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LEGISLATIVE COUNCIL BRIEF
BANKING ORDINANCE (CHAPTER 155)

BANKING (DISCLOSURE) (AMENDMENT) RULES 2013
BANKING (CAPITAL) (AMENDMENT) RULES 2013

INTRODUCTION

Further to the implementation of the first phase of the Basel III capital standards which came into effect on 1 January 2013, the Monetary Authority ("MA") has made –

(a) the Banking (Disclosure) (Amendment) Rules 2013 (**Annex A**) to prescribe revised requirements regarding disclosure by authorized institutions ("AIs") of their capital adequacy and associated relevant financial information; and

(b) the Banking (Capital) (Amendment) Rules 2013 (**Annex B**) to introduce miscellaneous refinements, principally to align the capital requirements in the Banking (Capital) Rules (Cap. 155, sub. leg. L) with the latest guidance documents issued by the Basel Committee on Banking Supervision ("BCBS").

JUSTIFICATIONS

2. The Legislative Council enacted the Banking (Amendment) Ordinance 2012 in February 2012 to provide the legal framework for implementation in Hong Kong of the revised regulatory capital, disclosure and liquidity standards promulgated by the BCBS (known as "Basel III"). These standards aim to further enhance the resilience of banks and the banking system, addressing weaknesses observed in the recent global financial crisis.

3. To this end, the Banking (Capital) (Amendment) Rules 2012 came into operation on 1 January 2013 to implement in Hong Kong the first phase of the new Basel III capital framework, which increases the level, quality and transparency of banks' capital base. In essence, these Rules have revised the minimum capital ratio requirements applicable to AIs, tightened the criteria for instruments to be recognized as regulatory capital, and extended the risk coverage of the capital framework in relation to counterparty credit risk[1] ("CCR") to capture (i) potential loss due to changes in the credit quality of a counterparty (referred to as credit valuation adjustment ("CVA") risk); and (ii) exposures to central counterparties ("CCPs").

Banking (Disclosure) (Amendment) Rules 2013

4. In relation to the new Basel III capital framework, we need to (i) introduce corresponding and consequential amendments to the Banking (Disclosure) Rules (Cap. 155, sub. leg. M) to enhance the consistency and comparability of banks' disclosures in respect of their capital base; and (ii) specify disclosure requirements relating to the internal models approach to the calculation of capital requirements for CCR, which were introduced by the Banking (Capital) (Amendment) Rules 2012. We will also incorporate some recently updated disclosure standards from the BCBS to promote sound risk management practices in banks.

5. In summary, the Basel III disclosure standards[2] require -

(a) a detailed breakdown of the full list of regulatory capital elements including all regulatory adjustments and the phase-in of such adjustments;

(b) a reconciliation of all regulatory capital elements back to the audited financial statements to help explain: (i) any differences

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[1] 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.

[2] According to the BCBS timetable, jurisdictions should give effect to the new disclosure requirements by no later than 30 June 2013. Accordingly, whilst AIs will be required to calculate their regulatory capital requirements according to the Basel III revised capital standards with effect from 1 January 2013, the first set of disclosures that will be subject to the new disclosure requirements will be those in relation to a balance sheet date on or after 30 June 2013.

in the scope of consolidation for accounting purposes and for regulatory purposes; and (ii) the relationship between balance sheet items and regulatory capital elements;

(c) a description of all limits and minima applied to the calculation of capital base;

(d) a description of the main features of regulatory capital instruments issued;

(e) provision of the full terms and conditions of regulatory capital instruments included in regulatory capital on a bank's website; and

(f) identification of specific components of capital, including regulatory capital instruments and regulatory adjustments, that benefit from the transitional arrangements included in the BCBS timeline for the introduction of Basel III.

Banking (Capital) (Amendment) Rules 2013

6. The BCBS released its latest technical guidance documents in November and December 2012 to clarify certain capital treatments for CCR and exposures to CCPs. These latest clarifications were consequently too late to be accommodated in the Banking (Capital) (Amendment) Rules 2012. They relate mainly to the -

(a) recognition of the credit risk mitigating effect of recognized credit derivative contracts cleared through CCPs and clarification of the treatment of collateral posted by AIs to CCPs;

(b) clearer specification of the conditions and methods for recognizing hedging instruments as eligible for the purpose of reducing the new CVA capital charge, and clarification of the conditions to be met for defaulted exposures to be exempted from the CVA capital charge requirements; and

(c) treatment for certain types of collateral in the calculation of capital charges for exposures to CCPs.

7. In line with the Basel capital framework, we are also taking the opportunity to introduce technical refinements to clarify the operation of certain provisions in relation to (i) the treatment of credit risk mitigation in the calculation of the capital charge for CVA risk and exposures to CCPs; and (ii) the calculation of the market risk capital charge for credit derivative contracts booked in AIs' trading books, as well as a few related miscellaneous amendments.

THE SUBSIDIARY LEGISLATION

Banking (Disclosure) (Amendment) Rules 2013

8. The major provisions of the amendments to the Banking (Disclosure) Rules are set out below -

(a) amendments to **sections 5** and **11** to reflect the wider scope of disclosure requirements prescribed in section 60A(1) of the Banking Ordinance to cover liquidity and capital resources under the Basel III framework;

(b) consequential amendments to **sections 32, 40, 54, 57, 60, 63, 69, 82** and **85** to cover revised definitions and references to capital calculation measures, in order to reflect changes introduced under the Banking (Capital) (Amendment) Rules 2012;

(c) amendments to **sections 6, 14, 18, 24, 33** and **45** to implement the enhanced disclosure requirements in respect of an AI's capital base as set out in paragraph 5 above;

(d) amendments to **sections 58 and 80** to incorporate disclosure requirements relating to capital charges under the internal models (CCR) approach (introduced under the Banking (Capital) (Amendment) Rules 2012) for the calculation of an AI's capital requirement for its default risk exposure under the

Basel III enhanced CCR framework[3]; and

(e) amendments to **sections 52, 61, 70 and 83** to incorporate recent BCBS disclosure standards for promoting sound risk management practices in banks.

Banking (Capital) (Amendment) Rules 2013

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

(a) amendments to **sections 100, 101, 134, 135, 215, 216**, **217, 265 and 278** to clarify that an AI may, in its regulatory capital calculation, substitute the risk-weight of a CCP for the risk-weight that would otherwise apply in respect of a loan exposure in circumstances where the AI hedges that exposure with a recognized credit default swap ("CDS") cleared through that CCP;

(b) amendments to **sections 203, 226P** and **226S** regarding the use of certain option contracts on CDS and short positions in bonds to hedge CVA risk, and the clarification of how certain AIs may recognize the credit risk mitigating effect of collateral under the standardized method of calculating capital charges for CVA risk;

(c) amendments to **section 226T** to clarify the conditions for hedging instruments to be regarded as eligible hedges of CVA risk and the treatment of an AI that has over-hedged the CVA risk in respect of a counterparty with an eligible CVA hedge;

(d) amendments to **sections 226V, 226X, 226Z, 226ZD** and **226ZE** to clarify the treatment of credit risk mitigation (including cases where the usual capital treatment cannot be applied) in the calculation of capital charges for exposures arising from transactions cleared by CCPs, and the capital

[3] Specifically, an AI will be required to disclose the breakdown of its default risk CCR exposures and the risk-weighted amount of such exposures for each type of relevant transaction.

treatment for collateral posted by AIs with CCPs;

(e) amendments to **sections 308, 309, 310 and 311** to clarify the provisions on offsetting in the calculation of the market risk capital charge for credit derivative contracts;

(f) amendments to **Schedule 1A** to incorporate the conditions for defaulted transactions to be exempted from the CVA capital charge;

(g) amendments to **Schedules 4F** and **4G** to clarify the treatment of certain capital investments booked in the trading books of AIs that are not required to be deducted from the capital base; and

(h) amendments to **Schedule 4H** to correct a cross reference, and clarify that the transitional arrangements for certain existing capital deductions apply in relation to all three tiers of regulatory capital.

