File Ref: B&M/2/1/63C

LEGISLATIVE COUNCIL BRIEF

Banking Ordinance (Cap. 155)

Banking (Amendment) Ordinance 2018 (Commencement) (No. 2) Notice 2018
Banking (Exposure Limits) Rules
Banking (Capital) (Amendment) Rules 2018
Banking (Disclosure) (Amendment) (No. 2) Rules 2018

INTRODUCTION

For the purpose of implementing the latest international standards on banking regulation promulgated by the Basel Committee on Banking Supervision ("BCBS") –

(a) the Secretary for Financial Services and the Treasury has appointed 1 July 2019 as the commencement date for the remaining provisions of the Banking (Amendment) Ordinance 2018 ("BAO")[1] under the **Banking (Amendment) Ordinance 2018 (Commencement) (No. 2) Notice 2018** ("Commencement Notice") (Annex A); and

(b) the Monetary Authority ("MA") has made –

(i) the **Banking (Exposure Limits) Rules** ("BELR") (Annex B) to deal with limitations on exposure limits in Part XV of the Banking Ordinance ("BO") and implement the 2014 BCBS standards on *Supervisory framework for measuring and controlling large exposures* ("BCBS large exposures framework");

[1] These refer to provisions in the BAO that have yet to commence operation as explained in paragraphs 3 and 4.

(ii) the **Banking (Capital) (Amendment) Rules 2018** ("BCAR") (Annex C) to implement the 2016 BCBS *TLAC holdings standard*; introduce capital treatment to complement the implementation of the BCBS large exposures framework; and incorporate in the existing securitisation framework the "internal assessment approach" ("IAA") of the 2014 BCBS *Revisions to the securitisation framework* ("BCBS revised securitisation framework"); and

(iii) the **Banking (Disclosure) (Amendment) (No. 2) Rules 2018** ("BDAR") (Annex D) to incorporate a minor definitional adjustment to align with the consequential amendment in the BCAR for implementing the BCBS large exposures framework.

JUSTIFICATIONS

2. The BCBS is an international body responsible for setting standards on banking regulation. It is incumbent upon Hong Kong, a member of the BCBS, to implement the latest standards promulgated by the BCBS, which will ensure the stability of our banking system, and promote our status as an international financial centre.

Banking (Amendment) Ordinance 2018 (Commencement) (No. 2) Notice 2018 and Banking (Exposure Limits) Rules

3. Enacted by the Legislative Council ("LegCo") in January 2018, the Banking (Amendment) Ordinance 2018 ("BAO 2018"), among other things, repeals the core provisions in Part XV of the Banking Ordinance ("BO") pertaining to limitations on financial exposures incurred by authorized institutions ("AIs"), which were set with reference to an earlier Basel framework. BAO 2018 also amends the BO to empower MA to make rules, in the form of subsidiary legislation, to reflect the now revised Basel standards on exposures limits for AIs.

4. The requirements relating to limitation on equity exposure (i.e.

section 87 of the BO) had been dealt with vide the Banking (Exposure Limits) Rules[2] in May 2018. The current legislative exercise is to replace and update the rest of Part XV of the BO (viz. sections 80, 81, 83, 85, 87A and 88) to deal with AIs' acquisition of share capital, limitations on credits made by AIs, their holding of interest in land and major share acquisition in order to keep pace with market developments and contemporary risk management practices; and to implement the large exposure standards promulgated by the BCBS, which will essentially replace the single/linked counterparty large exposure limits currently set out in section 81 of the BO. The corresponding sections in Part XV of the BO will be repealed upon commencement of the BELR from 1 July 2019.

Banking (Capital) (Amendment) Rules 2018 and Banking (Disclosure) (Amendment) (No. 2) Rules 2018

5. The purposes of the amendments in the BCAR are mainly to:

(a) implement the 2016 BCBS *TLAC holdings standard*, which sets out the regulatory capital treatment of banks' holdings of loss-absorbing capacity ("LAC") instruments;

(b) introduce a capital treatment to address concentration risk in sovereign exposures to complement the BCBS large exposures framework implemented through the BELR; and

(c) incorporate the IAA of the BCBS revised securitisation framework which is a methodology for calculating capital requirement specifically designed for certain securitisation exposures to asset-backed commercial paper programmes ("ABCP programmes").

6. A minor consequential change to a definition in the Banking (Disclosure) Rules arising from the implementation of the BCBS large exposures framework will be made vide the BDAR.

[2] This refers to the Banking (Exposure Limit) Rules (Cap. 155 sub. leg. R) gazetted on 18 May 2018 which subsequently took effect on 13 July 2018.

7. Taking this opportunity, the MA also seeks to specify the HKMC Insurance Limited and the HKMC Annuity Limited as domestic public sector entities for preferential capital treatment under the Banking (Capital) Rules ("BCR") to cater for the business restructuring of the Hong Kong Mortgage Corporation Limited, as well as to introduce some miscellaneous amendments to enhance the consistency and clarity of certain provisions in the BCR.

THE SUBSIDIARY LEGISLATION

Banking (Amendment) Ordinance 2018 (Commencement) (No. 2) Notice 2018

8. The Commencement Notice specifies 1 July 2019 as the date on which the remaining provisions of the BAO (as described in paragraphs 3 and 4 above) will commence operation.

Banking (Exposure Limits) Rules

9. The requirements in the existing sections 79A, 80, 81, 83, 85, 87, 87A and 88 of the BO will be replaced by those in the BELR. Major changes in the corresponding provisions in the BELR are explained as follows:

(a) Part 3 – The limit of the existing section 87A (limit on major share acquisition) of the BO takes the form of a prior approval requirement on major share acquisition of an AI. The purpose is to allow the MA to check whether a major share acquisition proposal is relevant to the ordinary business of an AI and whether it will result in a corporate structure that might undermine the effectiveness of banking supervision. In the BELR, specific exemptions will be given to shares acquired in the insurance and trading businesses of an AI. This serves to mitigate the unintended impact of the section 87A prior approval requirement on the development of certain businesses in Hong Kong;

(b) Part 4 – The restriction under the existing section 80 (advance against security of own shares, etc) of the BO will be extended from shares to certain other capital-in-nature instruments;

(c) Part 6 – The existing section 88 (limit on interest in land) of the BO contains a limit on interests in non-self-use land only, while a limit on interests in self-use land was included separately in a combined limit of different types of exposures (including some non-property exposures) under the former section 90 of the BO, which was repealed on 13 July 2018.[3] The purpose of the proposed revision to the section 88 limit under the BELR is to rationalise the design of the exposure limits by introducing a combined, single limit on interests in land (for both self-use and non-self-use);

(d) Part 7 – Reflecting the BCBS large exposures framework which imposes exposure limits on a single counterparty or group of linked counterparties[4], the BELR contain more details (as compared to the existing section 81 of the BO) on how individual exposures are measured and take into account credit risk mitigation. Locally, sovereign exposures of AIs will not be covered by the exposure limits but concentration in such exposures will generally be subject to an additional capital charge (introduced under the BCAR as explained in paragraph 5(b)); and

(e) Part 8 – The purpose of the limit under the existing Section 83 (connected party exposure limit) of the BO is to prevent abuses arising from transactions that an AI enters into with its connected parties. The determination of connected party exposures will align with the BCBS large exposures framework to reduce the compliance burden of the industry. The level of the connected party exposure limits are proposed to be revised under the BELR to keep pace with market developments. As for connected

[3] Incidental to the implementation of the BELR to replace the equity exposure limit under section 87 of the BO in July 2018, the combined exposure limit under section 90 of the BO was repealed at the same time because this combined limit includes equity exposures.

[4] Linked counterparties are counterparties of an AI that the financial or funding difficulties of one are likely to affect the others through a control or economic interdependence relationship.

natural persons (including relatives), the definition of relative will be streamlined to align with international practices. This addresses the industry's concerns that the current definition of relative is very broad (e.g. including former spouse of a director) and therefore hard to monitor in practice.

Banking (Capital) (Amendment) Rules 2018

10. The key amendments proposed in the BCAR are as follows:

TLAC holdings standards

(a) Sections 3E[5] and 3F – The revisions to these sections reflect the requirement in the BCBS *TLAC holdings standard* that banks must take into account their minimum LAC requirements[6] in determining the amount of distributions (e.g. dividend payout) they can make from capital;

(b) Section 48, new section 48A, sections 66, 116, 145, 183 and Schedules 4F and 4G – These sections (as revised or introduced) will (i) expand the scope of the existing capital treatment for instruments held by an AI to cover not only capital instruments, but also non-capital LAC liabilities[7], and (ii) introduce corresponding modifications on the existing deduction mechanism to cater for AIs' holdings of non-capital LAC liabilities;

(c) Schedules 4B and 4C – The revisions to these Schedules incorporate sales and distribution criteria as part of the qualifying criteria of Additional Tier 1 and Tier 2 capital instruments so as to align with the corresponding criteria for qualifying instruments eligible to be counted as LAC under the LAC Rules;

[5] All section references under paragraph 10 are those of the BCR.

[6] The minimum LAC requirements will be implemented in Hong Kong through the *Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules* ("LAC Rules") gazetted on 19 October 2018 which are currently undergoing negative vetting by the LegCo.

[7] The term "non-capital LAC liabilities" is defined in the LAC Rules.

(d) Sections 43(1), 47(1) and 48(1), schedules 4D and 4H – The revisions are to remove obsolete provisions in relation to transitional arrangements that have already ended;

Sovereign concentration risk

(e) Section 2 – The revisions are to introduce the concept of sovereign concentration risk and include this risk in the parameters for the calculation of the capital adequacy ratio;

(f) Section 4A – The revisions are to make the existing standard on valuation of exposures applicable also to sovereign concentration risk;

(g) Sections 29, 30 and 31, and a new Part 10 – The revisions are to specify the methodology for calculating the capital requirement of sovereign concentration risk. It generally requires an AI to provide capital to the extent that its exposures to a sovereign exceeds the amount of its Tier 1 capital (the greater the excess the higher will be the capital requirement);

Internal assessment approach

(h) Section 15 and new section 15B – The revisions to section 15 and the new section 15B specify the circumstances under which an AI may use the IAA to risk-weight its securitisation exposures to ABCP programmes;

(i) New sections 15C and 15D – These sections prescribe the requirements related to AIs' application to the MA for approval to use the IAA and the measures that may be taken by the MA if an AI has contravened certain requirements relevant for the approval;

(j) New section 266A – The new section specifies the manner in which internal credit ratings assigned by an AI to securitisation exposures to ABCP programmes are mapped to the corresponding risk-weights under the IAA; and

Others

(k) Schedule 1 (Part 1) – The revisions are to include the HKMC Insurance Limited and the HKMC Annuity Limited in the list of domestic public sector entities.

Banking (Disclosure) (Amendment) (No. 2) Rules 2018

11. The amendment proposed in the BDAR is to update the definition of "capital requirement" for disclosure purposes. A reference to the new "Part 10" of the BCR (item (g) of paragraph 9) will be inserted in the definition such that the disclosure requirements will be expanded to cover the capital treatment in relation to concentration risk in sovereign exposures.

LEGISLATIVE TIMETABLE

12. The Commencement Notice, the BELR, the BCAR and the BDAR will be published in the Gazette on 16 November 2018 and tabled before LegCo at the sitting of 21 November 2018. Subject to negative vetting by LegCo,

(a) Part 4 (except section 34), and sections 15 and 16 of the BCAR will come into operation on 11 January 2019;

(b) Part 2 (except sections 15 and 16) of the BCAR will come into operation on 1 April 2019; and

(c) the remaining provisions of the BAO, the BELR, Part 3 and section 34 of the BCAR in relation to concentration risk in sovereign exposures and the BDAR will come into operation on 1 July 2019.

IMPLICATIONS OF THE PROPOSALS

13. The Commencement Notice, the BELR, the BCAR and the BDAR are intended to bring the regulatory regime in Hong Kong up-to-date and in line with international standards. They will enhance the resilience of banks, ensure the stability of the banking system and reinforce Hong Kong's status as an international financial centre.

14. The four pieces of subsidiary legislation are in conformity with the Basic Law, including the provisions concerning human rights. The proposed subsidiary legislation will not affect the binding effect of the BO.

PUBLIC CONSULTATION

15. At the meeting of the LegCo Panel on Financial Affairs on 5 November 2018, the Hong Kong Monetary Authority ("HKMA") briefed members on the key features of the BELR, the BCAR and the BDAR. At the preceding two meetings of the Panel in February and May 2018, the HKMA also briefed members on the relevant background to these rules.

16. The HKMA has engaged the banking industry in formulating the policy proposals contained in the BELR and the BCAR through a series of consultations in 2018. Pursuant to sections 60A, 81A and 97C of the BO, statutory consultations were conducted on the draft provisions in the BELR, the BCAR and the BDAR in October 2018. The HKMA has taken into consideration comments received from the consultees[8] on the policy proposals and the draft provisions, and made adjustments as appropriate. The intent of certain provisions has also been clarified in response to some comments raised during the consultation process.

[8] For statutory consultations, these include 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.

PUBLICITY

17. We will issue a press release upon gazettal of the Commencement Notice and the three sets of Rules. The HKMA will also issue a circular letter to all AIs.

ENQUIRIES

18. Enquiries should be directed to Ms Eureka Cheung, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services), at 2810 2067, or the following officers at the HKMA:

- Mr Martin Sprenger, Head (Research and Development), at 2878 8278 (on BELR Part 7 and BCAR Part 10);

- Mr Frank Leung, Head (Banking Policy), at 2878 1457 (on BELR, other than Part 7); or

- Mr Richard Chu, Head (Banking Policy), at 2878 8276 (on BCAR, other than Part 10 and BDAR).

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
14 November 2018

Banking (Amendment) Ordinance 2018 (Commencement) (No. 2) Notice 2018

Under section 1(2) of the Banking (Amendment) Ordinance 2018 (6 of 2018), I appoint 1 July 2019 as the day on which the uncommenced provisions of the Ordinance come into operation.

Secretary for Financial Services and the Treasury

2018

Banking (Exposure Limits) Rules

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Banking (Exposure Limits) Rules

(Made by the Monetary Authority under section 81A 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 July 2019.

2. Interpretation

(1) In these Rules—

book (帳簿), in relation to an authorized institution, means its banking book or trading book;

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

CIS means a collective investment scheme;

determine (斷定) includes calculate;

financial facility (資金融通), in relation to an authorized institution, means—

(a) an advance, loan or credit facility (including a letter of credit);

(b) a financial guarantee; or

(c) a liability;

land (土地) includes land situated in or outside Hong Kong;

provide (提供), in relation to a financial facility, means—

(a) for an advance, loan or credit facility (including a letter of credit)—grant or permit to be outstanding;

(b) for a financial guarantee—give; or

(c) for a liability—incur.

(2) In these Rules, an expression specified below has the meaning given by section 2(1) of the Capital Rules—

Additional Tier 1 capital (額外一級資本);

banking book (銀行帳);

CET1 capital (CET1 資本);

collective investment scheme (集體投資計劃);

credit derivative contract (信用衍生工具合約);

derivative contract (衍生工具合約);

fair value (公平價值);

forward contract (遠期合約);

futures contract (期貨合約);

option contract (期權合約);

repo-style transaction (回購形式交易);

swap contract (掉期合約);

Tier 1 capital (一級資本);

trading book (交易帳).

(3) To avoid doubt, a reference in these Rules to a derivative contract includes a credit derivative contract.

(4) A reference in these Rules to a formula followed by a number (including an alphanumeric number) is a reference to the formula in these Rules bearing that number.

3. General provisions

(1) An approval or consent of the Monetary Authority in respect of any matter under these Rules may only be sought by making an application in a specified form (if any) to the Monetary Authority.

(2) A notice given or served by the Monetary Authority under these Rules to or on all authorized institutions, or to or on a class of authorized institutions, may be given or served by publishing it in the Gazette.

(3) In determining whether anything meets the description of "appropriate", "competent", "prudent", "reasonable", "relevant" or "reliable" in any provision of these Rules, regard must be had to any guidelines or codes of practice issued under the Ordinance that are applicable to the provision.

4. Conversion into Hong Kong dollar

For—

(a) valuing an exposure under these Rules; or

(b) determining a value or amount under these Rules,

if a value or amount is denominated in a currency other than the Hong Kong dollar, it must be converted into a Hong Kong dollar figure.

5. Valuation of exposure at fair value

(1) An authorized institution must establish and maintain effective valuation systems, controls and procedures for valuing its exposures at fair value under these Rules to ensure that the valuation is prudent and reliable.

(2) An authorized institution must make adjustments (if appropriate) to the valuation of its exposures at fair value to factor in—

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

(b) the liquidity of the exposures; and

(c) other relevant factors that may reasonably be expected to affect the prudence and reliability of the valuation.

(3) To avoid doubt, adjustments made under subrule (2) may exceed the adjustments made by the institution in accordance with the financial reporting standards adopted by it.

(4) If, in accordance with any provision of these Rules, an authorized institution must value any exposure or item at fair value, this rule applies in determining the fair value.

6. Monetary Authority may require applying these Rules on unconsolidated or consolidated basis

(1) For applying any provision of these Rules to an authorized institution incorporated in Hong Kong that has any subsidiary, the Monetary Authority may, by written notice to the institution, require it to apply the provision—

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

(b) on a consolidated basis in respect of the institution and 1 or more of its subsidiaries specified in the notice; or

(c) on an unconsolidated basis in respect of the institution, and on a consolidated basis in respect of the institution and 1 or more of its subsidiaries specified in the notice.

(2) For subrule (1)—

(a) applying a provision on an unconsolidated basis means applying the provision on the basis that the business of the institution includes all of its business in Hong Kong (being the business of its principal place of business in Hong Kong and its local branches (if any)) and the business of its branches (if any) outside Hong Kong; and

(b) applying a provision on a consolidated basis means applying the provision on the basis that the business of the institution includes those mentioned in paragraph (a), and the business of its local subsidiaries or subsidiaries outside Hong Kong as may be specified in the notice given to the institution.

(3) If a notice is given to an authorized institution under subrule (1), the provision that is the subject matter of the notice is to be applied on the basis specified in the notice.

(4) Any duty of confidentiality of an authorized institution's subsidiary is not to be treated as contravened because of the supply of any information by the subsidiary to the institution for enabling or assisting the institution to comply with a notice given to the institution under subrule (1).

7. Notifiable event—prescribed notification requirement under section 81C of Ordinance

(1) If a notifiable event occurs in relation to an authorized institution, it must—

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

(b) provide the Monetary Authority with any particulars of the event that the Monetary Authority requests.

(2) In this rule—

notifiable event (須通報事件) means a failure to comply with—

(a) rule 11 or (if applicable) that rule as varied under rule 12(1);

(b) a condition under—

(i) rule 14(1)(b)(ii);

(ii) rule 14(1)(c)(ii);

(iii) rule 14(1)(e); or

(iv) rule 14(3)(b);

(c) rule 23(1) or (3)(a) or 24(6);

(d) a condition under—

(i) rule 23(3)(b) or (4); or

(ii) rule 24(2) or (4)(a) or (if applicable) as amended under rule 24(4)(b);

(e) rule 27(1) or (2);

(f) a condition under rule 28(2);

(g) rule 31;

(h) rule 35(a) or (b) or (if applicable) that rule as varied under rule 36(1);

(i) a condition under rule 38(b)(ii);

(j) rule 44(1)(a) or (b) or (2)(a) or (b) or (if applicable) that rule as varied under rule 45(1);

(k) a condition under—

(i) rule 48(1)(e)(ii) or (f)(ii);

(ii) rule 48(3)(b); or

(iii) rule 57(1)(d)(ii);

(l) rule 87(a), (b) or (c) or (if applicable) that rule as varied under rule 88(1); or

(m) a condition under rule 92(2)(b).

Part 2

Equity

Division 1—General

8. Interpretation of Part 2

(1) In this Part—

aggregate equity exposure (股權風險承擔總額)—see rule 13;

equity derivative contract (股權衍生工具合約) means a futures contract, forward contract, swap contract, option contract or similar derivative contract the value of which is determined by reference to the value of, or any fluctuation in the value of, 1 or more than 1 underlying equity or an underlying equity index (being an index calculated by reference to a basket of equities);

equity exposure (股權風險承擔)—see rule 9;

equity exposure ratio (股權風險承擔比率), in relation to an authorized institution, means the ratio, expressed as a percentage, of the institution's aggregate equity exposure to the amount of the institution's Tier 1 capital.

(2) A reference in this Part to the weight of an equity in an equity index is a reference to the weight of that equity in the equity index as specified by the index provider that compiles the index.

(3) A reference in this Part to the weight of an equity in a basket of equities is a reference to the ratio of the fair value of that equity to the aggregate fair value of all the equities in the basket of equities.

9. Interpretation: *equity exposure*

(1) For this Part, if—

(a) a direct or indirect interest (whether voting or non-voting) of an authorized institution is a specified interest set out in subrule (2); and

(b) the interest is not consolidated for determining the institution's capital base in accordance with Part 3 of the Capital Rules,

the institution's exposure arising from that interest is an equity exposure of the institution.

(2) A specified interest is—

(a) the holding of any share capital issued by a company;

(b) the holding of any equity derivative contract;

(c) the holding in the equity components of a CIS that is engaged in the business of investing in equity or the acquisition and disposal of equity interests;

(d) the holding of any instrument that, if it were issued by the institution, would satisfy the requirements for inclusion in the institution's CET1 capital or Additional Tier 1 capital under Division 2 of Part 3 of the Capital Rules;

(e) the holding of any instrument—

(i) that is irredeemable;

(ii) that does not embody an obligation on the part of the issuer except an obligation falling within the description of any subparagraph of paragraph (f); and

(iii) that conveys a residual claim on the assets or income of the issuer;

(f) the holding of any instrument that embodies an obligation on the part of the issuer that falls within the description of any of the following subparagraphs—

(i) the issuer may indefinitely defer the settlement of the obligation;

(ii) the obligation requires (or permits at the issuer's discretion) settlement by issuing a fixed number of the issuer's equity shares;

(iii) the obligation requires (or permits at the issuer's discretion) settlement by issuing a variable number of the issuer's equity shares and, other things being equal, any change in the value of the obligation is attributable to, comparable to, and in the same direction as, the change in the value of a fixed number of the issuer's equity shares;

(iv) the institution has the option to require that the obligation be settled in equity shares unless the institution demonstrates to the satisfaction of the Monetary Authority that—

(A) for a traded instrument—the instrument trades more like a debt of the issuer than equity; or

(B) for an instrument other than a traded instrument—the instrument should be treated as a debt holding;

(g) the holding of any debt obligation, share, derivative contract, investment scheme or instrument that is structured with the intent of conveying the economic substance of equity interests;

(h) any of the institution's liabilities the return on which is linked to the return on equity interests (including but not

limited to short selling positions in relation to stock borrowing); or

(i) any commitment to acquire any holding described in paragraph (a), (b), (c), (d), (e), (f) or (g), or to incur the liabilities described in paragraph (h).

(3) To avoid doubt—

(a) an equity exposure may arise from a long position or a short position; and

(b) the classification of an interest that falls within the description of any paragraph of subrule (2) as a liability for accounting purposes does not in itself prevent the interest from being treated as an equity interest.

10. Application of Part 2

This Part applies to an authorized institution incorporated in Hong Kong.

Division 2—Limit on Equity Exposure

11. Limit on equity exposure

Subject to (if applicable) any variation under rule 12(1), an authorized institution must at all times maintain an equity exposure ratio not exceeding 25%.

12. Monetary Authority may vary limit on equity exposure

(1) Subject to subrules (3), (4), (5) and (6), the Monetary Authority may, by written notice served on an authorized institution, vary the limit prescribed under rule 11 for the institution if the Monetary Authority, after taking into account the considerations set out in subrule (2), is satisfied on reasonable grounds that it is prudent to make the variation.

(2) The considerations are—

(a) the risks associated with the level or concentration of the institution's equity exposures;

(b) any risk mitigation measures taken by the institution to manage those risks;

(c) the risks associated with those measures;

(d) any prevailing or reasonably anticipated market conditions that may affect the risks associated with the level or concentration of the institution's equity exposures; and

(e) any other factors that the Monetary Authority considers relevant.

