

LEGISLATIVE COUNCIL BRIEF
BANKING ORDINANCE (CHAPTER 155)
BANKING (AMENDMENT) ORDINANCE 2012
(COMMENCEMENT) NOTICE 2014
BANKING (CAPITAL) (AMENDMENT) RULES 2014
BANKING (LIQUIDITY) RULES

INTRODUCTION

Further to the first phase of Basel III (which came into effect starting 1 January 2013), and for the purpose of implementing the regulatory standards contained in the second phase of Basel III –

- (a) the Secretary for Financial Services and the Treasury has made the **Banking (Amendment) Ordinance 2012 (Commencement) Notice 2014 (Annex A)** to appoint 1 January 2015 as the date on which the uncommenced provisions of the Banking (Amendment) Ordinance 2012 (“BAO 2012”) will come into operation; and
- (b) the Monetary Authority (“MA”¹) has made –
 - (i) the **Banking (Capital) (Amendment) Rules 2014** (“BCAR 2014”) (**Annex B**) to introduce, for authorized institutions² (“AIs”) incorporated in Hong Kong, a series of capital buffers, viz., the Capital Conservation Buffer (“CB”), the Countercyclical Capital Buffer (“CCyB”) and, for AIs considered systemically important, a Higher Loss Absorbency Requirement (“HLA”); and
 - (ii) the **Banking (Liquidity) Rules** (“BLR”) (**Annex C**) to introduce the Basel III Liquidity Coverage Ratio (“LCR”) requirement.

¹ In this brief, 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.

JUSTIFICATIONS

2. The Legislative Council enacted the BAO 2012 in February 2012 to provide the legal framework for implementation in Hong Kong of the revised regulatory package of capital, liquidity and disclosure standards promulgated by the Basel Committee on Banking Supervision (“BCBS”) (known as “Basel III”). These standards aim to further enhance the resilience of banks and the banking system in the light of lessons from the recent global financial crisis. The BCBS has adopted a “phased approach” for the implementation of Basel III, with a view to ensuring that the banking sector can gradually meet the more stringent regulatory standards while continuing to lend and perform its credit intermediation function in support of the economy.

3. The Banking (Capital) (Amendment) Rules 2012³ and the Banking (Disclosure) (Amendment) Rules 2013 were made by the MA under the Banking Ordinance to prescribe the first phase of Basel III capital standards (which increased the minimum regulatory capital requirement, tightened the criteria for recognising instruments eligible for inclusion as regulatory capital, and enhanced the risk coverage of the capital framework for AIs incorporated in Hong Kong) and the associated disclosure requirements to enhance the consistency and comparability of AIs’ disclosures in respect of their capital base. The two sets of rules came into operation on 1 January and 30 June 2013 respectively in accordance with the BCBS timetable.

4. The MA has been monitoring the implementation of the first phase of Basel III capital and disclosure requirements in Hong Kong through its supervisory process. This includes review of AIs’ capital planning and the quarterly banking returns of capital positions. The MA observes that the implementation process has to date been smooth. The aggregate capitalisation of Hong Kong’s banking sector remains well above the Basel III minimum requirements⁴, with locally-incorporated AIs’ average Common Equity Tier 1 (“CET1”) capital ratio and Total capital ratio standing at 13.2% and 16.1% as at end-June 2014. The strong capitalisation and resilience of Hong Kong’s banking sector was noted by the International Monetary Fund in its recent assessment of Hong Kong.

³ Further amendments were made through the Banking (Capital) (Amendment) Rules 2013 to implement the technical guidance issued by the BCBS in December 2012 in relation to the counterparty credit risk framework and some miscellaneous refinements.

⁴ The Basel III minimum (Pillar 1) requirements are a Common Equity Tier 1 capital ratio of 4.5%, a Tier 1 capital ratio of 6% and a Total capital ratio of 8% of risk-weighted assets respectively.

Capital standards

5. As noted in paragraph 1 above, the BCAR 2014 contain amendments to implement the Basel III capital buffer requirements in Hong Kong. Seeking to bolster the resilience of banks in response to financial and economic stress, the buffers are designed to incentivise AIs to build up and hold, outside of periods of stress, an additional layer of CET1 capital above the “hard” minimum capital requirements. The intention is that AIs may operate within the “buffer zone” without breaching their minimum capital requirements, if their capital ratios fall as a result of the need to absorb losses or in response to an increase in the risk-weighted measure of their assets. However, AIs will be subject to restrictions on their ability to make discretionary distributions whilst their capital levels are within the “buffer zone”⁵. In summary, the Basel III capital buffer requirements consist of three components–

- (a) *CB* – AIs will need to hold an additional layer of CET1 capital, amounting to 2.5% of their total risk-weighted assets, in order to avoid distribution constraints. According to the BCBS timetable, the CB will be phased in via equal annual increments from 0.625% in January 2016 to 2.5% in January 2019;
- (b) *CCyB* – Under the Basel III framework, the relevant authority in each jurisdiction will put in place a jurisdictional CCyB requirement for CET1 capital, ranging, generally, between 0% and 2.5% of risk-weighted assets, for banks’ private sector credit exposures in its jurisdiction when the authority assesses that there is “excess aggregate credit growth associated with a build-up of system-wide risk” in the jurisdiction. The jurisdictional CCyB requirement is “countercyclical” in nature as it will only be “switched on” (or its level increased) in a given jurisdiction in times of “credit boom” (i.e. in response to excessive credit growth in the jurisdiction with systemic implications), and will be “switched off” (or its level reduced) when the credit cycle turns down, enabling banks to rely on the released capital to support their continued lending to the real economy. A jurisdictional CCyB requirement will directly apply to banks incorporated in the relevant jurisdiction and, on a reciprocal basis, authorities outside the relevant jurisdiction

⁵ Within the “buffer zone”, the closer the level of an AI’s CET 1 capital to its minimum CET1 capital requirement, the higher will be the restriction imposed upon its ability to make discretionary distributions within a given financial year.

will impose a corresponding CCyB requirement on their banks in relation to their banks' private sector credit exposures in the relevant jurisdiction.

Accordingly, the CCyB requirement to which each AI is subject to will be calculated by reference to the locations (including Hong Kong) of its private sector credit exposures and the applicable jurisdictional CCyB requirements in those locations.

The CCyB takes effect as an extension of the CB and hence banks will be subject to restrictions on distributions whilst their CET1 capital levels fall within the extended buffer zone. The CCyB will be phased in over a period of three years from 2016 to 2019.

Whilst the Basel III standard focuses primarily on a jurisdictional CCyB range of 0% to 2.5%, the BCBS specifically allows relevant authorities to exercise discretion in setting a jurisdictional CCyB requirement in excess of 2.5% if appropriate in light of local circumstances. As an international financial centre with a large banking sector and an open economy, Hong Kong is naturally exposed to the risk of volatile capital flows and can be influenced significantly by international financial conditions. The MA is therefore seeking to preserve flexibility in the BCAR 2014 to set (and recognise overseas) jurisdictional CCyB requirements above 2.5% as a macroprudential tool to guard against severe systemic risks in extraordinary circumstances.

In order to allow sufficient time for AIs to adjust their capital planning, the MA intends, in general, to give an advance announcement period of 12 months (in exceptional circumstances, this might be shortened to a period of not less than 6 months) before decisions to switch on or increase the jurisdictional CCyB requirement for Hong Kong take effect; and

- (c) *HLA* – The HLA will apply to banks considered systemically important, either globally (referred to as G-SIBs) or domestically (referred to as D-SIBs) whose failure could have significant spillover effects on the financial system and, ultimately, the broader economy. To avoid distribution constraints, G-SIBs and D-SIBs will be required to comply

with the HLA by maintaining an additional layer of CET1 capital (the HLA requirement) ranging from 1% to 3.5% (depending on their perceived level of systemic importance) of their total risk-weighted assets. The HLA takes effect as an extension of the CB and will be phased-in from 2016 to 2019 in equal annual increments.

Liquidity standards

6. The MA has made the BLR to implement the Basel III LCR requirement, which seeks to promote banks' resilience to short-term liquidity risks by ensuring that they have sufficient high quality liquid assets ("HQLA")⁶ to meet their obligations for at least 30 calendar days under an acute stress scenario.⁷ In line with the phased implementation timetable recommended by the BCBS, the minimum LCR requirement will begin at 60% on 1 January 2015, to be followed by annual increments of 10 percentage points until the minimum requirement reaches 100% on 1 January 2019.

7. Having regard to the diversity of AIs in terms of their business nature and scale of operation, the MA intends to adopt a two-tiered approach whereby the new LCR requirement will apply to internationally active AIs or those larger or more sophisticated AIs that are significant to the general stability of the Hong Kong banking system. In parallel, a Liquidity Maintenance Ratio ("LMR") requirement, which will be a modified version of the existing Liquidity Ratio requirement under the Banking Ordinance⁸, will apply to all other AIs with a lesser degree of operational sophistication or systemic importance to the banking sector. The LMR will also be implemented through the BLR.

⁶ There are three classes of assets (viz. level 1, level 2A and level 2B assets) that can qualify as HQLA, including, among others, high quality sovereign and corporate debt securities. In order to be considered HQLA, assets must meet a set of relevant qualifying criteria and requirements designed to demonstrate their ready liquefiability under stressed conditions.

⁷ The LCR is a ratio, expressed as a percentage, of the total stock of HQLA held by a bank to its total net cash outflows over a period of 30 calendar days calculated based on a set of stress assumptions.

⁸ Pursuant to section 102 of, and the Fourth Schedule to, the Banking Ordinance, all AIs are subject to a minimum Liquidity Ratio of 25%. Accordingly, relevant AIs subject to the LMR requirement shall in future maintain liquefiable assets sufficient to cover at least 25% of their qualifying liabilities (after deduction of some prescribed cash inflows) due within one month.

THE SUBSIDIARY LEGISLATION

Banking (Amendment) Ordinance 2012 (Commencement) Notice 2014

8. This Commencement Notice seeks to bring into effect from 1 January 2015 the provisions of the BAO 2012 relating to the powers of the MA to make rules prescribing liquidity requirements for AIs.

Banking (Capital) (Amendment) Rules 2014

9. The BCAR 2014 will add a new Part 1B to the Banking (Capital) Rules (“BCR”) to set out –

- (a) the constraints on distribution payments when an AI’s net CET1 capital level⁹ is equal to or below its buffer level;
- (b) provisions specifying—
 - (i) the determination of an AI’s buffer level (Sections 3G and 3I);
 - (ii) the calculation of the maximum amount an AI can distribute within the constraints (Sections 3H and 3I); and
 - (iii) actions that must be taken by an AI when the AI intends to make a distribution (Sections 3J, 3K and 3L);
- (c) the CB requirement and the phased timetable for 2016 to 2019 (Section 3M);
- (d) the CCyB requirement, including—
 - (i) the calculation of the CCyB requirement applicable to a given AI (Section 3O);
 - (ii) modifications that may be made by the MA to the level and/or effective date of the jurisdictional CCyB requirement announced by a jurisdiction outside Hong Kong, if the MA considers the modifications necessary for ensuring the adequate resilience of AIs or the effective working of the banking system in Hong Kong (Section 3P);
 - (iii) the MA’s power to set a jurisdictional CCyB requirement

⁹ An AI’s net CET1 capital level means the AI’s CET1 capital less the amount of that CET1 capital that the AI requires in order to comply with its minimum capital requirements.

for private sector credit exposures in Hong Kong and the phased timetable for 2016 to 2019 (Section 3Q(3), (4) and (9));

(iv) the MA's power, after consulting the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, the Hong Kong Association of Banks and The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies, to—

- vary the phased timetable referred to in subparagraph (iii); or
- set a jurisdictional CCyB requirement of more than 2.5% (Section 3Q(5) to (7)); and

(v) actions that must be taken by an AI if it intends to make a distribution out of the capital released by a reduction in the level of a jurisdictional CCyB requirement (as opposed to “using” that capital to absorb losses or support continued lending business) (Section 3R); and

(e) the HLA requirements, covering—

- (i) the designation of an AI as a G-SIB or D-SIB (Sections 3S and 3U); and
- (ii) the determination of the HLA applicable to a G-SIB or D-SIB and the phased timetable for HLA from 2016 to 2019 (Sections 3T, 3V, 3W and 3X).

10. It is proposed to add the following two organisations into the list of relevant international organisations in Part 10 of Schedule 1 to the BCR (which will enable AIs to accord them a 0% risk-weighting):

- (a) European Financial Stability Facility; and
- (b) European Stability Mechanism.

This reflects the BCBS announcement made in March this year that a 0% risk weight may be applied to claims on these two organisations.

11. In addition, the opportunity is taken to introduce miscellaneous amendments to certain provisions in the BCR to address differences or ambiguities vis-à-vis the regulatory capital standards issued by the BCBS as identified during a recent self-assessment conducted by the MA as part

of the BCBS Regulatory Consistency Assessment Programme (“RCAP”). The RCAP is the BCBS peer review process to assess the extent of compliance of BCBS member jurisdictions with the Basel 2/2.5/3 standards (please see amendments to sections 2(1),15, 27, 69, 145, 149, 205, 216, 227, 232A, 235, 261 and 269 of, and Schedules 4B and 4C to, the BCR).

Banking (Liquidity) Rules

12. The principal provisions set out in the proposed BLR cover –
- (a) the MA’s power to designate an AI as a category 1 institution (which will be subject to the LCR requirements) based on one or more of the grounds specified in the BLR. Other AIs not designated as category 1 institutions (i.e. category 2 institutions) will be subject to the LMR requirements (Part 1 as read with Schedule 1);
 - (b) the minimum level of LCR and LMR respectively applicable to category 1 and category 2 institutions, and circumstances under which a category 1 institution may monetize its HQLA to meet its obligations, even if this might cause the institution to maintain an LCR below the required minimum (Parts 2 and 3);
 - (c) the valuation of assets and liabilities included under, and the bases of calculation of, the LCR and LMR, as well as certain reporting requirements applicable to category 1 and category 2 institutions (Parts 4 and 5);
 - (d) actions that the MA may take when notified by a category 1 institution of certain events (Part 6);
 - (e) the technical requirements relating to the calculation by a category 1 institution of its LCR (Part 7 as read with Schedules 2 to 4); and
 - (f) the technical requirements relating to the calculation by a category 2 institution of its LMR (Part 8 as read with Schedule 5).

LEGISLATIVE TIMETABLE

13. The subsidiary legislation referred to in paragraph 1 above will be published in the Gazette on 24 October 2014, and tabled at the Legislative Council at its sitting of 29 October 2014. Subject to negative vetting by the Legislative Council, the subsidiary legislation will come into operation on 1 January 2015.

IMPLICATIONS OF THE PROPOSALS

14. The proposals for the second phase of Basel III implementation are consistent with the relevant BCBS Basel III standards. Given the strong capitalisation of the local banking sector, the MA does not expect the buffer proposals to have a material impact on AIs' capital positions. The BCBS phased arrangements for the capital buffers should provide sufficient time for any AIs, which need to do so, to adjust their capital positions in response to the new requirements. With careful capital planning by AIs, which the MA will monitor through its supervisory process, the proposals are not expected to have a significant impact on AIs' dividend policies in general.

15. In relation to the new liquidity standards, most AIs will be subject to the LMR, with only a relatively small number of the larger, more sophisticated AIs likely to be subject to the LCR requirements. The adoption of this two-tiered approach should avoid undue compliance burdens on AIs. The relevant quantitative impact studies conducted to date broadly indicate that AIs should have no major difficulty in meeting the relevant liquidity requirements from 1 January 2015 onwards, although some may need to fine-tune or adjust their liquidity or funding strategies. The phased arrangements for the LCR should provide sufficient time for relevant AIs, which need to do so, to adjust their liquidity positions to meet the new requirements. The MA will monitor the liquidity positions of AIs closely and provide necessary guidance, such as codes of practice¹⁰ or guidelines, to facilitate their compliance with the new requirements.

16. The two legislative proposals set out in paragraph 1 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.

¹⁰ Section 97M of the Banking Ordinance enables the MA, after consultation with specified persons, to approve and issue codes of practice to provide guidance on rules made by the MA for capital, disclosure and liquidity purposes.

INTERNATIONAL IMPLEMENTATION

17. A table is included in **Annex D** presenting comparative information regarding Hong Kong and some major jurisdictions (mainly members of the G20) on: (a) the progress in implementation of the first phase of Basel III requirements; and (b) the timetable for implementing the second phase of Basel III requirements. In summary –

- (a) All of the jurisdictions listed have already published rules to give effect to the first phase of Basel III implementation. There was some delay in both the US and the EU vis-à-vis the initial commencement date of 1 January 2013 under the BCBS timetable but the two jurisdictions have now both aligned themselves by implementing from 1 January 2014 the Basel III requirements at the levels applicable from 2014 under the BCBS transitional arrangements (meaning they have, in essence, “caught up”, by imposing a correspondingly shorter transitional period); and
- (b) In respect of the second phase of Basel III implementation, the jurisdictions covered in **Annex D** are generally following the BCBS timeline of introducing the LCR from not later than 1 January 2015 (except that the EU has recently announced a deferral of its implementation date for the LCR to October 2015 largely to allow time for completion of necessary legislative processes) and the capital buffer requirements from not later than 1 January 2016. The BCBS timeline for the introduction of the buffers requires rules to be in place not later than 1 January 2015 in light of the normal 12-month advance announcement period for any CCyB rate increase (including from zero – meaning that for a buffer to take effect from January 2016, notice would need to be given in January 2015). The EU, which encompasses 9 BCBS member jurisdictions, Singapore and New Zealand have elected not to set any upper limit to their CCyB rates for prudential considerations. The second phase of Basel III also covers requirements for the disclosure by banks of their leverage ratios calculated according to the Basel III leverage ratio measure. In this regard, we are preparing a set of proposed amendments to the Banking (Disclosure) Rules which will be tabled before the Legislative Council shortly.

PUBLIC CONSULTATION

18. We consulted the Legislative Council Panel on Financial Affairs on the legislative proposals on 7 July 2014. Members generally supported the policy direction of implementing the second phase of Basel III in Hong Kong. To avoid subjecting the banking sector to any disadvantage from lagging behind other financial centres, Members considered it important that Hong Kong stay in line in terms of the pace of Basel III implementation vis-à-vis other major jurisdictions.

19. The MA has engaged the banking sector intensively through industry-wide consultation and discussions, meetings and exchanges of correspondence with individual AIs or industry groups in relation to the implementation and the technical aspects of the abovementioned proposals, as part of the consultative process in developing the subsidiary legislation mentioned in paragraph 1. In addition, in accordance with section 97C and section 97H of the Banking Ordinance, the MA issued a draft of the provisions to be contained in the rules to consult the Financial Secretary, the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, the Hong Kong Association of Banks, and the Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies in August 2014. Responses indicated support for the direction of the amendments to the BCR and that of the new BLR. Relevant technical or drafting comments have been addressed in the finalised rules as appropriate, and the intent of certain provisions has been clarified.

PUBLICITY

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

ENQUIRIES

21. Enquiries should be directed to Mr. Jackie Liu, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) at 2810 2067, or to the following officers within the MA: (i) Mr. Richard Chu, Head (Banking Policy), at 2878 8276, for matters concerning capital standards and (ii) Ms. Rita Yeung, Head (Banking Policy), at 2878 1388, for matters concerning liquidity standards.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
22 October 2014

**Banking (Amendment) Ordinance 2012
(Commencement) Notice 2014**

Under section 1(2) of the Banking (Amendment) Ordinance 2012 (3 of 2012), I appoint 1 January 2015 as the day on which the uncommenced provisions of the Ordinance come into operation.

Secretary for Financial Services and
the Treasury

2014

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Banking (Capital) (Amendment) Rules 2014

(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 Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies)

1. Commencement

These Rules come into operation on 1 January 2015.

2. Banking (Capital) Rules amended

The Banking (Capital) Rules (Cap. 155 sub. leg. L) are amended as set out in sections 3 to 20.

3. Section 2 amended (interpretation)

(1) Section 2(1)—

Repeal the definition of *collective provisions*

Substitute

“*collective provisions* (集體準備金), in relation to the exposures of an authorized institution—

- (a) means an allowance for impairment loss for a group of exposures where—
 - (i) the group of exposures is considered by the institution as having similar credit risk characteristics that are indicative of the debtors’ ability to pay all amounts due according to the contractual terms of the group of exposures; and
 - (ii) the impairment loss has been assessed by the institution on a collective basis for the group

of exposures by reference to historical loss experience in respect of exposures with similar credit risk characteristics, relevant observable data reflecting current market conditions and other relevant factors; but

- (b) does not include any allowance for impairment loss ascribed to identified deterioration of particular assets or known liabilities, whether individual or grouped;”.

(2) Section 2(1), definition of *Fitch Ratings*—

Repeal paragraph (a)

Substitute

“(a) consists of members of the group of companies of which Fitch, Inc. is the ultimate holding company;”.

(3) Section 2(1), definition of *Standard & Poor’s Ratings Services*, paragraph (a)—

Repeal

“The McGraw-Hill Companies, Inc.”

Substitute

“McGraw Hill Financial, Inc.”.

(4) Section 2(1)—

Add in alphabetical order

“*investing institution* (投資機構) has the meaning given by section 227(1);”.

4. Section 2A added

Part 1, after section 2—

Add

“2A. Application

These Rules apply to an authorized institution incorporated in Hong Kong.”

5. Part 1B added

After Part 1A—

Add

“Part 1B

**Additional CET1 Capital Required to be
Maintained before Distribution Payment Allowed**

Division 1—General**3E. Interpretation of Part 1B**

(1) In this Part—

buffer level (緩衝水平), in relation to an authorized institution, means the buffer level applicable to the institution under section 3G;

capital conservation buffer ratio (防護緩衝資本比率), in relation to the calculation of an authorized institution’s buffer level, means the ratio set out in section 3M;

CB ratio (CB 比率) means a capital conservation buffer ratio;

CCyB ratio (CCyB 比率) means a countercyclical capital buffer ratio;

countercyclical capital buffer ratio (逆周期緩衝資本比率), in relation to the calculation of an authorized institution’s buffer level, means the ratio calculated under section 3O;

distribution payment (分派付款), in relation to the making of a payment by an authorized institution—

(a) means—

- (i) payment of dividends;
- (ii) payment for purchase of the institution’s own shares;
- (iii) discretionary payment on Additional Tier 1 capital instruments;
- (iv) discretionary bonus payment to the directors, senior management and employees of the institution; or
- (v) any other payment that is in substance a distribution of the institution’s CET1 capital; but

(b) does not include any payment that does not deplete the institution’s CET1 capital;

domestic systemically important authorized institution (具本地系統重要性認可機構) means an authorized institution so designated under section 3U;

D-SIB means a domestic systemically important authorized institution;

earnings (溢利), in relation to an authorized institution, means the amount of the institution’s profits calculated by—

(a) adding together—

- (i) the institution’s profits after taxation generated in a financial year out of which the institution may make a distribution payment; and

(ii) any distribution payment that has been made, and deducted from the institution's income, in the financial year; and

(b) subtracting from the sum calculated under paragraph (a) any additional tax that would have been reported if no distribution payment had been made in the financial year;

global systemically important authorized institution (具全球系統重要性認可機構) means an authorized institution so designated under section 3S;

G-SIB means a global systemically important authorized institution;

higher loss absorbency ratio (較高吸收虧損能力比率)—

(a) in relation to the calculation of a D-SIB's buffer level, means the ratio determined under section 3V; or

(b) in relation to the calculation of a G-SIB's buffer level, means the ratio determined under section 3T;

HLA ratio (HLA 比率) means a higher loss absorbency ratio;

maximum distributable amount (最高可分派數額)—see section 3H;

net CET1 capital (淨 CET1 資本), in relation to an authorized institution, means the institution's CET1 capital less the amount from the CET1 capital that the institution requires for complying with the minimum CET1 capital ratio, Tier 1 capital ratio and Total capital ratio set out in section 3B applicable to it as may be varied by the Monetary Authority under section 97F of the Ordinance.

