularly given the accommodating BCBS transitional timeline, although some banks have indicated that they will adopt a prudent approach in strengthening and consolidating their capital resources, and in managing their capital positions, in anticipation of the introduction of the enhanced regulatory capital standards.

25. The legislative proposals in paragraph 1 above are in conformity with the Basic Law, including the provisions concerning

human rights. The amendments proposed will not affect the current binding effect of the Banking Ordinance.

PUBLIC CONSULTATION

26. We consulted the Legislative Council Panel on Financial Affairs on the legislative proposals set out in paragraph 1 on 4 June 2012. Members generally supported the policy direction of gradually implementing Basel III in Hong Kong with effect from 1 January 2013. Members also discussed the impact of the new requirements on AIs, particularly the small and medium-sized ones, and the implementation progress of Hong Kong vis-à-vis other jurisdictions in this respect. The Administration and the MA reaffirmed that local banks were well capitalized (paragraph 24 above), and that it was important for our banking sector to adopt the international capital standards in a timely manner for both prudential and reputational reasons.

27. The MA has engaged in a series of discussions, meetings, and exchanges of correspondence with the industry as part of the consultative process to formulate the Banking (Capital) (Amendment) Rules 2012. In addition, in accordance with section 97C of the Banking Ordinance, the MA issued a draft of the provisions of these rules to consult the Financial Secretary, the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, the Hong Kong Association of Banks, and the DTC Association in August and September 2012, before finalising the amendments. Responses indicated support for the direction of the amendments. Relevant technical or drafting comments were addressed in the finalised rules as appropriate, and the intent of certain provisions was clarified.

PUBLICITY

28. We will issue a press release upon the issuance of this Legislative Council brief. The MA will also issue a circular letter to all AIs in this regard. A government spokesperson will be available to answer media and public enquiries.

ENQUIRIES

29. Enquiries should be directed to Mr. Jackie Liu, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) at 2810 2067, or Mr. Richard Chu, Head (Banking Policy), Hong Kong Monetary Authority, at 2878 8276.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
17 October 2012

Banking (Amendment) Ordinance 2012 (Commencement) Notice 2012

Under section 1(2) of the Banking (Amendment) Ordinance 2012 (3 of 2012), I appoint 1 January 2013 as the day on which the following sections of the Ordinance come into operation—

(a) sections 1, 2 and 3(1), (2) and (3);

(b) section 3(5) (except in so far as it relates to the addition of the new definition of ***liquidity requirement rule***);

(c) sections 4, 5(1), 6 and 7;

(d) section 8 (except in so far as it relates to the addition of the new Part XVIB and to the new section 97H(1) in the new Part XVIC);

(e) sections 9, 10 and 11;

(f) section 12 (except in so far as it relates to the new sections 97H(5), 97J(3) and 97K(7));

(g) section 15(2) (except in so far as it relates to section 104(2) of the Banking Ordinance (Cap. 155));

(h) section 15(3) (except in so far as it relates to liquidity ratio and section 105(1) of the Banking Ordinance (Cap. 155));

(i) sections 18(1), (2) and (4), 19, 20, 21 and 22.

Secretary for Financial Services and the Treasury

2012

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Banking (Capital) (Amendment) Rules 2012

(Made by the Monetary Authority under section 97C 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 2013.

2. Banking (Capital) Rules amended

The Banking (Capital) Rules (Cap. 155 sub. leg. L) are amended as set out in sections 3 to 164.

3. Section 2 amended (interpretation)

(1) Section 2(1)—

Repeal the definition of *back-testing*

Substitute

"***back-testing*** (回溯測試), in relation to the use of an internal model by an authorized institution—

(a) where the internal model is used to calculate counterparty credit risk, means a process whereby the realized values of risk measures and the hypothetical changes based on static positions are compared with the values of the risk measures forecast by the model; or

(b) in any other case, means a process whereby the daily changes in the value of a portfolio of exposures of the institution are compared with the daily VaR generated from the institution's internal model applicable to that portfolio;".

(2) Section 2(1)—

Repeal the definition of *credit derivative contract*

Substitute

"***credit derivative contract*** (信用衍生工具合約) means—

(a) a forward contract, swap contract, option contract or similar derivative contract entered into by 2 parties with the intention to transfer credit risk in relation to a reference obligation from one party (***protection buyer***) to the other party (***protection seller***);

(b) a long settlement transaction that falls within paragraph (a); or

(c) a long settlement transaction of which the counterparty credit risk profile and risk drivers are similar to those specific to a contract that falls within paragraph (a);".

(3) Section 2(1)—

Repeal the definition of *credit risk*

Substitute

"***credit risk*** (信用風險), in relation to an authorized institution, means the risk of loss arising from the change in the value of an on-balance sheet or off-balance sheet exposure of the institution due to—

(a) the change in the credit quality of the exposure concerned; or

(b) the failure of an obligor to meet the obligor's credit obligations to the institution or to the obligor's other creditors;".

(4) Section 2(1), definition of ***derivative contract***, after paragraph (b)—

Add

"(c) means a long settlement transaction that falls within paragraph (a); or

(d) means a long settlement transaction of which the counterparty credit risk profile and risk drivers are similar to those specific to a contract that falls within paragraph (a);".

(5) Section 2(1), definition of ***foreign public sector entity***, paragraphs (a) and (b)—

Repeal

"on Banking Supervision".

(6) Section 2(1), definition of ***long-term ECAI issue specific rating***, paragraphs (a) and (b)—

Repeal

"79(e)"

Substitute

"79(1)(e)".

(7) Section 2(1)—

Repeal the definition of *market risk*

Substitute

"***market risk*** (市場風險), in relation to an authorized institution, means the risk of loss arising from fluctuations in the value of positions held by the institution—

(a) for trading purposes in debt securities, debt-related derivative contracts, interest rate derivative

contracts, equities and equity-related derivative contracts; and

(b) in foreign exchange (including gold), exchange rate-related derivative contracts, commodities and commodity-related derivative contracts;".

(8) Section 2(1)—

Repeal the definition of *nettable*

Substitute

"***nettable*** (可作淨額計算的), in relation to an exposure (however described) of an authorized institution—

(a) in the case of the calculation of default risk exposure using the IMM(CCR) approach, means that the exposure is subject to a valid bilateral netting agreement or a valid cross-product netting agreement; or

(b) in any other case, means that the exposure is subject to a valid bilateral netting agreement;".

(9) Section 2(1)—

Repeal the definition of *operational risk*

Substitute

"***operational risk*** (業務操作風險), in relation to an authorized institution, means the risk of direct or indirect loss resulting from—

(a) inadequacies or failings in the processes or systems, or of the personnel, of the institution; or

(b) external events;".

(10) Section 2(1)—

Repeal the definition of *over-the-counter derivative transaction*

Substitute

"***over-the-counter derivative transaction*** (場外衍生工具交易) means a derivative contract (other than a credit derivative contract) that is not traded on an exchange;".

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

Repeal

"paragraph (i) or (j) of the definition of ***cash items*** in section 51(1) or 105 or referred to in paragraph (h) or (i)"

Substitute

"section 63A or 114A, referred to in paragraph (i) or (j) of the definition of ***cash items*** in section 51(1) or 105 or referred to in paragraph (h), (i) or (j)".

(12) Section 2(1)—

Repeal the definition of *potential exposure*

Substitute

"***potential exposure*** (潛在風險承擔), in relation to the current exposure method, means the principal amount (within the meaning of section 51(1), 105, 139(1) or 227(1), as the case requires) of a transaction or contract multiplied by the applicable CCF;".

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

(a) Paragraph (b), Chinese text—

Repeal

"51"

Substitute

"51(1)";

(b) **Repeal paragraphs (c) and (d)**

Substitute

"(c) a recognized guarantee (within the meaning of section 51(1), 105, 139(1) or 232A, as the case requires);

(d) a recognized credit derivative contract (within the meaning of section 51(1), 105, 139(1) or 232A, as the case requires); or

(e) collateral that falls within section 226H(3),".

(14) Section 2(1)—

Repeal the definition of *recognized netting*

Substitute

"***recognized netting*** (認可淨額計算)—

(a) in the case of the calculation of default risk exposure using the IMM(CCR) approach, means any netting done pursuant to—

(i) a valid bilateral netting agreement; or

(ii) a valid cross-product netting agreement; or

(b) in any other case, means any netting done pursuant to a valid bilateral netting agreement;".

(15) Section 2(1), definition of ***risk-weighted amount***, paragraph (a), after "or 6,"—

Add

"or Division 4 of Part 6A,".

(16) Section 2(1), definition of ***risk-weighted amount for credit risk***, paragraph (a), after "or 6,"—

Add

"or Division 4 of Part 6A,".

(17) Section 2(1), definition of ***short-term ECAI issue specific rating***, paragraphs (a) and (b)—

Repeal

"79(k)"

Substitute

"79(1)(k)".

(18) Section 2(1), definition of ***valid bilateral netting agreement***, paragraph (c), after "given"—

Add

"independent".

(19) Section 2(1), Chinese text, definition of ***信貸換算因數***—

Repeal

"51" (wherever appearing)

Substitute

"51(1)".

(20) Section 2(1)—

(a) definition of ***Basel Committee on Banking Supervision***;

(b) definition of ***core capital***;

(c) definition of ***section 79A(1) requirement***;

(d) definition of ***section 98(2) requirement***;

(e) definition of ***supplementary capital***—

Repeal the definitions.

(21) Section 2(1)—

Add in alphabetical order

"***Additional Tier 1 capital*** (額外一級資本), in relation to an authorized institution, is to be construed in accordance with section 39;

Additional Tier 1 capital instrument (額外一級資本票據) means any capital instrument that meets the qualifying criteria set out in Schedule 4B;

advanced CVA method (高級 CVA 方法) means the method of calculating an authorized institution's CVA capital charge set out in section 226P;

affiliate (附屬成員) has the meaning given by section 35;

bank subsidiary (銀行附屬公司) has the meaning given by section 35;

capital adequacy ratio (資本充足比率) has the meaning given by section 3;

CCP means a central counterparty;

CCP-related transaction (CCP 關聯交易), in relation to a clearing member of a CCP, means a derivative contract or SFT between the clearing member and a client of the clearing member that is directly related to a derivative contract or SFT between the clearing member and the CCP;

CEM risk-weighted amount (CEM 風險加權數額), in relation to derivative contracts entered into by an authorized institution, means the sum of the default risk risk-weighted amounts for all the counterparties to the contracts where the default risk risk-weighted amount for each of the counterparties is calculated as the product of—

(a) the outstanding default risk exposure (net of specific provisions if the STC approach or BSC approach is used) to the counterparty calculated by using the current exposure method; and

(b) the risk-weight applicable to the outstanding default risk exposure determined under the STC

approach, BSC approach or IRB approach, as the case requires;

central counterparty (中央交易對手方), in relation to contracts traded in one or more than one financial market, means an entity which, for the purposes of clearing and settling trades in the contracts, interposes itself between the counterparties to the contracts by becoming the buyer to every seller and the seller to every buyer under the contracts;

CET1 capital (CET1 資本) means Common Equity Tier 1 capital;

CET1 capital instrument (CET1 資本票據)—

(a) in relation to a joint-stock company, means an ordinary share (including a voting ordinary share and an ordinary share ranking pari passu with a voting ordinary share in all respects except the absence of voting rights) that meets the qualifying criteria set out in Schedule 4A; or

(b) in relation to any entity other than a joint-stock company, means any capital instrument that is equivalent to an ordinary share in terms of loss absorption and meets the qualifying criteria set out in Schedule 4A;

CET1 capital ratio (CET1 資本比率) means Common Equity Tier 1 capital ratio;

clearing member (結算成員), in relation to a CCP—

(a) means a member of, or a direct participant in, the CCP that is entitled to enter into a transaction with the CCP; or

(b) if—

(i) the CCP has a link to another CCP; and

(ii) a member of, or a direct participant in, that other CCP that is entitled to enter into a transaction with that other CCP is able to clear transactions through the CCP via the link,

means that other CCP;

client (結算客戶), in relation to a clearing member of a CCP, means a party to a transaction with the CCP through the clearing member where—

(a) the clearing member acts as a financial intermediary; or

(b) the clearing member guarantees the performance of the party to the CCP;

commercial entity (商業實體) has the meaning given by section 35;

Common Equity Tier 1 capital (普通股權一級資本), in relation to an authorized institution, is to be construed in accordance with section 38;

Common Equity Tier 1 capital ratio (普通股權一級資本比率), in relation to an authorized institution, means, subject to sections 29, 30 and 31, the ratio, expressed as a percentage, of the amount of the institution's CET1 capital to the sum of the institution's risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk, as determined in accordance with these Rules;

counterparty credit risk (對手方信用風險) means—

(a) counterparty default risk; and

(b) CVA risk;

counterparty default risk (對手方違責風險), in relation to a derivative contract or SFT entered into by an authorized

institution with a counterparty, means the risk that the counterparty could default before the final settlement of the cash flows of the contract or transaction;

credit valuation adjustment (信用估值調整), in relation to the calculation by an authorized institution of counterparty credit risk in respect of a counterparty, means an adjustment made by the institution to the valuation of a netting set with the counterparty to reflect the market value of the credit risk of that counterparty;

credit valuation adjustment capital charge (信用估值調整資本要求), in relation to the calculation by an authorized institution of counterparty credit risk in respect of a counterparty, means the amount of regulatory capital that the institution is required to hold for the CVA risk of the counterparty;

current exposure method (現行風險承擔方法)—

(a) in relation to an off-balance sheet exposure of an authorized institution to a counterparty under an OTC derivative transaction or credit derivative contract that is not covered by a valid bilateral netting agreement, means the method set out in—

(i) section 71(2);

(ii) section 73(b) and (c);

(iii) section 118(2);

(iv) section 120(b) and (c);

(v) section 165;

(vi) section 166(b) and (c);

(vii) section 181; or

(viii) section 182(b) and (c),

as the case requires, for calculating the credit equivalent amount of the exposure; or

(b) in relation to an off-balance sheet exposure of an authorized institution that is a net credit exposure to a counterparty arising from a portfolio of OTC derivative transactions or credit derivative contracts covered by a valid bilateral netting agreement, means the method set out in section 95, 131 or 209(2), as the case requires, for calculating the credit equivalent amount of the exposure;

CVA means a credit valuation adjustment;

CVA capital charge (CVA 資本要求) means a credit valuation adjustment capital charge;

CVA loss (CVA 損失), in relation to the calculation by an authorized institution of the outstanding default risk exposure to a counterparty, means the CVA (or a portion of the CVA) for the counterparty that has been recognized by the institution as an incurred write-down, where the amount of the incurred write-down is calculated—

(a) without taking into account any amount of debit valuation adjustments made for the netting sets with the counterparty that have been deducted from the CET1 capital of the institution under section 43(1)(h); and

(b) net of any amount of debit valuation adjustments made for the netting sets with the counterparty that have not been deducted from the CET1 capital of the institution under section 43(1)(h);

CVA risk (CVA 風險) has the meaning given by section 226A;

CVA risk-weighted amount (CVA 風險加權數額), in relation to an authorized institution and the CVA capital charge for a counterparty, means the amount calculated by the institution by multiplying the CVA capital charge by 12.5;

debit valuation adjustment (債務估值調整), in relation to a netting set held by an authorized institution, means an adjustment to the valuation of the netting set to reflect the market value of the credit risk of the institution;

default fund contribution (違責基金承擔), in relation to a clearing member of a CCP, means—

(a) the funded or unfunded contribution made by the clearing member to the CCP's mutualized loss-sharing arrangements; or

(b) the clearing member's underwriting of the CCP's mutualized loss-sharing arrangements;

default risk exposure (違責風險的風險承擔), in relation to the calculation by an authorized institution of counterparty credit risk in respect of a netting set with a counterparty, means the institution's exposure to the counterparty default risk of the counterparty and—

(a) subject to paragraphs (b) and (e), if the netting set falls within paragraph (a) or (c) of the definition of ***netting set*** and the transaction concerned is an OTC derivative transaction or credit derivative contract, that exposure is the credit equivalent amount (within the meaning of section 51(1), 105, 139(1) or 227(1), as the case requires) calculated using the current exposure method;

(b) subject to paragraph (e), if the netting set falls within paragraph (b) of the definition of ***netting set*** and the transactions concerned are OTC derivative transactions or credit derivative contracts, that exposure is the credit equivalent amount of the net credit exposure referred to in section 95 or 131 or the EAD referred to in section 209(2), as the case may be, calculated using the current exposure method;

(c) subject to paragraphs (d) and (e), if the netting set falls within paragraph (a) or (c) of the definition of ***netting set*** and the transaction concerned is an SFT, that exposure is the principal amount of securities sold or lent, or the money paid or lent, or the securities or money provided as collateral, as the case requires, under the SFT;

(d) subject to paragraph (e), if the netting set falls within paragraph (b) of the definition of ***netting set*** and the transactions concerned are SFTs, that exposure is the net credit exposure in respect of the SFTs calculated under section 96, 97 or 209(3), as the case requires;

(e) if the netting set is covered by an IMM(CCR) approval, that exposure is the amount calculated under section 226E(1) using the IMM(CCR) approach; and

(f) if the netting set consists of one or more than one derivative contract (other than a credit derivative contract) that is traded on an exchange, that exposure is the amount referred to in paragraph (a), (b) or (e), as the case may be, as if the contract were an OTC derivative transaction;

EE means expected exposure;

effective EPE (有效 EPE) means effective expected positive exposure;

effective expected positive exposure (有效預期正風險承擔), in relation to a netting set, means the amount calculated in accordance with section 226F or 226L, as the case requires;

eligible CVA hedge (合資格 CVA 對沖) has the meaning given by section 226A;

expected exposure (預期風險承擔), in relation to a netting set, means the amount calculated in accordance with section 226H;

financial sector entity (金融業實體) has the meaning given by section 35;

home authority (監管母銀行當局), in relation to an authorized institution, means the banking supervisory authority responsible for supervising the parent bank of the institution;

IMM(CCR) approach (IMM(CCR)計算法) means the internal models (counterparty credit risk) approach;

IMM(CCR) approval (IMM(CCR)批准) means an approval to use the IMM(CCR) approach granted by the Monetary Authority under section 10B(2)(a);

IMM(CCR) risk-weighted amount (IMM(CCR)風險加權數額) means the amount calculated under section 226D;

independent amount (獨立金額), in relation to a margin agreement associated with transactions between 2 counterparties that are not cleared by a CCP, means collateral posted by one counterparty to the other counterparty to mitigate the potential future exposure of the other counterparty to the first counterparty arising from the possible future change in the value of the transactions;

indirect holding (間接持有) has the meaning given by section 35;

insignificant capital investment (非重大資本投資) has the meaning given by section 35;

internal models (counterparty credit risk) approach (內部模式(對手方信用風險)計算法) means the method of calculating an authorized institution's default risk exposure set out in Division 2 of Part 6A;

joint-stock company (合股公司) means a company that has issued ordinary shares, irrespective of whether the shares are held privately or publicly;

long settlement transaction (長結算期交易), in relation to the calculation by an authorized institution of counterparty credit risk, means a transaction or contract where a counterparty undertakes to deliver a security, commodity or foreign currency amount against cash, other financial instruments or commodities, or vice versa, at a settlement or delivery date that is contractually specified in the transaction or contract as being more than the lower of—

(a) the market standard applicable to a transaction or contract of this type; and

(b) 5 business days after the date on which the institution enters into the transaction or contract;

margin agreement (保證金協議) has the meaning given by section 226A;

margin lending transaction (保證金借貸交易), in relation to the calculation by an authorized institution of counterparty credit risk—

(a) subject to paragraph (b), means a transaction under which the institution extends credit in connection

with the purchase, sale, carrying or trading of securities;

(b) does not include a transaction under which the credit extended is—

(i) secured by securities; and

(ii) in connection with a matter other than the purchase, sale, carrying or trading of securities;

margin period of risk (保證金風險期間) has the meaning given by section 226A;

margin threshold (保證金門檻) has the meaning given by section 226A;

minimum transfer amount (最低轉移額) has the meaning given by section 226A;

netting set (淨額計算組合) means—

(a) a transaction that falls within section 226J(1);

(b) a group of transactions with a counterparty (excluding any transaction that falls within section 226J(1)) that are subject to a recognized netting; or

(c) a transaction with a counterparty (excluding any transaction that falls within section 226J(1)) that is not subject to a recognized netting;

outstanding default risk exposure (違責風險的未結清風險承擔), in relation to a counterparty with whom the transactions entered into by an authorized institution consist of not less than one OTC derivative transaction or credit derivative contract, means the greater of—

(a) zero; or

(b) the difference between—

(i) the sum of default risk exposures across all netting sets with the counterparty; and

(ii) the CVA loss in respect of that counterparty;

section 3C requirement (第 3C 條規定), in relation to an authorized institution, means a requirement in a notice under section 3C specifying the basis on which the capital adequacy ratio of the institution is to be calculated;

securities financing transaction (證券融資交易) means—

(a) a repo-style transaction;

(b) a margin lending transaction;

(c) a long settlement transaction that falls within paragraph (a) or (b); or

(d) a long settlement transaction of which the counterparty credit risk profile and risk drivers are similar to those specific to a transaction that falls within paragraph (a) or (b);

SFT means a securities financing transaction;

shortcut method (捷徑方法), in relation to the IMM(CCR) approach, means the method of calculating the effective EPE to a counterparty set out in section 226L;

significant capital investment (重大資本投資) has the meaning given by section 35;

special purpose vehicle (特定目的工具) has the meaning given by section 35;

specific wrong-way risk (特定錯向風險) has the meaning given by section 226A;

standardized CVA method (標準 CVA 方法) means the method of calculating an authorized institution's CVA capital charge set out in section 226S;

synthetic holding (合成持有) has the meaning given by section 35;

Tier 1 capital (一級資本), in relation to an authorized institution, is to be construed in accordance with section 37;

Tier 1 capital ratio (一級資本比率), in relation to an authorized institution, means, subject to sections 29, 30 and 31, the ratio, expressed as a percentage, of the amount of the institution's Tier 1 capital to the sum of the institution's risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk, as determined in accordance with these Rules;

Tier 2 capital (二級資本), in relation to an authorized institution, is to be construed in accordance with section 40;

Tier 2 capital instrument (二級資本票據) means any capital instrument that meets the qualifying criteria set out in Schedule 4C;

Total capital (總資本), in relation to an authorized institution, means the sum of the institution's Tier 1 capital and Tier 2 capital;

Total capital ratio (總資本比率), in relation to an authorized institution, means, subject to sections 29, 30 and 31, the ratio, expressed as a percentage, of the amount of the institution's Total capital to the sum of the institution's risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk, as determined in accordance with these Rules;

valid cross-product netting agreement (有效跨產品淨額結算協議), in relation to an authorized institution's

transactions with a counterparty that are covered by an IMM(CCR) approval, has the meaning given by section 226B;".

4. Part 1A heading added

After section 2—

Add

"**Part 1A**

Capital Adequacy Ratio".

5. Section 3 substituted

Section 3—

Repeal the section

Substitute

"**3. Interpretation of Part 1A**

In this Part—

capital adequacy ratio (資本充足比率), in relation to an authorized institution, means the institution's—

(a) CET1 capital ratio;

(b) Tier 1 capital ratio; and

(c) Total capital ratio.".

6. Sections 3A to 3D added

Part 1A, after section 3—

Add

"3A. **Minimum capital adequacy ratio applicable to authorized institutions in 2013 and 2014**

Subject to any section 3C requirement that applies to an authorized institution, the institution—

(a) must not at any time in 2013—

(i) have a CET1 capital ratio of less than 3.5%;

(ii) have a Tier 1 capital ratio of less than 4.5%; or

(iii) have a Total capital ratio of less than 8%; and

(b) must not at any time in 2014—

(i) have a CET1 capital ratio of less than 4%;

(ii) have a Tier 1 capital ratio of less than 5.5%; or

(iii) have a Total capital ratio of less than 8%.

3B. **Minimum capital adequacy ratio applicable to authorized institutions from 2015**

Subject to any section 3C requirement that applies to an authorized institution, the institution must not at any time on and after 1 January 2015—

(a) have a CET1 capital ratio of less than 4.5%;

(b) have a Tier 1 capital ratio of less than 6%; or

(c) have a Total capital ratio of less than 8%.

3C. **Monetary Authority may require authorized institution that has any subsidiary to calculate capital adequacy ratio on unconsolidated or consolidated basis, etc.**

(1) For the purposes of calculating the capital adequacy ratio of an authorized institution that has one or more than one subsidiary, the Monetary Authority may, by notice in

writing given to the institution, require the capital adequacy ratio of the institution to be calculated—

(a) on an unconsolidated basis in respect of the institution;

(b) on a consolidated basis in respect of the institution and one or more of such subsidiaries; or

(c) on an unconsolidated basis in respect of the institution and on a consolidated basis in respect of the institution and one or more of such subsidiaries.

(2) An authorized institution must comply with the requirements of a notice given to it under subsection (1).

3D. **Authorized institution must notify Monetary Authority of failure to have minimum capital adequacy ratio**

If an authorized institution fails to comply with section 3A or 3B, or fails to have a capital adequacy ratio that is equal to or more than the ratio specified by the Monetary Authority in a notice served on the institution under section 97F(1) of the Ordinance, the institution must—

(a) immediately notify the Monetary Authority of the failure; and

(b) provide the Monetary Authority with any particulars of the failure that the Monetary Authority requires.".

7. **Section 4 amended (interpretation of Part 2)**

(1) Section 4, definition of ***consolidation group***, paragraph (b)—

Repeal

"section 98(2) requirement"

Substitute

"section 3C requirement".

(2) Section 4, definition of ***IRB coverage ratio***, after "institution's risk-weighted amount for credit risk"—

Add

"(but excluding any risk-weighted amount for credit risk of its exposures to a CCP that are subject to Division 4 of Part 6A)".

8. Section 4A amended (valuation of exposures measured at fair value)

Section 4A(1), after "6,"—

Add

"6A,".

9. 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(1)—

Repeal

"An"

Substitute

"Subject to section 16A, an".

10. 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(5)—

Repeal paragraph (c)

Substitute

"(c) the Monetary Authority may, by notice in writing given to the institution, advise the institution that the Monetary Authority is considering exercising the power under section 97F of the Ordinance to vary any capital requirement rule applicable to the institution, including by increasing all or any of the following—

(i) the institution's CET1 capital ratio;

(ii) the institution's Tier 1 capital ratio;

(iii) the institution's Total capital ratio;".

(2) Section 10(7)(b)—

Repeal

"101"

Substitute

"97F".

11. Sections 10A to 10D added

Part 2, Division 2, after section 10—

Add

"**10A. Authorized institution must only use current exposure method, etc. to calculate its counterparty credit risk**

(1) Subject to subsections (2), (4) and (5), an authorized institution must—

(a) use the current exposure method to calculate the institution's default risk exposures in respect of derivative contracts;

(b) use the method or methods set out in—

(i) section 76A(4), (5), (6) and (7);

(ii) section 96;

(iii) section 97;

(iv) section 123A(4), (5), (6) and (7);

(v) section 202(1); or

(vi) section 209(3),

as the case requires, to calculate the institution's default risk exposures in respect of SFTs; and

(c) use the standardized CVA method—

(i) to calculate the CVA capital charge in respect of OTC derivative transactions and credit derivative contracts; and

(ii) if the institution is required to do so pursuant to a notice under subsection (6) given to it by the Monetary Authority, to calculate the CVA capital charge in respect of SFTs.

(2) An authorized institution may use the IMM(CCR) approach to calculate its default risk exposures in respect of derivative contracts, SFTs or long settlement transactions only if it has an IMM(CCR) approval for those contracts or transactions.

(3) Subsection (4) applies to an authorized institution that has—

(a) an IMM(CCR) approval that covers derivative contracts; and

(b) an approval granted under section 18 to use the IMM approach to calculate the market risk capital charge for specific risk for interest rate exposures.

(4) An authorized institution to which this subsection applies must, unless otherwise required by the Monetary Authority under section 10C(1), or by virtue of section 10C(2), use the advanced CVA method—

(a) to calculate the CVA capital charge in respect of OTC derivative transactions and credit derivative contracts; and

(b) if the institution is required to do so pursuant to a notice under subsection (6) given to it by the Monetary Authority, to calculate the CVA capital charge in respect of SFTs.

(5) Subsection (1) does not prevent an authorized institution from using—

(a) a combination of the current exposure method and the IMM(CCR) approach; or

(b) a combination of the methods referred to in subsection (1)(b) and the IMM(CCR) approach,

to calculate the institution's default risk exposures if that combination is expressly permitted by, and in accordance with, another provision of these Rules.

(6) Where the Monetary Authority determines that an authorized institution's CVA risk arising from SFTs is material, the Monetary Authority may, by notice in writing given to the institution, require the institution to calculate and hold a CVA capital charge in respect of its SFTs.

(7) An authorized institution must comply with the requirements of a notice given to it under subsection (6).

(8) Subsections (1), (2), (3), (4), (5), (6) and (7) apply to an authorized institution regardless of whether the contracts or transactions concerned are booked in the institution's banking book or trading book.

10B. Authorized institution may apply for approval to use IMM(CCR) approach to calculate its default risk exposures

(1) An authorized institution that has obtained the Monetary Authority's approval to use the IMM approach to calculate its market risk may apply to the Monetary Authority for approval to use the IMM(CCR) approach to calculate its default risk exposures in respect of contracts or transactions falling within any one or more of the following categories—

(a) derivative contracts (other than long settlement transactions);

(b) SFTs (other than long settlement transactions);

(c) long settlement transactions.

(2) Subject to subsection (3), the Monetary Authority must determine an application under subsection (1) from an authorized institution by—

(a) granting approval to the institution to use the IMM(CCR) approach to calculate its default risk exposures in respect of—

(i) the categories of contracts or transactions specified in the application; or

(ii) any categories of contracts or transactions that the Monetary Authority specifies in the approval; or

(b) refusing to grant the approval (whether in whole or in part).

(3) Without limiting subsection (2)(b), the Monetary Authority must refuse to grant an approval to an authorized institution to use the IMM(CCR) approach if any one or more of the requirements specified in

Schedule 2A applicable to or in relation to the institution are not satisfied with respect to the institution.

(4) Subject to subsections (5) and (7), an authorized institution that has an IMM(CCR) approval must use the IMM(CCR) approach to calculate its default risk exposures in respect of all contracts and transactions that are covered by the approval.

(5) Subject to subsection (6), the Monetary Authority may specify, in an IMM(CCR) approval granted to an authorized institution, a transitional period in which the institution is permitted to use the current exposure method or the methods referred to in section 10A(1)(b) to calculate its default risk exposures for contracts or transactions in respect of a portion of its business that are covered by the IMM(CCR) approval.

(6) The Monetary Authority may specify the transitional period referred to in subsection (5) only if the authorized institution concerned has submitted to the Monetary Authority a plan for fully implementing, within a period that is reasonable in all the circumstances of the case, the IMM(CCR) approach for all contracts or transactions covered by the IMM(CCR) approval.

(7) An authorized institution may choose to use the current exposure method or the methods referred to in section 10A(1)(b) to calculate its default risk exposures for certain contracts or transactions that are covered by the IMM(CCR) approval if the institution demonstrates to the satisfaction of the Monetary Authority that its total default risk exposures to those contracts or transactions are immaterial.

(8) An authorized institution that has an IMM(CCR) approval must, for contracts or transactions that are not

covered by the IMM(CCR) approval, calculate its default risk exposures in respect of those contracts or transactions in accordance with section 10A(1).

(9) Where an authorized institution uses the IMM(CCR) approach to calculate its default risk exposures, the institution must not, without the prior consent of the Monetary Authority—

(a) make any significant change to any internal model that is the subject of the institution's IMM(CCR) approval; or

(b) revert to the current exposure method or any of the methods referred to in section 10A(1)(b).

10C. Provisions supplementary to prescribed methods for calculation of CVA capital charge

(1) An authorized institution to which section 10A(4) applies must use the advanced CVA method, unless the Monetary Authority determines that the standardized CVA method must be used, to calculate the CVA capital charge in respect of the following contracts or transactions—

(a) contracts or transactions that are not covered by the institution's IMM(CCR) approval;

(b) contracts or transactions in respect of a portion of the institution's business for which the institution is permitted under section 10B(5) to use the current exposure method or the methods referred to in section 10A(1)(b);

(c) contracts or transactions for which the institution has chosen under section 10B(7) to use the current exposure method or the methods referred to in section 10A(1)(b).

(2) Where an authorized institution's approved VaR model referred to in section 226P(1) may not reflect the risk of credit spread changes appropriately in respect of a counterparty because the VaR model does not appropriately reflect the specific risk of debt securities issued by the counterparty, the institution must use the standardized CVA method, instead of the advanced CVA method, to calculate the CVA capital charge for that counterparty.

10D. Measures that may be taken by Monetary Authority if authorized institution using IMM(CCR) approach no longer satisfies specified requirements

(1) The Monetary Authority may take one or more of the measures set out in subsections (2), (3), (4), (5) and (6) in respect of an authorized institution that is using the IMM(CCR) approach if the Monetary Authority determines that—

(a) the institution no longer satisfies any one or more of the requirements specified in Schedule 2A applicable to or in relation to the institution;

(b) the institution has contravened a condition attached under section 33A(1) or (2) to its IMM(CCR) approval; or

(c) the institution fails to fully implement the IMM(CCR) approach within the period specified, under section 10B(6), in the IMM(CCR) approval.

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

(a) use the current exposure method or the methods referred to in section 10A(1)(b), instead of the

IMM(CCR) approach, to calculate its default risk exposures; and

(b) if the institution is using the advanced CVA method to calculate the CVA capital charge in respect of certain of its contracts or transactions, use the standardized CVA method, instead of the advanced CVA method, to calculate the CVA capital charge,

in respect of the contracts or transactions as specified in the notice, beginning on the date, or the occurrence of the event, specified in the notice.

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

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

(b) implement the plan.

(4) The Monetary Authority may, by notice in writing given to the authorized institution, advise the institution that the Monetary Authority is considering exercising the power under section 97F of the Ordinance to vary any capital requirement rule applicable to the institution, including by increasing all or any of the following—

(a) the institution's CET1 capital ratio;

(b) the institution's Tier 1 capital ratio;

(c) the institution's Total capital ratio.

(5) The Monetary Authority may, by notice in writing given to the authorized institution, require the institution to calculate its default risk exposures by the use of a higher α (within the meaning of section 226E(1)) specified in the notice.

(6) The Monetary Authority may, by notice in writing given to the authorized institution, require the institution to reduce its counterparty credit risk exposures in any manner, or to adopt any measures, specified in the notice that, in the opinion of the Monetary Authority, will cause the institution to cease to fall within subsection (1) 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.

(7) An authorized institution must comply with the requirements of a notice given to it under subsection (2), (3), (5) or (6).

(8) To avoid doubt—

(a) the requirements specified in Schedule 2A are also applicable to and in relation to an authorized institution using the IMM(CCR) approach in respect of an internal model to which a significant change referred to in section 10B(9)(a) relates (whether or not the institution has, in respect of that change, been given the prior consent referred to in that section) and the other provisions of this section apply accordingly; and

(b) subsection (4) does not operate to prejudice the generality of the circumstances in which the Monetary Authority may exercise the power under section 97F of the Ordinance in respect of an

authorized institution to which that subsection applies.".

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

Section 15(1)—

Repeal

"section 16"

Substitute

"sections 16 and 16A".

13. Section 16 amended (authorized institution using IRB(S) approach shall use ratings-based method or supervisory formula method to calculate its credit risk for securitization exposures)

Section 16(c)—

Repeal

"shall deduct from its core capital and supplementary capital"

Substitute

"must allocate a risk-weight of 1,250% to".

14. Part 2, Division 4A added

Part 2, after section 16—

Add

"Division 4A—Calculation of Credit Risk for Exposures to CCPs, etc.

16A. Authorized institution must use Division 4 of Part 6A to calculate its credit risk for exposures to CCPs, etc.

An authorized institution must calculate in accordance with Division 4 of Part 6A—

(a) its credit risk for exposures to CCPs in respect of derivative contracts and SFTs cleared by the CCPs and, if the institution is a clearing member of any CCP, its credit risk for exposures to that CCP arising from its default fund contributions to that CCP;

(b) its credit risk for exposures to clearing members and clients in respect of CCP-related transactions;

(c) its credit risk for exposures to clients in respect of guarantees of the clients' performance under transactions or contracts cleared by CCPs; and

(d) its credit risk for exposures to persons who hold the collateral posted by the institution in respect of transactions or contracts cleared by CCPs.".

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

(1) Section 19(2)—

Repeal paragraph (c)

Substitute

"(c) the Monetary Authority may, by notice in writing given to the institution, advise the institution that the Monetary Authority is considering exercising the power under

section 97F of the Ordinance to vary any capital requirement rule applicable to the institution, including by increasing all or any of the following—

(i) the institution's CET1 capital ratio;

(ii) the institution's Tier 1 capital ratio;

(iii) the institution's Total capital ratio;".

(2) Section 19(4)(b)—

Repeal

"101"

Substitute

"97F".

16. 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(3)—

Repeal paragraph (b)

Substitute

"(b) the Monetary Authority may, by notice in writing given to the institution, advise the institution that the Monetary Authority is considering exercising the power under section 97F of the Ordinance to vary any capital requirement rule applicable to the institution, including by increasing all or any of the following—

(i) the institution's CET1 capital ratio;

(ii) the institution's Tier 1 capital ratio;

(iii) the institution's Total capital ratio;".

(2) Section 21(5)—

Repeal

"101"

Substitute

"97F".

17. Section 27 amended (authorized institution shall calculate its capital adequacy ratio on solo basis, solo-consolidated basis or consolidated basis)

Section 27(2)—

Repeal

"section 98(2) requirement"

Substitute

"section 3C requirement".

18. Section 28 amended (authorized institution may apply for approval to calculate its capital adequacy ratio on solo-consolidated basis)

Section 28(2)(a)—

Repeal

"section 98(2) requirement"

Substitute

"section 3C requirement".

19. Section 29 amended (solo basis for calculation of capital adequacy ratio)

(1) Section 29(1)(b)(i)—

Repeal

"supplementary capital"

Substitute

"Tier 2 capital".

(2) Section 29(1)(b)—

Repeal subparagraph (ii)

Substitute

"(ii) the amount, as determined on a solo basis, of the net book value of the institution's reserves attributable to fair value gains arising from the revaluation of the institution's holdings of land and buildings, which is not included in the Tier 2 capital of the institution; and".

(3) Section 29(2)(a)—

Repeal

"Rules; and"

Substitute

"Rules.".

(4) Section 29(2)—

Repeal paragraph (b).

20. Section 30 amended (solo-consolidated basis for calculation of capital adequacy ratio)

(1) Section 30(1)(b)(i)—

Repeal

"supplementary capital"

Substitute

"Tier 2 capital".

(2) Section 30(1)(b)—

Repeal subparagraph (ii)

Substitute

"(ii) the amount, as determined on a solo-consolidated basis, of the net book value of the institution's and its solo-

consolidated subsidiaries' reserves attributable to fair value gains arising from the revaluation of the institution's and its solo-consolidated subsidiaries' holdings of land and buildings, which is not included in the Tier 2 capital of the institution and its solo-consolidated subsidiaries; and".

(3) Section 30—

Repeal subsection (4).

21. Section 31 amended (consolidated basis for calculation of capital adequacy ratio)

(1) Section 31(1)(a), English text—

Repeal

"oversea"

Substitute

"overseas".

(2) Section 31(1)(b)(i)—

Repeal

"supplementary capital"

Substitute

"Tier 2 capital".