LEGISLATIVE TIMETABLE

10. The subsidiary legislation referred to in paragraph 1 above will be published in the Gazette on 12 April 2013, and tabled at the Legislative Council at its sitting of 17 April 2013. Subject to negative vetting by the Legislative Council, the relevant provisions will come into operation on 30 June 2013.

IMPLICATIONS OF THE PROPOSALS

11. The amendments proposed in the subsidiary legislation referred to in paragraph 1 are consistent with the Basel III disclosure and capital standards. The enhanced disclosure requirements in the Banking (Disclosure) (Amendment) Rules 2013 will help promote the exercise of market discipline in relation to the risk-taking activities of banks and hence should contribute to the promotion of sound risk management and the overall stability of the banking system. The amendments to the CCR framework, and to the calculation of market risk, as prescribed in the

Banking (Capital) (Amendment) Rules 2013 are not expected to have a significant impact on AIs' capital positions. The banking sector has already taken steps to upgrade its internal systems for the purposes of the implementation of the first phase of the Basel III capital standards from 1 January 2013. Also given that the industry has been aware of, and engaged in, the formulation of the new disclosure requirements for some time, it is not anticipated that the proposed amendments will create any undue compliance burden for AIs.

12. The two enactments are in conformity with the Basic Law, including the provisions concerning human rights. The proposed amendments will not affect the current binding effect of the Banking Ordinance.

PUBLIC CONSULTATION

13. We briefed the Legislative Council Panel on Financial Affairs on 4 June 2012 with regard to the MA's plan to make rules to implement the first phase of the Basel III capital requirements with effect from 1 January 2013, and to introduce the related disclosure requirements. We also updated Members, in the context of the scrutiny of the Banking (Capital) (Amendment) Rules 2012, on the importance to Hong Kong, as an international banking and financial centre, of closely aligning our capital requirements on banks with the international standards promulgated by the BCBS. Members generally supported this policy direction.

14. The MA has closely engaged the industry in a consultative process to formulate the Banking (Disclosure) (Amendment) Rules 2013 and the Banking (Capital) (Amendment) Rules 2013. In addition, in accordance with sections 60A and 97C of the Banking Ordinance, the MA issued a draft of the provisions of the two sets of 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 November 2012 and March 2013, before finalising the amendments. Responses indicated support for the amendments. Relevant technical or drafting comments were addressed in the finalised rules as appropriate, and the intent of certain provisions

was clarified.

PUBLICITY

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

ENQUIRIES

16. 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
10 April 2013

Banking (Disclosure) (Amendment) Rules 2013

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Banking (Disclosure) (Amendment) Rules 2013

(Made by the Monetary Authority under section 60A of the Banking Ordinance (Cap. 155) after consultation with the Financial Secretary, the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, The Hong Kong Association of Banks and The DTC Association)

1. Commencement

These Rules come into operation on 30 June 2013.

2. Banking (Disclosure) Rules amended

The Banking (Disclosure) Rules (Cap. 155 sub. leg. M) are amended as set out in sections 3 to 28.

3. Section 2 amended (interpretation)

(1) Section 2(1)—

Repeal the definition of *available-for-sale*

Substitute

"***available-for-sale*** (可供出售)—

(a) in relation to financial assets other than derivative contracts, means that the financial assets—

(i) are designated by an authorized institution as available for sale;

(ii) are not classified by an authorized institution as—

(A) loans and receivables; or

(B) financial assets measured at fair value through profit or loss; or

(iii) are not classified by an authorized institution as held-to-maturity investments;

(b) in relation to financial instruments other than derivative contracts, means that the financial instruments—

(i) are designated by an authorized institution as available for sale;

(ii) are not classified by an authorized institution as—

(A) loans and receivables; or

(B) financial instruments measured at fair value through profit or loss; or

(iii) are not classified by an authorized institution as held-to-maturity investments; or

(c) in relation to loans, means that the loans are designated by an authorized institution upon initial recognition as available for sale;".

(2) Section 2(1), definition of ***capital requirements***, paragraph (a)—

Repeal

"or 6,"

Substitute

"or 6 or Division 4 of Part 6A,".

(3) Section 2(1)—

Repeal the definition of *debt securities*

Substitute

"***debt securities*** (債務證券) means any negotiable securities other than loan capital, shares, stocks, certificates of deposit or import or export trade bills;".

(4) Section 2(1), definition of ***surplus provisions***—

Repeal

"supplementary capital"

Substitute

"Tier 2 capital".

(5) Section 2(1)—

(a) definition of ***consolidation requirement***;

(b) definition of ***issued debt securities***—

Repeal the definitions.

(6) Section 2(1)—

Add in alphabetical order

"***general wrong-way risk*** (一般錯向風險) means the risk that arises when the probability of default of counterparties is positively correlated with general market risk factors;

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

4. Section 5 amended (disclosure policy)

Section 5(a)(i)(A)—

Repeal

"profit and loss or capital adequacy ratio;"

Substitute

"including its profit and loss and its financial resources (including capital resources and liquidity resources);".

5. Section 6 amended (medium and location of disclosure and issue of press release)

(1) Section 6(1)—

Repeal

"and (3),"

Substitute

"and (3) and sections 24(5) and (6) and 45(5) and (6),".

(2) After section 6(1)(a)—

Add

"(ab) presenting the information required to be disclosed in the format, and using the standard disclosure templates, specified by the Monetary Authority;".

(3) Section 6(8)—

Repeal

"Where"

Substitute

"Subject to sections 24(4) and (5) and 45(4) and (5), where".

(4) Section 6(9)—

Repeal

"Where"

Substitute

"Subject to sections 24(4) and (5) and 45(4) and (5), where".

(5) After section 6(10)—

Add

"(10A) An authorized institution must—

(a) keep a copy of each of its disclosure statements relating to reporting periods ending on or after 30 June 2013 in readily accessible form; and

(b) if any disclosure statement kept under paragraph (a) contains a prescribed summary, keep a copy of

all the disclosures referred to in the prescribed summary in readily accessible form.".

6. Section 11 amended (consolidated group level disclosures)

(1) Section 11(3)—

Repeal

"profit and loss or capital adequacy ratio,"

Substitute

"including its profit and loss and its financial resources (including capital resources and liquidity resources),".

(2) Section 11(5)—

Repeal

"profit and loss or capital adequacy ratio"

Substitute

"including its profit and loss and its financial resources (including capital resources and liquidity resources),".