(2) The net CET1 capital ratio for an authorized institution is determined in the same way as the institution's CET1 capital ratio under these Rules, except that the

institution's net CET1 capital is used in place of the institution's CET1 capital for the determination.

(3) For the purposes of this Part—

(a) where an authorized institution creates an obligation to make a distribution payment, the institution is treated as making a distribution payment; and

(b) where an authorized institution intends to create an obligation to make a distribution payment, the institution is treated as intending to make a distribution payment.

Division 2—Constraints on Distribution Payment

3F. Distribution payment requirements

(1) This section applies in relation to an authorized institution with effect from—

(a) 1 January 2016; or

(b) if earlier, the date on which the institution's buffer level is greater than 0%.

(2) No distribution payment may be made by an authorized institution in a financial year unless this section and (where applicable) section 3J or 3K are complied with.

(3) Without affecting any requirement imposed on an authorized institution under any other Parts, subsection (4), (5) or (6) applies to the institution if it intends to make a distribution payment in a financial year (*relevant payment*).

(4) If an authorized institution's net CET1 capital ratio is above its buffer level, irrespective of whether the institution has earnings for the immediately preceding

financial year, the institution may make the relevant payment.

- (5) If an authorized institution's net CET1 capital ratio is equal to or below its buffer level, and the institution does not have earnings for the financial year immediately preceding the financial year in which notification of the relevant maximum distributable amount is required to be made under section 3K(3)(a) (*year of notification*), the institution must not make the relevant payment.
- (6) If an authorized institution's net CET1 capital ratio is equal to or below its buffer level, and the institution has earnings for the financial year immediately preceding the year of notification, the institution may make the relevant payment, but the relevant payment must not exceed the greater of—
 - (a) zero; and
 - (b) the maximum distributable amount notified to the Monetary Authority under section 3K(3)(a) less the aggregate amount of any distribution payments that have been made in the year of notification.

3G. Buffer level

There is applicable to an authorized institution a buffer level that is expressed as a percentage and calculated according to the following formula—

- (a) if the institution is a G-SIB or a D-SIB—
CB ratio + CCyB ratio + HLA ratio; or
- (b) in any other case—
CB ratio + CCyB ratio.

3H. Maximum distributable amount

- (1) The maximum distributable amount for an authorized institution is the product of—
 - (a) the institution's earnings for the financial year immediately preceding the financial year in which notification under section 3K(3)(a) is made; and
 - (b) the maximum distribution percentage determined by reference to the quartile of the institution's buffer level within which the institution's net CET1 capital ratio falls, as listed in Table 1AA.

Table 1AA

Determination of Maximum Distribution Percentage for Calculation of Maximum Distributable Amount

Quartile of buffer level within which net CET1 capital ratio falls	Maximum distribution percentage
1 st quartile (0% to 25% of buffer level)	0%
2 nd quartile (more than 25% to 50% of buffer level)	20%
3 rd quartile (more than 50% to 75% of buffer level)	40%
4 th quartile (more than 75% to 100% of buffer level)	60%

- (2) For the purposes of subsection (1)(b), an authorized institution must determine the quartile of the institution's buffer level within which the institution's net CET1 capital ratio falls as at the latest practicable date—

- (a) which must be within 2 months before the date on which notification under section 3K(3)(a) is made; and
- (b) for which the institution has the necessary data readily available for making the determination.

3I. Monetary Authority may require buffer level and maximum distribution percentage to be applied on unconsolidated or consolidated basis where there is subsidiary

- (1) For the purposes of applying the buffer level and the maximum distribution percentage to an authorized institution that has one or more subsidiaries, the Monetary Authority may, by notice in writing given to the institution, require the buffer level and the maximum distribution percentage to be applied—
 - (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 the 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 the subsidiaries.
- (2) An authorized institution must comply with the requirements of a notice given to it under subsection (1).

3J. What authorized institution must do where net CET1 capital ratio above buffer level

- (1) This section applies in relation to an authorized institution with effect from—
 - (a) 1 January 2016; or

- (b) if earlier, the date on which the institution's buffer level is greater than 0%.
- (2) If an authorized institution's net CET1 capital ratio is above its buffer level, and the institution intends to make a distribution payment that would result in its net CET1 capital ratio being equal to, or falling below, the buffer level, the institution must—
 - (a) consult the Monetary Authority before making the distribution payment; and
 - (b) submit to the Monetary Authority, within such period as the Monetary Authority may specify in writing (being a period reasonable in all the circumstances of the case), for approval a capital plan setting out the measures proposed to be taken by the institution, within such time frame as the Monetary Authority may specify, to manage and improve the institution's capital position.

3K. What authorized institution must do where net CET1 capital ratio not above buffer level

- (1) This section applies in relation to an authorized institution with effect from—
 - (a) 1 January 2016; or
 - (b) if earlier, the date on which the institution's buffer level is greater than 0%.
- (2) If an authorized institution's net CET1 capital ratio is equal to or below its buffer level, the institution must, on becoming aware of the fact, immediately notify the Monetary Authority and specify the quartile of the buffer level within which the net CET1 capital ratio falls.

- (3) If an authorized institution's net CET1 capital ratio is equal to or below its buffer level, and the institution intends to make a distribution payment, the institution must—
- (a) notify, within 1 month before making the distribution payment, the Monetary Authority of the maximum distributable amount for the institution;
 - (b) provide the Monetary Authority with any particulars that the Monetary Authority requires; and
 - (c) submit to the Monetary Authority, within such period as the Monetary Authority may specify in writing (being a period reasonable in all the circumstances of the case), for approval a capital plan setting out the measures proposed to be taken by the institution, within such time frame as the Monetary Authority may specify, to manage and improve the institution's capital position.

3L. Other requirements

- (1) This section applies in relation to an authorized institution with effect from—
 - (a) 1 January 2016; or
 - (b) if earlier, the date on which the institution's buffer level is greater than 0%.
- (2) An authorized institution must consult the Monetary Authority in advance if—
 - (a) the institution intends to raise capital in the private sector for putting itself into a position to make a distribution payment in excess of the maximum

distributable amount that would have otherwise been applicable to the institution in the absence of such intended capital raising; and

- (b) the amount of such intended capital would not result in any noticeable improvement in the capital position of the institution after the making of the distribution payment.

Division 3—CB Ratio

3M. CB ratio

The CB ratio for calculating an authorized institution's buffer level under section 3G—

- (a) for 2015, is 0%;
- (b) for 2016, is 0.625%;
- (c) for 2017, is 1.25%;
- (d) for 2018, is 1.875%; and
- (e) at any time on or after 1 January 2019, is 2.5%.

Division 4—CCyB Ratio

3N. Interpretation of Division 4

In this Division—

advance announcement period (預告期), in relation to a JCCyB ratio, means the period—

- (a) beginning on the date immediately after the date on which the ratio is announced; and
- (b) ending on the effective date of the ratio;

applicable JCCyB ratio (適用 JCCyB 比率), in relation to a jurisdiction in which an authorized institution has private sector credit exposures, means—

- (a) (where the jurisdiction is outside Hong Kong) an applicable JCCyB ratio as specified in section 3P; or
- (b) (where the jurisdiction is Hong Kong) an applicable JCCyB ratio as specified in section 3Q;

effective date (生效日期), in relation to a JCCyB ratio or an applicable JCCyB ratio, means the date on which the ratio becomes effective;

JCCyB ratio (JCCyB 比率), in relation to a jurisdiction outside Hong Kong in which an authorized institution has private sector credit exposures, means—

- (a) a capital buffer level, expressed as a percentage, announced by the relevant authority of the jurisdiction for the purpose of implementing the provisions concerning the countercyclical capital buffer 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); or
- (b) (if no such announcement has been made) 0%;

private obligor (私人承擔義務人) means an obligor that is not—

- (a) a sovereign;
- (b) a regional, provincial or municipal government;
- (c) a public sector entity;
- (d) a multilateral development bank; or

(e) a bank;

private sector credit exposures (私人機構信用風險承擔), in relation to an authorized institution, means—

- (a) non-securitization exposures for which the institution calculates a risk-weighted amount for credit risk in accordance with Part 4, 5 or 6, or Division 4 of Part 6A;
- (b) securitization exposures for which the institution calculates a risk-weighted amount for credit risk in accordance with Part 7; or
- (c) exposures for which the institution calculates a market risk capital charge for specific risk in accordance with Part 8,

to the extent that such exposures are to a private obligor only;

ultimate risk basis (最終風險基礎) means the allocation of private sector credit exposures to the jurisdiction where the risk ultimately lies to the best of an authorized institution’s knowledge and information.

30. CCyB ratio

- (1) The CCyB ratio for calculating an authorized institution’s buffer level under section 3G is calculated by the use of Formula 1A.

Formula 1A**Calculation of CCyB Ratio**

$$\text{CCyB} = \frac{\sum_j (\text{RWA}_j \cdot \text{AJCCyB}_j)}{\sum_j \text{RWA}_j}$$

where—

CCyB = the institution's CCyB ratio for calculating its buffer level under section 3G;

RWA_j = the sum of—

- (a) the risk-weighted amounts for credit risk that relate to the institution's private sector credit exposures in jurisdiction j calculated in accordance with—
 - (i) Part 4, 5 or 6, or Division 4 of Part 6A; and
 - (ii) Part 7; and
- (b) the risk-weighted amount for market risk that relates to the institution's private sector credit exposures in jurisdiction j derived by multiplying by 12.5 the aggregate of the market risk capital charge for specific

risk for the exposures calculated in accordance with Part 8 (Note: if the institution is exempted by the Monetary Authority under section 22(1) from calculating its market risk under section 17, this paragraph is to be disregarded);

AJCCyB_j = the applicable JCCyB ratio for jurisdiction j that is in effect on the latest practicable date referred to in section 3H(2) as at which the institution calculates its CCyB ratio for calculating its buffer level under section 3G.

- (2) Subject to subsection (3), the jurisdiction in which an authorized institution is considered to have private sector credit exposures must be determined by the institution, where possible, on an ultimate risk basis.
- (3) If, in relation to an authorized institution, it is not possible to determine under subsection (2) the jurisdiction in which the institution has private sector credit exposures, the jurisdiction is taken to be the jurisdiction where the exposures are booked.

3P. Applicable JCCyB ratio for jurisdiction outside Hong Kong

- (1) This section applies in relation to a jurisdiction outside Hong Kong in which an authorized institution has private sector credit exposures (*non-Hong Kong jurisdiction*).

- (2) Before 1 January 2016, the applicable JCCyB ratio for a non-Hong Kong jurisdiction is 0% and it is effective from 1 January to 31 December 2015.
- (3) Subject to subsection (2)—
- (a) where a JCCyB ratio for a non-Hong Kong jurisdiction is 0% because of paragraph (b) of the definition of *JCCyB ratio* in section 3N—
- (i) subject to subparagraph (ii), the applicable JCCyB ratio for the jurisdiction is 0%; or
 - (ii) if an announcement is at any time made by the Monetary Authority under subsection (4), the applicable JCCyB ratio is the one as announced by the Monetary Authority;
- (b) where a JCCyB ratio announced for a non-Hong Kong jurisdiction is not more than 2.5%—
- (i) subject to subparagraph (ii), the applicable JCCyB ratio for the jurisdiction is equal to the JCCyB ratio; or
 - (ii) if an announcement is at any time made by the Monetary Authority under subsection (4), the applicable JCCyB ratio is the one as announced by the Monetary Authority; or
- (c) where a JCCyB ratio announced for a non-Hong Kong jurisdiction is more than 2.5%—
- (i) subject to subparagraph (ii), the applicable JCCyB ratio is 2.5%; or
 - (ii) if an announcement is at any time made by the Monetary Authority under subsection (4), the applicable JCCyB ratio is the one as announced by the Monetary Authority.

- (4) Where the Monetary Authority considers that the applicable JCCyB ratio for a non-Hong Kong jurisdiction under subsection (3)(a)(i), (b)(i) or (c)(i) is not sufficient to adequately bolster authorized institutions' resilience in view of the risks posed to the institutions because of the excessive credit growth in the jurisdiction, the Monetary Authority may announce, in accordance with subsection (11), the following to be the applicable JCCyB ratio—
- (a) (for subsection (3)(a) or (b)) a ratio higher than the JCCyB ratio but not more than 2.5%; or
 - (b) (for subsection (3)(c)) the JCCyB ratio.
- (5) Subject to subsections (2), (6), (7), (8), (9) and (10), the effective date of a JCCyB ratio for a non-Hong Kong jurisdiction is taken to be the effective date of the applicable JCCyB ratio for the jurisdiction unless—
- (a) where the JCCyB ratio is higher than the previous one, the advance announcement period for the JCCyB ratio is less than 6 months or more than 12 months; or
 - (b) the Monetary Authority considers that, with a view to ensuring adequate resilience of authorized institutions, or the effective working of the banking system of Hong Kong, the effective date of the applicable JCCyB ratio should be different from that of the JCCyB ratio.
- (6) For subsection (5), if a JCCyB ratio for the jurisdiction is 0% because of paragraph (b) of the definition of *JCCyB ratio* in section 3N, 1 January 2016 is taken to be the effective date of the JCCyB ratio for the jurisdiction.
- (7) Subject to subsections (2) and (10), if an applicable JCCyB ratio for a non-Hong Kong jurisdiction is

- announced by the Monetary Authority under subsection (4), the Monetary Authority must announce, in accordance with subsection (11), the effective date of the applicable JCCyB ratio to be—
- (a) (where the announcement is made under subsection (4)(a) and the JCCyB ratio referred to in that subsection is 0% because of paragraph (b) of the definition of *JCCyB ratio* in section 3N) 12 months after the date of the announcement by the Monetary Authority, unless the Monetary Authority announces a different effective date under subsection (9); or
 - (b) (in any other case) a date not less than 6 months, and not more than 12 months, after the date of the announcement by the Monetary Authority.
- (8) For subsection (5)(a), subject to subsections (9) and (10), the effective date of the applicable JCCyB ratio for the jurisdiction is taken to be—
- (a) (where the advance announcement period is less than 6 months) 6 months after the date of the announcement of the JCCyB ratio by the relevant authority of the jurisdiction; or
 - (b) (where the advance announcement period is more than 12 months) 12 months after the date of the announcement of the JCCyB ratio by the relevant authority of the jurisdiction.
- (9) For subsections (5)(b) and (7)(a), subject to subsection (10), the Monetary Authority may announce, in accordance with subsection (11), the effective date of the applicable JCCyB ratio for the jurisdiction to be a date—

- (a) (subject to paragraph (b)) not more than 12 months after the date of the announcement by the Monetary Authority; and
 - (b) (where the applicable JCCyB ratio is higher than the previous one) not less than 6 months after the date of the announcement by the Monetary Authority.
- (10) The effective date of the applicable JCCyB ratio for a non-Hong Kong jurisdiction—
- (a) (for subsection (5) or (8)) is taken to be 1 January 2016 if the effective date provided under subsection (5) or (8) falls before 1 January 2016; or
 - (b) (for subsection (9)) must not be earlier than 1 January 2016.
- (11) An announcement under subsection (4), (7) or (9) must be made by the Monetary Authority by—
- (a) notifying all authorized institutions in writing; and
 - (b) posting a notification on the Monetary Authority's website.

3Q. Applicable JCCyB ratio for Hong Kong

- (1) Before 1 January 2016, subject to this section, the applicable JCCyB ratio for Hong Kong is 0%.
- (2) On and after 1 January 2016, if no applicable JCCyB ratio for Hong Kong is announced by the Monetary Authority under this section, the applicable JCCyB ratio is taken to be 0%.
- (3) Subject to subsections (4) and (5), if the Monetary Authority considers that a period of excessive credit growth in Hong Kong is leading to a build-up of system-wide risks in the financial system of Hong Kong, based

- on the Monetary Authority's assessment of the extent of risks, the Monetary Authority may announce, in accordance with subsection (10), a ratio of more than 0% to be the applicable JCCyB ratio for authorized institutions that have private sector credit exposures in Hong Kong.
- (4) For subsection (3), the applicable JCCyB ratio—
- (a) for 2016, must be not more than 0.625%;
 - (b) for 2017, must be not more than 1.25%;
 - (c) for 2018, must be not more than 1.875%; and
 - (d) at any time on or after 1 January 2019, must be not more than 2.5%.
- (5) The Monetary Authority may, after consulting the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, The Hong Kong Association of Banks and The DTC Association, take any of the actions specified in subsections (6) and (7).
- (6) The Monetary Authority may, subject to subsections (7) and (8), vary, by announcement in accordance with subsection (10), the provisions of subsection (4) if—
- (a) the Monetary Authority considers that the variation is warranted by the extent of any excessive credit growth in Hong Kong before, or during, the period covered by the provisions; and
 - (b) the Monetary Authority considers that the variation would have the effect of increasing authorized institutions' resilience to the risks arising from the excessive credit growth.
- (7) The Monetary Authority may announce, in accordance with subsection (10), a ratio of more than 2.5% to be the applicable JCCyB ratio if—

- (a) the latest applicable JCCyB ratio is 2.5% and has been in effect for a period of not less than 6 months;
 - (b) the Monetary Authority considers that the pace of credit growth did not slow to any material extent during the period; and
 - (c) the Monetary Authority considers it necessary to determine a ratio of more than 2.5% to be the applicable JCCyB ratio in order to protect authorized institutions from the expected consequences of excessive credit growth and the build-up of system-wide risks in the financial system of Hong Kong.
- (8) Where an applicable JCCyB ratio is higher than the previous one, the Monetary Authority must announce, in accordance with subsection (10), the applicable JCCyB ratio not less than 6 months, and not more than 12 months, before the effective date of the applicable JCCyB ratio.
- (9) If the Monetary Authority considers that the system-wide risks associated with a period of excessive credit growth are receding, or that the banking sector may be entering a period of stress, the Monetary Authority may reduce, by announcement in accordance with subsection (10), the applicable JCCyB ratio.
- (10) An announcement under subsection (3), (6), (7), (8) or (9) must be made by the Monetary Authority by—
- (a) notifying all authorized institutions in writing; and
 - (b) posting a notification on the Monetary Authority's website.

3R. Distribution payments made after reduction of applicable JCCyB ratio

- (1) An authorized institution must comply with subsection (2) if—
 - (a) a latest applicable JCCyB ratio for Hong Kong, or for a jurisdiction outside Hong Kong, is lower than the previous one; and
 - (b) the institution intends, within a period of 12 months after the effective date of the latest applicable JCCyB ratio, to use for making a distribution payment any of its earnings that would have been subject to constraint on distribution payments under this Part but for the lower applicable JCCyB ratio.
- (2) For subsection (1), an authorized institution must—
 - (a) consult the Monetary Authority before making the payment; and
 - (b) provide the Monetary Authority with a written justification regarding the prudence of the intended distribution payment within the context of the institution's capital planning.

Division 5—HLA Ratio**3S. G-SIB**

The Monetary Authority may designate an authorized institution as a global systemically important authorized institution if, in the opinion of the Monetary Authority, the risks associated with the institution are such as to render the institution capable of having a significant impact on the effective working and stability of the global financial system were the institution to become non-viable.

3T. HLA ratio as applicable to G-SIB

- (1) Subject to subsection (3) and section 3W, the Monetary Authority may, by reference to the degree of global systemic importance that the Monetary Authority assesses a G-SIB to bear, determine for the institution an HLA ratio as specified in subsection (2).
- (2) The HLA ratio applicable to the G-SIB concerned—
 - (a) for 2015, is 0%;
 - (b) for 2016, must be not less than 0.25% and not more than 0.875%;
 - (c) for 2017, must be not less than 0.5% and not more than 1.75%;
 - (d) for 2018, must be not less than 0.75% and not more than 2.625%; and
 - (e) at any time on or after 1 January 2019, must be not less than 1% and not more than 3.5%.
- (3) The Monetary Authority must notify the G-SIB concerned in writing of the HLA ratio determined for the institution, and the institution must apply, within 12 months from the notification, the HLA ratio to the calculation of its buffer level.

3U. D-SIB

The Monetary Authority may designate an authorized institution as a domestic systemically important authorized institution if, in the opinion of the Monetary Authority, the risks associated with the institution are such as to render the institution capable of having a significant impact on the effective working and stability of the banking or financial system of Hong Kong were the institution to become non-viable.

3V. HLA ratio as applicable to D-SIB

- (1) Subject to subsection (3) and section 3W, the Monetary Authority may, by reference to the degree of domestic systemic importance that the Monetary Authority assesses a D-SIB to bear, determine for the institution an HLA ratio as specified in subsection (2).
- (2) The HLA ratio applicable to the D-SIB concerned—
 - (a) for 2015, is 0%;
 - (b) for 2016, must be not less than 0.25% and not more than 0.875%;
 - (c) for 2017, must be not less than 0.5% and not more than 1.75%;
 - (d) for 2018, must be not less than 0.75% and not more than 2.625%; and
 - (e) at any time on or after 1 January 2019, must be not less than 1% and not more than 3.5%.
- (3) The Monetary Authority must notify the D-SIB concerned in writing of the HLA ratio determined for the institution, and the institution must apply, within 12 months from the notification, the HLA ratio to the calculation of its buffer level.

3W. Where authorized institution being both G-SIB and D-SIB

If an authorized institution is designated under this Division as both a G-SIB and a D-SIB, the HLA ratio applicable to the institution is the higher of the following—

- (a) the HLA ratio applicable to the institution as a G-SIB; and
- (b) the HLA ratio applicable to the institution as a D-SIB.

3X. Where both authorized institution and its subsidiary being D-SIB

If an authorized institution is a subsidiary of a D-SIB, and the Monetary Authority also designates the institution as a D-SIB, the Monetary Authority may determine under section 3V(1) for the institution an HLA ratio that is different from the one determined for the D-SIB of which the institution is a subsidiary.”.

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

- (1) Section 15(3)—

Repeal

“the STC(S) approach”

Substitute

“the approach or method as specified in subsection (3A)”.

- (2) After section 15(3)—

Add

“(3A) The institution under subsection (3) must use—

- (a) (if it is an originating institution) the STC(S) approach; or
- (b) (if it is an investing institution) the ratings-based method.”.

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

- (1) Section 27(3), definition of *relevant financial activity*, paragraph (i)—

Repeal

“or”.

- (2) Section 27(3), definition of *relevant financial activity*, paragraph (j)—

Repeal the full stop**Substitute**

“; or”.

- (3) Section 27(3), definition of *relevant financial activity*, after paragraph (j)—

Add

“(k) custodial and safekeeping services.”.

8. Section 69 amended (application of ECAI ratings)

Section 69(5)—

Repeal

“which falls within paragraph (a) of that subsection”

Substitute

“as described in the chapeau of that subsection”.