(3) If the Monetary Authority proposes to serve a notice (***proposed notice***) under subrule (1) on an authorized institution, the Monetary Authority must serve a draft of the notice (***draft notice***) on the institution.

(4) A draft notice must—

(a) specify—

(i) the proposed variation of the limit concerned; and

(ii) the circumstances pertaining to, and the grounds for, the proposed variation; and

(b) contain a statement that the institution may, within 14 days (or a longer period approved by the Monetary Authority in writing in any particular case) from the date of service of the draft notice, make written representation to the Monetary Authority on any or all of the matters specified in the draft notice.

(5) If an authorized institution makes any written representation in relation to a draft notice served on it, the Monetary Authority may, after considering the representation—

(a) serve a notice on the institution under subrule (1) in substantially the same terms as the draft notice;

(b) serve a notice on the institution under subrule (1) in terms modified to take account of the representation on being satisfied that the modification should be made; or

(c) elect not to serve a notice on the institution under subrule (1) if satisfied by the representation that the proposed notice should not be served on the institution.

(6) If no representation is made by an authorized institution in relation to a draft notice served on it, the Monetary Authority may serve a notice on the institution under subrule (1) in substantially the same terms as the draft notice.

(7) A decision of the Monetary Authority under subrule (1) is a decision to which section 101B(1) of the Ordinance applies.

(8) To avoid doubt—

(a) the Monetary Authority may serve a draft notice on an authorized institution to supersede an earlier draft notice served on the institution; and

(b) the reference to same terms in subrule (5)(a) or (6) does not include the statement mentioned in subrule (4)(b).

Division 3—Determination of Aggregate Equity Exposure

13. Aggregate equity exposure

(1) Subject to subrules (2), (3) and (4) and rule 14, an authorized institution's aggregate equity exposure is the sum of the value of the institution's equity exposures (valued in accordance with Division 4), arising from items in its books.

(2) The equity exposure arising from a long position and a short position in the same equity interests, in each of the

institution's books, may be offset, irrespective of the instrument from which the position is derived.

(3) However, an equity exposure arising from an item in the institution's banking book and an equity exposure arising from an item in its trading book must not be offset against each other.

(4) In determining the institution's aggregate equity exposure under subrule (1), a net short position in an equity interest is treated as if it were a net long position in the equity interest.

14. Equity exposure disregarded

(1) The following equity exposures of an authorized institution are not to be taken into account for determining the institution's aggregate equity exposure—

(a) an equity exposure arising from the holding of any capital interest as security for a financial facility provided by the institution;

(b) an equity exposure arising from the holding of any capital interest acquired by the institution in the course of the satisfaction of debts due to it, if—

(i) the following period has not expired—

(A) the period from the date of the acquisition of the capital interest to the date on which the capital interest may be disposed of at the earliest suitable opportunity, or the period of 18 months after the acquisition of the capital interest, whichever period expires first; or

(B) a longer period approved by the Monetary Authority in writing in any particular case; and

(ii) where a longer period is approved under subparagraph (i)(B)—the institution complies with the conditions that the Monetary Authority may attach to the approval;

(c) an equity exposure arising from the holding of any capital interest acquired under an underwriting or subunderwriting contract, if—

(i) the following period has not expired—

(A) the period of 7 working days after the acquisition of the capital interest; or

(B) a longer period approved by the Monetary Authority in writing in any particular case; and

(ii) where a longer period is approved under subparagraph (i)(B)—the institution complies with the conditions that the Monetary Authority may attach to the approval;

(d) an equity exposure arising from a commitment to acquire any capital interest under an underwriting or subunderwriting contract that falls within the description under rule 9(2)(i);

(e) an equity exposure arising from the holding, approved by the Monetary Authority in writing, of any capital interest of—

(i) another authorized institution (whether incorporated in or outside Hong Kong); or

(ii) a company carrying out nominee, executor or trustee functions, or other functions related to banking business, the business of taking deposits, insurance business, investments or other financial services,

if the institution complies with the conditions that the Monetary Authority may attach to the approval;

(f) an equity exposure arising from the holding, approved by the Monetary Authority in writing, of any capital interest that is deducted in determining the capital base of the institution under Part 3 of the Capital Rules;

(g) an equity exposure up to the amount incurred by the institution specifically to offset any holding described in paragraph (a), (b), (c), (e) or (f) or a commitment described in paragraph (d);

(h) an equity exposure arising from the holding of assets, or incurring of liabilities, in relation to a defined benefit pension fund or plan;

(i) an equity exposure that is specified in a consent given under subrule (2) if the conditions attached to the consent under subrule (3)(b) are complied with.

(2) The Monetary Authority may give a written consent to allow an equity exposure or a class of equity exposures not to be taken into account for determining an authorized institution's aggregate equity exposure, if the Monetary Authority considers that it is reasonable to do so, having regard to—

(a) the nature of, and the risks associated with, the equity exposure or class of equity exposures;

(b) any risk mitigation measures taken by the institution to manage those risks;

(c) the risks associated with those measures; and

(d) any other factors that the Monetary Authority considers relevant.

(3) The Monetary Authority may—

(a) give a written consent under subrule (2) to an authorized institution or a class of authorized institutions; and

(b) attach conditions to the consent.

(4) In subrule (1)—

capital interest (資本權益), in relation to an authorized institution, means—

(a) any share capital issued by a company; or

(b) any instrument that, if it were issued by an authorized institution, would satisfy the requirements for inclusion in the institution's CET1 capital or Additional Tier 1 capital under Division 2 of Part 3 of the Capital Rules.

Division 4—Valuation of Equity Exposure

15. General—current book value or contracted amount

(1) An authorized institution's equity exposure arising from an on-balance sheet item (other than the shares of a company, a repo-style transaction, an equity derivative contract, an item with an embedded equity derivative contract or a CIS) must be valued at the current book value of the item.

(2) An authorized institution's equity exposure arising from an off-balance sheet item (other than an equity derivative contract) must be valued at the contracted amount of the item.

16. Equity exposure arising from shares of company

The value of an authorized institution's equity exposure arising from the shares of a company is the sum of—

(a) the current book value of the shares; and

(b) the amount that is remaining unpaid on the shares and is not included in the current book value of the shares.

17. Equity exposure arising from equity derivative contract

(1) An authorized institution's equity exposure arising from each of its futures contracts, forward contracts and option contracts must be valued, with respect to the underlying equity—

(a) for a futures contract or forward contract relating to an individual equity or a basket of equities—at the fair value of the underlying equity or underlying basket of equities, as may be appropriate, under the contract;

(b) for a futures contract or forward contract relating to an equity index—

(i) at the current index value multiplied by the monetary value of 1 index point set by the futures exchange where the futures contract is traded; or

(ii) at the fair value of the underlying basket of equities by reference to which the index is compiled; or

(c) for an option contract relating to an individual equity, a basket of equities or an equity index—at the delta-weighted position of the contract.

(2) In valuing an authorized institution's equity exposure arising from an equity swap contract, the contract must be treated as—

(a) if the institution is receiving under the contract an amount based on the change in value of a particular equity, a basket of equities or an equity index—a long position; or

(b) if the institution is paying under the contract an amount based on the change in value of a different equity, a basket of equities or an equity index—a short position.

(3) In this rule—

delta-weighted position (得爾塔加權持倉) has the meaning given by section 281 of the Capital Rules.

18. Alternative valuation of equity exposure arising from equity derivative contract

(1) This rule applies to the valuation of an equity exposure of an authorized institution, arising from an equity derivative contract if there is an underlying basket of equities or equity index under the contract.

(2) If the institution has access to daily information for valuing its equity exposure with respect to the individual underlying equities under the equity derivative contract, the institution may, despite rule 17 and subject to subrule (3), break down the value of the equity exposure into values of equity exposures in the individual underlying equities in the basket of equities or equity index.

(3) For subrule (2), the value of the institution's equity exposure with respect to an individual underlying equity is calculated as the weight of that equity in the basket of equities or equity index multiplied by the value of the equity derivative contract valued in accordance with rule 17.

(4) A position of the institution in the individual underlying equities derived in accordance with subrule (2) may be offset against the institution's opposite position in the same equities under rule 13(2).

19. Equity exposure arising from repo-style transaction

In valuing an authorized institution's equity exposure arising from a repo-style transaction—

(a) if the transaction falls within paragraph (a) or (b) of the definition of ***repo-style transaction*** in section 2(1) of the Capital Rules, the institution must—

(i) treat the equity interest arising from the securities sold or lent under the transaction as an on-balance sheet item as if the institution had not entered into the transaction; and

(ii) value the exposure—

(A) if the securities are not shares of a company—in accordance with rule 15; or

(B) if the securities are shares of a company—in accordance with rule 16;

(b) if the transaction falls within paragraph (d) of the definition of ***repo-style transaction*** in section 2(1) of the Capital Rules, and the institution has provided any securities in exchange as collateral (***securities in exchange***) for securities borrowed under the transaction, the institution must—

(i) treat the equity interest arising from the securities in exchange as an on-balance sheet item as if the institution had not entered into the transaction; and

(ii) value the exposure—

(A) if the securities in exchange are not shares of a company—in accordance with rule 15; or

(B) if the securities in exchange are shares of a company—in accordance with rule 16.

20. Equity exposure arising from CIS

(1) An authorized institution's equity exposure arising from an on-balance sheet item relating to the equity components of a CIS must be valued—

(a) at the current book value of the institution's holding of interests arising from the CIS;

(b) subject to subrule (2), by using Formula 1; or

(c) subject to subrule (4), by using Formula 2.

(2) For subrule (1)(b), Formula 1 may be used if the maximum value of equity exposures permitted to be incurred by the CIS under its investment mandate is known to the institution.

(3) Formula 1 is as follows—

Formula 1

$$E_{CIS} = \text{Min } [V, V \times CIS_{max}]$$

where—

E_{CIS} = the value of the authorized institution's equity exposure arising from an on-balance sheet item relating to the equity components of the CIS;

V = the current book value of the institution's holding of interests arising from the CIS; and

CIS_{max} = the ratio of the maximum value of equity exposures permitted to be incurred by the CIS under its investment mandate to the total net asset value of the CIS as reported in the CIS's latest financial report (the maximum value of equity exposures permitted to be incurred by the CIS under its investment mandate must include the values of equity exposures converted from the CIS's holding of equity derivative contracts, and be determined on the assumption that the CIS borrows to the maximum value permitted under the mandate).

(4) For subrule (1)(c), Formula 2 may be used if—

(a) the institution has access to information with respect to the underlying exposure of the CIS and the following requirements are satisfied—

(i) the frequency of financial reporting of the CIS is not lower than that of the institution; and

(ii) the information is sufficient to allow the institution to value its equity exposure arising from the CIS by using that Formula; and

(b) the information provided to the institution under paragraph (a) is verified by an independent third party such as the depository, the custodian or the manager of the CIS, or the information is subscribed information provided by a competent and reliable third party market data provider.

(5) Formula 2 is as follows—

Formula 2

$$E_{CIS} = \text{Min } [V, V \times (CIS_{actual}/CIS_{NAV})]$$

where—

E_{CIS} = the value of the authorized institution's equity exposure arising from an on-balance sheet item relating to the equity components of the CIS;

V = the current book value of the institution's holding of interests arising from the CIS;

CIS_{actual} = the total value of equity exposures arising from the interests held by the CIS as reported in the CIS's latest financial report (the CIS's holding of equity derivative contracts must be

converted into values of equity exposures with respect to the underlying equity for inclusion in this total value); and

CIS_{NAV} = the total net asset value of the CIS as reported in the CIS's latest financial report.

(6) If—

(a) an authorized institution uses Formula 2 under subrule (1)(c) to value its equity exposure arising from an on-balance sheet item relating to the equity components of a CIS; and

(b) the total value of the exposures arising from the interests held by the CIS does not exceed the total net asset value of the CIS as reported in the CIS's latest financial report,

the institution may break down the value calculated in accordance with Formula 2 into positions in the individual underlying equities in the CIS by using Formula 3.

(7) For subrule (6), the total value of the exposures arising from the interests held by a CIS is the sum of the value of all exposures arising from the interests held by the CIS with respect to any asset class (including cash and exposures converted from the CIS's holding of derivative contracts).

(8) A position of an authorized institution in an individual underlying equity calculated by using Formula 3 may be offset against the institution's opposite position in the same equity under rule 13(2).

(9) Formula 3 is as follows—

Formula 3

$$E_u = E_{CIS} \times CIS_u/CIS_{actual}$$

where—

E_u = the value of the authorized institution's equity exposure with respect to the underlying equity held by the CIS;

E_{CIS} = the value of the institution's equity exposure arising from an on-balance sheet item relating to the equity components of the CIS calculated by using Formula 2;

CIS_u = the value of the equity exposure with respect to the underlying equity held by the CIS as reported in the CIS's latest financial report; and

CIS_{actual} = the total value of equity exposures arising from the interests held by the CIS as reported in the CIS's latest financial report (the CIS's holding of equity derivative contracts must be converted into values of equity exposures with respect to the underlying equity for inclusion in this total value).

(10) If an authorized institution has any off-balance sheet unfunded commitment to invest in a CIS, the institution's equity exposure arising from the commitment must be valued at the contracted amount.

Part 3

Acquisition of Share Capital of Company

Division 1—General

21. Interpretation of Part 3

In this Part—

value (價值), in relation to any shares of a company, means the sum of—

(a) the current book value of the shares; and

(b) the amount that is remaining unpaid on the shares and is not included in the current book value of the shares.

22. Application of Part 3

This Part applies to an authorized institution incorporated in Hong Kong.

Division 2—Limit on Acquisition of Share Capital of Company

23. Limit on acquisition of share capital of company

(1) Subject to subrules (2) and (3), an authorized institution must not, except with a consent given under rule 24(1), acquire all or part of the share capital of a company (whether or not the company was established by the institution)—

(a) whether by 1 acquisition or a series of acquisitions; and

(b) by whatever means,

to a value equivalent to 5% or more of the amount of the institution's Tier 1 capital at the time of the acquisition.

(2) Subrule (1) does not apply to—

(a) the acquisition of any share capital of a company—

(i) in the course of the satisfaction of debts due to the institution; or

(ii) subject to subrule (3), under an underwriting or subunderwriting contract;

(b) the acquisition of any share capital of a company in the ordinary course of the insurance business of the institution or a consolidated subsidiary of the institution if—

(i) the acquisition—

(A) is principally funded by the insurance premiums collected from the insurance business of the institution or a consolidated subsidiary of the institution, including any investment return and reinvestment return from such premiums; and

(B) complies with applicable regulations imposed by the relevant insurance authority or regulator; and

(ii) the institution and the relevant consolidated subsidiary have established adequate policies and procedures and have implemented them effectively to ensure that the share acquisition decisions in the insurance business are made independently from the share acquisition decisions in other businesses of the institution and the subsidiary; or

(c) the acquisition of any share capital of a company (whether by 1 acquisition or a series of acquisitions) booked in the trading book, if, the part of the institution's aggregate equity exposure (within the

meaning of rule 13), that is attributable to the institution's equity exposures (within the meaning of rule 9) to the company, is less than—

(i) 5% of the amount of the institution's Tier 1 capital; or

(ii) a higher percentage approved by the Monetary Authority in writing, if the Monetary Authority considers that it is reasonable to do so, having regard to—

(A) the nature of, and risks associated with, the relevant acquisition;

(B) any policies and procedures implemented by the institution to monitor and control those risks; and

(C) any other factors that the Monetary Authority considers relevant.

(3) The institution must—

(a) dispose of the share capital described in subrule (2)(a)(ii) within—

(i) 7 working days after the acquisition of the share capital; or

(ii) a longer period approved by the Monetary Authority in writing in any particular case; and

(b) where a longer period is approved under paragraph (a)(ii)—comply with the conditions that the Monetary Authority may attach to the approval.

(4) The Monetary Authority may attach conditions to an approval given under subrule (2)(c)(ii).

(5) In this rule—

consolidated subsidiary (綜合附屬公司), in relation to an authorized institution to which a notice is given under rule 6(1) requiring it to apply this rule on a consolidated basis, means a subsidiary of the institution that is specified in the notice.

24. Consent for acquisition

(1) On application by an authorized institution, the Monetary Authority may give a written consent to allow 1 acquisition or a series of acquisitions, described in rule 23(1).

(2) The Monetary Authority may attach conditions to a consent given under subrule (1).

(3) If the Monetary Authority refuses to give a consent under subrule (1), the Monetary Authority must, by written notice to the institution, inform the institution of the refusal.

(4) Without limiting subrule (1), the Monetary Authority may, by written notice to the institution—

(a) attach a further condition to a consent given under subrule (1); or

(b) amend or cancel a condition attached to the consent.

(5) If, after a consent is given under subrule (1), the Monetary Authority considers that it is no longer reasonable to allow the institution to hold share capital of the relevant company to a value equivalent to 5% or more of the amount of the institution's Tier 1 capital, the Monetary Authority may, by written notice to the institution, revoke the consent.

(6) If a consent given to an authorized institution is revoked under subrule (5), the institution must not, after the revocation takes effect, hold share capital of the relevant company to a value equivalent to 5% or more of the amount of the institution's Tier 1 capital.

Part 4

Financial Facility against Security of Own Shares etc.

Division 1—General

25. Interpretation of Part 4

(1) In this Part—

Basel Committee's capital standards (巴委會資本標準) means the capital standards first published by the Basel Committee in July 1988, entitled "International Convergence of Capital Measurement and Capital Standards", as amended or updated from time to time;

capital base eligible (具資本基礎資格), in relation to an instrument issued by an authorized institution incorporated outside Hong Kong, means eligible to be included in the institution's capital base under any regulatory regime in the jurisdiction of the institution's incorporation—

(a) that is applicable to the institution; and

(b) that prescribes requirements relating to the capital resources of financial institutions for implementing in that jurisdiction the Basel Committee's capital standards with or without modification;

capital-in-nature instrument (資本類票據) means an instrument other than shares—

(a) that is issued by an authorized institution incorporated in Hong Kong and qualifies under the Capital Rules as—

(i) a CET1 capital instrument;

(ii) an Additional Tier 1 capital instrument; or

(iii) a Tier 2 capital instrument;

(b) that is issued by an authorized institution incorporated outside Hong Kong and is capital base eligible;

(c) that—

(i) is issued by a company (whether incorporated in or outside Hong Kong) that is a holding company or subsidiary of an authorized institution incorporated in Hong Kong; and

(ii) would qualify as a CET1 capital instrument, an Additional Tier 1 capital instrument or a Tier 2 capital instrument under the Capital Rules if the instrument were issued by the institution; or

(d) that is issued by a holding company or subsidiary (whether incorporated in or outside Hong Kong) of an authorized institution incorporated outside Hong Kong and would be capital base eligible if the instrument were issued by the institution;

non-capital LAC debt instrument (非資本 LAC 債務票據) has the meaning given by rule 2(1) of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules (Cap. 628 sub. leg. B).

(2) In this Part, an expression specified below has the meaning given by section 2(1) of the Capital Rules—

Additional Tier 1 capital instrument (額外一級資本票據);

CET1 capital instrument (CET1 資本票據);

Tier 2 capital instrument (二級資本票據).

26. Application of Part 4

(1) This Part applies to—

(a) an authorized institution incorporated in Hong Kong; and

(b) subject to subrule (2), an authorized institution incorporated outside Hong Kong.

(2) For an authorized institution incorporated outside Hong Kong, this Part only applies to the business of the institution carried on in or from—

(a) its principal place of business in Hong Kong; and

(b) its local branches,

as if the business were collectively the business of a separate authorized institution.

Division 2—Limit on Financial Facility against Security of Own Shares etc.

27. Limit on financial facility against security of own shares etc.

(1) An authorized institution must not provide a financial facility against the security of any share, capital-in-nature instrument or non-capital LAC debt instrument issued by it.

(2) An authorized institution must not, except with a consent given under rule 28(1), provide a financial facility against the security of any share, capital-in-nature instrument or non-capital LAC debt instrument issued by—

(a) a holding company of the institution;

(b) a subsidiary of the institution; or

(c) a subsidiary of a holding company of the institution.

28. Consent for financial facility against security of shares etc. issued by associated company of authorized institution

(1) On application by an authorized institution, the Monetary Authority may give a written consent, generally or in any particular case or class of cases, to allow the institution to provide a financial facility against the security of any share,

capital-in-nature instrument or non-capital LAC debt instrument issued by—

(a) a holding company of the institution;

(b) a subsidiary of the institution; or

(c) a subsidiary of a holding company of the institution.

(2) The Monetary Authority may attach conditions to a consent given under subrule (1).

Part 5

Financial Facility Provided to Employee

Division 1—General

29. Interpretation of Part 5

(1) In this Part—

aggregate financial facility amount (資金融通總額), in relation to an employee of an authorized institution, means the sum of—

(a) the amount of all unsecured financial facilities provided by the institution to the employee; and

(b) the amount of the unsecured parts of all secured financial facilities provided by the institution to the employee;

secured financial facility (有保證資金融通) means a financial facility against which an acceptable security is provided;

unsecured financial facility (無保證資金融通) means a financial facility against which there is no acceptable security provided.

(2) For the definitions of ***secured financial facility*** and ***unsecured financial facility*** in subrule (1), a security is an acceptable security if, in the opinion of the Monetary Authority, it would be acceptable to a prudent banker.

(3) For this Part, if the amount of a secured financial facility exceeds at any time the current market value of the assets constituting the security, the part of the facility that exceeds that value is unsecured at that time.

30. Application of Part 5

(1) This Part applies to—

(a) an authorized institution incorporated in Hong Kong; and

(b) subject to subrule (2), an authorized institution incorporated outside Hong Kong.

(2) For an authorized institution incorporated outside Hong Kong, this Part only applies to the business of the institution carried on in or from—

(a) its principal place of business in Hong Kong; and

(b) its local branches,

as if the business were collectively the business of a separate authorized institution.

Division 2—Limit on Financial Facility Provided to Employee

31. Limit on financial facility provided to employee

An authorized institution must not, except with a consent given under rule 32, for any of its employees, at any time maintain an aggregate financial facility amount exceeding the employee's annual salary calculated by a method that the Monetary Authority considers reasonable.

32. Consent for exceeding limit on aggregate financial facility amount

On application by an authorized institution, the Monetary Authority may give a written consent, generally or in any particular case or class of cases, to allow the institution's aggregate financial facility amount for 1 or more of its employees to exceed the limit prescribed under rule 31.

Part 6

Interest in Land

Division 1—General

33. Interpretation of Part 6

In this Part—

adjusted land exposure (經調節土地風險承擔)—see rule 37(1)(b);

adjusted land exposure ratio (經調節土地風險承擔比率), in relation to an authorized institution, means the ratio, expressed as a percentage, of the institution's adjusted land exposure to the amount of the institution's Tier 1 capital;

adjusted Tier 1 capital amount (經調節一級資本額), in relation to an authorized institution, means—

(a) if the amount of the cumulative gain arising from the revaluation of the institution's self-use land in accordance with the applicable accounting standards (***cumulative gain amount***) is excluded from the calculation of the amount of its Tier 1 capital—the sum of the amount of its Tier 1 capital and the cumulative gain amount; or

(b) if the cumulative gain amount is not excluded from the calculation of the amount of its Tier 1 capital—the amount of its Tier 1 capital;

land exposure (土地風險承擔)—see rule 37(1)(a);

land exposure ratio (土地風險承擔比率), in relation to an authorized institution, means the ratio, expressed as a percentage, of the institution's land exposure to the institution's adjusted Tier 1 capital amount;

self-use land (自用土地)—see rule 37(2) and (3).

34. Application of Part 6

This Part applies to an authorized institution incorporated in Hong Kong.

Division 2—Limit on Holding of Interest in Land

35. Limit on holding of interest in land

Subject to (if applicable) any variation under rule 36(1), an authorized institution must at all times maintain—

(a) a land exposure ratio not exceeding 50%; and

(b) an adjusted land exposure ratio not exceeding 25%.