7. Section 14 amended (frequency)

(1) Section 14(1)—

Repeal

"An"

Substitute

"Subject to sections 24(6) and 45(6), an".

(2) Section 14(2)—

Repeal

"An"

Substitute

"Subject to sections 24(6) and 45(6), an".

8. Section 15 amended (group-wide disclosures made by parent bank of authorized institution)

Section 15—

Repeal paragraph (b)

Substitute

"(b) the foreign disclosures are prepared in accordance with the prevailing banking supervisory standards relating to disclosure issued by the Basel Committee and adopted by the relevant banking supervisory authority of the parent bank;".

9. Section 18 amended (scope of consolidation)

Section 18—

Repeal paragraph (a)

Substitute

"(a) the basis of consolidation including—

(i) an outline of the differences between the accounting scope of consolidation and the regulatory scope of consolidation;

(ii) a list of—

(A) the institution's subsidiaries (if any) that are included within the accounting scope of consolidation but not included within the regulatory scope of consolidation;

(B) the institution's subsidiaries (if any) that are included within the regulatory scope of consolidation but not included within the accounting scope of consolidation; and

(C) the institution's subsidiaries (if any) that are included within both the accounting scope of

consolidation and the regulatory scope of consolidation where the methods of consolidation differ between those 2 scopes, and an explanation of the differences in the 2 consolidation methods;

(iii) if the institution's shareholdings in any of its subsidiaries are deducted from the institution's CET1 capital, a list of such subsidiaries; and

(iv) a description of the principal activities of each of the subsidiaries mentioned in subparagraphs (ii)(A), (B) and (C) and (iii), including the amount of total assets and the amount of total equity reported on the financial statements of each subsidiary; and".

10. Section 24 substituted

Section 24—

Repeal the section

Substitute

"**24. Capital disclosures**

(1) An authorized institution must disclose the following information regarding its capital base as set out in the returns relating to capital adequacy it submitted to the Monetary Authority pursuant to section 63 of the Ordinance in respect of the interim reporting period—

(a) a detailed breakdown of the CET1 capital, Additional Tier 1 capital, Tier 2 capital and regulatory deductions applied pursuant to section 38(2) of the Capital Rules and Division 4 of Part 3 of those Rules to the capital base of the institution, showing which of those items are benefiting from

the transitional arrangements set out in Schedule 4H to those Rules;

(b) a full reconciliation of the CET1 capital items, Additional Tier 1 capital items, Tier 2 capital items and regulatory deductions applied pursuant to section 38(2) of the Capital Rules and Division 4 of Part 3 of those Rules to the capital base of the institution and the balance sheet in the published financial statements of the institution;

(c) a description of the main features of the CET1 capital instruments, Additional Tier 1 capital instruments and Tier 2 capital instruments issued by the institution;

(d) the full terms and conditions of all CET1 capital instruments, Additional Tier 1 capital instruments and Tier 2 capital instruments;

(e) separate disclosure of the nature and amounts of—

(i) each regulatory deduction applied pursuant to section 38(2) of the Capital Rules and Division 4 of Part 3 of those Rules to the capital base of the institution (reported separately for CET1 capital, Additional Tier 1 capital and Tier 2 capital, as the case requires); and

(ii) items not deducted from the institution's CET1 capital pursuant to section 43(1)(o) and (p) of the Capital Rules;

(f) a description of all limits and minima applied to the calculation of the capital base of the institution in accordance with the Capital Rules and the instruments and regulatory deductions to which those limits or minima, as the case may be, apply;

(g) where the institution discloses capital ratios calculated using elements of capital determined on a basis other than that laid down in the Capital Rules, a comprehensive explanation of the basis on which those capital ratios are calculated.

(2) For the purposes of section 6(1)(ab), an authorized institution must make the disclosures required by subsection (1)(a), (b), (c), (e) and (f) by using the standard disclosure templates specified by the Monetary Authority.

(3) An authorized institution must either—

(a) include the standard disclosure templates applicable to its disclosures in the interim financial statements published by it; or

(b) provide a direct link in its interim financial statements to the relevant sections of its website where the standard disclosure templates referred to in paragraph (a) can be found.

(4) An authorized institution must establish and maintain an archive of—

(a) all disclosures made by the institution under subsection (1)(a), (b), (e), (f) and (g) that relate to reporting periods ending on or after 30 June 2013; and

(b) all disclosures made by the institution under subsection (1)(c) and (d) for a period that corresponds to the remaining life of the capital instrument concerned.

(5) Subject to subsection (6) and unless otherwise approved by the Monetary Authority, an authorized institution

must make available on its website the full terms and conditions of all instruments included in its capital base.

(6) Whenever—

(a) a new capital instrument is issued and included in an authorized institution's capital base; or

(b) there is a redemption, conversion or write-down, or any other material change in the nature, of a capital instrument included in an authorized institution's capital base,

the institution must, as soon as is practicable, update the disclosures it has made under subsection (5) in order to take account of that new capital instrument, or that redemption, conversion or write-down, or other material change, as the case may be.

(7) An authorized institution must disclose the total amount of any relevant capital shortfall in any of its subsidiaries that are outside the regulatory scope of consolidation.

(8) Subject to subsections (9) and (10), an authorized institution must disclose its—

(a) CET1 capital ratio;

(b) Tier 1 capital ratio; and

(c) Total capital ratio.

(9) Where an authorized institution is required under section 3C of the Capital Rules to calculate its capital adequacy ratio on a consolidated basis, the institution must disclose its—

(a) CET1 capital ratio;

(b) Tier 1 capital ratio; and

(c) Total capital ratio,

calculated, in each case, on a consolidated basis.

(10) Where subsection (9) does not apply to an authorized institution, the institution must disclose its—

(a) CET1 capital ratio;

(b) Tier 1 capital ratio; and

(c) Total capital ratio,

calculated, in each case, on a solo basis or solo-consolidated basis, as the case requires.

(11) Where an authorized institution has earmarked part of its retained earnings for maintaining its regulatory reserve for general banking risks to satisfy the provisions of the Ordinance for prudential supervision purposes, the institution must disclose—

(a) that fact; and

(b) the amount of retained earnings so earmarked.

(12) In this section—

relevant capital shortfall (有關資本短欠), in relation to a subsidiary of an authorized institution—

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

(b) that is not the subject of consolidation under a section 3C requirement,

means the amount that is deducted from the institution's CET1 capital pursuant to section 43(1)(k) of the Capital Rules.".

11. Section 32 amended (interpretation of Part 4)

Section 32—

(a) definition of ***forecast transaction***;

(b) definition of ***highly probable forecast transaction***—

Repeal the definitions.

12. Section 33 amended (scope of consolidation)

Section 33—

Repeal paragraph (a)

Substitute

"(a) the basis of consolidation including—

(i) an outline of the differences between the accounting scope of consolidation and the regulatory scope of consolidation;

(ii) a list of—

(A) the institution's subsidiaries (if any) that are included within the accounting scope of consolidation but not included within the regulatory scope of consolidation;

(B) the institution's subsidiaries (if any) that are included within the regulatory scope of consolidation but not included within the accounting scope of consolidation; and

(C) the institution's subsidiaries (if any) that are included within both the accounting scope of consolidation and the regulatory scope of consolidation where the methods of consolidation differ between those 2 scopes, and an explanation of the differences in the 2 consolidation methods;

(iii) if the institution's shareholdings in any of its subsidiaries are deducted from the institution's CET1 capital, a list of such subsidiaries; and

(iv) a description of the principal activities of each of the subsidiaries mentioned in subparagraphs (ii)(A), (B) and (C) and (iii), including the amount of total assets and the amount of total equity

reported on the financial statements of each subsidiary; and".