9. Section 145 amended (equity exposures)

After section 145(3)—

Add

“(4) In this section—

corporate (法團) means—

- (a) a company; or
- (b) a partnership or any other unincorporated body, that is not a public sector entity.”.

10. Section 149 amended (default of obligor)

Section 149(6)(c)—

Repeal

“internal data or”

Substitute

“internal data (to the extent that such data had come into existence before 1 January 2007) or”.

11. Section 205 amended (recognized financial receivables)

(1) Section 205(2)—

Repeal

everything after “derived from”

Substitute

“the following do not fall within subsection (1)—

- (a) securitization transactions;
- (b) sub-participations;
- (c) credit derivative contracts; and
- (d) any affiliates of the direct obligor of an authorized institution.”.

(2) After section 205(2)—

Add

“(3) For the purposes of subsection (2)—

affiliate (附屬成員), in relation to a direct obligor of an authorized institution, means—

- (a) a subsidiary of the direct obligor;
- (b) a person that belongs to the same group of companies as the direct obligor; or

(c) an employee of the direct obligor.”.

12. 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)—

Repeal

“(5) and (6)”

Substitute

“(5), (6) and (7)”.

(2) After section 216(6)—

Add

“(7) Where the credit protection for an authorized institution’s exposure consists of a recognized credit derivative contract providing that, on the happening of a credit event—

(a) the credit protection provider is not obliged to make a payment for any loss until the loss exceeds a specified amount (*first loss portion*); and

(b) the credit protection provider is not obliged to make a payment for any loss except to the extent that the loss exceeds the first loss portion,

the institution must, in calculating its capital adequacy ratio, allocate a risk-weight of 1 250% to the first loss portion.”.

13. Section 227 amended (interpretation of Part 7)

(1) Section 227(1), definition of *excess spread*—

Repeal

everything after “means”

Substitute

“interest and other income derived by the SPE in the transaction from the underlying exposures in the transaction in excess of the transaction costs (including servicing fees and other expenses incurred by the SPE) and any interest payments and charge-offs incurred or made by the SPE, as specified in the documentation for the transaction, expressed as a percentage of the underlying exposures;”.

(2) Section 227(1), definition of *special purpose entity*, paragraph (b)—

Repeal

“insulates the underlying exposures transferred to it”

Substitute

“is insulated”.

14. Section 232A amended (recognized guarantees and recognized credit derivative contracts)

(1) Section 232A(1)—

Repeal

“(2) and (3)”

Substitute

“(2), (3) and (4)”.

(2) After section 232A(3)—

Add

“(4) Subsection (1) does not apply to—

(a) a guarantee for which the guarantor is an SPE; or

(b) a credit derivative contract for which the protection seller is an SPE.”.

15. Section 235 amended (provisions supplementary to section 234)

(1) Section 235(1)—

Repeal

“to a securitization issue”

Substitute

“for a securitization exposure”.

(2) Section 235(1)—

Repeal

“the securitization issue”

Substitute

“the transaction”.

16. Section 261 amended (provisions supplementary to section 260)

(1) Section 261(1)—

Repeal

“to a securitization issue”

Substitute

“for a securitization exposure”.

(2) Section 261(1)—

Repeal

“the securitization issue”

Substitute

“the transaction”.

17. Section 269 amended (provisions supplementary to section 268)

(1) Section 269(1)—

Repeal

“to a securitization issue”

Substitute

“for a securitization exposure”.

(2) Section 269(1)—

Repeal

“the securitization issue”

Substitute

“the transaction”.

18. Schedule 1 amended (specifications for purposes of certain definitions in these Rules)

Schedule 1, Part 10—

Add

“5. European Financial Stability Facility.

6. European Stability Mechanism.”.

19. Schedule 4B amended (qualifying criteria to be met to be Additional Tier 1 capital)

(1) Schedule 4B, section 1(q)(vii)—

Repeal

“; and”

Substitute a semicolon.

(2) Schedule 4B, after section 1(q)(vii)—

Add

“(viiia) the institution obtains the prior consent of the Monetary Authority before including, as Additional Tier 1 capital, any issuance of a capital instrument the terms and conditions of which provide for trigger events in

addition to the trigger events specified under this paragraph; and”.

- (3) Schedule 4B, section 1(q)(viii)—

Repeal

“and obtains the prior consent of the Monetary Authority”.

20. Schedule 4C amended (qualifying criteria to be met to be Tier 2 capital)

- (1) Schedule 4C, section 1(k)(vii)—

Repeal

“; and”

Substitute a semicolon.

- (2) Schedule 4C, after section 1(k)(vii)—

Add

“(viiia) the institution obtains the prior consent of the Monetary Authority before including, as Tier 2 capital, any issuance of a capital instrument the terms and conditions of which provide for trigger events in addition to the trigger events specified under this paragraph; and”.

- (3) Schedule 4C, section 1(k)(viii)—

Repeal

“and obtains the prior consent of the Monetary Authority”.

Monetary Authority

2014

Explanatory Note

These Rules are made by the Monetary Authority under section 97C of the Banking Ordinance (Cap. 155) to 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 amendments requiring an authorized institution incorporated in Hong Kong (*authorized institution*) to have regulatory capital buffers that consist of—
 - (a) a capital conservation buffer ratio;
 - (b) a countercyclical capital buffer ratio; and
 - (c) (for an authorized institution considered as systemically important in a global or domestic context) a higher loss absorbency ratio.
3. The requirement mentioned in paragraph 2 is imposed in line with the standards promulgated by the Basel Committee on Banking Supervision (*Basel Committee*) in the following documents—
 - (a) “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);
 - (b) “Guidance for national authorities operating the countercyclical capital buffer” published by the Basel Committee in December 2010;
 - (c) “Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement” published by the Basel Committee in July 2013; and

- (d) “A framework for dealing with domestic systemically important banks” published by the Basel Committee in October 2012.
4. The Rules also amend the principal Rules by adding, in alignment with the corresponding announcement made by the Basel Committee in March 2014, to the list of relevant international organizations in the principal Rules the following organizations—
 - (a) European Financial Stability Facility; and
 - (b) European Stability Mechanism.
5. The addition mentioned in paragraph 4 enables an authorized institution to accord those 2 organizations a 0% risk-weighting when making calculation to meet the minimum regulatory capital requirement, and the requirement mentioned in paragraph 2.
6. The Rules also provide for a series of miscellaneous amendments to improve the operational clarity of certain provisions in the principal Rules, and to align them more closely with the Basel Committee capital standards following a recent self-assessment by the Monetary Authority of the principal Rules against the text of the Basel Committee capital standards as part of the Regulatory Consistency Assessment Programme, which is an on-going process established by the Basel Committee to assess the extent of compliance of its member jurisdictions with its capital standards.
7. The Rules come into operation on 1 January 2015.

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Banking (Liquidity) Rules

(Made by the Monetary Authority under section 97H 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 Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies)

Part 1

Preliminary

1. Commencement

These Rules come into operation on 1 January 2015.

2. Interpretation

(1) In these Rules—

associated entity (聯繫實體), in relation to an authorized institution, is to be construed in accordance with section 97H(4) of the Ordinance;

Capital Rules (《資本規則》) means the Banking (Capital) Rules (Cap. 155 sub. leg. L);

category 1 institution (第 1 類機構) means an authorized institution designated under rule 3(1) as a category 1 institution;

category 2 institution (第 2 類機構) means an authorized institution that is not a category 1 institution;

central bank (中央銀行) means—

(a) the central bank of a country; or

- (b) an authority of a country that performs in the country functions similar to the functions performed by the Monetary Authority under section 5A(2) of the Exchange Fund Ordinance (Cap. 66);

consolidated basis (綜合基礎), in relation to the calculation by an authorized institution incorporated in Hong Kong of its LCR or LMR, means the basis set out in rule 11(1);

consolidated group (綜合集團), in relation to an authorized institution incorporated in Hong Kong that has one or more specified associated entities, means—

- (a) the institution's Hong Kong office;
- (b) the institution's overseas branches (if any); and
- (c) the institution's specified associated entities;

convertible (可兌換), in relation to a currency other than Hong Kong dollars in which funds are held by an authorized institution, means that the funds may be exchanged by the institution into Hong Kong dollars through—

- (a) an active foreign exchange market; or
- (b) an established exchange and clearing arrangement operated by the central bank that issues the currency (or operated by a person appointed by the central bank for that arrangement);

corporate (法團) means—

- (a) a company; or
- (b) a partnership, or any other unincorporated body, that is neither a public sector entity nor a financial institution;

country (國家) includes—

- (a) subject to paragraph (b), any part of a country; and
- (b) any jurisdiction;

currency notes and coins (流通紙幣及硬幣), in relation to an authorized institution, means legal tender notes or other notes, and coins, representing the lawful currency of a country or Hong Kong held by the institution;

customer (客戶) includes a counterparty;

debt securities (債務證券) means any securities other than—

- (a) equities;
- (b) securities that can be converted into equities; or
- (c) import or export trade bills;

determine (斷定) includes calculate;

EF debt security (外匯基金債務證券) means—

- (a) an Exchange Fund Bill;
- (b) an Exchange Fund Note; or
- (c) any other debt security issued by the Government for the account of the Exchange Fund under the Exchange Fund Ordinance (Cap. 66);

Exchange Fund Bill (外匯基金票據) means any instrument described as such as issued by the Government for the account of the Exchange Fund under the Exchange Fund Ordinance (Cap. 66);

Exchange Fund Note (外匯基金債券) means any instrument described as such as issued by the Government for the account of the Exchange Fund under the Exchange Fund Ordinance (Cap. 66);

fair value (公平價值)—

- (a) in relation to an asset (whether an on-balance sheet asset or off-balance sheet asset), means the amount for which the asset could be exchanged between knowledgeable, willing parties in an arm's length transaction; or

- (b) in relation to a liability (whether an on-balance sheet liability or off-balance sheet liability), means the amount for which the liability could be settled between knowledgeable, willing parties in an arm's length transaction;

financial institution (金融機構) has the meaning given by section 157A(3) of the Capital Rules;

Hong Kong office (香港辦事處), in relation to an authorized institution, means the institution's principal place of business in Hong Kong and its local branches (if any);

Hong Kong office basis (香港辦事處基礎), in relation to an authorized institution's calculation of its LCR or LMR, means the basis set out in rule 10(1)(a);

HQLA means high quality liquid assets;

LCR means a liquidity coverage ratio;

LCR period (LCR 涵蓋時期), in relation to a category 1 institution's LCR, means the period of 30 calendar days immediately following the date of the position in relation to which the LCR is calculated;

level 1 assets (1 級資產) means any assets specified in section 1 of Part 2 of Schedule 2;

level 2A assets (2A 級資產) means any assets specified in section 2 of Part 2 of Schedule 2;

level 2B assets (2B 級資產) means any assets specified in section 3 of Part 2 of Schedule 2;

liquefiable assets (流動資產), in relation to a category 2 institution, means the institution's stock of liquefiable assets, as determined in accordance with Part 8, that the institution is permitted to include in the calculation of its LMR;

liquidity coverage ratio (流動性覆蓋比率), in relation to a category 1 institution, means the ratio, expressed as a percentage, of the amount (calculated in Hong Kong dollars) of the institution's HQLA to the amount (calculated in Hong Kong dollars) of the institution's total net cash outflows, as calculated in accordance with Parts 4 and 7;

liquidity maintenance ratio (流動性維持比率), in relation to a category 2 institution, means the ratio, expressed as a percentage, of the amount (calculated in Hong Kong dollars) of the institution's liquefiable assets to the amount (calculated in Hong Kong dollars) of the institution's qualifying liabilities (after deductions), as calculated in accordance with Parts 4 and 8;

liquidity transfer restriction (流動性轉撥限制), in relation to an authorized institution, means any regulatory, legal, tax, accounting or other restriction or impediment that inhibits, or may potentially inhibit, the transfer of assets or the flow of funds between the institution's Hong Kong office and any of its associated entities and overseas branches;

LMR means a liquidity maintenance ratio;

margin lending transaction (保證金借出交易) has the meaning given by rule 39;

marketable debt securities (有價債務證券) means debt securities that have an established secondary market in or outside Hong Kong in which they can be monetized readily;

monetize (套現), in relation to an asset of an authorized institution, means to convert the asset into cash by—

- (a) a direct sale of the asset;
- (b) entering into a repo-style transaction that is collateralized by the asset; or
- (c) any other means;

pledged deposit (質押存款), in relation to an authorized institution, means a deposit placed with the institution by a customer (other than a bank) that is contractually pledged to the institution as collateral to secure a loan from the institution;

prescribed instrument (訂明票據) has the meaning given by section 137B(1) of the Ordinance;

relevant liquidity event (流動性相關事件) has the meaning given by rule 14(3);

residential mortgage-backed security (住宅按揭擔保證券) means a debt security—

- (a) that is issued by a special purpose entity or another company; and
- (b) the payments in respect of which are secured by a pool of underlying residential mortgage loans originated by banks or other financial institutions;

RMBS means a residential mortgage-backed security;

sovereign (官方實體) means—

- (a) the Government; or
- (b) the central government of a country;

special purpose entity (特定目的實體) means an entity (whether a company, trust or other entity)—

- (a) that is created for a specific purpose;
- (b) the activities of which are limited to those appropriate to achieving the purpose; and
- (c) the structure of which is intended to isolate the entity from the credit risk of an originator or seller of exposures;

specified associated entity (指明聯繫實體), in relation to an authorized institution incorporated in Hong Kong, means an

associated entity of the institution that is the subject of a notice given to the institution under rule 11(1) that is in force;

total net cash outflows (淨現金流出總額), in relation to a category 1 institution, means the institution's total expected cash outflows, after deduction of its total expected cash inflows, calculated in accordance with Division 5 of Part 7;

unconsolidated basis (非綜合基礎), in relation to the calculation by an authorized institution incorporated in Hong Kong of its LCR or LMR, means the basis set out in rule 10(1)(b).

(2) In these Rules, an expression specified below has the same meaning as it has in section 2(1) of the Capital Rules—

bank (銀行)

credit quality grade (信用質素等級)

ECAI

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

ECAI issuer rating (ECAI 發債人評級)

financial instrument (金融工具)

guarantee (擔保)

incorporated (成立為法團)

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

OTC derivative transaction (場外衍生工具交易)

public sector entity (公營單位)

relevant international organization (有關國際組織)

repo-style transaction (回購形式交易)

residential mortgage loan (住宅按揭貸款)

short-term ECAI issue specific rating (短期 ECAI 特定債項評級)

- (3) A reference in these Rules to a class includes a subclass (if any) falling within that class.
- (4) A reference in these Rules to a table or formula followed by a number (including an alphanumeric number) is a reference to the table or formula in these Rules bearing that number.
- (5) If, under a provision of these Rules, the approval of the Monetary Authority is required by an authorized institution in respect of any matter, the institution must seek the approval by making an application in a specified form (if any) to the Monetary Authority.
- (6) If, under a provision of these Rules, the Monetary Authority is required to give, or may give, notice of any matter to all authorized institutions, or to a class of such institutions, it is sufficient compliance with the provision if the Monetary Authority publishes the notice in the Gazette.
- (7) If any matter specified in a provision of these Rules is qualified by the word “adequate”, “appropriate”, “consistent”, “material”, “prudent”, “reasonable”, “relevant”, “reliable” or “significant”, then, for the purposes of assisting in ascertaining the nature of such qualification insofar as it relates to the matter, regard must be had to any guidelines or codes of practice issued under the Ordinance that are applicable to the provision.
- (8) A reference in a provision of these Rules to an asset or liability of an authorized institution is a reference only to an on-balance sheet asset or on-balance sheet liability of the institution unless the provision expressly states otherwise.
- (9) A reference in a provision of these Rules to an application that may be made by an authorized institution to the Monetary Authority is a reference to an application in a specified form (if any) to the Monetary Authority.

3. Designation of category 1 institution

- (1) The Monetary Authority may, by notice in writing to an authorized institution, designate the institution as a category 1 institution.
- (2) The designation may be made—
 - (a) on the Monetary Authority’s own volition, if the Monetary Authority is satisfied that any of the grounds specified in Part 1 of Schedule 1 is applicable to the institution; or
 - (b) on application by the institution, if—
 - (i) the Monetary Authority is satisfied that any of the grounds specified in Part 1 of Schedule 1 is applicable to the institution; or
 - (ii) subparagraph (i) does not apply to the institution, but the Monetary Authority is satisfied that all the grounds specified in Part 2 of that Schedule are applicable to the institution.
- (3) The designation takes effect—
 - (a) on the date specified in the notice; or
 - (b) when the event specified in the notice occurs.
- (4) Despite subrule (1), the Monetary Authority may decide not to designate an authorized institution as a category 1 institution in the circumstances specified in Part 3 of Schedule 1.
- (5) If—
 - (a) an authorized institution has been designated as a category 1 institution; and
 - (b) the Monetary Authority is satisfied that had the designation not been made, the Monetary Authority would not make the designation,

the Monetary Authority may, on the Monetary Authority's own volition or on application by the institution, by notice in writing to the institution, revoke the designation.

- (6) The revocation takes effect—
 - (a) on the date specified in the notice; or
 - (b) when the event specified in the notice occurs.
 - (7) A decision made by the Monetary Authority under subrule (1) or (5) is a decision to which section 101B(1) of the Ordinance applies.
-

Part 2

Minimum LCR, Notifiable Matters Concerning LCR and Monetization of HQLA in Certain Financial Circumstances: for Category 1 Institution

4. **Minimum LCR applicable to category 1 institution**
 - (1) Subject to subrule (3), a category 1 institution must, on and after 1 January 2019, at all times maintain an LCR of not less than 100%.
 - (2) Subject to subrule (3), a category 1 institution must—
 - (a) during the year of 2015, at all times maintain an LCR of not less than 60%;
 - (b) during the year of 2016, at all times maintain an LCR of not less than 70%;
 - (c) during the year of 2017, at all times maintain an LCR of not less than 80%; and
 - (d) during the year of 2018, at all times maintain an LCR of not less than 90%.
 - (3) A category 1 institution does not contravene subrule (1) or (2) if the institution's failure to maintain an LCR as required is due only to the institution's monetization of its HQLA as provided for in rule 6.
5. **Category 1 institution must notify Monetary Authority of any matter that will or may cause it to maintain LCR less than as required under rule 4**
 - (1) If a category 1 institution has reason to believe that a likely increase in its total net cash outflows or a likely reduction in its HQLA (or any combination of the increase and the

reduction) will cause, or could reasonably be construed as potentially causing, whether by itself or in conjunction with any other event, the institution's failure to maintain an LCR as required under rule 4, the institution must—

- (a) as soon as is practicable notify the Monetary Authority of the matter; and
 - (b) provide the Monetary Authority with any particulars of the matter that the Monetary Authority requests.
- (2) To avoid doubt, subrule (1) does not apply in the case of a relevant liquidity event.

6. Monetization of HQLA in certain financial circumstances

If—

- (a) a category 1 institution is undergoing significant financial stress; and
- (b) the institution's financial circumstances are such that, in order to meet its financial obligations as they fall due, it has no reasonable alternative other than to monetize its HQLA to the extent necessary to meet those obligations, even though this might cause it to maintain an LCR less than as required under rule 4,

it may monetize its HQLA to that extent in order to meet those obligations.

Part 3

Minimum LMR and Notifiable Matters Concerning LMR: for Category 2 Institution

7. Minimum LMR applicable to category 2 institution

A category 2 institution must maintain an LMR of not less than 25% on average in each calendar month.

8. Category 2 institution must notify Monetary Authority of any matter that will or may cause it to maintain LMR less than as required under rule 7

- (1) If a category 2 institution has reason to believe that a likely increase in its qualifying liabilities (after deductions) or a likely reduction in its liquefiable assets (or any combination of the increase and the reduction) will cause, or could reasonably be construed as potentially causing, whether by itself or in conjunction with any other event, the institution's failure to maintain an LMR as required under rule 7, the institution must—
 - (a) as soon as is practicable notify the Monetary Authority of the matter; and
 - (b) provide the Monetary Authority with any particulars of the matter that the Monetary Authority requests.
 - (2) To avoid doubt, subrule (1) does not apply in the case of a relevant liquidity event.
-

Part 4**Valuation of Assets, etc., at Fair Value and Bases of Calculation for Purposes of LCR and LMR****9. Valuation of assets, liabilities, off-balance sheet items and cash flows measured at fair value**

- (1) If an authorized institution measures any asset, liability, off-balance sheet item or cash flow at fair value, for the purposes of calculating its LCR or LMR, the institution must establish and maintain valuation systems, controls and procedures that are effective to ensure that the valuation of any such asset, liability, off-balance sheet item or cash flow is prudent and reliable.
- (2) For subrule (1), an authorized institution must make adjustments, where appropriate, to the valuation of any asset, liability, off-balance sheet item or cash flow that is measured at fair value to account for—
 - (a) the limitations of the valuation model or methodology and the data used by the institution in the valuation process;
 - (b) the liquidity of the asset, liability, off-balance sheet item or cash flow; and
 - (c) other relevant factors that might reasonably be expected to affect the prudence and reliability of the valuation of the asset, liability, off-balance sheet item or cash flow.
- (3) To avoid doubt, adjustments made by an authorized institution in accordance with this rule may exceed adjustments made by the institution in accordance with the financial reporting standards adopted by the institution.

10. Calculation of LCR or LMR on Hong Kong office basis and unconsolidated basis, etc.

- (1) An authorized institution must calculate its LCR or LMR—
 - (a) on the basis that the business of the institution includes all of its business in Hong Kong (being its principal place of business in Hong Kong and its local branches (if any)); and
 - (b) (if the institution is incorporated in Hong Kong and has an overseas branch) subject to subrule (3), on an unconsolidated basis (being the basis set out in paragraph (a) with the inclusion of the business of the institution's overseas branches but not its associated entities).
- (2) An authorized institution may apply to the Monetary Authority for approval to exclude the business of its overseas branch from the calculation of its LCR or LMR on an unconsolidated basis as set out in subrule (1)(b).
- (3) On the application under subrule (2), the Monetary Authority may, by notice in writing to the institution, determine the application by—
 - (a) granting approval to the institution to exclude the business of its overseas branch from the calculation of its LCR or LMR on an unconsolidated basis as set out in subrule (1)(b) if the institution demonstrates to the satisfaction of the Monetary Authority that the liquidity risk associated with the business is immaterial; or
 - (b) refusing the institution's application if the Monetary Authority is not satisfied as specified in paragraph (a).
- (4) For subrule (3)—
 - (a) if the institution's application is approved, the approval takes effect—

- (i) on the date specified in the notice; or
 - (ii) when the event specified in the notice occurs; or
 - (b) if the institution's application is refused, the notice must state the reasons why the Monetary Authority is not satisfied as specified in subrule (3)(a).
- (5) If—
- (a) an authorized institution has been granted an approval under subrule (3)(a); and
 - (b) the Monetary Authority is satisfied that had the business of an overseas branch of the institution not been the subject of the approval, the Monetary Authority would not grant the approval,
- the Monetary Authority may, by notice in writing to the institution, revoke the approval to the extent that the approval relates to the business.
- (6) The revocation takes effect—
- (a) on the date specified in the notice; or
 - (b) when the event specified in the notice occurs.