36. Monetary Authority may vary limit on holding of interest in land

(1) Subject to subrules (3), (4), (5) and (6), the Monetary Authority may, by written notice served on an authorized institution, vary any or both of the limits prescribed under rule 35(a) and (b) for the institution if the Monetary Authority, after taking into account the considerations set out in subrule (2), is satisfied on reasonable grounds that it is prudent to make the variation.

(2) The considerations are—

(a) the risks associated with the level or concentration of the institution's holding of interests in land;

(b) any risk mitigation measures taken by the institution to manage those risks;

(c) the risks associated with those measures;

(d) any prevailing or reasonably anticipated market conditions that may affect the risks associated with the level or concentration of the institution's holding of interests in land; and

(e) any other factors that the Monetary Authority considers relevant.

(3) If the Monetary Authority proposes to serve a notice (***proposed notice***) under subrule (1) on an authorized institution, the Monetary Authority must serve a draft of the notice (***draft notice***) on the institution.

(4) A draft notice must—

(a) specify—

(i) the proposed variation of the limit concerned; and

(ii) the circumstances pertaining to, and the grounds for, the proposed variation; and

(b) contain a statement that the institution may, within 14 days (or a longer period approved by the Monetary Authority in writing in any particular case) from the date of service of the draft notice, make written representation to the Monetary Authority on any or all of the matters specified in the draft notice.

(5) If an authorized institution makes any written representation in relation to a draft notice served on it, the Monetary Authority may, after considering the representation—

(a) serve a notice on the institution under subrule (1) in substantially the same terms as the draft notice;

(b) serve a notice on the institution under subrule (1) in terms modified to take account of the representation on being satisfied that the modification should be made; or

(c) elect not to serve a notice on the institution under subrule (1) if satisfied by the representation that the proposed notice should not be served on the institution.

(6) If no representation is made by an authorized institution in relation to a draft notice served on it, the Monetary Authority may serve a notice on the institution under subrule (1) in substantially the same terms as the draft notice.

(7) A decision of the Monetary Authority under subrule (1) is a decision to which section 101B(1) of the Ordinance applies.

(8) To avoid doubt—

(a) the Monetary Authority may serve a draft notice on an authorized institution to supersede an earlier draft notice served on the institution; and

(b) the reference to same terms in subrule (5)(a) or (6) does not include the statement mentioned in subrule (4)(b).

Division 3—Determination of Land Exposure and Adjusted Land Exposure

37. Land exposure and adjusted land exposure

(1) Subject to rule 38—

(a) an authorized institution's land exposure is the sum of the current book value of all interests in land held by the institution; and

(b) an authorized institution's adjusted land exposure is the institution's land exposure minus the sum of the current book value of all interests in the institution's self-use land held by the institution.

(2) For subrule (1)(b), if any land is used for—

(a) conducting an authorized institution's business; or

(b) providing housing or amenities for an authorized institution's employees,

the land is the institution's self-use land.

(3) Without limiting subrule (2), if an office of an authorized institution is situated in a part of any premises, the Monetary Authority may, for that subrule, give a written consent to allow the institution to treat the whole of the premises as being used for conducting the institution's business.

38. Interest in land disregarded

The following interests in land held by an authorized institution are not to be taken into account for determining the institution's land exposure or adjusted land exposure—

(a) any interest in land mortgaged (or otherwise provided as security) to the institution to secure a debt due to it;

(b) any interest in land acquired by the institution in the course of the satisfaction of debts due to it, if—

(i) the following period has not expired—

(A) the period from the date of the acquisition of the interest to the date on which the interest may be disposed of at the earliest suitable opportunity, or the period of 18 months after the acquisition of the interest, whichever period expires first; or

(B) a longer period approved by the Monetary Authority in writing in any particular case; and

(ii) where a longer period is approved under subparagraph (i)(B)—the institution complies with the conditions that the Monetary Authority may attach to the approval.

Part 7

Single Counterparty and Group of Linked Counterparties

Division 1—General

39. Interpretation of Part 7 and Schedule 1

(1) In this Part—

aggregate exposure ratio (總風險承擔比率) means an ASCE ratio or ALCGE ratio;

aggregate linked counterparty group exposure (對手方相連集團總風險承擔)—see rule 47;

aggregate linked counterparty group exposure ratio (對手方相連集團總風險承擔比率), in relation to an authorized institution and an LC group, means the ratio, expressed as a percentage, of the institution's ALCG exposure to that group, to the amount of the institution's Tier 1 capital;

aggregate single counterparty exposure (單一對手方總風險承擔)—see rule 46;

aggregate single counterparty exposure ratio (單一對手方總風險承擔比率), in relation to an authorized institution and a counterparty, means the ratio, expressed as a percentage, of the institution's ASC exposure to that counterparty, to the amount of the institution's Tier 1 capital;

ALCG exposure (ALCG 風險承擔) means an aggregate linked counterparty group exposure;

ALCGE ratio (ALCGE 比率) means an aggregate linked counterparty group exposure ratio;

ASC exposure (ASC 風險承擔) means an aggregate single counterparty exposure;

ASCE ratio (ASCE 比率) means an aggregate single counterparty exposure ratio;

Category A institution (A 類機構) means an authorized institution designated by the Monetary Authority as such under rule 49;

Category B institution (B 類機構) means an authorized institution that is not a Category A institution;

CCR exposure (CCR 風險承擔) means a counterparty credit risk exposure;

comprehensive approach (全面方法) has the meaning given by section 51(1) of the Capital Rules;

counterparty credit risk exposure (對手方信用風險承擔), in relation to an item in a book of an authorized institution, means the institution's exposure to a counterparty credit risk arising from the item;

credit protection (信用保障), in relation to an exposure of an authorized institution, means the protection afforded to the exposure by a recognized CRM, a collateral mentioned in rule 54(1)(b) or a credit derivative contract mentioned in rule 56(2);

credit protection provider (信用保障提供者)—

(a) in relation to a collateral—means the issuer of the collateral;

(b) in relation to a guarantee—means the guarantor under the guarantee; or

(c) in relation to a credit derivative contract—means the protection seller under the contract;

credit risk mitigation covered exposure (減險措施涵蓋的風險承擔) means an exposure that is covered by a recognized CRM;

credit risk mitigation uncovered portion (減險措施不涵蓋部分), in relation to a CRM covered exposure, means the portion of the exposure that is not covered by the relevant recognized CRM;

CRM covered exposure (CRM 涵蓋風險承擔) means a credit risk mitigation covered exposure;

CRM uncovered portion (CRM 不涵蓋部分) means a credit risk mitigation uncovered portion;

entity (實體) includes—

(a) a natural person;

(b) a body of persons, whether incorporated or unincorporated;

(c) a partnership; and

(d) a public body;

exempted sovereign entity (豁免官方實體) means—

(a) the Government;

(b) the central government of a country;

(c) the central bank of a country; or

(d) a sovereign foreign public sector entity;

exposure (風險承擔), in relation to an item in a book of an authorized institution, means—

(a) the institution's CCR exposure arising from the item; or

(b) the institution's non-CCR exposure arising from the item;

Financial Stability Board (金融穩定理事會) has the meaning given by section 2(1) of the Financial Institutions (Resolution) Ordinance (Cap. 628);

forward asset purchase (遠期資產購買), in relation to an authorized institution, means a contractually binding

commitment of the institution to purchase a loan, security or other asset (other than currency) from another party under a contract (excluding a put option contract written by the institution) on a specified future date;

FSB G-SIB list (金穩會 G-SIB 列表) means the current list of global systemically important banks published by the Financial Stability Board;

G-SIB-linked group (G-SIB 相連集團)—see rule 42;

group of linked counterparties (對手方相連集團)—see rule 41;

initial margin (開倉保證金) has the meaning given by section 226V(1) of the Capital Rules, with the modification that the meaning is in relation to any entity instead of only in relation to a CCP and its clearing member;

initial public offering (首次公開招股) means an act of offering the shares of a company in a stock market operated by the Stock Exchange of Hong Kong Limited for the first time;

investment structure (投資結構), in relation to an authorized institution, means an item in a book of the institution that possesses a structure that gives the institution an exposure arising from the assets underlying the structure;

Example—

A CIS or a securitization transaction.

IPO means an initial public offering;

LC group (LC 集團) means a group of linked counterparties;

local G-SIB (本地 G-SIB) means an authorized institution designated as a global systemically important authorized institution under section 3S of the Capital Rules;

local G-SIB designation (本地 G-SIB 指定), in relation to a local G-SIB, means the designation of it as a global systemically

important authorized institution under section 3S of the Capital Rules;

non-CCR exposure (非 CCR 風險承擔), in relation to an item in a book of an authorized institution, means the institution's exposure arising from the item, other than a CCR exposure;

non-segregated initial margin (無分隔開倉保證金), in relation to a derivative contract, means an initial margin that is not a segregated initial margin;

original maturity period (原訂到期期間), in relation to an exposure arising from an off-balance sheet item of an authorized institution specified in Table A, means the period between the following dates (both dates inclusive)—

(a) the date on which the institution incurs the exposure;

(b) the earliest date on which the institution can, at its option, unconditionally cancel the exposure;

recognized collateral (認可抵押品)—

(a) in relation to an authorized institution that uses the STC approach, under section 5(1)(a) of the Capital Rules, to calculate its credit risk for non-securitization exposures—means a collateral recognized under section 77 of the Capital Rules, as if sections 77, 78, 79 and 80 of the Capital Rules were applicable to the institution, but does not include a collateral falling within section 79(1)(p) of the Capital Rules (***section 79(1)(p) collateral***);

(b) in relation to an authorized institution that uses the BSC approach, under section 5(1)(b) of the Capital Rules, to calculate its credit risk for non-securitization exposures—means a collateral recognized under section 77 of the Capital Rules, as if section 77 (except section 77(h) and (i)(ii)) of and section 79 of the Capital Rules

were applicable to the institution, but does not include a section 79(1)(p) collateral;

(c) in relation to an authorized institution that uses the IRB approach, under section 5(1)(c) of the Capital Rules, to calculate its credit risk for non-securitization exposures—means a collateral recognized under section 77 of the Capital Rules, as if sections 77, 78, 79 and 80 of the Capital Rules were applicable to the institution, but does not include a section 79(1)(p) collateral;

recognized credit derivative contract (認可信用衍生工具合約), in relation to an exposure of an authorized institution, has the meaning given by section 51(1) of the Capital Rules, as if section 99 of the Capital Rules were applicable to the institution, but does not include a credit-linked note;

recognized credit risk mitigation (認可減險措施) means—

(a) a recognized netting done under a valid bilateral netting agreement;

(b) a recognized collateral;

(c) a recognized guarantee;

(d) a recognized credit derivative contract; or

(e) a credit-linked note;

recognized CRM (認可 CRM) means a recognized credit risk mitigation;

recognized guarantee (認可擔保), in relation to an exposure of an authorized institution, has the meaning given by section 51(1) of the Capital Rules, as if section 98 of the Capital Rules were applicable to the institution;

residential mortgage loan (住宅按揭貸款) has the meaning given by section 2(1) of the Capital Rules, with the modification that

the meaning is in relation to any lender instead of only in relation to an authorized institution;

segregated initial margin (分隔開倉保證金), in relation to a derivative contract, means an initial margin that is segregated from the collecting party's proprietary assets—

(a) by placing the collateral constituting the margin with a third party custodian; or

(b) through other legally valid arrangements,

to protect the collateral from the default or insolvency of the collecting party;

simple approach (簡易方法) has the meaning given by section 51(1) of the Capital Rules;

Table A (表 A) means Table A in Schedule 1;

Table B (表 B) means Table B in Schedule 1.

(2) In this Part, an expression specified below has the meaning given by section 2(1) of the Capital Rules—

affiliate (附屬成員);

asset sale with recourse (有追索權的資產出售);

bank (銀行);

BSC approach (BSC 計算法);

capital adequacy ratio (資本充足比率);

CCP;

central counterparty (中央交易對手方);

counterparty credit risk (對手方信用風險);

country (國家);

credit default swap (信用違責掉期);

credit event (信用事件);

credit-linked note (信用掛鈎票據);

credit risk (信用風險);

currency mismatch (貨幣錯配);

default fund contribution (違責基金承擔);

default risk exposure (違責風險的風險承擔);

direct credit substitute (直接信貸替代項目);

financial sector entity (金融業實體);

forward forward deposits placed (遠期有期存款);

group of companies (公司集團);

guarantee (擔保);

haircut (扣減);

incorporated (成立為法團);

IRB approach (IRB 計算法);

mark-to-market (按市價計值);

note issuance and revolving underwriting facilities (票據發行及循環式包銷融通);

notional amount (名義數額);

n^{th}-to-default credit derivative contract (n^{th} 違責者信用衍生工具合約);

obligor (承擔義務人);

partly paid-up shares and securities (部分付款股份及證券);

public sector entity (公營單位);

qualifying CCP (合資格 CCP);

recognized netting (認可淨額計算);

reference entity (參照實體);

reference obligation (參照義務);

risk-weighted amount (風險加權數額);

securities financing transaction (證券融資交易);

securitization transaction (證券化交易);

sovereign (官方實體);

sovereign foreign public sector entity (屬官方實體的非本地公營單位);

specific provisions (特定準備金);

standard supervisory haircut (標準監管扣減);

STC approach (STC 計算法);

synthetic securitization transaction (合成證券化交易);

trade-related contingency (貿易關聯或有項目);

transaction-related contingency (交易關聯或有項目);

underlying exposures (組成項目);

valid bilateral netting agreement (有效雙邊淨額結算協議).

(3) Expressions used in Schedule 1 have the same meaning as in this Part.

40. Applicable method, approach, provision, etc. in Capital Rules

A reference to a provision taking effect as if—

(a) a particular method or approach specified in the Capital Rules; or

(b) a provision or group of provisions of the Capital Rules,

were applicable to an authorized institution includes the case where that method, approach, provision or group of provisions is actually applicable to the institution.

41. Group of linked counterparties (LC group)

(1) For this Part, subject to subrules (3), (4) and (5)—

(a) for a counterparty of an authorized institution (***reference counterparty***), another counterparty of the institution is a linked counterparty of the reference counterparty if the other counterparty is an entity specified in subrule (2); and

(b) the reference counterparty and all of its linked counterparties are collectively treated as an LC group of the institution.

(2) The other counterparty is one that is—

(a) an entity that controls the reference counterparty;

(b) an entity that is controlled by the entity that controls the reference counterparty;

(c) an entity that is controlled by the reference counterparty;

(d) an entity that is not an entity specified in paragraph (a), (b) or (c), but is economically dependent on the reference counterparty or an entity specified in paragraph (a), (b) or (c);

(e) an entity that is controlled by an entity specified in paragraph (d); or

(f) any other entity that—

(i) controls; and

(ii) is economically dependent on,

an entity specified in paragraph (d).

(3) For subrule (1), if the reference counterparty is a counterparty in relation to which the institution's ASCE ratio does not exceed 5% or is an exempted sovereign entity, the institution, in determining its ASC exposure to the LC group (by reference to the reference counterparty), may treat any of the following entities as not being in the LC group—

(a) an entity specified in subrule (2)(d) that is economically dependent on the reference counterparty;

(b) an entity specified in subrule (2)(e) that is controlled by an entity specified in paragraph (a);

(c) an entity specified in subrule (2)(f) that controls and is economically dependent on an entity specified in paragraph (a).

(4) For subrule (1), if a counterparty of an authorized institution (***counterparty A***) is a linked counterparty of the reference counterparty by virtue of subrule (2)(a), (b) or (c) and the institution's ASCE ratio in relation to the counterparty A does not exceed 5%, the institution, in determining its ASC exposure to the LC group (by reference to the reference counterparty), may treat any of the following entities as not being in the LC group—

(a) an entity specified in subrule (2)(d) that is economically dependent on the counterparty A;

(b) an entity specified in subrule (2)(e) that is controlled by an entity specified in paragraph (a);

(c) an entity specified in subrule (2)(f) that controls and is economically dependent on an entity specified in paragraph (a).

(5) For subrule (1), if 2 or more counterparties of an authorized institution—

(a) are controlled by, or economically dependent on, an exempted sovereign entity, a specified sovereign-owned entity or The Financial Secretary Incorporated established under the Financial Secretary Incorporation Ordinance (Cap. 1015); and

(b) are otherwise not in an LC group under subrule (1),

regardless of whether the exempted sovereign entity, the specified sovereign-owned entity or The Financial Secretary Incorporated is a counterparty of the institution, the counterparties are treated as not being in an LC group of the institution.

(6) For this rule, subject to subrule (7), an entity (***subordinate entity***) is treated as being controlled by another entity (***parent entity***) if—

(a) the parent entity owns more than 50% of the voting rights in the subordinate entity;

(b) the parent entity has control of a majority of the voting rights in the subordinate entity under an agreement with other shareholders (or similar holders of voting rights);

(c) the parent entity has the right to appoint or remove a majority of the members of the subordinate entity's board of directors (or a similar governing body);

(d) a majority of the members of the subordinate entity's board of directors (or a similar governing body) have been appointed solely as a result of the parent entity exercising its voting rights; or

(e) the parent entity has the power, under a contract or otherwise, to exercise a controlling influence over the management or policies of the subordinate entity.

(7) For subrule (6), in so far as a parent entity falls within subrule (6)(a), (b), (c), (d) or (e), by virtue of its fiduciary capacity on behalf of a non-anonymous beneficiary—

(a) the subordinate entity is not to be treated as being controlled by the parent entity; and

(b) to avoid doubt, the subordinate entity is treated as being controlled by the beneficiary if, by virtue of the beneficiary's beneficial interest—

(i) the beneficiary owns more than 50% of the voting rights in the subordinate entity;

(ii) the beneficiary has control of a majority of the voting rights in the subordinate entity under an agreement with other shareholders (or similar holders of voting rights);

(iii) the beneficiary has the right to appoint or remove a majority of the members of the subordinate entity's board of directors (or a similar governing body);

(iv) a majority of the members of the subordinate entity's board of directors (or a similar governing body) have been appointed solely as a result of the beneficiary exercising its voting rights; or

(v) the beneficiary has the power, under a contract or otherwise, to exercise a controlling influence over the management or policies of the subordinate entity.

(8) For this rule, an entity (***Entity A***) is economically dependent on another entity (***Entity B***) if they are connected in a way that if Entity B were to encounter financial problems (in particular funding or repayment difficulties), Entity A would also be likely to encounter financial problems (in particular funding or repayment difficulties).

(9) In this rule—

specified sovereign-owned entity (指明官方擁有實體) means an entity that is specified in Schedule 2.

42. G-SIB-linked group

(1) For this Part, an LC group is a G-SIB-linked group if an entity in the group is—

(a) an international G-SIB; or

(b) a local G-SIB.

(2) The group becomes a G-SIB-linked group when—

(a) if subrule (1)(a) applies—the name representing the relevant entity or group of companies becomes included in the FSB G-SIB list; or

(b) if subrule (1)(b) applies—the relevant local G-SIB designation takes effect.

(3) To avoid doubt, if more than 1 entity in an LC group is an international G-SIB or a local G-SIB, the group is treated as having become a G-SIB-linked group when the group first had an entity in it becoming an international G-SIB or a local G-SIB.

(4) In this rule—

international G-SIB (國際 G-SIB) means—

(a) an entity that is in the FSB G-SIB list; or

(b) a company that is a member of a group of companies—

(i) that is in the FSB G-SIB list; or

(ii) any member of which is in the FSB G-SIB list.

43. Application of Part 7

This Part applies to an authorized institution incorporated in Hong Kong.

Division 2—Limit on Exposure to Single Counterparty and Group of Linked Counterparties

44. Limit on exposure to single counterparty and group of linked counterparties

(1) Subject to subrule (2) and (if applicable) any variation under rule 45(1), an authorized institution must at all times maintain—

(a) in relation to a counterparty of the institution—an ASCE ratio not exceeding 25%; and

(b) in relation to an LC group of the institution—an ALCGE ratio not exceeding 25%.

(2) Subject to subrules (3) and (4) and (if applicable) any variation under rule 45(1), a local G-SIB must at all times maintain—

(a) in relation to a counterparty of the institution that is in a G-SIB-linked group—an ASCE ratio not exceeding 15%; and

(b) in relation to an LC group of the institution that is a G-SIB-linked group—an ALCGE ratio not exceeding 15%.

(3) Subrule (2) only applies to a local G-SIB on and after the earlier of the following dates—

(a) the first anniversary date of the local G-SIB date;

(b) a date notified by the Monetary Authority in writing to the local G-SIB, which date must not fall within 6 months beginning on the local G-SIB date.

(4) Subrule (2) only applies in relation to a G-SIB-linked group or in relation to a counterparty in such a group on and after the earlier of the following dates—

(a) the first anniversary date of the G-SIB date;

(b) a date notified by the Monetary Authority in writing to the local G-SIB, which date must not fall within 6 months beginning on the G-SIB date.

(5) In this rule—

G-SIB date (G-SIB 日期), in relation to an LC group of an authorized institution that is a G-SIB-linked group or in relation to a counterparty in such a group—

(a) if the group becomes a G-SIB-linked group on a date on or after 1 July 2019—means the date on which it becomes a G-SIB-linked group; and

(b) if, immediately before 1 July 2019, the group was within the meaning of G-SIB-linked group as if these Rules had come into operation at that time—means 1 July 2019;

local G-SIB date (本地 G-SIB 日期), in relation to a local G-SIB—

(a) means the effective date of its local G-SIB designation; and

(b) if the effective date of its local G-SIB designation was before 1 July 2019—means 1 July 2019.

45. Monetary Authority may vary limit prescribed under rule 44

(1) Subject to subrules (3), (4), (5) and (6), the Monetary Authority may, by written notice served on an authorized institution, vary any or all of the following limits for the institution—

(a) the limits prescribed under rule 44(1)(a) and (2)(a), whether in relation to a particular counterparty, a class of counterparties or all counterparties of the institution;

(b) the limits prescribed under rule 44(1)(b) and (2)(b), whether in relation to a particular LC group, a class of LC groups or all LC groups of the institution,

if the Monetary Authority, after taking into account the considerations set out in subrule (2), is satisfied on reasonable grounds that it is prudent to make the variation.

(2) The considerations are—

(a) the risks associated with the level or concentration of the institution's exposures to 1 or more counterparties or LC groups;

(b) any risk mitigation measures taken by the institution to manage those risks;

(c) the risks associated with those measures; and

(d) any other factors that the Monetary Authority considers relevant.

(3) If the Monetary Authority proposes to serve a notice (***proposed notice***) under subrule (1) on an authorized institution, the Monetary Authority must serve a draft of the notice (***draft notice***) on the institution.

(4) A draft notice must—

(a) specify—

(i) the proposed variation of the limit concerned; and

(ii) the circumstances pertaining to, and the grounds for, the proposed variation; and

(b) contain a statement that the institution may, within 14 days (or a longer period approved by the Monetary Authority in writing in any particular case) from the date of service of the draft notice, make written representation to the Monetary Authority on any or all of the matters specified in the draft notice.

(5) If an authorized institution makes any written representation in relation to a draft notice served on it, the Monetary Authority may, after considering the representation—

(a) serve a notice on the institution under subrule (1) in substantially the same terms as the draft notice;

(b) serve a notice on the institution under subrule (1) in terms modified to take account of the representation on being satisfied that the modification should be made; or

(c) elect not to serve a notice on the institution under subrule (1) if satisfied by the representation that the proposed notice should not be served on the institution.

(6) If no representation is made by an authorized institution in relation to a draft notice served on it, the Monetary Authority may serve a notice on the institution under subrule (1) in substantially the same terms as the draft notice.

(7) A decision of the Monetary Authority under subrule (1) is a decision to which section 101B(1) of the Ordinance applies.

(8) To avoid doubt—

(a) the Monetary Authority may serve a draft notice on an authorized institution to supersede an earlier draft notice served on the institution; and

(b) the reference to same terms in subrule (5)(a) or (6) does not include the statement mentioned in subrule (4)(b).