13. Section 40 amended (hedge accounting)

Section 40(2)(e)—

Repeal

"forecast transaction"

Substitute

"uncommitted but anticipated future transaction".

14. Section 45 substituted

Section 45—

Repeal the section

Substitute

"45. Capital disclosures

(1) An authorized institution must disclose the following information regarding its capital base as set out in the returns relating to capital adequacy it submitted to the Monetary Authority pursuant to section 63 of the Ordinance in respect of the annual reporting period—

(a) a detailed breakdown of the CET1 capital, Additional Tier 1 capital, Tier 2 capital and regulatory deductions applied pursuant to section 38(2) of the Capital Rules and Division 4 of Part 3 of those Rules to the capital base of the institution, showing which of those items are benefiting from the transitional arrangements set out in Schedule 4H to those Rules;

(b) a full reconciliation of the CET1 capital items, Additional Tier 1 capital items, Tier 2 capital items

and regulatory deductions applied pursuant to section 38(2) of the Capital Rules and Division 4 of Part 3 of those Rules to the capital base of the institution and the balance sheet in the published financial statements of the institution;

(c) a description of the main features of the CET1 capital instruments, Additional Tier 1 capital instruments and Tier 2 capital instruments issued by the institution;

(d) the full terms and conditions of all CET1 capital instruments, Additional Tier 1 capital instruments and Tier 2 capital instruments;

(e) separate disclosure of the nature and amounts of—

(i) each regulatory deduction applied pursuant to section 38(2) of the Capital Rules and Division 4 of Part 3 of those Rules to the capital base of the institution (reported separately for CET1 capital, Additional Tier 1 capital and Tier 2 capital, as the case requires); and

(ii) items not deducted from the institution's CET1 capital pursuant to section 43(1)(o) and (p) of the Capital Rules;

(f) a description of all limits and minima applied to the calculation of the capital base of the institution in accordance with the Capital Rules and the instruments and regulatory deductions to which those limits or minima, as the case may be, apply;

(g) where the institution discloses capital ratios calculated using elements of capital determined on a basis other than that laid down in the Capital

Rules, a comprehensive explanation of the basis on which those capital ratios are calculated.

(2) For the purposes of section 6(1)(ab), an authorized institution must make the disclosures required by subsection (1)(a), (b), (c), (e) and (f) by using the standard disclosure templates specified by the Monetary Authority.

(3) An authorized institution must either—

(a) include the standard disclosure templates applicable to its disclosures in the annual financial statements published by it; or

(b) provide a direct link in its annual financial statements to the relevant sections of its website where the standard disclosure templates referred to in paragraph (a) can be found.

(4) An authorized institution must establish and maintain an archive of—

(a) all disclosures made by the institution under subsection (1)(a), (b), (e), (f) and (g) that relate to reporting periods ending on or after 30 June 2013; and

(b) all disclosures made by the institution under subsection (1)(c) and (d) for a period that corresponds to the remaining life of the capital instrument concerned.

(5) Subject to subsection (6) and unless otherwise approved by the Monetary Authority, an authorized institution must make available on its website the full terms and conditions of all instruments included in its capital base.

(6) Whenever—

(a) a new capital instrument is issued and included in an authorized institution's capital base; or

(b) there is a redemption, conversion or write-down, or any other material change in the nature, of a capital instrument included in an authorized institution's capital base,

the institution must, as soon as is practicable, update the disclosures it has made under subsection (5) in order to take account of that new capital instrument, or that redemption, conversion or write-down, or other material change, as the case may be.

(7) An authorized institution must disclose the total amount of any relevant capital shortfall in any of its subsidiaries that are outside the regulatory scope of consolidation.

(8) Subject to subsections (9) and (10), an authorized institution must disclose its—

(a) CET1 capital ratio;

(b) Tier 1 capital ratio; and

(c) Total capital ratio.

(9) Where an authorized institution is required under section 3C of the Capital Rules to calculate its capital adequacy ratio on a consolidated basis, the institution must disclose its—

(a) CET1 capital ratio;

(b) Tier 1 capital ratio; and

(c) Total capital ratio,

calculated, in each case, on a consolidated basis.

(10) Where subsection (9) does not apply to an authorized institution, the institution must disclose its—

(a) CET1 capital ratio;

(b) Tier 1 capital ratio; and

(c) Total capital ratio,

calculated, in each case, on a solo basis or solo-consolidated basis, as the case requires.

(11) Where an authorized institution has earmarked part of its retained earnings for maintaining its regulatory reserve for general banking risks to satisfy the provisions of the Ordinance for prudential supervision purposes, the institution must disclose—

(a) that fact; and

(b) the amount of retained earnings so earmarked.

(12) In this section—

relevant capital shortfall (有關資本短欠), in relation to a subsidiary of an authorized institution—

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

(b) that is not the subject of consolidation under a section 3C requirement,

means the amount that is deducted from the institution's CET1 capital pursuant to section 43(1)(k) of the Capital Rules.".

15. Section 52 amended (corporate governance)

(1) Section 52(b)—

Repeal

"Institutions"; and"

Substitute

"Institutions";".

(2) After section 52(b)—

Add

"(ba) the extent of its compliance with the guideline in Part 3 (disclosure on remuneration) of the Supervisory Policy Manual module CG — 5 issued by the Monetary Authority and entitled "Guideline on a Sound Remuneration System"; and".

(3) Section 52(c)—

Repeal

"referred to in paragraph (b)"

Substitute

"mentioned in paragraph (b) or the guideline mentioned in paragraph (ba)".

16. Section 54 amended (interpretation of Part 5)

Section 54—

Repeal

"51"

Substitute

"51(1)".

17. Section 57 amended (credit risk: specific disclosures)

(1) Section 57(d), after "equivalent amount"—

Add

"or default risk exposure".

(2) Section 57(f)—

Repeal

"deducted from the institution's core capital and supplementary capital"

Substitute

"that are risk-weighted at 1,250%".

18. Section 58 amended (general disclosures for counterparty credit risk-related exposures)

(1) Section 58(1)—

Repeal

"OTC derivative transactions, repo-style transactions and credit derivative contracts (other than recognized credit derivative contracts)"

Substitute

"securities financing transactions and derivative contracts".

(2) Section 58(1)(a)—

Repeal

"exposures; and"

Substitute

"exposures;".

(3) Section 58(1)(b)—

Repeal

"provisions."

Substitute

"provisions;".

(4) After section 58(1)(b)—

Add

"(c) its policies with respect to exposures that give rise to general wrong-way risk or specific wrong-way risk; and

(d) the impact on it in terms of the amount of collateral that it would have to provide if there were a downgrade in its credit rating.".