11. Calculation of LCR or LMR of authorized institution incorporated in Hong Kong on consolidated basis

- (1) Subject to subrules (4) and (6) and without limiting rule 12, the Monetary Authority may, by notice in writing to an authorized institution incorporated in Hong Kong that has one or more associated entities, require the institution to calculate its LCR or LMR on a consolidated basis (being the basis with the inclusion of all the business of the institution and one or more of its associated entities as specified in the notice).
- (2) The requirement takes effect—
 - (a) on the date specified in the notice; or

- (b) when the event specified in the notice occurs.
- (3) An authorized institution must comply with the requirements of a notice given to it under subrule (1).
- (4) Without limiting subrule (1), the Monetary Authority may decide which associated entities of an authorized institution incorporated in Hong Kong are to be specified in a notice under that subrule in consultation with the institution, having regard to—
 - (a) the respective liquidity risks that the entities pose to the institution; and
 - (b) whether the respective activities of the entities fall within any of the relevant financial activities.
- (5) An authorized institution may apply to the Monetary Authority for approval to exclude the business of a specified associated entity of the institution from the calculation of its LCR or LMR on a consolidated basis as set out in subrule (1).
- (6) On the application under subrule (5), the Monetary Authority may, by notice in writing to the institution, determine the application by—
 - (a) granting approval to the institution to exclude the business of a specified associated entity of the institution from the calculation of its LCR or LMR on a consolidated basis as set out in subrule (1) if the institution demonstrates to the satisfaction of the Monetary Authority that the liquidity risk associated with the business is immaterial; or
 - (b) refusing the institution's application if the Monetary Authority is not satisfied as specified in paragraph (a).
- (7) For subrule (6)—
 - (a) if the institution's application is approved, the approval takes effect—

- (i) on the date specified in the notice; or
 - (ii) when the event specified in the notice occurs; or
 - (b) if the institution's application is refused, the notice must state the reasons why the Monetary Authority is not satisfied as specified in subrule (6)(a).
- (8) If—
- (a) an authorized institution has been granted an approval under subrule (6)(a); and
 - (b) the Monetary Authority is satisfied that had the business of a specified associated entity of the institution not been the subject of the approval, the Monetary Authority would not grant the approval,
- the Monetary Authority may, by notice in writing to the institution, revoke the approval to the extent that the approval relates to the business.
- (9) The revocation takes effect—
- (a) on the date specified in the notice; or
 - (b) when the event specified in the notice occurs.
- (10) In this rule—
- relevant financial activity* (有關財務活動), in relation to an associated entity of an authorized institution, means—
- (a) an activity ancillary to a principal activity of the institution, including—
 - (i) owning and managing the institution's property; and
 - (ii) performing information technology functions for the institution;
 - (b) lending, including—
 - (i) the provision of consumer or mortgage credit;

- (ii) factoring;
 - (iii) forfeiting; and
 - (iv) the provision of guarantees and other financial commitments;
- (c) financial leasing;
- (d) money transmission services;
- (e) issuing and administering a means of payment, including—
- (i) credit cards;
 - (ii) travellers' cheques; and
 - (iii) bank drafts;
- (f) trading for the entity's own account, or for accounts of the entity's customers, in—
- (i) money market instruments;
 - (ii) foreign exchange;
 - (iii) financial instruments traded on an exchange;
 - (iv) OTC derivative transactions; or
 - (v) transferable securities;
- (g) participating in securities issues, including the provision of services relating to the issues;
- (h) the provision of—
- (i) advice to undertakings on capital structure or industrial strategy, including any matter relating to capital structure or industrial strategy; or
 - (ii) advice and services relating to mergers and the purchase of undertakings;
- (i) money broking;

- (j) portfolio management and the provision of advice relating to portfolio management; or
- (k) custodial and safekeeping services.

12. Calculation of LCR or LMR of authorized institution incorporated in Hong Kong on basis other than those under rules 10 and 11

- (1) Where an authorized institution is incorporated in Hong Kong, if the Monetary Authority, after taking into account the liquidity risk associated with a part of the institution's business in or outside Hong Kong, is satisfied that it is prudent and reasonable to do so, the Monetary Authority may, by notice in writing to the institution, require it to calculate its LCR or LMR on the basis of that part by itself, or in conjunction with any other part of the institution's other business as specified in the notice.
- (2) The requirement takes effect—
 - (a) on the date specified in the notice; or
 - (b) when the event specified in the notice occurs.
- (3) An authorized institution must comply with the requirements of a notice given to it under subrule (1).

Part 5

Reporting Requirements

13. Authorized institution must notify Monetary Authority of certain matters concerning its associated entities

- (1) An authorized institution that calculates its LCR or LMR on a consolidated basis as set out in rule 11(1) must give notice in writing to the Monetary Authority of any of the matters specified in subrule (2) as soon as is practicable after the institution is aware of the matter.
- (2) The matters referred to in subrule (1) are—
 - (a) an associated entity of the institution having ceased to be its associated entity;
 - (b) an entity having become an associated entity of the institution;
 - (c) the principal activities of an entity referred to in paragraph (b); and
 - (d) any significant change to the principal activities of the institution or any of its associated entities (including an entity referred to in paragraph (b)).

14. Prescribed notification requirements for purposes of section 97I of Ordinance

- (1) For the purposes of section 97I of the Ordinance, an authorized institution must immediately notify the Monetary Authority of a relevant liquidity event and provide the Monetary Authority with any particulars of the event that the Monetary Authority requests.
- (2) If an authorized institution notifies the Monetary Authority under subrule (1) of a relevant liquidity event that falls within

paragraph (a)(i), (ii) or (iv), or paragraph (b), of the definition of *relevant liquidity event* in subrule (3), the institution must, at the same time as it gives the notification, also give the Monetary Authority an assessment of its liquidity position, including—

- (a) the factors contributing to it having to give the Monetary Authority the notification;
- (b) the measures it has taken or will take to deal with the event; and
- (c) the potential duration of the event based on the institution's reasonable expectations.

(3) In this rule—

relevant liquidity event (流動性相關事件)—

- (a) for a category 1 institution, means—
 - (i) (if the institution is not the subject of a notice under rule 16(1) or (2) that is in force) that the institution fails to comply with rule 4 and such failure does not arise from the institution's taking action under rule 6 to monetize its HQLA to meet its financial obligations as they fall due;
 - (ii) (if the institution is not the subject of a notice under rule 16(1) or (2) that is in force) that the institution is taking, or is about to take, action under rule 6 to monetize its HQLA to meet its financial obligations as they fall due such that the action will cause, or could reasonably be construed as potentially causing, whether by itself or in conjunction with any other event, the institution's failure to maintain an LCR as required under rule 4;

- (iii) (if the institution is the subject of a notice under rule 16(1) or (2) that is in force) that the institution fails to comply with any condition specified in the notice; or
 - (iv) (if the institution is a rule 37 institution as defined by rule 36) that the institution fails to comply with rule 37(d); or
- (b) for a category 2 institution, means that the institution fails to comply with rule 7.

15. Category 2 institution must notify Monetary Authority of change of business plans, etc., that may cause it to fall under Part 1 of Schedule 1

- (1) Subject to subrule (2), if a category 2 institution's business plans, or particular circumstances, change, or are expected to change, in a manner that may be likely to cause any ground specified in Part 1 of Schedule 1 to arise in relation to the institution, the institution must—
 - (a) as soon as is practicable notify the Monetary Authority of the matter; and
 - (b) provide the Monetary Authority with any particulars of the matter that the Monetary Authority requests.
- (2) A category 2 institution must comply with subrule (1) irrespective of whether Part 3 of Schedule 1 may apply to it.

Part 6**Action that may be Taken by Monetary Authority when Notified of Certain Relevant Liquidity Event****16. Conditions that Monetary Authority may impose on category 1 institution when it gives notice under rule 14(1) of event that falls within paragraph (a)(ii) of definition of *relevant liquidity event***

- (1) Where a category 1 institution notifies the Monetary Authority under rule 14(1) of a relevant liquidity event that falls within paragraph (a)(ii) of the definition of *relevant liquidity event* in rule 14(3), the Monetary Authority may, by notice in writing to the institution (*subrule (1) notice*), require the institution to comply with the conditions specified in the notice that relate to the institution's LCR and with which the Monetary Authority is satisfied that, in all the circumstances of the case, it is prudent and reasonable that the institution must comply.
- (2) If a category 1 institution is the subject of a subrule (1) notice, the Monetary Authority may at any time, by notice in writing to the institution (*subrule (2) notice*) do either or both of the following as the Monetary Authority thinks proper—
 - (a) amend any conditions specified in the subrule (1) notice (including amending by specifying new conditions in the subrule (1) notice);
 - (b) cancel any conditions specified in the subrule (1) notice (including conditions specified in the subrule (1) notice pursuant to a prior subrule (2) notice).
- (3) The amendment or the cancellation takes effect—
 - (a) on the date specified in the notice; or

- (b) when the event specified in the notice occurs.
- (4) Without limiting subrule (1) or (2), conditions specified in a subrule (1) notice or subrule (2) notice to a category 1 institution may include one or more of the following—
 - (a) a condition that the institution must at all times maintain an LCR of not less than the percentage specified in the notice (which percentage must not be more than that as required under rule 4);
 - (b) a condition that the institution must submit to the Monetary Authority a plan, within such period (being a period which is reasonable in all the circumstances of the case) as specified in the notice, satisfying the Monetary Authority that, if the plan is implemented by the institution, it would maintain, within a period reasonable in all the circumstances of the case, an LCR as required under rule 4;
 - (c) a condition that the institution must start to implement the plan—
 - (i) on the date specified in the notice; or
 - (ii) when the event specified in the notice occurs;
 - (d) a condition that the institution must reduce its liquidity risk exposures in such manner, or adopt such measures, as are specified in the notice which, in the opinion of the Monetary Authority, will cause the institution to maintain, within a period reasonable in all the circumstances of the case, an LCR as required under rule 4;
 - (e) a condition that the institution must make such reports regarding its LCR to the Monetary Authority as are specified in the notice.

- (5) A category 1 institution must comply with the conditions specified in a notice given to it under this rule.
 - (6) A decision made by the Monetary Authority under subrule (1) or (2)(a) is a decision to which section 101B(1) of the Ordinance applies.
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Part 7

Calculation of LCR

Division 1—General

17. Interpretation of Part 7

In this Part—

approved RMBS (經批准 RMBS) means an RMBS that falls within section 3(b) of Part 2 of Schedule 2;

covered bond (資產覆蓋債券) means a bond issued by a bank or mortgage corporation—

- (a) that is subject to relevant laws or regulations specially designed to protect the holder of the bond; and
- (b) the proceeds from the issue of which must, in conformity with those relevant laws or regulations, be invested in assets—
 - (i) that, during the whole period of the validity of the bond, are capable of covering claims attached to the bond; and
 - (ii) that, in the event of the failure of the issuer of the bond, would be used on a priority basis for the reimbursement of the principal and payment of the accrued interest;

haircut (扣減), in relation to an asset held, or pledged to a counterparty, by a category 1 institution, means any adjustment to be applied to the principal amount of the asset for calculating the institution's LCR or other purposes, to take into account possible future fluctuations in the monetizable value of the asset;

host country (業務所在國家), in relation to a category 1 institution incorporated in Hong Kong, means a country outside Hong Kong in which—

- (a) any of the institution's overseas branches operates; or
- (b) any of the institution's associated entities is incorporated;

HQLA qualifying asset (HQLA 合資格資產) means an asset referred to in rule 25(a);

principal amount (本金額)—

- (a) in relation to an on-balance sheet item of a category 1 institution, means—
 - (i) if the item is measured at fair value, the value of the item determined in accordance with rule 9; or
 - (ii) if the item is not measured at fair value, the book value (including any accrued interest) of the item; or
- (b) in relation to an off-balance sheet item of a category 1 institution, means—
 - (i) subject to subparagraphs (ii) and (iii), the contracted amount;
 - (ii) for an undrawn facility, the amount of the undrawn facility; or
 - (iii) for a partially drawn facility, the amount of the undrawn portion;

relevant securities financing transaction (相關證券融資交易) means a securities financing transaction that falls within rule 34(1)(a);

retail deposit (零售存款) has the meaning given by rule 39;

securities financing transaction (證券融資交易), in relation to a category 1 institution, means—

- (a) a repo-style transaction; or
- (b) a margin lending transaction;

small business funding (小型企業借款) has the meaning given by rule 39;

withdrawable central bank reserves (可提取央行儲備), in relation to a category 1 institution, means—

- (a) any funds placed by the institution with the Monetary Authority for the account of the Exchange Fund that are repayable on demand; or
- (b) any of the following funds placed by the institution with a central bank—
 - (i) funds required to be so placed under the central bank's reserve requirements but only to the extent that those funds are allowed by the central bank to be drawn down by the institution in times of financial stress;
 - (ii) funds that are repayable on demand;
 - (iii) term funds that are explicitly and contractually repayable on notice and will be available for use by the institution on the first day of the LCR period;
 - (iv) term funds against which the institution can borrow from the central bank a loan on a term basis, or on an overnight but automatically renewable basis, as long as the term funds concerned are still placed with the central bank but, if the amount of the loan that the institution may borrow from the central bank against the term funds concerned and the amount of the funds are different, only the lower of those 2 amounts.

18. Assets, etc., must not be double counted in calculation of LCR

- (1) A category 1 institution must not, in the calculation of its LCR, double count an asset, liability, off-balance sheet item, or associated cash flow, that is included in that calculation.
- (2) Without limiting subrule (1), a category 1 institution must not, in the calculation of its LCR, include in its total net cash outflows any cash inflow associated with an asset included in its HQLA for the purposes of that calculation.

19. Calculation of LCR on Hong Kong office basis

A category 1 institution must, in the calculation of its LCR on a Hong Kong office basis, determine—

- (a) its HQLA held in its Hong Kong office; and
- (b) the total net cash outflows of its Hong Kong office,

as if its Hong Kong office were a single legal entity.

20. Calculation of LCR on unconsolidated basis

Subject to rules 22 and 24, a category 1 institution incorporated in Hong Kong must, in the calculation of its LCR on an unconsolidated basis—

- (a) determine the aggregate of its HQLA held in its Hong Kong office and its overseas branches;
- (b) determine the aggregate of the total net cash outflows of its Hong Kong office and its overseas branches; and
- (c) ensure that all inter-branch balances with, and transactions between, its Hong Kong office and its overseas branches are offset in that calculation.

21. Calculation of LCR on consolidated basis

- (1) Subject to rules 22 and 23, a category 1 institution incorporated in Hong Kong must, in the calculation of its LCR on a consolidated basis—
 - (a) determine the aggregate of its HQLA held by the members of its consolidated group;
 - (b) determine the aggregate of the total net cash outflows of the members of its consolidated group; and
 - (c) ensure that all inter-branch or inter-company balances with, and transactions between, the members of its consolidated group are offset in that calculation.
- (2) A category 1 institution must comply with subrule (1) as if the members of its consolidated group were a single legal entity.

22. Calculation of LCR on unconsolidated or consolidated basis, etc. when there are different liquidity requirements between Hong Kong and host countries

- (1) Where—
 - (a) a category 1 institution incorporated in Hong Kong calculates its LCR on an unconsolidated basis or consolidated basis, or the basis specified in a notice to the institution under rule 12; and
 - (b) the institution has an overseas branch that operates, or a specified associated entity that is incorporated, in a host country,

this rule applies in respect of the deposits and funding of the overseas branch or specified associated entity.

- (2) For subrule (1), subject to subrule (4), if—
 - (a) there are imposed by the relevant banking supervisory authority in the host country any liquidity requirements

- for the equivalent of an LCR and applicable to the deposits and funding concerned; and
- (b) those liquidity requirements are imposed for—
- (i) implementing the prevailing banking supervisory standards issued by the Basel Committee relating to the equivalent of an LCR; and
 - (ii) reflecting the prevailing standards issued by the Basel Committee for such types of the deposits and funding concerned,
- the institution must apply those liquidity requirements to the calculation of its LCR insofar as the calculation relates to the deposits and funding concerned.
- (3) For subrule (1), if—
- (a) there are not imposed by the relevant banking supervisory authority in the host country any liquidity requirements as mentioned in subrule (2); or
 - (b) the authority, for the purposes of the calculation of the equivalent of an LCR insofar as the calculation relates to the deposits and funding concerned, does not adopt or apply those liquidity requirements to the institution,
- the institution must apply the requirements of these Rules as applicable to the calculation of its LCR insofar as the calculation relates to the deposits and funding concerned.
- (4) For subrule (2), if the Monetary Authority—
- (a) is satisfied that the liquidity requirements imposed by the relevant banking supervisory authority in the host country are, for the purposes of the calculation of the equivalent of an LCR insofar as the calculation relates to the types of the deposits and funding concerned, less stringent than the requirements of these Rules as applicable to the calculation of the institution's LCR

- insofar as the calculation relates to the deposits and funding concerned; and
- (b) has given the institution a notice in writing stating the matter as mentioned in paragraph (a),
- the institution must apply the requirements of these Rules as applicable to the calculation of its LCR insofar as the calculation relates to the deposits and funding concerned.
- (5) Where subrule (2), (3) or (4) applies to a category 1 institution, the institution must construe, with all necessary modifications, the other requirements of these Rules in a manner consistent with the application of that subrule to it.
- (6) In this rule—
- deposits and funding* (存款及借款), in relation to a category 1 institution's overseas branch that operates, or specified associated entity that is incorporated, in a host country, means the retail deposits and small business funding of the overseas branch or specified associated entity.
- 23. Treatment of liquidity transfer restrictions in calculation of consolidated LCR**
- (1) A category 1 institution incorporated in Hong Kong that has one or more specified associated entities must not, in the calculation of its LCR on a consolidated basis, include the following—
- (a) any HQLA held by a member of its consolidated group (except to the extent that the total net cash outflows of the member are also included in the calculation); and
 - (b) any surplus HQLA held by the member.
- (2) Despite subrule (1)(b), surplus HQLA may be included in the calculation referred to in that subrule if—

- (a) the surplus HQLA is at all times freely transferable from the member of the category 1 institution's consolidated group that holds the surplus HQLA to the institution's Hong Kong office; and
 - (b) without limiting paragraph (a) and subject to subrule (3)—
 - (i) the transfer of the surplus HQLA from the country in which it is held by the member concerned to the institution's Hong Kong office is not subject to any liquidity transfer restriction; and
 - (ii) there is no reasonable doubt as to whether the surplus HQLA will at all times be freely transferable from the country in which it is held by the member concerned to the institution's Hong Kong office.
- (3) For subrule (2), for assessing the transferability of the surplus HQLA, a category 1 institution—
- (a) is only required to take into account the applicable laws, regulations and supervisory requirements of the country in which the surplus HQLA is held; and
 - (b) must have in place and maintain adequate processes to identify and monitor the applicable laws, regulations and supervisory requirements referred to in paragraph (a).
- (4) In this rule—
- surplus HQLA* (超額 HQLA), in relation to a member of a category 1 institution's consolidated group, means any of the institution's HQLA held by the member that is more than the higher of the following—
- (a) the total net cash outflows of the member;
 - (b) the HQLA required to be held by the prevailing regulations applicable to the member.

24. Treatment of liquidity transfer restrictions in calculation of unconsolidated LCR, etc.

Rule 23 applies, with all necessary modifications—

- (a) to a category 1 institution incorporated in Hong Kong that calculates its LCR on an unconsolidated basis as that rule applies to a category 1 institution incorporated in Hong Kong that calculates its LCR on a consolidated basis; and
- (b) to a category 1 institution incorporated in Hong Kong that calculates its LCR on the basis specified in a notice given to it under rule 12 as rule 23 applies to a category 1 institution incorporated in Hong Kong that calculates its LCR on a consolidated basis.

Division 2—Requirements that Asset, etc., must Satisfy before it can be Included in HQLA for Purposes of Calculation of LCR

25. Requirements that must be satisfied before asset can be included in HQLA for purposes of calculation of LCR

A category 1 institution must not, in the calculation of its LCR, include an asset in its HQLA unless—

- (a) subject to rules 29 and 30, the asset falls within a class of assets specified in Schedule 2 and meets the qualifying criteria (if any) specified in that Schedule for an asset that falls within that class;
- (b) the asset satisfies all the characteristic requirements specified in Schedule 3 that are applicable to the asset;
- (c) the asset satisfies all the operational requirements specified in Schedule 4 that are applicable to the asset; and

- (d) the institution satisfies all the operational requirements specified in Schedule 4 that are applicable to the institution insofar as those operational requirements relate to the asset.

26. Exclusion of non-qualifying asset from HQLA

If an asset included in a category 1 institution's HQLA ceases to satisfy any requirement of these Rules applicable to the inclusion of an asset in HQLA (including any case where the institution fails to satisfy any operational requirement specified in Schedule 4 that is applicable to the institution insofar as the operational requirement concerned relates to the asset), the institution must—

- (a) subject to paragraph (b), exclude the asset from its HQLA not later than 30 calendar days after the date of the cesser; or
- (b) exclude the asset from its HQLA immediately if it only becomes aware of the cesser after the 30 calendar days.

27. Management of HQLA and related foreign exchange risk

- (1) A category 1 institution must have in place and maintain adequate systems and procedures for the on-going assessment and management of its HQLA in order to ensure that—
 - (a) each asset included in the HQLA satisfies all the requirements of these Rules that are applicable to the inclusion of that asset in the HQLA;
 - (b) an asset included in the HQLA that ceases to satisfy any requirement of these Rules applicable to the inclusion of that asset in the HQLA is identified as soon as is practicable; and
 - (c) without limiting rule 26, prompt action is taken to exclude from the HQLA an asset identified as referred to in paragraph (b).

- (2) A category 1 institution must have in place and maintain adequate systems and procedures to manage the foreign exchange risk associated with its HQLA, including—
 - (a) managing its ability to access relevant foreign exchange markets for the exchange of funds from one currency to another taking into account the risk that the access to such markets may be hindered in times of financial stress;
 - (b) managing its HQLA so that the HQLA is able to generate liquidity to meet the institution's total net cash outflows in different currencies; and
 - (c) subject to Division 4, managing the composition of its HQLA by currency so that the HQLA is broadly consistent with the distribution of its total net cash outflows by currency.

28. HQLA must have diversification of classes of assets, etc.

- (1) A category 1 institution must—
 - (a) have in place and maintain adequate policies and limits to control the level of concentration of its HQLA within asset classes with respect to the type of asset, type of issue, type of issuer and, without limiting rule 27(2)(c), type of currency; and
 - (b) subject to subrule (2), ensure that the HQLA is well diversified within each of the asset classes comprising the HQLA.
- (2) Subrule (1)(b) does not apply to a level 1 asset included in a category 1 institution's HQLA if the asset falls within any of the following types of asset—
 - (a) currency notes and coins;
 - (b) withdrawable central bank reserves;

- (c) EF debt securities;
- (d) qualifying debt securities issued by the sovereign or central bank of the country in which the institution is incorporated;
- (e) qualifying debt securities issued by the sovereign or central bank of any country in which the institution operates.