Division 3—Determination of ASC Exposure and ALCG Exposure

Subdivision 1—ASC Exposure and ALCG Exposure

46. Aggregate single counterparty exposure (ASC exposure)

Subject to rule 48 and Subdivisions 2, 3 and 4, an authorized institution's ASC exposure to a counterparty of the institution is determined by adding—

(a) the sum of the value of all of the institution's CCR exposures to the counterparty (valued in accordance with Division 4), arising from derivative contracts and securities financing transactions entered into by the institution with the counterparty; and

(b) the sum of the value of all of the institution's non-CCR exposures to the counterparty (valued in accordance with Division 5), arising from items in the institution's books.

47. Aggregate linked counterparty group exposure (ALCG exposure)

(1) Subject to subrules (2) and (4), an authorized institution's ALCG exposure to an LC group of the institution is the sum of the ASC exposure to all counterparties of the institution in the group.

(2) If a counterparty of the institution in the group acts as a CCP for an item in the institution's books, the value of the institution's clearing-related exposures to the counterparty may be excluded from the institution's ALCG exposure to the group.

(3) To avoid doubt, the value of the institution's clearing-related exposures to the counterparty, mentioned in subrule (2), must be included in determining the institution's ASC exposure to the counterparty under rule 46.

(4) If the same portion of an exposure of an authorized institution is included in the institution's ASC exposure to 2 or more entities in an LC group, the exposure is to be counted once only in determining the institution's ALCG exposure to the group.

48. Exposure disregarded

(1) The following exposures of an authorized institution are not to be taken into account for determining an ASC exposure or an ALCG exposure—

(a) an exposure to an affiliate of the institution, if the institution and the affiliate are accounted for on a full basis in the consolidated financial statements of the holding company of the group of companies to which they belong, for the purposes of and in compliance with—

(i) the Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants;

(ii) the International Financial Reporting Standards issued by the International Accounting Standards Board; or

(iii) the standards of accounting practices applicable to the holding company in the place in which it is incorporated;

(b) an exposure in the institution's trading book that is not associated with the credit risk or default risk of a counterparty (for example, exposure to commodities and currencies);

(c) an exposure to an exempted sovereign entity (including, in relation to the Government, the holding of Exchange Fund Bills and Exchange Fund Notes for the account of the Exchange Fund);

(d) an exposure arising from any share capital, debt securities or investment structure held as security for a financial facility provided by the institution, except for a

collateral mentioned in rule 54(2)(a)(ii) or a recognized collateral mentioned in rule 54(2)(a)(iii);

(e) an exposure arising from any share capital, debt securities or investment structure acquired by the institution in the course of the satisfaction of debts due to it, if—

(i) the following period has not expired—

(A) the period from the date of the acquisition of the share capital, debt securities or investment structure to the date on which the share capital, debt securities or investment structure may be disposed of at the earliest suitable opportunity, or the period of 18 months after the acquisition of the share capital, debt securities or investment structure, whichever period expires first; or

(B) a longer period approved by the Monetary Authority in writing in any particular case; and

(ii) where a longer period is approved under subparagraph (i)(B)—the institution complies with the conditions that the Monetary Authority may attach to the approval;

(f) an exposure arising from any share capital or debt securities acquired under an underwriting or subunderwriting contract, if—

(i) the following period has not expired—

(A) the period of 7 working days after the acquisition of the share capital or debt securities; or

(B) a longer period approved by the Monetary Authority in writing in any particular case; and

(ii) where a longer period is approved under subparagraph (i)(B)—the institution complies with the conditions that the Monetary Authority may attach to the approval;

(g) an exposure arising from—

(i) an indemnity given by the institution to an entity to protect the entity against any damages which may be incurred by the entity as a result of the entity registering a transfer of shares under the following circumstances—

(A) the instrument by means of which the transfer has been effected, or purports to have been effected, has been provided, or purports to have been provided, by a subsidiary of the institution;

(B) the authenticating signature on the instrument has been imprinted on it by a machine used by the subsidiary to imprint that signature on such instruments; and

(C) that signature was unlawfully so imprinted on the instrument; or

(ii) a financial guarantee given by the institution to the entity in respect of any similar indemnity given by the subsidiary to the entity;

(h) an exposure to the Housing Authority (established under section 3 of the Housing Ordinance (Cap. 283)), arising from a guarantee given by the Housing Authority for the

Home Ownership Scheme or Private Sector Participation Scheme;

(i) an exposure to any of the following companies, arising from the obligations placed on the company for the Mortgage Insurance Programme set up by The Hong Kong Mortgage Corporation Limited—

(i) The Hong Kong Mortgage Corporation Limited;

(ii) a subsidiary of The Hong Kong Mortgage Corporation Limited;

(j) an exposure to any of the following companies, arising from the obligations placed on the company for the Guaranteed Mortgage-Backed Pass-Through Securitisation Programme set up by The Hong Kong Mortgage Corporation Limited—

(i) The Hong Kong Mortgage Corporation Limited;

(ii) a company that issues mortgage-backed securities in connection with the Programme;

(k) an exposure to a bank that meets both of the following descriptions—

(i) the exposure was incurred at a location on a particular calendar date by reference to the time zone of that location;

(ii) that calendar date has not ended at that location;

(l) an exposure of the institution under the following circumstances—

(i) the institution acts as a receiving bank in an IPO; and

(ii) the exposure is incurred to another authorized institution for placing the subscription monies received by the receiving bank to the interbank

market, including by means of a swap contract in relation to foreign exchanges;

(m) a clearing-related exposure (whether a CCR exposure or a non-CCR exposure) to a qualifying CCP;

(n) an exposure that is specified in a consent given under subrule (2), if the conditions attached to the consent under subrule (3)(b) are complied with.

(2) The Monetary Authority may give a written consent to allow an exposure or a class of exposures not to be taken into account for determining an ASC exposure or an ALCG exposure, if the Monetary Authority considers that it is reasonable to do so, having regard to—

(a) the nature of, and the risks associated with, the exposure or class of exposures;

(b) any risk mitigation measures taken by the institution to manage those risks;

(c) the risks associated with those measures; and

(d) any other factors that the Monetary Authority considers relevant.

(3) The Monetary Authority may—

(a) give a written consent under subrule (2) to an authorized institution or a class of authorized institutions; and

(b) attach conditions to the consent.

(4) In this rule—

receiving bank (收款銀行), in relation to an IPO, means a bank appointed by the issuer of the IPO to—

(a) receive subscription monies; and

(b) provide other services relating to the IPO such as returning monies to unsuccessful subscribers.

Subdivision 2—Credit Risk Mitigation

49. Designation of Category A institution

(1) The Monetary Authority may, by written notice to an authorized institution, designate the institution as a Category A institution.

(2) The designation may be made—

(a) on the Monetary Authority's own volition, if the Monetary Authority is satisfied that the institution—

(i) is internationally active; or

(ii) is significant to the general stability and effective working of the banking system in Hong Kong; or

(b) on application by the institution, if the Monetary Authority is satisfied that the institution has the capacity (including systems and resources) to determine an ASC exposure or an ALCG exposure taking into account the effect of credit risk mitigation applicable to a Category A 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 subrules (1) and (2), the Monetary Authority may decide not to designate an authorized institution as a Category A institution under the following circumstances—

(a) the institution's particular circumstances provide reasonable justification for it not to be designated as a Category A institution; and

(b) it would not materially prejudice the institution's calculation of an aggregate exposure ratio under this Part if the designation were not made.

(5) If—

(a) an authorized institution has been designated as a Category A 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 written notice 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.

50. Credit risk mitigation—Category A institution

(1) This rule applies to the valuation of a CRM covered exposure of a Category A institution, arising from an item in its banking book.

(2) If the recognized CRM that covers the exposure is not yet considered in valuing the exposure, the value of the exposure must be adjusted, in accordance with Division 6, to the value of the CRM uncovered portion of the exposure.

51. Credit risk mitigation—Category B institution

(1) This rule applies to the valuation of a CRM covered exposure of a Category B institution, arising from an item in its banking book.

(2) If the recognized CRM that covers the exposure—

(a) is—

(i) a recognized netting done under a valid bilateral netting agreement; or

(ii) a recognized collateral that is a cash deposit; and

(b) is not yet considered in valuing the exposure,

the value of the exposure must be adjusted, in accordance with Division 6, to the value of the CRM uncovered portion of the exposure.

Subdivision 3—Specific Circumstances

52. Investment with additional risk factor

(1) Subrule (2) applies if, in relation to an authorized institution, an entity—

(a) is the fund manager of 1 or more CISs, in relation to each of which the institution has an exposure arising from its holding of interests under the CIS (except where the custodian of the assets in the scheme is a separate legal entity);

(b) is the liquidity support provider to 1 or more asset-backed commercial paper programmes, in relation to each of which the institution has an exposure arising from its holding of interests under the programme;

(c) is the sponsor of 1 or more asset-backed commercial paper programmes, in relation to each of which the institution has an exposure arising from its holding of interests under the programme;

(d) is the credit protection provider (through a credit default swap or guarantee) of 1 or more synthetic securitization transactions, in relation to each of which the institution

has an exposure arising from its holding of interests under the transaction; or

(e) plays any other role which represents a common risk factor for 1 or more CISs, asset-backed commercial paper programmes, synthetic securitization transactions or similar items, in relation to each of which the institution has an exposure arising from its holding of interests under the CIS, asset-backed commercial paper programme, synthetic securitization transaction or similar item.

(2) The institution—

(a) is treated as having an exposure to the entity arising from each of the holdings mentioned in subrule (1); and

(b) must, for determining its ASC exposure to the entity—

(i) value each of the exposures as equivalent to the current book value of the relevant holding; and

(ii) include all of the exposures as non-CCR exposures of the institution.

(3) In this rule—

asset-backed commercial paper programme (有資產支持的商業票據計劃) has the meaning given by section 227(1) of the Capital Rules;

liquidity facility (流動資金融通) has the meaning given by section 227(1) of the Capital Rules, with the modification that the meaning is in relation to any entity instead of only in relation to an authorized institution;

liquidity support provider (流動資金支援者) means a party that provides liquidity facilities.

53. Protection seller and protection buyer of credit derivative contract

If—

(a) an authorized institution enters into a credit derivative contract as a protection seller; and

(b) the fair value of the contract is positive from the perspective of the institution (that is, the present value of contracted but not yet paid periodical payment from the protection buyer exceeds the present value of the expected obligation of the protection seller under the contract),

the institution must, for determining its ASC exposure to the protection buyer under this Part, include the positive value in calculating the sum of the value of all of the institution's CCR exposures to the protection buyer.

54. Credit protection provider

(1) Subrule (2) applies if an authorized institution—

(a) has offset an exposure in the trading book of the institution against a credit derivative contract mentioned in rule 56(2);

(b) has taken into account the value of any collateral in valuing a CCR exposure under rule 59 or 60; or

(c) has adjusted the value of a CRM covered exposure to the value of the CRM uncovered portion of the exposure in accordance with Division 6.

(2) The institution must include a new exposure to the relevant credit protection provider as follows—

(a) whether the exposure mentioned in subrule (1) (*protected exposure*) is a CCR exposure or a non-CCR exposure—

(i) if the credit protection is in the form of a recognized credit derivative contract or a credit derivative contract mentioned in rule 56(2) and the contract is not a credit default swap mentioned in paragraph (b)—the amount of the reduction in the value of the protected exposure must be included in determining the institution's ASC exposure to the counterparty of the contract;

(ii) if the value of the credit protection, that is in the form of a collateral, is taken into account in valuing the protected exposure under rule 59 or 60—the value so taken into account must be included in determining the institution's ASC exposure to the issuer of the collateral;

(iii) if the credit protection is in the form of a recognized collateral—the amount of the reduction in the value of the protected exposure must be included in determining the institution's ASC exposure to the issuer of the collateral;

(iv) if the credit protection is in the form of a recognized guarantee—the amount of the reduction in the value of the protected exposure must be included in determining the institution's ASC exposure to the guarantor under the guarantee;

(b) if the credit protection is in the form of a credit derivative contract mentioned in rule 56(2) that is a credit default swap, and either the counterparty or the reference entity of the contract is not a financial sector entity—an amount equivalent to the default risk exposure to the counterparty calculated as mentioned in rule 59 must be included in determining the institution's ASC exposure to the counterparty of the contract.

Subdivision 4—Offsetting and Deduction

55. General

For determining an ASC exposure under this Part, the valuation of an exposure may be subject to offsetting and deduction in accordance with this Subdivision.

56. Offsetting of positions

(1) A long position and a short position with respect to the same counterparty in an authorized institution's trading book may be offset as follows—

(a) a long position and a short position in the same issue of securities in the trading book may be offset;

(b) a long position and a short position in different issues of securities in the trading book issued by the same counterparty may be offset, if the long position is senior, or of equivalent seniority, to the short position.

(2) An exposure arising from the holding of securities issued by a counterparty in an authorized institution's trading book may be offset against a credit derivative contract, in the institution's trading book, entered into by the institution to hedge the exposure if the position being hedged is senior, or of equivalent seniority, to the reference obligation of the credit derivative contract.

(3) For subrule (1)(a), 2 issues are treated as the same issue if the following (as applicable) are identical—

(a) the issuer;

(b) coupon;

(c) currency;

(d) maturity;

(e) priority to claim on the issuer's income or assets.

(4) For determining the relative seniority of a long position and a short position in different issues of securities under subrules (1)(b) and (2)—

(a) the securities may be allocated into broad buckets of different degrees of seniority (including, for example, "equity", "subordinated debt" or "senior debt");

(b) if the institution chooses to allocate securities in the way mentioned in paragraph (a), the allocation must be applied consistently across the institution's entire portfolio of positions in its trading book.

(5) A long position with respect to a counterparty in an authorized institution's banking book may be offset against a short position in an option contract with respect to the counterparty in its banking book.

(6) The following is taken to be zero—

(a) a net short position after any offsetting mentioned in subrule (1)(a) or (b), (2) or (5);

(b) a short position not used to offset a long position as mentioned in subrule (1)(a) or (b), (2) or (5).

(7) To avoid doubt, an authorized institution may choose not to do any offsetting mentioned in subrule (1)(a) or (b), (2) or (5).

57. Deduction

(1) In valuing an exposure of an authorized institution, the following amounts are to be deducted—

(a) the amount that is deducted in determining the capital base of the institution in accordance with the Capital Rules;

(b) any specific provision made in respect of the exposure, that is not yet considered in valuing the exposure;

(c) for an exposure covered by a recognized collateral, or a recognized guarantee, issued by an exempted sovereign entity—the amount so covered;

(d) for an exposure covered by a letter of comfort where—

(i) the letter of comfort is approved by the Monetary Authority; and

(ii) the conditions (if any) attached to the approval, whether generally or in any particular case or class of cases, are complied with—

the amount so covered;

(e) for an exposure that has been written off in the books of the institution—the amount written off.

(2) If more than 1 deduction under subrule (1)(a), (b), (c), (d) or (e) corresponds to the same portion of an exposure, the institution—

(a) must apply only 1 deduction in valuing the exposure; but

(b) may choose to use any 1 of paragraphs (a), (b), (c), (d) and (e) of subrule (1).

Division 4—Valuation of CCR Exposure

58. Application of Division 4

This Division applies to the valuation of a CCR exposure of an authorized institution to a counterparty for determining the institution's ASC exposure to the counterparty.

59. Derivative contract

A CCR exposure arising from a derivative contract entered into by an authorized institution is valued by using the following methods—

(a) if the institution does not adopt an internal modelling approach to calculate the amount of the default risk exposure of its derivative contracts for calculating its capital adequacy ratio under the Capital Rules—the method that the institution currently adopts (being a method prescribed under the Capital Rules) for that calculation, but without converting the exposure into a risk-weighted amount as in the case of determining regulatory capital under the Capital Rules;

(b) if the institution adopts an internal modelling approach to calculate the amount of the default risk exposure of its derivative contracts for calculating its capital adequacy ratio under the Capital Rules—a method prescribed under the Capital Rules, as notified by the Monetary Authority in writing after consultation with the institution.

60. Securities financing transaction

A CCR exposure arising from a securities financing transaction entered into by an authorized institution is valued by using the following methods—

(a) if the institution does not adopt an internal modelling approach to calculate the amount of the default risk exposure of its securities financing transactions for calculating its capital adequacy ratio under the Capital Rules—the method that the institution currently adopts (being a method prescribed under the Capital Rules) for that calculation, but without converting the exposure into a risk-weighted amount as in the case of determining regulatory capital under the Capital Rules;

(b) if the institution adopts an internal modelling approach to calculate the amount of the default risk exposure of its securities financing transactions for calculating its

capital adequacy ratio under the Capital Rules—a method prescribed under the Capital Rules, as notified by the Monetary Authority in writing after consultation with the institution.

Division 5—Valuation of Non-CCR Exposure

Subdivision 1—Application of Division 5

61. Application of Division 5

This Division applies to the valuation of a non-CCR exposure of an authorized institution to a counterparty for determining the institution's ASC exposure to the counterparty.

Subdivision 2—Non-CCR Exposure (Banking Book)

62. Application of Subdivision 2

This Subdivision applies to a non-CCR exposure arising from an item in an authorized institution's banking book.

63. General—current book value

A non-CCR exposure, arising from an item in an authorized institution's banking book, must be valued at the item's current book value, unless this Subdivision or Subdivision 3 contains a provision that specifically provides for the valuation of the exposure.

64. Shares of company

A non-CCR exposure, arising from the holding of shares of a company, must be valued at the sum of—

(a) the current book value of the shares; and

(b) the amount that is remaining unpaid on the shares and is not included in the current book value of the shares.

65. Off-balance sheet item specified in Table A

(1) A non-CCR exposure, arising from an off-balance sheet item specified in Table A, must be valued by multiplying the item's principal amount (less the amount of any specific provision in respect of the exposure) by—

(a) the credit conversion factor specified in column 3 of Table A opposite that item; or

(b) for each of items 9, 10, 11 and 12 in Table A—100%, if the institution chooses not to apply the credit conversion factor mentioned in paragraph (a).

(2) In this rule—

principal amount (本金額), in relation to an off-balance sheet item specified in Table A, means—

(a) for an undrawn facility or the undrawn portion of a partially drawn facility—the amount of the undrawn commitment; or

(b) in any other case—the contracted amount of the item.

Subdivision 3—Non-CCR Exposure (Banking Book or Trading Book)

66. Application of Subdivision 3

This Subdivision applies to a non-CCR exposure, arising from an item in a book of an authorized institution, irrespective of whether the item is in its banking book or trading book.

67. Securities financing transaction

(1) This rule applies to the valuation of a non-CCR exposure arising from a securities financing transaction entered into by an authorized institution.

(2) For a repo-style transaction that falls within paragraph (a) or (b) of the definition of ***repo-style transaction*** in section 2(1) of the Capital Rules, the institution must treat the securities sold or lent under the transaction as remaining as its holding, and—

(a) if the securities are booked in the institution's banking book, the value of the exposure is—

(i) for shares, the sum of—

(A) the current book value of the shares; and

(B) the amount that is remaining unpaid on the shares and is not included in the current book value of the shares; and

(ii) for securities other than shares, the current book value of the securities; and

(b) if the securities are booked in the institution's trading book—the exposure must be valued at the current market value of the securities.

(3) For a repo-style transaction that falls within paragraph (d) of the definition of ***repo-style transaction*** in section 2(1) of the Capital Rules, the institution must treat any securities that it provides in exchange as collateral (***securities in exchange***) for securities borrowed under the transaction as remaining as its holding, and—

(a) if the securities in exchange are booked in the institution's banking book, the value of the exposure is—

(i) for shares, the sum of—

(A) the current book value of the shares; and

(B) the amount that is remaining unpaid on the shares and is not included in the current book value of the shares; and

(ii) for securities other than shares, the current book value of the securities; and

(b) if the securities in exchange are booked in the institution's trading book—the exposure must be valued at the current market value of the securities.

68. Option contract

(1) This rule applies to the valuation of a non-CCR exposure arising from an option contract entered into by an authorized institution.

(2) The exposure (***E***) is valued as the change in option price that would result from a default in respect of the assets underlying the contract, calculated by using the following formula—

(a) for a long position in a call option contract—

$$E = V$$

(b) for a long position in a put option contract—

$$E = -S + V$$

(c) for a short position in a call option contract—

$$E = -V$$

(d) for a short position in a put option contract—

$$E = S - V$$

where—

S = the strike price; and

V = the fair value of the option contract.

69. Counterparty acting as CCP

(1) This rule applies to the valuation of a non-CCR exposure to a counterparty arising from an item for which the counterparty acts as a CCP.

(2) A clearing-related non-CCR exposure listed in Table B must be valued by using the method or at the amount specified in column 2 of Table B opposite the exposure.

70. Covered bond

(1) This rule applies to the valuation of a non-CCR exposure arising from a covered bond held by an authorized institution.

(2) The exposure must be valued—

(a) at the nominal value of the covered bond; or

(b) if all conditions in subrule (3) are met at the inception of the covered bond and throughout its remaining maturity—at 30% of the nominal value.

(3) For subrule (2)(b), the conditions are as follows—

(a) the pool of the covered bond's underlying assets (*cover pool*) exclusively consists of claims falling within the following description—

(i) a claim on, or guaranteed by, a sovereign, a public sector entity or a multilateral development bank;

(ii) a claim secured by a residential mortgage loan that would qualify for the allocation of a risk-weight of 35% under section 65(1) of the Capital Rules if the mortgage had been extended by the institution and

in aggregate has a loan-to-value ratio not exceeding 80%;

(b) subject to paragraph (c), the ratio of the nominal value of the cover pool assigned by the issuer to cover the issuer's obligations under the covered bonds to the outstanding amount of the nominal value of the covered bonds exceeds 110%;

(c) if the ratio mentioned in paragraph (b) becomes less than 110% but not less than 100%, the shortfall is covered by—

(i) assets that are of the same type as that of the underlying assets;

(ii) liquid and high-quality assets (for example, cash or marketable debt securities); or

(iii) derivative contracts entered into by the issuer for hedging the risks arising from the covered bonds.

(4) For calculating the loan-to-value ratio for a residential mortgage loan mentioned in subrule (3)(a)(ii), section 206(i) and (j) of the Capital Rules must be complied with for valuing the collateral and for monitoring and reviewing the value of the collateral, as if those provisions were applicable to the issuer of the covered bond.

(5) In this rule—

covered bond (資產覆蓋債券) has the meaning given by rule 17 of the Banking (Liquidity) Rules (Cap. 155 sub. leg. Q);

loan-to-value ratio (貸款與價值比率) has the meaning given by section 65(10) of the Capital Rules, with the modification that the meaning is in relation to a residential mortgage loan provided by any lender instead of only in relation to a residential mortgage loan provided by an authorized institution.

71. Investment structure

(1) This rule applies to the valuation of the non-CCR exposures arising from an investment structure held by an authorized institution.

(2) If the value of the exposure to each asset underlying the investment structure, valued by the method mentioned in subrule (6), is less than 0.25% of the amount of the institution's Tier 1 capital, the institution must—

(a) assign an exposure arising from the investment structure as an exposure to a distinct counterparty and value the exposure at the current book value of the institution's investment in the investment structure; or

(b) assign an exposure to each asset underlying the investment structure and value each exposure by the method mentioned in subrule (6).

(3) If the value of the exposure to 1 or more assets underlying the investment structure, valued by the method mentioned in subrule (6), equals to or exceeds 0.25% of the amount of the institution's Tier 1 capital, the institution must—

(a) assign an exposure to that asset or each of those assets and value each exposure by the method mentioned in subrule (6); and

(b) for the remaining assets underlying the investment structure—

(i) assign an exposure arising from those remaining assets as an exposure to a distinct counterparty and value the exposure as follows—

(A) first, assume that an exposure is assigned to each of those remaining assets and value each of those exposures by the method mentioned in subrule (6); and

(B) second, add together the values of exposures mentioned in sub-subparagraph (A); or

(ii) assign an exposure to each of the remaining assets and value each exposure by the method mentioned in subrule (6).