(3) Section 31(1)(b)—

Repeal subparagraph (ii)

Substitute

"(ii) the amount, as determined on a consolidated basis, of the net book value of the institution's consolidation group's reserves attributable to fair value gains arising from the revaluation of the institution's consolidation group's holdings of land and buildings, which is not included in

the Tier 2 capital of the institution's consolidation group; and".

(4) Section 31(4)(a)—

Repeal

"Rules; and"

Substitute

"Rules.".

(5) Section 31(4)—

Repeal paragraph (b).

22. Section 33 amended (exceptions to section 27)

(1) Section 33(2)(a)—

Repeal

"section 98(2) requirement"

Substitute

"section 3C requirement".

(2) Section 33(5)(a)—

Repeal

"section 98(2) requirement"

Substitute

"section 3C requirement".

23. Part 2, Division 7A heading amended (attachment of conditions to approvals granted under section 6(2)(a), 8(2)(a), 18(2)(a), 20(2)(a) or 25(2)(a))

Part 2, Division 7A, heading, after "**8(2)(a),**"—

Add

"**10B(2)(a),**".

24. Section 33A amended (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) Section 33A, heading, after "**8(2)(a),**"—

Add

"**10B(2)(a),**".

(2) Section 33A(1), after "8(2)(a),"—

Add

"10B(2)(a),".

(3) Section 33A(2), after "8(2)(a),"—

Add

"10B(2)(a),".

25. Section 34 amended (reviewable decisions)

Section 34(1), after "8(2),"—

Add

"10B(2),".

26. Part 3 substituted

Part 3—

Repeal the Part

Substitute

"Part 3

Determination of Capital Base

Division 1—General

35. Interpretation of Part 3

In this Part—

affiliate (附屬成員), in relation to an authorized institution, means—

(a) an entity that—

(i) has a beneficial interest in, or controls, 20% or more of the total number of ordinary shares in the institution; or

(ii) is entitled to exercise, or control the exercise of, 20% or more of the voting power in the institution;

(b) an entity in which the institution or an entity falling within paragraph (a)—

(i) has a beneficial interest in, or controls, 20% or more of the total number of ordinary shares; or

(ii) is entitled to exercise, or control the exercise of, 20% or more of the voting power;

bank subsidiary (銀行附屬公司), in relation to an authorized institution, means a subsidiary of the institution that—

(a) is a bank or any other entity that is subject to substantially similar regulation and supervision as a bank; and

(b) is subject to consolidation under a section 3C requirement;

cash flow hedge (現金流對沖), in relation to a hedging relationship of an authorized institution, means a hedge of an exposure of the institution to variability in cash flows that—

(a) is attributable to—

(i) a particular risk associated with an asset or liability recognized on the institution's balance sheet; or

(ii) a highly probable uncommitted but anticipated future transaction; and

(b) could affect the institution's profit or loss;

commercial entity (商業實體) means any entity in the private sector, other than a financial sector entity;

connected company (有連繫公司), in relation to an authorized institution, means—

(a) a subsidiary, or the holding company, of the institution; or

(b) a company that falls within section 64(1)(b), (c), (d) or (e) of the Ordinance in respect of the institution;

financial sector entity (金融業實體) means an entity that is engaged predominantly in one or more of the following activities, whether by itself or through any of its subsidiaries—

(a) banking;

(b) securities business;

(c) insurance business;

(d) financial leasing;

(e) the issuance of credit cards;

(f) portfolio management;

(g) investment advisory services;

(h) custodial and safekeeping services;

(i) central clearing services;

(j) activities ancillary to banking;

(k) activities similar to any of the activities set out in any of paragraphs (a), (b), (c), (d), (e), (f), (g), (h) and (i);

indirect holding (間接持有), in relation to an authorized institution, means an exposure of the institution in respect of a capital instrument issued by a financial sector entity in circumstances where the instrument is not held by the institution directly but a loss of value in the instrument will result in a loss to the institution substantially equivalent to the loss in value of a direct holding;

insignificant capital investment (非重大資本投資), in relation to an authorized institution, means an investment by the institution in a capital instrument issued by an entity, other than an affiliate of the institution, of which the institution owns not more than 10% of the issued ordinary share capital;

reciprocal cross holding (互相交叉持有) means an arrangement—

(a) under which an authorized institution holds capital instruments issued by a financial sector entity and the entity also holds capital instruments issued by the institution; and

(b) which is designed to artificially inflate the capital position of the institution and the entity;

retained earnings (保留溢利), in relation to an authorized institution, means the amount of profits and losses of the institution brought forward pursuant to prevailing accounting standards as at a particular date, and includes the institution's—

(a) unaudited profit or loss of the current financial year; and

(b) profit or loss of the immediately preceding financial year pending audit completion;

significant capital investment (重大資本投資), in relation to an authorized institution, means an investment by the institution in a capital instrument issued by—

(a) an affiliate of the institution; or

(b) an entity, other than an affiliate of the institution, of which the institution owns more than 10% of the issued ordinary share capital;

special purpose vehicle (特定目的工具), in relation to an authorized institution, means a company or any other entity—

(a) that is established by the institution for the sole purpose of raising capital for the institution; and

(b) that does not trade or conduct any business except raising capital for the institution;

synthetic holding (合成持有), in relation to an authorized institution, means an exposure of the institution to an instrument the value of which is directly linked to the value of the capital instruments issued by a financial sector entity.

36. Determination of capital base

The capital base of an authorized institution is the sum of the institution's—

(a) Tier 1 capital; and

(b) Tier 2 capital.

Division 2—Tier 1 Capital

37. Tier 1 capital

The Tier 1 capital of an authorized institution is the sum of the institution's—

(a) CET1 capital; and

(b) Additional Tier 1 capital.

38. CET1 capital

(1) The CET1 capital of an authorized institution is the sum of the following capital items, calculated in Hong Kong dollars and after the deductions specified in Division 4 have been made in accordance with that Division—

(a) the institution's CET1 capital instruments except any such instruments that are issued by the institution by virtue of capitalizing any property revaluation reserves of the institution referred to in section 40(1)(d);

(b) the amount standing to the credit of the institution's share premium account resulting from the issue of the institution's CET1 capital instruments;

(c) subject to subsection (2), the institution's retained earnings and other disclosed reserves;

(d) the applicable amount of minority interests arising from the CET1 capital instruments issued by the

consolidated bank subsidiaries of the institution and held by third parties, that is recognized as CET1 capital of the institution on a consolidated basis, as calculated based on the requirements set out in sections 2(1) and 3 of Schedule 4D.

(2) An authorized institution must exclude from reserves or retained earnings, as the case requires, under subsection (1)(c)—

(a) cumulative cash flow hedge reserves that relate to the hedging of financial instruments that are not fair valued on the balance sheet (including projected cash flows);

(b) cumulative fair value gains or losses on liabilities of the institution that are valued at fair value and that result from changes in the institution's own credit risk except any debit valuation adjustments for derivative contracts arising from the institution's own credit risk referred to in section 43(1)(h);

(c) cumulative fair value gains arising from the revaluation of the institution's holdings of land and buildings (whether for the institution's own use or for investment purposes);

(d) cumulative fair value gains generated from any transaction or arrangement entered into between the institution and another member of the institution's consolidation group involving the disposal of land and buildings (whether for the institution's own use or for investment purposes) that are held by the institution, or that other member, unless otherwise approved by the Monetary Authority; and

(e) the institution's regulatory reserve for general banking risks referred to in section 40(1)(f).

(3) To avoid doubt, any capital instruments issued to third parties through a special purpose vehicle must not be included in an authorized institution's CET1 capital.

39. Additional Tier 1 capital

(1) The Additional Tier 1 capital of an authorized institution is the sum of the following capital items, calculated in Hong Kong dollars and after the deductions specified in Division 4 have been made in accordance with that Division—

(a) the institution's Additional Tier 1 capital instruments;

(b) the amount standing to the credit of the institution's share premium account resulting from the issue of capital instruments that fall within paragraph (a);

(c) the applicable amount of capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties, that is recognized as Additional Tier 1 capital of the institution on a consolidated basis, as calculated based on the requirements set out in sections 2(2) and 4 of Schedule 4D.

(2) If an authorized institution issues capital instruments to third parties through a special purpose vehicle and—

(a) the special purpose vehicle is consolidated with the institution;

(b) the capital instruments meet the qualifying criteria set out in Schedule 4B; and

(c) the only asset of the special purpose vehicle is its investment in the capital of the institution in a form that meets the qualifying criteria set out in Schedule 4B,

the capital instruments may be included in the Additional Tier 1 capital of the institution on a consolidated basis as if the institution itself had issued the capital instruments directly to the third parties.

(3) If an authorized institution issues capital instruments to third parties through a special purpose vehicle via a consolidated bank subsidiary of the institution and—

(a) the special purpose vehicle is consolidated with the bank subsidiary;

(b) the capital instruments meet the qualifying criteria set out in Schedule 4B; and

(c) the only asset of the special purpose vehicle is its investment in the capital of the bank subsidiary in a form that meets the qualifying criteria set out in Schedule 4B,

the institution may treat the capital instruments as if the bank subsidiary itself had issued the capital instruments directly to the third parties and, accordingly, may include the capital instruments in determining the applicable amount of the capital instruments to be included in the Additional Tier 1 capital of the institution on a consolidated basis, as calculated based on the requirements set out in sections 2(2) and 4 of Schedule 4D.

Division 3—Tier 2 Capital

40. Tier 2 capital

(1) The Tier 2 capital of an authorized institution is the sum of the following capital items, calculated in Hong Kong dollars and after the deductions specified in Division 4 have been made in accordance with that Division—

(a) the institution's Tier 2 capital instruments;

(b) the amount standing to the credit of the institution's share premium account resulting from the issue of capital instruments that fall within paragraph (a);

(c) the applicable amount of Tier 2 capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties, that is recognized as Tier 2 capital of the institution on a consolidated basis, as calculated based on the requirements set out in sections 2(2) and 5 of Schedule 4D;

(d) subject to section 41, that part of the institution's reserves and retained earnings that is attributable to fair value gains arising from—

(i) the revaluation of the institution's holdings of land and buildings except land and buildings mortgaged to the institution to secure a debt;

(ii) the revaluation of the institution's share of the net asset value of any subsidiary of the institution to the extent that the value has changed as a result of the revaluation of the subsidiary's holdings of land and buildings except land and buildings mortgaged to the subsidiary to secure a debt; and

(iii) disposal of land and buildings (whether for the institution's own use or for investment purposes) referred to in section 38(2)(d);

(e) the shares issued by the institution through capitalizing that part of the institution's reserves and retained earnings that is attributable to fair value gains described in paragraph (d);

(f) subject to section 42, the institution's regulatory reserve for general banking risks and collective provisions.

(2) If an authorized institution issues capital instruments to third parties through a special purpose vehicle and—

(a) the special purpose vehicle is consolidated with the institution;

(b) the capital instruments meet the qualifying criteria set out in Schedule 4C; and

(c) the only asset of the special purpose vehicle is its investment in the capital of the institution in a form that meets the qualifying criteria set out in Schedule 4C,

the capital instruments may be included in the Tier 2 capital of the institution on a consolidated basis as if the institution itself had issued the capital instruments directly to the third parties.

(3) If an authorized institution issues capital instruments to third parties through a special purpose vehicle via a consolidated bank subsidiary of the institution and—

(a) the special purpose vehicle is consolidated with the bank subsidiary;

(b) the capital instruments meet the qualifying criteria set out in Schedule 4C; and

(c) the only asset of the special purpose vehicle is its investment in the capital of the bank subsidiary in a form that meets the qualifying criteria set out in Schedule 4C,

the institution may treat the capital instruments as if the bank subsidiary itself had issued the capital instruments directly to the third parties and, accordingly, may include the capital instruments in determining the applicable amount of the capital instruments to be included in the Tier 2 capital of the institution on a consolidated basis, as calculated based on the requirements set out in sections 2(2) and 5 of Schedule 4D.

41. Provisions supplementary to section 40(1)(d)

(1) An authorized institution's reserves and retained earnings fall within that part of reserves and retained earnings referred to in section 40(1)(d) only if—

(a) the institution has a clearly documented policy on the frequency and method of revaluation of its holdings of land and buildings that is satisfactory to the Monetary Authority;

(b) the institution does not depart from that policy except after consultation with the Monetary Authority;

(c) subject to paragraph (d), any revaluation of the institution's holdings of land and buildings is undertaken by an independent professional valuer;

(d) in any case where the institution demonstrates to the satisfaction of the Monetary Authority that, despite all reasonable efforts, the institution has been unable to obtain the services of an

independent professional valuer to undertake the revaluation of all or part of the institution's holdings of land and buildings, any revaluation of such holdings undertaken by a person who is not an independent professional valuer is endorsed in writing by an independent professional valuer;

(e) any revaluation of the institution's holdings of land and buildings is—

(i) approved by the institution's external auditors; and

(ii) explicitly reported in the institution's audited accounts; and

(f) the fair value gains referred to in section 40(1)(d) are recognized in accordance with applicable accounting standards and any such gains not recognized in the financial statements of the institution are excluded from the part of reserves and retained earnings referred to in that section.

(2) An authorized institution must not include in its Tier 2 capital more than 45% of any fair value gains of any item referred to in section 40(1)(d) arising from any revaluation referred to in that section.

(3) An authorized institution must not, in calculating its Tier 2 capital, set-off losses in respect of land and buildings that are for the institution's own use where the losses are recognized in the institution's profit or loss against unrealized gains that are reflected directly in equity through the statement of changes in equity.

(4) An authorized institution must deduct from its CET1 capital any cumulative losses of the institution arising from the institution's holdings of land and buildings below the depreciated cost value (whether or not any

such land and buildings are held for the institution's own use or for investment purposes).

42. Provisions supplementary to section 40(1)(f)

(1) Subject to subsections (2), (3) and (4), an authorized institution that uses the STC approach or BSC approach, or both, must not include in its Tier 2 capital that amount of its total regulatory reserve for general banking risks and collective provisions that exceeds 1.25% of the institution's total risk-weighted amount for credit risk, being the sum of all the institution's risk-weighted amounts for—

(a) all the institution's non-securitization exposures to credit risk subject to the STC approach or BSC approach, or both; and

(b) all the institution's securitization exposures to credit risk subject to the STC(S) approach.

(2) An authorized institution that uses any combination of the STC approach, BSC approach and IRB approach—

(a) subject to paragraph (b), must apportion its total regulatory reserve for general banking risks and collective provisions between the STC approach, BSC approach, IRB approach, STC(S) approach and IRB(S) approach on a pro rata basis in accordance with the proportions of the institution's risk-weighted amount for credit risk that are calculated by using the STC approach, BSC approach, IRB approach, STC(S) approach or IRB(S) approach, as the case requires;

(b) may, with the prior consent of the Monetary Authority, use its own method to apportion its total regulatory reserve for general banking risks and

collective provisions between the STC approach, BSC approach, IRB approach, STC(S) approach and IRB(S) approach; and

(c) must, after it has carried out the apportionment referred to in paragraph (a) or (b)—

(i) comply with subsection (1) in respect of that portion of its total regulatory reserve for general banking risks and collective provisions that is apportioned to the STC approach or BSC approach, or both, and the STC(S) approach; and

(ii) subject to subsections (3)(c) and (4), exclude from its Tier 2 capital that portion of its total regulatory reserve for general banking risks and collective provisions that is apportioned to the IRB approach and IRB(S) approach.

(3) Where an authorized institution uses the IRB approach—

(a) subject to paragraphs (b) and (c), the institution must deduct the amount of the excess of its total EL amount over its total eligible provisions from its CET1 capital in accordance with section 43(1)(i);

(b) the deduction to be made under paragraph (a) must be gross of tax effects (if any); and

(c) if the total EL amount referred to in paragraph (a) is less than the total eligible provisions referred to in that paragraph, the institution may include the amount of the excess of the total eligible provisions over the total EL amount in its Tier 2 capital up to 0.6% of its risk-weighted amount for credit risk calculated by using the IRB approach.

(4) Where an authorized institution uses the IRB(S) approach, the institution may include that portion of its total regulatory reserve for general banking risks and collective provisions that is apportioned to the IRB(S) approach in accordance with subsection (2)(a) or (b) in its Tier 2 capital up to 0.6% of its risk-weighted amount for credit risk calculated by using the IRB(S) approach.

Division 4—Regulatory Deductions

43. Deductions from CET1 capital

(1) An authorized institution must deduct from its CET1 capital in accordance with the transitional arrangements set out in sections 2 and 3 of Schedule 4H—

(a) the amount of any goodwill that is recognized by the institution as an intangible asset of the institution, net of any associated deferred tax liabilities;

(b) the amount of other intangible assets of the institution, net of any associated deferred tax liabilities;

(c) assets of any defined benefit pension fund or plan (except those of such assets to which the institution can demonstrate to the satisfaction of the Monetary Authority that it has unrestricted and unfettered access), net of the amount of obligations under the fund or plan and any associated deferred tax liabilities;

(d) subject to section 44(1), the amount of deferred tax assets, net of deferred tax liabilities (excluding those associated with and already taken into account in the deduction of the amount of

goodwill, the amount of other intangible assets and assets of any defined benefit pension fund or plan) of the institution;

(e) the amount of any gain-on-sale arising from a securitization transaction in which the institution is the originating institution;

(f) the amount of any securitization exposure of the institution that the Monetary Authority may, by notice in writing given to the institution, require the institution to deduct from its CET1 capital;

(g) 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) if that exposure is a financial instrument that gives rise to the cash flow hedge reserves that fall within section 38(2)(a);

(ii) such part of that amount that has been taken into account in the calculation of the amount of the institution's retained earnings or other disclosed reserves (or part of the retained earnings or other disclosed reserves) that fall within section 38(1)(c);

(h) the amount of any debit valuation adjustments made by the institution in respect of derivative contracts arising from the institution's own credit risk (which must not be offset by any accounting valuation adjustments arising from the institution's counterparty credit risk);

(i) if the institution uses the IRB approach and the institution's total EL amount referred to in section 42(3)(a) exceeds the institution's total eligible

provisions referred to in that section, the amount of the excess of the total EL amount over the total eligible provisions;

(j) any cumulative losses of the institution arising from the institution's holdings of land and buildings below the depreciated cost value referred to in section 41(4);

(k) subject to section 45, the amount of any relevant capital shortfall in respect of a subsidiary of the institution that—

(i) is a securities firm or insurance firm; and

(ii) is not the subject of consolidation under a section 3C requirement;

(l) subject to section 44(2), the amount of any direct holdings, indirect holdings and synthetic holdings by the institution of its own CET1 capital instruments, unless already derecognized under applicable accounting standards, calculated in accordance with Schedule 4E;

(m) subject to section 44(2), the amount of any direct holdings, indirect holdings and synthetic holdings by the institution of CET1 capital instruments issued by any financial sector entity where that entity has a reciprocal cross holding with the institution;

(n) subject to sections 44(2) and 46(1), any capital investment in a connected company of the institution where that connected company is a commercial entity to the extent that the net book value of such investment exceeds 15% of the capital base of the institution as reported in the

institution's capital adequacy ratio return as at the immediately preceding calendar quarter end date;

(o) subject to sections 44(2) and 46(2), the applicable amount of the institution's direct holdings, indirect holdings and synthetic holdings of CET1 capital instruments issued by financial sector entities, calculated in accordance with Schedule 4F, if—

(i) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution;

(ii) the holdings are insignificant capital investments; and

(iii) the holdings do not otherwise fall within paragraphs (l) and (m);

(p) subject to sections 44(2) and 46(2), the applicable amount of the institution's direct holdings, indirect holdings and synthetic holdings of CET1 capital instruments issued by financial sector entities, calculated in accordance with Schedule 4G, if—

(i) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution;

(ii) the holdings are significant capital investments; and

(iii) the holdings do not otherwise fall within paragraphs (l) and (m);

(q) subject to sections 44(2) and 46(2)—

(i) (if the institution calculates its capital adequacy ratio on a solo basis under a section 3C requirement) the amount of the institution's direct holdings of CET1 capital

instruments issued by financial sector entities that are members of the institution's consolidation group;

(ii) (if the institution calculates its capital adequacy ratio on a solo-consolidated basis under a section 3C requirement) the amount of the institution's direct holdings of CET1 capital instruments issued by financial sector entities, other than any solo-consolidated subsidiaries, that are members of the institution's consolidation group; and

(r) any amount that would otherwise be deducted from the institution's Additional Tier 1 capital under section 47 but cannot be so deducted because the institution does not have sufficient Additional Tier 1 capital to satisfy the deduction.

(2) In this section—

relevant capital shortfall (有關資本短欠), in relation to a subsidiary of an authorized institution, means the amount specified in a notice under section 45(1)(b) given to the institution in respect of that subsidiary.

44. Provisions supplementary to section 43(1)(d), (l), (m), (n), (o), (p) and (q)

(1) For the purposes of determining the net deferred tax assets referred to in section 43(1)(d), deferred tax assets may be netted with deferred tax liabilities only if the deferred tax assets and deferred tax liabilities relate to taxes levied by the same taxation authority and offsetting is permitted by the relevant taxation authority.

(2) For the purposes of paragraphs (l), (m), (n), (o), (p) and (q) of section 43(1), an authorized institution must—

(a) exclude from the holdings referred to in those paragraphs any holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(b) reduce the amount to be deducted under those paragraphs by any amount of goodwill (related to any holdings of shares falling within those paragraphs) already deducted under section 43(1)(a); and

(c) include in the amount to be deducted under those paragraphs potential future holdings that the institution could be contractually obliged to purchase.

45. Provisions supplementary to section 43(1)(k)

(1) Where a subsidiary of an authorized institution that is a securities firm or insurance firm fails to meet the minimum capital requirements applicable to it and fails to remedy the breach within a period as determined or prescribed by the securities regulator or insurance regulator of the securities firm or insurance firm, as the case may be, then—

(a) the institution must, as soon as practicable after it becomes aware of the failure, give notice in writing to the Monetary Authority of particulars of the securities firm or insurance firm, as the case may be, and the details of the failure; and

(b) the Monetary Authority may, by notice in writing given to the institution, and beginning on the date, or the occurrence of the event, specified in the notice, and ending on the date, or the occurrence of

the event, specified in the notice, require the institution to deduct from its CET1 capital an amount that, in the opinion of the Monetary Authority, represents the shortfall of the securities firm or insurance firm, as the case may be, in meeting those minimum capital requirements.

(2) The amount to be deducted under section 43(1)(k) by an authorized institution from its CET1 capital—

(a) is in addition to any other deduction the institution is required to make under section 43 from its CET1 capital in respect of the subsidiary concerned of the institution; and

(b) represents the amount by which that subsidiary is deficient in meeting its minimum capital requirements.

(3) An authorized institution must comply with the requirements of a notice given to it under subsection (1)(b).

46. Provisions supplementary to section 43(1)(n), (o), (p) and (q)

(1) An authorized institution must treat as part of the capital investment that is to be deducted under section 43(1)(n) the aggregate amount of any loans, facilities or other credit exposures provided by the institution to any connected company of the institution where the connected company is a commercial entity as if such loans, facilities or other credit exposures were direct capital investment by the institution in the commercial entity, except where the institution demonstrates to the satisfaction of the Monetary Authority that any such loan was made, any such facility was granted, or any such

other credit exposure was incurred, in the ordinary course of the institution's business.

(2) An authorized institution must treat as part of the amount of its direct holdings, indirect holdings and synthetic holdings of CET1 capital instruments that are to be deducted under section 43(1)(o), (p) and (q) the aggregate amount of any loans, facilities or other credit exposures provided by the institution to any connected company of the institution where the connected company is a financial sector entity as if such loans, facilities or other credit exposures were direct holdings, indirect holdings or synthetic holdings of the institution in the financial sector entity, except where the institution demonstrates to the satisfaction of the Monetary Authority that any such loan was made, any such facility was granted, or any such other credit exposure was incurred, in the ordinary course of the institution's business.

47. Deductions from Additional Tier 1 capital

(1) Subject to subsection (2), an authorized institution must deduct from its Additional Tier 1 capital in accordance with the transitional arrangements set out in sections 2 and 3 of Schedule 4H—

(a) the amount of any direct holdings, indirect holdings and synthetic holdings by the institution of its own Additional Tier 1 capital instruments, unless already derecognized under applicable accounting standards, calculated in accordance with Schedule 4E;

(b) the amount of any direct holdings, indirect holdings and synthetic holdings by the institution of Additional Tier 1 capital instruments issued by any

financial sector entity where that entity has a reciprocal cross holding with the institution;

(c) the applicable amount of the institution's direct holdings, indirect holdings and synthetic holdings of Additional Tier 1 capital instruments issued by financial sector entities, calculated in accordance with Schedule 4F, if—

(i) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution;

(ii) the holdings are insignificant capital investments; and

(iii) the holdings do not otherwise fall within paragraphs (a) and (b);

(d) the applicable amount of the institution's direct holdings, indirect holdings and synthetic holdings of Additional Tier 1 capital instruments issued by financial sector entities, calculated in accordance with Schedule 4G, if—

(i) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution;

(ii) the holdings are significant capital investments; and

(iii) the holdings do not otherwise fall within paragraphs (a) and (b);

(e) (if the institution calculates its capital adequacy ratio on a solo basis under a section 3C requirement) the amount of the institution's direct holdings of Additional Tier 1 capital instruments

issued by financial sector entities that are members of the institution's consolidation group;

(f) (if the institution calculates its capital adequacy ratio on a solo-consolidated basis under a section 3C requirement) the amount of the institution's direct holdings of Additional Tier 1 capital instruments issued by financial sector entities, other than any solo-consolidated subsidiaries, that are members of the institution's consolidation group; and

(g) any amount that would otherwise be deducted from the institution's Tier 2 capital under section 48 but cannot be so deducted because the institution does not have sufficient Tier 2 capital to satisfy the deduction.

(2) An authorized institution must—

(a) exclude from the holdings referred to in subsection (1) any holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(b) reduce the amount to be deducted under subsection (1) by any amount of goodwill (related to any holdings of Additional Tier 1 capital instruments falling within subsection (1)(a), (b), (c), (d), (e) or (f)) already deducted under section 43(1)(a); and

(c) include in the amount to be deducted under subsection (1) potential future holdings that the institution could be contractually obliged to purchase.

48. Deductions from Tier 2 capital

(1) Subject to subsection (2), an authorized institution must deduct from its Tier 2 capital in accordance with the transitional arrangements set out in sections 2 and 3 of Schedule 4H—

(a) the amount of any direct holdings, indirect holdings and synthetic holdings by the institution of its own Tier 2 capital instruments, unless already derecognized under applicable accounting standards, calculated in accordance with Schedule 4E;

(b) the amount of any direct holdings, indirect holdings and synthetic holdings by the institution of Tier 2 capital instruments issued by any financial sector entity where that entity has a reciprocal cross holding with the institution;

(c) the applicable amount of the institution's direct holdings, indirect holdings and synthetic holdings of Tier 2 capital instruments issued by financial sector entities, calculated in accordance with Schedule 4F, if—

(i) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution;

(ii) the holdings are insignificant capital investments; and

(iii) the holdings do not otherwise fall within paragraphs (a) and (b);

(d) the applicable amount of the institution's direct holdings, indirect holdings and synthetic holdings of Tier 2 capital instruments issued by financial

sector entities, calculated in accordance with Schedule 4G, if—

(i) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution;

(ii) the holdings are significant capital investments; and

(iii) the holdings do not otherwise fall within paragraphs (a) and (b);

(e) (if the institution calculates its capital adequacy ratio on a solo basis under a section 3C requirement) the amount of the institution's direct holdings of Tier 2 capital instruments issued by financial sector entities that are members of the institution's consolidation group; and

(f) (if the institution calculates its capital adequacy ratio on a solo-consolidated basis under a section 3C requirement) the amount of the institution's direct holdings of Tier 2 capital instruments issued by financial sector entities, other than any solo-consolidated subsidiaries, that are members of the institution's consolidation group.

(2) An authorized institution must—

(a) exclude from the holdings referred to in subsection (1) any holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate; and

(b) include in the amount to be deducted under subsection (1) potential future holdings that the

institution could be contractually obliged to purchase.".

27. Section 51 amended (interpretation of Part 4)

(1) Section 51(1), definition of ***attributed risk-weight***, paragraph (c)—

Repeal

"64, 66 or 67"

Substitute

"63A, 64, 66, 67 or 68A".

(2) Section 51(1), definition of ***cash items***, paragraph (j)(i)—

Repeal

"a non-delivery-versus-payment basis"

Substitute

"a basis other than a delivery-versus-payment basis".

(3) Section 51(1), definition of ***principal amount***, after paragraph (b)(iv)—

Add

"(v) in the case of an exposure to a person arising from the person holding collateral posted by the institution in a manner that is not bankruptcy remote from the person, the fair value of the collateral;".

(4) Section 51(1), Chinese text, definition of ***屬官方實體的非本地公營單位***, paragraph (b)—

Repeal

"位。"

Substitute

"位；".

(5) Section 51(1)—

Add in alphabetical order

"***SFT risk-weighted amount*** (SFT 風險加權數額), in relation to SFTs, means the sum of the default risk risk-weighted amounts for all counterparties to the SFTs where the default risk risk-weighted amount for each of the counterparties is calculated as the product of—

(a) the sum of default risk exposures across all the SFTs with the counterparty calculated under—

(i) section 76A(4), (5), (6) and (7);

(ii) section 96; or

(iii) section 97,

as the case requires, net of specific provisions; and

(b) the applicable risk-weight determined under section 74(1);".

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

(1) Section 52(2)(a)—

Repeal

"64, 65, 66, 67 and 68"

Substitute

"63A, 64, 65, 66, 67, 68 and 68A".

(2) Section 52(2)(b)—

Repeal

"paragraph (c)"

Substitute

"paragraphs (c) and (d)".

(3) Section 52(2)(c)—

Repeal

"rating."

Substitute

"rating;".

(4) After section 52(2)(c)—

Add

"(d) if an authorized institution has bought credit protection for an exposure and the credit protection is in the form of a single-name credit default swap that falls within section 226J(1), the institution must not take into account the credit risk mitigation effect of the swap when calculating the risk-weighted amount of the exposure.".

(5) Section 52(3)—

Repeal paragraph (a)

Substitute

"(a) subject to paragraph (b), in the case of an authorized institution's off-balance sheet exposures that are counterparty credit risk exposures in respect of OTC derivative transactions, credit derivative contracts or SFTs—

(i) the institution must, if it has an IMM(CCR) approval and an approval to use the IMM approach to calculate the market risk capital charge for specific risk for interest rate exposures, calculate the risk-weighted amount of those off-balance sheet exposures as the sum of the amounts specified in subsection (3A)(a), (b) and (c);

(ii) the institution must, if it has an IMM(CCR) approval but does not have an approval to use the IMM approach to calculate the market risk capital charge for specific risk for interest rate exposures, calculate the risk-weighted amount of those off-balance sheet exposures as the sum of the amounts specified in subsection (3A)(a), (b) and (d); and

(iii) the institution must, if it does not have an IMM(CCR) approval for any of its transactions or contracts, calculate the risk-weighted amount of those off-balance sheet exposures as the sum of the CEM risk-weighted amount, the SFT risk-weighted amount, and the CVA risk-weighted amount determined using the standardized CVA method;

(ab) subject to paragraph (b), in the case of an authorized institution's off-balance sheet exposures that do not fall within paragraph (a), the institution must calculate the risk-weighted amount of each of those exposures by—

(i) converting the principal amount of the exposure, net of specific provisions, into its credit equivalent amount in the manner set out in section 71 or 73, as the case requires; and

(ii) multiplying the credit equivalent amount by the exposure's relevant risk-weight determined under section 74;".

(6) Section 52(3)(b)—

Repeal

"paragraph (c)"

Substitute

"paragraphs (c), (d) and (e)".

(7) Section 52(3)(c)—

Repeal

"rating."

Substitute

"rating;".

(8) After section 52(3)(c)—

Add

"(d) if an off-balance sheet exposure of an authorized institution is a counterparty credit risk exposure in respect of OTC derivative transactions, credit derivative contracts or SFTs, the institution must not, under paragraph (b), take into account the effect of any recognized credit risk mitigation applicable to the exposure if that effect has already been taken into account in the calculation of its default risk exposures in respect of those transactions or contracts;

(e) if an authorized institution has bought credit protection for an exposure and the credit protection is in the form of a single-name credit default swap that falls within section 226J(1), the institution must not take into account the credit risk mitigation effect of the swap when calculating the risk-weighted amount of the exposure.".

(9) After section 52(3)—

Add

"(3A) The amounts referred to in subsection (3)(a)(i) and (ii) are—

(a) the IMM(CCR) risk-weighted amount of the transactions or contracts concerned that are covered by the IMM(CCR) approval;

(b) the CEM risk-weighted amount or SFT risk-weighted amount of the transactions or contracts concerned that are not covered by the IMM(CCR) approval or that fall within section 10B(5) or (7);

(c) the CVA risk-weighted amount determined using the advanced CVA method, the standardized CVA method, or a combination of those 2 methods that is permitted under these Rules, as the case requires; and

(d) the CVA risk-weighted amount determined using the standardized CVA method.".

29. Section 53 amended (on-balance sheet exposures and off-balance sheet exposures to be covered)

(1) Section 53—

Renumber the section as section 53(1).

(2) Section 53(1)(a)—

Repeal subparagraphs (i) and (ii)

Substitute

"(i) that under Division 4 of Part 3 are required to be deducted from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital;

(ii) that are subject to the requirements of Division 4 of Part 6A; or

(iii) that are subject to the requirements of Part 7;".

(3) Section 53(1)—

Repeal paragraph (b)

Substitute

"(b) subject to subsection (2), all of the institution's exposures to counterparties—

(i) under OTC derivative transactions, credit derivative contracts or SFTs booked in its trading book; or

(ii) in respect of assets that are—

(A) posted by the institution as collateral for transactions or contracts booked in its trading book; and

(B) held by the counterparties in a manner that is not bankruptcy remote from the counterparties; and".

(4) After section 53(1)—

Add

"(2) Subsection (1)(b) does not apply to exposures that are subject to—

(a) deduction from any of the authorized institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital under Division 4 of Part 3; or

(b) the requirements of Division 4 of Part 6A.".

30. Section 54 amended (classification of exposures)

(1) After section 54(h)—

Add

"(ha) exposures in respect of failed delivery on transactions entered into on a basis other than a delivery-versus-payment basis;".

(2) Section 54(k)—

Repeal

"or".

(3) Section 54(l)—

Repeal

"exposures."

Substitute

"exposures;".

(4) After section 54(l)—

Add

"(m) significant exposures to commercial entities.".

31. Section 59 amended (bank exposures)

(1) Section 59(5)—

Repeal

"Where"

Substitute

"Subject to subsection (5A), where".

(2) After section 59(5)—

Add

"(5A) Subsection (5) does not apply to an exposure of an authorized institution to a bank in respect of a self-liquidating letter of credit that—

(a) is issued by the bank;

(b) has a maturity of less than one year; and

(c) has been confirmed by the institution.".

32. Section 63A added

After section 63—

Add

"63A. **Failed delivery on transactions entered into on non-delivery-versus-payment basis**

An authorized institution must allocate a risk-weight of 1,250% to—

(a) the amount of payment made, or the current market value of the thing delivered, by the institution in respect of any transaction in securities (other than a repo-style transaction), or any transaction in foreign exchange or commodities, that—

(i) is entered into on a basis other than a delivery-versus-payment basis; and

(ii) has remained unsettled after the contractual date of payment or delivery to the institution for 5 or more business days; and

(b) the amount of any positive current exposure associated with any transaction referred to in paragraph (a).".

33. Section 64 amended (regulatory retail exposures)

Section 64(2)(a)—

Repeal subparagraph (ii)

Substitute

"(ii) in the case of an off-balance sheet exposure in respect of an OTC derivative transaction, credit derivative contract or SFT, the amount of the exposure is—

(A) the outstanding default risk exposure in respect of the OTC derivative transaction or credit derivative contract; or

(B) the default risk exposure in respect of the SFT,

as the case requires; and".

34. Section 65 amended (residential mortgage loans)

Section 65(6)(b)(iii)—

Repeal

"79(a)"

Substitute

"79(1)(a)".

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

Section 66—

Repeal subsections (1) and (2)

Substitute

"(1) This section applies to—

(a) in the case of an authorized institution's holdings of capital instruments issued by financial sector entities—

(i) insignificant capital investments that are not subject to deduction from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital under sections 43(1)(o), 47(1)(c) and 48(1)(c); and

(ii) significant capital investments that are not subject to deduction from an authorized institution's CET1 capital under section 43(1)(p); or

(b) in any other case—

(i) equities held by an authorized institution that do not fall within section 62 or 68A; and

(ii) any other on-balance sheet exposures of the institution that do not fall within any of sections 55, 56, 57, 58, 59, 60, 61, 62, 63, 63A, 64, 65 and 67 (including accrued interest if subsection (5) is applicable).

(2) Subject to subsections (3) and (4), an authorized institution must allocate a risk-weight of—

(a) 100% to an exposure to which this section applies except for an exposure falling within subsection (1)(a)(ii); and

(b) 250% to an exposure falling within subsection (1)(a)(ii).".

36. Section 67 amended (past due exposures)

Section 67(1)—

Repeal

"66"

Substitute

"66(2)(a)".

37. Section 68 amended (credit-linked notes)

Section 68(c)—

Repeal

"exposure, or deduct the exposure from its core capital and supplementary capital,"

Substitute

"exposure".

38. Section 68A added

After section 68—

Add

"68A. Significant exposures to commercial entities

(1) This section applies to—

(a) an authorized institution's holdings of shares in any commercial entity if the holdings amount to more than 10% of the ordinary shares issued by that commercial entity; and

(b) an authorized institution's holdings of shares in any commercial entity if that commercial entity is an affiliate of the institution.

(2) Subject to section 43(1)(n), where the net book value of an authorized institution's holdings referred to in subsection (1)(a) or (b) exceeds 15% of its capital base as reported in its capital adequacy ratio return as at the immediately preceding calendar quarter end date, the institution must allocate a risk-weight of 1,250% to that amount of the net book value of the holdings that exceeds that 15%.".

39. Section 69 amended (application of ECAI ratings)

Section 69—

Repeal subsections (3) and (4)

Substitute

"(3) Subject to subsections (5) and (8), where an exposure (however described) of an authorized institution that falls within any subsection of section 55, 57, 59, 60 or 61 does not have an ECAI issue specific rating, and the person to whom the institution has the exposure does not have an ECAI issuer rating but has a long-term ECAI issue specific rating assigned to a debt obligation issued or undertaken by the person, the institution must, in

complying with the requirements under that subsection of section 55, 57, 59, 60 or 61, as the case may be, in relation to the exposure—

(a) use the long-term ECAI issue specific rating if—

(i) the exposure ranks equally with, or is subordinated in respect of payment or repayment to, the debt obligation; and

(ii) the use of the long-term ECAI issue specific rating by the institution would result in the allocation by the institution of a risk-weight to the exposure that would be equal to, or higher than, the risk-weight allocated by the institution to the exposure on the basis that the person has neither an ECAI issuer rating nor an ECAI issue specific rating assigned to a debt obligation issued or undertaken by the person; and

(b) use the long-term ECAI issue specific rating if—

(i) the exposure ranks equally with, or senior in respect of payment or repayment to, the debt obligation; and

(ii) the use of the long-term ECAI issue specific rating by the institution would result in the allocation by the institution of a risk-weight to the exposure that would be lower than the risk-weight allocated by the institution to the exposure on the basis that the person has neither an ECAI issuer rating nor an ECAI issue specific rating assigned to a debt obligation issued or undertaken by the person.