(5) Section 58—

Repeal subsection (3)

Substitute

"(3) An authorized institution must disclose, in respect of the relevant transactions—

(a) the gross total positive fair value of the relevant transactions that are not securities financing transactions;

(b) the default risk exposures, after taking into account the effect of any valid bilateral netting agreements, for the relevant transactions that are not securities financing transactions;

(c) the default risk exposures, after taking into account the effect of any valid bilateral netting agreements, for the relevant transactions that are securities financing transactions;

(d) the default risk exposures, after taking into account the effect of any valid cross-product netting agreements, for the relevant transactions;

(e) the recognized collateral (broken down by type of collateral) held by the institution for the relevant transactions;

(f) the default risk exposures, after taking into account the effect of any recognized collateral, for the relevant transactions;

(g) the respective risk-weighted amounts for the relevant transactions;

(h) the notional amounts of recognized credit derivative contracts that provide credit protection for the relevant transactions; and

(i) the breakdown of the institution's default risk exposures and the risk-weighted amount of the

default risk exposures for each type of relevant transaction and for each of the current exposure method and the IMM(CCR) approach.".

(6) Section 58—

Repeal subsection (5).

19. Section 60 amended (asset securitization)

(1) Section 60(1)(i)—

Repeal

"related companies (within the meaning of section 35 of the Capital Rules)"

Substitute

"affiliates".

(2) Section 60(1)(u)—

Repeal

"core capital"

Substitute

"CET1 capital".

(3) Section 60(1)(v)—

Repeal

"have been deducted from the institution's core capital and supplementary capital"

Substitute

"the institution has allocated a risk-weight of 1,250%".

20. Section 61 amended (market risk)

Section 61(3)(b)(i)—

Repeal

"316(3)"

Substitute

"4A".

21. Section 63 amended (equity exposures: disclosures for banking book positions)

Section 63(c)—

Repeal subparagraph (ii)

Substitute

"(ii) the total unrealized gains recognized in, or unrealized losses deducted from, the institution's retained earnings (or reserves) but not passing through the profit and loss account.".

22. Section 69 amended (asset securitization)

Section 69(1)(k)—

Repeal

"core capital and supplementary capital"

Substitute

"CET1 capital or allocated a risk-weight of 1,250%".

23. Section 70 amended (market risk)

Section 70(3)(b)(i)—

Repeal

"316(3)"

Substitute

"4A".

24. Section 80 amended (general disclosures for counterparty credit risk-related exposures)

(1) Section 80(1)—

Repeal

"OTC derivative transactions, repo-style transactions and credit derivative contracts (other than recognized credit derivative contracts)"

Substitute

"securities financing transactions and derivative contracts".

(2) Section 80(1)(a)—

Repeal

"exposures; and"

Substitute

"exposures;".

(3) Section 80(1)(b)—

Repeal

"provisions."

Substitute

"provisions;".

(4) After section 80(1)(b)—

Add

"(c) its policies with respect to exposures that give rise to general wrong-way risk or specific wrong-way risk; and

(d) the impact on it in terms of the amount of collateral that it would have to provide if there were a downgrade in its credit rating.".

(5) Section 80—

Repeal subsection (3)

Substitute

"(3) An authorized institution must disclose, in respect of the relevant transactions—

(a) the gross total positive fair value of the relevant transactions that are not securities financing transactions;

(b) the default risk exposures, after taking into account the effect of any valid bilateral netting agreements, for the relevant transactions that are not securities financing transactions;

(c) the default risk exposures, after taking into account the effect of any valid bilateral netting agreements, for the relevant transactions that are securities financing transactions;

(d) the default risk exposures, after taking into account the effect of any valid cross-product netting agreements, for the relevant transactions;

(e) the recognized collateral (broken down by type of collateral) held by the institution for the relevant transactions;

(f) the default risk exposures, after taking into account the effect of any recognized collateral, for the relevant transactions;

(g) the respective risk-weighted amounts for the relevant transactions;

(h) the notional amounts of recognized credit derivative contracts that provide credit protection for the relevant transactions; and

(i) the breakdown of the institution's default risk exposures and the risk-weighted amount of the

default risk exposures for each type of relevant transaction and for each of the current exposure method and the IMM(CCR) approach.".

(6) Section 80—

Repeal subsection (5).

25. Section 82 amended (asset securitization)

(1) Section 82(1)(i)—

Repeal

"related companies (within the meaning of section 35 of the Capital Rules)"

Substitute

"affiliates".

(2) Section 82(1)(u)—

Repeal

"core capital"

Substitute

"CET1 capital".

(3) Section 82(1)(v)—

Repeal

"have been deducted from the institution's core capital and supplementary capital"

Substitute

"the institution has allocated a risk-weight of 1,250%".

26. Section 83 amended (market risk)

Section 83(2)(b)(i)—

Repeal

"316(3)"

Substitute

"4A".

27. Section 85 amended (equity exposures: disclosures for banking book positions)

Section 85(c)—

Repeal subparagraph (ii)

Substitute

"(ii) the total unrealized gains recognized in, or unrealized losses deducted from, the institution's retained earnings (or reserves) but not passing through the profit and loss account.".

28. Section 105 amended (capital and capital adequacy)

(1) Section 105(a)—

Repeal subparagraphs (i) and (ii)

Substitute

"(i) the prevailing banking supervisory standards relating to capital adequacy issued by the Basel Committee and adopted by the relevant banking supervisory authority of the jurisdiction in which the institution is incorporated; or

(ii) any other standards that are substantially similar to those described in subparagraph (i),".

(2) Section 105(b)—

Repeal

"document or Directive"

Substitute

"standards".

Monetary Authority

2013

Explanatory Note

These Rules are made by the Monetary Authority under section 60A of the Banking Ordinance (Cap. 155) and amend the Banking (Disclosure) Rules (Cap. 155 sub. leg. M) (***principal Rules***).

2. The main purpose of the Rules is to incorporate into the principal Rules—

(a) Pillar 3 disclosures (basically, the public disclosure of prudential information) specific for banks using the internal models approach to calculate capital requirements for counterparty credit risk exposures as set out in Table 8 (general disclosures for exposures related to counterparty credit risk) in the document entitled "International Convergence of Capital Measurement and Capital Standards — A Revised Framework (Comprehensive Version)" published by the Basel Committee on Banking Supervision (***Basel Committee***) in June 2006;

(b) amendments necessitated by the new disclosure requirements contained in the document entitled "Composition of capital disclosure requirements — Rules text" published by the Basel Committee in June 2012;

(c) amendments necessitated by the amendments made to the Banking Ordinance (Cap. 155) by the Banking (Amendment) Ordinance 2012 (3 of 2012); and

(d) amendments necessitated by the amendments made to the Banking (Capital) Rules (Cap. 155 sub. leg. L) by the Banking (Capital) (Amendment) Rules 2012 (L.N. 156 of 2012).

3. The Rules come into operation on 30 June 2013.

Banking (Capital) (Amendment) Rules 2013

Contents

Banking (Capital) (Amendment) Rules 2013

(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 30 June 2013.

2. Banking (Capital) Rules amended

The Banking (Capital) Rules (Cap. 155 sub. leg. L) are amended as set out in sections 3 to 31.

3. Section 2 amended (interpretation)

Section 2(1)—

Add in alphabetical order

"***qualifying CCP*** (合資格 CCP) has the meaning given by section 226V(1);".