(4) If the institution is unable to identify the underlying assets of the investment structure—

(a) in the case that the current book value of the institution's investment in the investment structure is less than 0.25% of the amount of the institution's Tier 1 capital, the institution must—

(i) assign the exposure arising from the investment structure as an exposure to a distinct counterparty; and

(ii) value the exposure at the current book value of the institution's investment in the investment structure; and

(b) in any other case, the institution must—

(i) assign the exposure as an exposure to a hypothetical counterparty called the "unknown client" and value the exposure at the current book value of the institution's investment in the investment structure; and

(ii) add all exposures to the unknown client as if they were related to a counterparty, to which rule 44(1) applies.

(5) An authorized institution must not enter into a scheme to avoid the application of subrule (3), with a view to circumventing a limit prescribed under rule 44(1) or (2).

Example—

Investing in several individually immaterial investment structures with identical underlying assets.

(6) If, under subrule (2) or (3), an exposure assigned to an underlying asset (***asset A***) is to be valued by the method mentioned in this subrule, the exposure must be valued as follows—

(a) if the rights of all the investors in the investment structure are identical, by using Formula 4;

(b) if there are differences in seniority levels among the investors in the investment structure, by multiplying the following—

(i) the share of the institution's investment in the tranche, expressed as a percentage;

(ii) the lower of—

(A) the nominal value of the tranche of the investment structure in which the institution holds an interest; and

(B) the nominal value of each underlying asset in the portfolio of assets underlying the investment structure.

(7) Formula 4 is as follows—

Formula 4

$$E(A) = \text{Min}\,(S_A \times NAV_{AI}/NAV_S), BV$$

where—

$E(A)$ = the value of the institution's exposure to asset A underlying the investment structure;

S_A = the total value of the investment structure's exposure to asset A as reported in the latest financial report of the investment structure;

NAV_{AI} = the net asset value of the share of the institution's holding of interests in the investment structure;

NAV_S = the net asset value of the investment structure; and

BV = the current book value of the institution's holding of interests in the investment structure.

(8) To avoid doubt, an authorized institution's exposure to a counterparty, arising from an asset underlying an investment structure, must be included in the institution's non-CCR exposures to the counterparty in determining the institution's ASC exposure to the counterparty.

(9) In this rule—

tranche (份額) means a contractually established segment (***relevant segment***) of the credit risk associated with a pool of underlying exposures in a securitization transaction, or in a transaction of a similar structure, if—

(a) a position in the relevant segment entails a risk of credit loss greater than, or less than, that of a position of the same amount in each other contractually established segment; and

(b) no account is taken of any credit protection provided by third parties directly to the holders of positions in the relevant segment or in other contractually established segments.

Subdivision 4—Non-CCR Exposure (Trading Book)

72. Application of Subdivision 4

This Subdivision applies to a non-CCR exposure arising from an item in an authorized institution's trading book.

73. General—current book value

A non-CCR exposure, arising from an item in an authorized institution's trading book, must be valued at the item's current book value, unless this Subdivision or Subdivision 3 contains a provision that specifically provides for the valuation of the exposure.

74. Shares or debt securities

A non-CCR exposure arising from the holding of shares or debt securities must be valued at the current market value of the shares or debt securities.

75. Futures, forward or swap contract

(1) This rule applies to a non-CCR exposure arising from any of the following derivative contracts entered into by an authorized institution—

(a) a futures contract;

(b) a forward contract;

(c) a swap contract.

(2) The exposure must be valued as follows—

(a) first, the contract must be decomposed into individual legs in accordance with sections 289(2)(c)(i), (ii) and (iii) and 292(1)(c), (d) and (e) of the Capital Rules, as if those provisions were applicable to the institution;

(b) second—

(i) subject to paragraph (c), only legs representing non-CCR exposures are to be included as an exposure; and

(ii) each of those legs must be valued at the fair value of the relevant underlying asset of the contract; and

(c) third, a leg representing an exposure to an underlying basket of securities or securities index under the contract (***underlying basket***) must be measured in accordance with rule 71 as if the underlying basket were an investment structure held by the institution with the modifications that—

(i) a reference to the current book value of the institution's investment in the investment structure is treated as the fair value of the underlying basket; and

(ii) Formula 4 is to be replaced by Formula 5.

(3) Formula 5 is as follows—

Formula 5

$$E(A) = W \times FV$$

where—

E(A) = the value of the institution's exposure arising from a security (***security A***) underlying the investment structure;

W = the weight of security A in the underlying basket of securities or securities index mentioned in subrule (4); and

FV = the fair value of the underlying basket of securities or securities index mentioned in subrule (4).

(4) For Formula 5—

(a) the weight of a security in a basket of securities is the ratio of the fair value of that security to the aggregate fair value of all the securities in the basket of securities;

(b) the weight of a security in a securities index is the weight of the security in the securities index as specified by the index provider that compiles the index; and

(c) the fair value of a securities index equals to—

(i) the current index value multiplied by—

(A) for a futures contract, the monetary value of 1 index point set by the futures exchange where the futures contract is traded; or

(B) in any other case, the monetary value of 1 index point as agreed by the counterparties of the derivatives contract; or

(ii) the fair value of the underlying basket of securities by reference to which the index is compiled.

(5) If an individual leg is an exposure treated as arising from a zero-coupon specific risk-free security, that exposure may be excluded.

(6) In subrule (5)—

specific risk-free security (無特定風險證券) has the meaning given by section 281 of the Capital Rules.

76. Credit derivative contract

(1) This rule applies to a non-CCR exposure arising from a credit derivative contract entered into by an authorized institution.

(2) For a credit derivative contract other than an n^{th}-to-default credit derivative contract under which the institution is the protection seller, the institution must value an exposure to the

reference entity, arising from the contract, at the amount due in the case a credit event specified in the contract occurs minus the absolute mark-to-market value of the credit derivative contract.

(3) For an n^{th}-to-default credit derivative contract under which the institution is the protection seller, the institution must—

(a) value the exposure, arising from each of the basket of reference obligations, to the relevant reference entity by using Formula 6; or

(b) value the exposure, arising from each of the basket of reference obligations, to the relevant reference entity in the full nominal amount of the contract.

(4) Formula 6 is as follows—

Formula 6

$$E = N \times \max(1/n, \min(1, 1.6 - 0.2n))$$

where—

E = the value of the institution's exposure to the relevant reference entity;

N = the notional amount of the contract; and

n = the number of reference obligations that need to default to trigger payment by the protection seller.

77. Other derivative contract

(1) This rule applies to a non-CCR exposure arising from a derivative contract entered into by an authorized institution, unless this Division contains a provision that specifically provides for the valuation of the exposure.

(2) If the exposure to the underlying obligor of a derivative contract arises from a long position under the contract, the exposure must be valued at the amount that the institution would lose if the underlying obligor were to immediately default.

(3) If the exposure to the underlying obligor of a derivative contract arises from a short position under the contract, the exposure must be valued at the amount that the institution would gain if the underlying obligator were to immediately default.

Division 6—Valuation of CRM Uncovered Portion of Exposure

78. Application of Division 6

This Division applies to the valuation of the CRM uncovered portion of a CRM covered exposure, for an adjustment under Subdivision 2 of Division 3.

79. On-balance sheet netting

(1) This rule applies to an exposure of an authorized institution that is covered by a recognized netting done under a valid bilateral netting agreement.

(2) The CRM uncovered portion of the exposure is valued at its net credit exposure calculated by using Formula 7 under section 94 of the Capital Rules, subject to the maturity mismatches provisions under section 103(1) and (3) of the Capital Rules, as if that Formula and those provisions were applicable to the institution.

80. Recognized collateral

(1) This rule applies to an exposure of an authorized institution that is covered by a recognized collateral.

(2) If the institution uses, under section 5(1)(b) of the Capital Rules, the BSC approach to calculate the credit risk for non-securitization exposures, the CRM uncovered portion of the exposure is valued as follows—

(a) for an exposure not arising from an item specified in Table A—by using Formula 7;

(b) for an exposure arising from an item specified in Table A—by using Formula 7 with the modification that "current market value of recognized collateral" in that Formula is multiplied by—

(i) the credit conversion factor specified in column 3 of Table A opposite that item; or

(ii) for an exposure arising from items 9, 10, 11 and 12 in Table A—100%, if the institution chooses not to apply the credit conversion factor mentioned in subparagraph (i).

(3) Formula 7 is as follows—

Formula 7

Value of CRM uncovered portion = max [0, (original exposure – current market value of recognized collateral)]

where—

original exposure = the value of the exposure as calculated according to this Part, but for this Division.

(4) If the institution uses, under section 5(1)(a) of the Capital Rules, the STC approach to calculate the credit risk for non-securitization exposures, the CRM uncovered portion of the exposure is valued as follows—

(a) for an exposure with respect to which the simple approach is used, under Division 6 of Part 4 of the Capital Rules, to account for the credit risk mitigation effect of the recognized collateral—by using the same method under subrule (2)(a) or (b);

(b) for an exposure with respect to which the comprehensive approach is used, under Division 7 of Part 4 of the Capital Rules, to account for the credit risk mitigation effect of the recognized collateral—at the following value—

(i) for an exposure not arising from an item specified in Table A—the net credit exposure in Formula 2 under section 87 of, or Formula 4 under section 89 of, the Capital Rules (as the case requires, depending on the nature of the exposure), subject to—

(A) the applicable haircut provisions of the Capital Rules if the recognized collateral consists of a basket of securities under section 90 of the Capital Rules; and

(B) the maturity mismatches provisions under—

(I) section 103(1), (3) and (4) of the Capital Rules; and

(II) section 103(2) of the Capital Rules, with the modification that the reference to calculating a risk-weighted amount is treated as a reference to calculating the value of an exposure,

as if that Formula and those provisions of the Capital Rules were applicable to the institution;

(ii) for an exposure arising from an item specified in Table A—the net credit exposure in Formula 3 under section 88 of the Capital Rules, subject to—

(A) the modification of the CCF applicable to the off-balance sheet exposure under that Formula to—

(I) the credit conversion factor specified in column 3 of Table A opposite that item; or

(II) for an exposure arising from items 9, 10, 11 and 12 in Table A—100%, if the institution chooses not to apply the credit conversion factor mentioned in sub-sub-subparagraph (I);

(B) the applicable haircut provisions of the Capital Rules if the recognized collateral consists of a basket of securities under section 90 of the Capital Rules; and

(C) the maturity mismatches provisions under—

(I) section 103(1), (3) and (4) of the Capital Rules; and

(II) section 103(2) of the Capital Rules, with the modification that the reference to calculating a risk-weighted amount is treated as a reference to calculating the value of an exposure,

as if that Formula and those provisions of the Capital Rules were applicable to the institution.

(5) If the institution uses, under section 5(1)(c) of the Capital Rules, the IRB approach to calculate the credit risk for non-securitization exposures, the CRM uncovered portion of the exposure is valued as follows—

(a) first, by determining whether the simple approach or comprehensive approach is to be used for the recognized collateral under section 78 of the Capital Rules, as if that provision were applicable to the institution;

(b) second—

(i) if the institution determines to use the simple approach (after applying section 78 of the Capital Rules)—by using the same method under subrule (2)(a) or (b); or

(ii) if the institution determines to use the comprehensive approach (after applying section 78 of the Capital Rules)—by using the same method under subrule (4)(b).

81. Recognized guarantee or recognized credit derivative contract

(1) This rule applies to an exposure of an authorized institution that is covered by a recognized guarantee or recognized credit derivative contract.

(2) The CRM uncovered portion of the exposure is valued by using Formula 8.

(3) Formula 8 is as follows—

Formula 8

Value of CRM uncovered portion = $\max \{0, (\text{original exposure} - G \times (1 - H_{fx}))\}$

where—

original exposure = the value of the exposure as calculated according to this Part, but for this Division;

G = the maximum liability of the credit protection provider to the institution under the credit protection (subject to the maturity mismatch provisions specified in subrule (4)); and

H_{fx} = the haircut applicable in consequence of a currency mismatch, if any, under the standard supervisory haircut specified in Schedule 7 of the Capital Rules, subject to adjustment as set out in section 92 of the Capital Rules.

(4) The following maturity mismatch provisions are specified for determining the value of G in Formula 8, as if the provisions were applicable to the institution—

(a) section 103(1), (3) and (4) of the Capital Rules;

(b) section 103(2) of the Capital Rules, with the modification that the reference to calculating a risk-weighted amount is treated as a reference to calculating the value of an exposure.

82. Credit-linked note

(1) This rule applies to an exposure that is covered by a credit-linked note.

(2) The CRM uncovered portion of the exposure is valued by the method set out in rule 80 as if the exposure were—

(a) covered by a recognized collateral; and

(b) secured by the amount of sales proceeds of the note as cash deposits.

83. Overlap of coverage of recognized CRM

(1) This rule applies if the same portion of an exposure of an authorized institution is covered by more than 1 recognized CRM.

(2) The CRM uncovered portion of the exposure must be valued—

(a) by taking into account only the recognized CRM that would result in the lowest risk-weighted amount of the portion covered by the overlapping recognized CRMs; and

(b) if the risk-weighted amount of the CRM uncovered portion is the same for 2 or more of the overlapping recognized CRMs—by taking into account any 1 of those recognized CRMs chosen by the institution.

(3) For calculating the risk-weighted amount of a portion of an exposure under this rule, Divisions 5, 6, 7, 8, 9 and 10 of Part 4 of the Capital Rules are to be applied, as if those Divisions were applicable to the institution.

Part 8

Connected Party

Division 1—General

84. Interpretation of Part 8

(1) In this Part—

ACNP exposure (ACNP 風險承擔) means an aggregate connected natural persons exposure;

ACNPE ratio (ACNPE 比率) means an aggregate connected natural persons exposure ratio;

ACP exposure (ACP 風險承擔) means an aggregate connected parties exposure;

ACPE ratio (ACPE 比率) means an aggregate connected parties exposure ratio;

aggregate connected natural persons exposure (所有關連自然人總風險承擔)—see rule 91;

aggregate connected natural persons exposure ratio (所有關連自然人總風險承擔比率), in relation to an authorized institution, means the ratio, expressed as a percentage, of the institution's ACNP exposure, to the amount of the institution's Tier 1 capital;

aggregate connected parties exposure (關連各方總風險承擔)—see rule 90;

aggregate connected parties exposure ratio (關連各方總風險承擔比率), in relation to an authorized institution, means the ratio, expressed as a percentage, of the institution's ACP exposure, to the amount of the institution's Tier 1 capital;

aggregate single connected party exposure (單一關連一方總風險承擔)—see rule 89;

ASCP exposure (ASCP 風險承擔) means an aggregate single connected party exposure;

connected natural person (關連自然人), in relation to an authorized institution, means a natural person who is a connected party of the institution within the meaning of rule 85(1)(a), (b), (c), (d), (e) or (f);

connected party (關連一方)—see rule 85;

non-listed company (非上市公司) means a company not listed on a recognized stock market, but does not include a statutory corporation that is specified in Schedule 3;

recognized stock market (認可證券市場) means a stock market as defined by section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571).

(2) In this Part, an expression specified below has the meaning given by rule 39(1)—

ASC exposure (ASC 風險承擔);

Category A institution (A 類機構);

Category B institution (B 類機構);

CRM covered exposure (CRM 涵蓋風險承擔);

entity (實體);

exposure (風險承擔);

recognized collateral (認可抵押品);

recognized CRM (認可 CRM).

85. Meaning of *connected party*

(1) For this Part, in relation to an authorized institution, each of the following entities is a connected party of the institution—

(a) a director of the institution;

(b) a relative of a natural person who is a director of the institution;

(c) an employee of the institution who is responsible (either individually or as a member of a committee) for approving applications for financial facilities;

(d) a relative of an employee described in paragraph (c);

(e) subject to subrule (2), a controller or minority shareholder controller of the institution;

(f) a relative of a natural person who is a controller or minority shareholder controller of the institution;

(g) subject to subrule (2), a firm, partnership or non-listed company in which the institution or any of the following entities is interested as a director, partner, manager or agent—

(i) a controller, minority shareholder controller or director of the institution;

(ii) a relative of a natural person who is a controller, minority shareholder controller or director of the institution;

(h) a natural person, firm, partnership or non-listed company to whom the institution has provided a financial facility, if any of the following entities is a guarantor of the facility—

(i) a controller, minority shareholder controller or director of the institution;

(ii) a relative of a natural person who is a controller, minority shareholder controller or director of the institution.

(2) However, the following entity is not a connected party of an authorized institution even if it falls within the description of subrule (1)(e) or (g)—

(a) another authorized institution;

(b) a non-local bank approved under subrule (3).

(3) The Monetary Authority may, in relation to an authorized institution, approve a non-local bank for subrule (2)(b) if—

(a) in the opinion of the Monetary Authority, the bank is adequately supervised by the relevant banking supervisory authority; or

(b) the licence or other authorization of the bank to carry on the business of banking is not for the time being suspended by the relevant banking supervisory authority.

(4) In this rule—

adopted (領養) means adopted in a manner recognized by the laws of Hong Kong;

cohabitation relationship (同居關係) means a relationship between 2 natural persons (whether of the same sex or of the opposite sex) who live together as a couple in an intimate relationship;

cohabitee (同居伴侶), in relation to a natural person who is in a cohabitation relationship with another natural person, means the other natural person;

non-local bank (非本地銀行) has the meaning given by paragraph (a) of the definition of ***foreign bank*** in section 86(4) of the Ordinance;

party to a union of concubinage (夫妾關係的一方), in relation to a union of concubinage, means the male partner or the female partner of the union;

relative (親屬), in relation to a natural person, means the following—

(a) a parent, grandparent or great grandparent;

(b) a step-parent or adoptive parent;

(c) a brother or sister;

(d) the spouse;

(e) if the person is a party to a union of concubinage—the other party of the union;

(f) a cohabitee;

(g) a parent, step-parent or adoptive parent of a spouse;

(h) a brother or sister of a spouse;

(i) a son, step-son, adopted son, daughter, step-daughter or adopted daughter;

(j) a grandson, granddaughter, great grandson or great granddaughter;

union of concubinage (夫妾關係) means a union of concubinage entered into by a male partner and a female partner before 7 October 1971, under which union the female partner has, during the lifetime of the male partner, been accepted by his wife as his concubine and recognized as such by his family generally.

86. Application of Part 8

This Part applies to an authorized institution incorporated in Hong Kong.

Division 2—Limit on Exposure to Connected Party

87. Limit on exposure to connected party

Subject to (if applicable) any variation under rule 88(1), an authorized institution must at all times maintain—

(a) an ACPE ratio not exceeding 15%;

(b) an ACNPE ratio not exceeding 5%; and

(c) in relation to each connected natural person of the institution—an ASCP exposure not exceeding $10,000,000.

88. Monetary Authority may vary limit on exposure to connected party

(1) Subject to subrules (3), (4), (5) and (6), the Monetary Authority may, by written notice served on an authorized institution, vary any or all of the limits prescribed under rule 87(a), (b) and (c) for the institution if the Monetary Authority, after taking into account the considerations set out in subrule (2), is satisfied on reasonable grounds that it is prudent to make the variation.

(2) The considerations are—

(a) the risks associated with the level or concentration of the institution's exposures to its connected parties;

(b) any risk mitigation measures taken by the institution to manage those risks;

(c) the risks associated with those measures; and

(d) any other factors that the Monetary Authority considers relevant.

(3) If the Monetary Authority proposes to serve a notice (***proposed notice***) under subrule (1) on an authorized

institution, the Monetary Authority must serve a draft of the notice (***draft notice***) on the institution.

(4) A draft notice must—

(a) specify—

(i) the proposed variation of the limit concerned; and

(ii) the circumstances pertaining to, and the grounds for, the proposed variation; and

(b) contain a statement that the institution may, within 14 days (or a longer period approved by the Monetary Authority in writing in any particular case) from the date of service of the draft notice, make written representation to the Monetary Authority on any or all of the matters specified in the draft notice.

(5) If an authorized institution makes any written representation in relation to a draft notice served on it, the Monetary Authority may, after considering the representation—

(a) serve a notice on the institution under subrule (1) in substantially the same terms as the draft notice;

(b) serve a notice on the institution under subrule (1) in terms modified to take account of the representation on being satisfied that the modification should be made; or

(c) elect not to serve a notice on the institution under subrule (1) if satisfied by the representation that the proposed notice should not be served on the institution.

(6) If no representation is made by an authorized institution in relation to a draft notice served on it, the Monetary Authority may serve a notice on the institution under subrule (1) in substantially the same terms as the draft notice.

(7) A decision of the Monetary Authority under subrule (1) is a decision to which section 101B(1) of the Ordinance applies.

(8) To avoid doubt—

(a) the Monetary Authority may serve a draft notice on an authorized institution to supersede an earlier draft notice served on the institution; and

(b) the reference to same terms in subrule (5)(a) or (6) does not include the statement mentioned in subrule (4)(b).

Division 3—Determination of Exposure to Connected Parties

89. Aggregate single connected party exposure (ASCP exposure)

An authorized institution's ASCP exposure to a connected party of the institution is the same as the institution's ASC exposure to the party, determined in accordance with rule 46, subject to any modification under Division 4.

90. Aggregate connected parties exposure (ACP exposure)

For calculating an authorized institution's ACPE ratio under this Part, the ACP exposure of the institution is the sum of the institution's ASCP exposure to all of its connected parties.

91. Aggregate connected natural persons exposure (ACNP exposure)

For calculating an authorized institution's ACNPE ratio under this Part, the ACNP exposure of the institution is the sum of the institution's ASCP exposure to all of its connected natural persons.

92. Exposure disregarded

(1) The Monetary Authority may give a written consent to allow an exposure or a class of exposures not to be taken into account for determining an authorized institution's ASCP

exposure to a connected party, if the Monetary Authority considers that it is reasonable to do so, having regard to—

(a) the nature of, and the risks associated with, the exposure or class of exposures;

(b) any risk mitigation measures taken by the institution to manage those risks;

(c) the risks associated with those measures; and

(d) any other factors that the Monetary Authority considers relevant.

(2) The Monetary Authority may—

(a) give a written consent under subrule (1) to an authorized institution or a class of authorized institutions; and

(b) attach conditions to the consent.

Division 4—Modification

93. CRM covered exposure

(1) For determining an ASCP exposure to a connected party in accordance with rule 46, by virtue of rule 89, subrules (2) and (3) modify the provisions in Part 7 for the valuation of a CRM covered exposure.

(2) If an exposure to a connected party, arising from an item in a Category B institution's banking book, is covered by a recognized CRM—

(a) rule 50 applies; and

(b) rule 51 does not apply,

as if the institution were a Category A institution, even if it is a Category B institution.

(3) Without limiting any provision in Part 7, if—

(a) any interest in land—

(i) is pledged to the institution as a collateral (or otherwise provided as security) to cover an exposure to a connected party arising from an item in an authorized institution's banking book;

(ii) is so pledged or provided for a period not shorter than the life of the item; and

(iii) is revalued by the institution at least once every 6 months during the life of the item; and

(b) the requirements in section 77(a), (b), (c), (d), (e), (ea) and (f) of the Capital Rules are satisfied,

the interest in land is treated as a recognized collateral for valuing the exposure and this subrule takes effect as if section 77 of the Capital Rules were applicable to the institution (and to avoid doubt, including the case where that section is actually applicable to the institution).

94. Exposure to 2 or more entities etc.

(1) If an exposure of an authorized institution is to 2 or more entities jointly, rule 87(c) applies as if the exposure were to each of those entities severally.

(2) For rule 87(b) and (c), if a natural person—

(a) controls a firm, partnership or non-listed company; and

(b) is a connected natural person of an authorized institution,

an exposure of the institution to the firm, partnership or non-listed company is treated as an exposure to the person.

(3) For subrule (2)(a), a firm, partnership or non-listed company (***controlled entity***) is treated as being controlled by a natural person if—

(a) the person owns more than 50% of the voting rights in the controlled entity;

(b) the person has control of a majority of the voting rights in the controlled entity under an agreement with other shareholders (or similar holders of voting rights);

(c) the person has the right to appoint or remove a majority of the members of the controlled entity's board of directors (or a similar governing body);

(d) a majority of the members of the controlled entity's board of directors (or a similar governing body) have been appointed solely as a result of the person exercising his or her voting rights; or

(e) the person has the power, under a contract or otherwise, to exercise a controlling influence over the management or policies of the controlled entity.