29. General exclusion of assets from HQLA, etc.

- (1) The Monetary Authority may, by notice in writing to all category 1 institutions, specify that a category 1 institution must not include in its HQLA, with effect from the date, or the occurrence of an event, specified in the notice, an asset, or a class of assets, of the type specified in the notice, on the ground that the Monetary Authority is satisfied that that type of asset or class of assets, as the case may be, is not, or is no longer, sufficiently liquid in private markets or readily monetizable by other means to be included in any category 1 institution's HQLA.
- (2) Every category 1 institution must comply with the requirements of a notice given to it under subrule (1).

30. Specific exclusion of assets from HQLA, etc.

- (1) The Monetary Authority may, by notice in writing to a category 1 institution, require the institution, with effect from the date, or the occurrence of an event, specified in the notice—
 - (a) to cease to include in its HQLA the asset specified in the notice on the ground that the Monetary Authority is satisfied that it no longer satisfies, or has never satisfied, the requirement of these Rules as specified in the notice

that is applicable to the inclusion of that asset in its HQLA; or

- (b) without limiting rules 27(2) and 28(1), to make the changes specified in the notice to its HQLA on the ground that the Monetary Authority is satisfied that those changes are necessary in order to mitigate the risks associated with the institution's failure, as specified in the notice, to comply with rule 27(2) or 28(1).

- (2) A category 1 institution must comply with the requirements of a notice given to it under subrule (1).

31. Provisions supplementary to rule 25

- (1) The Monetary Authority may, 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, and if satisfied that it is prudent and reasonable to do so in the prevailing financial circumstances, by notice in writing to all category 1 institutions, specify that a category 1 institution may include in its HQLA, with effect from the date, or the occurrence of an event, specified in the notice, a relevant asset specified in the notice if the institution and the relevant asset comply with—
 - (a) the prevailing banking supervisory standards issued by the Basel Committee relating to the inclusion of the relevant asset in HQLA; and
 - (b) the conditions (if any) specified in the notice relating to the inclusion of the relevant asset in the institution's HQLA.
- (2) If a category 1 institution includes a relevant asset in its HQLA in accordance with a notice under subrule (1), the institution must construe, with all necessary modifications, the

other requirements of these Rules in a manner consistent with the inclusion of that asset in the HQLA.

(3) In this rule—

relevant asset (有關資產) means an asset (which may be an off-balance sheet asset), or an asset which falls within a class of assets (which may be a class of off-balance sheet assets), of a type which—

- (a) under the prevailing banking supervisory standards issued by the Basel Committee relating to the inclusion of assets in HQLA, may be included in HQLA; and
- (b) under the other provisions of these Rules, is not presently permitted to be included in a category 1 institution’s HQLA.

Division 3—Determination of HQLA: General

32. General requirements applicable to determination of HQLA

Subject to rules 33, 34, 35, 36, 37 and 38, a category 1 institution must determine the total weighted amount of its HQLA—

- (a) subject to paragraphs (b), (c) and (d), as the sum of the total weighted amounts of its level 1 assets, level 2A assets and level 2B assets, calculated in accordance with rule 35;
- (b) if any of its level 1 assets, level 2A assets or level 2B assets are not available to the institution on the first day of the LCR period concerned, by excluding the asset concerned from its HQLA for that period and irrespective of the asset’s remaining maturity;
- (c) so that the sum of—
 - (i) the total weighted amount of level 2A assets; and
 - (ii) the total weighted amount of level 2B assets,

does not exceed 40% of the total weighted amount of its HQLA (**40% ceiling**); and

- (d) so that the total weighted amount of level 2B assets does not exceed 15% of the total weighted amount of its HQLA (**15% ceiling**).

33. Calculation of total weighted amount of HQLA (without reversal of relevant securities financing transaction)

- (1) Subject to rule 34, a category 1 institution must, for the purposes of rule 32, calculate the total weighted amount of its HQLA by the use of Formula 1.

Formula 1

Calculation of Total Weighted Amount of HQLA

Total weighted amount of HQLA = total weighted amount of level 1 assets + total weighted amount of level 2A assets + total weighted amount of level 2B assets – adjustment for 15% ceiling – adjustment for 40% ceiling

where—

adjustment for 15% ceiling = max (level 2B assets – 15/85* (level 1 assets + level 2A assets), level 2B assets – 15/60* level 1 assets, 0);

adjustment for 40% ceiling = max ((level 2A assets + level 2B assets – adjustment for 15% ceiling) – 2/3* level 1 assets, 0);

level 1 assets = total weighted amount of level 1 assets calculated in accordance

with rule 35(1)(a);
 level 2A assets = total weighted amount of level 2A assets calculated in accordance with rule 35(1)(b); and
 level 2B assets = total weighted amount of level 2B assets calculated in accordance with rule 35(1)(c).

(2) To avoid doubt, a category 1 institution must comply with subrule (1) after all haircuts required by rule 35 have been made to its HQLA.

34. Calculation of total weighted amount of HQLA (if there is relevant securities financing transaction)

- (1) Subrule (2) applies to a category 1 institution if—
- (a) the institution has entered into a securities financing transaction that matures within the LCR period concerned and the transaction involves the exchange, during that period, of an HQLA qualifying asset of the institution for another HQLA qualifying asset from the counterparty to the transaction;
 - (b) the HQLA qualifying asset from the counterparty satisfies, or will satisfy when it is given to the institution, all the requirements of rule 25(b) and (c) applicable to the asset; and
 - (c) the institution satisfies, or will satisfy when it is given the HQLA qualifying asset from the counterparty, all the requirements of rule 25(d) applicable to the institution insofar as those requirements relate to the asset.
- (2) A category 1 institution to which this subrule applies must—

- (a) by the use of Formula 2, calculate the total weighted amount of its HQLA after the reversal of the relevant securities financing transaction concerned; and
- (b) take the lower amount of the 2 amounts calculated under paragraph (a) and rule 33 as the total weighted amount of its HQLA for the purposes of rule 32.

Formula 2

Calculation of Total Weighted Amount of HQLA (Adjusted for Reversal of any Relevant Securities Financing Transaction)

Total weighted amount of HQLA = total weighted amount of level 1 assets + total weighted amount of level 2A assets + total weighted amount of level 2B assets – adjustment for 15% ceiling – adjustment for 40% ceiling

where—

adjustment for 15% ceiling = max (adjusted level 2B assets – 15/85* (adjusted level 1 assets + adjusted level 2A assets), adjusted level 2B assets – 15/60* adjusted level 1 assets, 0);

adjustment for 40% ceiling = max ((adjusted level 2A assets + adjusted level 2B assets – adjustment for 15% ceiling) – 2/3* adjusted level 1 assets, 0);

adjusted level 1 assets = total weighted amount of level 1 assets adjusted for the reversal of any relevant securities financing

transaction involving the exchange by the category 1 institution of any level 1 asset, level 2A asset or level 2B asset for receipt by the category 1 institution from the counterparty of any level 1 asset within the LCR period concerned;

adjusted level = total weighted amount of level 2A assets adjusted for the reversal of any relevant securities financing transaction involving the exchange by the category 1 institution of any level 1 asset, level 2A asset or level 2B asset for receipt by the category 1 institution from the counterparty of any level 2A asset within the LCR period concerned; and

adjusted level = total weighted amount of level 2B assets adjusted for the reversal of any relevant securities financing transaction involving the exchange by the category 1 institution of any level 1 asset, level 2A asset or level 2B asset for receipt by the category 1 institution from the counterparty of any level 2B asset within the LCR period concerned.

- (3) To avoid doubt, a category 1 institution to which subrule (2) applies must comply with that subrule after all haircuts required by rule 35 have been made to its HQLA.

35. Haircuts

- (1) Subject to rule 38, for the purposes of rule 32—

- (a) the total weighted amount of level 1 assets is the sum of the weighted amount of assets that fall within each of the asset subclasses specified in column 1 of Table 1 under the asset class of level 1 assets, calculated by multiplying together—
- (i) the principal amount of assets that fall within each of those asset subclasses; and
 - (ii) the post-haircut factor specified in column 2 of Table 1 in relation to each of those asset subclasses;
- (b) the total weighted amount of level 2A assets is the sum of the weighted amount of assets that fall within each of the asset subclasses specified in column 1 of Table 1 under the asset class of level 2A assets, calculated by multiplying together—
- (i) the principal amount of assets that fall within each of those asset subclasses; and
 - (ii) the post-haircut factor specified in column 2 of Table 1 in relation to each of those asset subclasses; and
- (c) the total weighted amount of level 2B assets is the sum of the weighted amount of assets that fall within each of the asset subclasses specified in column 1 of Table 1 under the asset class of level 2B assets, calculated by multiplying together—
- (i) the principal amount of assets that fall within each of those asset subclasses; and
 - (ii) the post-haircut factor specified in column 2 of Table 1 in relation to each of those asset subclasses.

Table 1

Post-haircut Factors

	Column 1 Asset class/asset subclass	Column 2 Post-haircut factor
1.	Level 1 assets	
	(a) currency notes and coins	100%
	(b) withdrawable central bank reserves	100%
	(c) marketable debt securities referred to in section 1(c) of Part 2 of Schedule 2	100%
	(d) marketable debt securities referred to in section 1(d) of Part 2 of Schedule 2	100%
	(e) marketable debt securities referred to in section 1(e) of Part 2 of Schedule 2	100%
2.	Level 2A assets	
	(a) marketable debt securities referred to in section 2(a) of Part 2 of Schedule 2	85%
	(b) marketable debt securities referred to in section 2(b) of Part 2 of	85%

Column 1 Asset class/asset subclass	Column 2 Post-haircut factor
Schedule 2	
(c) covered bonds referred to in section 2(c) of Part 2 of Schedule 2	85%

3. Level 2B assets

(a) marketable debt securities referred to in section 3(a) of Part 2 of Schedule 2	50%
(b) approved RMBS	75%

(2) Subject to subrule (3), the principal amount of assets that fall within each of the asset subclasses listed in Table 1 is the fair value of the assets concerned.

(3) The principal amount of assets that fall within the asset subclasses of currency notes and coins and withdrawable central bank reserves listed in Table 1 is the book value of the assets concerned (including any accrued interest in the case of withdrawable central bank reserves).

Division 4—Determination of HQLA: Requirements Applicable to Category 1 Institutions that Use Foreign Currency-denominated HQLA to Cover HKD LCR Mismatch

36. Interpretation of Division 4

In this Division—

foreign currency-denominated HQLA (外幣計值 HQLA), in relation to the calculation by a category 1 institution of its

LCR, means the total weighted amount of its HQLA, as determined in accordance with this Part before making any adjustment in respect of the 40% ceiling and 15% ceiling referred to in rule 32, that are denominated in foreign currencies;

foreign currency-denominated total net cash outflows (外幣計值淨現金流出總額), in relation to the calculation by a category 1 institution of its LCR, means the institution's total net cash outflows, as calculated in accordance with Division 5 before the application of rule 40(2) to those outflows, that are denominated in foreign currencies;

HKD-denominated HQLA (港元計值 HQLA), in relation to the calculation by a category 1 institution of its LCR, means the total weighted amount of its HQLA, as determined in accordance with this Part before making any adjustment in respect of the 40% ceiling and 15% ceiling referred to in rule 32, that are denominated in Hong Kong dollars;

HKD-denominated total net cash outflows (港元計值淨現金流出總額), in relation to the calculation by a category 1 institution of its LCR, means the institution's total net cash outflows, as calculated in accordance with Division 5 before the application of rule 40(2) to those outflows, that are denominated in Hong Kong dollars;

HKD LCR mismatch (港元 LCR 錯配), in relation to the calculation by a category 1 institution of its LCR, means that portion of the institution's HKD-denominated total net cash outflows that is not covered by its HKD-denominated HQLA;

relevant portion (有關部分), in relation to the calculation by a category 1 institution of its LCR, is to be construed in accordance with rule 38;

rule 37 institution (第 37 條機構) means a category 1 institution that uses, or is proposing to use, part of its foreign currency-

denominated HQLA to cover its HKD LCR mismatch in the calculation of its LCR in accordance with rule 37.

37. Circumstances and requirements under which category 1 institution may use foreign currency-denominated HQLA to cover HKD LCR mismatch

Without limiting rule 27(2)(c) but subject to rule 38, a category 1 institution may use part of its foreign currency-denominated HQLA to cover its HKD LCR mismatch in the calculation of its LCR only if—

- (a) the institution can demonstrate to the satisfaction of the Monetary Authority that it has a genuine need to use such HQLA to comply with rule 4;
- (b) such HQLA are level 1 assets and have not already been used by the institution to cover its foreign currency-denominated total net cash outflows;
- (c) the institution applies the foreign exchange haircuts required under rule 38 in the calculation of its LCR;
- (d) the use of such HQLA does not result in the institution holding HKD-denominated HQLA that are level 1 assets being less than 20% of its HKD-denominated total net cash outflows; and
- (e) the institution can demonstrate to the satisfaction of the Monetary Authority that it has the necessary systems and capacity to manage the level of foreign exchange risk associated with the use of such HQLA.

38. Application of foreign exchange haircuts

- (1) Subject to subrule (2), a rule 37 institution, in determining the amount of its HQLA for calculating its LCR, must deduct from the total weighted amount of its HQLA an amount calculated by multiplying together—

- (a) the principal amount of the level 1 assets constituting that portion of foreign currency-denominated HQLA held by the institution to cover its HKD LCR mismatch (*relevant portion*); and
- (b) the foreign exchange haircut specified in Table 2 as applicable to those assets.

Table 2

Foreign Exchange Haircuts

Type of foreign currency	Foreign exchange haircut
Level 1 assets denominated in US dollars	2%
Level 1 assets denominated in Euro, Japanese yen or pound sterling	8%
Level 1 assets denominated in any other foreign currency that is freely convertible into Hong Kong dollars	10%

- (2) Subrule (1) does not apply to the relevant portion, or that part of the relevant portion, that is not more than 25% of the relevant rule 37 institution’s HKD-denominated total net cash outflows.

Division 5—Calculation of Total Net Cash Outflows

39. Interpretation of Division 5

In this Division—

Basel III LCR document (《巴塞爾 III LCR 文件》) means the document entitled “Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools” published by the Basel Committee in January 2013;

cash management services (現金管理服務), in relation to a category 1 institution, means services provided by the institution that directly or indirectly enable its customers to manage their cash flows, assets and liabilities, or to conduct financial transactions necessary for their on-going operations, in relation to payment remittances, the collection and aggregation of funds, payroll administration or control over the disbursement of funds;

clearing services (結算服務), in relation to a category 1 institution, means services provided by the institution that enable its customers to transfer funds or assets indirectly through direct participants in settlement systems to final recipients, but such services are limited to the transmission, reconciliation or confirmation of payment orders, daylight overdrafts or overnight financing, the maintenance of post-settlement balances or the determination of intraday and end-of-day settlement positions;

committed facility (有承諾融通), in relation to a category 1 institution, means a contractual agreement between the institution and its customer under which the institution has a contractually irrevocable commitment to extend funds to the customer at a future date, whether for credit or liquidity purposes, in accordance with the terms and conditions specified in the agreement;

committed liquidity facility (有承諾流動性融通), in relation to a category 1 institution, means a committed facility that serves as a standby facility granted by the institution to its customer to refinance the customer’s debt obligations (for example, under a commercial paper programme) in situations where the

customer is unable to refinance those debt obligations in financial markets;

correspondent banking services (代理銀行服務) means services under which a correspondent bank holds deposits and other funding from a respondent bank for the clearing and settlement of transactions in a currency other than the currency of the country in which the respondent bank is incorporated or operates;

custodial-related services (託管關聯服務), in relation to a category 1 institution, means services that are—

- (a) provided by the institution—
 - (i) for the safekeeping, processing and reporting of financial assets on behalf of its customers; or
 - (ii) for the facilitation, on behalf of its customers, of operational and administrative arrangements associated with transactions involving the customers' financial assets; and
- (b) limited to—
 - (i) the settlement of transactions involving securities;
 - (ii) the transfer of contractual payments;
 - (iii) the processing of collateral;
 - (iv) the provision of custodial-related cash management services;
 - (v) the receipt of dividends and other income;
 - (vi) client subscriptions and redemption;
 - (vii) asset and corporate trust servicing;
 - (viii) treasury;
 - (ix) escrow;
 - (x) fund transfer;

- (xi) stock transfer and agency services;
- (xii) payment and settlement services not related to correspondent banking services; or
- (xiii) depository receipts;

derivative contract (衍生工具合約) means—

- (a) a financial instrument (other than a bond, loan, share, note or structured financial instrument) the value of which is determined by reference to the value of, or any fluctuation in the value of, one or more than one underlying asset, index, financial instrument, rate or thing as designated in the financial instrument; or
- (b) (where a financial instrument that falls within paragraph (a) is embedded in or combined with, or forms part of, a bond, loan, share, note or structured financial instrument) the financial instrument that falls within that paragraph;

effective deposit insurance scheme (有效存款保險計劃) means—

- (a) the Deposit Protection Scheme established under section 11 of the Deposit Protection Scheme Ordinance (Cap. 581);
- (b) a deposit insurance scheme—
 - (i) that has the ability to make prompt payouts of insured deposits;
 - (ii) for which the deposit coverage is clearly defined;
 - (iii) of which public awareness is high; and
 - (iv) in which the deposit insurer has formal legal powers to fulfil its mandate and is operationally independent, transparent and accountable; or

- (c) an explicit and legally binding deposit guarantee provided by the sovereign in a country that effectively functions as deposit insurance in that country;

excess non-segregated collateral (超額非分隔抵押品), in relation to a category 1 institution, means the fair value of non-segregated collateral held by the institution that is—

- (a) posted by the institution's counterparty under a derivative contract or other transaction; and
- (b) in excess of the amount of collateral contractually required to be posted to the institution under that contract or transaction;

fully insured (十足受保), in relation to a deposit covered under an effective deposit insurance scheme, means that 100% of the deposit amount (up to the deposit coverage limit) is insured by the scheme;

fully performing (一直依期清償), in relation to an asset or exposure of a category 1 institution, means that the asset or exposure is not past due and has not been rescheduled;

investment grade (投資等級) has the meaning given by section 281 of the Capital Rules;

IRB subclass (IRB 子類別) has the meaning given by section 2(1) of the Capital Rules;

less stable retail deposit (較不穩定零售存款), in relation to a category 1 institution, means a retail deposit taken by the institution that is not a stable retail deposit or retail term deposit;

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

margin lending transaction (保證金借出交易), in relation to a category 1 institution, means a secured lending transaction

under which the institution extends a margin loan to its customer;

margin loan (保證金貸款), in relation to a category 1 institution, means a collateralized loan extended by the institution to its customer under a margin agreement in connection with the trading of securities by the customer;

material adverse event (重大不利事件), in relation to a derivative contract or other contract entered into by a category 1 institution with a counterparty, means an event specified in the contract that relates to adverse changes in the institution's credit-worthiness or financial conditions (caused by a downgrade of its ECAI issuer rating up to and including a 3-notch downgrade or a downgrade of such rating to a rating that is not investment grade), the occurrence of which will require the institution to fulfil its obligations specified in the contract (which may include the payment of a sum of money or the posting of additional collateral) to the counterparty;

non-contractual contingent funding obligation (非合約或有出資義務), in relation to a category 1 institution, includes, but is not limited to, an obligation of the institution that is—

- (a) associated with the issue or sponsorship of financial instruments (including structured financial instruments), or the provision of financial services, that may necessitate the funding support of, or the extension of funds by, the institution in times of financial stress; or
- (b) associated with financial instruments (including structured financial instruments) originated, sponsored, marketed or sold by the institution that may render it necessary for the institution, out of reputation risk considerations, to repurchase those instruments from the holders of the instruments if there is a failure to satisfy

the holders' reasonable expectations about the liquidity and marketability of the instruments;

non-segregated collateral (非分隔抵押品), in relation to a category 1 institution, means collateral posted by the institution's counterparty under a derivative contract or other transaction that is not segregated from other assets held by the institution;

operational deposit (營運存款), in relation to a category 1 institution, means a deposit placed, by a wholesale customer (other than a small business customer) of the institution, with the institution in the course of the institution providing to the customer operational services—

- (a) on which the customer has become significantly dependent for its business operation; and
- (b) that does not arise from the institution's provision of correspondent banking services or prime brokerage services to the customer;

operational services (營運服務) means clearing services, custodial-related services or cash management services;

other contingent funding obligation (其他或有出資義務), in relation to a category 1 institution, means a contractual or non-contractual contingent funding obligation of the institution that—

- (a) is not a lending commitment; and
- (b) is not otherwise included in the calculation of the institution's total net cash outflows for calculating its LCR;

other contractual cash outflow (其他合約現金流出), in relation to a category 1 institution, means a contractual cash outflow of the institution (other than a contractual cash outflow relating to the operating expenses of the institution) that—

- (a) occurs within the LCR period; and
- (b) is not otherwise included in the calculation of the institution's total net cash outflows for calculating its LCR;

other established relationship (其他既定關係), in relation to a category 1 institution, means a banking relationship between the institution and a customer of the institution, other than the placing of deposits with the institution, in relation to loans, credit cards, investments or wealth management accounts;

prime brokerage services (主要經紀服務), in relation to a category 1 institution, means services provided by the institution to institutional or professional investors to facilitate their investment and trading activities;

rescheduled (重組) has the meaning given by section 51(1) of the Capital Rules;

retail customer (零售客戶), in relation to a category 1 institution, means a customer of the institution who is an individual;

retail deposit (零售存款), in relation to a category 1 institution, means a deposit taken by the institution from a retail customer;

retail term deposit (零售定期存款), in relation to a category 1 institution, means a retail deposit, taken by the institution from a retail customer, that has a remaining term to maturity, or a withdrawal notice period, greater than the LCR period, and—

- (a) which the retail customer has no legal right to withdraw within the LCR period; or
- (b) any early withdrawal of which will result in the retail customer being charged a significant penalty that is materially greater than the loss of interest that may arise from the early withdrawal;

secured funding transaction (有抵押借款交易), in relation to a category 1 institution, means a securities repurchase transaction or securities lending transaction, or other similar transaction, entered into by the institution with a counterparty who provides a sum of money or other securities to the institution on a collateralized basis;

secured lending transaction (有抵押借出交易), in relation to a category 1 institution, means a securities reverse repurchase transaction or securities borrowing transaction, margin lending transaction, or other similar transaction, entered into by the institution with a counterparty in which the institution provides a sum of money or other securities to the counterparty on a collateralized basis;

securities borrowing transaction (證券借入交易), in relation to a category 1 institution, means a repo-style transaction entered into by the institution under which the institution borrows securities from a counterparty and provides a sum of money or other securities to the counterparty in exchange as collateral;

securities lending transaction (證券借出交易), in relation to a category 1 institution, means a repo-style transaction entered into by the institution under which the institution lends securities to a counterparty and receives a sum of money or other securities from the counterparty in exchange as collateral;

securities repurchase transaction (證券回購交易), in relation to a category 1 institution, means a repo-style transaction entered into by the institution under which the institution agrees to sell securities to a counterparty for a sum of money with a commitment to repurchase the securities, at a specified price and on a specified future date, from the counterparty;

securities reverse repurchase transaction (證券逆向回購交易), in relation to a category 1 institution, means a repo-style transaction entered into by the institution under which the institution agrees to acquire securities from a counterparty for a sum of money with a commitment to resell the securities, at a specified price and on a specified future date, to the counterparty;

securities swap transaction (證券掉期交易), in relation to a category 1 institution, means—

- (a) a securities lending transaction under which the institution lends securities to a counterparty and receives other securities from the counterparty in exchange as collateral; or
- (b) a securities borrowing transaction under which the institution borrows securities from a counterparty and provides other securities to the counterparty in exchange as collateral;

small business customer (小型企業客戶), in relation to a category 1 institution, means a corporate (or, if applicable, a group of related corporates) which has provided the institution with total aggregated funding of less than 10 million Hong Kong dollars (or its equivalent in another currency), and in respect of which—

- (a) if the institution has a credit exposure to the corporate (or the group), the credit exposure meets the criteria for the IRB subclass of small business retail exposures under section 144 of the Capital Rules; or
- (b) if the institution has no credit exposure to the corporate (or the group), that aggregated funding is managed by the institution as if it were a retail deposit;

small business funding (小型企業借款), in relation to a category 1 institution, means unsecured wholesale funding provided to the institution by small business customers;

stable retail deposit (穩定零售存款), in relation to a category 1 institution, means a retail deposit taken by the institution from a retail customer and that is payable on demand, or has a remaining term to maturity (or a withdrawal notice period) within the LCR period, where—

- (a) the deposit is fully insured by an effective deposit insurance scheme; and
- (b) either—
 - (i) the retail customer has at least 2 other established relationships with the institution, where—
 - (A) subject to sub-subparagraph (B), at least one of the relationships (but not that of a credit card account) has been established for not less than 6 months and the account underlying that relationship has not been dormant or inactive in the last 6 months; and
 - (B) the requirement in sub-subparagraph (A) is deemed to be satisfied if the relationship relates to a mortgage loan that charges a penalty for early settlement of the loan within 6 months from the date on which the loan is drawn down; or
 - (ii) the deposit is maintained by the retail customer in a transactional account at the institution;

structured financing transaction (結構式融資交易) means a collateralized transaction involving the issue of a structured financial instrument in which the repayment of obligations and other exposures to the transaction is largely derived,

directly or indirectly, from the cash flows generated by the pool of underlying assets that secures the obligations and other exposures to the transaction;

total aggregated funding (整體借款總額), in relation to a small business customer (or, if applicable, a group of related small business customers) of a category 1 institution, means the gross amount of funding (including any deposit or other form of funding) provided to the institution by the customer (or the group as if it were a single customer);

trade-related contingency (貿易關聯或有項目) has the meaning given by section 2(1) of the Capital Rules;

transactional account (交易帳戶), in relation to a category 1 institution, means a deposit account maintained at the institution that is designated by the account-holder to receive funds or make payments on a regular basis;

uncommitted facility (無承諾融通), in relation to a category 1 institution, means a facility granted by the institution to its customer that—

- (a) is for extending credit or providing liquidity to the customer; and
- (b) is unconditionally revocable by the institution without prior notice to the customer;

unsecured wholesale funding (無抵押批發借款), in relation to a category 1 institution, means a deposit or liability (other than any liability or obligation arising from derivative contracts)—

- (a) from or to a person other than an individual; and
- (b) that is not collateralized by a legal right to any designated asset owned by the institution in the case of the default, bankruptcy, insolvency, liquidation or resolution of the institution;

wholesale customer (批發客戶), in relation to a category 1 institution, means a customer of the institution other than a retail customer.