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

(1) Section 100—

Repeal subsection (1)

Substitute

"(1) Where an authorized institution's exposure is covered by a recognized guarantee or recognized credit derivative contract, the institution must determine the risk-weight to be allocated to the exposure in accordance with subsections (2), (3), (4), (5), (6), (7), (8), (9) and (10).".

(2) Section 100(2)—

Repeal

"(8) and (9),"

Substitute

"(8), (9) and (10),".

(3) Section 100(2)(a)—

Repeal

"the credit protection covered portion of".

(4) Section 100(2)(b), Chinese text—

Repeal

"該信用保障涵蓋部分"

Substitute

"該承擔的信用保障涵蓋部分，".

(5) After section 100(9)—

Add

"(10) Where an authorized institution's exposure is covered by a recognized credit derivative contract cleared by a qualifying CCP, the institution may allocate to the credit protection covered portion of the exposure—

(a) a risk-weight of 2% if—

(i) the institution is a clearing member of the qualifying CCP; or

(ii) the institution is a client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(b) a risk-weight of 4% if the institution is a client of a clearing member of the 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.".

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

(1) Section 101(3)—

Repeal

"Where"

Substitute

"Subject to subsection (6A), where".

(2) Section 101(4)—

Repeal

"Where"

Substitute

"Subject to subsection (6A), where".

(3) Section 101(6)—

Repeal

"Where"

Substitute

"Subject to subsection (6A), where".

(4) After section 101(6)—

Add

"(6A) For the purposes of subsections (3), (4) and (6), where the credit derivative contract concerned is cleared by a qualifying CCP, the words "the attributed risk-weight of the credit protection provider" in those subsections are deemed to read as—

(a) "a risk-weight of 2%" if—

(i) the authorized institution concerned is a clearing member of the qualifying CCP; or

(ii) the authorized institution concerned is a client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(b) "a risk-weight of 4%" if the authorized institution concerned is a client of a clearing member of the 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.".

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

(1) Section 134—

Repeal subsection (1)

Substitute

"(1) Where an authorized institution's exposure is covered by a recognized guarantee or recognized credit derivative contract, the institution must determine the risk-weight to be allocated to the exposure in accordance with subsections (2), (3), (4), (5), (6) and (7).".

(2) Section 134(2)—

Repeal

"(4) and (5),"

Substitute

"(4), (5), (6) and (7),".

(3) Section 134(2)(a)—

Repeal

"the credit protection covered portion of".

(4) Section 134(2)(b), Chinese text—

Repeal

"該信用保障涵蓋部分"

Substitute

"該承擔的信用保障涵蓋部分，".

(5) Section 134(3)—

Repeal

"a guarantor"

Substitute

"the guarantor of the recognized guarantee".

(6) After section 134(6)—

Add

"(7) Where an authorized institution's exposure is covered by a recognized credit derivative contract cleared by a qualifying CCP, the institution may allocate to the credit protection covered portion of the exposure—

(a) a risk-weight of 2% if—

(i) the institution is a clearing member of the qualifying CCP; or

(ii) the institution is a client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(b) a risk-weight of 4% if the institution is a client of a clearing member of the 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. Section 135 amended (provisions supplementary to section 134)

(1) Section 135(3)—

Repeal

"Where"

Substitute

"Subject to subsection (6A), where".

(2) Section 135(4)—

Repeal

"Where"

Substitute

"Subject to subsection (6A), where".

(3) Section 135(6)—

Repeal

"Where"

Substitute

"Subject to subsection (6A), where".

(4) After section 135(6)—

Add

"(6A) For the purposes of subsections (3), (4) and (6), where the credit derivative contract concerned is cleared by a qualifying CCP, the words "the attributed risk-weight of the credit protection provider" in those subsections are deemed to read as—

(a) "a risk-weight of 2%" if—

(i) the authorized institution concerned is a clearing member of the qualifying CCP; or

(ii) the authorized institution concerned is a client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(b) "a risk-weight of 4%" if the authorized institution concerned is a client of a clearing member of the 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.".

8. Section 168 amended (maturity under advanced IRB approach)

Section 168(1), Formula 20A, paragraph (c)—

Repeal

"maturity ="

Substitute

"*maturity* =".

9. Section 203 amended (credit risk mitigation—general)

Section 203(1A)—

Repeal

"estimates of any of the credit risk components of the applicable risk-weight function"

Substitute

"calculation of the risk-weighted amount of its exposures".

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

Section 215(b), after "shall,"—

Add

"subject to sections 216(3B) and 217(5),".

11. 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 "(3A),"—

Add

"(3B),".

(2) Section 216(2)(a)—

Repeal

"(3) and (3A)"

Substitute

"(3), (3A) and (3B)".

(3) Section 216(3)—

Repeal

"An"

Substitute

"Subject to subsection (3B), an".

(4) After section 216(3A)—

Add

"(3B) Where an authorized institution's exposure is covered by a recognized credit derivative contract cleared by a qualifying CCP, the institution may allocate to the covered portion of the exposure—

(a) a risk-weight of 2% if—

(i) the institution is a clearing member of the qualifying CCP; or

(ii) the institution is a client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(b) a risk-weight of 4% if the institution is a client of a clearing member of the 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.".

12. 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(1)—

Repeal

"subsection (2) and sections 210(2) and 215,"

Substitute

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

(2) After section 217(4)—

Add

"(5) Where an authorized institution's exposure is covered by a recognized credit derivative contract cleared by a qualifying CCP, the institution may allocate to the covered portion of the exposure—

(a) a risk-weight of 2% if—

(i) the institution is a clearing member of the qualifying CCP; or

(ii) the institution is a client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(b) a risk-weight of 4% if the institution is a client of a clearing member of the 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.".

13. Section 226D amended (calculation of IMM(CCR) risk-weighted amount at portfolio level under IMM(CCR) approach)

Section 226D(1)(b), Chinese text—

Repeal

"包括"

Substitute

"包含".

14. Section 226P amended (advanced CVA method)

(1) Section 226P(2)(a)—

Repeal

"and".

(2) Section 226P(2)(b)—

Repeal

"referenced)."

Substitute

"referenced); and".

(3) After section 226P(2)(b)—

Add

"(c) it properly captures the non-linear risk of options on credit default swaps if the institution, under subsection (3), includes eligible CVA hedges that consist of such

options in the CVA capital charge calculation for the purpose of reducing the institution's CVA capital charge.".

15. Section 226S amended (standardized CVA method)

(1) Section 226S(1), Formula 23J, paragraph (d)—

Repeal

"credit default swap, with counterparty "*i*" as the reference entity,"

Substitute

"eligible CVA hedge referencing counterparty "*i*"".

(2) Section 226S(1), Formula 23J, paragraph (e)—

Repeal

"index credit default swap on"

Substitute

"eligible CVA hedge referencing".

(3) Section 226S(1), Formula 23J, paragraph (e)(ii)—

Repeal

"index credit default swap"

Substitute

"index eligible CVA hedge".

(4) Section 226S(1), Formula 23J, paragraph (e)(ii)—

Repeal

"the swap"

Substitute

"the hedge".