(4) Subject to subsections (5) and (8), where an exposure (however described) of an authorized institution that

falls within any subsection of section 55, 57, 59, 60 or 61 does not have an ECAI issue specific rating, and the person to whom the institution has the exposure has an ECAI issuer rating but does not have a long-term ECAI issue specific rating assigned to a debt obligation issued or undertaken by the person, the institution must, in complying with the requirements under that subsection of section 55, 57, 59, 60 or 61, as the case may be, in relation to the exposure—

(a) use the ECAI issuer rating if—

(i) the use of the ECAI issuer rating by the institution would result in the allocation by the institution of a risk-weight to the exposure that would be equal to, or higher than, the risk-weight allocated by the institution to the exposure on the basis that the person has neither an ECAI issuer rating nor an ECAI issue specific rating assigned to a debt obligation issued or undertaken by the person;

(ii) the ECAI issuer rating is only applicable to unsecured exposures to the person as an issuer that are not subordinated to other exposures to that person; and

(iii) the exposure to the person ranks equally with, or is subordinated to, the unsecured exposures referred to in subparagraph (ii); and

(b) use the ECAI issuer rating if—

(i) the use of the ECAI issuer rating by the institution would result in the allocation by the institution of a risk-weight to the exposure that would be lower than the risk-weight allocated by the institution to the exposure on

the basis that the person has neither an ECAI issuer rating nor an ECAI issue specific rating assigned to a debt obligation issued or undertaken by the person;

(ii) the ECAI issuer rating is only applicable to unsecured exposures to the person as an issuer that are not subordinated to other exposures to that person; and

(iii) the exposure to the person is not subordinated to other exposures to the person as an issuer.".

40. Section 70A added

Part 4, Division 4, before section 71—

Add

"**70A. Application of sections 71(2) and (3), 72 and 73(b) and (c)**

Sections 71(2) and (3), 72 and 73(b) and (c) do not apply to OTC derivative transactions or credit derivative contracts for which an authorized institution has an IMM(CCR) approval except for transactions or contracts for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method.".

41. Section 74 amended (determination of risk-weights applicable to off-balance sheet exposures)

(1) Section 74(1)—

Repeal

"subsection (2)"

Substitute

"subsections (2) and (6A)".

(2) Section 74(1)—

Repeal

"64, 65, 66 and 67"

Substitute

"63A, 64, 65, 66, 67 and 68A".

(3) Section 74(3)(a)—

Repeal

"risk-weight, or deduct the exposure from the institution's core capital and supplementary capital,"

Substitute

"risk-weight".

(4) Section 74(4)(a)—

Repeal

"risk-weight, or deduct the exposure from the institution's core capital and supplementary capital,"

Substitute

"risk-weight".

(5) After section 74(6)—

Add

"(6A) Where an off-balance sheet exposure referred to in subsection (1) of an authorized institution arises from a single-name credit default swap that falls within section 226J(1) and the default risk exposure in respect of the swap is determined in accordance with section 226J(3), the institution must determine the risk-weight attributable to the exposure by reference to the attributed risk-weight of the counterparty in respect of the swap without taking into account any recognized credit risk mitigation afforded to the swap.".

42. Section 75 amended (calculation of risk-weighted amount of exposures in respect of repo-style transactions booked in banking book)

(1) Section 75, heading—

Repeal

"repo-style transactions"

Substitute

"assets underlying SFTs".

(2) Section 75(1)—

Repeal

"a repo-style transaction"

Substitute

"the asset underlying an SFT".

(3) Section 75(2)—

Repeal

"Where the repo-style transaction"

Substitute

"Subject to subsection (5), where the SFT is a repo-style transaction that".

(4) Section 75—

Repeal subsection (3).

(5) Section 75(4)—

Repeal

"Where the repo-style transaction"

Substitute

"Subject to subsection (5), where the SFT is a repo-style transaction that".

(6) Section 75(4)—

Repeal paragraph (a).

(7) After section 75(4)—

Add

"(5) Where the asset underlying an SFT is a securitization issue, an authorized institution must determine the risk-weight attributable to the asset in accordance with Part 7.".

43. Section 76 substituted

Section 76—

Repeal the section

Substitute

"76. Calculation of risk-weighted amount of exposures in respect of assets underlying SFTs booked in trading book

An authorized institution must calculate the risk-weighted amount of an exposure in respect of the asset underlying an SFT booked in its trading book by reference to Part 8 if—

(a) the SFT is a repo-style transaction that falls within paragraph (a) or (b) of the definition of ***repo-style transaction*** in section 2(1); or

(b) the SFT is a repo-style transaction that falls within paragraph (d) of the definition of ***repo-style transaction*** in section 2(1) and the collateral provided by the institution is in the form of securities.".

44. Section 76A added

Part 4, Division 4, after section 76—

Add

"76A. Calculation of risk-weighted amount of default risk exposures in respect of SFTs

(1) Where an authorized institution does not have an IMM(CCR) approval for SFTs, the institution must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) in accordance with subsections (4), (5), (6) and (7).

(2) Subject to subsection (3), an authorized institution that has an IMM(CCR) approval for SFTs must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) using the IMM(CCR) approach.

(3) Where—

(a) an authorized institution has an IMM(CCR) approval for SFTs but the approval does not include SFTs that are long settlement transactions; or

(b) an authorized institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the methods referred to in section 10A(1)(b) for certain SFTs,

the institution must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) that are not, by virtue of the circumstance described in paragraph (a) or (b), subject to the IMM(CCR) approach, in accordance with subsections (4), (5), (6) and (7).

(4) Where the SFT is a repo-style transaction that falls within paragraph (a) or (b) of the definition of ***repo-style transaction*** in section 2(1), the authorized institution must treat the securities sold or lent under the transaction as if they were an on-balance sheet exposure to the counterparty secured on the money or securities that are provided to, or to the order of, the institution under the transaction and, accordingly, calculate the risk-weighted amount of the institution's default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction.

(5) Where the SFT is a repo-style transaction that falls within paragraph (c) of the definition of ***repo-style transaction*** in section 2(1), the authorized institution must treat the money paid by the institution under the transaction as if it were a loan to the counterparty secured on the securities that are provided to, or to the order of, the institution under the transaction and, accordingly, calculate the risk-weighted amount of the institution's default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction.

(6) Where the SFT is a margin lending transaction, the authorized institution must calculate the risk-weighted amount of its default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction.

(7) Where the SFT is a repo-style transaction that falls within paragraph (d) of the definition of ***repo-style transaction*** in section 2(1)—

(a) if and to the extent that the authorized institution has provided collateral in the form of money under the transaction, the institution must treat the money paid by the institution under the transaction as if it were a loan to the counterparty secured on the securities borrowed by the institution and, accordingly, calculate the risk-weighted amount of the institution's default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction; and

(b) if and to the extent that the authorized institution has provided collateral in the form of securities under the transaction, the institution must treat those securities as if they were an on-balance sheet exposure to the counterparty secured on the securities borrowed by the institution and, accordingly, calculate the risk-weighted amount of the institution's default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction.".

45. Section 77 amended (recognized collateral)

(1) After section 77(e)—

Add

"(ea) if the collateral is provided under a margin agreement for OTC derivative transactions, credit derivative contracts or SFTs, the institution—

(i) has devoted sufficient resources to enable the orderly operation of the agreement; and

(ii) has collateral management policies in place to control, monitor and report—

(A) risks (including liquidity risk and concentration risk) associated with the agreement;

(B) reuse of collateral; and

(C) the rights ceded by the institution in respect of collateral posted;".

(2) Section 77(f)—

Repeal

"such that the current market value of the collateral would be likely to fall in the case of any material deterioration in the financial condition of the obligor".

(3) Section 77(i)(i)—

Repeal

"79(a)"

Substitute

"79(1)(a)".

(4) Section 77(i)(ii)—

Repeal

"80(a)"

Substitute

"80(1)(a)".

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

(1) Section 79—

Renumber the section as section 79(1).

(2) Section 79(1)—

Repeal

"For"

Substitute

"Subject to subsection (2), for".

(3) After section 79(1)—

Add

"(2) Any reference to debt securities in subsection (1) does not include debt securities that, if treated as an on-balance sheet exposure of an authorized institution, would fall within the definition of ***re-securitization exposure*** in section 2(1).".

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

(1) Section 80—

Renumber the section as section 80(1).

(2) Section 80(1)—

Repeal

"For"

Substitute

"Subject to subsection (2), for".

(3) Section 80(1)(a)—

Repeal

"79(a)"

Substitute

"79(1)(a)".

(4) After section 80(1)—

Add

"(2) Collateral referred to in subsection (1) does not include debt securities that, if treated as an on-balance sheet exposure of an authorized institution, would fall within the definition of ***re-securitization exposure*** in section 2(1).".

48. Section 81 amended (calculation of risk-weighted amount of exposures taking into account credit risk mitigation effect of recognized collateral under simple approach)

Section 81(2)(a)—

Repeal

"79(a)"

Substitute

"79(1)(a)".

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

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

Repeal

"79(a)"

Substitute

"79(1)(a)".

50. Section 85 amended (calculation of risk-weighted amount of OTC derivative transactions and credit derivative contracts)

Section 85(1)—

Repeal paragraphs (a), (b), (c) and (d)

Substitute

"(a) dividing the outstanding default risk exposure of the transaction, net of specific provisions, into—

(i) the credit protection covered portion; and

(ii) the credit protection uncovered portion;

(b) multiplying the credit protection covered portion by the risk-weight attributable to the recognized collateral and multiplying the credit protection uncovered portion by the risk-weight attributable to the exposure; and

(c) adding together the 2 products derived from the application of paragraph (b).".

51. Section 88 amended (calculation of net credit exposure of off-balance sheet exposures other than credit derivative contracts booked in trading book or OTC derivative transactions)

(1) Section 88, heading—

Repeal

"**booked in trading book**".

(2) Section 88—

Repeal

"booked in the trading book of the institution".

(3) Section 88, Formula 3, heading—

Repeal

"**Booked in the Trading Book and**"

Substitute

"**or**".

52. Section 89 amended (calculation of net credit exposure of credit derivative contracts booked in trading book and OTC derivative transactions)

(1) Section 89, heading—

Repeal

"**booked in trading book**".

(2) Section 89—

Repeal

"booked in the trading book of the institution".

(3) Section 89, Formula 4, heading—

Repeal

"**Booked in Trading Book**".

(4) Section 89, Formula 4—

Repeal

"credit equivalent amount of off-balance sheet exposure (calculated by aggregating the potential exposure and current exposure in respect of the credit derivative contract or OTC derivative transaction, as the case may be) net of specific provisions, if any;"

Substitute

"outstanding default risk exposure of the credit derivative contract or OTC derivative transaction, as the case may be, net of specific provisions, if any;".

53. Section 91 amended (minimum holding periods)

(1) Section 91—

Renumber the section as section 91(1).

(2) After section 91(1)—

Add

"(2) Where the exposure referred to in subsection (1) arises from a netting set that falls within any of the descriptions in section 226M(2), (3) or (5), the assumed minimum holding period of the netting set must be equal to the longer margin period of risk that would apply to the netting set under section 226M(2), (3) or (5), as the case requires.".

54. Section 92 amended (adjustment of standard supervisory haircuts in certain circumstances)

Section 92, Formula 6—

Repeal

"as set out in Table 12"

Substitute

"determined in accordance with section 91".

55. Section 94A added

After section 94—

Add

"**94A. Application of sections 95, 96 and 97**

(1) Where an authorized institution uses the IMM(CCR) approach to calculate the default risk exposure of a netting set that contains OTC derivative transactions or credit derivative contracts—

(a) subject to paragraph (b), the institution must take into account the effect of any recognized netting in the manner set out in Part 6A instead of in the manner set out in section 95;

(b) paragraph (a) does not apply in the case of OTC derivative transactions or credit derivative contracts for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method.

(2) Where an authorized institution uses the IMM(CCR) approach to calculate the default risk exposure of a netting set that contains SFTs—

(a) subject to paragraph (b), the institution must take into account the effect of any recognized netting in the manner set out in Part 6A instead of in the manner set out in section 96 or 97;

(b) paragraph (a) does not apply in the case of SFTs for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the methods referred to in section 10A(1)(b).".

56. Section 95 amended (netting of OTC derivative transactions and netting of credit derivative contracts booked in trading book)

(1) Section 95, heading—

Repeal

"**booked in trading book**".

(2) Section 95(6), definition of ***derivative transaction***, paragraph (b)—

Repeal

"booked in the trading book".

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

(1) Section 96(2)(b)(i)—

Repeal

"80(a)"

Substitute

"80(1)(a)".

(2) Section 96(5)(b)(ii)—

Repeal

"80(a)"

Substitute

"80(1)(a)".

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

Section 97—

Repeal subsection (4)

Substitute

"(4) The Monetary Authority must refuse to grant approval under subsection (3) to an authorized institution unless the institution satisfies the Monetary Authority that, in the case of the VaR model in respect of which the approval is sought—

(a) the model will take into account any price relationship between the value of money and securities sold, transferred, loaned or paid by the institution and the value of money and securities received by the institution under nettable repo-style transactions, and, in particular in this regard, whether the prices have a positive relationship (that

is, their prices move in the same direction) or negative relationship (that is, their prices move in the opposite direction), or have no relationship at all;

(b) 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;

(c) if the nettable repo-style transactions are subject to daily remargining, the model will assume a minimum holding period of 5 business days and that minimum holding period—

(i) will be subject to increase to the extent that the liquidity of the securities provided by way of collateral under those transactions is such that a longer minimum holding period should be assumed; and

(ii) will be increased in the manner set out in section 226M(2), (3) or (5), as the case requires, if those transactions constitute a netting set that falls within any of the descriptions in that section; and

(d) if the nettable repo-style transactions are not subject to daily remargining, the model will assume a minimum holding period that is at least equal to the minimum holding period calculated by the use of Formula 9A.

Formula 9A

Calculation of Minimum Holding Period where Section 97(4)(d) is Applicable

Minimum holding period = F + N – 1

where—

F = 5 business days or the supervisory floor determined in accordance with section 226M(2) or (3), as the case may be; and

N = actual number of days between each remargining of the transactions.".

59. Section 98 amended (recognized guarantees)

(1) Section 98(a)(v), after "firm;"—

Add

"or".

(2) Section 98(a)—

Repeal subparagraphs (vi) and (vii)

Substitute

"(vi) a corporate that has an ECAI issuer rating,".

60. Section 99 amended (recognized credit derivative contracts)

(1) Section 99(1)(b)(v), after "firm;"—

Add

"or".

(2) Section 99(1)(b)—

Repeal subparagraphs (vi) and (vii)

Substitute

"(vi) a corporate that has an ECAI issuer rating,".

61. Section 100 amended (capital treatment of recognized guarantees and recognized credit derivative contracts)

Section 100—

Repeal subsection (9)

Substitute

"(9) Where the credit protection covered portion of an authorized institution's exposure is such credit protection covered portion by virtue of a recognized guarantee (***original guarantee***) and is the subject of a counter-guarantee given by a sovereign, the institution may, in respect of the credit protection covered portion, treat the counter-guarantee as if it were the original guarantee if—

(a) the counter-guarantee covers all credit risk elements of the exposure to the extent that it relates to the credit protection covered portion;

(b) the counter-guarantee is given in such terms that it can be called if—

(i) for any reason the obligor in respect of the exposure to which the original guarantee relates fails to make payments due in respect of the exposure; and

(ii) the original guarantee could be called;

(c) the original guarantee and the counter-guarantee meet all of the requirements for guarantees set out in section 98 (except that the counter-guarantee

need not meet the requirements set out in section 98(b) and (c)); and

(d) the institution reasonably considers, and demonstrates to the satisfaction of the Monetary Authority, that—

(i) the cover of the counter-guarantee is adequate and effective; and

(ii) there is no evidence to suggest that the coverage of the counter-guarantee is less effective than that of a direct and explicit guarantee by the sovereign that gives the counter-guarantee.".

62. Section 101 amended (provisions supplementary to section 100)

(1) Section 101(2)—

Repeal

"deduct the first loss portion from its core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1,250% to the first loss portion".

(2) Section 101(8)(b), English text—

Repeal

"shall"

Substitute

"must".

(3) Section 101(8)—

Repeal paragraph (c)

Substitute

"(c) must allocate a risk-weight of 1,250% to the first loss portion, being any specified amount of loss, on the happening of a credit event, below which the protection seller is not obliged to share in the loss.".

63. Section 103 amended (maturity mismatches)

Section 103(4)—

Repeal

"79(a)"

Substitute

"79(1)(a)".

64. Section 105 amended (interpretation of Part 5)

(1) Section 105, definition of ***attributed risk-weight***—

(a) **Repeal**

"113 and 116"

Substitute

"113, 114A, 116 and 117A";

(b) Paragraph (b), Chinese text—

Repeal

"擔。"

Substitute

"擔；".

(2) Section 105, definition of ***cash items***, paragraph (j)(i)—

Repeal

"a non-delivery-versus-payment basis"

Substitute

"a basis other than a delivery-versus-payment basis".

(3) Section 105, definition of ***principal amount***, after paragraph (b)(iv)—

Add

"(v) in the case of an exposure to a person arising from the person holding collateral posted by the institution in a manner that is not bankruptcy remote from the person, the fair value of the collateral;".

(4) Section 105—

Add in alphabetical order

"***SFT risk-weighted amount*** (SFT 風險加權數額), in relation to SFTs, means the sum of the default risk risk-weighted amounts for all counterparties to the SFTs where the default risk risk-weighted amount for each of the counterparties is calculated as the product of—

(a) the sum of default risk exposures across all the SFTs with the counterparty calculated under section 123A(4), (5), (6) and (7), net of specific provisions; and

(b) the applicable risk-weight determined under section 121(1);".

65. Section 106 amended (calculation of risk-weighted amount of exposures)

(1) Section 106(2)—

Repeal paragraph (b)

Substitute

"(b) subject to paragraph (c), an authorized institution may reduce the risk-weighted amount of the institution's on-balance sheet exposure by taking into account the effect of any recognized credit risk mitigation in respect of the exposure in the manner set out in Divisions 5, 6, 7 and 8;

(c) if an authorized institution has bought credit protection for an exposure and the credit protection is in the form of a single-name credit default swap that falls within section 226J(1), the institution must not take into account the credit risk mitigation effect of the swap when calculating the risk-weighted amount of the exposure.".

(2) Section 106(3)—

Repeal paragraph (a)

Substitute

"(a) subject to paragraph (b), in the case of an authorized institution's off-balance sheet exposures that are counterparty credit risk exposures in respect of OTC derivative transactions, credit derivative contracts or SFTs—

(i) the institution must, if it has an IMM(CCR) approval and an approval to use the IMM approach to calculate the market risk capital charge for specific risk for interest rate exposures, calculate the risk-weighted amount of those off-balance sheet exposures as the sum of the amounts specified in subsection (4)(a), (b) and (c);

(ii) the institution must, if it has an IMM(CCR) approval but does not have an approval to use the IMM approach to calculate the market risk capital charge for specific risk for interest rate exposures, calculate the risk-weighted amount of those off-balance sheet exposures as the sum of the amounts specified in subsection (4)(a), (b) and (d); and

(iii) the institution must, if it does not have an IMM(CCR) approval for any of its transactions or contracts, calculate the risk-weighted amount of

those off-balance sheet exposures as the sum of the CEM risk-weighted amount, the SFT risk-weighted amount, and the CVA risk-weighted amount determined using the standardized CVA method;

(ab) subject to paragraph (b), in the case of an authorized institution's off-balance sheet exposures that do not fall within paragraph (a), the institution must calculate the risk-weighted amount of each of those exposures by—

(i) converting the principal amount of the exposure, net of specific provisions, into its credit equivalent amount in the manner set out in section 118 or 120, as the case requires; and

(ii) multiplying the credit equivalent amount by the exposure's relevant risk-weight determined under section 121;".

(3) Section 106(3)—

Repeal paragraph (b)

Substitute

"(b) subject to paragraphs (c) and (d), an authorized institution may reduce the risk-weighted amount of the institution's off-balance sheet exposure by taking into account the effect of any recognized credit risk mitigation in respect of the exposure in the manner set out in Divisions 5, 6, 7 and 8;

(c) if an off-balance sheet exposure of an authorized institution is a counterparty credit risk exposure in respect of OTC derivative transactions, credit derivative contracts or SFTs, the institution must not, under paragraph (b), take into account the effect of any recognized credit risk mitigation applicable to the exposure if that effect has already been taken into

account in the calculation of its default risk exposures in respect of those transactions or contracts;

(d) if an authorized institution has bought credit protection for an exposure and the credit protection is in the form of a single-name credit default swap that falls within section 226J(1), the institution must not take into account the credit risk mitigation effect of the swap when calculating the risk-weighted amount of the exposure.".

(4) After section 106(3)—

Add

"(4) The amounts referred to in subsection (3)(a)(i) and (ii) are—

(a) the IMM(CCR) risk-weighted amount of the transactions or contracts concerned that are covered by the IMM(CCR) approval;

(b) the CEM risk-weighted amount or SFT risk-weighted amount of the transactions or contracts concerned that are not covered by the IMM(CCR) approval or that fall within section 10B(5) or (7);

(c) the CVA risk-weighted amount determined using the advanced CVA method, the standardized CVA method, or a combination of those 2 methods that is permitted under these Rules, as the case requires; and

(d) the CVA risk-weighted amount determined using the standardized CVA method.".

66. Section 107 amended (on-balance sheet exposures and off-balance sheet exposures to be covered)

(1) Section 107—

Renumber the section as section 107(1).

(2) Section 107(1)(a)—

Repeal subparagraphs (i) and (ii)

Substitute

"(i) that under Division 4 of Part 3 are required to be deducted from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital;

(ii) that are subject to the requirements of Division 4 of Part 6A; or

(iii) that are subject to the requirements of Part 7;".

(3) Section 107(1)—

Repeal paragraph (b)

Substitute

"(b) subject to subsection (2), all of the institution's exposures to counterparties—

(i) under OTC derivative transactions, credit derivative contracts or SFTs booked in its trading book; or

(ii) in respect of assets that are—

(A) posted by the institution as collateral for transactions or contracts booked in its trading book; and

(B) held by the counterparties in a manner that is not bankruptcy remote from the counterparties; and".

(4) After section 107(1)—

Add

"(2) Subsection (1)(b) does not apply to exposures that are subject to—

(a) deduction from any of the authorized institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital under Division 4 of Part 3; or

(b) the requirements of Division 4 of Part 6A.".

67. Section 108 amended (classification of exposures)

(1) After section 108(e)—

Add

"(ea) exposures in respect of failed delivery on transactions entered into on a basis other than a delivery-versus-payment basis;".

(2) Section 108(f)—

Repeal

"or".

(3) Section 108(g)—

Repeal

"exposures."

Substitute

"exposures;".

(4) After section 108(g)—

Add

"(h) significant exposures to commercial entities.".

68. Section 114A added

After section 114—

Add

"**114A. Failed delivery on transactions entered into on non-delivery-versus-payment basis**

An authorized institution must allocate a risk-weight of 1,250% to—

(a) the amount of payment made, or the current market value of the thing delivered, by the institution in respect of any transaction in securities (other than a repo-style transaction), or any transaction in foreign exchange or commodities, that—

(i) is entered into on a basis other than a delivery-versus-payment basis; and

(ii) has remained unsettled after the contractual date of payment or delivery to the institution for 5 or more business days; and

(b) the amount of any positive current exposure associated with any transaction referred to in paragraph (a).".

69. Section 116 amended (other exposures)

Section 116—

Repeal subsections (1) and (2)

Substitute

"(1) This section applies to—

(a) in the case of an authorized institution's holdings of capital instruments issued by financial sector entities—

(i) insignificant capital investments that are not subject to deduction from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital under sections 43(1)(o), 47(1)(c) and 48(1)(c); and

(ii) significant capital investments that are not subject to deduction from an authorized institution's CET1 capital under section 43(1)(p); or

(b) in any other case—

(i) equities held by an authorized institution that do not fall within section 117A; and

(ii) any other on-balance sheet exposures of the institution that do not fall within any of sections 109, 110, 111, 112, 113, 114, 114A and 115 (including accrued interest if subsection (5) is applicable).

(2) Subject to subsections (3) and (4), an authorized institution must allocate a risk-weight of—

(a) 100% to an exposure to which this section applies except for an exposure falling within subsection (1)(a)(ii); and

(b) 250% to an exposure falling within subsection (1)(a)(ii).".

70. Section 117A added

Part 5, Division 3, after section 117—

Add

"**117A. Significant exposures to commercial entities**

(1) This section applies to—

(a) an authorized institution's holdings of shares in any commercial entity if the holdings amount to more than 10% of the ordinary shares issued by that commercial entity; and

(b) an authorized institution's holdings of shares in any commercial entity if that commercial entity is an affiliate of the institution.

(2) Subject to section 43(1)(n), where the net book value of an authorized institution's holdings referred to in subsection (1)(a) or (b) exceeds 15% of its capital base as reported in its capital adequacy ratio return as at the immediately preceding calendar quarter end date, the institution must allocate a risk-weight of 1,250% to that amount of the net book value of the holdings that exceeds that 15%.".

71. Section 117B added

Part 5, Division 4, before section 118—

Add

"**117B. Application of sections 118(2) and (3), 119 and 120(b) and (c)**

Sections 118(2) and (3), 119 and 120(b) and (c) do not apply to OTC derivative transactions or credit derivative contracts for which an authorized institution has an IMM(CCR) approval except for transactions or contracts for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method.".

72. Section 121 amended (determination of risk-weights applicable to off-balance sheet exposures)

(1) Section 121(1)—

Repeal

"subsection (2)"

Substitute

"subsections (2) and (6A)".

(2) Section 121(1)—

Repeal

"115 and 116"

Substitute

"114A, 115, 116 and 117A".

(3) After section 121(6)—

Add

"(6A) Where an off-balance sheet exposure referred to in subsection (1) of an authorized institution arises from a single-name credit default swap that falls within section 226J(1) and the default risk exposure in respect of the swap is determined in accordance with section 226J(3), the institution must determine the risk-weight attributable to the exposure by reference to the attributed risk-weight of the counterparty in respect of the swap without taking into account any recognized credit risk mitigation afforded to the swap.".

73. Section 122 amended (calculation of risk-weighted amount of exposures in respect of repo-style transactions booked in banking book)

(1) Section 122, heading—

Repeal

"**repo-style transactions**"

Substitute

"**assets underlying SFTs**".

(2) Section 122(1)—

Repeal

"a repo-style transaction"

Substitute

"the asset underlying an SFT".

(3) Section 122(2)—

Repeal

"Where the repo-style transaction"

Substitute

"Subject to subsection (5), where the SFT is a repo-style transaction that".

(4) Section 122—

Repeal subsection (3).

(5) Section 122(4)—

Repeal

"Where the repo-style transaction"

Substitute

"Subject to subsection (5), where the SFT is a repo-style transaction that".

(6) Section 122(4)—

Repeal paragraph (a).

(7) After section 122(4)—

Add

"(5) Where the asset underlying an SFT is a securitization issue, an authorized institution must determine the risk-weight attributable to the asset in accordance with Part 7.".

74. Section 123 substituted

Section 123—

Repeal the section

Substitute

"123. Calculation of risk-weighted amount of exposures in respect of assets underlying SFTs booked in trading book

An authorized institution must calculate the risk-weighted amount of an exposure in respect of the asset underlying an SFT booked in its trading book by reference to Part 8 if—

(a) the SFT is a repo-style transaction that falls within paragraph (a) or (b) of the definition of ***repo-style transaction*** in section 2(1); or

(b) the SFT is a repo-style transaction that falls within paragraph (d) of the definition of ***repo-style transaction*** in section 2(1) and the collateral provided by the institution is in the form of securities.".

75. Section 123A added

Part 5, Division 4, after section 123—

Add

"123A. Calculation of risk-weighted amount of default risk exposures in respect of SFTs

(1) Where an authorized institution does not have an IMM(CCR) approval for SFTs, the institution must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) in accordance with subsections (4), (5), (6) and (7).

(2) Subject to subsection (3), an authorized institution that has an IMM(CCR) approval for SFTs must calculate the risk-weighted amount of its default risk exposures in

respect of SFTs (whether booked in its banking book or trading book) using the IMM(CCR) approach.

(3) Where—

(a) an authorized institution has an IMM(CCR) approval for SFTs but the approval does not include SFTs that are long settlement transactions; or

(b) an authorized institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the methods referred to in section 10A(1)(b) for certain SFTs,

the institution must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) that are not, by virtue of the circumstance described in paragraph (a) or (b), subject to the IMM(CCR) approach, in accordance with subsections (4), (5), (6) and (7).

(4) Where the SFT is a repo-style transaction that falls within paragraph (a) or (b) of the definition of ***repo-style transaction*** in section 2(1), the authorized institution must treat the securities sold or lent under the transaction as if they were an on-balance sheet exposure to the counterparty secured on the money or securities that are provided to, or to the order of, the institution under the transaction and, accordingly, calculate the risk-weighted amount of the institution's default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction.

(5) Where the SFT is a repo-style transaction that falls within paragraph (c) of the definition of ***repo-style***

transaction in section 2(1), an authorized institution must treat the money paid by the institution under the transaction as if it were a loan to the counterparty secured on the securities that are provided to, or to the order of, the institution under the transaction and, accordingly, calculate the risk-weighted amount of the institution's default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction.

(6) Where the SFT is a margin lending transaction, the authorized institution must calculate the risk-weighted amount of its default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction.

(7) Where the SFT is a repo-style transaction that falls within paragraph (d) of the definition of ***repo-style transaction*** in section 2(1)—

(a) if and to the extent that the authorized institution has provided collateral in the form of money under the transaction, the institution must treat the money paid by the institution under the transaction as if it were a loan to the counterparty secured on the securities borrowed by the institution and, accordingly, calculate the risk-weighted amount of the institution's default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction; and

(b) if and to the extent that the authorized institution has provided collateral in the form of securities under the transaction, the institution must treat those securities as if they were an on-balance sheet exposure to the counterparty secured on the securities borrowed by the institution and, accordingly, calculate the risk-weighted amount of the institution's default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction.".

76. Section 124 amended (recognized collateral)

(1) After section 124(e)—

Add

"(ea) if the collateral is provided under a margin agreement for OTC derivative transactions, credit derivative contracts or SFTs, the institution—

(i) has devoted sufficient resources to enable the orderly operation of the agreement; and

(ii) has collateral management policies in place to control, monitor and report—

(A) risks (including liquidity risk and concentration risk) associated with the agreement;

(B) reuse of collateral; and

(C) the rights ceded by the institution in respect of collateral posted;".

(2) Section 124(f)—

Repeal

"such that the current market value of the collateral would be likely to fall in the case of any material deterioration in the financial condition of the obligor".

(3) Section 124(h)—

Repeal

"125(a)"

Substitute

"125(1)(a)".

77. Section 125 amended (collateral which may be recognized for purposes of section 124(h))

(1) Section 125—

Renumber the section as section 125(1).

(2) Section 125(1)—

Repeal

"For"

Substitute

"Subject to subsection (2), for".

(3) After section 125(1)—

Add

"(2) Any reference to debt securities in subsection (1) does not include debt securities that, if treated as an on-balance sheet exposure of an authorized institution, would fall within the definition of ***re-securitization exposure*** in section 2(1).".

78. Section 126 amended (calculation of risk-weighted amount of exposures taking into account credit risk mitigation effect of recognized collateral)

(1) Section 126(2)(a)—

Repeal

"125(a)"

Substitute

"125(1)(a)".

(2) Section 126—

Repeal subsection (4)

Substitute

"(4) An authorized institution must—

(a) if the recognized collateral is not a securitization issue, determine the risk-weight to be allocated to the collateral in accordance with sections 109, 110, 111, 112, 113, 114, 115 and 116 as if the collateral were an on-balance sheet exposure; and

(b) if the recognized collateral is a securitization issue, determine the risk-weight to be allocated to the collateral in accordance with sections 237, 238 and 239 as if the collateral were an on-balance sheet exposure.".

79. Section 129 amended (calculation of risk-weighted amount of OTC derivative transactions and credit derivative contracts)

Section 129(1)—

Repeal paragraphs (a), (b), (c) and (d)

Substitute

"(a) dividing the outstanding default risk exposure of the transaction, net of specific provisions, into—

(i) the credit protection covered portion; and

(ii) the credit protection uncovered portion;

(b) multiplying the credit protection covered portion by the risk-weight attributable to the recognized collateral and multiplying the credit protection uncovered portion by the risk-weight attributable to the exposure; and

(c) adding together the 2 products derived from the application of paragraph (b).".

80. Section 130A added

After section 130—

Add

"**130A. Application of section 131**

Where an authorized institution uses the IMM(CCR) approach to calculate the default risk exposure of a netting set that contains OTC derivative transactions or credit derivative contracts—

(a) subject to paragraph (b), the institution must take into account the effect of any recognized netting in the manner set out in Part 6A instead of in the manner set out in section 131;

(b) paragraph (a) does not apply in the case of OTC derivative transactions or credit derivative contracts for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method.".

81. Section 131 amended (netting of OTC derivative transactions and netting of credit derivative contracts booked in trading book)

(1) Section 131, heading—

Repeal

"booked in trading book".

(2) Section 131(5), definition of ***derivative transaction***, paragraph (b)—

Repeal

"booked in the trading book".

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

Section 134—

Repeal subsection (6)

Substitute

"(6) Where the credit protection covered portion of an authorized institution's exposure is such credit protection covered portion by virtue of a recognized guarantee (***original guarantee***) and is the subject of a counter-guarantee given by a sovereign, the institution may, in respect of the credit protection covered portion, treat the counter-guarantee as if it were the original guarantee if—

(a) the counter-guarantee covers all credit risk elements of the exposure to the extent that it relates to the credit protection covered portion;

(b) the counter-guarantee is given in such terms that it can be called if—

(i) for any reason the obligor in respect of the exposure to which the original guarantee relates fails to make payments due in respect of the exposure; and

(ii) the original guarantee could be called;

(c) the original guarantee and the counter-guarantee meet all of the requirements for guarantees set out in section 132 (except that the counter-guarantee need not meet the requirements set out in section 132(b) and (c)); and

(d) the institution reasonably considers, and demonstrates to the satisfaction of the Monetary Authority, that—

(i) the cover of the counter-guarantee is adequate and effective; and

(ii) there is no evidence to suggest that the coverage of the counter-guarantee is less effective than that of a direct and explicit guarantee by the sovereign that gives the counter-guarantee.".

83. Section 135 amended (provisions supplementary to section 134)

(1) Section 135(2)—

Repeal

"deduct the first loss portion from its core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1,250% to the first loss portion".

(2) Section 135(8)(b), English text—

Repeal

"shall"

Substitute

"must".

(3) Section 135(8)—

Repeal paragraph (c)

Substitute

"(c) must allocate a risk-weight of 1,250% to the first loss portion, being any specified amount of loss, on the happening of a credit event, below which the protection seller is not obliged to share in the loss.".

84. Section 137 amended (maturity mismatches)

Section 137(3)—

Repeal

"125(a)"

Substitute

"125(1)(a)".

85. Section 139 amended (interpretation of Part 6)

(1) Section 139(1), definition of ***capital floor***, after "(3),"—

Add

"(3A),".

(2) Section 139(1), definition of ***cash items***, paragraph (i)(i)—

Repeal

"a non-delivery-versus-payment basis"

Substitute

"a basis other than a delivery-versus-payment basis".

(3) Section 139(1), definition of ***cash items***, after paragraph (i)—

Add

"(j) the amounts of payment made or the current market value of the thing delivered, and the positive current exposure incurred, by the institution in respect of transactions in securities (other than repo-style transactions), or transactions in foreign exchange or commodities, that—

(i) are entered into on a basis other than a delivery-versus-payment basis; and

(ii) have remained unsettled after the contractual date of payment or delivery to the institution for 5 or more business days;".

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

Repeal paragraph (b)

Substitute

"(b) in the case of an exposure in respect of an OTC derivative transaction or credit derivative contract, using the current exposure method;".

(5) Section 139(1)—

Repeal the definition of *eligible provisions*

Substitute

"***eligible provisions*** (合資格準備金), in relation to an authorized institution, means the sum of—

(a) the institution's specific provisions, partial write-offs, regulatory reserve for general banking risks and collective provisions attributed to non-securitization exposures that are subject to the IRB approach; and

(b) any discounts falling within section 163(3) or 164(5) on exposures referred to in paragraph (a) that are in default,

exclusive of any CVA and CVA loss;".

(6) Section 139(1)—

Repeal the definition of *expected loss amount*

Substitute

"***expected loss amount*** (預期損失額), in relation to an exposure of an authorized institution, means—

(a) subject to paragraph (b), the expected loss amount of the exposure calculated by multiplying the EL of the exposure by the EAD of the exposure;

(b) if the exposure is an off-balance sheet exposure arising from a netting set that consists of one or more than one OTC derivative transaction or credit derivative contract, the expected loss amount of the exposure calculated by multiplying the EL of the exposure by the outstanding default risk exposure of the netting set;".

(7) Section 139(1), definition of ***exposure at default***—

Repeal

"equivalent amount"

Substitute

"equivalent amount, default risk exposure or outstanding default risk exposure, as the case may be".

(8) Section 139(1), definition of ***principal amount***, after paragraph (b)(iv)—

Add

"(v) in the case of an exposure to a person arising from the person holding collateral posted by the institution in a manner that is not bankruptcy remote from the person, the fair value of the collateral;".

(9) Section 139(1), definition of ***recognized collateral***, paragraph (b)(ii)—

Repeal

"(e)"

Substitute

"(e), (ea)".

(10) Section 139(1)—

Repeal the definition of *recognized financial collateral*

Substitute

"***recognized financial collateral*** (認可財務抵押品)—

(a) subject to paragraph (b), means any collateral that—

(i) falls within the description in section 80(1)(a), (b), (c) or (d); and

(ii) satisfies the requirements under section 77(a), (b), (c), (d), (e), (ea) and (f);

(b) does not include any collateral in the form of real property, or any collateral in the form of debt securities that, if treated as an on-balance sheet exposure of an authorized institution, would fall within the definition of ***re-securitization exposure*** in section 2(1);".

(11) Section 139(1), Chinese text, definition of ***PD/LGD 計算法***—

Repeal

"法。"

Substitute

"法；".

(12) Section 139(1)—

Add in alphabetical order

"***SFT risk-weighted amount*** (SFT 風險加權數額), in relation to SFTs, means the sum of the default risk risk-weighted amounts for all counterparties to the SFTs where the default risk risk-weighted amount for each of the counterparties is calculated as the product of—

(a) the sum of default risk exposures across all the SFTs with the counterparty calculated under section 202(1) or (3) or 209(3), as the case requires; and

(b) the applicable risk-weight determined under this Part;".

86. Section 140 amended (calculation of risk-weighted amount of exposures)

Section 140—

Repeal subsection (1)

Substitute

"(1) Subject to subsection (2) and section 141, an authorized institution must calculate the risk-weighted amount of the institution's exposure to credit risk by aggregating the figures derived from the application of subsections (1A), (1B) and (1C).

(1A) Subject to subsections (1B) and (1C), the authorized institution must multiply the EAD of the exposure by the exposure's relevant risk-weight.

(1B) For an equity exposure in respect of which—

(a) the authorized institution uses the internal models method; and

(b) the relevant risk-weight set out in section 186(3)(a)(ii) does not apply,

the institution must multiply the potential loss of the equity exposure as calculated using the institution's internal models by 12.5 in accordance with section 186.