40. Calculation of total net cash outflows

- (1) A category 1 institution must, in calculating its total net cash outflows under the LCR—
 - (a) calculate its total expected cash outflows, in accordance with rule 41;
 - (b) subject to subrule (2), calculate its total expected cash inflows in accordance with rule 42; and
 - (c) deduct its total expected cash inflows calculated under paragraph (b) from its total expected cash outflows calculated under paragraph (a).
- (2) A category 1 institution's total expected cash inflows calculated under subrule (1)(b) must not be more than 75% of the institution's total expected cash outflows calculated under subrule (1)(a).

41. Calculation of total expected cash outflows

- (1) A category 1 institution must, for the purposes of rule 40(1)(a), calculate its total expected cash outflows within the LCR period arising from the following types of on-balance sheet liability or off-balance sheet obligation of the institution—
 - (a) stable retail deposits;
 - (b) less stable retail deposits;
 - (c) retail term deposits;
 - (d) small business funding;
 - (e) operational deposits;

- (f) unsecured wholesale funding (other than operational deposits) provided by—
 - (i) corporates (other than small business customers);
 - (ii) sovereigns;
 - (iii) the Monetary Authority for the account of the Exchange Fund;
 - (iv) central banks;
 - (v) multilateral development banks; and
 - (vi) public sector entities;
- (g) unsecured wholesale funding other than funding mentioned in paragraphs (d), (e) and (f);
- (h) debt securities and prescribed instruments issued by the institution and redeemable within the LCR period;
- (i) liabilities or obligations arising from secured funding transactions (including securities swap transactions);
- (j) contractual net cash outflows arising from derivative contracts;
- (k) liabilities or obligations arising from derivative contracts or other transactions (which are not otherwise covered in paragraph (j)) for covering additional liquidity needs arising from the following situations—
 - (i) derivative contracts or other transactions with material adverse event clauses;
 - (ii) potential loss in the market value of collateral posted by the institution to its counterparty;
 - (iii) holding of excess non-segregated collateral posted by the institution's counterparty who has the contractual right to withdraw the excess collateral from the institution;

- (iv) holding of non-segregated collateral posted by the institution's counterparty—
 - (A) that qualifies for inclusion as HQLA under the LCR (*HQLA collateral*); and
 - (B) under which the counterparty has a contractual right to substitute the posted HQLA collateral by one or more than one type of collateral that qualifies as HQLA at a lower level or does not qualify as HQLA;
- (v) contractual obligations of the institution to post collateral to its counterparty;
- (vi) increase in collateral needs under derivative contracts or other transactions that are subject to collateral requirements arising from adverse changes in the market value of such contracts or transactions;
- (vii) repayment of funding obtained from structured financial instruments issued by the institution and redeemable within the LCR period; and
- (viii) obligations under structured financing transactions for repayment of maturing debt or provision of funding or asset that may arise from any embedded option in such transactions;
- (l) potential drawdown of undrawn committed facilities (including committed credit facilities and committed liquidity facilities);
- (m) contractual lending obligations to the Monetary Authority for the account of the Exchange Fund, central banks and financial institutions not otherwise covered in this subrule;

- (n) contractual lending obligations to the institution's retail customers and other customers that are not otherwise covered in this subrule, the aggregate amount of which exceeds 50% of total contractual payment obligations from the same types of customer to the institution;
 - (o) other contingent funding obligations, whether contractual or non-contractual; and
 - (p) other contractual cash outflows.
- (2) Subject to subrules (3) and (4), a category 1 institution may exclude a pledged deposit from the calculation of its total expected cash outflows if—
 - (a) the deposit is pledged as collateral against a loan that will not be settled within the LCR period;
 - (b) the pledge arrangement concerned is subject to a legally enforceable contract that effectively disallows withdrawal of the deposit before the loan is fully settled; and
 - (c) the amount of deposit to be excluded from the calculation does not exceed the outstanding balance of the loan.
 - (3) If a pledged deposit is pledged as collateral against an undrawn credit facility—
 - (a) subrule (2) does not apply to the deposit; and
 - (b) the category 1 institution must, in the calculation of its total expected cash outflows insofar as the calculation relates to that deposit and facility, use the higher of the outflow rates that are respectively applicable to the deposit or facility as if the deposit were not a pledged deposit.
 - (4) If a pledged deposit is pledged as collateral against a partially drawn credit facility, then—

- (a) subrule (2) only applies to the drawn portion of the facility; and
 - (b) subrule (3) only applies to the undrawn portion of the facility.
- (5) Subject to subrules (6) and (7), a category 1 institution must account for any type of funding it has obtained in the calculation of its total expected cash outflows if—
- (a) the funding is callable by the fund provider within the LCR period;
 - (b) the earliest possible contractual maturity date of the funding falls within the LCR period; or
 - (c) the funding is either payable on demand or does not have a specific maturity date.
- (6) If—
- (a) the funding obtained by the category 1 institution is callable at its option within the LCR period; and
 - (b) there is market expectation that the institution will exercise that option and thus cause that funding to be repaid before its contractual maturity date,
- the institution must include the funding in the calculation of its total expected cash outflows as if the funding were to be repaid within the LCR period.
- (7) Subrule (5) does not apply to funding that is callable by the fund provider subject to a contractually defined and legally binding notice period that extends beyond the LCR period.
- (8) A category 1 institution must, for the purposes of rule 40(1)(a), calculate, by using the standard calculation methodology templates specified by the Monetary Authority, its total expected cash outflows by multiplying together—

- (a) the principal amount of each of its on-balance sheet liabilities and off-balance sheet obligations of the types listed in subrule (1); and
 - (b) an outflow rate determined in accordance with subrule (9).
- (9) Subject to subrules (10) and (11), the outflow rate (and the manner of its application) for each type of on-balance sheet liabilities or off-balance sheet obligations listed in subrule (1) must be consistent with, and no less stringent than, the relevant outflow rate (or any other term having a similar denotation) referred to in paragraphs 73 to 141 of the Basel III LCR document.
- (10) For those types of on-balance sheet liabilities or off-balance sheet obligations mentioned in subrule (1) (other than the non-contractual contingent funding obligations mentioned in subrule (11)), if—
- (a) the applicable outflow rate is to be determined by the relevant banking supervisory authority in a country and therefore is not specified in the Basel III LCR document; or
 - (b) the Monetary Authority is satisfied that having regard to the prevailing circumstances in Hong Kong, it is prudent and reasonable to apply a higher outflow rate than that specified in the Basel III LCR document,
- a category 1 institution must apply the outflow rates specified in Table 3 to those types of liabilities or obligations.

Table 3

Outflow Rates for Calculation of Total Expected Cash Outflows Arising from On-balance Sheet Liabilities or Off-balance Sheet Obligations Referred to in Rule 41(10)

Paragraph under rule 41(1)	Type of on-balance sheet liability or off-balance sheet obligation	Outflow rate
Paragraph (b)	Less stable retail deposits	10% (subject to subrule (13))
Paragraph (c)	Retail term deposits	5%
Paragraph (h)	Debt securities and prescribed instruments issued by a category 1 institution and redeemable within the LCR period (irrespective of whether the holders of the debt securities or prescribed instruments are retail customers or wholesale customers)	100%
Paragraph (o)	Other contingent funding obligations—	
	(a) trade-related contingencies;	3%
	(b) guarantees and letters of credit unrelated to trade-related	10%

Paragraph under rule 41(1)	Type of on-balance sheet liability or off-balance sheet obligation	Outflow rate
	contingencies;	
(c)	uncommitted facilities;	0%
(d)	non-contractual contingent funding obligations arising from—	100%
	(i) debt securities or structured financial instruments, in respect of which a category 1 institution (or its associated entity) is the issuer, a market maker or a dealer, or has been involved as an originator, sponsor, marketing agent or seller;	
	(ii) money market funds or other types of collective investment	

Paragraph under rule 41(1)	Type of on-balance sheet liability or off-balance sheet obligation	Outflow rate
	funds marketed by a category 1 institution (or its associated entity); or (iii) circumstances not otherwise specified in paragraph 140 of the Basel III LCR document, where there is a reasonable expectation that the obligations will materialize within the LCR period	
(11)	For a category 1 institution's non-contractual contingent funding obligations under subrule (1)(o), if—	
(a)	the obligations relate to potential liquidity drawn by either of the following that is not consolidated for the purposes of rule 11(1)—	
(i)	a joint venture;	
(ii)	an entity in which the institution has a minority interest; and	
(b)	there is a reasonable expectation that the institution will be the main provider of liquidity should the joint venture or entity concerned be in need of liquidity,	

- the institution must comply with subrule (12).
- (12) For subrule (11), the institution must—
- (a) notify the Monetary Authority of the existence of the contingent funding obligations and the circumstances giving rise to the obligations; and
- (b) agree with the Monetary Authority the methodology for determining the expected cash outflow arising from the obligations on a case-by-case basis.
- (13) If the Monetary Authority is satisfied that—
- (a) the outflow rate of 10% specified in Table 3 in respect of less stable retail deposits is not adequate to cover the liquidity risks associated with all or part of the deposits held by a category 1 institution; and
- (b) it is prudent and reasonable to increase the outflow rate to a level above 10% applicable to the institution for the deposits concerned,
- the Monetary Authority may exercise the power under section 97K of the Ordinance.
- (14) Subrule (13) does not operate to limit the circumstances in respect of which the Monetary Authority may exercise the power under section 97K of the Ordinance in the case of a category 1 institution to which that subrule applies.
- 42. Calculation of total expected cash inflows**
- (1) A category 1 institution must, in calculating its total expected cash inflows under rule 40(1)(b)—
- (a) include only contractual cash inflows (including any accrued interest) that—
- (i) are expected to be received within the LCR period; and

- (ii) arise from assets (whether on-balance sheet assets or off-balance sheet assets) that are fully performing and in respect of which the institution has no reason to expect a default within the LCR period;
 - (b) assume that those inflows are received by the institution at the latest possible date based on contractual rights available to its customers; and
 - (c) not include any cash inflows that are contingent in nature.
- (2) A category 1 institution must, for the purposes of rule 40(1)(b), calculate its expected cash inflow within the LCR period arising from the following types of asset (whether an on-balance sheet asset or off-balance sheet asset), transaction or activity of the institution—
- (a) secured lending transactions (including securities swap transactions);
 - (b) secured or unsecured loans (other than those that fall within paragraph (a));
 - (c) release of balances maintained by the institution in segregated accounts in accordance with requirements for the protection of customer assets;
 - (d) maturing securities not included by the institution in its HQLA;
 - (e) undrawn facilities granted to the institution by another financial institution;
 - (f) operational deposits placed by the institution at other financial institutions;
 - (g) contractual net cash inflows arising from derivative contracts; and

- (h) other contractual cash inflows arising from assets, transactions or activities not otherwise covered in this subrule.
- (3) A category 1 institution must, for the purposes of rule 40(1)(b), calculate, by using the standard calculation methodology templates specified by the Monetary Authority, its total expected cash inflows by multiplying together—
- (a) the principal amount of each of its assets (whether on-balance sheet assets or off-balance sheet assets) of the types listed in subrule (2); and
 - (b) an inflow rate determined in accordance with subrule (4).
- (4) Subject to subrules (5) and (6), the inflow rate (and the manner of its application) for each type of asset listed in subrule (2) must be consistent with, and no less stringent than, the relevant inflow rate (or any other term having a similar denotation) referred to in paragraphs 142 to 160 of the Basel III LCR document.
- (5) For those types of contractual cash inflows under subrule (2)(h), if the applicable inflow rate is to be determined by the relevant banking supervisory authority in a country and therefore is not specified in the Basel III LCR document, a category 1 institution must apply the inflow rates specified in Table 4 to those types of cash inflows.

Table 4

**Inflow Rates for Calculation of Expected Cash Inflow
 Applicable to Other Contractual Cash Inflows under Rule
 42(2)(h)**

Type of other contractual cash inflow	Inflow rate
Other contractual cash inflow to be received from—	
(a) any of the following—	100%
(i) the Monetary Authority for the account of the Exchange Fund;	
(ii) central banks;	
(iii) financial institutions;	
(b) retail customers or small business customers;	50%
(c) sovereigns, public sector entities, multilateral development banks, wholesale customers (excluding small business customers), or any other persons not falling within paragraph (a) or (b)	50%
(6) A category 1 institution must have in place and maintain—	
(a) adequate policies and limits to ensure that its liquidity position is not unduly reliant on the receipt of expected cash inflows from a limited number of wholesale customers; and	
(b) adequate policies and systems for managing assets received as collateral from its counterparties under secured lending transactions so that it is able to fulfil any	

contractual obligation under those transactions to return one or more of those assets to the counterparty concerned whenever the counterparty decides not to renew the secured lending transaction concerned on its maturity.

Part 8

Calculation of LMR

Division 1—General

43. Interpretation of Part 8

In this Part—

average LMR (平均 LMR), in relation to a category 2 institution, means the average of the institution's LMR in a calendar month, as determined in accordance with rule 48;

fully performing (一直依期清償), in relation to a loan extended by a category 2 institution, means—

- (a) that—
 - (i) if the loan is repayable by periodic instalments at intervals of not more than one month, there is no instalment that is in arrears for more than one month on the working day when the LMR is calculated; or
 - (ii) in any other case, there are no arrears of principal or interest payment in respect of the loan; and
- (b) that the loan (*relevant loan*) is not a loan that has been raised to repay another loan granted to the same customer by the institution, or in respect of which the repayment date or dates has or have been postponed, unless—
 - (i) the raising of the relevant loan or the postponement of the repayment date or dates, as the case may be, was not caused by a deterioration in the financial position of the customer or by the customer's

inability to repay on the original repayment date or dates; and

- (ii) the new or revised repayment terms are not unfavourable to the institution as compared to the terms of other loans, of a similar nature to that of the relevant loan, granted by the institution to other customers and negotiated at arm's length;

net due from banks (存放銀行同業淨額), in relation to a category 2 institution, means the amount, if any, by which the total one-month liabilities of the institution to other banks are exceeded by the total one-month liabilities of other banks to the institution;

one-month liability (一個月債務), in relation to a category 2 institution or its customer, means—

- (a) any liability, other than a contingent liability, the effect of which will or could be to reduce within 1 month the liquefiable assets of the institution or its customer; and
- (b) any contingent liability that, in the opinion of the Monetary Authority, may result in a reduction within 1 month of the liquefiable assets of the institution or its customer.

44. Assets, etc., must not be double counted in calculation of LMR

- (1) A category 2 institution must not, in the calculation of its LMR, double count an asset, liability, off-balance sheet item, or associated cash flow, that is included in that calculation.
- (2) Without limiting subrule (1), a category 2 institution must not, in the calculation of its LMR, deduct from its qualifying liabilities any cash inflow associated with an asset included in its liquefiable assets for the purposes of that calculation.

45. Calculation of LMR on Hong Kong office basis

A category 2 institution must, in the calculation of its LMR on a Hong Kong office basis, determine—

- (a) its liquefiable assets held in its Hong Kong office; and
- (b) the qualifying liabilities (after deductions) of its Hong Kong office,

as if its Hong Kong office were a single legal entity.

46. Calculation of LMR on unconsolidated basis

A category 2 institution incorporated in Hong Kong must, in the calculation of its LMR on an unconsolidated basis—

- (a) determine the aggregate of its liquefiable assets held in its Hong Kong office and its overseas branches;
- (b) determine the aggregate of the qualifying liabilities (after deductions) of its Hong Kong office and its overseas branches; and
- (c) ensure that all inter-branch balances with, and transactions between, its Hong Kong office and its overseas branches are offset in that calculation.

47. Calculation of LMR on consolidated basis

(1) A category 2 institution incorporated in Hong Kong must, in the calculation of its LMR on a consolidated basis—

- (a) determine the aggregate of its liquefiable assets held by the members of its consolidated group;
- (b) determine the aggregate of the qualifying liabilities (after deductions) of the members of its consolidated group; and

- (c) ensure that all inter-branch or inter-company balances with, and transactions between, the members of its consolidated group are offset in that calculation.
- (2) A category 2 institution must comply with subrule (1) as if the members of its consolidated group were a single legal entity.

Division 2—Calculation of Average LMR, Liquefiable Assets, Qualifying Liabilities, etc.

48. Calculation of average LMR in each calendar month

- (1) Subject to subrule (2), a category 2 institution must, for the purposes of rule 7, calculate, for each calendar month, its average LMR on the basis of the sum of the net weighted amounts of its liquefiable assets, as determined in accordance with subrule (3), and the sum of the net weighted amounts of its qualifying liabilities (after deductions), as determined in accordance with subrule (4), for each working day of that month.
- (2) The Monetary Authority may, by notice in writing to a category 2 institution, permit the institution to calculate its average LMR by reference to such days during the month as the Monetary Authority specifies in the notice (and, if any such specified day is a public holiday, the immediately preceding working day must be taken to be that specified day for the purposes of that calculation).
- (3) The net weighted amount of liquefiable assets of a category 2 institution is the total of the weighted amounts calculated in accordance with subrules (6) and (7)(a) of each liquefiable asset item specified in Table A in section 2 of Schedule 5 held by the institution that satisfies the requirements of rule 49 applicable to the item, after deducting from that total the

- weighted amount calculated in accordance with subrule (6) of the deductible item specified in Table B in that section.
- (4) The net weighted amount of qualifying liabilities (after deductions) of a category 2 institution is the difference between—
- the total of the weighted amounts calculated in accordance with subrule (6) of each qualifying liability item specified in Table C in section 2 of Schedule 5; and
 - subject to subrule (5), the total of the weighted amounts calculated in accordance with subrules (6) and (7)(b) of each deductible item specified in Table D in that section.
- (5) A category 2 institution's total weighted amount calculated under subrule (4)(b) must not be more than 75% of the institution's total weighted amount calculated under subrule (4)(a).
- (6) Subject to subrule (7), the weighted amount of each item specified in Table A, B, C or D in section 2 of Schedule 5 must be calculated by multiplying together—
- the principal amount of the item; and
 - the liquidity conversion factor specified in Table A, B, C or D in that section in relation to the item.
- (7) If a category 2 institution has any net due from banks—
- the weighted amount of the institution's net due from banks to be included in its liquefiable assets (under item 4 in Table A in section 2 of Schedule 5) in accordance with subrule (3) must not exceed 40% of the total weighted amount of its qualifying liabilities as referred to in subrule (4)(a) (*40% cap*); and
 - the weighted amount of the institution's net due from banks exceeding the 40% cap, if any, must be included as a deductible item (under item 3 in Table D in that

section) as referred to in subrule (4)(b) for the purpose of calculating its qualifying liabilities (after deductions).

- (8) In this rule—

principal amount (本金額)—

- in relation to an item that is gold bullion or a marketable debt security or prescribed instrument specified in Table A in section 2 of Schedule 5, means the fair value of the item determined in accordance with rule 9 at the close of business on a working day; or
- in relation to any other item specified in Table A, B, C or D in that section, means the book value (including any accrued interest) of that item at the close of business on a working day.