(5) Section 226S(1), Formula 23J, paragraph (e)(ii)—

Repeal

"credit default swap on"

Substitute

"eligible CVA hedge for".

(6) Section 226S(1), Formula 23J, paragraph (f)—

Repeal

"index credit default swap"

Substitute

"index eligible CVA hedge".

(7) Section 226S(1), Formula 23J, paragraph (h)—

Repeal

"credit default swap"

Substitute

"single-name eligible CVA hedge".

(8) Section 226S(1), Formula 23J, paragraph (i)—

Repeal

"credit default swap"

Substitute

"index eligible CVA hedge".

(9) After section 226S(2)—

Add

"(2A) For the purposes of paragraph (c) in Formula 23J, if an authorized institution uses—

(a) the IRB approach to calculate the institution's credit risk for non-securitization exposures to the counterparty; and

(b) the current exposure method to calculate the institution's default risk exposures in respect of derivative contracts, or the methods referred to in section 10A(1)(b) to calculate such exposures in respect of SFTs,

the institution may recognize the credit risk mitigating effect of recognized collateral by applying Formula 19 and in accordance with section 160(3), and take the resulting net credit exposure (E*) as the basis for determining the EAD_i^{total} of a netting set in accordance with other applicable provisions of this section.".

(10) Section 226S(3), Chinese text—

Repeal

"機構"

Substitute

"認可機構".

(11) Section 226S(4)—

Repeal

"credit default swap"

Substitute

"eligible CVA hedge".

(12) Section 226S(4)—

Repeal

"swaps"

Substitute

"hedges".

(13) Section 226S(5)—

Repeal

"credit default swap"

Substitute

"eligible CVA hedge".

(14) Section 226S(5)—

Repeal

"swaps"

Substitute

"hedges".

(15) After section 226S(5)—

Add

"(5A) If the hedging instrument used in an eligible CVA hedge is an option on a credit default swap (regardless of whether the swap is a single-name or index credit default swap), an authorized institution may construe the notional amount mentioned in paragraph (d) or (e) in Formula 23J, as the case requires, as the delta-adjusted notional amount of the option concerned.".

16. Section 226T amended (eligible CVA hedges)

(1) After section 226T(1)(b)—

Add

"(ba) the external counterparties of the hedges fall within section 99(1)(b)(i), (ii), (iii), (iv), (v) or (vi);".

(2) Section 226T(1)(c)(iii)—

Repeal

"directly; or"

Substitute

"directly;".

(3) Section 226T(1)(c)(iv), after "swaps;"—

Add

"or".

(4) After section 226T(1)(c)(iv)—

Add

"(v) subject to subsection (2), options on index credit default swaps where the options do not contain a clause that would result in the options being terminated following a credit event;".

(5) Section 226T(6)(b)—

Repeal

"and".

(6) After section 226T(6)(b)—

Add

"(ba) must not, if it has over-hedged the CVA risk in respect of a counterparty with an eligible CVA hedge that falls within subsection (1)(c)(i), (ii) or (iii), include the excess portion of the eligible CVA hedge in its CVA capital charge calculation for the purpose of reducing its CVA capital charge; and".

(7) After section 226T(6)—

Add

"(7) An authorized institution that has over-hedged the CVA risk in respect of a counterparty with an eligible CVA hedge (***CVA hedge A***) may, with the prior consent of the Monetary Authority, treat any credit protection sold for the purpose of unwinding the excess portion of CVA hedge A as an eligible CVA hedge for the CVA risk associated with the excess portion of CVA hedge A if—

(a) all the applicable requirements set out in subsection (1) are met in respect of the protection sold; and

(b) the protection sold is subject to the same process, documentation and controls applicable to eligible CVA hedges.".

17. Section 226V amended (interpretation of Division 4)

Section 226V(2)—

Repeal paragraph (a)

Substitute

"(a) an authorized institution's default risk exposure to a CCP includes—

(i) any initial margin that is held by the CCP and posted by the institution; and

(ii) if the institution is a clearing member of the CCP, any variation margin that is held by the CCP and payable by the CCP to the institution; and".

18. Section 226X amended (exposures of clearing members to qualifying CCPs)

(1) After section 226X(2)—

Add

"(2A) For the purposes of subsections (1) and (2), if an authorized institution uses the IRB approach to calculate its credit risk for non-securitization exposures, the institution must take into account any credit risk mitigating effect in its calculation of the risk-weighted amount of default risk exposures to qualifying CCPs in accordance with Division 10 of Part 6 with the following modifications—

(a) the institution may recognize the credit risk mitigating effect of recognized collateral by applying Formula 19 and in accordance with section 160(3), and take the resulting net credit exposure (E*) as the basis for determining the risk-weighted amount;

(b) the institution may recognize the credit risk mitigating effect of a recognized guarantee by applying Part 4 unless—

(i) an exposure of the institution to the qualifying CCP is fully covered by a recognized guarantee; and

(ii) the institution uses the IRB approach to calculate its credit risk for exposures to the guarantor of the recognized guarantee mentioned in subparagraph (i);

(c) the institution may recognize the credit risk mitigating effect of a recognized credit derivative contract by applying Part 4 unless—

(i) an exposure of the institution to the qualifying CCP is fully covered by a recognized credit derivative contract; and

(ii) the institution uses the IRB approach to calculate its credit risk for exposures to the counterparty to the recognized credit derivative contract mentioned in subparagraph (i).".

(2) Section 226X(3)—

Repeal

"subsection (2)"

Substitute

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

19. Section 226Z amended (exposures of clearing members to clients)

After section 226Z(2)—

Add

"(2A) For the purposes of subsections (1) and (2), if—

(a) an authorized institution has collected collateral from its client for a transaction cleared by a CCP and passed on the collateral to the CCP to secure that transaction; and

(b) the collateral is not recognized collateral in respect of the institution's default risk exposure to the client arising from the transaction because the institution does not have a first lien (or any similar right or security interest) on the collateral,

the institution may take into account the credit risk mitigating effect of the collateral passed on to the CCP in calculating the risk-weighted amount of the institution's default risk exposure to the client arising from the transaction as if the collateral were recognized collateral.".

20. Section 226ZD amended (exposures of clearing members to non-qualifying CCPs)

After section 226ZD(1)—

Add

"(1A) To avoid doubt, for the purposes of subsection (1), an authorized institution must take into account any credit risk mitigating effect in its calculation of the risk-

weighted amount of its exposures to non-qualifying CCPs in accordance with Part 4.".

21. Section 226ZE amended (treatment of posted collateral)

(1) After section 226ZE(6)—

Add

"(6A) Subsections (1), (2), (3), (4), (5) and (6) do not apply to a collateral that is a default risk exposure to a CCP under section 226V(2)(a).".

(2) Section 226ZE(7)—

Repeal paragraph (a)

Substitute

"(a) an authorized institution must, in respect of a collateral that is a default risk exposure to a CCP under section 226V(2)(a), determine the risk-weight applicable to the exposure in accordance with section 226X, 226ZB or 226ZD, as the case requires; and".

22. Section 265 amended (recognized credit risk mitigation)

Section 265(b)(ii)—

Repeal

"216(3)"

Substitute

"216(3), section 216(3) and (3A) or section 216(3B), as the case may be,".