(1C) For a counterparty credit risk exposure in respect of OTC derivative transactions, credit derivative contracts or SFTs—

(a) the authorized institution must, if it has an IMM(CCR) approval and an approval to use the IMM approach to calculate the market risk capital charge for specific risk for interest rate exposures, calculate the risk-weighted amount of the counterparty credit risk exposure as the sum of—

(i) the IMM(CCR) risk-weighted amount of the transactions or contracts concerned that are covered by the IMM(CCR) approval;

(ii) the CEM risk-weighted amount or SFT risk-weighted amount of the transactions or contracts concerned that are not covered by the IMM(CCR) approval or that fall within section 10B(5) or (7); and

(iii) the CVA risk-weighted amount determined using the advanced CVA method, the standardized CVA method, or a combination of those 2 methods that is permitted under these Rules, as the case requires;

(b) the authorized institution must, if it has an IMM(CCR) approval but does not have an

approval to use the IMM approach to calculate the market risk capital charge for specific risk for interest rate exposures, calculate the risk-weighted amount of the counterparty credit risk exposure as the sum of—

(i) the IMM(CCR) risk-weighted amount of the transactions or contracts concerned that are covered by the IMM(CCR) approval;

(ii) the CEM risk-weighted amount or SFT risk-weighted amount of the transactions or contracts concerned that are not covered by the IMM(CCR) approval or that fall within section 10B(5) or (7); and

(iii) the CVA risk-weighted amount determined using the standardized CVA method; and

(c) the authorized institution must, if it does not have an IMM(CCR) approval for any of its transactions or contracts, calculate the risk-weighted amount of the counterparty credit risk exposure as the sum of—

(i) the CEM risk-weighted amount;

(ii) the SFT risk-weighted amount; and

(iii) the CVA risk-weighted amount determined using the standardized CVA method.

(1D) For the purposes of subsection (1C), the authorized institution may, in the case of a default risk exposure in respect of long settlement transactions, determine the exposure's relevant risk-weight using the STC approach on a permanent basis.

(1E) For the purposes of subsection (1C)(a)(iii), (b)(iii) and (c)(iii), an authorized institution must treat the total

amount of the CVA capital charge for its counterparties determined in accordance with Division 3 of Part 6A as the basis for determining the CVA risk-weighted amount of the institution, regardless of whether any of those counterparties falls within this Part.".

87. Section 140A amended (calculation of exposure at default)

Section 140A(1)—

Repeal

"165, 166, 179, 180, 181, 182, 183, 195, 196, 197, 201 or 202,"

Substitute

"164A, 165, 166, 179, 180, 180A, 181, 182, 183, 195, 196, 197, 201 or 202, or Part 6A,".

88. Section 141 amended (exposures to be covered)

(1) Section 141—

Renumber the section as section 141(1).

(2) Section 141(1)(a)—

Repeal subparagraphs (i) and (ii)

Substitute

"(i) that under Division 4 of Part 3 are required to be deducted from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital;

(ii) that are subject to the requirements of Division 4 of Part 6A; or

(iii) that are subject to the requirements of Part 7; and".

(3) Section 141(1)—

Repeal paragraph (b)

Substitute

"(b) subject to subsection (2), all of the institution's exposures to counterparties—

(i) under OTC derivative transactions, credit derivative contracts or SFTs booked in its trading book; or

(ii) in respect of assets that are—

(A) posted by the institution as collateral for transactions or contracts booked in its trading book; and

(B) held by the counterparties in a manner that is not bankruptcy remote from the counterparties.".

(4) After section 141(1)—

Add

"(2) Subsection (1)(b) does not apply to exposures that are subject to—

(a) deduction from any of the authorized institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital under Division 4 of Part 3; or

(b) the requirements of Division 4 of Part 6A.".

89. Section 145 amended (equity exposures)

Section 145(1)(b)(iv)—

Repeal

"section 38 for inclusion in the institution's core capital"

Substitute

"Division 2 of Part 3 for inclusion in the institution's CET1 capital or Additional Tier 1 capital".

90. Section 146 amended (other exposures)

(1) Section 146(2)(a)—

Repeal

"items; and"

Substitute

"items.".

(2) Section 146(2)—

Repeal paragraph (b).

91. Section 149 amended (default of obligor)

(1) Section 149(2)(a)(ii), English text—

Repeal

"consolidated"

Substitute

"consolidation".

(2) Section 149—

Repeal subsections (5A) and (5B)

Substitute

"(5A) Subject to subsections (5B), (5C) and (5D), 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 (***defaulting obligor***) in the connected group has occurred; 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 in accordance with the

institution's policy and practices referred to in section 154(d).

(5B) Subsection (5A) does not apply in respect of the authorized institution's exposures to all obligors in the connected group if—

(a) the default referred to in paragraph (a) of that subsection (***relevant default***) is a default to which subsection (2)(a) applies by virtue of—

(i) the fact that the relevant default is a retail exposure in respect of which the defaulting obligor is past due for more than 90 days in respect of any payment owing by the obligor to the institution in respect of that exposure; and

(ii) the fact that the defaulting obligor is not also past due for more than 90 days in respect of any payment owing by the obligor to the institution in respect of any other exposure that is not a retail exposure; and

(b) the institution has not, following the occurrence of the relevant default, exercised its discretion under subsection (2)(a)(ii) to treat all other outstanding credit obligations of the defaulting obligor to the institution (or to any member of the consolidation group of the institution) as being in default.

(5C) The authorized institution may disregard subsection (5A) in respect of the institution's exposures to any obligor in the connected group if that obligor has not been rated on the basis referred to in paragraph (b) of that subsection.

(5D) The authorized institution may disregard subsection (5A) in respect of the institution's exposures to any obligor in the connected group if the institution demonstrates to the

satisfaction of the Monetary Authority that disregarding that subsection in respect of those exposures—

(a) is neither imprudent nor unreasonable; and

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

92. Section 153 amended (rating assignment horizon)

(1) Section 153(b)—

Repeal

"obligor; and"

Substitute

"obligor;".

(2) Section 153(c)—

Repeal

"obligations."

Substitute

"obligations; and".

(3) After section 153(c)—

Add

"(d) when estimating the PD for an obligor that is highly leveraged or whose assets are predominantly traded assets, ensure such estimate reflects the performance of the obligor's assets based on volatilities calibrated to data from periods of significant financial stress.".

93. Section 154 amended (rating coverage)

(1) Section 154—

Repeal paragraph (c)

Substitute

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

(2) Section 154(d)(iii)—

Repeal

"manner."

Substitute

"manner; and".

(3) After section 154(d)—

Add

"(e) set out in policies and put into operation a process for the identification of specific wrong-way risk for each legal entity to which the institution is exposed.".

94. Section 156 amended (calculation of risk-weighted amount of corporate, sovereign and bank exposures)

(1) Section 156(2)—

Repeal

"subsection (5)"

Substitute

"subsections (5) and (5A)".

(2) After section 156(5)—

Add

"(5A) Where an exposure falls within section 140(1D), an authorized institution may calculate the risk-weighted amount of the exposure by multiplying the EAD of the exposure by the relevant risk-weight attributable to that exposure determined under Part 4.".

(3) After section 156(8)—

Add

"(9) Where an authorized institution that uses the advanced CVA method to calculate its CVA capital charge demonstrates to the satisfaction of the Monetary Authority that its VaR model used in the advanced CVA method adequately covers the effects of rating migrations, the institution may—

(a) calculate the risk-weight applicable to a default risk exposure in respect of OTC derivative transactions or credit derivative contracts under subsection (2) with the full maturity adjustment set equal to 1; and

(b) calculate the risk-weight applicable to a default risk exposure in respect of OTC derivative transactions or credit derivative contracts under subsection (5) with the full maturity adjustment set equal to 1 but the credit protection provider must be one of the counterparties covered by the CVA capital charge calculation.

(10) In subsection (9)—

full maturity adjustment (全面到期期限調整) means—

(a) that amount calculated by the component $(1 - 1.5 \times b)^{-1} \times (1 + (M - 2.5) \times b)$ in Formula 16; or

(b) that amount calculated by the component $\frac{1+(M_{os}-2.5)\times b_{os}}{1-1.5\times b_{os}}$ in Formula 17,

as the case requires.".

95. Section 157A added

After section 157—

Add

"157A. Provisions supplementary to section 156(2) and (5)—asset value correlation multiplier for exposures to certain financial institutions

(1) Subsection (2) applies to an obligor that is—

(a) a large regulated financial institution; or

(b) a financial institution that is not supervised by a financial regulator.

(2) Where a corporate, sovereign or bank exposure of an authorized institution is to an obligor to which this subsection applies, the institution must multiply the correlation (R) or correlation (ρ_{os}) in the risk-weight function set out in Formula 16 or 17, as the case requires, by 1.25.

(3) In this section—

financial institution (金融機構) means an entity that—

(a) is a financial sector entity; or

(b) is engaged predominantly in any one or more of the following activities, whether by itself or through any of its subsidiaries—

(i) lending;

(ii) factoring;

(iii) provision of credit enhancement;

(iv) securitization;

(v) proprietary trading;

(vi) any other financial services activity specified in Part 11 of Schedule 1;

financial regulator (金融監管者) means a regulatory authority that imposes supervisory standards (including supervisory standards relating to capital and liquidity) that are substantially consistent with international standards;

large regulated financial institution (大型受監管金融機構) means a financial institution that is supervised by a financial regulator and that—

(a) has total assets of not less than $780 billion as determined by reference to the institution's most recent audited consolidated financial statements or (if the institution does not have any subsidiary) the institution's most recent audited financial statements; or

(b) is a member of a group of companies (comprised of the ultimate holding company and all of its subsidiaries) that has total assets of not less than $780 billion as determined by reference to the group's most recent audited consolidated financial statements.".

96. Section 158 amended (provisions supplementary to section 156—risk-weights for specialized lending)

(1) Section 158(1), after "corporates"—

Add

"or section 157A in respect of exposures to obligors that fall within any of the descriptions in section 157A(1)(a) and (b)".

(2) Section 158(2)(c)(i)—

Repeal

"on Banking Supervision".

97. Section 160 amended (loss given default under foundation IRB approach)

(1) Section 160(1)(a)—

Repeal

"use"

Substitute

"subject to paragraphs (c) and (d), use".

(2) Section 160(1)(a)(ii)—

Repeal

"and".

(3) Section 160(1)(b)—

Repeal

"use"

Substitute

"subject to paragraphs (c) and (d), use".

(4) Section 160(1)(b)—

Repeal

"exposures."

Substitute

"exposures;".

(5) After section 160(1)(b)—

Add

"(c) use a supervisory estimate of 100% for the LGD of the institution's default risk exposures in respect of single-name credit default swaps if—

(i) the swaps fall within section 226J(1); and

(ii) those exposures are determined in accordance with section 226J(3); and

(d) for transactions that fall within section 226J(4), use a supervisory estimate of 100% for the LGD of the institution's default risk exposures in respect of the transactions if—

(i) the institution has the Monetary Authority's approval to calculate incremental risk charge for the transactions; and

(ii) the determination of the default risk exposures under that section has used existing calculations for incremental risk charge that already contain an LGD assumption.".

(6) Section 160(3), Formula 18—

Repeal

"45% for the LGD of a senior exposure"

Substitute

"the LGD specified in subsection (1)(a), (c) or (d), as the case may be,".

(7) Section 160(4)(a)—

Repeal

"of 45% specified in subsection (1)(a)"

Substitute

"specified in subsection (1)(a), (c) or (d), as the case may be".

(8) Section 160(4)(c)(iii)—

Repeal

"of 45% specified in subsection (1)(a)"

Substitute

"specified in subsection (1)(a), (c) or (d), as the case may be".

(9) Section 160(4)(e)—

Repeal

"of 45% specified in subsection (1)(a)"

Substitute

"specified in subsection (1)(a), (c) or (d), as the case may be".

98. Section 161 amended (loss given default under advanced IRB approach)

(1) Section 161(1)—

Repeal

"An"

Substitute

"Subject to subsections (2) and (3), an".

(2) Section 161(2)—

Repeal

"For the purposes of subsection (1), an"

Substitute

"An".

(3) After section 161(2)—

Add

"(3) An authorized institution that uses the advanced IRB approach must comply with section 160(1)(c) or (d), as the case requires, in estimating the LGD of a facility type that comprises default risk exposures in respect of—

(a) single-name credit default swaps that fall within the description in section 160(1)(c)(i) and (ii); or

(b) transactions that fall within the description in section 160(1)(d)(i) and (ii),

as if the institution were an authorized institution that uses the foundation IRB approach.".

99. Section 163 amended (exposure at default under foundation IRB approach—on-balance sheet exposures and off-balance sheet exposures other than OTC derivative transactions and credit derivative contracts)

Section 163(1)(a)(i)—

Repeal

"core capital"

Substitute

"CET1 capital".

100. Section 164 amended (exposure at default under advanced IRB approach—on-balance sheet exposures and off-balance sheet exposures other than OTC derivative transactions and credit derivative contracts)

Section 164(1)(a)(ii)(A)—

Repeal

"core capital"

Substitute

"CET1 capital".

101. Section 164A added

After section 164—

Add

"**164A. Application of sections 165 and 166(b) and (c)**

Sections 165 and 166(b) and (c) do not apply to OTC derivative transactions or credit derivative contracts for which an authorized institution has an IMM(CCR) approval except for transactions or contracts for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method.".

102. Section 168 amended (maturity under advanced IRB approach)

(1) Section 168(1)(a)(ii)—

Repeal

"(b)"

Substitute

"(b), (ba), (bb)".

(2) Section 168(1)(b)—

Repeal

"paragraph (c)"

Substitute

"paragraphs (ba), (bb) and (c)".

(3) After section 168(1)(b)—

Add

"(ba) if the exposure is a default risk exposure in respect of a netting set calculated using the IMM(CCR) approach and the original maturity of the longest-dated contract contained in the netting set is greater than one year, the M of the exposure is calculated by the use of Formula 20A instead of Formula 20;

(bb) subject to paragraph (c)—

(i) if the exposure is a default risk exposure in respect of a netting set calculated using the IMM(CCR) approach and all the transactions in the netting set have an original maturity of not more than one year—

(A) the effective maturity of each transaction in the netting set is calculated by the use of Formula 20; and

(B) the effective maturity of the netting set is calculated as the weighted average effective maturity of the transactions (using the notional amount of each transaction for weighting the maturity of the transactions within the netting set); and

(ii) if the netting set referred to in subparagraph (i) contains only one transaction, Formula 20 is used to calculate the M of the exposure;".

(4) Section 168(1)(c), after "paragraph (b)"—

Add

"or (bb)".

(5) Section 168(1)(d)—

Repeal

"if the exposure"

Substitute

"subject to paragraphs (ba) and (bb), if the exposure".

(6) Section 168(1)(d), after "the M"—

Add

"but the M must be not less than one year".

(7) Section 168(1), after Formula 20—

Add

"Formula 20A

Formula to be Used Instead of Formula 20 where Section 168(1)(ba) is Applicable

$$M = \frac{\sum_{k=1}^{t_k \le 1\,year} \text{Effective EE}_k \times \Delta t_k \times df_k + \sum_{t_k > 1\,year}^{maturity} EE_k \times \Delta t_k \times df_k}{\sum_{k=1}^{t_k \le 1\,year} \text{Effective EE}_k \times \Delta t_k \times df_k}$$

where—

(a) df_k is the risk-free discount factor for future time period t_k;

(b) Effective EE_k = effective EE at time t_k calculated in accordance with section 226G;

(c) maturity = the time when the transaction that has the longest residual maturity in the netting set matures; and

(d) $\Delta t_k = t_k - t_{k-1}$, which is the time interval between t_k and t_{k-1} when EE is calculated at dates that are not equally spaced over time.".

(8) Section 168(3)—

Repeal

"a relevant short-term exposure"

Substitute

"an exposure that falls within paragraph (a) or (b) of the definition of ***relevant short-term exposure*** in subsection (5)".

(9) Section 168—

Repeal subsection (4)

Substitute

"(4) Where an exposure of an authorized institution falls within paragraph (ab) of the definition of ***relevant short-term exposure*** in subsection (5)—

(a) subject to paragraphs (b) and (c), the institution must calculate the M of the exposure in accordance with subsection (1)(d) except that the M need not be equal to or greater than one year;

(b) subject to paragraph (c), if the exposure is a default risk exposure calculated using the IMM(CCR) approach, the institution must calculate the M in accordance with subsection (1)(bb) except that the M need not be equal to or greater than one year; and

(c) in determining the M, the institution must apply a minimum level of M equal to—

(i) 10 days for a netting set that contains OTC derivative transactions, credit derivative contracts or margin lending transactions;

(ii) 5 days for a netting set that contains repo-style transactions; and

(iii) 10 days for a netting set that contains transactions or contracts that fall within both subparagraphs (i) and (ii).".

(10) Section 168(5), definition of ***relevant short-term exposure***, paragraph (a)—

Repeal

"transaction or securities margin lending transaction which is fully or almost fully collateralized, or in respect of a repo-

style transaction with an original maturity of less than one year, where the documentation for the transaction"

Substitute

"transaction, credit derivative contract or margin lending transaction that is fully or almost fully collateralized, or in respect of a repo-style transaction with an original maturity of less than one year, where the documentation for the transaction or contract".

(11) Section 168(5), definition of ***relevant short-term exposure***, after paragraph (a)—

Add

"(ab) means an exposure in respect of a netting set in which all the transactions or contracts fall within the description in paragraph (a);".

(12) Section 168(5), definition of ***relevant short-term exposure***, paragraph (b)(ii)—

Repeal

"non-delivery-versus-payment transaction"

Substitute

"transaction that is entered into on a basis other than a delivery-versus-payment basis".

103. Section 180A added

After section 180—

Add

"**180A. Application of sections 181 and 182(b) and (c)**

Sections 181 and 182(b) and (c) do not apply to OTC derivative transactions or credit derivative contracts for which an authorized institution has an IMM(CCR) approval except

for transactions or contracts for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method.".

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

Section 182, Chinese text—

Repeal

everything after "EAD 的目的，"

Substitute

"計算該風險承擔的信貸等值數額如下 —

(a) 除(c)段另有規定外，如表 20 沒有指明該承擔，而該承擔不屬場外衍生工具交易或信用衍生工具合約，應用 100% CCF，並按照在作出所有必需的變通後的第 180 條的規定；

(b) 除(c)段另有規定外，如該承擔屬表 11 沒有指明的場外衍生工具交易或信用衍生工具合約，將該承擔視為屬表 11 第 5 項所指者，應用該項指明的有關 CCF，並按照在作出所有必需的變通後的第 181 條的規定；或

(c) 應用依據附表 1 第 2 部適用於該承擔的 CCF，並按照在作出所有必需的變通後的第 180 或 181 條(視情況所需而定)的規定。".

105. Section 183 amended (equity exposures—general)

(1) Section 183(1)—

Repeal

"subsection (2),"

Substitute

"subsections (2), (5), (6) and (7),".

(2) After section 183(4)—

Add

"(5) Subsection (6) applies to—

(a) an authorized institution's holdings of shares in any commercial entity if the holdings amount to more than 10% of the ordinary shares issued by that commercial entity; and

(b) an authorized institution's holdings of shares in any commercial entity if that commercial entity is an affiliate of the institution.

(6) Subject to section 43(1)(n), where the net book value of an authorized institution's holdings referred to in subsection (5)(a) or (b) exceeds 15% of its capital base as reported in its capital adequacy ratio return as at the immediately preceding calendar quarter end date, the institution must allocate a risk-weight of 1,250% to the EAD of that amount of the net book value of the holdings that exceeds that 15% in the calculation of the risk-weighted amount of that portion of the equity exposure.

(7) An authorized institution must calculate the risk-weighted amount of an equity exposure to a financial sector entity that is a significant capital investment by multiplying that portion of the EAD of the equity exposure that is not subject to deduction from the institution's CET1 capital under section 43(1)(p) by a risk-weight of 250%.".

106. Section 191 amended (PD/LGD approach—rating assignment horizon)

(1) Section 191(b)—

Repeal

"obligor; and"

Substitute

"obligor;".

(2) Section 191(c)—

Repeal

"obligations."

Substitute

"obligations; and".

(3) After section 191(c)—

Add

"(d) when estimating the PD for an obligor that is highly leveraged or whose assets are predominantly traded assets, ensure such estimate reflects the performance of the obligor's assets based on volatilities calibrated to data from periods of significant financial stress.".

107. Section 194 amended (PD/LGD approach—calculation of risk-weighted amount of equity exposures)

(1) Section 194(1)—

Repeal

"158, 159, 160, 161, 162, 163, 164,"

Substitute

"157A, 158, 159, 160, 161, 162, 163, 164, 164A,".

(2) Section 194(1)(b)(i), after "corporates"—

Add

"or section 157A in respect of exposures to obligors that fall within any of the descriptions in section 157A(1)(a) and (b)".

(3) Section 194(1)—

Repeal paragraph (g)

Substitute

"(g) if the risk-weight calculated in accordance with paragraphs (a), (b), (c) and (d) for an equity exposure of the institution plus the EL associated with the equity exposure multiplied by 12.5 exceeds 1,250%, the institution must allocate a risk-weight of 1,250% in the calculation of the risk-weighted amount of the equity exposure;".

(4) After section 194(1)(g)—

Add

"(ga) the institution must allocate a risk weight of 1,250% to the EL amount of an equity exposure calculated in accordance with section 223, and add the product of the 2 items to the risk-weighted amount of the institution's equity exposures; and".

108. Section 195 amended (cash items)

Section 195(1), Table 21, after item 4—

Add

"5.	Cash items that fall within paragraph (j) of the definition of ***cash items*** in section 139(1)	1,250%".

109. Section 202 substituted

Section 202—

Repeal the section

Substitute

"**202. Securities financing transactions**

(1) Where an authorized institution does not have an IMM(CCR) approval for SFTs, the institution must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) in accordance with subsection (6) and section 76A(4), (5), (6) and (7), and calculate the risk-weighted amount of its exposures to the assets underlying the SFTs in accordance with subsections (4) and (5) and sections 75 and 76.

(2) Subject to subsections (3), (4), (5) and (6), an authorized institution that has an IMM(CCR) approval for SFTs must apply sections 75, 76 and 76A(2) to all its SFTs.

(3) Where—

(a) an authorized institution has an IMM(CCR) approval for SFTs but the approval does not include SFTs that are long settlement transactions; or

(b) an authorized institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the methods referred to in section 10A(1)(b) for certain SFTs,

the institution must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) that are not, by virtue of the circumstance described in paragraph (a) or (b), subject to the IMM(CCR) approach, in accordance with subsection (6) and section 76A(4), (5), (6) and (7), and calculate the risk-weighted amount of its exposures to the assets underlying the SFTs in accordance with subsections (4) and (5) and sections 75 and 76.

(4) Where an authorized institution applies section 75 to an SFT booked in its banking book, the institution must determine the risk-weight to be allocated to its exposure under the SFT in accordance with—

(a) the risk-weight function for corporate, sovereign and bank exposures;

(b) the risk-weight function for retail exposures; or

(c) the market-based approach or the PD/LGD approach for equity exposures,

as the case may be, according to the nature of the asset underlying the SFT, and, where applicable, the IRB class within which the issuer of the asset falls.

(5) Where an authorized institution applies section 76 to an SFT booked in its trading book, the institution must determine the risk-weight to be allocated to its exposure under the SFT by reference to Part 8.

(6) Where an authorized institution applies section 76A(2) or 76A(4), (5), (6) and (7), as the case requires, to an SFT, the institution must determine the risk-weight to be allocated to its exposure under the SFT in accordance with—

(a) the risk-weight function for corporate, sovereign and bank exposures; or

(b) the risk-weight function for retail exposures,

as the case may be, according to the IRB class within which an exposure to the counterparty to the SFT falls and, where applicable, in accordance with the treatment of credit risk mitigation set out in Division 10.".

110. Section 203 amended (credit risk mitigation—general)

(1) Section 203(1)—

Repeal

"An"

Substitute

"Subject to subsections (1A) and (1B), an".

(2) After section 203(1)—

Add

"(1A) An authorized institution must not take into account the effect of recognized credit risk mitigation in accordance with this Division in calculating the risk-weighted amount of its exposures to the extent that the credit risk mitigating effect concerned has already been taken into account in the institution's estimates of any of the credit risk components of the applicable risk-weight function in accordance with these Rules other than this Division.

(1B) Where an authorized institution has bought credit protection for an exposure and the credit protection is in the form of a single-name credit default swap that falls within section 226J(1), the institution must not take into account the credit risk mitigating effect of the swap when calculating the risk-weighted amount of the exposure.".

111. Section 209 amended (recognized netting)

(1) Section 209(1)—

Repeal

"For"

Substitute

"Subject to subsections (3A) and (3B), for".

(2) Section 209(2)—

Repeal

"subsection (4)"

Substitute

"subsections (3A) and (4)".

(3) Section 209(2)(b)—

Repeal

"booked in the institution's trading book".

(4) Section 209(3)—

Repeal

"Where"

Substitute

"Subject to subsection (3B), where".

(5) After section 209(3)—

Add

"(3A) Where an authorized institution uses the IMM(CCR) approach to calculate the EAD of a netting set that contains OTC derivative transactions or credit derivative contracts, the institution must take into account the effect of any recognized netting in respect of OTC derivative transactions or credit derivative contracts in the manner set out in Part 6A instead of in the manner set out in subsections (1) and (2) except for transactions or contracts for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method.

(3B) Where an authorized institution uses the IMM(CCR) approach to calculate the EAD of a netting set that contains SFTs, the institution must take into account the effect of any recognized netting in respect of repo-style transactions in the manner set out in Part 6A instead of in the manner set out in subsections (1) and (3) except

for transactions for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the methods referred to in section 10A(1)(b).".

112. 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 99(1)(b)(vi) are deemed to read as—

"(vi) a corporate—

(A) that has an ECAI issuer rating; or

(B) to which the institution has an exposure that is assessed under the institution's rating system and assigned to an obligor grade with an estimate of PD,".".

113. 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)

(1) Section 216(1), after "subsections (2), (3),"—

Add

"(3A),".

(2) Section 216(2)(a)—

Repeal

"subsection (3)"

Substitute

"subsections (3) and (3A)".

(3) After section 216(3)—

Add

"(3A) Where the credit protection covered portion of an authorized institution's exposure is such credit protection covered portion by virtue of a recognized guarantee (***original guarantee***) and is the subject of a counter-guarantee given by a sovereign, the institution may, in respect of the credit protection covered portion, treat the counter-guarantee as if it were the original guarantee if—

(a) the counter-guarantee covers all credit risk elements of the exposure to the extent that it relates to the credit protection covered portion;

(b) the counter-guarantee is given in such terms that it can be called if—

(i) for any reason the obligor in respect of the exposure to which the original guarantee relates fails to make payments due in respect of the exposure; and

(ii) the original guarantee could be called;

(c) the original guarantee and the counter-guarantee meet all of the requirements for guarantees set out in section 98 (except that the counter-guarantee need not meet the requirements set out in section 98(b) and (c)); and

(d) the institution reasonably considers, and demonstrates to the satisfaction of the Monetary Authority, that—

(i) the cover of the counter-guarantee is adequate and effective; and

(ii) there is no evidence to suggest that the coverage of the counter-guarantee is less effective than that of a direct and explicit guarantee by the sovereign that gives the counter-guarantee.".

114. 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)

(1) Section 217(2)—

Repeal

"to subsection (3)"

Substitute

"to subsections (3) and (4)".

(2) Section 217(2)(a)—

Repeal

"and subsection (3)".

(3) After section 217(3)—

Add

"(4) Where the credit protection covered portion of an authorized institution's exposure is such credit protection covered portion by virtue of a recognized guarantee (***original guarantee***) and is the subject of a counter-guarantee given by a sovereign, the institution may, in respect of the credit protection covered portion, treat the counter-guarantee as if it were the original guarantee if—

(a) the counter-guarantee covers all credit risk elements of the exposure to the extent that it relates to the credit protection covered portion;

(b) the counter-guarantee is given in such terms that it can be called if—

(i) for any reason the obligor in respect of the exposure to which the original guarantee relates fails to make payments due in respect of the exposure; and

(ii) the original guarantee could be called;

(c) the original guarantee and the counter-guarantee meet all of the requirements for guarantees set out in section 98 (except that the counter-guarantee need not meet the requirements set out in section 98(b) and (c)); and

(d) the institution reasonably considers, and demonstrates to the satisfaction of the Monetary Authority, that—

(i) the cover of the counter-guarantee is adequate and effective; and

(ii) there is no evidence to suggest that the coverage of the counter-guarantee is less effective than that of a direct and explicit guarantee by the sovereign that gives the counter-guarantee.".

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

(1) Section 220(1)(b)—

Repeal

"core capital and supplementary capital in accordance with section 48(2)(b)"

Substitute

"CET1 capital in accordance with section 43(1)(i)".

(2) Section 220(1)(c)—

Repeal

"45(3)"

Substitute

"42(3)(c)".

(3) Section 220(1)(c)—

Repeal

"supplementary capital"

Substitute

"Tier 2 capital".

116. Section 221 amended (determination of eligible provisions for calculation of total eligible provisions)

Section 221—

Repeal

"45(2)"

Substitute

"42(2)".

117. Section 223 amended (equity exposures—PD/LGD approach)

(1) Section 223(1)—

Repeal

"deduct from its core capital and supplementary capital the EL amount of the equity exposures in accordance with section 48(2)(i)"

Substitute

"allocate a risk-weight of 1,250% to the EL amount of the equity exposures".

(2) Section 223(2)(b)—

Repeal

"maximum risk-weight set out in section 194(1)(g)(i)"

Substitute

"risk-weight set out in section 194(1)(g)".

(3) Section 223(2)(b), after "zero;"—

Add

"and".

(4) Section 223(2)—

Repeal paragraph (c).

118. Section 224 amended (application of scaling factor)

(1) Section 224—

Renumber the section as section 224(1).

(2) Section 224(1)—

Repeal

"An"

Substitute

"Subject to subsection (2), an".

(3) After section 224(1)—

Add

"(2) Subsection (1) does not apply to CVA risk-weighted amount.".

119. Section 225 amended (application of Division 13)

(1) Section 225(1)—

Repeal

"(5)"

Substitute

"(4A)".

(2) After section 225(4)—

Add

"(4A) For so long as the Monetary Authority is satisfied that the prevailing banking supervisory standards relating to capital issued by the Basel Committee require a capital floor to continue to be applied to entities using the Internal Ratings-Based Approach referred to in those standards after the third anniversary of the date on which the entities commenced using the Approach, the Monetary Authority may exercise, in relation to an authorized institution, any of the Monetary Authority's powers under subsection (6).".

(3) Section 225—

Repeal subsection (5)

Substitute

"(5) The powers referred to in subsections (2), (3) and (4) are that the Monetary Authority may, by notice in writing given to the authorized institution concerned—

(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; and

(c) specify, in the notice, an adjustment factor (not exceeding 100%) that is to be used by the institution for the purposes of calculating the capital floor in accordance with section 226.

(6) The powers referred to in subsection (4A) are that the Monetary Authority may, by notice in writing given to the authorized institution concerned—

(a) subject to subsection (7), 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) subject to subsection (7), again apply this Division to the institution for any period, or until the occurrence of any event, specified in the notice; and

(c) specify in the notice—

(i) subject to subsection (8), an adjustment factor (not exceeding 100%) that is to be used by the institution for the purposes of calculating the capital floor in accordance with section 226; and

(ii) any other adjustments to the method of calculating the capital floor set out in section 226 that the Monetary Authority considers reasonable to ensure that the capital floor is calculated substantially in accordance with the relevant prevailing banking supervisory standards relating to capital issued by the Basel Committee.

(7) The period for which the application of this Division is extended under subsection (6)(a), or for which this Division is applied again under subsection (6)(b), must end once the Monetary Authority is satisfied that the prevailing banking supervisory standards relating to capital issued by the Basel Committee no longer require a capital floor to continue to be applied to entities adopting the Internal Ratings-Based Approach referred to in those standards.

(8) The adjustment factor specified under subsection (6)(c)(i) must be set at a level considered reasonable by the Monetary Authority to ensure that the capital floor is calculated substantially in accordance with the relevant prevailing banking supervisory standards relating to capital issued by the Basel Committee.

(9) An authorized institution must comply with the requirements of a notice given to it under subsection (5) or (6).".

120. Section 226 amended (calculation of capital floor)

(1) Section 226(1)(a)(i), after "(3),"—

Add

"(3A),".

(2) Section 226—

Repeal subsection (2)

Substitute

"(2) Subject to section 225(6)(c)(ii), an authorized institution that starts to use the IRB approach during the transitional period must, for the purposes of subsection (1), calculate the floor amount of capital by multiplying the amount determined under subsection (3) during the transitional

period, or under subsection (3A) after that period, in respect of the institution by an adjustment factor determined under subsection (6).".

(3) Section 226(3), after "(2)"—

Add

"during the transitional period".

(4) After section 226(3)—

Add

"(3A) An authorized institution must arrive at the relevant amount for the purposes of subsection (2) after the transitional period by—

(a) determining its risk-weighted amount for credit risk by using—

(i) the BSC approach or, with the prior consent of the Monetary Authority, the STC approach for non-securitization exposures; and

(ii) the STC(S) approach for securitization exposures;

(b) determining its risk-weighted amount for market risk by using the calculation approach used by the institution for market risk;

(c) aggregating the amounts determined under paragraphs (a) and (b); and

(d) taking 8% of that aggregated amount and—

(i) adding to it all the deductions made from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital; and

(ii) subtracting from it the amount of regulatory reserve for general banking risks and

collective provisions that is included in the institution's Tier 2 capital.".

(5) Section 226(4)—

Repeal

"An"

Substitute

"Subject to section 225(6)(c)(ii), an".

(6) Section 226(5)(a)(i)—

Repeal

"and".

(7) Section 226(5)(a)(ii)—

Repeal

"exposures;"

Substitute

"exposures; and".

(8) After section 226(5)(a)(ii)—

Add

"(iii) the methodologies prescribed under Division 4 of Part 6A for exposures to CCPs;".

(9) Section 226(5)(e)(i)—

Repeal

"core capital and supplementary capital"

Substitute

"CET1 capital, Additional Tier 1 capital and Tier 2 capital".

(10) Section 226(5)(e)(ii)—

Repeal

"supplementary capital"

Substitute

"Tier 2 capital".

(11) After section 226(5)—

Add

"(5A) For the purposes of subsection (5)(a)(i), an authorized institution must treat the total amount of the CVA capital charge for its counterparties determined in accordance with Division 3 of Part 6A as the basis for determining the CVA risk-weighted amount of the institution under section 52(3)(a) and (3A), regardless of whether any of those counterparties falls within Part 4.".

(12) Section 226(6), after "225(5)(c)"—

Add

"and (6)(c)(i)".

(13) Section 226(7)—

Repeal

"An"

Substitute

"Subject to section 225(6)(c)(ii), an".

(14) Section 226(7)(e)(i)—

Repeal

"supplementary capital under section 45(3)"

Substitute

"Tier 2 capital under section 42(3)".

(15) Section 226(7)(e)(i)—

Repeal

"supplementary capital under section 48(2)(b)"

Substitute

"CET1 capital under section 43(1)(i)".

(16) After section 226(7)(e)(i)—

Add

"(ia) subtracting from it the portion of the institution's total regulatory reserve for general banking risks and collective provisions relevant to the IRB(S) approach that is included in the institution's Tier 2 capital under section 42(4);".

(17) Section 226(7)(e)(ii)—

Repeal

"core capital and supplementary capital"

Substitute

"CET1 capital, Additional Tier 1 capital and Tier 2 capital".

(18) Section 226(7)(e)(iii)—

Repeal

"supplementary capital"

Substitute

"Tier 2 capital".

(19) After section 226(7)—

Add

"(8) In this section—

core capital (核心資本) has the meaning given by section 1 of Schedule 4H;

supplementary capital (附加資本) has the meaning given by section 1 of Schedule 4H.".

121. Part 6A added

After Part 6—

Add

"Part 6A

Calculation of Counterparty Credit Risk

Division 1—General

226A. Interpretation of Part 6A

In this Part—

credit protection covered portion (信用保障涵蓋部分) has the meaning given by section 51(1);

cross-product net amount (跨產品淨額), in relation to any bilateral master agreements or transactions covered by a valid cross-product netting agreement, means a net sum of—

(a) the positive and negative close-out values of the individual bilateral master agreements; and

(b) the positive and negative mark-to-market values of the individual transactions;

current exposure (現行風險承擔), in relation to the use of the IMM(CCR) approach and a netting set with a counterparty, means the larger of—

(a) zero; or

(b) the market value of the transaction or transactions within the netting set that would be lost upon the default of the counterparty (but assuming no recovery on the value of that transaction or those transactions in bankruptcy);

CVA risk (CVA 風險), in relation to a transaction with a counterparty, means the risk of mark-to-market losses in the transaction arising from a change in the CVA for the counterparty;

effective EE (有效 EE) means effective expected exposure;

effective expected exposure (有效預期風險承擔), in relation to a netting set, means the amount calculated in accordance with section 226G;

eligible CVA hedge (合資格 CVA 對沖) means a hedge that falls within section 226T(1);

margin agreement (保證金協議) means a contractual agreement or provisions to an agreement under which one counterparty must supply collateral to a second counterparty when an exposure of that second counterparty to the first counterparty exceeds a specified level;

margin period of risk (保證金風險期間) means, in the event of counterparty default, the period from the last exchange of collateral covering a netting set until the netting set can be closed out and the resulting market risk is re-hedged;

margin threshold (保證金門檻), in relation to a margin agreement, means the maximum amount of unsecured exposure above which one of the parties to the agreement has the right to call for collateral;

minimum transfer amount (最低轉移額), in relation to a margin agreement, means an amount below which no transfer of collateral is made;

payment transaction (付款交易) means a transaction that executes a payment or fund transfer;

recognized credit derivative contract (認可信用衍生工具合約) has the meaning given by section 51(1), 105, 139(1) or 232A, as the case requires;

single-name contingent credit default swap (單一名稱或有信用違責掉期) means a single-name credit default swap the notional amount of which is referenced to the mark-to-market value of a transaction specified in the swap;

specific wrong-way risk (特定錯向風險) means the risk that arises when the exposure to a counterparty is positively correlated with the probability of default of the counterparty due to the nature of the transactions with the counterparty;

spot transaction (即期交易) means a single outright transaction involving the delivery of a security, commodity, foreign currency (including gold) or any other financial instrument against cash within a period that is regarded as an immediate delivery under the market standard for that particular security, commodity, currency or financial instrument at the current market price on the date of the transaction;

spread gamma (利差伽碼), in relation to the calculation of the CVA in respect of a counterparty, means a measure of the rate of change in delta to changes in the credit spread of the counterparty, where delta is the ratio of the change in the CVA to the change in the credit spread.

226B. Valid cross-product netting agreement

(1) In this Part, a reference to a valid cross-product netting agreement is to be construed, in relation to an authorized institution's transactions with a counterparty that are covered by an IMM(CCR) approval, as an agreement

(***netting arrangement***) in respect of which the conditions set out in subsection (2) are met.