49. Requirements that must be satisfied before asset can be included in liquefiable assets for purposes of calculation of LMR

- Subject to rules 51 and 52, a category 2 institution must not, in the calculation of its LMR, include an asset in its liquefiable assets unless the asset falls within a class of assets specified in Table A in section 2 of Schedule 5 and meets the other qualifying criteria specified in subrule (2).
- The other qualifying criteria referred to in subrule (1) are—
 - the asset must be readily monetizable;
 - the asset must not be overdue or in default;
 - the asset must be free from encumbrances and there must be no regulatory, legal, contractual or other restrictions that inhibit the category 2 institution from liquidating, selling, transferring or assigning the asset;

- (d) the value of the asset must be readily identifiable and measurable;
 - (e) subject to subrule (3), the asset must be freely transferable and available to the category 2 institution and must not be subject to any liquidity transfer restriction;
 - (f) the asset must not be a subordinated debt security;
 - (g) if the asset is a structured financial instrument, the structure of the instrument must be simple and standardized; and
 - (h) the asset must be denominated in Hong Kong dollars or in a currency freely convertible into Hong Kong dollars.
- (3) If one or more assets held by a member of a category 2 institution's consolidated group are subject to liquidity transfer restriction, such assets must not be included in the institution's liquefiable assets for the calculation of its LMR—
- (a) except to the extent that the qualifying liabilities (after deductions) of the member are also included in the calculation; and
 - (b) unless the assets so included satisfy all other relevant requirements in subrules (1) and (2).
- (4) The Monetary Authority may, by notice in writing to a category 2 institution that has made an application to the Monetary Authority for the grant of an approval referred to in item 6(f) of Table A in section 2 of Schedule 5, determine the application by—
- (a) granting approval to the institution, with effect from the date, or the occurrence of an event, specified in the notice, to include the RMBS, other debt security or prescribed instrument specified in the notice in its

- liquefiable assets if the institution demonstrates to the satisfaction of the Monetary Authority that—
- (i) that RMBS, other debt security or prescribed instrument meets the criteria specified in subrule (2) applicable to it; and
 - (ii) the inclusion of that RMBS, other debt security or prescribed instrument as a liquefiable asset would not prejudice the institution's calculation of the LMR, having regard to the risks associated with holding that RMBS, other debt security or prescribed instrument; or
- (b) if the Monetary Authority is not satisfied as referred to in paragraph (a), refusing to grant the approval and specifying in the notice the reasons why the Monetary Authority is not so satisfied.
- (5) If the Monetary Authority grants an approval under subrule (4)(a) to a category 2 institution, the approval may be granted subject to any conditions that the Monetary Authority thinks proper to attach to the approval in any particular case.
- (6) Without limiting subrule (5), the Monetary Authority may at any time, by notice in writing to a category 2 institution in respect of which the Monetary Authority has granted an approval under subrule (4)(a), do either or both of the following as the Monetary Authority thinks proper—
- (a) attach to the approval any conditions (including those for amending the conditions already attached to the approval);
 - (b) cancel any conditions attached to the approval.
- (7) For subrule (6), the conditions or cancellation takes effect—
- (a) on the date specified in the notice; or
 - (b) when the event specified in the notice occurs.

50. Management of liquefiable assets and related risks by category 2 institution

- (1) A category 2 institution must have in place and maintain adequate systems and procedures for the on-going assessment and management of its liquefiable assets in order to ensure that—
 - (a) each asset included in the liquefiable assets satisfies all the requirements of this Part that are applicable to its inclusion in the liquefiable assets;
 - (b) an asset included in the liquefiable assets which ceases to satisfy any requirement of this Part applicable to its inclusion in the liquefiable assets is identified as soon as is practicable; and
 - (c) prompt action is taken to exclude from the liquefiable assets an asset identified as referred to in paragraph (b).
- (2) A category 2 institution must have in place and maintain adequate systems and procedures to monitor and control the risks, including but not limited to liquidity risk, associated with its holdings in liquefiable assets.

51. General exclusion of assets from liquefiable assets, etc.

- (1) The Monetary Authority may, by notice in writing to all category 2 institutions, specify that a category 2 institution must not include in its liquefiable assets, with effect from the date, or the occurrence of an event, specified in the notice, an asset, or a class of assets, of the type specified in the notice, on the ground that the Monetary Authority is satisfied that that type of asset or class of assets—
 - (a) is not capable of generating liquidity for the institution within 1 month; or

- (b) is not, or is no longer, sufficiently liquid in private markets or readily monetizable by other means to be included in any category 2 institution's liquefiable assets.
- (2) Every category 2 institution must comply with the requirements of a notice given to it under subrule (1).

52. Specific exclusion of assets from liquefiable assets, etc.

- (1) The Monetary Authority may, by notice in writing to a category 2 institution, require the institution, with effect from the date, or the occurrence of an event, specified in the notice—
 - (a) to cease to include in its liquefiable assets the asset specified in the notice on the ground that the Monetary Authority is satisfied that it no longer satisfies, or has never satisfied, the requirement of these Rules as specified in the notice that is applicable to the inclusion of that asset in its liquefiable assets; or
 - (b) without limiting rule 50, to make the changes specified in the notice to its liquefiable assets on the ground that the Monetary Authority is satisfied that those changes are necessary in order to mitigate the liquidity risk associated with the institution's failure, specified in the notice, to comply with that rule.
- (2) A category 2 institution must comply with the requirements of a notice given to it under subrule (1).

53. Calculation of net weighted amount of qualifying liabilities (after deductions)

- (1) Subject to subrules (2) and (3), a category 2 institution may exclude a pledged deposit from the calculation of its LMR if—

- (a) the deposit is pledged as collateral against a loan that will not be settled within 1 month;
 - (b) the pledge arrangement concerned is subject to a legally enforceable contract that effectively disallows withdrawal of the deposit before the loan is fully settled;
 - (c) the deposit would otherwise be included in the calculation of qualifying liabilities under rule 48; and
 - (d) the amount of deposit to be excluded from the calculation does not exceed the outstanding balance of the loan.
- (2) A category 2 institution must not, in calculating its net weighted amount of qualifying liabilities under the LMR, deduct a cash inflow from its qualifying liabilities unless the cash inflow—
- (a) is expected to be received within 1 month; and
 - (b) arises from assets (whether on-balance sheet assets or off-balance sheet assets) that are fully performing and in respect of which the institution has no reason to expect a default within 1 month.
- (3) For the purposes of subrule (2), a category 2 institution must—
- (a) assume that a cash inflow is received by the institution at the latest possible date based on contractual rights available to its customers; and
 - (b) not include any cash inflow that is contingent in nature.

Schedule 1

[rr. 3 & 15]

**Grounds for Designating Authorized Institution as
Category 1 Institution and Exceptions to those Grounds**

Part 1

**Grounds for Designating Authorized Institution as
Category 1 Institution (whether on Monetary
Authority's Own Volition or on Institution's
Application)**

1. The authorized institution is internationally active.
2. The authorized institution is significant to the general stability and effective working of the banking system in Hong Kong.
3. The liquidity risk associated with the authorized institution is material.
4. The authorized institution (*first-mentioned institution*) is so connected to another authorized institution (being a category 1 institution) (*second-mentioned institution*) that, if the first-mentioned institution were not to be designated as a category 1 institution, such connection would prejudice, or may potentially prejudice—
 - (a) the calculation of the LCR under Part 7 of these Rules by the second-mentioned institution;
 - (b) the calculation of the LMR under Part 8 of these Rules by the first-mentioned institution; or

- (c) the calculation mentioned in both paragraphs (a) and (b).

Part 2

Grounds for Designating Authorized Institution as Category 1 Institution (on Institution's Application)

1. The authorized institution's particular circumstances provide reasonable justification for it to be designated as a category 1 institution.
2. The authorized institution has the capacity (including systems and resources) to comply with all the provisions of these Rules that apply to category 1 institutions.

Part 3

Circumstances in which Monetary Authority may Decide Not to Designate Authorized Institution as Category 1 Institution

1. For an authorized institution incorporated in or outside Hong Kong, the Monetary Authority is satisfied that—
 - (a) the institution's particular circumstances provide reasonable justification for it not to be designated as a category 1 institution; and
 - (b) it would not materially prejudice the institution's calculation of its LMR under Part 8 of these Rules if it were not designated as a category 1 institution.
2. For an authorized institution incorporated outside Hong Kong, the Monetary Authority is satisfied that—

- (a) the institution is adequately supervised in respect of liquidity risk by the relevant banking supervisory authority of the place of its incorporation; and
 - (b) the institution complies with the liquidity requirements in the place of its incorporation that are comparable to the provisions of these Rules that apply to category 1 institutions.
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Schedule 2 [rr. 2, 17, 25 & 35]

Classes of Assets which may be Included in HQLA for Calculating LCR and Qualifying Criteria Applicable to those Classes

Part 1

Interpretation of Schedule 2

1. Interpretation of Schedule 2

In this Schedule—

associated entity (聯繫實體), in relation to a financial institution, is to be construed in accordance with section 97H(4) of the Ordinance as if the references to an authorized institution were the references to a financial institution;

covered bond (資產覆蓋債券) has the meaning given by rule 17;

credit risk (信用風險) has the meaning given by section 2(1) of the Capital Rules;

haircut (扣減) has the meaning given by rule 17;

IRB approach (IRB 計算法) has the meaning given by section 2(1) of the Capital Rules;

local currency (本地貨幣) has the meaning given by section 2(1) of the Capital Rules;

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

standardized (credit risk) approach (標準(信用風險)計算法) has the meaning given by section 2(1) of the Capital Rules;

withdrawable central bank reserves (可提取央行儲備) has the meaning given by rule 17.

Part 2

Classes of Assets which may be Included in HQLA for Calculating LCR

1. Level 1 assets

The following assets are level 1 assets for the purposes of these Rules—

- (a) currency notes and coins;
- (b) withdrawable central bank reserves;
- (c) subject to section 1 of Part 3 of this Schedule, marketable debt securities that are issued or guaranteed by a sovereign, central bank, public sector entity, relevant international organization or multilateral development bank, or that are EF debt securities;
- (d) subject to section 2 of Part 3 of this Schedule, marketable debt securities that are issued by the sovereign or central bank of a country and denominated in the local currency of that country, or that are EF debt securities, and which, under the standardized (credit risk) approach—
 - (i) do not qualify for 0% risk-weight under section 55(2) of the Capital Rules; or
 - (ii) qualify for 0% risk-weight only by virtue of section 56(1) or (2) of the Capital Rules; and
- (e) subject to section 3 of Part 3 of this Schedule, marketable debt securities that are issued by the sovereign or central bank of a country and denominated

in a currency that is not the local currency of that country and which do not, under the standardized (credit risk) approach, qualify for 0% risk-weight under section 55(2) of the Capital Rules.

2. Level 2A assets

The following assets are level 2A assets for the purposes of these Rules—

- (a) subject to section 4 of Part 3 of this Schedule, marketable debt securities that are issued or guaranteed by a sovereign, central bank or public sector entity;
- (b) subject to section 5 of Part 3 of this Schedule, marketable debt securities issued by corporates; and
- (c) subject to section 6 of Part 3 of this Schedule, covered bonds.

3. Level 2B assets

The following assets are level 2B assets for the purposes of these Rules—

- (a) subject to section 7 of Part 3 of this Schedule, marketable debt securities issued by corporates; and
- (b) subject to sections 8 and 9 of Part 3 of this Schedule, RMBS.

Part 3

Qualifying Criteria Applicable to Classes of Assets which may be Included in HQLA for Calculating LCR

1. Qualifying criteria—marketable debt securities (level 1 assets) under section 1(c) of Part 2 of this Schedule

- (1) A marketable debt security does not fall within section 1(c) of Part 2 of this Schedule unless—
 - (a) it qualifies, in the calculation of credit risk under the standardized (credit risk) approach, for 0% risk-weight—
 - (i) subject to subsections (2) and (3), under section 55(2) of the Capital Rules in any case where the debt security is issued or guaranteed by a sovereign or central bank or is an EF debt security;
 - (ii) under section 57(2)(b) of the Capital Rules in any case where the debt security is issued or guaranteed by a public sector entity;
 - (iii) under section 56(4) of the Capital Rules in any case where the debt security is issued or guaranteed by a relevant international organization; and
 - (iv) under section 58 of the Capital Rules in any case where the debt security is issued or guaranteed by a multilateral development bank;
 - (b) it is traded in large, deep and active markets, characterized by a low level of concentration, and where debt securities of that type can be monetized through direct sale or repo-style transactions;

- (c) it has a proven record as a reliable source of liquidity in those markets, even during a period of financial stress; and
 - (d) it is not an obligation of a financial institution or an associated entity of a financial institution (except that the debt security is issued by a bank which is a public sector entity).
- (2) Section 56(2) of the Capital Rules must be disregarded for the purposes of calculating credit risk as specified in subsection (1)(a)(i).
- (3) For the purposes of subsection (1)(a)(i), an EF debt security must be treated as if it were a marketable debt security issued by a central bank.

2. Qualifying criteria—marketable debt securities (level 1 assets) under section 1(d) of Part 2 of this Schedule

- (1) A marketable debt security issued by the sovereign or central bank of a country does not fall within section 1(d) of Part 2 of this Schedule, unless the category 1 institution holding the debt security is incorporated in that country or carries on a banking business, through a branch or subsidiary, in that country.
- (2) To avoid doubt, if a marketable debt security, issued by a sovereign or central bank and with a risk-weight of 20% under the standardized (credit risk) approach, falls within both sections 1(d) and 2(a) of Part 2 of this Schedule, it may, at the discretion of the category 1 institution, be treated as falling within section 1(d) of that Part.
- (3) For the purposes of this section, an EF debt security must be treated as if it were a marketable debt security issued by a central bank.

3. Qualifying criteria—marketable debt securities (level 1 assets) under section 1(e) of Part 2 of this Schedule

- (1) A marketable debt security does not fall within section 1(e) of Part 2 of this Schedule unless—
- (a) it is issued by the sovereign or central bank of a country in which the category 1 institution holding the debt security is incorporated or carries on a banking business through a branch or subsidiary; and
 - (b) the amount of the category 1 institution's holding in the debt security that may be eligible for inclusion in the institution's HQLA does not exceed the amount of total net cash outflows in the currency of the debt security arising from the institution's banking business in the country in which the debt security is issued.
- (2) To avoid doubt, if a marketable debt security, issued by a sovereign or central bank and with a risk-weight of 20% under the standardized (credit risk) approach, falls within both sections 1(e) and 2(a) of Part 2 of this Schedule, it may, at the discretion of the category 1 institution, be treated as falling within section 1(e) of that Part.

4. Qualifying criteria—marketable debt securities (level 2A assets) under section 2(a) of Part 2 of this Schedule

- (1) A marketable debt security does not fall within section 2(a) of Part 2 of this Schedule unless—
- (a) it qualifies, in the calculation of credit risk under the standardized (credit risk) approach, for 20% risk-weight—
 - (i) subject to subsections (2) and (3), under section 55(2) of the Capital Rules in any case where the debt security is issued or guaranteed by a sovereign or central bank; and

- (ii) under section 57 of the Capital Rules in any case where the debt security is issued or guaranteed by a public sector entity;
 - (b) it is traded in large, deep and active markets, characterized by a low level of concentration, and where debt securities of that type can be monetized through direct sale or repo-style transactions;
 - (c) subject to subsection (3), it has a proven record as a reliable source of liquidity in those markets, even during a period of financial stress; and
 - (d) it is not an obligation of a financial institution or an associated entity of a financial institution (except that the debt security is issued by a bank which is a public sector entity).
- (2) Section 56(2) of the Capital Rules must be disregarded for the purposes of calculating credit risk as specified in subsection (1)(a)(i).
- (3) A marketable debt security, for meeting the criterion specified in subsection (1)(c), must not have experienced a decline of more than 10% of its market price, or (if it is used as collateral in a repo-style transaction) an increase in haircut of more than 10 percentage points, within—
- (a) any period of 30 calendar days during a relevant period of significant liquidity stress since the debt security was issued; or
 - (b) (if no such relevant period of significant liquidity stress is applicable to the debt security) any period of 30 calendar days since the debt security was issued.

- 5. Qualifying criteria—marketable debt securities (level 2A assets) under section 2(b) of Part 2 of this Schedule**
- (1) A marketable debt security does not fall within section 2(b) of Part 2 of this Schedule unless—
- (a) subject to subsection (2), if the debt security is issued by a corporate incorporated outside India, it has an ECAI issue specific rating that, if mapped to the scale of credit quality grades in Part 1 of Table C (for a long-term ECAI issue specific rating) or Part 1 of Table E (for a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security being assigned a credit quality grade of 1;
 - (b) subject to subsection (2), if the debt security is issued by a corporate incorporated in India, it has an ECAI issue specific rating that, if mapped to the scale of credit quality grades in Table C (for a long-term ECAI issue specific rating) or Table E (for short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security being assigned a credit quality grade of 1;
 - (c) if the debt security does not have an ECAI issue specific rating and the category 1 institution holding the debt security has the Monetary Authority's approval to use the IRB approach under section 8 of the Capital Rules (or, if the institution is incorporated outside Hong Kong, it has the approval of the relevant banking supervisory authority to use an internal ratings-based approach that reflects the standards issued by the Basel Committee for calculation of its regulatory capital for credit risk), it is internally rated by the institution as having a probability of default corresponding to the credit quality grade required under paragraph (a) or (b);

- (d) it is traded in large, deep and active markets, characterized by a low level of concentration, and where debt securities of that type can be monetized through direct sale or repo-style transactions;
 - (e) subject to subsection (3), it has a proven record as a reliable source of liquidity in those markets, even during a period of financial stress;
 - (f) it is not issued by a financial institution or any of its associated entities; and
 - (g) it is not a structured financial instrument or subordinated debt security.
- (2) If a marketable debt security has more than one ECAI issue specific rating, the category 1 institution holding the debt security must, for the purposes of subsection (1)(a) and (b), apply section 69(2) of the Capital Rules to determine the ECAI issue specific rating of the debt security.
- (3) A marketable debt security, for meeting the criterion specified in subsection (1)(e), must not have experienced a decline of more than 10% of its market price, or (if it is used as collateral in a repo-style transaction) an increase in haircut of more than 10 percentage points, within—
- (a) any period of 30 calendar days during a relevant period of significant liquidity stress since the debt security was issued; or
 - (b) (if no such relevant period of significant liquidity stress is applicable to the debt security) any period of 30 calendar days since the debt security was issued.

- 6. Qualifying criteria—covered bonds (level 2A assets) under section 2(c) of Part 2 of this Schedule**
- (1) A covered bond does not fall within section 2(c) of Part 2 of this Schedule unless—
- (a) it is issued by a person other than the category 1 institution holding the covered bond or any of the institution’s associated entities;
 - (b) subject to subsection (2), it has an ECAI issue specific rating that, if mapped to the scale of credit quality grades in Table B (for a long-term ECAI issue specific rating) or Part 1 of Table E (for a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the covered bond being assigned a credit quality grade of 1;
 - (c) if the covered bond does not have an ECAI issue specific rating and the category 1 institution holding the covered bond has the Monetary Authority’s approval to use the IRB approach under section 8 of the Capital Rules (or, if the institution is incorporated outside Hong Kong, it has the approval of the relevant banking supervisory authority to use an internal ratings-based approach that reflects the standards issued by the Basel Committee for calculation of its regulatory capital for credit risk), it is internally rated by the institution as having a probability of default corresponding to the credit quality grade required under paragraph (b);
 - (d) it is traded in large, deep and active markets, characterized by a low level of concentration, and where covered bonds of that type can be monetized through direct sale or repo-style transactions; and

- (e) subject to subsection (3), it has a proven record as a reliable source of liquidity in those markets, even during a period of financial stress.
- (2) If a covered bond has more than one ECAI issue specific rating, the category 1 institution holding the covered bond must, for the purposes of subsection (1)(b), apply section 69(2) of the Capital Rules to determine the ECAI issue specific rating of the covered bond.
- (3) A covered bond, for meeting the criterion specified in subsection (1)(e), must not have experienced a decline of more than 10% of its market price, or (if it is used as collateral in a repo-style transaction) an increase in haircut of more than 10 percentage points, within—
 - (a) any period of 30 calendar days during a relevant period of significant liquidity stress since the covered bond was issued; or
 - (b) (if no such relevant period of significant liquidity stress is applicable to the covered bond) any period of 30 calendar days since the covered bond was issued.

7. Qualifying criteria—marketable debt securities (level 2B assets) under section 3(a) of Part 2 of this Schedule

- (1) A marketable debt security does not fall within section 3(a) of Part 2 of this Schedule unless—
 - (a) subject to subsection (2), if the debt security is issued by a corporate incorporated outside India, it has an ECAI issue specific rating that, if mapped to the scale of credit quality grades in Part 1 of Table C (for a long-term ECAI issue specific rating) or Part 1 of Table E (for a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security being assigned a credit quality grade of 2;

- (b) subject to subsection (2), if the debt security is issued by a corporate incorporated in India, it has an ECAI issue specific rating that—
 - (i) if mapped to the scale of credit quality grades in Part 1 of Table C (for a long-term ECAI issue specific rating) or Part 1 of Table E (for a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security being assigned a credit quality grade of 2; and
 - (ii) if mapped to the scale of credit quality grades in Part 2 of Table C (for a long-term ECAI issue specific rating) or Part 2 of Table E (for a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security being assigned a credit quality grade of 2 or 3;
- (c) if the debt security does not have an ECAI issue specific rating and the category 1 institution holding the debt security has the Monetary Authority's approval to use the IRB approach under section 8 of the Capital Rules (or, if the institution is incorporated outside Hong Kong, it has the approval of the relevant banking supervisory authority to use an internal ratings-based approach that reflects the standards issued by the Basel Committee for calculation of its regulatory capital for credit risk), it is internally rated by the institution as having a probability of default corresponding to the credit quality grade required under paragraph (a) or (b);
- (d) it is traded in large, deep and active markets, characterized by a low level of concentration, and where debt securities of that type can be monetized through direct sale or repo-style transactions;

- (e) subject to subsection (3), it has a proven record as a reliable source of liquidity in those markets, even during a period of financial stress;
 - (f) it is not issued by a financial institution or any of its associated entities; and
 - (g) it is not a structured financial instrument or subordinated debt security.
- (2) If a marketable debt security has more than one ECAI issue specific rating, the category 1 institution holding the debt security must, for the purposes of subsection (1)(a) and (b), apply section 69(2) of the Capital Rules to determine the ECAI issue specific rating of the debt security.
- (3) A marketable debt security, for meeting the criterion specified in subsection (1)(e), must not have experienced a decline of more than 20% of its market price, or (if it is used as collateral in a repo-style transaction) an increase in haircut of more than 20 percentage points, within—
- (a) any period of 30 calendar days during a relevant period of significant liquidity stress since the debt security was issued; or
 - (b) (if no such relevant period of significant liquidity stress is applicable to the debt security) any period of 30 calendar days since the debt security was issued.

8. Qualifying criteria—RMBS (level 2B assets) under section 3(b) of Part 2 of this Schedule

- (1) An RMBS does not fall within section 3(b) of Part 2 of this Schedule unless—
- (a) it has the approval of the Monetary Authority under section 9 of this Part;

- (b) it is issued, and its underlying assets are originated, by a person other than the category 1 institution holding the RMBS or any of the institution's associated entities;
- (c) subject to subsection (2), if the RMBS is issued by a public sector entity, financial institution or corporate incorporated outside India, it has a long-term ECAI issue specific rating that, if mapped to the scale of credit quality grades in Table B or Part 1 of Table C, as the case requires, in Schedule 6 to the Capital Rules, would result in the RMBS being assigned a credit quality grade of 1;
- (d) subject to paragraph (e) and subsection (2), if the RMBS is issued by a public sector entity, financial institution or corporate incorporated in India, it has a long-term ECAI issue specific rating that, if mapped to the scale of credit quality grades in Table B or Table C, as the case requires, in Schedule 6 to the Capital Rules, would result in the RMBS being assigned a credit quality grade of 1;
- (e) it does not have any of the following ECAI issue specific ratings in the case of Table B or Part 1 of Table C, as the case requires, in Schedule 6 to the Capital Rules—
 - (i) Standard & Poor's Ratings Services AA-;
 - (ii) Moody's Investors Service Aa3;
 - (iii) Fitch Ratings AA-;
 - (iv) Rating and Investment Information, Inc. AA-;
 - (v) Japan Credit Rating Agency, Ltd. AA-;
- (f) it is traded in large, deep and active markets, characterized by a low level of concentration, and where RMBS of that type can be monetized through direct sale or repo-style transactions;

- (g) subject to subsection (3), it has a proven record as a reliable source of liquidity in those markets, even during a period of financial stress;
 - (h) it is backed by a pool of residential mortgage loans that have full recourse to the mortgagor and the weighted average loan-to-value ratio of which does not exceed 80% at the time when the RMBS is issued; and
 - (i) it is subject to regulations which require issuers of the RMBS to retain an interest in the RMBS.
- (2) If an RMBS has more than one ECAI issue specific rating, the category 1 institution holding the RMBS must, for the purposes of subsection (1)(c) and (d), apply section 69(2) of the Capital Rules to determine the ECAI issue specific rating of the RMBS.
- (3) An RMBS, for meeting the criterion specified in subsection (1)(g), must not have experienced a decline of more than 20% of its market price, or (if it is used as collateral in a repo-style transaction) an increase in haircut of more than 20 percentage points, within—
- (a) any period of 30 calendar days during a relevant period of significant liquidity stress since the RMBS was issued; or
 - (b) (if no such relevant period of significant liquidity stress is applicable to the RMBS) any period of 30 calendar days since the RMBS was issued.
- (4) To avoid doubt, the underlying assets of the RMBS must not contain any structured financial instrument.