Part 9

Repeal and Transitional and Savings Provisions

Division 1—Repeal

95. Banking (Exposure Limits) Rules repealed

The Banking (Exposure Limits) Rules (Cap. 155 sub. leg. R) are repealed.

Division 2—Transitional and Savings Provisions (Equity)

96. Interpretation of Division 2

In this Division—

repealed Rules (《已廢除規則》) means the Banking (Exposure Limits) Rules (Cap. 155 sub. leg. R).

97. Application of rule 11 on unconsolidated basis or consolidated basis—deemed rule 6(1) notice

(1) A former rule 5(1) notice given to an authorized institution is deemed, if it was in effect immediately before 1 July 2019, to be a notice given to the institution under rule 6(1) on that date requiring it to apply rule 11 on the basis specified in the former rule 5(1) notice.

(2) In this rule—

former rule 5(1) notice (前第 5(1)條通知) means—

(a) a notice given under rule 5(1) of the repealed Rules requiring an authorized institution to apply rule 10 of the repealed Rules on the basis specified in the notice; or

(b) a notice deemed to be given under rule 5(1) of the repealed Rules, by virtue of rule 21(2) of the repealed Rules, requiring an authorized institution to calculate its aggregate equity exposures of the repealed Rules on the basis specified in the notice.

98. Variation of equity exposure limit—deemed rule 12(1) notice

(1) A former variation notice served on an authorized institution is deemed, if it was in effect immediately before 1 July 2019, to be a notice served on the institution under rule 12(1) on that date.

(2) Subject to subrule (3)—

(a) a former draft notice served on an authorized institution before 1 July 2019 is deemed to be a draft notice served on the institution under rule 12(3) on that date; and

(b) a written representation made by the institution in relation to the former draft notice is deemed to be a written representation made by the institution in relation to the deemed draft notice.

(3) In relation to a draft notice deemed to be served on an authorized institution under rule 12(3) by virtue of subrule (2)(a)—

(a) rule 12(4)(b) does not apply; and

(b) in making a decision under rule 12(5), the Monetary Authority—

(i) must consider representation made by the institution within the original representation period; and

(ii) may, but is not obliged, consider any representation made by the institution after the expiry of the original representation period.

(4) In this rule—

former draft notice (前通知草擬本) means a draft notice—

(a) served under rule 11(3) of the repealed Rules; and

(b) in relation to which the Monetary Authority had not made a decision under rule 11(5) or (6) of the repealed Rules before 1 July 2019;

former variation notice (前更改通知) means a notice served under rule 11(1) of the repealed Rules;

original representation period (原申述期間), in relation to a former draft notice, means the following period, whichever is the longer—

(a) the 14-day period mentioned in rule 11(4)(b) of the repealed Rules;

(b) where a longer period was allowed under rule 11(4)(b) of the repealed Rules—the longer period.

99. Longer period—deemed rule 14(1)(b)(i)(B) or (c)(i)(B) approval

(1) Subrule (2) applies if—

(a) a longer period was—

(i) approved; or

(ii) deemed to be approved, by virtue of rule 22(1) of the repealed Rules,

under rule 13(1)(b)(ii) of the repealed Rules in relation to any share capital; and

(b) the period had, immediately before 1 July 2019, yet to expire.

(2) In relation to the share capital mentioned in subrule (1)(a), the portion of the period beginning on 1 July 2019 is deemed to be a longer period approved under rule 14(1)(b)(i)(B) on that date.

(3) Subrule (4) applies if—

(a) a longer period was—

(i) approved; or

(ii) deemed to be approved, by virtue of rule 22(2) of the repealed Rules,

under rule 13(1)(c)(i)(B) of the repealed Rules in relation to any share capital; and

(b) the period had, immediately before 1 July 2019, yet to expire.

(4) In relation to the share capital mentioned in subrule (3)(a)—

(a) the portion of the period beginning on 1 July 2019 is deemed to be a longer period approved under rule 14(1)(c)(i)(B) on that date; and

(b) a condition attached to the earlier approval is deemed, if it was in effect immediately before 1 July 2019, to be a condition attached to the deemed approval on that date.

100. Share capital disregarded—deemed rule 14(1)(e) or (f) approval

(1) If—

(a) an approval was given, or deemed to be given by virtue of rule 22(3) of the repealed Rules, under rule 13(1)(e) of the repealed Rules; and

(b) the approval was in effect immediately before 1 July 2019,

the approval is deemed to be an approval given under rule 14(1)(e) on 1 July 2019.

(2) If—

(a) an approval was given, or deemed to be given by virtue of rule 22(4) of the repealed Rules, under rule 13(1)(f) of the repealed Rules; and

(b) the approval was in effect immediately before 1 July 2019,

the approval is deemed to be an approval given under rule 14(1)(f) on 1 July 2019.

101. Equity exposure disregarded—deemed rule 14(2) consent

(1) If a former rule 13(2) consent given to an authorized institution was in effect immediately before 1 July 2019—

(a) the former rule 13(2) consent is deemed to be a consent given to the institution under rule 14(2) on 1 July 2019; and

(b) a condition imposed on the former rule 13(2) consent is deemed, if it was in effect immediately before 1 July 2019, to be a condition attached to the deemed consent on that date.

(2) In this rule—

former rule 13(2) consent (前第 13(2)條同意) means a consent given under rule 13(2) of the repealed Rules.

Division 3—Transitional and Savings Provisions (Acquisition of Share Capital of Company)

102. Application of rule 23 on unconsolidated basis or consolidated basis—deemed rule 6(1) notice

(1) A former section 79A notice given to an authorized institution is deemed, if it was in effect immediately before 1 July 2019, to be a notice given under rule 6(1) to the institution on that

date requiring it to apply rule 23 on the basis specified in the former section 79A notice.

(2) In this rule—

former section 79A notice (前第 79A 條通知) means a notice given under section 79A of the Ordinance requiring an authorized institution to apply section 87A of the Ordinance on a certain basis.

103. Acquiring share capital—deemed rule 24(1) consent

(1) If a former section 87A(2)(a) approval given to an authorized institution was in effect immediately before 1 July 2019—

(a) the approval is deemed to be a consent given to the institution under rule 24(1) on 1 July 2019;

(b) a condition attached to the approval is deemed, if it was in effect immediately before 1 July 2019, to be a condition attached to the deemed consent on that date; and

(c) a condition is deemed to be attached to the deemed consent on 1 July 2019 requiring the institution to come to hold the share capital, that is the subject matter of approval, no later than 30 September 2019.

(2) To avoid doubt, if the institution had already come to hold the share capital, that is the subject matter of the former section 87A(2)(a) approval, before 1 July 2019, the institution may not acquire further share capital under the consent deemed to be given under rule 24(1), but is still subject to the condition (if any) mentioned in subrule (1)(b).

(3) In this rule—

former section 87A(2)(a) approval (前第 87A(2)(a)條批准) means—

(a) an approval given under section 87A(2)(a) of the Ordinance; or

(b) an approval deemed to be granted under section 87A(2)(a) of the Ordinance, by virtue of section 87A(3) of the Ordinance.

104. Longer period—deemed rule 23(3)(a)(ii) approval

(1) Subrule (2) applies if—

(a) a further period was approved under section 87A(8) of the Ordinance in relation to any share capital; and

(b) the period had, immediately before 1 July 2019, yet to expire.

(2) In relation to the share capital mentioned in subrule (1)(a)—

(a) the portion of the period beginning on 1 July 2019 is deemed to be a longer period approved under rule 23(3)(a)(ii) on that date; and

(b) a condition attached to the earlier approval is deemed, if it was in effect immediately before 1 July 2019, to be a condition attached to the deemed approval on that date.

Division 4—Transitional and Savings Provisions (Financial Facility against Security of Own Shares etc.)

105. Financial facility against security of authorized institution's capital-in-nature instrument etc.—application of rule 27(1) and (2)

(1) If, before 1 July 2019—

(a) an authorized institution provided a financial facility against the security of a capital-in-nature instrument, or non-capital LAC debt instrument, issued by—

(i) the institution;

(ii) a holding company of the institution;

(iii) a subsidiary of the institution; or

(iv) a subsidiary of a holding company of the institution; and

(b) the financial facility is still in effect at the beginning of 1 July 2019,

rule 27(1) and (2) does not apply in relation to the financial facility.

(2) In this rule—

capital-in-nature instrument (資本類票據) has the meaning given by rule 25(1);

non-capital LAC debt instrument (非資本 LAC 債務票據) has the meaning given by rule 25(1).

106. Financial facility against security of own shares etc. issued by associated company—deemed rule 28(1) consent

(1) If an approval under section 80(2) of the Ordinance given to an authorized institution was in effect immediately before 1 July 2019—

(a) the approval is deemed to be a consent given to the institution under rule 28(1) on 1 July 2019; and

(b) a condition attached to the approval is deemed, if it was in effect immediately before 1 July 2019, to be a condition attached to the deemed consent on that date.

(2) The deemed consent ceases to have effect at the end of 30 September 2019.

Division 5—Transitional and Savings Provision (Financial Facility Provided to Employee)

107. Unsecured financial facility to employee—deemed rule 32 consent

A consent under section 85(1) of the Ordinance is deemed, if it was in effect immediately before 1 July 2019, to be a consent given under rule 32 on that date.

Division 6—Transitional and Savings Provisions (Interest in Land)

Subdivision 1—Grace Period for Compliance

108. Grace period for complying with rule 35(a)

(1) This rule applies to an authorized institution if, immediately before 1 July 2019, its land exposure ratio, calculated as if these Rules had come into operation at that time, exceeded 50%.

(2) If, within the grace period, the institution—

(a) does not contravene section 88 of the Ordinance as in force immediately before 1 July 2019; and

(b) does not acquire any interest in land (except as described in rule 38(a) or (b)),

the institution is treated as being compliant with rule 35(a) until the grace period expires.

(3) In this rule—

grace period (寬限期) means the period beginning on 1 July 2019 and expiring at the end of the earlier of the following dates—

(a) 30 September 2019;

(b) the date on which the institution becomes compliant with rule 35(a) or (if applicable) that rule as varied under rule 36(1);

land exposure ratio (土地風險承擔比率) has the meaning given by rule 33.

Subdivision 2—Deeming Provisions

109. Application of rule 35 on unconsolidated basis or consolidated basis—deemed rule 6(1) notice

(1) A former section 79A notice given to an authorized institution is deemed, if it was in effect immediately before 1 July 2019, to be a notice given under rule 6(1) to the institution on that date requiring it to apply rule 35 on the basis specified in the former section 79A notice.

(2) In this rule—

former section 79A notice (前第 79A 條通知) means a notice given under section 79A of the Ordinance requiring an authorized institution to apply section 88 of the Ordinance on a certain basis.

110. Premises for conducting authorized institution's business—deemed rule 37(3) consent

If, immediately before 1 July 2019, the Monetary Authority regarded under section 88(3) of the Ordinance the whole of any premises in which an office of an authorized institution is situated as necessary for conducting the business of the institution, a consent is deemed to be given under rule 37(3) on 1 July 2019 to allow the institution to treat the whole of the premises as being used for conducting the institution's business.

111. Longer period—deemed rule 38(b)(i)(B) approval

If—

(a) a further period was allowed under section 88(5) of the Ordinance in relation to an interest in land; and

(b) the period had, immediately before 1 July 2019, yet to expire,

the portion of the period beginning on 1 July 2019 is deemed to be a longer period approved under rule 38(b)(i)(B) on that date.

Division 7—Transitional and Savings Provisions (Single Counterparty and Group of Linked Counterparties)

Subdivision 1—Grace Period for Compliance

112. Grace period for complying with rule 44(1)(a)

(1) If, at a particular time during the grace period—

(a) an authorized institution's ASCE ratio, in relation to a counterparty of it, exceeds the limit prescribed under rule 44(1)(a) or (if applicable) that rule as varied under rule 45(1); but

(b) the institution does not, in relation to the counterparty, contravene section 81(1)(a) of the Ordinance as in force immediately before 1 July 2019,

the institution is treated as being compliant, at that time, with rule 44(1)(a) or (if applicable) that rule as varied under rule 45(1), in relation to the counterparty.

(2) In this rule—

ASCE ratio (ASCE 比率) has the meaning given by rule 39(1);

grace period (寬限期) means the period beginning on 1 July 2019 and expiring at the end of 31 December 2019.

113. Grace period for complying with rule 44(1)(b)

(1) If, at a particular time during the grace period—

(a) an authorized institution's ALCGE ratio, in relation to an LC group of it, exceeds the limit prescribed under rule 44(1)(b) or (if applicable) that rule as varied under rule 45(1); but

(b) the institution does not, in relation to the entities in the group, contravene section 81(1)(a), (b), (c) or (d) of the Ordinance as in force immediately before 1 July 2019,

the institution is treated as being compliant, at that time, with rule 44(1)(b) or (if applicable) that rule as varied under rule 45(1), in relation to the group.

(2) In this rule—

ALCGE ratio (ALCGE 比率) has the meaning given by rule 39(1);

grace period (寬限期) means the period beginning on 1 July 2019 and expiring at the end of 31 December 2019;

LC group (LC 集團) has the meaning given by rule 39(1).

Subdivision 2—Deeming Provisions

114. Application of rule 44 on unconsolidated basis or consolidated basis—deemed rule 6(1) notice

(1) A former section 79A notice given to an authorized institution is deemed, if it was in effect immediately before 1 July 2019, to be a notice given under rule 6(1) to the institution on that date requiring it to apply rule 44 on the basis specified in the former section 79A notice.

(2) In this rule—

former section 79A notice (前第 79A 條通知) means a notice given under section 79A of the Ordinance requiring an

authorized institution to apply section 81 of the Ordinance on a certain basis.

115. Longer period—deemed rule 48(1)(e)(i)(B) or (f)(i)(B) approval

(1) Subrule (2) applies if—

(a) a further period was approved under section 81(7) of the Ordinance in relation to any share capital or debt securities; and

(b) the period had, immediately before 1 July 2019, yet to expire.

(2) In relation to the share capital or debt securities mentioned in subrule (1)(a)—

(a) the portion of the period beginning on 1 July 2019 is deemed to be a longer period approved under rule 48(1)(e)(i)(B) on that date; and

(b) a condition attached to the earlier approval is deemed, if it was in effect immediately before 1 July 2019, to be a condition attached to the deemed approval on that date.

(3) Subrule (4) applies if—

(a) a further period was approved under section 81(6)(i)(ii) of the Ordinance in relation to any share capital or debt securities; and

(b) the period had, immediately before 1 July 2019, yet to expire.

(4) In relation to the share capital or debt securities mentioned in subrule (3)(a)—

(a) the portion of the period beginning on 1 July 2019 is deemed to be a longer period approved under rule 48(1)(f)(i)(B) on that date; and

(b) a condition attached to the earlier approval is deemed, if it was in effect immediately before 1 July 2019, to be a condition attached to the deemed approval on that date.

116. Letter of comfort—deemed rule 57(1)(d)(i) approval

(1) If a letter of comfort was accepted by the Monetary Authority under section 81(6)(b)(ii) of the Ordinance and the acceptance was in effect immediately before 1 July 2019—

(a) the acceptance is deemed to be an approval of the letter of comfort given under rule 57(1)(d)(i) on 1 July 2019; and

(b) a condition attached to the acceptance is deemed, if it was in effect immediately before 1 July 2019, to be a condition attached to the deemed rule 57(1)(d)(i) approval on that date.

(2) Subject to subrule (3), a deemed rule 57(1)(d)(i) approval ceases to have effect at the end of 30 June 2020.

(3) Subrule (2) does not apply to a deemed rule 57(1)(d)(i) approval of a letter of comfort that covers an exposure, arising from the 80% Loan Guarantee Product under the SME Financing Guarantee Scheme set up by The Hong Kong Mortgage Corporation Limited, to—

(a) The Hong Kong Mortgage Corporation Limited; or

(b) a subsidiary of The Hong Kong Mortgage Corporation Limited.

(4) In this rule—

deemed rule 57(1)(d)(i) approval (當作第 57(1)(d)(i)條批准) means an approval deemed to be given under rule 57(1)(d)(i) by virtue of subrule (1)(a).

Division 8—Transitional and Savings Provisions (Connected Party)

Subdivision 1—Grace Period for Compliance

117. Grace period for complying with rule 87(a)

(1) If, at a particular time during the grace period—

(a) an authorized institution's ACPE ratio exceeds the limit prescribed under rule 87(a) or (if applicable) that rule as varied under rule 88(1); but

(b) the institution does not contravene section 83(1) of the Ordinance as in force immediately before 1 July 2019,

the institution is treated as being compliant, at that time, with rule 87(a) or (if applicable) that rule as varied under rule 88(1).

(2) In this rule—

ACPE ratio (ACPE 比率) has the meaning given by rule 84(1);

grace period (寬限期) means the period beginning on 1 July 2019 and expiring at the end of 31 December 2019.

118. Grace period for complying with rule 87(b)

(1) If, at a particular time during the grace period—

(a) an authorized institution's ACNPE ratio exceeds the limit prescribed under rule 87(b) or (if applicable) that rule as varied under rule 88(1); but

(b) the institution does not contravene section 83(2)(a) of the Ordinance as in force immediately before 1 July 2019,

the institution is treated as being compliant, at that time, with rule 87(b) or (if applicable) that rule as varied under rule 88(1).

(2) In this rule—

ACNPE ratio (ACNPE 比率) has the meaning given by rule 84(1);

grace period (寬限期) means the period beginning on 1 July 2019 and expiring at the end of 31 December 2019.

119. Grace period for complying with rule 87(c)

(1) If, at a particular time during the grace period—

(a) an authorized institution's ASCP exposure, in relation to a connected natural person of it, exceeds the limit prescribed under rule 87(c) or (if applicable) that rule as varied under rule 88(1); but

(b) the institution does not, in relation to the person, contravene section 83(2)(b) of the Ordinance as in force immediately before 1 July 2019,

the institution is treated as being compliant, at that time, with rule 87(c) or (if applicable) that rule as varied under rule 88(1), in relation to the person.

(2) In this rule—

ASCP exposure (ASCP 風險承擔) has the meaning given by rule 84(1);

connected natural person (關連自然人) has the meaning given by rule 84(1);

grace period (寬限期) means the period beginning on 1 July 2019 and expiring at the end of 31 December 2019.

Subdivision 2—Deeming Provisions

120. Application of rule 87 on unconsolidated basis or consolidated basis—deemed rule 6(1) notice

(1) A former section 79A notice given to an authorized institution is deemed, if it was in effect immediately before 1 July 2019, to be a notice given under rule 6(1) to the institution on that date requiring it to apply rule 87 on the basis specified in the former section 79A notice.

(2) In this rule—

former section 79A notice (前第 79A 條通知) means a notice given under section 79A of the Ordinance requiring an authorized institution to apply section 83 of the Ordinance on a certain basis.

121. Non-local bank—deemed rule 85(3) approval

(1) A former section 83(4) approval given to an authorized institution is deemed, if it was in effect immediately before 1 July 2019, to be an approval of a non-local bank given under rule 85(3) to the institution on that date.

(2) The deemed approval ceases to have effect at the end of 30 September 2019.

(3) In this rule—

former section 83(4) approval (前第 83(4)條批准) means an approval given under section 83(4)(e) or (g) of the Ordinance;

non-local bank (非本地銀行) has the meaning given by rule 85(4).

122. Exposure disregarded—deemed rule 92(1) consent

(1) If a former section 83(4A) permit given to an authorized institution was in effect immediately before 1 July 2019—

(a) the former section 83(4A) permit is deemed to be a consent given to the institution under rule 92(1) on 1 July 2019; and

(b) a condition attached to the former section 83(4A) permit is deemed, if it was in effect immediately before 1 July 2019, to be a condition attached to the deemed consent on that date.

(2) The deemed consent ceases to have effect at the end of 30 September 2019.

(3) In this rule—

former section 83(4A) permit (前第 83(4A)條容許) means a permit given under section 83(4A) of the Ordinance.

Schedule 1

[r. 39]

Tables for Calculation

Note—

See rule 39(3) for interpretation of this Schedule.

Table A

Credit Conversion Factors

Column 1	Column 2	Column 3
Item	Off-balance sheet item	Credit conversion factor
1.	Direct credit substitute	100%
2.	Transaction-related contingency	50%
3.	Trade-related contingency	20%
4.	Asset sale with recourse	100%
5.	Forward asset purchase	100%
6.	Partly paid-up shares and securities	100%
7.	Forward forward deposits placed	100%

Column 1	Column 2	Column 3
Item	Off-balance sheet item	Credit conversion factor
8.	Note issuance and revolving underwriting facilities	50%
9.	Off-balance sheet item not falling within any of items 1 to 8 and arising from a commitment which may be cancelled at any time unconditionally by an authorized institution, or providing for automatic cancellation due to a deterioration in the credit worthiness of the entity to whom the institution has made the commitment	10%
10.	Off-balance sheet item not falling within any of items 1 to 9, 11 and 12 and arising from a commitment—	
	(a) which has an original maturity period of not more than 1 year	20%
	(b) which has an original maturity period of more than 1 year	50%
11.	Off-balance sheet item not falling within any of items 1 to 9 and arising from a commitment which has an original maturity period of not more than 1 year, and the drawdown of which will give rise to—	
	(a) a direct credit substitute	20%
	(b) a transaction-related contingency	20%

Column 1 Item	Column 2 Off-balance sheet item	Column 3 Credit conversion factor
	(c) a trade-related contingency	20%
	(d) an asset sale with recourse	20%
	(e) a forward asset purchase	20%
	(f) partly paid-up shares and securities	20%
	(g) forward forward deposits placed	20%
	(h) note issuance and revolving underwriting facilities	20%
12.	Off-balance sheet item not falling within any of items 1 to 9 and arising from a commitment which has an original maturity period of more than 1 year, and the drawdown of which will give rise to—	
	(a) a direct credit substitute	50%
	(b) a transaction-related contingency	50%
	(c) a trade-related contingency	20%
	(d) an asset sale with recourse	50%
	(e) a forward asset purchase	50%
	(f) partly paid-up shares and securities	50%
	(g) forward forward deposits placed	50%
	(h) note issuance and revolving underwriting facilities	50%
13.	Off-balance sheet item not giving rise to a	100%

Column 1 Item	Column 2 Off-balance sheet item	Column 3 Credit conversion factor
	default risk exposure in respect of a derivative contract or securities financing transaction and not falling within any of items 1 to 12	

Table B

Non-CCR Exposure to Counterparty Acting as Central Counterparty

Column 1 Exposure	Column 2 Method or amount
Non-CCR exposure in relation to clearing services provided by the counterparty, acting as a CCP, arising from any of the following items—	
(a) a segregated initial margin	$0
(b) a non-segregated initial margin	Nominal amount of initial margin posted
(c) a funded default fund contribution	Nominal amount of the funded contribution
(d) an unfunded default fund contribution	$0
(e) a holding of shares in the CCP	Nominal amount of the shares

Schedule 2

[r. 41]

Specified Sovereign-owned Entity

1. China Investment Corporation

2. Central Huijin Investment Ltd.

Schedule 3

[r. 84]

Statutory Corporation Excluded from Meaning of Non-listed Company

Monetary Authority

2018

Explanatory Note

The main objective of these Rules is to limit concentrations of the exposures of an authorized institution (***AI***) within the meaning of the Banking Ordinance (Cap. 155) (***BO***).

2. The Rules consolidate the current requirements under sections 80, 81, 83, 85, 87A and 88 of the BO and the Banking (Exposure Limits) Rules (Cap. 155 sub. leg. R) (***Cap. 155R***). The requirements are also updated in order to—

   (a) keep pace with market developments and contemporary risk management practices; and

   (b) implement the standards set out in the "Supervisory framework for measuring and controlling large exposures" published by the Basel Committee on Banking Supervision in April 2014.