(2) The conditions are—

(a) the netting arrangement—

(i) is in writing;

(ii) is bilateral between the institution and the counterparty;

(iii) permits netting across transactions of different product categories;

(iv) creates a single legal obligation for all individual bilateral master agreements and individual transactions covered by the netting arrangement; and

(v) provides, in effect, that the institution would have a single claim or obligation to receive or pay only the cross-product net amount, in the event that the counterparty to the netting arrangement, or a counterparty to whom the netting arrangement has been validly assigned, fails to comply with any obligation under any of the bilateral master agreements or transactions due to default, insolvency, bankruptcy, or similar circumstance;

(b) the institution has been given independent, written and reasoned legal advice that concludes with a high degree of certainty that, in the event of a challenge in a court of law or before an administrative authority, including a challenge resulting from default, insolvency, bankruptcy, or similar circumstance, the relevant court or administrative authority would find the institution's

exposure to be the cross-product net amount under—

(i) the law of the jurisdiction in which the counterparty is incorporated or the equivalent location in the case of non-corporate entities, and if a branch of the counterparty is involved, then also under the law of the jurisdiction in which the branch is located;

(ii) the law that governs the individual bilateral master agreements and individual transactions covered by the netting arrangement; and

(iii) the law that governs the netting arrangement;

(c) the legal advice referred to in paragraph (b) addresses the validity and enforceability of the netting arrangement under its terms and the impact of the netting arrangement on the material provisions of any individual bilateral master agreement covered by the netting arrangement;

(d) the legal advice referred to in paragraph (b)—

(i) is generally recognized by the legal community in Hong Kong; or

(ii) is a memorandum of law that addresses all relevant issues in a reasoned manner;

(e) the institution establishes and maintains procedures to verify that any transaction that is covered by the netting arrangement and to be included in a netting set is covered by legal advice described in paragraphs (b), (c) and (d);

(f) the institution establishes and maintains procedures to monitor developments in any law relevant to the netting arrangement in order to ensure that the

netting arrangement continues to satisfy the conditions set out in this subsection applicable to it;

(g) the netting arrangement is not subject to a provision that permits the non-defaulting counterparty to make only limited payment, or no payment at all, to the defaulter or the estate of the defaulter, regardless of whether the defaulter is a net creditor under the netting arrangement;

(h) each bilateral master agreement covered by the netting arrangement falls within the definition of ***valid bilateral netting agreement*** in section 2(1) and the credit risk mitigation for each transaction covered by the netting arrangement meets the applicable requirements for the recognition of credit risk mitigation set out in Part 4, 5 or 6, as the case may be;

(i) the institution maintains in its files documentation adequate to support the nettings under the netting arrangement;

(j) the institution measures and manages its aggregate credit exposure to the counterparty to the netting arrangement on a net basis; and

(k) the institution aggregates credit exposures to the counterparty to the netting arrangement to arrive at a single legal exposure across transactions covered by the netting arrangement and that aggregation is factored into credit limits and internal capital processes.

(3) For the purposes of subsection (2)—

(a) repo-style transactions;

(b) margin lending transactions; and

(c) derivative contracts,

are to be treated as different product categories.

Division 2—IMM(CCR) Approach

226C. Application of Division 2

(1) This Division applies to an authorized institution that has an IMM(CCR) approval for calculating the default risk exposures in respect of contracts or transactions falling within any one or more of the categories referred to in section 10B(1)(a), (b) and (c).

(2) Unless otherwise expressly permitted by, and in accordance with, another provision of these Rules, an authorized institution must calculate its default risk exposures in respect of all the transactions (however described) that are covered by its IMM(CCR) approval in accordance with this Division.

226D. Calculation of IMM(CCR) risk-weighted amount at portfolio level under IMM(CCR) approach

(1) An authorized institution must, for each of its counterparties—

(a) calculate the sum of its default risk exposures (and outstanding default risk exposures in the case of netting sets that contain OTC derivative transactions or credit derivative contracts) in respect of all the netting sets with the counterparty based on effective EPEs that are estimated using current market data, and multiply the sum so calculated by the risk-weight applicable to the counterparty to obtain the risk-weighted amount of the sum (***risk-weighted amount A***); and

(b) subject to subsection (3), calculate the sum of its default risk exposures (and outstanding default risk exposures in the case of netting sets that contain OTC derivative transactions or credit derivative contracts) in respect of all the netting sets with the counterparty based on effective EPEs that are estimated using a stress calibration as set out in section 3(f) of Schedule 2A, and multiply the sum so calculated by the risk-weight applicable to the counterparty to obtain the risk-weighted amount of the sum (***risk-weighted amount B***).

(2) An authorized institution must, after completing the calculations required under subsection (1)—

(a) aggregate all of its counterparties' risk-weighted amount A;

(b) aggregate all of its counterparties' risk-weighted amount B; and

(c) determine the IMM(CCR) risk-weighted amount as the greater of the 2 aggregates.

(3) The calibration referred to in subsection (1)(b) must be a single consistent stress calibration for the whole portfolio of counterparties concerned.

(4) For the purposes of subsection (1), an authorized institution that uses the STC approach or BSC approach to calculate its credit risk for non-securitization exposures must risk-weight its default risk exposures and, if applicable, outstanding default risk exposures net of specific provisions.

226E. Calculation of default risk exposure at netting set level under IMM(CCR) approach

(1) Subject to subsection (2) and sections 226I and 226J(3) and (4), an authorized institution must use Formula 23A to calculate the default risk exposure of a netting set.

Formula 23A

Calculation of Default Risk Exposure at Netting Set Level under IMM(CCR) Approach

Default risk exposure = $\alpha \times$ effective EPE

where—

$\alpha = 1.4$.

(2) Subject to subsection (3), the Monetary Authority may, by notice in writing given to an authorized institution, require the institution to use a higher α in Formula 23A based on the risk profile of the institution's counterparty credit risk exposures.

(3) Factors that the Monetary Authority may take into account for the purposes of deciding whether or not to give a notice under subsection (2) to an authorized institution include—

(a) the granularity of the institution's counterparties;

(b) the level of exposures to general wrong-way risk (being the risk that arises when the probability of default of counterparties is positively correlated with general market risk factors);

(c) the correlation of market values across the institution's counterparties; and

(d) other institution-specific characteristics of the institution's counterparty credit risk exposures.

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

226F. Calculation of effective EPE

Subject to section 226K, an authorized institution must use Formula 23B to calculate the effective EPE of a netting set.

Formula 23B

Calculation of Effective EPE of Netting Set

$$\text{Effective EPE} = \sum_{k=1}^{\min(1\text{ year, maturity})} \text{effective EE}_{t_k} \times \Delta t_k$$

where—

effective EE_{t_k} = effective EE at time t_k calculated in accordance with section 226G;

maturity = the time when the transaction that has the longest residual maturity in the netting set matures; and

Δt_k = $t_k - t_{k-1}$, which is the time interval between t_k and t_{k-1} when EE is calculated at dates that are not equally spaced over time.

226G. Calculation of effective EE

(1) An authorized institution must use Formula 23C to calculate the effective EE at time t_k in respect of a netting set.

Formula 23C

Calculation of Effective EE at Time t_k in Respect of Netting Set

$$\text{Effective EE}_{t_k} = \max\left(\text{effective EE}_{t_{k-1}}, \text{EE}_{t_k}\right)$$

where—

EE_{t_k} = EE at time t_k calculated in accordance with section 226H.

(2) In using Formula 23C—

(a) the current date is denoted as t_0; and

(b) effective EE_{t_0} equals current exposure.

226H. Calculation of EE

(1) An authorized institution must calculate the EE of a netting set at any particular future date (being a date before the transaction that has the longest residual maturity in the netting set matures) as the average of the distribution of exposures at that particular future date.

(2) An authorized institution must estimate the distribution of exposures at any particular future date by—

(a) estimating the probability distribution of the net market values of the transactions within the netting set at that future date, given the realized market value of those transactions up to the present time; and

(b) setting all negative net market values obtained in the estimation referred to in paragraph (a) to zero.

(3) Subject to subsection (4), an authorized institution may, when estimating the probability distribution referred to in subsection (2)(a), include any collateral that—

(a) falls within the description in section 80(1)(a), (b), (c) or (d); and

(b) satisfies the requirements under section 77(a), (b), (c), (d), (e), (ea) and (f),

except collateral in the form of debt securities that, if treated as an on-balance sheet exposure of the institution, would fall within the definition of ***re-securitization exposure*** in section 2(1).

(4) Subsection (3) does not apply in the case of an authorized institution that has an IMM(CCR) approval that prohibits the institution from using that subsection.

226I. Treatments for certain credit derivative contracts

An authorized institution must treat the default risk exposure in respect of a credit derivative contract as zero if—

(a) the contract is a credit default swap in which the institution is the protection seller and regulatory capital calculated in accordance with Part 4, 5 or 6, as the case may be, has been provided for the institution's exposure to the credit risk of the reference obligation underlying the swap; or

(b) the institution is the protection buyer in the contract and the credit risk mitigation effect of the contract has been recognized and taken into account in

accordance with Divisions 9 and 10 of Part 4, Divisions 7 and 8 of Part 5, Division 10 of Part 6, or Division 3, 5 or 6 of Part 7, for the purposes of the calculation of the risk-weighted amount of the exposure to which credit protection is provided by the contract.

226J. Treatments for transactions with specific wrong-way risk

(1) Where in respect of an authorized institution's transaction with a counterparty there is—

(a) a legal connection between the counterparty and the issuer of the assets underlying the transaction (or, where the transaction is a credit derivative contract, the reference entity specified in that contract); and

(b) specific wrong-way risk,

the institution must treat the transaction as a separate netting set from its other netting sets with the counterparty.

(2) For the purposes of subsection (1), a legal connection is considered to exist if the counterparty and the issuer (or the reference entity in the case of a credit derivative contract)—

(a) would constitute a single risk because one of them, directly or indirectly, has control over the other; or

(b) would be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other would be likely to encounter funding or repayment difficulties.

(3) An authorized institution must, if a single-name credit default swap falls within subsection (1), set the default risk exposure to the counterparty in respect of that swap as equal to the full expected loss in the remaining fair value of the reference obligations specified in that swap (being the amount determined after recognizing any market value that has already been lost and any expected recoveries, assuming the reference entity concerned is in liquidation).

(4) An authorized institution must, if—

(a) a transaction is referenced to a single issuer;

(b) the transaction is not a single-name credit default swap; and

(c) the transaction falls within subsection (1),

set the default risk exposure to the counterparty in respect of that transaction as equal to the value of the transaction estimated under the assumption of a jump-to-default of the asset underlying the transaction.

226K. Treatments for margin agreements

(1) An authorized institution must, for a netting set that is subject to a margin agreement, determine the effective EPE in respect of the netting set by—

(a) using the effective EE calculated from Formula 23C without taking into account the margin agreement;

(b) if the netting set is subject to daily remargining and daily mark-to-market, using the shortcut method set out in section 226L; or

(c) subject to subsections (2) and (3), if the internal model used by the institution captures the effects of

margin agreements when estimating EE, using the EE generated by the model directly in Formula 23C.

(2) Subsection (1)(c) does not apply in the case of an authorized institution that has an IMM(CCR) approval that prohibits the institution from using that subsection.

(3) An authorized institution must not, for the purposes of subsection (1)(c), recognize, in its default risk exposure calculations for OTC derivative transactions, credit derivative contracts and SFTs, the effect of collateral that is not cash of the same currency as the default risk exposure unless—

(a) the institution models collateral jointly with the exposure in the calculations; or

(b) if the institution is not able to meet the requirement in paragraph (a), it applies standard supervisory haircuts (within the meaning of section 51(1)) to the collateral.

(4) An authorized institution must not capture the effect of a reduction of default risk exposure due to any clauses of a collateral agreement that require receipt of collateral when the credit quality of the counterparty concerned deteriorates.

226L. Shortcut method

(1) Under the shortcut method, the effective EPE to a counterparty with a margin agreement equals the lesser of—

(a) the effective EPE calculated without taking into account any collateral held or posted by the authorized institution as margins under the margin agreement, plus any collateral that has been posted

by the institution to the counterparty as an independent amount or initial margin; or

(b) an add-on calculated in accordance with subsection (2), plus the larger of—

(i) the current exposure, net of all collateral currently held and taking into account all collateral posted by the authorized institution but excluding any collateral called or in dispute; or

(ii) the largest net exposure, including all collateral held or posted by the authorized institution under the margin agreement, that would not trigger a collateral call, being an amount that must reflect all applicable margin thresholds, minimum transfer amounts, independent amounts and initial margins under the margin agreement.

(2) An authorized institution must use Formula 23D to calculate the add-on referred to in subsection (1)(b).

Formula 23D

Calculation of Add-on

$$E[\max(\Delta MtM, 0)]$$

where—

(a) $E[\ldots]$ is the expectation (being the average over scenarios); and

(b) ΔMtM is the possible change of the mark-to-market value of the transactions in the netting set during the margin period of risk but—

(i) changes in the value of collateral need to be reflected using the applicable standard supervisory haircuts (within the meaning of section 51(1)) with no collateral payments assumed during the margin period of risk; and

(ii) the margin period of risk must be subject to adjustment as set out in section 226M.

(3) In this section—

initial margin (開倉保證金), in relation to a CCP and its clearing member, means the collateral posted by the clearing member or the clearing member's client to the CCP to mitigate the potential future exposure of the CCP to the clearing member arising from the possible future change in the value of the clearing member's transactions or the client's transactions, as the case may be.

226M. Margin period of risk

(1) Subject to subsections (2), (3) and (5), if a netting set is subject to a margin agreement and the transactions in the netting set are subject to daily remargining and daily mark-to-market, an authorized institution must subject the margin period of risk used for calculating the default risk exposure in respect of the netting set to the following supervisory floors—

(a) 5 business days if the netting set consists of repo-style transactions only;

(b) 10 business days in any other case.

(2) An authorized institution must, if a netting set contains more than 5 000 transactions at any point in time during a quarter, impose a supervisory floor of 20 business days on the margin period of risk for that netting set for the following quarter.

(3) An authorized institution must, if a netting set contains at least one transaction—

(a) that involves illiquid collateral; or

(b) that is an OTC derivative transaction or credit derivative contract that cannot be easily replaced,

impose a supervisory floor of 20 business days on the margin period of risk for that netting set.

(4) For the purposes of subsection (3)—

(a) an authorized institution must determine whether or not collateral is illiquid collateral and whether or not an OTC derivative transaction or credit derivative contract is one that cannot be easily replaced—

(i) on the assumption of stressed market conditions; and

(ii) taking into consideration whether, for the collateral, transaction or contract concerned, there are continuously active markets where a counterparty would, within 2 or fewer business days, obtain multiple price quotations that would not move the market or represent a price reflecting a market discount (in the case of collateral) or premium (in the case of an OTC derivative transaction or credit derivative contract);

(b) a transaction cannot be easily replaced if—

(i) the transaction is not marked-to-market daily; or

(ii) the fair value of the transaction, or the fair value of the asset underlying the transaction, is determined by models using inputs that are not observable in the market; and

(c) an authorized institution must consider whether the transactions undertaken by it or the assets it holds as collateral are concentrated in a particular counterparty, and if that counterparty exited the market precipitously, whether the institution would be able to replace those transactions.

(5) An authorized institution must, if it has experienced more than 2 margin call disputes over a particular netting set during the previous 2 quarters and the disputes have lasted longer than the margin period of risk applicable to that netting set under subsection (1), (2) or (3), as the case requires, use a margin period of risk that is at least double the supervisory floor applicable to that netting set under that subsection for the subsequent 2 quarters.

(6) An authorized institution must, for a netting set that is not subject to daily remargining, set the margin period of risk at not less than the margin period of risk calculated by using Formula 23E.

Formula 23E

Calculation of Margin Period of Risk for Netting Set Not Subject to Daily Remargining

$$\text{Margin period of risk} = F + N - 1$$

where—

F = the supervisory floor specified in subsection (1), (2) or (3), as the case requires, that is applicable to the netting set; and

N = the actual number of days between each remargining of the netting set.

Division 3—Calculation of CVA Capital Charge

226N. Transactions and contracts to be covered

An authorized institution must calculate a CVA capital charge for all its OTC derivative transactions, credit derivative contracts and (if required by the Monetary Authority under section 10A(6)) SFTs, except the transactions and contracts specified in Schedule 1A.

226O. Application of sections 226P and 226Q

Sections 226P and 226Q apply to an authorized institution that is eligible to use the advanced CVA method to calculate the CVA capital charge.

226P. Advanced CVA method

(1) An authorized institution must calculate its CVA capital charge—

(a) by using the VaR model approved by the Monetary Authority under section 18 for calculating the market risk capital charge for specific risk for interest rate exposures under the IMM approach; and

(b) in accordance with this section and section 226Q.

(2) An authorized institution must use the VaR model in such a way that—

(a) it models the impact of changes in the credit spreads of counterparties on the CVAs for the counterparties; and

(b) it does not model the sensitivity of the CVAs to changes in other market factors (including the value of the asset, commodity, exchange rate or interest rate to which a derivative contract is referenced).

(3) An authorized institution may reduce its CVA capital charge by taking into account the effect of any eligible CVA hedges.

(4) For the purposes of subsections (6), (8), (9), (10), (11), (12) and (13), an authorized institution must, to avoid double counting, ensure that the EEs that are used as inputs in Formula 23F, 23G, 23H or 23I have not been adjusted for any credit risk or CVA risk mitigating effect of any eligible CVA hedges that the institution intends to use to reduce its CVA capital charge.

(5) For the purposes of subsections (6), (8), (9), (10), (11), (12) and (13), if an authorized institution has purchased credit protection in the form of a recognized credit derivative contract from a protection seller for a default risk exposure (***protected exposure***) to a counterparty, the institution must, when using Formula 23F, 23G, 23H or 23I, deduct the credit protection covered portion of the protected exposure from the EE profile of the counterparty and add the credit protection covered portion to the EE profile of the protection seller for all valuation dates (that is t_i) that are not greater than the maturity of the credit protection.

(6) An authorized institution must generate all the inputs used in its approved VaR model referred to in subsection (1)(a) based on Formula 23F.

Formula 23F

Inputs to be Used in Approved VaR Model Referred to in Section 226P(1)

$$CVA = \left(LGD_{MKT}\right)\cdot \sum_{i=1}^{T} Max\left(0;\exp\left(-\frac{s_{i-1}\cdot t_{i-1}}{LGD_{MKT}}\right)-\exp\left(-\frac{s_i\cdot t_i}{LGD_{MKT}}\right)\right)\cdot \left(\frac{EE_{i-1}\cdot D_{i-1}+EE_i\cdot D_i}{2}\right)$$

where—

(a) CVA is the CVA for a particular counterparty;

(b) t_i is the time of the i-th revaluation, starting from $t_0 = 0$;

(c) t_T is the longest contractual residual maturity across the netting sets with the counterparty;

(d) s_i is the credit spread of the counterparty at time t_i but—

(i) the credit default swap (CDS) spread of the counterparty must be used whenever such a spread is available; and

(ii) if the CDS spread is not available, a proxy spread must be used that is

appropriate to the counterparty having regard to the credit rating, industry and geographical location of the counterparty;

(e) LGD_{MKT} is the loss given default of the counterparty determined based on the spread of a market instrument of the counterparty but, if a market instrument of the counterparty is not available, a proxy spread must be used that is appropriate to the counterparty having regard to the credit rating, industry and geographical location of the counterparty;

(f) EE_i is the EE to the counterparty at time t_i, that is the sum of the individual EEs of all the netting sets with the counterparty; and

(g) D_i is the default risk-free discount factor at time t_i, where $D_0 = 1$.

(7) An authorized institution using the IRB approach must not use the LGD estimated for a counterparty under the IRB approach as the LGD_{MKT} for that counterparty.

(8) Where an authorized institution's approved VaR model referred to in subsection (1)(a) is based on full re-pricing, the institution must use Formula 23F to calculate the CVA.

(9) Where an authorized institution's approved VaR model referred to in subsection (1)(a) is based on credit spread sensitivities for specific tenors, the institution must generate each credit spread sensitivity based on Formula 23G for $i < T$ and on Formula 23H for $i = T$.

Formula 23G

Calculation of Credit Spread Sensitivity for Specific Tenors for $i < T$

$$CS01_i = 0.0001 \cdot t_i \cdot \exp\left(-\frac{s_i \cdot t_i}{LGD_{MKT}}\right) \cdot \left(\frac{EE_{i-1} \cdot D_{i-1} - EE_{i+1} \cdot D_{i+1}}{2}\right)$$

where—

(a) $CS01_i$ = regulatory sensitivity of CVA to 1 basis point change in credit spread at time t_i; and

(b) other components have the same meaning as in Formula 23F.

Formula 23H

Calculation of Credit Spread Sensitivity for Specific Tenors for $i = T$

$$CS01_T = 0.0001 \cdot t_T \cdot \exp\left(-\frac{s_T \cdot t_T}{LGD_{MKT}}\right) \cdot \left(\frac{EE_{T-1} \cdot D_{T-1} + EE_T \cdot D_T}{2}\right)$$

where—

(a) $CS01_T$ = regulatory sensitivity of CVA to 1 basis point change in credit spread at time t_T; and

(b) other components have the same meaning as in Formula 23F.

(10) Where an authorized institution's approved VaR model referred to in subsection (1)(a) is based on credit spread sensitivities to parallel shifts in credit spreads, the institution must generate the credit spread sensitivity based on Formula 23I.

Formula 23I

Calculation of Credit Spread Sensitivity to Parallel Shifts

$$CS01 = 0.0001 \cdot \sum_{i=1}^{T}\left(t_i \cdot \exp\left(-\frac{s_i \cdot t_i}{LGD_{MKT}}\right) - t_{i-1} \cdot \exp\left(-\frac{s_{i-1} \cdot t_{i-1}}{LGD_{MKT}}\right)\right) \cdot \left(\frac{EE_{i-1} \cdot D_{i-1} + EE_i \cdot D_i}{2}\right)$$

where—

(a) $CS01$ = regulatory sensitivity of CVA to 1 basis point parallel shift in credit spreads; and

(b) other components have the same meaning as in Formula 23F.

(11) Where an authorized institution's approved VaR model referred to in subsection (1)(a) is based on spread gammas, the institution must calculate the spread gammas based on Formula 23F.

(12) An authorized institution using the shortcut method set out in section 226L must calculate the CVA capital charge for a counterparty by—

(a) using Formula 23F, 23G, 23H or 23I, as the case requires; and

(b) applying to Formula 23F, 23G, 23H or 23I, as the case requires, a constant EE profile with EE set equal to the effective EPE determined under the shortcut method for a maturity equal to the greater of—

(i) half of the longest residual maturity occurring in the netting set concerned; or

(ii) the weighted average residual maturity of all transactions in the netting set (using the notional amount of each transaction for weighting the maturity).

(13) An authorized institution must include transactions which are not covered by its IMM(CCR) approval or for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method or the methods referred to in section 10A(1)(b) in its CVA capital charge calculation under the advanced CVA method by assuming a constant EE profile for such transactions for the purposes of Formula 23F, 23G, 23H or 23I, as the case requires, with EE set equal to the default risk exposure as calculated under the current exposure method or any of the methods referred to in section 10A(1)(b) for a residual maturity equal to the greater of—

(a) half of the longest residual maturity occurring in the netting set concerned; or

(b) the weighted average residual maturity of all transactions in the netting set (using the notional amount of each transaction for weighting the maturity).

(14) An authorized institution must include transactions for which the internal model used by it does not produce an EE profile in its CVA capital charge calculation under the advanced CVA method in accordance with the method set out in subsection (13).

226Q. Specific requirements relating to VaR under advanced CVA method

(1) An authorized institution using the advanced CVA method to calculate the CVA capital charge must—

(a) ensure that the CVA capital charge covers general and specific credit spread risks and, if the institution has the Monetary Authority's approval to calculate incremental risk charge for transactions that are subject to the CVA capital charge, excludes the incremental risk charge;

(b) determine the CVA capital charge as the sum of a VaR and a stressed VaR generated by the model referred to in section 226P(1)(a) used by the institution; and

(c) determine the VaR and the stressed VaR referred to in paragraph (b) in accordance with the quantitative standards set out in subsections (2) and (3) and section 1(n) of Schedule 3.

(2) An authorized institution must—

(a) calculate the VaR based on EEs that are estimated using parameters calibrated to current market data; and

(b) determine the VaR as the higher of—

(i) the institution's VaR as at the last trading day; or

(ii) the average VaR for the last 60 trading days multiplied by a multiplication factor determined in the manner set out in section 319(1).

(3) An authorized institution must—

(a) calculate the stressed VaR based on EEs that are estimated using a stress calibration as set out in section 3(f)(i) of Schedule 2A; and

(b) determine the stressed VaR as the higher of—

(i) the institution's latest available stressed VaR; or

(ii) the average stressed VaR for the last 60 trading days multiplied by a multiplication factor determined in the manner set out in section 319(4).

(4) For the purposes of subsection (3), the period of stress must be the most severe one-year stress period within the 3-year period used for the stress calibration.

226R. Application of section 226S

Section 226S applies to an authorized institution that is required to use the standardized CVA method to calculate the CVA capital charge.

226S. Standardized CVA method

(1) An authorized institution must use Formula 23J to calculate the CVA capital charge for a portfolio of counterparties.

Formula 23J

Calculation of CVA Capital Charge under Standardized CVA Method

$$K = 2.33 \cdot \sqrt{h} \cdot \sqrt{\left(\sum_i 0.5 \cdot w_i \cdot \left(M_i \cdot EAD_i^{total} - M_i^{hedge} \cdot B_i \right) - \sum_{ind} w_{ind} \cdot M_{ind} \cdot B_{ind} \right)^2 + A}$$

$$A = \sum_i 0.75 \cdot w_i^2 \cdot \left(M_i \cdot EAD_i^{total} - M_i^{hedge} \cdot B_i \right)^2$$

where—

(a) h is the one-year risk horizon (in units of a year) and $h = 1$;

(b) w_i is the weight applicable to counterparty "i", which is determined by mapping the ECAI issuer rating of the counterparty to one of the 7 weights in Table 23A or 23B, whichever is applicable, but, where a counterparty does not have an ECAI issuer rating—

(i) subject to subparagraph (iii), an authorized institution that uses the IRB approach to calculate its credit risk for non-securitization exposures to the counterparty must map the internal rating of the counterparty to one of the ECAI issuer ratings in Table 23A based on a mapping scheme approved in writing by the Monetary Authority in order to determine the weight applicable to the counterparty;

(ii) an authorized institution that uses the STC approach or BSC approach to calculate its credit risk for non-securitization exposures to the counterparty must assign a weight of 1% to the counterparty;

(iii) the Monetary Authority may, by notice in writing given to an authorized institution that uses the IRB approach to calculate its credit risk for non-securitization exposures to a counterparty but has not obtained the approval referred to in subparagraph (i), specify a transitional period during which the institution is permitted to apply subparagraph (ii) to the counterparty or is required to assign a weight specified in the notice to the counterparty, and the institution must comply with the notice;

(c) EAD_i^{total} is the default risk exposure (without any adjustment for CVA losses) of a netting set with counterparty "i" with the effect of collateral taken into account in such a manner as permitted under the IMM(CCR) approach, the current exposure method or the methods referred to in section 10A(1)(b), as the case may be, but, for the purposes of calculating EAD_i^{total} —

(i) subject to subparagraph (ii), if an authorized institution does not have an IMM(CCR) approval for using the IMM(CCR) approach to calculate the default risk exposure of the netting set, the institution must discount the default

risk exposure of that netting set by a factor that is equal to $(1-\exp(-0.05M_i))/(0.05M_i)$;

(ii) if the default risk exposure of the netting set is calculated by using the IMM(CCR) approach, the discount referred to in subparagraph (i) is not required;

(d) B_i is the notional amount of a single-name credit default swap, with counterparty "*i*" as the reference entity, purchased for hedging CVA risk but that notional amount must be discounted by a factor that is equal to $\left(1-\exp\left(-0.05M_i^{hedge}\right)\right)/\left(0.05M_i^{hedge}\right)$;

(e) B_{ind} is the notional amount of an index credit default swap on index "*ind*" purchased for hedging CVA risk but—

(i) the authorized institution must discount the notional amount by a factor that is equal to $(1-\exp(-0.05M_{ind}))/(0.05M_{ind})$;

(ii) if counterparty "*i*" is a constituent of index "*ind*", the notional amount attributable to that counterparty (based on its weight in the index credit default swap concerned) may, with the prior consent of the Monetary Authority, be subtracted by the authorized institution from the notional amount of the swap and be treated by the institution as a single-name credit default swap on that counterparty (that is, may be included in

the calculation of B_i) with maturity based on the maturity of index "*ind*";

(f) w_{ind} is the weight applicable to the index credit default swap referred to in paragraph (e), which is determined by mapping index "*ind*" to one of the 7 weights in Table 23A based on the average spread of index "*ind*";

(g) M_i is the effective maturity of a netting set with counterparty "*i*" but—

(i) if the institution has an IMM(CCR) approval for using the IMM(CCR) approach to calculate the default risk exposure of the netting set, it must calculate M_i as the greater of one year or the M calculated in accordance with section 168(1)(ba);

(ii) if the institution does not have an IMM(CCR) approval for using the IMM(CCR) approach to calculate the default risk exposure of the netting set, it must calculate M_i as the greater of one year or the M calculated in accordance with section 168(1)(b) or (d), as the case requires; and

(iii) the institution must not cap M_i at 5 years for the purposes of calculating the CVA capital charge;

(h) M_i^{hedge} is the maturity of the credit default swap referred to in paragraph (d); and

(i) M_{ind} is the maturity of the credit default swap referred to in paragraph (e).

Table 23A

Ratings Applicable to All Counterparties

Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.	Weight
AAA	Aaa	AAA	AAA	AAA	0.7%
AA+	Aa1	AA+	AA+	AA+	0.7%
AA	Aa2	AA	AA	AA	
AA-	Aa3	AA-	AA-	AA-	
A+	A1	A+	A+	A+	0.8%
A	A2	A	A	A	
A-	A3	A-	A-	A-	
BBB+	Baa1	BBB+	BBB+	BBB+	1.0%
BBB	Baa2	BBB	BBB	BBB	
BBB-	Baa3	BBB-	BBB-	BBB-	
BB+	Ba1	BB+	BB+	BB+	2.0%
BB	Ba2	BB	BB	BB	
BB-	Ba3	BB-	BB-	BB-	
B+	B1	B+	B+	B+	3.0%
B	B2	B	B	B	
B-	B3	B-	B-	B-	
CCC+	Caa1	CCC	CCC+	CCC	10.0%
CCC	Caa2		CCC		
CCC-	Caa3		CCC-		

Table 23B

Ratings Applicable to Counterparties that are Corporates Incorporated in India

Credit Analysis and Research Limited	CRISIL Limited	ICRA Limited	Weight
CARE AAA (Is)	CRISIL AAA	IrAAA	0.7%
CARE AA+ (Is)	CRISIL AA+	IrAA+	0.8%
CARE AA (Is)	CRISIL AA	IrAA	
CARE AA- (Is)	CRISIL AA-	IrAA-	
CARE A+ (Is)	CRISIL A+	IrA+	0.8%
CARE A (Is)	CRISIL A	IrA	
CARE A- (Is)	CRISIL A-	IrA-	
CARE BBB+ (Is)	CRISIL BBB+	IrBBB+	1.0%
CARE BBB (Is)	CRISIL BBB	IrBBB	
CARE BBB- (Is)	CRISIL BBB-	IrBBB-	
CARE BB+ (Is)	CRISIL BB+	IrBB+	2.0%
CARE BB (Is)	CRISIL BB	IrBB	
CARE BB- (Is)	CRISIL BB-	IrBB-	
CARE B+ (Is)	CRISIL B+	IrB+	3.0%
CARE B (Is)	CRISIL B	IrB	
CARE B- (Is)	CRISIL B-	IrB-	
CARE C+ (Is)	CRISIL C+	IrC+	10.0%
CARE C (Is)	CRISIL C	IrC	
CARE C- (Is)	CRISIL C-	IrC-	

(2) For the purposes of paragraph (b) in Formula 23J, if counterparty "*i*" has more than one ECAI issuer rating the use of which would result in the allocation of different weights to counterparty "*i*" under Table 23A or 23B, an authorized institution must use any one of those ratings except the one or more of those ratings that would result in the allocation by the institution of the lowest of those different weights.

(3) An authorized institution must, if there is more than one netting set with counterparty "*i*", construe the expression $M_i \cdot EAD_i^{total}$ in Formula 23J as the sum of the quantities $M_i \cdot EAD_i^{total}$ calculated for the netting sets.

(4) An authorized institution must, if there is more than one single-name credit default swap purchased for hedging the CVA risk in respect of counterparty "*i*", construe the expression $M_i^{hedge} \cdot B_i$ in Formula 23J as the sum of the quantities $M_i^{hedge} \cdot B_i$ calculated for the swaps.

(5) An authorized institution must, if there is more than one index credit default swap purchased for hedging the CVA risk, construe the expression $M_{ind} \cdot B_{ind}$ in Formula 23J as the sum of the quantities $M_{ind} \cdot B_{ind}$ calculated for the swaps.

(6) An authorized institution—

(a) subject to paragraph (b), must not include a CVA hedge in its use of Formula 23J unless it is an eligible CVA hedge;

(b) must, to avoid double counting in EAD_i^{total} in that Formula, ensure that EAD_i^{total} has not been adjusted for any credit risk or CVA risk mitigating effect of any eligible CVA hedges that the institution intends to use to reduce its CVA capital charge.

(7) If an authorized institution has purchased credit protection in the form of a recognized credit derivative contract from a protection seller for a default risk exposure (***protected exposure***) to a counterparty, the institution must deduct the product of the credit protection covered portion of the protected exposure and the residual maturity of the credit protection from the $M \cdot EAD^{total}$ of the counterparty and add the product to the $M \cdot EAD^{total}$ of the protection seller.

226T. Eligible CVA hedges

(1) An authorized institution, when calculating a CVA capital charge, may take hedges into account only if—

(a) the hedges are used and managed for the purpose of mitigating CVA risk;

(b) the hedges are entered into with external counterparties so that the CVA risk is transferred outside of the institution and, if the institution is part of a group, outside of the group;

(c) subject to paragraph (d), the hedging instruments used in the hedges are—

(i) single-name credit default swaps;

(ii) single-name contingent credit default swaps;

(iii) hedging instruments equivalent to the hedging instruments referred to in subparagraph (i) or (ii) and referencing the counterparty concerned directly; or

(iv) subject to subsection (2), index credit default swaps;

(d) the hedges are not—

(i) tranched or n^{th}-to-default credit default swaps;

(ii) credit-linked notes; or

(iii) first loss protection; and

(e) the payment under the hedging instruments used in the hedges does not depend on cross-default.

(2) Where an authorized institution uses the advanced CVA method to calculate the CVA capital charge, the institution may, subject to subsection (3), include index credit default swaps as eligible CVA hedges in the calculation only if—

(a) the basis (being the difference between the spread of any individual counterparty (or, subject to paragraph (b), the proxy spread when the spread is not available) and the spreads of the index credit default swaps) is reflected in the VaR generated by the VaR model concerned;

(b) in any case where the counterparty has no available spread, the institution uses a reasonable basis time series out of a representative group of similar names for which a spread is available to determine a proxy spread.

(3) Where the Monetary Authority is not satisfied that the basis referred to in subsection (2) is sufficiently reflected in an authorized institution's VaR, the Monetary Authority may, by notice in writing given to the institution, require the institution to reflect, in its VaR, 50% of the notional amount of the index credit default swap hedge concerned.

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

(5) An authorized institution must, if the hedging instrument in an eligible CVA hedge is a credit default swap and

restructuring is not one of the credit events specified in the swap, take into account the CVA risk mitigating effect of the swap in its CVA capital charge calculation—

(a) if the institution calculates CVA capital charge using the advanced CVA method, in the same manner as that under the IMM approach in respect of the use of credit default swaps to offset the market risk capital charge for specific risk;

(b) if the institution calculates CVA capital charge using the standardized CVA method, in accordance with sections 308, 309, 310 and 311, insofar as they relate to credit default swaps and with all necessary modifications.

(6) Where an authorized institution has included eligible CVA hedges in a CVA capital charge calculation, the institution—

(a) must exclude the hedges from its market risk capital charge calculation;

(b) must not treat the hedges as recognized credit derivative contracts other than for CVA risk; and

(c) must, if its default risk exposure to the protection sellers arising from the hedges calculated by the IMM(CCR) approach or the current exposure method is larger than zero, include the default risk exposure in its CVA capital charge calculation and must not set the default risk exposure to zero.

Division 4—Exposures to CCPs

226U. Application of Division 4

(1) This Division applies to any authorized institution, regardless of the approach adopted by the institution for calculating its credit risk for non-securitization exposures.

(2) To avoid doubt, exposures to CCPs, clearing members or clients arising from delayed or failed settlement of—

(a) cash transactions in securities (other than repo-style transactions), foreign exchange or commodities; and

(b) cash-settled derivative contracts,

are not subject to the requirements of this Division but are subject to the capital treatments set out in Part 4, 5 or 6, as the case requires, for transactions settled on a delivery-versus-payment basis or a basis other than the delivery-versus-payment basis.

226V. Interpretation of Division 4

(1) In this Division—

Basel CCR Rules (《巴塞爾 CCR 規則》) means the rules set out in Annex 4 (as amended by the document entitled "Basel III: A global regulatory framework for more resilient banks and banking systems" published by the Basel Committee in December 2010 (revised in June 2011) and the document entitled "Capital requirements for bank exposures to central counterparties" published by the Basel Committee in July 2012) to the document entitled "International Convergence of Capital Measurement and Capital Standards — A Revised

Framework (Comprehensive Version)" published by the Basel Committee in June 2006;

Committee on Payment and Settlement Systems (支付及結算系統委員會) means the committee, whose secretariat is hosted by the Bank for International Settlements in Basel, Switzerland, that serves as a forum for central banks to monitor and analyze developments in domestic payment, clearing and settlement systems as well as in cross-border and multicurrency settlement schemes;

initial margin (開倉保證金), in relation to a CCP and its clearing member—

(a) subject to paragraph (b), means the collateral posted by the clearing member or the clearing member's client to the CCP to mitigate the potential future exposure of the CCP to the clearing member arising from the possible future change in the value of the clearing member's transactions or the client's transactions, as the case may be;

(b) does not include—

(i) any default fund contributions made by the clearing member; and

(ii) any collateral posted by the clearing member or client that can be used by the CCP to mutualize losses among clearing members;

International Organization of Securities Commissions (證券委員會國際組織) means the international association of securities regulators, whose general secretariat is based in Madrid, Spain, that sets international standards for securities markets and promotes information exchange and cooperation among its members;

non-qualifying CCP (不合資格 CCP) means a CCP that is not a qualifying CCP;

offsetting transaction (抵銷交易), in relation to a clearing member of a CCP and a client of the clearing member, means a transaction between the clearing member and the CCP that is for the purpose of offsetting a transaction between the clearing member and the client when the clearing member acts on behalf of the client as an intermediary between the client and the CCP;

qualifying CCP (合資格 CCP) means a CCP—

(a) that has been granted a licence by a regulator or overseer to operate as a CCP (including a licence granted by way of confirming an exemption) and is permitted by the regulator or overseer to operate as such with respect to products offered by the CCP;

(b) that is based and prudentially supervised in a jurisdiction where the regulator or overseer has established, and publicly indicated that it applies to the CCP on a continuous basis, domestic rules and regulations that are consistent with the principles in the document entitled "Principles for financial market infrastructures" published by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions, as in force from time to time;

(c) that has calculated and made available, or has made available sufficient information for other relevant parties to calculate, the parameters specified in paragraph 123 of the Basel CCR Rules in accordance with the methodology and requirements set out in that paragraph, so that the CCP's clearing

members are able to calculate the regulatory capital for their default fund contribution to the CCP, and update the calculation at least quarterly and whenever there are material changes to the number of, or the level of exposure in respect of, cleared transactions or material changes to the financial resources of the CCP; and

(d) that has provided sufficient information in the manner specified in paragraph 124 of the Basel CCR Rules to its regulator or overseer, clearing members and the relevant banking supervisory authorities of the clearing members to enable them to review the calculations of the parameters referred to in paragraph (c) or the capital charge calculations performed by the clearing members;

variation margin (變動保證金), in relation to a CCP and its clearing member, means the collateral posted by the clearing member or the clearing member's client on a daily or intraday basis to the CCP based on price movements of the clearing member's transactions or the client's transactions, as the case may be.