- 9. Category 1 institution requires Monetary Authority's approval to include RMBS in its HQLA**
- (1) The Monetary Authority may, by notice in writing to a category 1 institution that has made an application to the Monetary Authority for the grant of an approval under this subsection, determine the application by—
- (a) granting approval to the institution, with effect from the date, or the occurrence of an event, specified in the notice, to include the RMBS specified in the notice in its HQLA if the institution demonstrates to the satisfaction of the Monetary Authority that—
 - (i) that RMBS satisfies the requirements of section 8 of this Part applicable to it; and
 - (ii) the institution has in place and maintains adequate systems and measures to monitor and control the risks associated with holding that RMBS; or
 - (b) if the Monetary Authority is not satisfied as referred to in paragraph (a), refusing to grant the approval and specifying in the notice the reasons why the Monetary Authority is not so satisfied.
- (2) If the Monetary Authority grants an approval under subsection (1)(a) to a category 1 institution, the approval may be granted subject to any conditions that the Monetary Authority thinks proper to attach to the approval in any particular case.
- (3) Without limiting subsection (2), the Monetary Authority may at any time, by notice in writing to a category 1 institution in respect of which the Monetary Authority has granted an approval under subsection (1)(a), do either or both of the following as the Monetary Authority thinks proper—

- (a) attach to the approval any conditions (including those for amending the conditions already attached to the approval);
 - (b) cancel any conditions attached to the approval.
 - (4) For subsection (3), the conditions or cancellation takes effect—
 - (a) on the date specified in the notice; or
 - (b) when the event specified in the notice occurs.
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Schedule 3

[r. 25]

**Characteristic Requirements that Asset must Satisfy
before it can be Included in HQLA for Purposes of
Calculation of LCR**

1. Interpretation of Schedule 3

In this Schedule—

current market price (現行市場價格) means the current market price as determined in accordance with rule 9 as if it were measured at fair value;

general wrong-way risk (一般錯向風險) is to be construed in accordance with section 226E(3)(b) of the Capital Rules;

haircut (扣減) has the meaning given by rule 17;

recognized exchange (認可交易所) has the meaning given by section 2(1) of the Capital Rules;

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

2. Principal characteristic

Subject to section 3 of this Schedule, the asset must at all times be immediately monetizable with little or no loss of value.

3. General characteristics

The asset does not fall within section 2 of this Schedule unless it has the following characteristics—

- (a) the risks (including any risk of default) that are associated with the asset are so low that they do not

- prejudice the asset's ability to be monetizable as specified in section 2 of this Schedule;
- (b) the value of the asset is readily identifiable and measurable, and can be readily agreed on by the parties to a transaction involving the asset, by reference to—
 - (i) the asset's book value;
 - (ii) the asset's current market price; or
 - (iii) a simple valuation method or pricing formula based on publicly available market data;
 - (c) if the asset is a structured financial instrument, the structure of the instrument is simple and standardized;
 - (d) the asset does not—
 - (i) have a strong correlation with another asset that has a material risk; and
 - (ii) significantly expose the holder of the asset to specific wrong-way risk or general wrong-way risk;
 - (e) if the asset is traded in a secondary market—
 - (i) the market is active and sizable having regard to—
 - (A) the diversity and large number of participants in the market;
 - (B) the presence of committed market makers; and
 - (C) the high volumes and low pricing spreads traded in the market;
 - (ii) the asset is able to be readily monetized without a substantial discount or haircut to its market price; and

- (iii) the historical volatility associated with the trading prices and spreads of the asset are low;
 - (f) if the asset is listed on an exchange, the exchange is a recognized exchange; and
 - (g) the asset is denominated in Hong Kong dollars or in a currency freely convertible into Hong Kong dollars.
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Schedule 4

[rr. 25 & 26]

Operational Requirements that Category 1 Institution and Asset must Satisfy before Asset can be Included in HQLA for Purposes of Calculation of LCR

1. Interpretation of Schedule 4

In this Schedule—

approved RMBS (經批准 RMBS) has the meaning given by rule 17;

credit enhancement (信用提升) has the meaning given by section 227(1) of the Capital Rules;

derivative contract (衍生工具合約) has the meaning given by rule 39;

market risk (市場風險) has the meaning given by section 2(1) of the Capital Rules;

securities financing transaction (證券融資交易) has the meaning given by rule 17.

2. Operational requirements

- (1) The category 1 institution must have in place and maintain adequate operational capacity and systems to readily monetize any asset in its HQLA without being constrained by its internal business or risk management strategy.
- (2) The category 1 institution's HQLA must be—
 - (a) managed by a liquidity management function designated by the institution for the purpose (*designated function*) which has the continuous authority and legal and

operational capability to monetize any asset included in the institution's HQLA; and

- (b) subject to subsection (3), maintained in a separate pool of assets under the control of the designated function with the sole intent of being used as a source of contingency funding.
- (3) The category 1 institution does not need to satisfy subsection (2)(b) if it demonstrates to the satisfaction of the Monetary Authority that—
 - (a) the designated function can monetize any asset in the institution's HQLA at any time within a period of financial stress that lasts for 30 calendar days; and
 - (b) the proceeds of monetizing any asset in the institution's HQLA are available to the designated function throughout a period of financial stress that lasts for 30 calendar days without direct conflict with the institution's internal business or risk management strategy.
- (4) The category 1 institution periodically monetizes a representative portion of its HQLA to test or verify its ability to access relevant markets for monetizing assets included in its HQLA in case of need.
- (5) Subject to section 3(2) of this Schedule, each asset in the category 1 institution's HQLA is free from encumbrances and, in particular, there must be no regulatory, legal, contractual or other restrictions that inhibit the institution from liquidating, selling, transferring or assigning any asset in its HQLA.
- (6) The category 1 institution has in place and maintains adequate policies and monitoring systems to enable it to have full knowledge of the composition of its HQLA, at least on a daily basis, including the legal entity, location, and custodial or

other account in which the assets in its HQLA are held and the currencies in which the assets are denominated.

- (7) Subject to section 3(2)(e) of this Schedule, and rule 23(1)(a), the asset is freely transferable and available to the category 1 institution, whether between its Hong Kong office and any of its specified associated entities and overseas branches, and is not subject to any liquidity transfer restriction.
- (8) If the asset is included in the category 1 institution's HQLA and is likely to be monetized through direct sale, there are no impediments to the sale of the asset and there are no requirements to hold such assets, including, but not limited to, statutory minimum inventory requirements if the institution is a market maker for assets of that type.

3. Provisions supplementary to section 2 of this Schedule

- (1) In section 2(1) of this Schedule, the reference to the category 1 institution having operational capacity means the institution has in place and maintains adequate systems and procedures, including the designated function referred to in section 2(2)(a) of this Schedule, with access to all necessary information for monetizing an asset in its HQLA within the standard settlement period for the type of asset concerned in the country concerned.
- (2) To avoid doubt, it is declared that—
 - (a) an asset is not free from encumbrances if—
 - (i) subject to paragraph (c), the asset is pledged by the category 1 institution, either explicitly or implicitly, to secure, collateralize or provide credit enhancement to a transaction; or
 - (ii) the asset is designated by the institution to cover specific expenses;

- (b) if an asset satisfies all the other requirements of these Rules for inclusion in the institution's HQLA but is pledged to the institution in a securities financing transaction or derivative contract, the asset may only be included in the HQLA if—
 - (i) the institution has a contractual right to re-hypothecate the asset, but the asset has not been re-hypothecated and is legally and contractually available for use by the institution to obtain liquidity within the LCR period;
 - (ii) the institution has no obligation to return the asset to a third party on demand or at any time within the LCR period; and
 - (iii) the institution includes the expected cash outflow arising from the securities financing transaction or derivative contract within the LCR period in the calculation of its total expected cash outflows;
- (c) subject to paragraph (d), if an asset of the category 1 institution satisfies all the other requirements of these Rules for inclusion in the institution's HQLA but is pre-positioned or deposited with, or pledged to, the Monetary Authority for the account of the Exchange Fund, or a central bank or public sector entity, for obtaining liquidity facilities, the asset may only be included in the institution's HQLA to the extent that the institution has not utilized the asset to draw on those facilities;
- (d) if the category 1 institution has pre-positioned or deposited with, or pledged to, the Monetary Authority for the account of the Exchange Fund, or a central bank or public sector entity, a pool of assets consisting of level 1 assets, level 2A assets, level 2B assets and other

assets that do not qualify as HQLA, and no specific asset in the pool has been designated as collateral for any of the institution's liquidity facilities received from the Monetary Authority for the account of the Exchange Fund, or the central bank or public sector entity, the institution may, in determining which assets in the pool will be encumbered as it draws on the facilities, adopt the following order—

- (i) first order of encumbrance: assets that do not qualify as HQLA;
 - (ii) second order of encumbrance: level 2B assets that are not approved RMBS;
 - (iii) third order of encumbrance: approved RMBS;
 - (iv) fourth order of encumbrance: level 2A assets; and
 - (v) fifth order of encumbrance: level 1 assets;
- (e) for the purposes of section 2(7) of this Schedule, if the asset is held by the category 1 institution in a legal entity that does not have access to relevant markets for monetizing the asset, the asset is not freely transferable unless the asset can be freely transferred to the institution (or to a specified associated entity of the institution that can monetize the asset); and
- (f) for the purposes of section 2(2), (3), (4), (5), (6), (7) and (8) of this Schedule, if the category 1 institution hedges the market risk of an asset included in its HQLA, it takes into account the cash flows that may arise from the hedging arrangement (including any early closure of the hedge when the asset is sold) in the calculation of its LCR.
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Schedule 5

[rr. 48 & 49]

Liquidity Conversion Factors Applicable to Assets and Liabilities in Calculation of LMR**1. Interpretation of Schedule 5**

In this Schedule—

eligible loan repayment (合格貸款付還), in relation to the calculation by a category 2 institution of its LMR, means a repayment—

- (a) to the institution by a customer (other than the Monetary Authority for the account of the Exchange Fund, or a central bank or a bank) in respect of a loan—
 - (i) that the institution is not committed to continue, by renewal or otherwise; and
 - (ii) that is fully performing;
- (b) the date of which is fixed;
- (c) that will fall due within 1 month;
- (d) in respect of which the institution has no reason to expect a default; and
- (e) if the loan referred to in paragraph (a) is secured by a pledged deposit referred to in rule 53(1)—
 - (i) (where the loan will be fully repaid after receiving that repayment) consisting only of that part of the repayment that exceeds the aggregate of the deposit and interest payable on the deposit;
 - (ii) (where the loan will not be so fully repaid) consisting only of that repayment insofar as it is not made by a corresponding reduction of the

amount of the deposit or interest payable on the deposit, or both (but excluding any repayment in respect of residential mortgage loans referred to in item 7 of Table A in section 2 of this Schedule);

LMR period (LMR 涵蓋時期), in relation to a category 2 institution's LMR, means the period of 1 calendar month immediately following the date of the position in relation to which the LMR is calculated;

net due from banks (存放銀行同業淨額) has the meaning given by rule 43;

one-month liability (一個月債務) has the meaning given by rule 43;

qualifying ECAI issue specific rating (合資格 ECAI 特定債項評級), in relation to a marketable debt security or prescribed instrument, means—

- (a) the ECAI issue specific rating of the debt security or instrument that—
 - (i) if mapped to the scale of credit quality grades in Table A, Table B or Part 1 of Table C (in the case of a long-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security or instrument being assigned a credit quality grade of 1 or 2; or
 - (ii) if mapped to the scale of credit quality grades in Part 1 of Table E (in the case of a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security or instrument being assigned a credit quality grade of 1 or 2; or
- (b) without limiting paragraph (a), if the debt security or instrument is issued by a corporate incorporated in India,

the ECAI issue specific rating of the debt security or instrument that—

- (i) if mapped to the scale of credit quality grades in Part 2 of Table C (in the case of a long-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security or instrument being assigned a credit quality grade of 1, 2 or 3; or
- (ii) if mapped to the scale of credit quality grades in Part 2 of Table E (in the case of a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security or instrument being assigned a credit quality grade of 1, 2 or 3;

qualifying ECAI issuer rating (合資格 ECAI 發債人評級), in relation to the issuer or guarantor of a marketable debt security or prescribed instrument, means—

- (a) the ECAI issuer rating of the issuer or guarantor that, if mapped to the scale of credit quality grades in Table A, Table B or Part 1 of Table C in Schedule 6 to the Capital Rules, would result in the debt security or instrument being assigned a credit quality grade of 1 or 2; or
- (b) without limiting paragraph (a), if the issuer or guarantor of the debt security or instrument is a corporate incorporated in India, the ECAI issuer rating of the issuer or guarantor that, if mapped to the scale of credit quality grades in Part 2 of Table C in Schedule 6 to the Capital Rules, would result in the debt security or instrument being assigned a credit quality grade of 1, 2 or 3;

qualifying ECAI rating (合資格 ECAI 評級), in relation to a marketable debt security or prescribed instrument, means—

- (a) a qualifying ECAI issue specific rating assigned to the debt security or instrument; or
- (b) a qualifying ECAI issuer rating assigned to the issuer or the guarantor of the debt security or instrument.

2. Tables

Table A

Item	Liquefiable assets	Liquidity conversion factor
1.	Currency notes and coins	100%
2.	Gold bullion	90%
3.	Claims on, or reserves maintained with, the Monetary Authority for the account of the Exchange Fund or central banks that are repayable to a category 2 institution overnight, on demand, or on notice which expires on the first day of the LMR period	100%
4.	Net due from banks of a category 2 institution to be included in its liquefiable assets referred to in rule 48(3), subject to the condition that the weighted amount must not exceed the 40% cap referred to in rule 48(7)	80%
5.	Export bills—	
	(a) payable within one month and which are either drawn under letters of credit issued by banks or accepted and payable by banks; or	90%

Item	Liquefiable assets	Liquidity conversion factor
	(b) covered by irrevocable re-discounting facilities approved by the Monetary Authority	90%
6.	Marketable debt securities or prescribed instruments that are—	
	(a) issued or guaranteed by—	
	(i) the Government, the Monetary Authority for the account of the Exchange Fund, or a domestic public sector entity, with a remaining term to maturity of—	
	(A) not more than one year;	100%
	(B) more than one year;	95%
	(ii) an authorized institution incorporated in Hong Kong or the Hong Kong branch of an authorized institution incorporated outside Hong Kong, with a remaining term to maturity of—	
	(A) not more than one month;	100%
	(B) more than one month but not more than one year;	95%
	(C) more than one year;	90%
	(b) issued or guaranteed by the central bank or central government of a country, a multilateral development bank, or a relevant international	

Item	Liquefiable assets	Liquidity conversion factor
	organization, where the debt security or instrument, or its issuer or guarantor, has a qualifying ECAI rating, with a remaining term to maturity of—	
	(i) not more than one year;	100%
	(ii) more than one year;	95%
(c)	with a qualifying ECAI issue specific rating, issued or guaranteed by—	
	(i) a bank, other than those included in paragraph (a)(ii), with a remaining term to maturity of—	
	(A) not more than one month;	100%
	(B) more than one month but not more than one year;	95%
	(C) more than one year;	90%
	(ii) a regional government of a country or other entity, with a remaining term to maturity of—	
	(A) not more than one year;	90%
	(B) more than one year but not more than 5 years;	85%
	(C) more than 5 years;	80%
(d)	without a qualifying ECAI issue specific rating, issued or guaranteed by—	

Item	Liquefiable assets	Liquidity conversion factor
	(i) a bank, other than those included in paragraph (a)(ii), if—	
	(A) the debt security or instrument has a remaining term to maturity of not more than one month; or	100%
	(B) the bank has a qualifying ECAI issuer rating;	80%
	(ii) a regional government of a country which has a qualifying ECAI issuer rating;	80%
(e)	not included elsewhere in this item, re-discountable with the Monetary Authority for the account of the Exchange Fund, or the central bank of a country that has a qualifying ECAI issuer rating (where such re-discounting arrangement is available to the category 2 institution);	80%
(f)	RMBS, other debt securities or instruments specifically approved for inclusion by the Monetary Authority;	80%
(g)	not included elsewhere in this item with a remaining term to maturity of not more than one month	80%
7.	Residential mortgage loans in respect of which there has been issued by The Hong Kong	90%

Item	Liquefiable assets	Liquidity conversion factor
	Mortgage Corporation Limited an irrevocable commitment to purchase which is approved by the Monetary Authority	

Table B

Item	Deduction from liquefiable assets	Liquidity conversion factor
1.	Debt securities or prescribed instruments with a remaining term to maturity of not more than one month issued by a category 2 institution (other than any debt security or prescribed instrument that the Monetary Authority has approved to be excluded from inclusion in this Table where the institution concerned has demonstrated to the satisfaction of the Monetary Authority that the treatment to be accorded to the debt security or instrument for the purpose of the calculation of qualifying liabilities is appropriate)	100%

Table C

Item	Qualifying liabilities	Liquidity conversion factor
1.	Total one-month liabilities of a category 2 institution to the Monetary Authority for the account of the Exchange Fund, or central banks	100%
2.	If a category 2 institution's total one-month liabilities to banks exceed the total one-month	100%

Item	Qualifying liabilities	Liquidity conversion factor
	liabilities of banks to the institution, the amount of its total one-month liabilities to banks	
3.	Other one-month liabilities	100%

Table D

Item	Deduction from qualifying liabilities	Liquidity conversion factor
1.	Total one-month liabilities of the Monetary Authority for the account of the Exchange Fund, or central banks to a category 2 institution (other than the amount included in item 3 of Table A)	100%
2.	If a category 2 institution's total one-month liabilities to banks exceed the total one-month liabilities of banks to the institution, the amount of the total one-month liabilities of banks to it	100%
3.	The weighted amount, if any, of a category 2 institution's net due from banks exceeding the 40% cap referred to in rule 48(7)	100%
4.	Eligible loan repayments	80%

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Monetary Authority

Explanatory Note

These Rules are made by the Monetary Authority under section 97H of the Banking Ordinance (Cap. 155) as added by section 8 of the Banking (Amendment) Ordinance 2012 (3 of 2012).

2. The main purpose of the Rules is to—
 - (a) give effect, in Hong Kong, to the requirements of the document entitled “Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools” published by the Basel Committee on Banking Supervision in January 2013; and
 - (b) replace and revise the requirements presently set out in section 102 of, and the Fourth Schedule to, the Banking Ordinance (Cap. 155).
3. The requirements referred to in paragraph 2(a) above will only apply to authorized institutions that are designated by the Monetary Authority under rule 3(1) as category 1 institutions (see the definition of *category 1 institution* in rule 2(1)) on one or more of the grounds specified in Part 1 or 2 of Schedule 1. Those grounds include, among others, that the authorized institution is internationally active or significant to the general stability and effective working of the banking system in Hong Kong or that the liquidity risk associated with the authorized institution is material.
4. The principal requirement placed on a category 1 institution is that it must at all times maintain a liquidity coverage ratio (*LCR*) (see the definition of *liquidity coverage ratio* in rule 2(1)) of not less than 100% on and after 1 January 2019 with staged increments from 2015 to 2018 leading up to that 100% (see rule 4). Rule 5 requires a category 1 institution to notify the Monetary Authority of any matter that will or may cause it to maintain a liquidity coverage ratio less than as required under rule 4. Rule 6 sets out the

circumstances in which a category 1 institution may monetize its high quality liquid assets included in the calculation of its LCR to meet its financial obligations, even if this might cause the institution to maintain an LCR less than as required under rule 4.

5. Part 7, as read with Schedules 1, 2, 3 and 4, sets out the technical requirements relating to the calculation by a category 1 institution of its LCR.
6. All authorized institutions that are not designated by the Monetary Authority as category 1 institutions are automatically category 2 institutions (see the definition of *category 2 institution* in rule 2(1)) and subject to the revised requirements referred to in paragraph 2(b) above.
7. The principal requirement placed on a category 2 institution is that it must maintain a liquidity maintenance ratio (*LMR*) (see the definition of *liquidity maintenance ratio* in rule 2(1)) of not less than 25% on average in each calendar month (see rule 7). Rule 8 requires a category 2 institution to notify the Monetary Authority of any matter that will or may cause it to maintain an LMR less than as required under rule 7.
8. Part 8, as read with Schedule 5, sets out the technical requirements relating to the calculation by a category 2 institution of its LMR.
9. Part 4 sets out requirements relating to the valuation of assets that are applicable to category 1 institutions and category 2 institutions in calculating LCR or LMR. Part 5 sets out certain reporting requirements. Part 6 sets out the action that the Monetary Authority may take when notified of certain relevant liquidity events (see the definition of *relevant liquidity event* in rule 14).
10. The Rules come into operation on 1 January 2015 (see rule 1).

Annex D - Basel III implementation progress among jurisdictions

Jurisdictions	Phase 1 commencement	Phase 2 commencement				
	Minimum Capital Ratios and Capital Disclosures	Capital Conservation Buffer	Countercyclical Capital Buffer	Higher Loss Absorbency Requirement	Liquidity Coverage Ratio	Leverage Ratio Disclosures
Hong Kong	2013	2016	2016#	2016	2015	2015
<i>G20</i>						
Australia	2013*	2016	2016	2016	2015	2015
Canada	2013	2016	2016	2016	2015	2015
China	2013*	2013	2016	2013	Dec-2014	2012
India	Minimum Capital ratios: 2013* Capital Disclosures: Jun-2014	2016	2016	2016	2015	2015
Japan	Mar-2013	2016	2016	2016	Mar-2015	Mar-15
South Korea	Dec-2013	2016	To be confirmed	To be confirmed	2015	2015
United States	2014	2016	2016	To be confirmed	2015	2015
European Union	2014	2016	2016#	2016	Oct-2015^	2015
<i>Non-G20</i>						
Singapore	2013*	2016	2016#	2016	2015	2015
Switzerland	2013	2016	2012	2012	2015	2015

* Jurisdiction adopting a minimum standard higher than and/or an implementation timetable faster than that set out in the Basel III framework

Flexibility to go higher than 2.5%

^ The delay in implementation is mainly due to lead time required for completing legislative processes within the EU