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

Section 278(b)(ii)—

Repeal

"216(3);"

Substitute

"216(3), section 216(3) and (3A) or section 216(3B), as the case may be;".

24. Section 308 amended (use of credit derivative contracts to offset specific risk)

(1) Section 308(1)—

Repeal

"which is identical to the reference obligation specified in the credit derivative contract, or in another credit derivative contract,".

(2) After section 308(1)—

Add

"(1A) Subject to subsection (2), an authorized institution may use a credit derivative contract booked in the institution's trading book to offset the market risk capital charge for specific risk calculated for the institution's trading book position in another credit derivative contract in accordance with—

(a) section 309 (excluding section 309(1)(b)) with all necessary modifications;

(b) section 310 with all necessary modifications; or

(c) section 311 (excluding section 311(1)(a)) with all necessary modifications.".

(3) Section 308(2)—

Repeal

"which is identical to the reference obligation specified in the credit derivative contract,".

25. Section 309 amended (offsetting in full)

(1) Section 309(1)—

Repeal

everything before "always move"

Substitute

"(1) For the purposes of section 308(1), an authorized institution may offset 100% of the market risk capital charge for specific risk for its position in a credit derivative contract against that for a position in the underlying exposure which is identical to the reference obligation specified in the contract where the values of the 2 positions, being the long or short position in the contract, and the short or long position respectively in the underlying exposure which is identical to the reference obligation specified in the contract,".

(2) Section 309(2)—

Repeal

everything before "pursuant to"

Substitute

"(2) Where an authorized institution offsets the market risk capital charge for specific risk for its positions".

26. Section 310 amended (offsetting by 80%)

(1) Section 310(1), after "against"—

Add

"that for".

(2) Section 310(1)(a), Chinese text—

Repeal

"經常"

Substitute

"總是".

(3) Section 310(2)(b)(ii)—

Repeal

"position in the underlying exposure;"

Substitute

"swap contract or note, as the case may be;".

(4) Section 310(2)(b)(iii)—

Repeal

"the reference obligation specified in".

(5) Section 310(3)—

Repeal

"its positions in a credit derivative contract"

Substitute

"the market risk capital charge for specific risk for its positions".

(6) Section 310(3)(b), Chinese text—

Repeal

"其他"

Substitute

"另一".

27. Section 311 amended (other offsetting)

(1) Section 311(1)—

Repeal

everything before "usually move"

Substitute

"(1) For the purposes of section 308(1), an authorized institution may offset partially the market risk capital charge for specific risk for its position in a credit derivative contract against that for a position in the underlying exposure where the values of the 2 positions, being the long or short position in the contract, and the short or long position respectively in the underlying exposure,".

(2) Section 311(1)(a), English text—

Repeal

"position would"

Substitute

"positions would".

(3) Section 311(1)(a), after "between the reference obligation"—

Add

"specified in the contract".

(4) Section 311(1)(b), English text—

Repeal

"position would"

Substitute

"positions would".

(5) Section 311(1)(c)—

Repeal

"position would fall within section 310 but for there being a mismatch between the position in the underlying exposure and the reference obligation specified in the contract"

Substitute

"positions would fall within section 310 but for there being an asset mismatch between the reference obligation specified in the contract and the position in the underlying exposure".

(6) Section 311—

Repeal subsection (2)

Substitute

"(2) Where an authorized institution offsets the market risk capital charge for specific risk for its positions pursuant to subsection (1)—

(a) 100% of the market risk capital charge for specific risk is required to be calculated for the position with the higher market risk capital charge for specific risk; and

(b) the market risk capital charge for specific risk to be calculated for the other position is to be zero.".

28. Schedule 1A amended (transactions and contracts not subject to CVA capital charge)

(1) Schedule 1A, section 1—

Repeal paragraph (e)

Substitute

"(e) OTC derivative transactions, credit derivative contracts and SFTs (other than those falling within paragraph (a), (b), (c) or (d))—

(i) that are in default as determined under the terms and conditions of the transactions or contracts;

(ii) in respect of which the losses due to the default have been recognized by the authorized institution concerned for accounting and reporting purposes; and

(iii) the exposures in respect of which have been transformed into simple claims that do not have the risk characteristics of derivative contracts or SFTs.".

(2) Schedule 1A, section 2—

Repeal

"a qualifying CCP (within the meaning of section 226V(1) of these Rules)"

Substitute

"a qualifying CCP".

29. Schedule 4F amended (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) Schedule 4F, section 1(6)—

Repeal

"5 or 6"

Substitute

"5, 6 or 8".

(2) Schedule 4F, section 1(8)(a)—

Repeal

"5 or 6"

Substitute

"5, 6 or 8".

30. Schedule 4G amended (deduction of holdings where authorized institution has significant capital investments in financial sector entities that are outside scope of consolidation under section 3C requirement)

Schedule 4G, section 1(5)—

Repeal

"5 or 6"

Substitute

"5, 6 or 8".

31. Schedule 4H amended (transitional arrangements in relation to Banking (Capital) (Amendment) Rules 2012)

(1) Schedule 4H, section 3(5)—

Repeal

"deduction from CET1 capital"

Substitute

"deduction from CET1 capital, Additional Tier 1 capital or Tier 2 capital, as the case requires,".

(2) Schedule 4H, section 3(5)—

Repeal Table C

Substitute

"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, Additional Tier 1 capital or Tier 2 capital, as the case requires, expressed in percentage points	Remaining amount to be deducted on an equal basis from Tier 1 capital and Tier 2 capital 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%".

(3) Schedule 4H, section 5(2)(b)(i)—

Repeal

"1(p)"

Substitute

"1(q)".

(4) Schedule 4H, section 5(2)(b)(ii)—

Repeal

"1(j)"

Substitute

"1(k)".

Monetary Authority

2013

Explanatory Note

These Rules are made by the Monetary Authority under section 97C of the Banking Ordinance (Cap. 155) and amend the Banking (Capital) Rules (Cap. 155 sub. leg. L) (***principal Rules***).

2. The main purpose of the Rules is to incorporate into the principal Rules—

(a) amendments relating to the clarifications in respect of the capital treatments for counterparty credit risk as set out in the document entitled "Basel III counterparty credit risk and exposures to central counterparties — Frequently asked questions" published by the Basel Committee on Banking Supervision (***Basel Committee***) in December 2012;

(b) amendments for clarifying—

(i) the treatment of certain capital investments booked in an authorized institution's trading book that are not required to be deducted from the institution's capital base;

(ii) the transitional arrangements for the treatment of certain capital deductions and capital instruments; and

(iii) how, if the usual prescribed treatment under the internal ratings-based approach for credit risk cannot be applied, an authorized institution that adopts that approach in the calculation of its regulatory capital ratios should recognize the effect of credit risk mitigation under—

(A) the standardized CVA method; and

(B) the framework for calculating regulatory capital for exposures to central counterparties;

(c) amendments for bringing certain provisions of the principal Rules into closer alignment with corresponding provisions of the document entitled "International Convergence of Capital Measurement and Capital Standards — A Revised Framework (Comprehensive Version)" published by the Basel Committee in June 2006; and

(d) minor amendments for achieving consistency in terminology in the provisions of the principal Rules.

3. The Rules come into operation on 30 June 2013.