(2) For the purposes of this Division—

(a) an authorized institution's default risk exposure to a CCP includes any initial margin posted by the institution and any variation margin that is payable by the CCP to the institution; and

(b) in determining whether any netting done pursuant to a netting agreement with a CCP is recognized netting—

(i) any reference to agreement in the definition of ***valid bilateral netting agreement*** in section 2(1); or

(ii) any reference to bilateral master agreement in section 226B(2),

is to be construed as a netting agreement employed by a CCP that provides legally enforceable rights of set-off.

226W. Calculation of credit risk exposures

(1) An authorized institution must calculate its default risk exposure to a CCP, a clearing member or a client in respect of OTC derivative transactions, credit derivative contracts and SFTs using the same methodology as it would be required to use if the transactions or contracts—

(a) were not cleared by CCPs; or

(b) were not CCP-related transactions or offsetting transactions.

(2) Where an authorized institution's transaction with a CCP is a derivative contract traded on an exchange, the institution must calculate its default risk exposure in respect of the contract using the same methodology as it would be required to use if the contract were an OTC derivative transaction or a credit derivative contract, as the case requires.

(3) An authorized institution may treat the default risk exposure to a CCP, in respect of payment transactions or spot transactions, as zero if the CCP's default risk exposures to all clearing members are fully collateralized on a daily basis.

(4) If a credit exposure to a CCP arises from the holding by the CCP of collateral posted by an authorized institution, and the collateral is not held on a bankruptcy remote

basis, the credit exposure is taken to be equal to the fair value of the collateral.

(5) For the purposes of subsections (1) and (2), where a netting set with a CCP falls within the description in section 226M(2) and an authorized institution uses the IMM(CCR) approach or any of the methods under sections 76A(4), (5), (6) and (7), 96, 97, 123A(4), (5), (6) and (7), 202(1) and (3) and 209(3) to calculate the default risk exposure in respect of the netting set, the higher supervisory floor of 20 business days required under section 226M(2) will not apply to the calculation of the default risk exposure if the netting set—

(a) does not contain illiquid collateral or transactions that cannot be easily replaced; and

(b) does not contain any disputed transactions.

226X. Exposures of clearing members to qualifying CCPs

(1) An authorized institution that is a clearing member of a qualifying CCP must calculate the risk-weighted amount of its—

(a) default risk exposure to the qualifying CCP in respect of derivative contracts or SFTs entered into with the qualifying CCP for the institution's own purposes; and

(b) default risk exposure to the qualifying CCP that arises when the institution provides clearing services to its clients and is obliged to reimburse the clients for any loss suffered by them due to changes in the value of their transactions in the event that the qualifying CCP defaults,

by allocating a risk-weight of 2% to the exposures.

(2) For the purposes of subsection (1), an authorized institution may calculate the risk-weighted amount taking into account any credit risk mitigation techniques (including recognized netting and margining) that are recognized under these Rules in the same manner as permitted for the calculation of the risk-weighted amount of its default risk exposures in respect of bilateral transactions.

(3) An authorized institution must not under subsection (2) take into account the effect of any credit risk mitigation techniques applicable to a default risk exposure of the institution in respect of the contracts or transactions concerned if that effect has already been taken into account in the calculation of the default risk exposure.

(4) An authorized institution that is a clearing member of a qualifying CCP must apply a risk-weight of 1,250% to its funded default fund contribution to the qualifying CCP, or, subject to section 226Y, use Formula 23K to calculate the regulatory capital for its default fund contribution (K_{AI}) to the qualifying CCP.

Formula 23K

Calculation of Regulatory Capital for Default Fund Contribution by Authorized Institution that is Clearing Member of Qualifying CCP

$$K_{AI} = \left(1 + \beta \cdot \frac{N}{N-2}\right) \cdot \frac{DF_{AI}}{DF_{CM}} \cdot K^{*}_{CM}$$

where—

(a) $\beta = \frac{A_{Net,1} + A_{Net,2}}{\sum_i A_{Net,i}}$ where

subscripts 1 and 2 denote the clearing members with the 2 largest A_{Net} values and subscript i denotes clearing member "i" but—

(i) for derivative contracts, A_{Net} is an amount calculated as $0.15 \cdot A_{Gross} + 0.85 \cdot NGR \cdot A_{Gross}$ where A_{Gross} has the same meaning as in section 95 and NGR is calculated in accordance with paragraph 123(1) of the Basel CCR Rules;

(ii) for SFTs, A_{Net} is an amount calculated as $E \cdot H_e + C \cdot \left(H_c + H_{fx}\right)$ where—

(A) E is the amount of the qualifying CCP's exposure to the SFTs;

(B) C is the current market value of the collateral, which would fall within the definition of ***recognized collateral*** in section 51(1) if the qualifying CCP were an authorized

institution, received by the qualifying CCP; and

(C) H_e, H_c and H_{fx} are haircuts that would have the meaning given by Formula 2 and would be subject to section 90 if the qualifying CCP were an authorized institution;

(b) N = number of clearing members;

(c) DF_{AI} = funded default fund contribution from the authorized institution;

(d) DF_{CM} = total of funded default fund contributions from all clearing members (or financial resources contributed by any other member that are available to mutualize losses); and

(e) K^*_{CM} = aggregate capital requirement on default fund contributions from all clearing members before adjustments for granularity and concentration calculated in accordance with the methodology and requirements set out in paragraph 123 of the Basel

CCR Rules.

(5) An authorized institution that has chosen to apply a risk-weight of 1,250% to its funded default fund contribution to a qualifying CCP under subsection (4) may disregard paragraphs (c) and (d) of the definition of ***qualifying CCP*** in section 226V(1) when determining whether a CCP is a qualifying CCP.

(6) If an authorized institution has chosen to apply a risk-weight of 1,250% to its funded default fund contribution to a qualifying CCP under subsection (4), the total risk-weighted amount of the institution's default risk exposures and default fund contribution to the qualifying CCP ($RWA_{(TE+DF)}$) is to be calculated as follows—

$$RWA_{(TE+DF)} = Min\{(2\%\cdot TE_i + 1{,}250\%\cdot DF_{AI}), 20\%\cdot TE_i\}$$

where—

(a) TE_i = the total of the default risk exposures of the institution referred to in subsection (1) to the qualifying CCP; and

(b) DF_{AI} = funded default fund contribution from the institution.

226Y. Provisions supplementary to section 226X(4)

(1) An authorized institution must, if Formula 23K cannot work because the qualifying CCP does not have any funded default fund contributions, calculate K_{AI} by allocating K^*_{CM} based on $\frac{UDF_{AI}}{UDF_{CM}}$ instead of based on $\frac{DF_{AI}}{DF_{CM}}$, where—

(a) UDF_{AI} = the institution's unfunded default fund commitment; and

(b) UDF_{CM} = the total of all clearing members' unfunded default fund commitment.

(2) An authorized institution must, if the authorized institution's share of K_{CM}^{*} based on its proportionate unfunded default fund commitment is not determinable, allocate K_{CM}^{*} based on $\frac{IM_{AI}}{IM_{CM}}$ instead of based on $\frac{UDF_{AI}}{UDF_{CM}}$, where—

(a) IM_{AI} = the initial margin posted by the institution to the qualifying CCP; and

(b) IM_{CM} = the total of initial margin posted by all clearing members to the qualifying CCP.

(3) An authorized institution must recalculate K_{AI}—

(a) at least on a quarterly basis; and

(b) whenever there are material changes to—

(i) the number of transactions of the institution cleared by the qualifying CCP or the number of transactions cleared by the qualifying CCP;

(ii) the exposure of the institution or qualifying CCP in respect of transactions cleared by the qualifying CCP; or

(iii) the financial resources of the qualifying CCP.

(4) The Monetary Authority may, if a qualifying CCP's mutualized loss sharing arrangements would not allocate losses to its clearing members proportionate to their funded default fund contributions, and after consultation

with the authorized institution concerned, by notice in writing given to the institution, require it to make adjustments specified in the notice to the allocation methodology used in Formula 23K or set out in subsection (1) or (2), as the case may be, in order to reflect the loss allocation basis under the mutualized loss sharing arrangements of that qualifying CCP.

(5) An authorized institution must comply with the requirements of a notice given to it under subsection (4).

(6) An authorized institution must calculate the risk-weighted amount of its exposure to the qualifying CCP in respect of its default fund contribution as the product of K_{AI} and 12.5.

226Z. Exposures of clearing members to clients

(1) An authorized institution that is a clearing member of a CCP must calculate—

(a) the risk-weighted amount of its default risk exposure and CVA risk-weighted amount in respect of its clients arising from CCP-related transactions; and

(b) the risk-weighted amount of its default risk exposures and CVA risk-weighted amount arising from guarantees of clients' performance,

in accordance with Part 4, 5 or 6, as the case requires, and Division 3.

(2) Where an authorized institution—

(a) is a clearing member of a CCP; and

(b) has entered into a transaction, being the CCP-related transaction for a derivative contract traded

on an exchange, with its client under a bilateral agreement between the institution and its client,

the institution must calculate the risk-weighted amount of its default risk exposure and CVA risk-weighted amount in respect of the client arising from the derivative contract as if the derivative contract were an OTC derivative transaction.

(3) In calculating the default risk exposure that enters into the risk-weighted amount calculation referred to in subsections (1) and (2), if the CCP concerned is a qualifying CCP—

(a) an authorized institution that uses the IMM(CCR) approach may, despite section 226M(1), apply a margin period of risk of at least 5 business days to a netting set that would otherwise be subject to a margin period of risk of at least 10 business days under that section; and

(b) an authorized institution that calculates the default risk exposure using methods other than the IMM(CCR) approach may multiply the default risk exposure so calculated by a scaling factor in accordance with subsection (4).

(4) The scaling factor referred to in subsection (3)(b) is to be determined by mapping the margin period of risk of the transaction concerned to the applicable scaling factor in accordance with Table 23C.

Table 23C

Scaling Factors Applicable to Margin Periods of Risk

Margin period of risk	Scaling factor
5 business days	0.71
6 business days	0.77
7 business days	0.84
8 business days	0.89
9 business days	0.95
10 business days or more	1

226ZA. Exposures of clients to clearing members

(1) Where an authorized institution—

(a) is a client of a clearing member of a CCP; and

(b) enters into a CCP-related transaction (***relevant transaction***) with the clearing member that acts as a financial intermediary between the institution and the CCP,

the institution must, subject to subsections (3), (4) and (5), calculate the risk-weighted amount of its default risk exposure and CVA risk-weighted amount in respect of the clearing member arising from the relevant transaction in accordance with Part 4, 5 or 6, as the case requires, and Division 3.

(2) Where an authorized institution—

(a) is a client of a clearing member of a CCP; and

(b) has entered into a transaction, being the CCP-related transaction for a derivative contract traded on an exchange, with the clearing member under a bilateral agreement between the institution and the clearing member,

the institution must calculate the risk-weighted amount of its default risk exposure and CVA risk-weighted amount in respect of the clearing member arising from the derivative contract as if the derivative contract were an OTC derivative transaction.

(3) An authorized institution may, if the CCP is a qualifying CCP and all the conditions set out in subsection (6) are met, calculate the risk-weighted amount of its default risk exposure to the clearing member arising from the relevant transaction in accordance with section 226X(1), (2) and (3) as if its default risk exposure were to the CCP.

(4) An authorized institution may, if the CCP is a qualifying CCP and all the conditions set out in subsection (6) (excluding the condition set out in subsection (6)(a)(iii)) are met, calculate the risk-weighted amount of its default risk exposure to the clearing member arising from the relevant transaction in accordance with section 226X(1), (2) and (3) as if its default risk exposure were to the CCP except that the applicable risk-weight must be 4% instead of 2%.

(5) An authorized institution may, if the CCP is a non-qualifying CCP and all the conditions set out in subsection (6) (excluding the condition set out in subsection (6)(a)(iii)) are met, calculate the risk-weighted amount of its default risk exposure to the clearing member arising from the relevant transaction in accordance with section 226ZD(1) as if its default risk exposure were to the CCP.

(6) The conditions that must be met for the relevant transaction of an authorized institution to receive the treatment referred to in subsections (3), (4) and (5) are—

(a) the offsetting transaction for the relevant transaction is identified by the CCP as a client transaction and the collateral for supporting the offsetting transaction is held by the CCP or the clearing member, or both, as applicable, under arrangements that prevent any losses to the institution due to—

(i) the default or insolvency of the clearing member;

(ii) the default or insolvency of the clearing member's other clients; and

(iii) the joint default or joint insolvency of the clearing member and any of its other clients;

(b) the institution has been given independent, written and reasoned legal advice that concludes that, in the event of a challenge in a court of law or before an administrative authority, the relevant court or administrative authority would find that the institution would bear no losses on account of the insolvency of the clearing member or of any other clients of the clearing member under—

(i) the law of the jurisdictions in which the institution, the clearing member and the CCP are incorporated or the equivalent locations in the case of non-corporate entities, and if a branch of the institution, the clearing member or the CCP is involved, then also under the law of the jurisdiction in which the branch is located;

(ii) the law that governs the individual transactions and collateral; and

(iii) the law that governs any contract or agreement necessary to meet the condition set out in paragraph (a); and

(c) relevant laws, regulations, rules, contractual or administrative arrangements provide that the offsetting transaction with the clearing member is highly likely to continue to be indirectly transacted through the CCP, or by the CCP, if the clearing member defaults or becomes insolvent, and in such circumstances, the institution's positions and collateral with the CCP will be transferred at market value unless the institution requests to close out the positions at market value.

226ZB. Exposures of clients to CCPs

(1) Subject to subsections (2), (3) and (4), where an authorized institution is a client of a clearing member of a CCP, if the institution enters into a transaction (***relevant transaction***) with the CCP and the performance of the institution under the relevant transaction is guaranteed by the clearing member, the institution must calculate the risk-weighted amount of its default risk exposure and CVA risk-weighted amount in respect of the clearing member arising from the relevant transaction in accordance with Part 4, 5 or 6, as the case requires, and Division 3.

(2) The authorized institution may, if the CCP is a qualifying CCP and all the conditions set out in section 226ZA(6) are met, calculate the risk-weighted amount of its default risk exposure to a qualifying CCP arising from the relevant transaction in accordance with section 226X(1), (2) and (3).

(3) The authorized institution may, if the CCP is a qualifying CCP and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)) are met, calculate the risk-weighted amount of its default risk exposure to the CCP arising from the relevant transaction in accordance with section 226X(1), (2) and (3) except that the applicable risk-weight must be 4% instead of 2%.

(4) The authorized institution may, if the CCP is a non-qualifying CCP and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)) are met, calculate the risk-weighted amount of its default risk exposure to the CCP arising from the relevant transaction in accordance with section 226ZD(1).

226ZC. CCP ceases to be qualifying CCP

(1) Where a CCP ceases to be a qualifying CCP—

(a) subject to subsection (2), an authorized institution may, for a period of not more than 3 months commencing on the cessation, continue to calculate its default risk exposure in respect of transactions cleared by the CCP as if the CCP were a qualifying CCP; and

(b) an institution may, at any time before the expiration of the period referred to in paragraph (a), and must, on and after the expiration of that period, calculate its default risk exposures in respect of transactions cleared by the CCP on the basis that the CCP is a non-qualifying CCP unless the CCP again becomes a qualifying CCP.

(2) The Monetary Authority may, by notice in writing given to an authorized institution, require the institution to calculate its default risk exposure to a CCP that has ceased to be a qualifying CCP in accordance with the requirements applicable to a non-qualifying CCP, beginning on the date, or 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).

(4) Subsections (1) and (2) apply to the calculation of regulatory capital for default fund contribution to a CCP as they apply to the calculation of default risk exposures in respect of transactions cleared by the CCP.

226ZD. Exposures of clearing members to non-qualifying CCPs

(1) An authorized institution that is a clearing member of a non-qualifying CCP must calculate, in accordance with Part 4, the risk-weighted amount of—

(a) its default risk exposure to the CCP in respect of derivative contracts or SFTs entered into with the CCP; and

(b) its default risk exposure to the CCP arising from guarantees provided by the institution to its clients for any loss due to changes in the value of the clients' transactions in the event that the CCP defaults.

(2) Subject to subsection (3), an authorized institution must allocate a risk-weight of 1,250% to its default fund contribution to a non-qualifying CCP and, for that purpose, the institution's default fund contribution must include the funded and unfunded contributions that the

institution is liable to pay if the non-qualifying CCP requires the institution to do so.

(3) If the default fund contribution of an authorized institution to a non-qualifying CCP consists of a binding commitment in respect of an unfunded default fund contribution to the CCP and the amount of the commitment is unlimited, the institution must determine the amount of the commitment to which a 1,250% risk-weight is to apply based on its own estimation, unless the Monetary Authority, by notice in writing given to the institution, requires the institution to—

(a) use the amount specified by the Monetary Authority in the notice as the amount of the commitment to which a 1,250% risk-weight is to apply; or

(b) use the method specified by the Monetary Authority in the notice to estimate the amount of the commitment to which a 1,250% risk-weight is to apply.

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

226ZE. Treatment of posted collateral

(1) Subject to subsections (2), (3), (4), (5) and (6), where an authorized institution has posted collateral to a CCP or a clearing member of a CCP and the collateral is not held in a bankruptcy remote manner, the institution must, in respect of the collateral, calculate the risk-weighted amount of its credit exposure to the person holding the collateral by assigning a risk-weight applicable to that person in accordance with Part 4, 5 or 6, as the case requires.

(2) Where the person referred to in subsection (1) is a CCP, the institution must determine the risk-weight applicable to the CCP in accordance with Part 4, 5 or 6, as the case requires, if the CCP is a qualifying CCP and in accordance with Part 4 if the CCP is a non-qualifying CCP.

(3) Where an authorized institution is a clearing member of a CCP and has posted collateral for transactions with the CCP, the institution is not, in respect of the collateral, required to hold regulatory capital for its credit exposure to the person holding the collateral if the collateral—

(a) is held by a custodian; and

(b) is bankruptcy remote from the CCP.

(4) Where an authorized institution is a client of a clearing member of a CCP and has posted collateral for transactions with the CCP, the institution is not, in respect of the collateral, required to hold regulatory capital for its credit exposure to the person holding the collateral if the collateral—

(a) is held by a custodian; and

(b) is bankruptcy remote from the CCP, the clearing member concerned and the other clients of the clearing member.

(5) Subject to subsection (6), where an authorized institution is a client of a clearing member of a CCP and has posted collateral for transactions with the CCP, and the collateral—

(a) is held by the CCP on the institution's behalf; and

(b) is not held on a bankruptcy remote basis,

the institution must calculate the risk-weighted amount of its credit exposure to the clearing member in respect

of the collateral by assigning a risk-weight applicable to the clearing member in accordance with Part 4, 5 or 6, as the case requires.

(6) Where an authorized institution is a client of a clearing member of a CCP and has a credit exposure to the CCP in respect of collateral posted by it that falls within subsection (5)(a) and (b)—

(a) a risk-weight of 2% must be allocated to the exposure if the CCP is a qualifying CCP and all the conditions set out in section 226ZA(6) are met;

(b) a risk-weight of 4% must be allocated to the exposure if the CCP is a qualifying CCP and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)) are met; or

(c) a risk-weight determined under Part 4 may be allocated to the exposure if the CCP is a non-qualifying CCP and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)) are met.

(7) To avoid doubt—

(a) if the person referred to in subsection (1) is a CCP, the collateral referred to in that subsection does not include any collateral that is regarded as a default risk exposure to the CCP under section 226V(2)(a); and

(b) an authorized institution that has posted an asset as collateral must hold regulatory capital for the credit risk or market risk, whichever is applicable, of the asset itself calculated in accordance with Part 4, 5, 6, 7 or 8, as the case requires, as if it had not been posted as collateral and, if the collateral is held by

another person, as if the collateral were held by the institution.

(8) In this section—

custodian (保管人) means a trustee, agent, pledgee, secured creditor or any other person that holds property (***property holder***) in a way—

(a) that does not give the property holder a beneficial interest in the property; and

(b) that will not result in the property being subject to legally-enforceable claims by the property holder's creditors, or to a court-ordered stay of the return of the property, if the property holder becomes insolvent or bankrupt.".

122. Section 227 amended (interpretation of Part 7)

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

Repeal

"has the meaning assigned to it by section 51(1), with all necessary modifications"

Substitute

"means the credit equivalent amount calculated as the product of the principal amount (after deduction of specific provisions) of the exposure and the applicable CCF".

(2) Section 227(1), definition of ***gain-on-sale***—

Repeal

"core capital"

Substitute

"CET1 capital".

123. Section 230 amended (measures which may be taken by Monetary Authority if originating institution provides implicit support)

(1) Section 230(2)—

Repeal paragraph (c)

Substitute

"(c) by notice in writing given to the institution, advise the institution that the Monetary Authority is considering exercising the power under section 97F of the Ordinance to vary any capital requirement rule applicable to the institution, including by increasing all or any of the following—

(i) the institution's CET1 capital ratio;

(ii) the institution's Tier 1 capital ratio;

(iii) the institution's Total capital ratio.".

(2) Section 230(5)—

Repeal

"101"

Substitute

"97F".

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

(1) Section 232(d)(i)—

Repeal

"provided"

Substitute

"subject to section 232A(2) and (3), provided".

(2) Section 232(e)—

Repeal

"if"

Substitute

"subject to section 232A(2) and (3), if".

(3) Section 232(f)—

Repeal

"if a"

Substitute

"subject to section 232A(2) and (3), if a".

125. Section 232A added

Part 7, Division 2, after section 232—

Add

"232A. Recognized guarantees and recognized credit derivative contracts

(1) Subject to subsections (2) and (3)—

(a) a guarantee that falls within section 98 constitutes a recognized guarantee under this Part in relation to a securitization exposure of an authorized institution; and

(b) a credit derivative contract that falls within section 99 constitutes a recognized credit derivative contract under this Part in relation to a securitization exposure of an authorized institution.

(2) Where an authorized institution uses the STC(S) approach, for the purposes of—

(a) section 232(d) and (e) (where the credit protection referred to in that section is provided to a securitization exposure);

(b) section 232(f);

(c) section 243(2)(b) (where the underlying exposures referred to in that section are securitization exposures); and

(d) section 247,

sections 98(a)(vi) and 99(1)(b)(vi) 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, 2 or 3; and

(B) had an ECAI issuer rating at the time the credit protection was given 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;

(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, 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; and

(B) had an ECAI issuer rating at the time the credit protection was given 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,".

(3) Where an authorized institution uses the IRB(S) approach, for the purposes of—

(a) section 232(d) and (e) (where the credit protection referred to in that section is provided to a securitization exposure);

(b) section 232(f);

(c) section 255(2)(b) (where the underlying exposures referred to in that section are securitization exposures);

(d) section 265;

(e) section 278; and

(f) section 279,

sections 98(a)(vi) and 99(1)(b)(vi) are deemed to read as—

"(vi) a corporate incorporated outside India—

(A) that—

(I) 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; and

(II) had an ECAI issuer rating at the time the credit protection was given 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) that—

(I) 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, 2 or 3 in Part 1 of Table C in Schedule 6; and

(II) had an exposure assessed under the institution's rating system at the time the credit protection was given with an estimate of PD that was 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;

(vii) a corporate incorporated in India—

(A) that—

(I) 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; and

(II) had an ECAI issuer rating at the time the credit protection was given 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) that—

(I) 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, 2 or 3 in Part 1 of Table C in Schedule 6 or a credit quality grade of 1, 2, 3 or 4 in Part 2 of that Table; and

(II) had an exposure assessed under the institution's rating system at the time the credit protection was given with an estimate of PD that was 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,".".

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

(1) Section 236, heading—

Repeal

"**Deductions from core capital and supplementary capital**"

Substitute

"**Allocation of risk-weight of 1,250% to certain items**".

(2) Section 236(1)—

Repeal

"Subject to subsection (2), an authorized institution shall deduct from any of its core capital and supplementary capital"

Substitute

"An authorized institution must allocate a risk-weight of 1,250% to".

(3) Section 236(1)—

Repeal paragraph (b).

(4) Section 236(1)(d)(iv), after "facility;"—

Add

"and".

(5) Section 236(1)(da)—

Repeal

"exposure; and"

Substitute

"exposure.".

(6) Section 236(1)—

Repeal paragraph (e).

(7) Section 236—

Repeal subsection (2).

127. Section 236A added

After section 236—

Add

"**236A. Deduction from CET1 capital**

(1) An authorized institution must deduct from its CET1 capital any gain-on-sale arising from a securitization transaction if the institution is the originating institution.

(2) If the Monetary Authority, by notice in writing given to an authorized institution under section 43(1)(f), requires the institution to deduct from its CET1 capital a securitization exposure of the institution specified in the notice, the institution must make the deduction based on—

(a) the principal amount (after deduction of specific provisions) of the securitization exposure if the exposure is an on-balance sheet exposure; or

(b) the credit equivalent amount of the securitization exposure if the exposure is an off-balance sheet exposure.".

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

(1) Section 237(1)(a)—

Repeal

"or determining whether the exposures are to be deducted from the institution's core capital and supplementary capital,".

(2) Section 237(1)(b)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(3) Section 237(2)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(4) Section 237(2)(a)(ii)—

Repeal

"deduct the exposures from the institution's core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1,250% to the exposures".

(5) Section 237(2)—

Repeal Table 24

Substitute

"**Table 24**

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

Long-term credit quality grade	Risk-weight
1	20%

Long-term credit quality grade	Risk-weight
2	50%
3	100%
4	350% (for investing institutions) 1,250% (for originating institutions)
5	1,250%".

(6) Section 237(3)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(7) Section 237(3)—

Repeal Table 25

Substitute

"Table 25

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

Short-term credit quality grade	Risk-weight
1	20%
2	50%
3	100%

Short-term credit quality grade	Risk-weight
4	1,250%".

(8) Section 237(4)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(9) Section 237(4)(a)(ii)—

Repeal

"deduct the exposures from the institution's core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1,250% to the exposures".

(10) Section 237(4)—

Repeal Table 25A

Substitute

"Table 25A

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

Long-term credit quality grade	Risk-weight
1	40%

Long-term credit quality grade	Risk-weight
2	100%
3	225%
4	650% (for investing institutions) 1,250% (for originating institutions)
5	1,250%".

(11) Section 237(5)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(12) Section 237(5)—

Repeal Table 25B

Substitute

"Table 25B

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

Short-term credit quality grade	Risk-weight
1	40%
2	100%
3	225%

Short-term credit quality grade	Risk-weight
4	1,250%".

129. Section 238 amended (most senior tranche in securitization transaction)

Section 238(3)—

Repeal

"shall deduct the securitization position referred to in subsection (1) from its core capital and supplementary capital"

Substitute

"must allocate a risk-weight of 1,250% to the securitization position referred to in subsection (1)".

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

(1) Section 240(2)(a)(i)—

Repeal

"facility, or whether that undrawn portion is to be deducted from the institution's core capital and supplementary capital,"

Substitute

"facility".

(2) Section 240(2)(a)(iii)—

Repeal

"or, if deduction referred to in that subparagraph is required, make the deduction".

(3) Section 240(4)—

Repeal

"shall deduct the undrawn portion of the facility from the institution's core capital and supplementary capital"

Substitute

"must allocate a risk-weight of 1,250% to the undrawn portion of the facility".

(4) Section 240(5)(a)—

Repeal

"facility, or whether that drawn portion is to be deducted from the institution's core capital and supplementary capital,"

Substitute

"facility".

(5) Section 240(5)(c)—

Repeal

"deduct the drawn portion of the facility from the institution's core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1,250% to the drawn portion of the facility".

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

(1) Section 243(3)(a)—

Repeal

"paragraphs (b) and (c)"

Substitute

"paragraph (b)".

(2) Section 243(3)(a), after "modifications;"—

Add

"and".

(3) Section 243(3)(b)(ii)—

Repeal

"and (4); and"

Substitute

"and (4).".

(4) Section 243(3)—

Repeal paragraph (c).

132. Section 250 amended (application of scaling factor)

Section 250—

Repeal

"224"

Substitute

"224(1)".

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

(1) Section 251, heading—

Repeal

"**Deductions from core capital and supplementary capital**"

Substitute

"**Allocation of risk-weight of 1,250% to certain items**".

(2) Section 251(1)—

Repeal

"Subject to subsection (2), an authorized institution shall deduct from any of its core capital and supplementary capital"

Substitute

"An authorized institution must allocate a risk-weight of 1,250% to".

(3) Section 251(1)—

Repeal paragraph (b).

(4) Section 251(1)—

Repeal paragraph (d).

(5) Section 251(1)—

Repeal paragraph (f)

Substitute

"(f) any liquidity facility or servicer cash advance facility as required in section 264 or 277, as the case requires.".

(6) Section 251—

Repeal subsection (2).

134. Section 251A added

After section 251—

Add

"251A. Deduction from CET1 capital

(1) An authorized institution must deduct from its CET1 capital any gain-on-sale arising from a securitization transaction if the institution is the originating institution.

(2) If the Monetary Authority, by notice in writing given to an authorized institution under section 43(1)(f), requires the institution to deduct from its CET1 capital a securitization exposure of the institution specified in the notice, the institution must make the deduction based on—

(a) the principal amount (after deduction of specific provisions, partial write-off or non-refundable purchase price discount, as the case may be) of the securitization exposure if the exposure is an on-balance sheet exposure; or

(b) the credit equivalent amount of the securitization exposure if the exposure is an off-balance sheet exposure.".

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

(1) Section 255(3)(a)—

Repeal

"paragraphs (b) and (c)"

Substitute

"paragraph (b)".

(2) Section 255(3)(a), after "modifications;"—

Add

"and".

(3) Section 255(3)(b)(ii)—

Repeal

"and (4); and"

Substitute

"and (4).".

(4) Section 255(3)—

Repeal paragraph (c).

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

(1) Section 262(1)(a)—

Repeal

"or determining whether the exposures are to be deducted from the institution's core capital and supplementary capital,".

(2) Section 262(1)(b)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(3) Section 262(4)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(4) Section 262(4)—

Repeal Table 26

Substitute

"Table 26

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

Long-term credit quality grade	Risk-weight		
	A	B	C
1	7%	12%	20%
2	8%	15%	25%
3	10%	18%	35%
4	12%	20%	35%
5	20%	35%	35%
6	35%	50%	50%
7	60%	75%	75%
8	100%	100%	100%
9	250%	250%	250%
10	425%	425%	425%
11	650%	650%	650%
12	1,250%	1,250%	1,250%".

(5) Section 262(8)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(6) Section 262(8)—

Repeal Table 27

Substitute

"Table 27

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

Short-term credit quality grade	Risk-weight		
	A	B	C
1	7%	12%	20%
2	12%	20%	35%
3	60%	75%	75%
4	1,250%	1,250%	1,250%".

(7) Section 262(10)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(8) Section 262(10)—

Repeal Table 27A

Substitute

"Table 27A

Risk-weights 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
1	20%	30%
2	25%	40%
3	35%	50%
4	40%	65%
5	60%	100%
6	100%	150%
7	150%	225%
8	200%	350%
9	300%	500%
10	500%	650%
11	750%	850%
12	1,250%	1,250%".

(9) Section 262(11)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(10) Section 262(11)—

Repeal Table 27B

Substitute

"Table 27B

Risk-weights 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
1	20%	30%
2	40%	65%
3	150%	225%
4	1,250%	1,250%".

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

(1) Section 264(1)(a)—

Repeal

"facility, or whether that undrawn portion is to be deducted from the institution's core capital and supplementary capital,"

Substitute

"facility".

(2) Section 264(1)(b), after "portion;"—

Add

"and".

(3) Section 264(1)(c)—

Repeal

"paragraph (a); and"

Substitute

"paragraph (a).".

(4) Section 264(1)—

Repeal paragraph (d).

(5) Section 264(2)(a)—

Repeal

"facility, or whether that drawn portion is to be deducted from the institution's core capital and supplementary capital,"

Substitute

"facility".

(6) Section 264(2)(a), after "subsection (1)(a);"—

Add

"and".

(7) Section 264(2)(b)—

Repeal

"paragraph (a); and"

Substitute

"paragraph (a).".

(8) Section 264(2)—

Repeal paragraph (c).

138. Section 265 amended (recognized credit risk mitigation)

(1) Section 265(b)—

Repeal

"51(1)" (wherever appearing)

Substitute

"232A".

(2) Section 265(c)(i)—

Repeal

"(2) and (4), wherever applicable,"

Substitute

"(2)(a) and (4)".

139. Section 270 amended (use of supervisory formula)

(1) Section 270(1)—

Repeal

"(3), (4) and (5),"

Substitute

"(3) and (4),".

(2) Section 270—

Repeal subsection (5).

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

(1) Section 271(a), Chinese text—

Repeal

"資本要求" (wherever appearing)

Substitute

"資本要求及 EL 額的和".

(2) Section 271(c)(ii)—

Repeal

everything after "discount"

Substitute

"in respect of the underlying exposure, as the case may be, may be used to reduce the capital charge for the securitization exposure concerned that is subject to an effective risk-weight of 1,250%.".

141. Section 272 amended (credit enhancement level of tranche)

(1) Section 272(1)(a)—

Repeal

"relevant amounts of all securitization positions"

Substitute

"outstanding amounts of all tranches".

(2) Section 272(1)(b)(ii)—

Repeal

"realized or held by the institution".

(3) Section 272(1)—

Repeal paragraph (c)

Substitute

"(c) subject to paragraph (d), if any interest rate contract or exchange rate contract in a securitization transaction ranks junior for payment to the tranche concerned, an authorized institution may use the current exposure of the contract to calculate L;".

(4) Section 272—

Repeal subsection (2).

142. Section 273 amended (thickness of tranche)

(1) Section 273(1)(a)—

Repeal

"relevant amount of that tranche of the transaction to the EAD"

Substitute

"nominal amount of that tranche of the transaction to the nominal amount".

(2) Section 273(1)—

Repeal paragraph (b)

Substitute

"(b) for the purposes of paragraph (a), if the tranche or any underlying exposure concerned is an exposure arising from an interest rate contract or exchange rate contract, the institution must—

(i) if the current exposure of the contract is not negative, determine the nominal amount of the exposure arising from the contract as the sum of the current exposure and the potential exposure of the contract;

(ii) if the current exposure of the contract is negative, determine the nominal amount of the exposure arising from the contract as only the potential exposure of the contract.".

(3) Section 273—

Repeal subsection (2)

Substitute

"(2) To avoid doubt, an authorized institution that has an IMM(CCR) approval for OTC derivative transactions must comply with subsection (1)(b), in determining the nominal amount of the exposure arising from an OTC

derivative transaction, as if it did not have that approval for those transactions.".

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

Section 275(b), Chinese text—

Repeal

"有關風險"

Substitute

"證券化類別風險".

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

(1) Section 277—

Repeal subsection (2).

(2) Section 277(3)—

Repeal paragraphs (c) and (d)

Substitute

"(c) multiply the risk-weight determined in accordance with paragraph (a) by the credit equivalent amount calculated in accordance with paragraph (b).".

(3) Section 277(4)—

Repeal

"facility, or whether that undrawn portion is to be deducted from the institution's core capital and supplementary capital, in accordance with subsections (1)(a) and (b) and (2)."

Substitute

"facility in accordance with subsection (1)(a) and (b).".

(4) Section 277(5)—

Repeal

"shall deduct the credit equivalent amount of the undrawn portion of the facility from the institution's core capital and supplementary capital."

Substitute

"must allocate a risk-weight of 1,250% to the credit equivalent amount of the undrawn portion of the facility.".

(5) Section 277(6A)—

Repeal

"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)."

Substitute

"facility in accordance with subsection (1)(a).".

(6) Section 277—

Repeal subsection (7).

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

(1) Section 278(b)—

Repeal

"51(1)" (wherever appearing)

Substitute

"232A".

(2) Section 278(c)(i)—

Repeal

"(2) and (4), where applicable,"

Substitute

"(2)(a) and (4)".

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

Section 279(1)(a)—

Repeal

"51(1)" (wherever appearing)

Substitute

"232A".

147. Section 283 amended (positions to be used to calculate market risk)

Section 283(2)—

Repeal paragraphs (a) and (b)

Substitute

"(a) a recognized credit derivative contract (within the meaning of section 51(1), 105, 139(1) or 232A, as the case requires) booked in the institution's trading book as a hedge to a credit exposure booked in the institution's banking book;

(b) an exposure that under Division 4 of Part 3 is required to be deducted from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital; or

(c) an eligible CVA hedge.".

148. Section 287A amended (calculation of market risk capital charge for specific risk for interest rate exposures that fall within section 286(a)(ii))

(1) Section 287A(1)—

Repeal

"(2), (3), (4), (5), (6), (7), (8), (9), (10) and (11)"

Substitute

"(2) and (3)".

(2) Section 287A(3), after "subsections"—

Add

"(3A),".

(3) After section 287A(3)—

Add

"(3A) For the purposes of subsection (3), an authorized institution must, in relation to its securitization exposures referred to in subsection (1)—

(a) subject to paragraph (b), allocate a market risk capital charge factor of 100% to the exposures where they fall within any of the descriptions of exposures in sections 236(1)(a), (c), (d) and (da) and 251(1)(a), (c), (e), (ea) and (f); and

(b) deduct from its CET1 capital a securitization exposure of the institution specified in any notice in writing given to the institution by the Monetary Authority under section 43(1)(f).".

(4) Section 287A—

Repeal subsection (5)

Substitute

"(5) For the purposes of subsection (3), an authorized institution must, subject to subsection (3A)(b), 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 multiplying the positions by the appropriate market risk capital charge factors as

specified in subsection (3A)(a), (6), (7), (8) or (9), as appropriate.".

(5) Section 287A(6), after "must,"—

Add

"subject to subsection (3A),".

(6) Section 287A(6)—

Repeal Tables 28A and 28B

Substitute

"**Table 28A**

Market Risk Capital Charge Factors for Specific Risk 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
1	1.6%
2	4.0%
3	8.0%
4	28.0% (for investing institutions) 100.0% (for originating institutions)
5	100.0%

Table 28B

Market Risk Capital Charge Factors for Specific Risk 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
1	1.6%
2	4.0%
3	8.0%
4	100.0%".

(7) Section 287A(7), after "must,"—

Add

"subject to subsection (3A),".

(8) Section 287A(7)—

Repeal Tables 28C and 28D

Substitute

"**Table 28C**

Market Risk Capital Charge Factors for Specific Risk Applicable to Long-term Credit Quality Grades under STC(S) Approach (Re-securitization Exposures)

Long-term credit quality grade	Market risk capital charge factor
1	3.2%
2	8.0%
3	18.0%
4	52.0% (for investing institutions) 100.0% (for originating institutions)
5	100.0%

Table 28D

Market Risk Capital Charge Factors for Specific Risk Applicable to Short-term Credit Quality Grades under STC(S) Approach (Re-securitization Exposures)

Short-term credit quality grade	Market risk capital charge factor
1	3.2%
2	8.0%
3	18.0%
4	100.0%".

(9) Section 287A(8), after "must,"—

Add

"subject to subsection (3A),".