3. Sections 7, 8 10, 11, 13 and 14 of the Banking (Amendment) Ordinance 2018 (6 of 2018) (***BAO***) repeal sections 80, 81, 83, 85, 87A and 88 of the BO. The commencement date of the Rules is the same as the commencement date appointed for those sections of the BAO.

Part 1—Preliminary (Rules 1 to 7)

4. Rule 1 provides for commencement, and rule 2 defines terms and expressions for the interpretation of the Rules.

5. Rule 3 contains general provisions relating to approvals, consents and notices given by the Monetary Authority (***MA***), and the application of guidelines or codes of practice issued under the BO.

6. Rule 4 provides for calculations in Hong Kong dollars.

7. Rule 5 contains provisions relating to the valuation of exposures at fair value.

8. Rule 6 provides that the MA may require an AI to apply a provision of the Rules on an unconsolidated basis or on a consolidated basis.

9. Rule 7(1) requires an AI to notify the MA of notifiable events listed in rule 7(2). These are prescribed notification requirements within the meaning of section 81C of the BO.

Part 2—Equity (Rules 8 to 20)

10. Rule 11 provides that an AI incorporated in Hong Kong must maintain an equity exposure ratio not exceeding 25%.

11. Other provisions in Part 2 provide for variation, exclusion and calculation.

Part 3—Acquisition of Share Capital of Company (Rules 21 to 24)

12. Rule 23 provides that, subject to certain exclusion, an AI incorporated in Hong Kong must not acquire the share capital of a company to a value equivalent to 5% or more of the amount of the AI's Tier 1 capital.

13. Rule 24 provides for the MA's consent to allow an AI to acquire such share capital.

Part 4—Financial Facility against Security of Own Shares etc. (Rules 25 to 28)

14. Rule 27 provides that an AI must not provide a financial facility against the security of—

   (a) shares, capital-in-nature instruments or non-capital LAC debt instruments issued by it; or

   (b) shares, capital-in-nature instruments or non-capital LAC debt instruments issued by its associated companies.

15. However, for an AI incorporated outside Hong Kong, Part 4 only applies to its Hong Kong business.

16. Rule 28 provides for the MA's consent to allow an AI to provide a financial facility against the security of shares, capital-in-nature instruments or non-capital LAC debt instruments issued by its associated companies.

Part 5—Financial Facility Provided to Employee (Rules 29 to 32)

17. Rule 31 provides that an AI must not, for any of its employees, maintain an aggregate financial facility amount (***limit***) exceeding the employee's annual salary.

18. However, for an AI incorporated outside Hong Kong, Part 5 only applies to its Hong Kong business.

19. Other provisions in Part 5 provide for the MA's consent to exceed the limit.

Part 6—Interest in Land (Rules 33 to 38)

20. Rule 35 provides that an AI incorporated in Hong Kong must—

(a) maintain the value of its holding of interests in land at a ratio not exceeding 50% as compared to the amount of its Tier 1 capital (adjusted by including the amount of the cumulative gain arising from the revaluation of its self-use land); and

(b) excluding interests in land for its self-use, maintain the value of its holding of interests in land at a ratio not exceeding 25% as compared to the amount of its Tier 1 capital.

21. Other provisions in Part 6 provide for variation, exclusion and calculation.

Part 7—Single Counterparty and Group of Linked Counterparties (Rules 39 to 83)

22. Rule 44 provides that an AI incorporated in Hong Kong must maintain its aggregate exposure to a single counterparty or a group of linked counterparties at a ratio not exceeding 25% as compared to the amount of its Tier 1 capital.

23. If an authorized institution is designated as a global systemically important authorized institution under section 3S of the Banking (Capital) Rules (Cap. 155 sub. leg. L), the institution's aggregate exposure to—

(a) a counterparty that is in a G-SIB-linked group (as defined by rule 42); or

(b) a G-SIB-linked group (as defined by rule 42),

is subject to a tighter "15%" limit.

24. Other provisions in Part 7 provide for variation, exclusion and calculation.

Part 8—Connected Party (Rules 84 to 94)

25. Rule 87 provides that an AI incorporated in Hong Kong must—

(a) maintain, as compared to the amount of its Tier 1 capital—

(i) an aggregate connected parties exposure ratio not exceeding 15%;

(ii) an aggregate connected natural persons exposure ratio not exceeding 5%; and

(b) maintain its exposure to a single connected natural person at an amount not exceeding $10,000,000.

26. Other provisions in Part 8 provide for variation, exclusion and calculation.

Part 9—Repeal and Transitional and Savings Provisions (Rules 95 to 122)

27. Part 9 repeals Cap. 155R and provides for transition to the scheme under the Rules from the current operation under Part XV of the BO and Cap. 155R..

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Banking (Capital) (Amendment) Rules 2018

(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)

Part 1

Preliminary

1. Commencement

(1) Subject to subsections (2) and (3), these Rules come into operation on 11 January 2019.

(2) Part 2 (except sections 15 and 16) comes into operation on 1 April 2019.

(3) Part 3 and section 34 come into operation on 1 July 2019.

2. Banking (Capital) Rules amended

The Banking (Capital) Rules (Cap. 155 sub. leg. L) are amended as set out in Parts 2, 3 and 4.

Part 2

Amendments Relating to Holdings of Non-capital LAC Liabilities

3. Section 2 amended (interpretation)

(1) Section 2(1), definition of ***insignificant capital investment***—

Repeal

"***capital investment*** (非重大資本"

Substitute

"***LAC investment*** (非重大 LAC".

(2) Section 2(1), definition of ***significant capital investment***—

Repeal

"***capital investment*** (重大資本"

Substitute

"***LAC investment*** (重大 LAC".

(3) Section 2(1)—

Add in alphabetical order

"***LAC Rules*** (《LAC 規則》) means the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules (Cap. 628 sub. leg. B);

material subsidiary (重要附屬公司) has the meaning given by rule 2(1) of the LAC Rules;

non-capital LAC debt instrument (非資本 LAC 債務票據) has the meaning given by rule 2(1) of the LAC Rules;

non-capital LAC debt resources (非資本 LAC 債務資源), in relation to an authorized institution, means the sum of all non-capital LAC debt instruments issued by the institution;

non-capital LAC liability (非資本 LAC 負債) has the meaning given by rule 2(1) of the LAC Rules;

professional investor (專業投資者) has the meaning given by rule 2(1) of the LAC Rules;

resolution entity (處置實體) has the meaning given by rule 2(1) of the LAC Rules;".

4. Section 3E amended (interpretation of Part 1B)

Section 3E(1), definition of ***net CET1 capital***—

Repeal

everything after "requires for"

Substitute

"maintaining—

(a) 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; and

(b) the minimum external or internal LAC risk-weighted ratio (as the case requires) that the institution is required to maintain under the LAC Rules.".

5. Section 3F amended (distribution payment requirements)

(1) Section 3F(2)—

Repeal

everything after "provisions"

Substitute

"and requirement are complied with—

(a) this section;

(b) if applicable, section 3J or 3K;

(c) section 3Z;

(d) if the institution is a resolution entity or material subsidiary and the payment is made on a day on which the institution must meet a LAC requirement—the LAC requirement.".

(2) After section 3F(6)—

Add

"(7) In subsection (2)—

LAC requirement (LAC 規定) has the meaning given by rule 2(1) of the LAC Rules.".

6. Section 35 amended (interpretation of Part 3)

(1) Section 35—

Repeal the definition of *indirect holding*

Substitute

"***indirect holding*** (間接持有), in relation to an authorized institution, means an exposure of the institution in respect of a capital instrument issued by, or a non-capital LAC liability of, a financial sector entity in circumstances where—

(a) the instrument or liability is not held by the institution directly; but

(b) a loss of value in the instrument or liability will result in a loss to the institution substantially equivalent to the loss in value of a direct holding;".

(2) Section 35—

Repeal the definition of *insignificant capital investment*

Substitute

"***insignificant LAC investment*** (非重大 LAC 投資), in relation to an authorized institution, means an investment by the institution in a capital instrument issued by, or a non-capital LAC liability of, an entity that is neither of the following—

(a) an affiliate of the institution;

(b) an entity of which the institution owns more than 10% of the issued ordinary share capital;".

(3) Section 35—

Repeal the definition of *reciprocal cross holding*

Substitute

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

(a) under which—

(i) an authorized institution holds capital instruments issued by, or non-capital LAC liabilities of, a financial sector entity; and

(ii) the entity also holds capital instruments issued by, or non-capital LAC liabilities of, the institution; and

(b) which is designed to artificially inflate the capital position or loss-absorbing capacity of the institution and the entity;".

(4) Section 35, definition of ***significant capital investment***—

Repeal everything before paragraph (a)

Substitute

"***significant LAC investment*** (重大 LAC 投資), in relation to an authorized institution, means an investment by the institution in a capital instrument issued by, or a non-capital LAC liability of—".

(5) Section 35, definition of ***synthetic holding***—

Repeal

everything after "linked"

Substitute

"to the value of—

(a) the capital instruments issued by a financial sector entity; or

(b) the non-capital LAC liabilities of a financial sector entity.".

(6) Section 35—

Add in alphabetical order

"***loss-absorbing capacity*** (吸收虧損能力) has the meaning given by rule 2(1) of the LAC Rules;".

7. Section 43 amended (deductions from CET1 capital)

(1) Section 43(1)—

Repeal

"in accordance with the transitional arrangements set out in sections 2 and 3 of Schedule 4H".

(2) Section 43(1)(o)(ii) and (p)(ii)—

Repeal

"capital"

Substitute

"LAC".

8. Section 47 amended (deductions from Additional Tier 1 capital)

(1) Section 47(1)—

Repeal

"in accordance with the transitional arrangements set out in sections 2 and 3 of Schedule 4H".

(2) Section 47(1)(c)(ii) and (d)(ii)—

Repeal

"capital"

Substitute

"LAC".

9. Section 48 amended (deductions from Tier 2 capital)

(1) Section 48(1)—

Repeal

"in accordance with the transitional arrangements set out in sections 2 and 3 of Schedule 4H".

(2) Section 48(1)(b) and (c), after "issued by"—

Add

", or non-capital LAC liabilities of,".

(3) Section 48(1)(c)(ii)—

Repeal

"capital"

Substitute

"LAC".

(4) Section 48(1)(c)(iii)—

Repeal

"paragraphs (a) and (b)"

Substitute

"paragraph (a) or (b) or section 48A(1)(a) or (b)".

(5) Section 48(1)(d), after "issued by"—

Add

", or non-capital LAC liabilities of,".

(6) Section 48(1)(d)(ii)—

Repeal

"capital"

Substitute

"LAC".

(7) Section 48(1)(d)(iii)—

Repeal

"paragraphs (a) and (b)"

Substitute

"paragraph (a) or (b) or section 48A(1)(a) or (b)".

(8) Section 48(1)(e)—

Repeal

"and".

(9) Section 48(1)(f)—

Repeal the full stop

Substitute

"; and".

(10) After section 48(1)(f)—

Add

"(g) either of the following—

(i) (if the institution maintains any non-capital LAC debt resources) any amount by which the total amount of the institution's holdings of non-capital LAC liabilities falling within section 48A exceeds the institution's non-capital LAC debt resources;

(ii) (if the institution does not maintain any non-capital LAC debt resources) the total amount of the institution's holdings of non-capital LAC liabilities falling within section 48A.".

(11) Section 48(2)(a)—

Repeal

"referred to in"

Substitute

"of Tier 2 capital instruments to be deducted under".

(12) After section 48(2)—

Add

"(3) The amount of an authorized institution's holdings of non-capital LAC liabilities falling within section 48A that do not exceed the institution's non-capital LAC debt resources and that are not deducted from the institution's Tier 2 capital under subsection (1)(g)(i) is to continue to be risk-weighted in accordance with the applicable risk-weight under Part 4, 5, 6 or 8, as the case requires.".

10. Section 48A added

After section 48—

Add

"48A. Total amount of holdings of non-capital LAC liabilities to be calculated for section 48(1)(g)

(1) For the purposes of section 48(1)(g), an authorized institution must calculate the total amount of the following—

(a) the amount of any direct holdings, indirect holdings and synthetic holdings by the institution of its own non-capital LAC liabilities, unless already derecognized under applicable accounting standards;

(b) the amount of any direct holdings, indirect holdings and synthetic holdings by the institution of non-capital LAC liabilities of financial sector entities that are within the same banking group as the institution but outside the scope of consolidation under a section 3C requirement;

(c) (if the institution calculates its capital adequacy ratio on a solo basis under a section 3C requirement) the amount of the institution's direct holdings of non-capital LAC liabilities of financial sector entities that are members of the institution's consolidation group; and

(d) (if the institution calculates its capital adequacy ratio on a solo-consolidated basis under a section 3C requirement) the amount of the institution's direct holdings of non-capital LAC liabilities of financial sector entities, other than solo-consolidated subsidiaries, that are members of the institution's consolidation group.

(2) In calculating the total amount under subsection (1), the institution must include potential future holdings that the institution could be contractually obliged to purchase.".

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

Section 66(1)(a)—

Repeal

everything after "issued"

Substitute

"by, and non-capital LAC liabilities of, financial sector entities—

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

(ii) significant LAC investments that are not subject to deduction from the institution's CET1 capital under section 43(1)(p); and

(iii) (if the institution maintains any non-capital LAC debt resources) holdings of non-capital LAC liabilities falling within section 48A that are not subject to deduction from the institution's Tier 2 capital under section 48(1)(g)(i); or".

12. Section 116 amended (other exposures)

Section 116(1)(a)—

Repeal

everything after "issued"

Substitute

"by, and non-capital LAC liabilities of, financial sector entities—

(i) insignificant LAC investments that are not subject to deduction from any of the institution's CET1

capital, Additional Tier 1 capital and Tier 2 capital under sections 43(1)(o), 47(1)(c) and 48(1)(c);

(ii) significant LAC investments that are not subject to deduction from the institution's CET1 capital under section 43(1)(p); and

(iii) (if the institution maintains any non-capital LAC debt resources) holdings of non-capital LAC liabilities falling within section 48A that are not subject to deduction from the institution's Tier 2 capital under section 48(1)(g)(i); or".

13. Section 145 amended (equity exposures)

After section 145(1)(b)(vi)—

Add

"(via) holdings of any non-capital LAC liability of a financial sector entity;".

14. Section 183 amended (equity exposures—general)

Section 183(7)—

Repeal

"significant capital"

Substitute

"significant LAC".

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

(1) Schedule 4B, after section 1(a)—

Add

"(ab) subject to section 3 of this Schedule, the instrument, if issued in Hong Kong, must be issued to a professional investor;".

(2) Schedule 4B, section 1(r)(iii)—

Repeal the full stop

Substitute a semicolon.

(3) Schedule 4B, after section 1(r)—

Add

"(s) subject to section 3 of this Schedule—

(i) the terms and conditions of the instrument contain a provision that the instrument is intended to qualify as Additional Tier 1 capital under these Rules; and

(ii) any prospectus or offering document prepared by or for the issuer in relation to the instrument—

(A) adequately discloses the risks inherent in the holding of the instrument, including the risks in relation to its subordination and the circumstances in which the holder may suffer loss as a result of the holding;

(B) contains a statement that the instrument is complex and of high risk; and

(C) contains a statement that the instrument, if issued in Hong Kong, must be issued to a professional investor;

(t) subject to section 3 of this Schedule, the instrument is in a denomination of no less than—

(i) if denominated in Hong Kong dollars—HK$2,000,000;

(ii) if denominated in US dollars—US$250,000;

(iii) if denominated in Euros—Euro 200,000; or

(iv) if denominated in any other currency—the equivalent in that currency to HK$2,000,000 with reference to the relevant exchange rate on the date of issue.".

(4) Schedule 4B, after section 2—

Add

"**3. Section 1(ab), (s) and (t) of this Schedule not applicable to certain instruments**

(1) Section 1(ab), (s) and (t) of this Schedule does not apply to an instrument issued before 11 January 2019.

(2) Section 1(ab), (s)(ii) and (t) of this Schedule does not apply in determining whether an instrument qualifies as Additional Tier 1 capital of an authorized institution if the instrument is issued to and held by an entity within the same banking group as the institution.".

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

(1) Schedule 4C, after section 1(a)—

Add

"(ab) subject to section 3 of this Schedule, the instrument, if issued in Hong Kong, must be issued to a professional investor;".

(2) Schedule 4C, section 1(l)(iii)—

Repeal the full stop

Substitute a semicolon.

(3) Schedule 4C, after section 1(l)—

Add

"(m) subject to section 3 of this Schedule—

(i) the terms and conditions of the instrument contain a provision that the instrument is intended to qualify as Tier 2 capital under these Rules; and

(ii) any prospectus or offering document prepared by or for the issuer in relation to the instrument—

(A) adequately discloses the risks inherent in the holding of the instrument, including the risks in relation to its subordination and the circumstances in which the holder may suffer loss as a result of the holding;

(B) contains a statement that the instrument is complex and of high risk; and

(C) contains a statement that the instrument, if issued in Hong Kong, must be issued to a professional investor;

(n) subject to section 3 of this Schedule, the instrument is in a denomination of no less than—

(i) if denominated in Hong Kong dollars—HK$2,000,000;

(ii) if denominated in US dollars—US$250,000;

(iii) if denominated in Euros—Euro 200,000; or

(iv) if denominated in any other currency—the equivalent in that currency to HK$2,000,000 with reference to the relevant exchange rate on the date of issue.".

(4) Schedule 4C, after section 2—

Add

"3. **Section 1(ab), (m) and (n) of this Schedule not applicable to certain instruments**

(1) Section 1(ab), (m) and (n) of this Schedule does not apply to an instrument issued before 11 January 2019.

(2) Section 1(ab), (m)(ii) and (n) of this Schedule does not apply in determining whether an instrument qualifies as Tier 2 capital of an authorized institution if the instrument is issued to and held by an entity within the same banking group as the institution.".

17. Schedule 4D amended (requirements to be met for minority interests and capital instruments issued by consolidated bank subsidiaries and held by third parties to be included in authorized institution's capital base)

Schedule 4D, section 2—

Repeal subsection (4).

18. Schedule 4F substituted

Schedule 4F—

Repeal the Schedule

Substitute

"Schedule 4F

[ss. 43, 47 & 48]

Deduction of Holdings where Authorized Institution has Insignificant LAC Investments in Financial Sector Entities that are outside Scope of Consolidation under Section 3C Requirement

1. Interpretation

In this Schedule—

(a) ***CET1 Capital (post-regulatory deduction)*** (CET1資本(經監管扣減後)), in relation to an authorized institution, means the amount of the institution's CET1 capital that is calculated after applying all regulatory deductions under sections 38(2) and 43(1) of these Rules, except those set out in section 43(1)(n), (o), (p) and (q) of these Rules;

(b) ***Inv(CET1)*** (投資額(CET1)), in relation to an authorized institution, means the amount of the institution's holdings of insignificant LAC investments that are CET1 capital investments in financial sector entities;

(c) ***Inv(AT1)*** (投資額(AT1)), in relation to an authorized institution, means the amount of the institution's holdings of insignificant LAC investments that are Additional Tier 1 capital investments in financial sector entities;

(d) ***Inv(T2)*** (投資額(T2)), in relation to an authorized institution, means the amount of the institution's holdings of insignificant LAC investments that are Tier 2 capital investments in financial sector entities;

(e) ***NCLAC investment*** (NCLAC投資) and ***Inv(NCLAC)*** (投資額(NCLAC)), in relation to an

authorized institution, respectively mean the institution's holdings of insignificant LAC investments that are non-capital LAC liabilities in financial sector entities, and the amount of the holdings;

(f) ***10% threshold*** (10%門檻) is the amount calculated as follows—

CET1 Capital (post-regulatory deduction) x 10%;

(g) ***5% threshold*** (5%門檻) is the amount calculated as follows—

CET1 Capital (post-regulatory deduction) x 5%.

2. Deduction of holdings by resolution entity and material subsidiary

(1) In this section—

section 2 institution (第 2 條機構)—

(a) means an authorized institution that is a resolution entity or material subsidiary; but

(b) excludes an authorized institution if, because of subsection (2), it may be treated as a section 3 institution (within the meaning of section 3 of this Schedule).

(2) With the Monetary Authority's prior consent, an authorized institution which is a material subsidiary may be treated as a section 3 institution (within the meaning of section 3 of this Schedule).

(3) For the purposes of this section—

(a) a section 2 institution may designate any holdings in the institution's NCLAC investment as gross long deduction position if the holdings—

(i) are booked in the institution's trading book; and

(ii) are sold within 30 business days of the date of their acquisition;

(b) once any holdings in the institution's NCLAC investment have been designated under paragraph (a) as gross long deduction position, the holdings must not subsequently be included within the 10% threshold; and

(c) any holdings in the institution's NCLAC investment, despite having been designated under paragraph (a) as gross long deduction position, must cease to be treated as so designated if either or both of the conditions under that paragraph is or are no longer met in respect of the holdings.

(4) For the purposes of this section—

(a) ***Inv(CurDsg NCLAC)*** (投資額(現行指定 NCLAC)), in relation to a section 2 institution, means the amount of the institution's holdings of NCLAC investment that are currently designated under subsection (3)(a) as gross long deduction position;

(b) ***Inv(NvDsg NCLAC)*** (投資額(從未指定 NCLAC)), in relation to a section 2 institution, means the amount of the institution's holdings of NCLAC investment that have never been designated under subsection (3)(a) as gross long deduction position;

(c) ***Inv(FmDsg NCLAC)*** (投資額(曾指定 NCLAC)), in relation to a section 2 institution, means the amount of the institution's holdings of NCLAC investment that were formerly designated under

subsection (3)(a) as gross long deduction position but in respect of which either or both of the conditions under that subsection is or are no longer met;

(d) in determining Inv(CET1), Inv(AT1), Inv(T2) and Inv(NvDsg NCLAC)—

(i) the net long positions in both the institution's banking book and trading book must be included; and

(ii) the gross long position may be offset against a short position in the same underlying exposure if the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year;

(e) in determining Inv(CurDsg NCLAC), the gross long positions in the trading book must be included;

(f) ***Excess(10% threshold)(net long)*** (超出額(10%門檻)(淨長倉)) is the greater of the following—

(i) the amount calculated as follows—

[Inv(CET1) + Inv(AT1) + Inv(T2) + Inv(NvDsg NCLAC)] – 10% threshold;

(ii) zero;

(g) ***Excess(5% threshold)(gross long)*** (超出額(5%門檻)(總長倉)) is the greater of the following—

(i) the amount calculated as follows—

Inv(CurDsg NCLAC) – 5% threshold;

(ii) zero;

(h) ***CET1 percentage*** (CET1 百分比) is the percentage calculated as follows—

100% x {Inv(CET1) / [Inv(CET1) + Inv(AT1) + Inv(T2) + Inv(NvDsg NCLAC)]};

(i) ***AT1 percentage*** (AT1 百分比) is the percentage calculated as follows—

100% x {Inv(AT1) / [Inv(CET1) + Inv(AT1) + Inv(T2) + Inv(NvDsg NCLAC)]}; and

(j) ***T2 percentage*** (T2 百分比) is the percentage calculated as follows—

100% x {[Inv(T2) + Inv(NvDsg NCLAC)] / [Inv(CET1) + Inv(AT1) + Inv(T2) + Inv(NvDsg NCLAC)]}.

(5) For the purposes of section 43(1)(o) of these Rules, the applicable amount of a section 2 institution's holdings of insignificant LAC investments that are CET1 capital investments in financial sector entities to be deducted from the institution's CET1 capital must be calculated as follows—

Excess(10% threshold)(net long) x CET1 percentage.

(6) For the purposes of section 47(1)(c) of these Rules, the applicable amount of a section 2 institution's holdings of insignificant LAC investments that are Additional Tier 1 capital investments in financial sector entities to be deducted from the institution's Additional Tier 1 capital must be calculated as follows—

Excess(10% threshold)(net long) x AT1 percentage.