(10) Section 287A(8)—

Repeal Tables 28E and 28F

Substitute

"Table 28E

Market Risk Capital Charge Factors for Specific Risk 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
1	0.56%	0.96%	1.60%
2	0.64%	1.20%	2.00%
3	0.80%	1.44%	2.80%
4	0.96%	1.60%	2.80%
5	1.60%	2.80%	2.80%
6	2.80%	4.00%	4.00%
7	4.80%	6.00%	6.00%
8	8.00%	8.00%	8.00%
9	20.00%	20.00%	20.00%
10	34.00%	34.00%	34.00%
11	52.00%	52.00%	52.00%
12	100.00%	100.00%	100.00%

Table 28F

Market Risk Capital Charge Factors for Specific Risk 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
1	0.56%	0.96%	1.60%
2	0.96%	1.60%	2.80%
3	4.80%	6.00%	6.00%
4	100.00%	100.00%	100.00%".

(11) Section 287A(9), after "must,"—

Add

"subject to subsection (3A),".

(12) Section 287A(9)—

Repeal Tables 28G and 28H

Substitute

"Table 28G

Market Risk Capital Charge Factors for Specific Risk 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	Market risk capital charge factor: Non-senior re-securitization positions B
1	1.60%	2.40%
2	2.00%	3.20%
3	2.80%	4.00%
4	3.20%	5.20%
5	4.80%	8.00%
6	8.00%	12.00%
7	12.00%	18.00%
8	16.00%	28.00%
9	24.00%	40.00%
10	40.00%	52.00%
11	60.00%	68.00%
12	100.00%	100.00%

Table 28H

Market Risk Capital Charge Factors for Specific Risk 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	Market risk capital charge factor: Non-senior re-securitization positions B
1	1.60%	2.40%
2	3.20%	5.20%
3	12.00%	18.00%
4	100.00%	100.00%".

(13) Section 287A(10)—

Repeal

"subsection (11)"

Substitute

"subsections (3A) and (11)".

(14) After section 287A(11)—

Add

"(12) To avoid doubt, the credit risk mitigation treatment specified in Part 7 does not apply in relation to an authorized institution's calculation of market risk capital charge for specific risk interest rate exposures referred to in subsection (1).".

149. Section 307 amended (specific risk)

Section 307(5)(b)—

Repeal

"position, or deduct the position from the core capital and supplementary capital of the institution, in accordance with section 287A(6) or (8),"

Substitute

"position in accordance with section 287A(3A), (6) or (8) (as the case requires),".

150. Section 313 amended (counterparty credit risk)

Section 313—

Repeal subsection (5)

Substitute

"(5) To avoid doubt—

(a) there is no counterparty credit risk for an authorized institution as the purchaser or issuer of a credit-linked note;

(b) an authorized institution must use the current exposure method or the IMM(CCR) approach, as the case requires, to calculate its default risk exposures arising from credit derivative contracts booked in its trading book; and

(c) an authorized institution must calculate the CVA capital charge in respect of credit derivative contracts booked in its trading book in accordance with Part 6A.".

151. Section 316 amended (positions to be used to calculate market risk)

Section 316(2)—

Repeal paragraphs (a) and (b)

Substitute

"(a) a recognized credit derivative contract (within the meaning of section 51(1), 105, 139(1) or 232A, as the case requires) booked in the institution's trading book as

a hedge to a credit exposure booked in the institution's banking book;

(b) an exposure that under Division 4 of Part 3 is required to be deducted from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital; or

(c) an eligible CVA hedge.".

152. Section 318 amended (capital treatment for trading book positions subject to incremental risk charge or comprehensive risk charge)

Section 318(4)(a)—

Repeal

"the market risk capital charge for general market risk and".

153. Section 321 amended (counterparty credit risk)

Section 321—

Repeal subsection (5)

Substitute

"(5) To avoid doubt—

(a) there is no counterparty credit risk for an authorized institution as the purchaser or issuer of a credit-linked note;

(b) an authorized institution must use the current exposure method or the IMM(CCR) approach, as the case requires, to calculate its default risk exposures arising from credit derivative contracts booked in its trading book; and

(c) an authorized institution must calculate the CVA capital charge in respect of credit derivative

contracts booked in its trading book in accordance with Part 6A.".

154. Section 340 amended (provisions applicable where certain authorized institutions have difficulties with BIA approach, STO approach or ASA approach)

(1) Section 340(d)—

Repeal

"approval"

Substitute

"consent".

(2) Section 340(e)—

Repeal

"approval"

Substitute

"consent".

155. Schedule 1 amended (specifications for purposes of certain definitions in section 2(1) of these Rules)

(1) Schedule 1, after "[ss. 2, 73, 120,"—

Add

"157A,".

(2) Schedule 1, heading—

Repeal

"**Section 2(1) of**".

(3) Schedule 1, after Part 10—

Add

"**Part 11**

Financial Services Activities of Financial Institutions".

156. Schedule 1A added

After Schedule 1—

Add

"**Schedule 1A** [s. 226N]

Transactions and Contracts not Subject to CVA Capital Charge

1. Excepted transactions and contracts

The following transactions and contracts are specified for the purposes of section 226N of these Rules—

(a) OTC derivative transactions, credit derivative contracts and SFTs with a CCP where the authorized institution concerned is a clearing member of the CCP;

(b) OTC derivative transactions, credit derivative contracts and SFTs with a clearing member of a CCP that fall within section 226ZA(3), (4) or (5) of these Rules where the authorized institution concerned is a client of the clearing member;

(c) OTC derivative transactions, credit derivative contracts and SFTs with a CCP that fall within section 226ZB(2), (3) or (4) of these Rules where

the authorized institution concerned is a client of a clearing member of the CCP;

(d) recognized credit derivative contracts (within the meaning of section 51(1), 105, 139(1) or 232A of these Rules, as the case requires) purchased by an authorized institution to provide credit protection to the institution's banking book exposures where—

(i) the exposures are—

(A) credit risk exposures other than default risk exposures in respect of OTC derivative transactions, credit derivative contracts and (if the Monetary Authority requires the institution to calculate a CVA capital charge in respect of its SFTs under section 10A(6) of these Rules) SFTs; or

(B) default risk exposures in respect of OTC derivative transactions, credit derivative contracts and SFTs that fall within paragraph (a), (b), (c) or (e); and

(ii) the recognized credit derivative contracts are not treated as recognized credit derivative contracts or eligible CVA hedges for any other exposures of the institution;

(e) OTC derivative transactions, credit derivative contracts and SFTs, other than those transactions or contracts that fall within paragraph (a), (b), (c) or (d), that are in default as determined under the terms and conditions of the transactions or contracts.

2. Meaning of CCP in section 1 of this Schedule

To avoid doubt, a CCP referred to in section 1 of this Schedule may be either a qualifying CCP (within the meaning of section 226V(1) of these Rules) or a non-qualifying CCP (within the meaning of section 226V(1) of these Rules).".

157. Schedule 2 amended (minimum requirements to be satisfied for approval under section 8 of these Rules to use IRB approach)

Schedule 2, section 1(b)(viii)—

Repeal

"any rules made by the Monetary Authority under section 60A of the Ordinance as amended by the Banking (Amendment) Ordinance 2005 (19 of 2005)"

Substitute

"the Banking (Disclosure) Rules (Cap. 155 sub. leg. M)".

158. Schedule 2A added

After Schedule 2—

Add

"**Schedule 2A** [ss. 10B, 10D, 226D & 226Q]

Minimum Requirements to be Satisfied for Approval under Section 10B(2)(a) of these Rules to Use IMM(CCR) Approach

1. General requirements

An authorized institution that makes an application under section 10B(1) of these Rules to use the IMM(CCR) approach

must demonstrate to the satisfaction of the Monetary Authority that—

(a) the board of directors (or a committee designated by the board) and the senior management of the institution—

(i) approve all the key elements of, and any material changes to, the institution's counterparty credit risk management system (being the methods, models, processes, controls, and data collection and information technology systems used by the institution that enable the identification, measurement, management and control of counterparty credit risk by the institution);

(ii) possess an understanding of the design and operation of, and the management reports generated by, the institution's counterparty credit risk management system adequate for them to perform their functions specified in this paragraph;

(iii) exercise oversight of the institution's counterparty credit risk management system sufficient to ensure that the system complies with paragraph (b); and

(iv) ensure that there is a reporting system within the institution to provide information (including information relating to any material changes to, or deviations from, established policies and procedures or any material findings identified in a review or audit referred to in paragraph (k)) to them

regularly and in sufficient detail as will enable them to—

(A) exercise the oversight referred to in subparagraph (iii); and

(B) make informed decisions relating to the institution's counterparty credit risk exposures;

(b) the institution's counterparty credit risk management system—

(i) is suitable for the purposes of identifying, measuring, managing, controlling and reporting the institution's counterparty credit risk taking into account the characteristics and extent of the institution's counterparty credit risk exposures;

(ii) identifies, measures, monitors and controls counterparty credit risk over the life of transactions;

(iii) measures and manages both current exposures (gross and net of collateral held, where appropriate) and future exposures; and

(iv) is operated in a prudent and consistently effective manner that is also consistent with sound practices for counterparty credit risk management;

(c) the institution—

(i) clearly documents the counterparty credit risk management system and the internal policies, controls and procedures relating to the operation of the system, including—

(A) the internal models to which the application relates (***relevant models***);

(B) the calculation of the risk measures generated by the relevant models with sufficient details for a third party to re-create the risk measures; and

(C) the model validation process, including frequency and methodologies of validation and analyses used; and

(ii) has a system for monitoring and ensuring compliance with those internal policies, controls and procedures;

(d) the institution has a risk control unit—

(i) that is functionally independent of the institution's staff and management responsible for originating counterparty credit risk exposures;

(ii) that reports directly to the institution's senior management;

(iii) that is responsible for—

(A) the design or selection of the institution's counterparty credit risk management system;

(B) the testing, validation and implementation of the institution's counterparty credit risk management system;

(C) the oversight of the effectiveness of the institution's counterparty credit risk management system for the purposes of

paragraph (b), including the control of data integrity;

(D) the production and analysis of daily management reports on the output of the relevant models, including an evaluation of the relationship between measures of counterparty credit risk exposure and credit and trading limits;

(E) the ongoing review of, and changes to, the institution's counterparty credit risk management system; and

(F) the conduct of a regular back-testing programme to verify the accuracy and reliability of the relevant models;

(iv) the work of which is an integral part of the day-to-day credit risk management process of the institution, including the planning, monitoring and controlling of the institution's credit and overall risk profile; and

(v) the daily management reports of which are reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual traders and reductions in the institution's overall risk exposure;

(e) the institution has a collateral management unit—

(i) that is adequately staffed and with sufficient resources to process margin calls and disputes in a timely and accurate manner at all times (including during periods of severe market crisis), and to enable the institution to limit its

number of large disputes caused by trade volumes; and

(ii) that is responsible for—

(A) calculating and making margin calls, managing margin call disputes and reporting levels of independent amounts, initial margins (within the meaning of section 226L(3) of these Rules) and variation margins (within the meaning of section 226V(1) of these Rules) accurately on a daily basis;

(B) controlling the integrity of the data used to make margin calls and ensuring that such data are consistent and reconciled regularly with all relevant data sources within the institution;

(C) tracking the extent of reuse of collateral posted to the institution (both cash and non-cash) and the rights ceded by the institution in respect of the collateral that it posts;

(D) tracking concentration in individual types of collateral accepted by the institution; and

(E) producing and maintaining appropriate collateral management information (including information on the type of collateral (both cash and non-cash) received and posted, categories of collateral reused and the terms of the reuse, the size, aging and cause of margin call disputes, and the trends in

the areas to which such information relates) and reporting the information to the institution's senior management on a regular basis;

(f) the institution has a sufficient number of staff who are qualified and trained to use the relevant models in the institution's business, risk control, audit and back office functions as will enable those functions to work prudently and effectively in identifying, measuring, managing, controlling and reporting the institution's counterparty credit risk;

(g) the use of the relevant models is part of the institution's counterparty credit risk management system and plays an essential role in the institution's daily risk management, capital planning and corporate governance functions, with—

(i) the results generated by the relevant models being used in—

(A) planning, measuring, monitoring and controlling the institution's counterparty credit risk exposures;

(B) determining the institution's trading and credit risk exposure limits and measuring the usage of those limits;

(C) credit approval; and

(D) internal capital allocation; and

(ii) the relationship between the relevant models and the limits referred to in subparagraph (i)(B) being maintained consistently over time and understood by the institution's senior

management, credit function and staff engaged in trading activity;

(h) the institution—

(i) uses stress-testing and scenario analysis to identify risk factors that give rise to general wrong-way risk (being the risk that arises when the probability of default of counterparties is positively correlated with general market risk factors) and address the possibility of severe shocks;

(ii) monitors general wrong-way risk by product, by region, by industry, or by other categories that are relevant to the business of the institution;

(iii) has policies and procedures for identifying, monitoring and controlling transactions with specific wrong-way risk at the inception and throughout the life of the transactions; and

(iv) provides regular reports on wrong-way risks to its senior management and board of directors (or a committee designated by the board);

(i) the cash management policy of the institution takes account of the liquidity risks arising from potential incoming margin calls (including calls for posting of collateral due to adverse market shocks or potential downgrade of the institution's external credit rating and calls for return of collateral);

(j) the institution ensures that the nature and horizon of collateral reuse are consistent with its liquidity needs and do not jeopardize its ability to post or return collateral in a timely manner;

(k) an independent review or audit of the soundness and adequacy of the institution's counterparty credit risk management system and the institution's compliance with internal policies, controls and procedures, including the requirements specified in this Schedule, in respect of the system is conducted regularly by the institution's internal auditors or by independent external parties that are qualified to do so; and

(l) the institution, before being granted an IMM(CCR) approval—

(i) has been using internal models that are broadly consistent with the requirements set out in this Schedule, for a period (not less than one year in any case) that is considered by the Monetary Authority as reasonable in all the circumstances of the case, to estimate the distribution of exposures (within the meaning given in section 226H(2) of these Rules) using current market data; and

(ii) has been conducting back-testing, being back-testing that is broadly consistent with the requirements set out in this Schedule relating to back-testing, using historical data on movements in market risk factors.

2. Specific requirements relating to relevant models

Without limiting section 1 of this Schedule, an authorized institution must demonstrate to the satisfaction of the Monetary Authority that—

(a) the relevant models specify the forecast of the probability distribution of changes in the market

value of a netting set attributable to changes in relevant market factors and calculate the institution's counterparty default risk exposure for the netting set at each future date given the changes in the market factors;

(b) the relevant models capture and accurately reflect, on a continuing basis, all material factors affecting counterparty default risk inherent in the institution's transactions;

(c) the relevant models capture transaction specific information in order to aggregate exposures at netting set level;

(d) the institution calculates counterparty default risk on the basis of a distribution of exposures that accounts for the possible non-normality of the distribution of exposures;

(e) the relevant models have a proven track record of acceptable accuracy in measuring counterparty default risk;

(f) the relevant models used for pricing options account for the non-linearity of option value with respect to market risk factors; and

(g) the relevant models are capable of estimating EE on a daily basis (unless the institution is able to otherwise demonstrate to the satisfaction of the Monetary Authority that a less frequent calculation is warranted) and the EE is estimated along a time profile of forecasting horizons that adequately reflects the time structure of future cash flows and maturity of transactions.

3. Specific requirements relating to integrity of modelling process

Without limiting sections 1 and 2 of this Schedule, an authorized institution must demonstrate to the satisfaction of the Monetary Authority that—

(a) transaction terms and specifications are reflected in the relevant models in a timely, complete, and conservative manner, and maintained in a secure database that is subject to formal and periodic audit;

(b) the terms and specifications of any valid bilateral netting agreements or valid cross-product netting agreements are input into the database by an independent unit;

(c) the transmission of data on transaction terms and specifications to the relevant models is subject to internal audit and the institution has formal processes for reconciliation between the relevant models and the source data systems to verify on an ongoing basis that transaction terms and specifications are reflected in EE correctly or at least conservatively;

(d) the institution has internal procedures to verify that—

(i) before including a transaction in a netting set, the transaction is covered by a valid bilateral netting agreement or a valid cross-product netting agreement, as the case may be, and the legal enforceability of the agreement has been verified by legal staff; and

(ii) before recognizing the effect of collateral in the calculation of counterparty default risk,

the collateral meets the legal certainty standards set out in section 77 of these Rules;

(e) the institution, when calibrating its relevant models using historical market data—

(i) uses current market data to compute current exposures;

(ii) estimates the parameters of the models using either—

(A) at least 3 years of historical market data; or

(B) market implied data; and

(iii) updates the data quarterly, or more frequently if market conditions warrant it;

(f) for the purposes of performing the calculations referred to in section 226D(1)(b) of these Rules, the institution calibrates its relevant models and estimates the parameters of the models using either—

(i) 3 years of data that include a period of stress to the credit default spreads of the institution's counterparties; or

(ii) market implied data from a suitable period of stress; and

(g) the institution adopts the following measures to ensure the soundness and adequacy of the stress calibration referred to in paragraph (f)—

(i) the institution demonstrates, at least quarterly, that—

(A) the period of stress referred to in paragraph (f) coincides with a period of

increased credit default swap spreads or other credit spreads of a representative selection of the institution's counterparties with traded credit spreads; and

(B) where adequate credit spread data for a counterparty is not available for the purposes of sub-subparagraph (A), the institution maps the counterparty to specific credit spread data based on the counterparty's geographical location, internal rating and business type;

(ii) the relevant models use data (either historical or implied) that include data from a period of credit stress and use such data in a manner that is consistent with the method used for the calibration of the relevant models to current market data;

(iii) for the purposes of evaluating the effectiveness of its stress calibration, the institution creates several benchmark portfolios that are vulnerable to the same main risk factors to which the institution is exposed and compares the exposures to the benchmark portfolios calculated using—

(A) current positions at current market prices, and model parameters calibrated in the manner set out in paragraph (f)(i); and

(B) current positions at market prices at the end of the 3 years referred to in paragraph (f)(i), and model parameters

calibrated in the manner set out in that paragraph.

4. Specific requirements relating to stress-testing

Without limiting sections 1, 2 and 3 of this Schedule, an authorized institution must demonstrate to the satisfaction of the Monetary Authority that—

(a) the institution has a comprehensive stress-testing programme for counterparty credit risk that is conducted regularly and includes the following elements—

(i) the programme comprehensively captures transactions and aggregates exposures across all forms of trading and across different product categories at the counterparty-specific level, and the time frame selected for the capturing and aggregation is commensurate with the frequency with which stress tests are conducted;

(ii) there is at least monthly stress-testing of principal market risk factors, including interest rates, exchange rates, equities prices, credit spreads and commodity prices, for all counterparties of the institution to assess and address concentration in specific directional risks;

(iii) there is at least quarterly multifactor stress-testing to assess material non-directional risks including yield curve exposures and basis risks, and the stress-testing addresses, at a minimum, the following scenarios—

(A) severe economic or market events;

(B) significant decrease in broad market liquidity;

(C) the liquidation of a large financial intermediary;

(iv) there is at least quarterly stress-testing of joint movement of counterparty credit risk exposures and related counterparty creditworthiness;

(v) the stress tests (including those referred to in subparagraphs (i), (ii), (iii) and (iv)) are conducted at the counterparty-specific level and the counterparty-group level (grouped by industry, region or other relevant criteria), and in aggregate at the institution-wide level;

(vi) the severity of shocks is consistent with the purpose of the stress test;

(vii) the programme includes provision, where appropriate, for reverse stress tests to identify extreme, but plausible, scenarios that could result in significant adverse outcomes; and

(b) the stress-testing results—

(i) are reported regularly to the institution's senior management and periodically to the institution's board of directors (or a committee designated by the board) and cover the largest counterparty-level impacts across the institution's portfolio, material segmental concentrations (within the same industry or region) and portfolio and counterparty specific trends; and

(ii) are used in—

(A) managing the institution's counterparty credit risk, including the setting of policies, risk appetite and exposure limits and the identification and mitigation of excessive or concentrated risks relative to the institution's risk appetite; and

(B) performing the assessment of the adequacy of the institution's regulatory capital and internal capital for counterparty credit risk and the institution's ability to withstand any future events, or changes in economic conditions, that could have adverse effects on the institution's counterparty credit risk exposures.

5. Specific requirements relating to model validation

Without limiting sections 1, 2, 3 and 4 of this Schedule, an authorized institution must demonstrate to the satisfaction of the Monetary Authority that—

(a) the institution has a reliable validation system for validating the accuracy, comprehensiveness and consistency of the relevant models (including the risk measures and risk factor predictions generated by or used in the models) by parties—

(i) who are qualified and trained to do so and who are independent of the staff and management responsible for originating counterparty credit risk and the development of the relevant models; and

(ii) whose aim is to ascertain whether the relevant models are conceptually sound, able to capture all material factors affecting counterparty default risk, and continue to perform as intended;

(b) the validation referred to in paragraph (a) must meet the following requirements—

(i) the validation is conducted—

(A) when a relevant model is initially developed and thereafter regularly at a frequency that is adequate to reflect the recent performance of the model; and

(B) when any significant changes are made to a relevant model or when there have been significant structural changes in the market or changes to the composition of the institution's portfolio of exposures that might lead to the relevant model concerned no longer being adequate to capture all material factors affecting counterparty default risk;

(ii) the validation assesses the accuracy, comprehensiveness and consistency of the relevant models in respect of the results generated by the models at both the institution-wide level and the netting set level;

(iii) the validation procedures—

(A) are clearly documented in sufficient detail as will enable a third party to evaluate the appropriateness of the

procedures and re-create the analysis performed by the institution;

(B) define assessment criteria and describe the process by which unacceptable performance will be determined and remedied;

(C) ensure that the relevant models cover all factors and products that have a material contribution to counterparty default risk exposure;

(D) ensure that all counterparties for which the relevant models are used are covered by the validation;

(E) ensure that both the assumptions and approximations underlying the relevant models are prudent and appropriate for the measurement of the institution's counterparty default risk exposures; and

(F) define how representative counterparty portfolios are constructed under paragraph (d)(v) for the purposes of the validation;

(c) the validation of the relevant models and the risk measures that produce forecasts of distributions assesses more than a single statistic of the distributions;

(d) as part of the initial and on-going validation process, the institution—

(i) conducts appropriate back-testing to—

(A) assess the performance of the relevant models and the risk measures and

market risk factor predictions that are used to estimate EE; and

(B) test the key assumptions of the relevant models and the risk measures;

(ii) includes in back-testing—

(A) a number of distinct prediction time horizons set out to at least one year, over a range of various start dates and covering a wide range of market conditions; and

(B) for collateralized transactions, prediction time horizons that reflect typical margin periods of risk applied in such transactions and long time horizons that are at least one year;

(iii) tests the pricing models used to calculate counterparty default risk exposure for a given scenario of future shocks to market risk factors and against appropriate independent benchmarks;

(iv) verifies that transactions are assigned to an appropriate netting set within the relevant models;

(v) conducts static, historical back-testing on representative counterparty portfolios, with the representative counterparty portfolios chosen based on their sensitivity to the material risk factors and correlations to which the institution is exposed;

(vi) validates the relevant models and risk measures out to time horizons that are

commensurate with the maturity of transactions covered by the institution's IMM(CCR) approval; and

(vii) assesses the frequency with which the parameters of the relevant models are updated; and

(e) the validation results, including those of back-testing, are reviewed periodically by a level of management with sufficient authority to decide the actions that will be taken to address any weaknesses identified in the relevant models.

6. Additional requirements relating to relevant models that capture effects of margin agreements

Without limiting sections 1, 2, 3, 4 and 5 of this Schedule, an authorized institution must demonstrate to the satisfaction of the Monetary Authority that, if the relevant models used by the institution capture the effects of margin agreements when estimating EE, the models—

(a) meet the requirements of sections 1, 2, 3, 4 and 5 of this Schedule in respect of the prediction of future collateral values;

(b) include transaction-specific information in order to capture the effects of margining;

(c) take into account both the current amount of collateral and collateral that would be passed between counterparties in the future;

(d) account for the nature of margin agreements (whether the agreement concerned is unilateral or bilateral), the frequency of margin calls, the margin period of risk, the margin thresholds, and the minimum transfer amount; and

(e) either estimate the mark-to-market change in the value of collateral posted, or apply the rules for recognized collateral set out in Part 4, 5 or 6 of these Rules, as the case requires.

7. Additional requirements relating to shortcut method

Without limiting sections 1, 2, 3, 4, 5 and 6 of this Schedule, an authorized institution that uses the shortcut method must demonstrate to the satisfaction of the Monetary Authority that—

(a) the institution's back-testing programme tests regularly whether the counterparty default risk exposures predicted by the shortcut method over all margin periods of risk within one year are consistent with the realized values of the exposures;

(b) if some of the transactions in a netting set have a maturity of less than one year and the netting set would have higher risk factor sensitivities if those transactions were removed from the netting set, this fact will be taken into account in the back-testing and other validation processes for the method; and

(c) the institution has procedures to ensure that if the back-testing result indicates that effective EPE is underestimated, appropriate actions will be taken to make the predicted values more conservative.".

159. 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,"—

Add

"226Q,".

(2) Schedule 3, section 4(g)—

Repeal

"on Banking Supervision".

160. Schedules 4A to 4H added

After Schedule 4—

Add

"Schedule 4A [s. 2 & Sch. 4D]

Qualifying Criteria to be Met to be CET1 Capital

1. Qualifying criteria

A capital instrument qualifies as CET1 capital of an authorized institution only if the following criteria are met—

(a) the instrument entitles the holder of the instrument to the most subordinated claim in a liquidation of the institution;

(b) the instrument entitles the holder of the instrument to a claim on the residual assets of the institution, that, in the event of its liquidation, and after the payment of all senior claims, is proportional with the holder's share of issued capital and is not fixed or subject to a cap (that is, the holder has an unlimited and variable claim);

(c) the instrument is perpetual and the principal amount of the instrument must not be repaid outside of a liquidation (except discretionary repurchases or other discretionary means of reducing capital that is permitted under applicable law);

(d) the institution has not created, and has not done anything to create, an expectation at issuance that the instrument will be bought back, redeemed or cancelled, and there are no statutory or contractual terms that might reasonably give rise to such an expectation;

(e) for distributions to holders of the instrument—

(i) the distributions are paid only out of distributable items;

(ii) the level of distributions is not in any way tied or linked to the amount paid up at issuance;

(iii) the terms and conditions of the instrument do not include a cap or other restrictions on the maximum level of distributions except to the extent that the institution is unable to pay distributions that exceed the level of distributable items;

(iv) the terms and conditions of the instrument do not include any obligation for the institution to make distributions to holders of the instrument;

(v) the non-payment of distributions does not constitute an event of default of the institution; and

(vi) there are no preferential distributions, including in respect of CET1 capital instruments, and distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made;

(f) subject to section 2 of this Schedule, the instrument takes the first and proportionately greatest share of losses as they occur;

(g) the instrument absorbs losses on a going concern basis proportionately and pari passu with all other CET1 capital instruments of the same quality issued by the institution;

(h) the paid-up amount is recognized as equity capital for the purposes of determining balance sheet insolvency;

(i) the paid-up amount is classified as equity within the meaning of applicable accounting standards;

(j) the instrument is directly issued by the institution and paid up;

(k) the institution has not directly or indirectly funded the purchase of the instrument;

(l) the paid-up amount is not secured or covered by a guarantee of the institution or by an affiliate of the institution, and is not subject to any other arrangement that legally or economically enhances the seniority of the claim;

(m) the instrument is only issued with the approval of the shareholders of the institution, either given directly by the shareholders or, if permitted by applicable law, given by the board of directors or by other persons duly authorized by the shareholders;

(n) the instrument is clearly and separately disclosed on the balance sheet in the financial statements of the institution.

2. Provision supplementary to section 1(f) of this Schedule

Where the capital instrument referred to in section 1(f) of this Schedule is an ordinary share, and the authorized institution concerned has any other capital instrument that has a permanent write-down feature, the criterion set out in that section is to be assessed in respect of the ordinary share as if the institution had no such other capital instrument.

Schedule 4B

[ss. 2 & 39 & Schs. 4D & 4H]

Qualifying Criteria to be Met to be Additional Tier 1 Capital

1. Qualifying criteria

A capital instrument qualifies as Additional Tier 1 capital of an authorized institution only if the following criteria are met—

(a) the instrument is issued and paid up;

(b) the instrument is subordinated to depositors, general creditors and other subordinated debt of the institution;

(c) the paid-up amount is not secured or covered by a guarantee of the institution or by an affiliate of the institution, and is not subject to any other arrangement that legally or economically enhances the seniority of the claim;

(d) the instrument is perpetual and the terms and conditions of the instrument contain no step-ups or other incentives to redeem;

(e) if the terms and conditions of the instrument include one or more call options, any such option may only be exercised at the initiative of the issuer after at least 5 years, and—

(i) to exercise a call option, the institution must have the prior consent of the Monetary Authority;

(ii) the institution has not created, and has not done anything to create, an expectation at issuance that the call option will be exercised; and

(iii) the institution must not exercise a call option unless it—

(A) replaces the called instrument with capital of the same or better quality and the replacement of the capital is effected on conditions that are sustainable for the income capacity of the institution; or

(B) demonstrates that its capital position is well above the minimum capital requirements applicable to it, and will remain to be well above those requirements after the call option is exercised;

(f) any repayment of principal (whether through repurchase, redemption or otherwise) can only be made with the prior consent of the Monetary Authority and the institution has not assumed or

created market expectations that the Monetary Authority's consent will be given;

(g) the dividend or coupon distributions in respect of the instrument are subject to the following—

(i) the institution has full discretion at all times to cancel the distributions on the instrument for an unlimited period and on a non-cumulative basis;

(ii) the institution has full access to cancelled payments to meet its obligations as they fall due;

(iii) the cancellation of distributions on the instrument does not constitute an event of default for the instrument;

(iv) the cancellation of distributions on the instrument imposes no restrictions on the institution except in relation to distributions to ordinary shareholders;

(h) dividends or coupons are paid only out of distributable items;

(i) the instrument does not have a credit sensitive dividend feature such that the level of dividend or coupon to be paid is reset periodically based in whole or in part on the institution's own credit risk;

(j) the instrument does not contribute to liabilities exceeding assets of the institution if a balance sheet test forms part of national insolvency law applicable to the insolvency of the issuing institution;

(k) where the instrument is classified as a liability for accounting purposes—

(i) the terms and conditions of the instrument include a provision requiring the amount of the instrument to be written down, or converted to ordinary shares, when the CET1 capital ratio of the institution reaches—

(A) a level at or below 5.125%; or

(B) a level higher than 5.125% where determined by the institution and specified in the terms and conditions of the instrument;

(ii) the write-down or conversion to be effected under subparagraph (i) generates equity capital under applicable accounting standards and the instrument only receives recognition in Additional Tier 1 capital up to the minimum level of CET1 capital generated by a full write-down or conversion of the instrument; and

(iii) under the terms and conditions of the instrument, the write-down or conversion will occur at least to the extent necessary to return the institution's CET1 capital ratio to a level specified in subparagraph (i) or to the extent of the full amount of the instrument, whichever is the lower;

(l) for the purposes of paragraph (k), the write-down mechanism that allocates losses to the instrument when the CET1 capital ratio falls to a level specified in paragraph (k)(i) has the following effects—

(i) it reduces the claim of the holder of the instrument in a liquidation of the institution;

(ii) it reduces the amount to be re-paid when a call option is exercised;

(iii) it partially or fully reduces dividend or coupon distributions in respect of the instrument;

(m) neither the institution nor an affiliate of the institution over which the institution exercises control or significant influence (excluding the holding company of the institution) has purchased the instrument;

(n) the institution has not directly or indirectly funded the purchase of the instrument;

(o) the instrument has no features that hinder recapitalization (for example, provisions that require the issuer to compensate holders of the instrument if a new instrument is issued at a lower price during a specified time frame);

(p) if the instrument is not issued out of an operating entity (being an entity established to conduct business with clients with a view to making a profit in its own right) or any holding company of the institution (for example, the instrument is issued by a special purpose vehicle), proceeds are immediately available without limitation to an operating entity or the holding company of the institution, as the case may be, in a form that meets all of the other qualifying criteria set out in this Schedule for inclusion in Additional Tier 1 capital;

(q) the terms and conditions of the instrument contain a provision requiring the instrument to be written down, or converted into ordinary shares, at the

point of non-viability and, in this regard, the institution ensures that—

(i) the instrument will be either written off or converted into ordinary shares on the occurrence of the trigger event;

(ii) any compensation paid to the holders of the instrument as a result of a write-off will be paid immediately in the form of ordinary shares of the institution or, with the Monetary Authority's prior consent, of any other company;

(iii) the trigger event is the earlier of—

(A) the Monetary Authority notifying the institution in writing that the Monetary Authority is of the opinion that a write-off or conversion is necessary, without which the institution would become non-viable; or

(B) the Monetary Authority notifying the institution in writing that a decision has been made by the government body, a government officer or other relevant regulatory body with the authority to make such a decision, that a public sector injection of capital or equivalent support is necessary, without which the institution would become non-viable;

(iv) the issuance of new ordinary shares as a result of the trigger event can occur promptly following the occurrence of such trigger event so that, in the case of the trigger event referred to in subparagraph (iii)(B), it can

occur before any public sector injection of capital thereby ensuring that the capital provided by the public sector will not be diluted;

(v) (if the institution wishes any instrument issued by an overseas subsidiary of the institution to be included in the capital base for the purposes of calculating its consolidated capital adequacy ratio pursuant to a section 3C requirement in addition to being included in the overseas subsidiary's solo capital adequacy ratio) the terms and conditions of the instrument specify that the Monetary Authority, in addition to the relevant authority in the jurisdiction of the overseas subsidiary, may trigger the write-down or conversion of the instrument;

(vi) (if the institution issuing the instrument is a Hong Kong subsidiary of an overseas banking group and the institution wishes the instrument to be included in the calculation of the capital adequacy ratio of its parent bank on a consolidated basis in addition to being included in its solo capital adequacy ratio) the terms and conditions of the instrument specify an additional trigger event, being the earlier of—

(A) the home authority notifying the parent bank of the institution in writing that the authority is of the opinion that a write-off or conversion is necessary, without which the institution or the parent bank

of the institution would become non-viable; or

(B) the home authority notifying the parent bank of the institution in writing that the authority has decided that a public sector injection of capital or equivalent support, in the jurisdiction of the home authority, is necessary, without which the institution or the parent bank of the institution would become non-viable;

(vii) the institution maintains, at all times, all prior authorization necessary to immediately issue the relevant number of ordinary shares specified in the terms and conditions of the instrument, and there are no impediments to the write-off or automatic conversion of the instrument into ordinary shares of the institution if the trigger event or additional trigger event occurs; and

(viii) the institution submits the following information and documents to the Monetary Authority and obtains the prior consent of the Monetary Authority before including any issuance of a capital instrument as Additional Tier 1 capital—

(A) if the terms and conditions of the instrument provide for trigger events in addition to the trigger events specified under this paragraph, a notice in writing to the Monetary Authority containing—

(I) the rationale for those additional trigger events; and

(II) an assessment by the institution of the possible market implications that might arise from the inclusion of those additional trigger events or on the occurrence of those additional trigger events;

(B) a detailed description of the rationale for the specified conversion method, including computations of the indicative dilution of the institution's ordinary shares that would occur on the occurrence of the trigger event and the resulting ordinary shareholder structure, and an explanation of why such a conversion method would help to ensure or maintain the viability of the institution.

2. Application of section 1(k) and (q) of this Schedule to capital instruments other than ordinary shares

Section 1(k) and (q) of this Schedule, with necessary modifications, applies to a capital instrument that is equivalent to an ordinary share in the case of an entity other than a joint-stock company as it applies to an ordinary share in the case of a joint-stock company.

Schedule 4C [ss. 2 & 40 & Schs. 4D & 4H]

Qualifying Criteria to be Met to be Tier 2 Capital

1. Qualifying criteria

A capital instrument qualifies as Tier 2 capital of an authorized institution only if the following criteria are met—

(a) the instrument is issued and paid up;

(b) the instrument is subordinated to depositors and general creditors of the institution;

(c) the paid-up amount is not secured or covered by a guarantee of the institution or by an affiliate of the institution, and is not subject to any other arrangement that legally or economically enhances the seniority of the claim;

(d) the instrument has a minimum original maturity of at least 5 years, the terms and conditions of the instrument contain no step-ups or other incentives to redeem, and the recognition of the instrument in regulatory capital in the remaining 5 years before maturity is amortized on a straight line basis of 20% per year;

(e) if the terms and conditions of the instrument include one or more call options, any such option may only be exercised at the initiative of the issuer after at least 5 years, and—

(i) to exercise a call option, the institution must have the prior consent of the Monetary Authority;

(ii) the institution has not created, and has not done anything to create, an expectation at issuance that the call option will be exercised; and

(iii) the institution must not exercise a call option unless it—

(A) replaces the called instrument with capital of the same or better quality and the replacement of the capital is effected on conditions that are sustainable for the income capacity of the institution; or

(B) demonstrates that its capital position is well above the minimum capital requirements applicable to it, and will remain to be well above those requirements after the call option is exercised;

(f) the holders of the instrument have no rights to accelerate the payment or repayment of future scheduled payments (coupon or principal) except in the event of a liquidation of the institution;

(g) the instrument does not have a credit sensitive dividend feature such that the level of dividend or coupon to be paid is reset periodically based in whole or in part on the institution's own credit risk;

(h) neither the institution nor an affiliate of the institution over which the institution exercises control or significant influence (excluding the

holding company of the institution) has purchased the instrument;

(i) the institution has not directly or indirectly funded the purchase of the instrument;

(j) if the instrument is not issued out of an operating entity (being an entity established to conduct business with clients with a view to making a profit in its own right) or any holding company of the institution (for example, the instrument is issued by a special purpose vehicle), proceeds are immediately available without limitation to an operating entity or the holding company of the institution, as the case may be, in a form that meets all of the other qualifying criteria set out in this Schedule for inclusion in Tier 2 capital;

(k) the terms and conditions of the instrument contain a provision requiring the instrument to be written down, or converted into ordinary shares, at the point of non-viability and, in this regard, the institution ensures that—

(i) the instrument will be either written off or converted into ordinary shares on the occurrence of the trigger event;

(ii) any compensation paid to the holders of the instrument as a result of a write-off will be paid immediately in the form of ordinary shares of the institution or, with the Monetary Authority's prior consent, of any other company;

(iii) the trigger event is the earlier of—

(A) the Monetary Authority notifying the institution in writing that the Monetary

Authority is of the opinion that a write-off or conversion is necessary, without which the institution would become non-viable; or

(B) the Monetary Authority notifying the institution in writing that a decision has been made by the government body, a government officer or other relevant regulatory body with the authority to make such a decision, that a public sector injection of capital or equivalent support is necessary, without which the institution would become non-viable;

(iv) the issuance of new ordinary shares as a result of the trigger event can occur promptly following the occurrence of such trigger event so that, in the case of the trigger event referred to in subparagraph (iii)(B), it can occur before any public sector injection of capital thereby ensuring that the capital provided by the public sector will not be diluted;

(v) (if the institution wishes any instrument issued by an overseas subsidiary of the institution to be included in the capital base for the purposes of calculating its consolidated capital adequacy ratio pursuant to a section 3C requirement in addition to being included in the overseas subsidiary's solo capital adequacy ratio) the terms and conditions of the instrument specify that the Monetary Authority, in addition to the relevant authority in the jurisdiction of the

overseas subsidiary, may trigger the write-down or conversion of the instrument;

(vi) (if the institution issuing the instrument is a Hong Kong subsidiary of an overseas banking group and the institution wishes the instrument to be included in the calculation of the capital adequacy ratio of its parent bank on a consolidated basis in addition to being included in its solo capital adequacy ratio) the terms and conditions of the instrument specify an additional trigger event, being the earlier of—

(A) the home authority notifying the parent bank of the institution in writing that the authority is of the opinion that a write-off or conversion is necessary, without which the institution or the parent bank of the institution would become non-viable; or

(B) the home authority notifying the parent bank of the institution in writing that the authority has decided that a public sector injection of capital or equivalent support, in the jurisdiction of the home authority, is necessary, without which the institution or the parent bank of the institution would become non-viable;

(vii) the institution maintains, at all times, all prior authorization necessary to immediately issue the relevant number of ordinary shares specified in the terms and conditions of the instrument and there are no impediments to the write-off or automatic conversion of the

instrument into ordinary shares of the institution if the trigger event or additional trigger event occurs; and

(viii) the institution submits the following information and documents to the Monetary Authority and obtains the prior consent of the Monetary Authority before including any issuance of a capital instrument as Tier 2 capital—

(A) if the terms and conditions of the instrument provide for trigger events in addition to the trigger events specified under this paragraph, a notice in writing to the Monetary Authority containing—

(I) the rationale for those additional trigger events; and

(II) an assessment by the institution of the possible market implications that might arise from the inclusion of those additional trigger events or on the occurrence of those additional trigger events;

(B) a detailed description of the rationale for the specified conversion method, including computations of the indicative dilution of the institution's ordinary shares that would occur on the occurrence of the trigger event and the resulting ordinary shareholder structure, and an explanation of why such a conversion method would help to ensure

or maintain the viability of the institution.

2. Application of section 1(k) of this Schedule to capital instruments other than ordinary shares

Section 1(k) of this Schedule, with necessary modifications, applies to a capital instrument that is equivalent to an ordinary share in the case of an entity other than a joint-stock company as it applies to an ordinary share in the case of a joint-stock company.

Schedule 4D

[ss. 38, 39 & 40]

Requirements to be Met for Minority Interests and Capital Instruments Issued by Consolidated Bank Subsidiaries and Held by Third Parties to be Included in Authorized Institution's Capital Base

1. Interpretation of Schedule 4D

In this Schedule—

retained earnings (保留溢利) has the meaning given by section 35 of these Rules;

Tier 1 capital instrument (一級資本票據) means CET1 capital instrument and Additional Tier 1 capital instrument.

2. Minority interests and capital instruments

(1) For inclusion of a minority interest arising from the CET1 capital instruments issued by a consolidated bank subsidiary of an authorized institution and held by third parties (***minority interest***) in the institution's CET1 capital calculated on a consolidated basis, the following requirements must be met—

(a) the CET1 capital instruments would, if they were issued by the institution, meet the qualifying criteria set out in Schedule 4A for inclusion in CET1 capital;

(b) the minority interest must include retained earnings and reserves and share premium accounts, if any, of the consolidated bank subsidiary that are attributable to third parties resulting from the issue of the CET1 capital instruments.

(2) For inclusion of a capital instrument issued by a consolidated bank subsidiary of an authorized institution and held by third parties (***minority capital instrument***) in the institution's Additional Tier 1 capital, Tier 1 capital, Tier 2 capital and Total capital calculated on a consolidated basis, the following requirements must be met—

(a) for inclusion in the institution's Additional Tier 1 capital, the minority capital instrument would, if it were issued by the institution, meet the qualifying criteria set out in Schedule 4B;

(b) for inclusion in the institution's Tier 2 capital, the minority capital instrument would, if it were issued by the institution, meet the qualifying criteria set out in Schedule 4C;

(c) the minority capital instrument must include share premium accounts, if any, of the consolidated bank subsidiary that are attributable to third parties resulting from the issue of the instrument.

(3) For inclusion of a minority interest or minority capital instrument in an authorized institution's capital base calculated on a consolidated basis, the institution or an affiliate of the institution must not fund directly or indirectly (whether through a special purpose vehicle or through any other vehicle or arrangement) the purchase of the interest or instrument in the relevant consolidated bank subsidiary of the institution.

(4) For inclusion of a minority interest or minority capital instrument in an authorized institution's capital base calculated on a consolidated basis, capital instruments issued by subsidiaries of the institution and held by third parties before 1 January 2013 that do not—

(a) meet the qualifying criteria set out in Schedule 4A for inclusion in CET1 capital;

(b) meet the qualifying criteria set out in Schedule 4B for inclusion in Additional Tier 1 capital; or

(c) meet the qualifying criteria set out in Schedule 4C for inclusion in Tier 2 capital,

are subject to the transitional arrangements set out in sections 2 and 4 of Schedule 4H.

3. Computation of applicable amount of minority interests for inclusion in authorized institution's CET1 capital on consolidated basis

(1) Where a bank subsidiary of an authorized institution is a member of the institution's consolidation group, the maximum amount of minority interests in the subsidiary

that may be included in the CET1 capital of the institution on a consolidated basis is the total amount of minority interests arising from the issuance by the subsidiary to third parties of CET1 capital instruments that meet the requirements of section 2 of this Schedule, less the amount of surplus CET1 capital of the subsidiary attributable to third parties, where—

(a) the surplus CET1 capital of the subsidiary is calculated as the CET1 capital of the subsidiary less the lower of—

(i) the sum of the risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk of the subsidiary, calculated on a solo basis or a solo-consolidated basis, as the case may be, multiplied by a percentage equal to the sum of—

(A) subject to subsection (2), the minimum CET1 capital ratio that the subsidiary must comply with, on a solo basis or a solo-consolidated basis, as the case may be, under sections 3A and 3B of these Rules and, if applicable, as varied by the Monetary Authority under section 97F of the Ordinance (specified minimum ratio); and

(B) 2.5%; or

(ii) the portion of the sum of the risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk of the institution calculated on a consolidated basis, that relates to the

subsidiary, multiplied by a percentage equal to the sum of—

(A) subject to subsection (2), the minimum CET1 capital ratio that the institution must comply with, on a consolidated basis, under sections 3A and 3B of these Rules and, if applicable, as varied by the Monetary Authority under section 97F of the Ordinance (specified minimum ratio); and

(B) 2.5%; and

(b) the amount of the surplus CET1 capital of the subsidiary that is attributable to third parties is calculated by multiplying the surplus CET1 capital by the percentage of the CET1 capital instruments in the subsidiary that are held by third parties.

(2) Subject to subsection (3), an authorized institution may choose to use 4.5% instead of the specified minimum ratio referred to in subsection (1)(a)(i)(A) and (ii)(A).

(3) For the purposes of subsection (2)—

(a) an authorized institution must notify the Monetary Authority before it uses the substitute percentage referred to in that subsection; and

(b) if an authorized institution has chosen to use the substitute percentage referred to in that subsection, the institution must not, without the Monetary Authority's prior consent, use the specified minimum ratio referred to in subsection (1)(a)(i)(A) and (ii)(A).

(4) To avoid doubt—

(a) the calculation under subsection (1) must be undertaken for each individual bank subsidiary separately; and

(b) an authorized institution must use only either the specified minimum ratio referred to in subsection (1)(a)(i)(A) and (ii)(A) or the substitute percentage referred to in subsection (2) in respect of all the bank subsidiaries of the institution that are members of the institution's consolidation group.

4. Computation of applicable amount of minority interests and minority capital instruments for inclusion in authorized institution's Tier 1 capital on consolidated basis

(1) Subject to subsection (2), where a bank subsidiary of an authorized institution is a member of the institution's consolidation group, the maximum amount of Tier 1 capital instruments issued by the subsidiary to third parties that may be included in the Tier 1 capital of the institution on a consolidated basis is the total amount of Tier 1 capital instruments held by third parties that meet the requirements of section 2 of this Schedule, less the amount of surplus Tier 1 capital of the subsidiary attributable to third parties, where—

(a) the surplus Tier 1 capital of the subsidiary is calculated as the Tier 1 capital of the subsidiary less the lower of—

(i) the sum of the risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk of the subsidiary, calculated on a solo basis or a solo-consolidated basis, as the case

may be, multiplied by a percentage equal to the sum of—

(A) subject to subsection (3), the minimum Tier 1 capital ratio that the subsidiary must comply with, on a solo basis or a solo-consolidated basis, as the case may be, under sections 3A and 3B of these Rules and, if applicable, as varied by the Monetary Authority under section 97F of the Ordinance (specified minimum ratio); and

(B) 2.5%; or

(ii) the portion of the sum of the risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk of the institution calculated on a consolidated basis, that relates to the subsidiary, multiplied by a percentage equal to the sum of—

(A) subject to subsection (3), the minimum Tier 1 capital ratio that the institution must comply with, on a consolidated basis, under sections 3A and 3B of these Rules and, if applicable, as varied by the Monetary Authority under section 97F of the Ordinance (specified minimum ratio); and

(B) 2.5%; and

(b) the amount of the surplus Tier 1 capital of the subsidiary that is attributable to third parties is calculated by multiplying the surplus Tier 1 capital by the percentage of the sum of the Tier 1 capital

instruments in the subsidiary that are held by third parties.

(2) The amount of Tier 1 capital recognized in the consolidated Additional Tier 1 capital of an authorized institution must exclude the portion that has been recognized in the consolidated CET1 capital under section 3 of this Schedule.

(3) Subject to subsection (4), an authorized institution may choose to use 6% instead of the specified minimum ratio referred to in subsection (1)(a)(i)(A) and (ii)(A).

(4) For the purposes of subsection (3)—

(a) an authorized institution must notify the Monetary Authority before it uses the substitute percentage referred to in that subsection; and

(b) if an authorized institution has chosen to use the substitute percentage referred to in that subsection, the institution must not, without the Monetary Authority's prior consent, use the specified minimum ratio referred to in subsection (1)(a)(i)(A) and (ii)(A).

(5) To avoid doubt—

(a) the calculation under subsection (1) must be undertaken for each individual bank subsidiary separately; and

(b) an authorized institution must use only either the specified minimum ratio referred to in subsection (1)(a)(i)(A) and (ii)(A) or the substitute percentage referred to in subsection (3) in respect of all the bank subsidiaries of the institution that are members of the institution's consolidation group.

5. Computation of applicable amount of minority interests and minority capital instruments for inclusion in authorized institution's Total capital on consolidated basis

(1) Subject to subsection (2), where a bank subsidiary of an authorized institution is a member of the institution's consolidation group, the maximum amount of Tier 1 capital instruments and Tier 2 capital instruments issued by the subsidiary to third parties that may be included in the Total capital of the institution on a consolidated basis is the total amount of Tier 1 capital instruments and Tier 2 capital instruments held by third parties that meet the requirements of section 2 of this Schedule, less the amount of surplus Total capital of the subsidiary attributable to third parties, where—

(a) the surplus Total capital of the subsidiary is calculated as the Total capital of the subsidiary less the lower of—

(i) the sum of the risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk of the subsidiary, calculated on a solo basis or a solo-consolidated basis, as the case may be, multiplied by a percentage equal to the sum of—

(A) subject to subsection (3), the minimum Total capital ratio that the subsidiary must comply with, on a solo basis or a solo-consolidated basis, as the case may be, under sections 3A and 3B of these Rules and, if applicable, as varied by the Monetary Authority under section 97F of the Ordinance (specified minimum ratio); and

(B) 2.5%; or

(ii) the portion of the sum of the risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk of the institution calculated on a consolidated basis, that relates to the subsidiary, multiplied by a percentage equal to the sum of—

(A) subject to subsection (3), the minimum Total capital ratio that the institution must comply with, on a consolidated basis, under sections 3A and 3B of these Rules and, if applicable, as varied by the Monetary Authority under section 97F of the Ordinance (specified minimum ratio); and

(B) 2.5%; and

(b) the amount of the surplus Total capital of the subsidiary that is attributable to third parties is calculated by multiplying the surplus Total capital by the percentage of the sum of the Tier 1 capital instruments and Tier 2 capital instruments in the subsidiary that are held by third parties.

(2) The amount of Total capital recognized in the consolidated Tier 2 capital of an authorized institution must exclude the portion that has been recognized in the consolidated Tier 1 capital under section 4 of this Schedule.

(3) Subject to subsection (4), an authorized institution may choose to use 8% instead of the specified minimum ratio referred to in subsection (1)(a)(i)(A) and (ii)(A).

(4) For the purposes of subsection (3)—

(a) an authorized institution must notify the Monetary Authority before it uses the substitute percentage referred to in that subsection; and

(b) if an authorized institution has chosen to use the substitute percentage referred to in that subsection, the institution must not, without the Monetary Authority's prior consent, use the specified minimum ratio referred to in subsection (1)(a)(i)(A) and (ii)(A).

(5) To avoid doubt—

(a) the calculation under subsection (1) must be undertaken for each individual bank subsidiary separately; and

(b) an authorized institution must use only either the specified minimum ratio referred to in subsection (1)(a)(i)(A) and (ii)(A) or the substitute percentage referred to in subsection (3) in respect of all the bank subsidiaries of the institution that are members of the institution's consolidation group.

Schedule 4E

[ss. 43, 47 & 48]

Deduction of Holdings of Own CET1 Capital Instruments, Additional Tier 1 Capital Instruments and Tier 2 Capital Instruments

1. Deduction of holdings of own CET1 capital instruments, Additional Tier 1 capital instruments and Tier 2 capital instruments

(1) For the purposes of sections 43(1)(l), 47(1)(a) and 48(1)(a) of these Rules, an authorized institution must, subject to subsections (2), (3) and (4)—

(a) calculate the amount of any direct holdings, indirect holdings or synthetic holdings of its own CET1 capital instruments, Additional Tier 1 capital instruments and Tier 2 capital instruments (***own capital instruments***) to be deducted from its capital base on the basis of gross long positions (irrespective of whether the positions are booked in the banking book or the trading book); and

(b) make such deductions from its CET1 capital, Additional Tier 1 capital or Tier 2 capital, as the case requires.

(2) An authorized institution must calculate the amount of holdings of its own capital instruments on the basis of the net long position if the long and short positions are in the same underlying exposure and the short positions involve no counterparty credit risk.

(3) An authorized institution must take the amount to be deducted for indirect holdings that take the form of

holdings of index securities as the amount of holdings of index securities that corresponds to the proportion of its own capital instruments included in the underlying index.

(4) An authorized institution must net gross long positions in its own capital instruments resulting from holdings of index securities against short positions in its own capital instruments resulting from short positions in the same underlying index, including where those short positions involve counterparty credit risk.

Schedule 4F [ss. 43, 47 & 48]

Deduction of Holdings where Authorized Institution has Insignificant Capital Investments in Financial Sector Entities that are outside Scope of Consolidation under Section 3C Requirement

1. Deduction of holdings

(1) For the purposes of sections 43(1)(o), 47(1)(c) and 48(1)(c) of these Rules, an authorized institution must—

(a) calculate the applicable amount of its insignificant capital investments in capital instruments issued by financial sector entities to be deducted from CET1 capital, Additional Tier 1 capital or Tier 2 capital; and

(b) make such deductions from its CET1 capital, Additional Tier 1 capital or Tier 2 capital, as the case requires.

(2) The amount of an authorized institution's insignificant capital investments in CET1 capital instruments issued by financial sector entities to be deducted from the institution's CET1 capital must be calculated by—

(a) aggregating all of the institution's holdings of insignificant capital investments issued by financial sector entities;

(b) ascertaining the applicable amount of the institution's holdings of insignificant capital investments in financial sector entities that in aggregate exceed 10% of the institution's CET1 capital (calculated after applying all regulatory deductions under sections 38(2) and 43(1) of these Rules except those set out in section 43(1)(n), (o), (p) or (q) of these Rules);

(c) ascertaining the institution's holdings of CET1 capital investments in financial sector entities as a percentage of the institution's total holdings of insignificant capital investments in those entities; and

(d) multiplying the sum obtained in paragraph (b) by the percentage obtained in paragraph (c).

(3) The amount of an authorized institution's insignificant capital investments issued by financial sector entities to be deducted from the institution's Additional Tier 1 capital must be calculated by—

(a) aggregating all of the institution's holdings of insignificant capital investments issued by financial sector entities;

(b) ascertaining the applicable amount of the institution's holdings of insignificant capital investments in financial sector entities that in aggregate exceed 10% of the institution's CET1 capital (calculated after applying all regulatory deductions under sections 38(2) and 43(1) of these Rules except those set out in section 43(1)(n), (o), (p) or (q) of these Rules);

(c) ascertaining the institution's holdings of Additional Tier 1 capital investments in financial sector entities as a percentage of the institution's total holdings of insignificant capital investments in those entities; and

(d) multiplying the sum obtained in paragraph (b) by the percentage obtained in paragraph (c).

(4) The amount of an authorized institution's insignificant capital investments issued by financial sector entities to be deducted from the institution's Tier 2 capital must be calculated by—

(a) aggregating all of the institution's holdings of insignificant capital investments issued by financial sector entities;

(b) ascertaining the applicable amount of the institution's holdings of insignificant capital investments in financial sector entities that in aggregate exceed 10% of the institution's CET1 capital (calculated after applying all regulatory deductions under sections 38(2) and 43(1) of these Rules except those set out in section 43(1)(n), (o), (p) or (q) of these Rules);

(c) ascertaining the institution's holdings of Tier 2 capital investments in financial sector entities as a

percentage of the institution's total holdings of insignificant capital investments in those entities; and

(d) multiplying the sum obtained in paragraph (b) by the percentage obtained in paragraph (c).

(5) An authorized institution's aggregate holdings of insignificant capital investments issued by financial sector entities must be calculated as follows—

(a) direct holdings, indirect holdings and synthetic holdings of capital instruments must be included;

(b) the net long positions in both the banking book and trading book must be included and, in this regard, the gross long position may be offset against a short position in the same underlying exposure if the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year;

(c) underwriting positions held for 5 business days or less (or for such longer period as the Monetary Authority may approve) must be excluded;

(d) subject to subsection (7), if the capital instrument of the entity in which the institution has invested does not meet the qualifying criteria for CET1 capital, Additional Tier 1 capital or Tier 2 capital, the institution must treat the capital instrument as a CET1 capital instrument for the purposes of the deduction; and

(e) the institution may, with the prior consent of the Monetary Authority, temporarily exclude certain investments where they have been made in the context of resolving or providing financial

assistance to reorganize a distressed financial sector entity.

(6) For the purposes of subsection (5)(c), an authorized institution must risk-weight underwriting positions referred to in that subsection in accordance with the applicable risk-weight under Part 4, 5 or 6 of these Rules, as the case requires.

(7) An authorized institution may, with the prior consent of the Monetary Authority, map the capital instrument referred to in subsection (5)(d) to Additional Tier 1 capital or Tier 2 capital, as appropriate, whichever is of the closest corresponding quality for the purposes of the deduction.

(8) For the purposes of subsections (2), (3) and (4)—

(a) the amount of insignificant capital investments issued by financial sector entities that do not exceed the 10% threshold referred to in those subsections and that are not deducted from an authorized institution's CET1 capital, Additional Tier 1 capital or Tier 2 capital is to continue to be risk-weighted in accordance with the applicable risk-weight under Part 4, 5 or 6 of these Rules, as the case requires; and

(b) for the application of risk-weighting, the amount of the investments must be allocated on a pro rata basis between those below and those above that threshold.

Schedule 4G [ss. 43, 47 & 48]

Deduction of Holdings where Authorized Institution has Significant Capital Investments in Financial Sector Entities that are outside Scope of Consolidation under Section 3C Requirement

1. Deduction of holdings

(1) For the purposes of section 43(1)(p) of these Rules, an authorized institution must—

(a) calculate the applicable amount of its significant capital investments in CET1 capital instruments issued by financial sector entities to be deducted from CET1 capital; and

(b) make such deductions from its CET1 capital.

(2) The amount of an authorized institution's significant capital investments in CET1 capital instruments issued by financial sector entities to be deducted from the institution's CET1 capital is the amount by which the shares concerned in aggregate exceed 10% of the institution's CET1 capital (calculated after applying all regulatory deductions under sections 38(2) and 43(1) of these Rules except those set out in section 43(1)(p) of these Rules).

(3) All significant capital investments in capital instruments issued by financial sector entities that are not in the form of CET1 capital instruments must be fully deducted from an authorized institution's Additional Tier 1 capital or Tier 2 capital, as the case requires, by reference to the

tier of capital for which the capital instruments would qualify if they were issued by the institution itself.

(4) An authorized institution's aggregate holdings of significant capital investments in capital instruments issued by financial sector entities must be calculated as follows—

(a) direct holdings, indirect holdings and synthetic holdings of capital instruments must be included;

(b) the net long positions in both the banking book and trading book must be included and, in this regard, the gross long position may be offset against a short position in the same underlying exposure if the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year;

(c) underwriting positions held for 5 business days or less (or for such longer period as the Monetary Authority may approve) must be excluded;

(d) subject to subsection (6), if the capital instrument of the entity in which the institution has invested does not meet the qualifying criteria for CET1 capital, Additional Tier 1 capital or Tier 2 capital, the institution must treat the capital instrument as a CET1 capital instrument for the purposes of the deduction; and

(e) the institution may, with the prior consent of the Monetary Authority, temporarily exclude certain investments where they have been made in the context of resolving or providing financial assistance to reorganize a distressed authorized institution.

(5) For the purposes of subsection (4)(c), an authorized institution must risk-weight underwriting positions referred to in that subsection in accordance with the applicable risk-weight under Part 4, 5 or 6 of these Rules, as the case requires.

(6) An authorized institution may, with the prior consent of the Monetary Authority, map the capital instrument referred to in subsection (4)(d) to Additional Tier 1 capital or Tier 2 capital, as appropriate, whichever is of the closest corresponding quality for the purposes of the deduction.

(7) The amount of an authorized institution's significant capital investment in CET1 capital instruments of a financial sector entity that does not exceed the 10% threshold referred to in subsection (2) and that is not deducted from an authorized institution's CET1 capital must be risk-weighted at 250%.

Schedule 4H

[ss. 43, 47, 48 & 226 & Sch. 4D]

Transitional Arrangements in Relation to Banking (Capital) (Amendment) Rules 2012

1. Interpretation of Schedule 4H

In this Schedule—

core capital (核心資本), in relation to an authorized institution, means the sum, calculated in Hong Kong

dollars, of the net book values of the institution's capital items specified in section 38 of the pre-amended Capital Rules;

pre-amended Capital Rules (《未修訂資本規則》) means the Banking (Capital) Rules (Cap. 155 sub. leg. L) as in force immediately before 1 January 2013;

supplementary capital (附加資本), in relation to an authorized institution, means the sum, calculated in Hong Kong dollars, of the net book values of the institution's capital items specified in section 42 of the pre-amended Capital Rules.

2. Authorized institution may choose not to apply transitional arrangements

(1) An authorized institution may, for any reason, choose not to apply the transitional arrangements set out in this Schedule for a certain item or individual investment that is subject to deduction from CET1 capital, Additional Tier 1 capital or Tier 2 capital, as the case requires, in accordance with Division 4 of Part 3 of these Rules.

(2) If an authorized institution decides not to apply the transitional arrangements set out in this Schedule for an item or investment under subsection (1), it must inform the Monetary Authority in writing of its decision, and must not change its decision without the prior consent of the Monetary Authority.

3. Capital deductions

(1) For those items that must be deducted from the capital base of an authorized institution in accordance with Division 4 of Part 3 of these Rules, the deductions must be made in accordance with the applicable arrangements referred to in this section.

(2) The deduction amount of a certain item or investment for which the transitional arrangements set out in this Schedule apply is the amount of that item or investment that was outstanding immediately before 1 January 2013 (adjusted for any fair value changes as required by applicable accounting standards on each reporting date), and any amount in respect of the same item or investment incurred on or after that date must be deducted in accordance with Division 4 of Part 3 of these Rules.

(3) Table A applies, for the purposes of deduction on and after 1 January 2013, in respect of items that were subject to deduction from core capital under section 48(1) of the pre-amended Capital Rules before that date but are subject to deduction from CET1 capital on and after that date.

Table A

Deductions on and after 1 January 2013

Date	Amount to be deducted from core capital before 1 January 2013 expressed in percentage points	Amount to be deducted from CET1 capital on and after 1 January 2013 expressed in percentage points
Before 1 January 2013	100%	0%
On and after	0%	100%

Date	Amount to be deducted from core capital before 1 January 2013 expressed in percentage points	Amount to be deducted from CET1 capital on and after 1 January 2013 expressed in percentage points
1 January 2013		

(4) Table B applies, for the purposes of deduction from 1 January 2013 to 31 December 2017 (both dates inclusive), in respect of items that—

(a) were not required to be deducted under section 48(2)(c), (d), (e), (f) and (g) of the pre-amended Capital Rules, but were subject to the risk-weighting framework of those Rules, before 1 January 2013; and

(b) but for this subsection, would be subject to deduction under Division 4 of Part 3 of these Rules on and after 1 January 2013.

Table B

Deductions from 1 January 2013 to 31 December 2017 (both dates inclusive)

Date from which deduction is to be made	Amount to be deducted expressed in percentage points	Amount to be subject to risk-weighting before 1 January 2013 expressed in percentage points
1 January 2013	0%	100%
1 January 2014	20%	80%
1 January 2015	40%	60%
1 January 2016	60%	40%
1 January 2017	80%	20%

(5) Table C applies, for the purposes of deduction from 1 January 2013 to 31 December 2017 (both dates inclusive), in respect of items that were subject to deduction on an equal basis from core capital and supplementary capital under section 48(2) of the pre-amended Capital Rules before 1 January 2013 but are subject to deduction from CET1 capital on and after 1 January 2013.

Table C

Deductions from 1 January 2013 to 31 December 2017 (both dates inclusive)

Date from which deduction is to be made	Amount to be deducted from CET1 capital expressed in percentage points	Amount to be deducted from Tier 1 capital* expressed in percentage points	Amount to be deducted from Tier 2 capital expressed in percentage points
1 January 2013	0%	50%	50%
1 January 2014	20%	60%	40%
1 January 2015	40%	70%	30%
1 January 2016	60%	80%	20%
1 January 2017	80%	90%	10%

* The amount required to be deducted as specified under this column includes the amount required to be deducted from CET1 capital.

(6) For the purpose of a deduction that an authorized institution is required to make from Tier 1 capital and Tier 2 capital by virtue of the application of Table C—

(a) if the amount required to be deducted from Tier 1 capital is greater than the actual amount of Additional Tier 1 capital, the amount of shortfall in Additional Tier 1 capital must be deducted from the institution's CET1 capital;

(b) if the amount required to be deducted from Tier 2 capital is greater than the actual amount of Tier 2 capital, the amount of shortfall must be met by the institution's Tier 1 capital.

4. Recognition of minority interests and capital instruments issued by consolidated bank subsidiaries and held by third parties in authorized institution's capital base

(1) If—

(a) a minority interest; or

(b) a capital instrument issued by a bank subsidiary of an authorized institution and held by third parties,

is eligible for inclusion in the capital base of the institution in accordance with Part 3 of these Rules, the minority interest or capital instrument may be so included on and after 1 January 2013.

(2) If—

(a) a minority interest; or

(b) a capital instrument issued by a subsidiary of an authorized institution that is subject to a section 3C requirement and held by third parties,

is no longer eligible for inclusion in the institution's capital base on 1 January 2013 but was included in the calculation of the institution's capital base before that date, the minority interest or capital instrument must be progressively excluded from the capital base of the institution in accordance with Table D.

Table D

Exclusion of Non-eligible Minority Interests or Capital Instruments from Capital Base of Authorized Institution

Date from which minority interests or capital instruments are to be excluded	Amount of minority interests or capital instruments to be excluded expressed in percentage points
1 January 2013	0%
1 January 2014	20%
1 January 2015	40%
1 January 2016	60%
1 January 2017	80%
1 January 2018	100%

5. Capital instruments that no longer qualify for inclusion in capital base

(1) The capital instruments (***extant capital instruments***) of an authorized institution that were included in the institution's capital base immediately before 1 January 2013 but do not meet all the qualifying criteria set out in Schedule 4B or 4C, as the case may be, must be phased out during the 10-year period beginning from that date.

(2) Subject to subsections (3), (4), (5) and (6), for the purpose of calculating the amount of extant capital instruments to be phased out, the maximum amount of extant capital instruments that may be recognized in the capital base of an authorized institution from 1 January 2013 to 31 December 2021 (both dates inclusive) is limited to the sum of the nominal amount (including any related share premium) of instruments that were recognized in the capital base of the institution immediately before 1 January 2013 and—

(a) that were issued on or before 12 September 2010; or

(b) that were issued on or before 31 December 2012 and—

(i) in the case of Additional Tier 1 capital instruments, meet the qualifying criteria set out in Schedule 4B (excluding section 1(p) of that Schedule); or

(ii) in the case of Tier 2 capital instruments, meet the qualifying criteria set out in Schedule 4C (excluding section 1(j) of that Schedule),

multiplied by a progressively reducing percentage during the period as specified in Table E.

Table E

Progressive Phasing Out of Non-eligible Capital Instruments

Date from which reducing percentage is applicable	Amount to be included in capital base expressed in percentage points
1 January 2013	90%
1 January 2014	80%
1 January 2015	70%
1 January 2016	60%
1 January 2017	50%
1 January 2018	40%
1 January 2019	30%

Date from which reducing percentage is applicable	Amount to be included in capital base expressed in percentage points
1 January 2020	20%
1 January 2021	10%

(3) The aggregate amount of supplementary capital instruments of an authorized institution that was excluded from the institution's capital base before 1 January 2013 on the basis that—

(a) the institution's total supplementary capital was greater than the institution's total core capital; or

(b) the part of the institution's total supplementary capital that comprised term debt was greater than 50% of the institution's total core capital,

may, if those capital instruments meet all the qualifying criteria set out in Schedule 4B or 4C, as the case may be, and with the prior consent of the Monetary Authority, be included in the institution's capital base.

(4) The maximum amount referred to in subsection (2) must be calculated separately for Additional Tier 1 capital instruments and Tier 2 capital instruments.

(5) The nominal amount referred to in subsection (2) must have taken into account the required amortization specified in section 1(d) of Schedule 4C in the case of Tier 2 capital instruments, but any redemption or amortization of instruments occurring on or after 1 January 2013 must not reduce the nominal amount.

(6) Extant capital instruments with an incentive to be redeemed are subject to the following requirements—

(a) for an instrument with a call option in combination with a step-up (or another incentive to redeem) that was exercisable on a date (***specified date***) that falls before 1 January 2013, if the instrument was not called on the specified date and, on a forward-looking basis, will meet the qualifying criteria for inclusion in Additional Tier 1 capital or Tier 2 capital, the instrument may be recognized as Additional Tier 1 capital or Tier 2 capital, as the case requires;

(b) for an instrument with a call option in combination with a step-up (or another incentive to redeem) that is exercisable on a date (***specified date***) that falls on or after 1 January 2013—

(i) if the instrument is not called on the specified date and, on a forward-looking basis, will meet the qualifying criteria for inclusion in Additional Tier 1 capital or Tier 2 capital, the instrument may be recognized as Additional Tier 1 capital or Tier 2 capital, as the case requires, on and after the specified date; and

(ii) before the specified date, the instrument must be treated as an instrument that no longer qualifies as Additional Tier 1 capital or Tier 2 capital and, accordingly, must be phased out in accordance with Table E;

(c) for an instrument with a call option in combination with a step-up (or another incentive to redeem) that was exercisable on a date (***specified date***) that falls after 12 September 2010 but before 1 January 2013, if the instrument was not called on the specified date and, on a forward-looking basis, will not meet the qualifying criteria for inclusion in

Additional Tier 1 capital or Tier 2 capital, the instrument will no longer be recognized as regulatory capital and will be excluded from the institution's capital base on and after 1 January 2013;

(d) for an instrument with a call option in combination with a step-up (or another incentive to redeem) that is exercisable on a date (***specified date***) that falls on or after 1 January 2013—

(i) if the instrument is not called on the specified date and, on a forward-looking basis, will not meet the qualifying criteria for inclusion in Additional Tier 1 capital or Tier 2 capital, the instrument will no longer be recognized as regulatory capital and will be excluded from the institution's capital base on and after the specified date; and

(ii) before the specified date, the instrument must be treated as an instrument that no longer qualifies as Additional Tier 1 capital or Tier 2 capital and, accordingly, must be phased out in accordance with Table E;

(e) for an instrument with a call option in combination with a step-up (or another incentive to redeem) that was exercisable on a date (***specified date***) that falls on or before 12 September 2010, if the instrument was not called on the specified date and, on a forward-looking basis, will not meet the qualifying criteria for inclusion in Additional Tier 1 capital or Tier 2 capital, the instrument must be treated as an instrument that no longer qualifies as Additional Tier 1 capital or Tier 2 capital and, accordingly, must be phased out in accordance with Table E.".

161. Schedule 5 repealed (other deductions from core capital and supplementary capital)

Schedule 5—

Repeal the Schedule.

162. Schedule 6 amended (credit quality grades)

(1) Schedule 6—

Repeal

"[ss. 55, 59, 60, 61, 61A, 62, 79, 98, 99, 139, 211,"

Substitute

"[ss. 55, 59, 60, 61, 61A, 62, 79, 98, 99, 139, 232A,".

(2) Schedule 6, Chinese text, Table C, Part 2, column 3—

Repeal

"CRISIL

BBB+

CRISIL BBB

CRISIL BBB-"

Substitute

"CRISIL BBB+

CRISIL BBB

CRISIL BBB-".

163. 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: Non-securitization exposures (sovereign issuers)	Non-securitization exposures (other issuers)	Securitization exposures (excluding re-securitization exposures)
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%	2%
			(b) more than 1 year but not more than 5 years	2%	4%	8%
			(c) more than 5 years	4%	8%	16%
2.	Recognized collateral that falls within any of section 79(1)(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, 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%	2%
			(b) more than 1 year but not more than 5 years	2%	4%	8%
			(c) more than 5 years	4%	8%	16%
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	(a) not more than 1 year	1%	2%	4%
			(b) more than 1 year	3%	6%	12%

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Standard supervisory haircuts: Non-securitization exposures (sovereign issuers)	Non-securitization exposures (other issuers)	Securitization exposures (excluding re-securitization exposures)
		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)	but not more than 5 years			
			(c) more than 5 years	6%	12%	24%
4.	Recognized collateral that falls within any of section 79(1)(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	(a) not more than 1 year	1%	2%	4%
			(b) more than 1 year but not more than 5	3%	6%	12%

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Standard supervisory haircuts: Non-securitization exposures (sovereign issuers)	Non-securitization exposures (other issuers)	Securitization exposures (excluding re-securitization exposures)
		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)	years			
			(c) more than 5 years	6%	12%	24%
5.	Debt securities with long-term ECAI issue specific ratings	grade 4	All	15%	not applicable	not applicable
6.	Recognized collateral that falls within section 79(1)(e), (f) or (h) of these Rules	grade 4	All	15%	not applicable	not applicable

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Standard supervisory haircuts: Non-securitization exposures (sovereign issuers)	Non-securitization exposures (other issuers)	Securitization exposures (excluding re-securitization exposures)
7.	Debt securities without ECAI issue specific ratings issued by banks or securities firms, that satisfy the criteria set out in section 79(1)(m) of these Rules	not applicable	(a) not more than 1 year	not applicable	2%	not applicable
			(b) more than 1 year but not more than 5 years	not applicable	6%	not applicable
			(c) more than 5 years	not applicable	12%	not applicable
8.	Recognized collateral that falls within section 79(1)(m) of these Rules	not applicable	(a) not more than 1 year	not applicable	2%	not applicable
			(b) more than 1 year but not more	not applicable	6%	not applicable

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Standard supervisory haircuts: Non-securitization exposures (sovereign issuers)	Non-securitization exposures (other issuers)	Securitization exposures (excluding re-securitization exposures)
			than 5 years			
			(c) more than 5 years	not applicable	12%	not applicable".

(2) Schedule 7, section 1, Table, Part 2, item 2—

Repeal

"79(a)"

Substitute

"79(1)(a)".

(3) Schedule 7, section 1, Table, Part 2, item 4—

Repeal

"79(d)"

Substitute

"79(1)(d)".

(4) Schedule 7, section 1, Table, Part 2, item 6—

Repeal

"80(b)"

Substitute

"80(1)(b)".

(5) Schedule 7, section 1, Table, Part 2, item 8—

Repeal

"79(o) or 80(c)"

Substitute

"79(1)(o) or 80(1)(c)".

(6) Schedule 7, section 1, Table, Part 3, item 4—

Repeal

"80(a)"

Substitute

"80(1)(a)".

164. Schedule 15 amended (standardized business lines)

Schedule 15, Chinese text, section 1, Table, item 4—

Repeal

"應收帳款融通"

Substitute

"應收帳融通".

Monetary Authority

2012

Explanatory Note

These Rules are made by the Monetary Authority under section 97C of the Banking Ordinance (Cap. 155) as amended by the Banking (Amendment) Ordinance 2012 (3 of 2012), 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 5 years and were last amended by the Banking (Capital) (Amendment) Rules 2011 (L.N. 137 of 2011).

3. The main purpose of the Rules is to incorporate into the principal Rules—

(a) amendments relating to the internal model method for calculating counterparty credit risk as set out in Annex 4 to the document entitled "International Convergence of Capital Measurement and Capital Standards — A Revised Framework (Comprehensive Version)" (***Basel II***) published by the Basel Committee on Banking Supervision (***Basel Committee***) in June 2006;

(b) amendments relating to enhancements to the risk coverage of Basel II as set out in the document entitled "Basel III: A global regulatory framework for more resilient banks and banking systems" published by the Basel Committee in December 2010 (revised in June 2011);

(c) amendments relating to the capital and capital ratios of an authorized institution as set out in the document referred to in subparagraph (b) and the supplementary document entitled "Minimum requirements to ensure

loss absorbency at the point of non-viability" published by the Basel Committee in January 2011;

(d) amendments relating to bringing the capital treatment of trade finance in line with that set out in the document entitled "Treatment of trade finance under the Basel capital framework" published by the Basel Committee in October 2011;

(e) amendments relating to the new capital framework for exposures to central counterparties as set out in the document entitled "Capital requirements for bank exposures to central counterparties" published by the Basel Committee in July 2012;

(f) amendments relating to the revised treatment of debt valuation adjustments in respect of derivative liabilities arising from changes in the market value of an authorized institution's own credit risk, as set out in the press release entitled "Regulatory treatment of valuation adjustments to derivative liabilities: final rule issued by the Basel Committee" issued by the Basel Committee in July 2012;

(g) amendments necessitated by problems and ambiguities identified by the Monetary Authority in the operation of the principal Rules to date; and

(h) 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 2013.

Banking (Specification of Multilateral Development Bank) (Amendment) Notice 2012

(Made by the Monetary Authority under section 2(19) of the Banking Ordinance (Cap. 155))

1. Commencement

This Notice comes into operation on 1 January 2013.

2. Banking (Specification of Multilateral Development Bank) Notice amended

The Banking (Specification of Multilateral Development Bank) Notice (Cap. 155 sub. leg. N) is amended as set out in section 3.

3. Section 2 amended (specification of multilateral development bank)

(1) Section 2(l)—

Repeal

"and".

(2) Section 2(m)—

Repeal the full stop

Substitute

"; and".

(3) After section 2(m)—

Add

"(n) the Multilateral Investment Guarantee Agency.".

Monetary Authority

2012

Explanatory Note

Under section 2(19) of the Banking Ordinance (Cap. 155) (***Ordinance***), the Monetary Authority may by notice published in the Gazette specify to be a multilateral development bank (***MDB***) for the purposes of the Ordinance any bank or lending or development body established by agreement between, or guaranteed by, 2 or more countries, territories or international organizations other than for purely commercial purposes.

2. Exposures to MDBs are treated more favourably for the purposes of calculating the capital adequacy ratio and liquidity ratio of an authorized institution.

3. This Notice amends the Banking (Specification of Multilateral Development Bank) Notice (Cap. 155 sub. leg. N) to specify the Multilateral Investment Guarantee Agency to be an MDB for the purposes of the Ordinance.