(7) For the purposes of section 48(1)(c) of these Rules, the applicable amount of a section 2 institution's holdings of insignificant LAC investments that are Tier 2 capital investments in, or non-capital LAC liabilities of,

financial sector entities to be deducted from the institution's Tier 2 capital must be calculated as follows—

[Excess(10% threshold)(net long) x T2 percentage] + Excess(5% threshold)(gross long) + Inv(FmDsg NCLAC).

3. Deduction of holdings by authorized institution, not being resolution entity or material subsidiary

(1) In this section—

section 3 institution (第 3 條機構) means an authorized institution which—

(a) is not a resolution entity or material subsidiary; or

(b) is a material subsidiary which, because of section 2(2) of this Schedule, may be treated as a section 3 institution.

(2) For the purposes of this section, a section 3 institution may allocate any holdings in the institution's NCLAC investment as gross long deduction position.

(3) For the purposes of this section—

(a) ***Inv(Alc NCLAC)*** (投資額(現行分配 NCLAC)), in relation to a section 3 institution, means the amount of the institution's holdings of NCLAC investment that are currently allocated under subsection (2) as gross long deduction position;

(b) ***Inv(Non-Alc NCLAC)*** (投資額(未分配 NCLAC)), in relation to a section 3 institution, means the amount of the institution's holdings of NCLAC investment that are not currently allocated under subsection (2) as gross long deduction position;

(c) in determining Inv(CET1), Inv(AT1), Inv(T2) and Inv(Non-Alc NCLAC)—

(i) the net long positions in both the institution's banking book and trading book must be included; and

(ii) the gross long position may be offset against a short position in the same underlying exposure if the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year;

(d) in determining Inv(Alc NCLAC), the gross long positions in both the banking book and trading book must be included;

(e) ***Excess(10% threshold)(net long)*** (超出額(10%門檻)(淨長倉)) is the greater of the following—

(i) the amount calculated as follows—

[Inv(CET1) + Inv(AT1) + Inv(T2) + Inv(Non-Alc NCLAC)] – 10% threshold;

(ii) zero;

(f) ***Excess(5% threshold)(gross long)*** (超出額(5%門檻)(總長倉)) is the greater of the following—

(i) the amount calculated as follows—

Inv(Alc NCLAC) – 5% threshold;

(ii) zero;

(g) ***CET1 percentage*** (CET1 百分比) is the percentage calculated as follows—

100% x {Inv(CET1) / [Inv(CET1) + Inv(AT1) + Inv(T2) + Inv(Non-Alc NCLAC)]};

(h) ***AT1 percentage*** (AT1 百分比) is the percentage calculated as follows—

100% x {Inv(AT1) / [Inv(CET1) + Inv(AT1) + Inv(T2) + Inv(Non-Alc NCLAC)]}; and

(i) ***T2 percentage*** (T2 百分比) is the percentage calculated as follows—

100% x {[Inv(T2) + Inv(Non-Alc NCLAC)] / [Inv(CET1) + Inv(AT1) + Inv(T2) + Inv(Non-Alc NCLAC)]}.

(4) For the purposes of section 43(1)(o) of these Rules, the applicable amount of a section 3 institution's holdings of insignificant LAC investments that are CET1 capital investments in financial sector entities to be deducted from the institution's CET1 capital must be calculated as follows—

Excess(10% threshold)(net long) x CET1 percentage.

(5) For the purposes of section 47(1)(c) of these Rules, the applicable amount of a section 3 institution's holdings of insignificant LAC investments that are Additional Tier 1 capital investments in financial sector entities to be deducted from the institution's Additional Tier 1 capital must be calculated as follows—

Excess(10% threshold)(net long) x AT1 percentage.

(6) For the purposes of section 48(1)(c) of these Rules, the applicable amount of a section 3 institution's holdings of insignificant LAC investments that are Tier 2 capital investments in, or non-capital LAC liabilities of, financial sector entities to be deducted from the institution's Tier 2 capital must be calculated as follows—

[Excess(10% threshold)(net long) x T2 percentage] +

Excess(5% threshold)(gross long).

4. Calculation of insignificant LAC investments holdings

(1) An authorized institution's aggregate holdings of insignificant LAC investments in financial sector entities must be calculated as follows—

(a) the direct holdings, indirect holdings and synthetic holdings by the institution of capital instruments and non-capital LAC liabilities must be included;

(b) the underwriting positions held for 5 business days or less (or for any longer period approved by the Monetary Authority) must be excluded;

(c) subject to subsection (3), if the capital instrument of the entity in which the institution has invested does not meet the qualifying criteria for CET1 capital, Additional Tier 1 capital or Tier 2 capital, the institution must treat the capital instrument as a CET1 capital instrument for the purposes of the deduction; and

(d) the institution may, with the prior consent of the Monetary Authority, temporarily exclude certain investments if they have been made in the context of resolving, or providing financial assistance to reorganize, a distressed financial sector entity.

(2) For the purposes of subsection (1)(b), an authorized institution must risk-weight the underwriting positions referred to in that subsection in accordance with the applicable risk-weight under Part 4, 5, 6 or 8 of these Rules, as the case requires.

(3) An authorized institution may, with the prior consent of the Monetary Authority, map the capital instrument

referred to in subsection (1)(c) to Additional Tier 1 capital or Tier 2 capital, as appropriate, whichever is of the closest corresponding quality for the purposes of the deduction.

5. Undeducted insignificant LAC investments to be risk-weighted

(1) The amount of an authorized institution's holdings of insignificant LAC investments in financial sector entities that are covered either by the 10% threshold or by the 5% threshold and that are not deducted from the institution's CET1 capital, Additional Tier 1 capital or Tier 2 capital under section 2 or 3 of this Schedule is to continue to be risk-weighted in accordance with the applicable risk-weight under Part 4, 5, 6 or 8 of these Rules, as the case requires.

(2) For determining the investments that are covered by the 10% threshold and are subject to risk-weighting, the amount of holdings of the investments must be allocated on a pro rata basis between those below and those above that threshold.".

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

(1) Schedule 4G, heading—

Repeal

"Capital"

Substitute

"LAC".

(2) Schedule 4G, section 1(1)(a), (2) and (3)—

Repeal

"significant capital"

Substitute

"significant LAC".

(3) Schedule 4G, after section 1(3)—

Add

"(3A) All significant LAC investments in non-capital LAC liabilities of financial sector entities must be fully deducted from an authorized institution's Tier 2 capital.".

(4) Schedule 4G, section 1(4)—

Repeal

"capital investments in capital instruments issued by"

Substitute

"LAC investments in capital instruments issued by, and non-capital LAC liabilities of,".

(5) Schedule 4G, section 1(4)—

Repeal paragraph (a)

Substitute

"(a) the direct holdings, indirect holdings and synthetic holdings by the institution of the following must be included—

(i) capital instruments; and

(ii) non-capital LAC liabilities;".

(6) Schedule 4G, Chinese text, section 1(4)(d)—

Repeal

"在符合第(6)款的規定下"

Substitute

"除第(6)款另有規定外".

(7) Schedule 4G, section 1(4)(e)—

Repeal

"resolving or providing financial assistance to reorganize a distressed authorized institution"

Substitute

"resolving, or providing financial assistance to reorganize, a distressed financial sector entity".

(8) Schedule 4G, section 1(7)—

Repeal

"significant capital"

Substitute

"significant LAC".

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

(1) Schedule 4H—

Repeal

"[ss. 43, 47, 48 & 226 & Sch. 4D]"

Substitute

"[s. 226]".

(2) Schedule 4H—

Repeal sections 3 and 4.

Part 3

Amendments Relating to Sovereign Concentration Risk

21. Section 2 amended (interpretation)

(1) Section 2(1), definition of ***Common Equity Tier 1 capital ratio***—

Repeal

"and risk-weighted amount for operational risk"

Substitute

", risk-weighted amount for operational risk and risk-weighted amount for sovereign concentration risk".

(2) Section 2(1), definition of ***relevant risk***—

Repeal

"or operational risk"

Substitute

", operational risk or sovereign concentration risk".

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

Repeal

"or".

(4) Section 2(1), definition of ***risk-weighted amount***, paragraph (d), after the semicolon—

Add

"or".

(5) Section 2(1), definition of ***risk-weighted amount***, after paragraph (d)—

Add

"(e) in relation to the calculation of the sovereign concentration risk of an authorized institution, means the amount of the institution's exposure to sovereign concentration risk calculated in accordance with Part 10;".

(6) Section 2(1), definition of ***Tier 1 capital ratio***—

Repeal

"and risk-weighted amount for operational risk"

Substitute

", risk-weighted amount for operational risk and risk-weighted amount for sovereign concentration risk".

(7) Section 2(1), definition of ***Total capital ratio***—

Repeal

"and risk-weighted amount for operational risk"

Substitute

", risk-weighted amount for operational risk and risk-weighted amount for sovereign concentration risk".

(8) Section 2(1), definition of ***tranche***, before "has"—

Add

", except in section 348,".

(9) Section 2(1)—

Add in alphabetical order

"***risk-weighted amount for sovereign concentration risk*** (官方實體集中風險的風險加權數額), in relation to an authorized institution, means the total risk-weighted amount of the institution's exposures to sovereign concentration risk calculated in accordance with Part 10;

sovereign concentration risk (官方實體集中風險), in relation to an authorized institution—

(a) means the risk of large losses to the institution arising from obligors which are specified sovereign entities of a particular country suddenly failing to meet their credit obligations to the institution or to other creditors of the obligors; and

(b) includes the risk of other counterparties of the institution failing to meet their credit obligations to the institution as a result of the sudden failure referred to in paragraph (a);

specified sovereign entity (指明官方實體) has the meaning given by section 342(1);".

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

Section 4A(1)—

Repeal

"or 8"

Substitute

", 8 or 10".

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

Section 29(1)(a)—

Repeal subparagraphs (ii) and (iii)

Substitute

"(ii) market risk;

(iii) operational risk; and

(iv) sovereign concentration risk;".

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

Section 30(1)(a)—

Repeal subparagraphs (ii) and (iii)

Substitute

"(ii) market risk;

(iii) operational risk; and

(iv) sovereign concentration risk;".

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

Section 31(1)(a)—

Repeal subparagraphs (ii) and (iii)

Substitute

"(ii) market risk;

(iii) operational risk; and

(iv) sovereign concentration risk;".

26. Part 10 added

After Part 9—

Add

"Part 10

Calculation of Sovereign Concentration Risk

Division 1—Interpretation

342. Interpretation of Part 10

(1) In this Part—

concentrated sovereign exposure (集中官方實體風險承擔)—see section 343(2);

Exposure Limits Rules (《風險承擔限度規則》) means the Banking (Exposure Limits) Rules;

investment structure (投資結構) has the meaning given by rule 39(1) of the Exposure Limits Rules;

non-section 350 specified sovereign exposure (非第 350 條指明官方實體風險承擔), in relation to an authorized institution, means an exposure of the institution to a specified sovereign entity and—

(a) includes, without limitation, an exposure of the institution arising from a contract, or from the holding of interests in an investment structure, if any assets underlying the contract or investment structure are issued by a specified sovereign entity; but

(b) excludes an exposure of the institution arising from any guarantee given, or collateral issued, by a specified sovereign entity; and

(c) excludes an exposure of the institution arising from a credit derivative contract under which a specified sovereign entity is the protection seller, except a counterparty credit risk exposure;

section 350 specified sovereign exposure (第350條指明官方實體風險承擔), in relation to an authorized institution, means an exposure of the institution to a specified sovereign entity that is required by section 350(1) or (3) to be included in calculations under this Part;

specified sovereign entity (指明官方實體) means an exempted sovereign entity, as defined by rule 39(1) of the Exposure Limits Rules, but excludes—

(a) the Central People's Government of the People's Republic of China;

(b) the People's Bank of China;

(c) a sovereign foreign public sector entity of the Mainland of China;

(d) the Government of the United States of America; and

(e) the Government;

specified sovereign exposure (指明官方實體風險承擔) means a section 350 specified sovereign exposure or a non-section 350 specified sovereign exposure.

(2) In this Part, the amount of an authorized institution's specified sovereign exposure to a country is the amount calculated in accordance with section 343(1).

Division 2—Calculation of Risk-weighted Amount for Sovereign Concentration Risk

343. Specified sovereign exposure to country and concentrated sovereign exposure

(1) An authorized institution must calculate the amount of its specified sovereign exposure to each country by

aggregating the amounts of its specified sovereign exposures to the specified sovereign entities of the country, each exposure valued in accordance with Division 3.

(2) An authorized institution's specified sovereign exposure to a country is a concentrated sovereign exposure if the amount of the specified sovereign exposure exceeds 100% of the Tier 1 capital of the institution.

344. Calculation of risk-weighted amount of concentrated sovereign exposure to country

If an authorized institution's specified sovereign exposure to a country is a concentrated sovereign exposure, the institution must calculate the risk-weighted amount of its concentrated sovereign exposure to the country by—

(a) dividing the exposure into the portions as specified in column 2 of Table 34;

(b) for each portion of the exposure exceeding 100% of the Tier 1 capital of the institution as specified in items 2, 3, 4, 5 and 6 (as applicable) in column 2 of Table 34—multiplying the amount of the exposure in the portion by the risk weight specified in column 3 of that Table opposite the portion; and

(c) aggregating the results from paragraph (b) for the portions specified in items 2, 3, 4, 5 and 6 (as applicable) in column 2 of Table 34.

Table 34

Risk-weights for Portions of Concentrated Sovereign Exposure to Country

Item	Portion of concentrated sovereign exposure to country (expressed as percentage of Tier 1 capital)	Risk-weight
1.	Portion exceeding 0% but not exceeding 100%	not applicable
2.	Portion exceeding 100% but not exceeding 150%	5%
3.	Portion exceeding 150% but not exceeding 200%	6%
4.	Portion exceeding 200% but not exceeding 250%	9%
5.	Portion exceeding 250% but not exceeding 300%	15%
6.	Portion exceeding 300%	30%

345. Calculation of risk-weighted amount for sovereign concentration risk

An authorized institution must calculate the risk-weighted amount for sovereign concentration risk by aggregating the risk-weighted amounts of the institution's concentrated sovereign exposures to all countries calculated in accordance with section 344.

Division 3—Valuation of Specified Sovereign Exposures

346. Valuation of non-section 350 specified sovereign exposure booked in banking book

(1) In this section—

subsection (1) exposure (第(1)款風險承擔), in relation to an authorized institution, means a non-section 350 specified sovereign exposure of the institution that is booked in its banking book but excludes an exposure arising from—

(a) the institution's interests in an investment structure, being an investment structure with any underlying assets issued by a specified sovereign entity; or

(b) a repo-style transaction—

(i) which falls within paragraph (a), (b) or (d) of the definition of ***repo-style transaction*** in section 2(1); and

(ii) under which securities issued by a specified sovereign entity are sold or lent by the institution or are provided by the institution as collateral (as the case requires).

(2) An authorized institution must value a subsection (1) exposure in accordance with this section.

(3) A subsection (1) exposure that arises from an on-balance sheet item and is not a counterparty credit risk exposure must be valued—

(a) in the case of holding of shares, at the sum of—

(i) the current book value of the shares; and

(ii) the amount that is for the time being remaining unpaid on the shares and is not counted under subparagraph (i); or

(b) in any other case, at the current book value of the item unless this section specifically provides for the valuation of the exposure.

(4) A subsection (1) exposure that arises from an off-balance sheet item and is not a counterparty credit risk

exposure must be valued by multiplying the item's principal amount (less the amount of any specific provision in respect of the exposure) by—

(a) the credit conversion factor specified, opposite that item, in column 3 of Table A in Schedule 1 to the Exposure Limits Rules unless paragraph (b) applies; or

(b) if the exposure arises from an off-balance sheet item specified in item 9, 10, 11 or 12 in that Table and the institution chooses not to apply the credit conversion factor mentioned in paragraph (a)—100%.

(5) In subsection (4)—

principal amount (本金額), in relation to an off-balance sheet item specified in Table A in Schedule 1 to the Exposure Limits Rules, means—

(a) for an undrawn facility or the undrawn portion of a partially drawn facility—the amount of the undrawn commitment; or

(b) in any other case—the contracted amount of the item.

(6) A subsection (1) exposure that is a counterparty credit risk exposure in respect of a SFT must be valued at the amount of default risk exposure in respect of the SFT.

(7) A subsection (1) exposure that is a counterparty credit risk exposure in respect of a derivative contract must be valued at the amount of default risk exposure in respect of the contract.

(8) A subsection (1) exposure that arises from an option contract, being an option contract with any underlying

assets issued by a specified sovereign entity, must be valued as follows—

a long position in a call option contract: V

a long position in a put option contract: $-S + V$

a short position in a call option contract: $-V$

a short position in a put option contract: $S - V$

where—

S = strike price of the option contract; and

V = fair value of the option contract.

347. Valuation of non-section 350 specified sovereign exposure booked in trading book

(1) In this section—

subsection (1) exposure (第(1)款風險承擔), in relation to an authorized institution, means a non-section 350 specified sovereign exposure of the institution that is booked in its trading book but excludes an exposure arising from—

(a) the institution's interests in an investment structure, being an investment structure with any underlying assets issued by a specified sovereign entity; or

(b) a repo-style transaction—

(i) which falls within paragraph (a), (b) or (d) of the definition of ***repo-style transaction*** in section 2(1); and

(ii) under which securities issued by a specified sovereign entity are sold or lent by the institution or are provided by the institution as collateral (as the case requires).

(2) An authorized institution must value a subsection (1) exposure in accordance with this section.

(3) Unless this section specifically provides for the valuation of the exposure, in relation to a subsection (1) exposure—

(a) a long position must be valued as the amount of loss that would be sustained by the institution if the obligor were to immediately default; and

(b) a short position must be valued as the amount of gain that would accrue to the institution if the obligor were to immediately default.

(4) A subsection (1) exposure arising from securities issued by a specified sovereign entity must be valued at the current market value of the securities.

(5) A subsection (1) exposure arising from a contract, being a contract with any underlying assets issued by a specified sovereign entity, must be valued at the fair value of the underlying assets if the contract is a futures contract, forward contract, swap contract or a similar contract.

(6) If a subsection (1) exposure arises from a credit derivative contract under which the institution is the protection seller and a specified sovereign entity is the reference entity, the exposure must be valued at the amount that the institution is obliged to pay in the case a credit event on the part of the specified sovereign entity occurs, minus the absolute value of the credit protection.

(7) A subsection (1) exposure arising from an option contract, being an option contract with any underlying assets issued by a specified sovereign entity, must be valued as follows—

a long position in a call option contract: V

a long position in a put option contract: −S + V

a short position in a call option contract: −V

a short position in a put option contract: S − V

where—

S = strike price of the option contract; and

V = fair value of the option contract.

(8) Even if a counterparty credit risk exposure of an authorized institution is derived from a contract which is booked in the institution's trading book, the counterparty credit risk exposure is taken to be an exposure booked in the institution's banking book for the purposes of this section and section 346.

348. Valuation of non-section 350 specified sovereign exposure arising from interests in investment structure

(1) If—

(a) an authorized institution holds interests in an investment structure; and

(b) any assets underlying the investment structure are issued by a specified sovereign entity (each an ***SSE asset***),

the institution must value the exposure to the specified sovereign entity arising from the institution's interests in the investment structure (whether the exposure is booked in the institution's banking book or trading book) (***subsection (1) exposure***) in accordance with this section.

(2) The subsection (1) exposure must be valued—

(a) at zero, if—

(i) the current book value of the institution's holding of interests in the investment structure is less than 0.25% of the amount of the institution's Tier 1 capital; or

(ii) the total value of the exposures arising from all SSE assets is less than 0.25% of the amount of the institution's Tier 1 capital; or

(b) at the total value of the exposures arising from all SSE assets if paragraph (a) does not apply.

(3) For the purposes of subsection (2)(a)(ii) and (b), the institution must—

(a) assign an exposure to each SSE asset; and

(b) determine the total value of the exposures arising from SSE assets by—

(i) calculating the value of each exposure arising from an SSE asset by the method mentioned in subsection (4); and

(ii) aggregating all the values calculated under subparagraph (i).

(4) For the purposes of subsection (3)(b)(i), an authorized institution must calculate the value of an exposure arising from an SSE asset (***asset A***) as follows—

(a) if the rights of all the investors in the investment structure are identical, by using Formula 32;

(b) if there are differences in seniority levels among the investors in the investment structure, by multiplying—

(i) the share of the institution's investment in the tranche of the investment structure in which

the institution holds an interest, expressed as a percentage; by

(ii) the lower of—

(A) the nominal value of the tranche; and

(B) the nominal value of asset A.

(5) Formula 32 is as follows—

Formula 32

$$E(A) = \text{Min}\left((S_A \times NAV_{AI} / NAV_S), BV\right)$$

where—

$E(A)$ = value of the institution's exposure to the specified sovereign entity arising from asset A;

S_A = total value of the investment structure's exposure to asset A as disclosed in the latest financial report of the investment structure;

NAV_{AI} = net asset value of the institution's holding of interests in the investment structure;

NAV_S = net asset value of the investment structure;

BV = current book value of the institution's holding of interests in the investment structure.

(6) In subsection (4)—

tranche (份額) means a contractually established segment (***relevant segment***) of the credit risk associated with a

pool of underlying exposures in a securitization transaction, or in a transaction of a similar structure, if—

(a) a position in the relevant segment entails a risk of credit loss greater than, or less than, that of a position of the same amount in each other contractually established segment; and

(b) no account is taken of any credit protection provided by third parties directly to the holders of positions in the relevant segment or in other contractually established segments.

349. Valuation of non-section 350 specified sovereign exposure arising from repo-style transaction

(1) This section applies to the valuation of an authorized institution's non-section 350 specified sovereign exposure arising from a repo-style transaction that is not a counterparty credit risk exposure where—

(a) the transaction falls within paragraph (a), (b) or (d) of the definition of ***repo-style transaction*** in section 2(1); and

(b) securities issued by a specified sovereign entity are sold or lent by the institution under the transaction or are provided by the institution as collateral under the transaction (as the case requires) (the securities are referred to as ***SSE securities***).

(2) The institution must continue to treat the SSE securities as being held by it, as if it had never entered into the repo-style transaction.

(3) If the SSE securities are booked in the institution's banking book, the non-section 350 specified sovereign exposure referred to in subsection (1) must be valued—

(a) in the case of holding of shares, at the sum of—

(i) the current book value of the shares; and

(ii) the amount that is for the time being remaining unpaid on the shares and is not counted under subparagraph (i); or

(b) in any other case, at the current book value of the SSE securities.

(4) If the SSE securities are booked in the institution's trading book, the non-section 350 specified sovereign exposure referred to in subsection (1) must be valued at the current market value of the SSE securities.

350. Exposure to specified sovereign entity arising from certain guarantee given by it or certain collateral issued by it

(1) If an authorized institution has taken into account the value of any collateral issued by a specified sovereign entity in the valuation of a counterparty credit risk exposure under rule 59 or 60 of the Exposure Limits Rules (***value taken into account***)—

(a) the institution must include in calculations under this Part an exposure to the specified sovereign entity arising from the collateral (***paragraph (a) exposure***); and

(b) the paragraph (a) exposure must be valued at the value taken into account.

(2) Subsection (3) applies if—

(a) a CRM covered exposure of an authorized institution is covered by a recognized guarantee given by, or a recognized collateral issued by, a specified sovereign entity; and

(b) because of the recognized guarantee or recognized collateral, the institution has reduced the value of the CRM covered exposure to the value of the CRM uncovered portion of the exposure in accordance with Division 6 of Part 7 of the Exposure Limits Rules by an amount (***reduction amount***) for the purposes of calculating an aggregate exposure ratio under those Rules.

(3) The institution must include in calculations under this Part an exposure to the specified sovereign entity arising from the recognized guarantee or recognized collateral (as the case requires) and the exposure must be valued at the reduction amount.

(4) In this section, an expression specified below has the meaning given by rule 39(1) of the Exposure Limits Rules—

aggregate exposure ratio (總風險承擔比率);

CRM covered exposure (CRM 涵蓋風險承擔);

CRM uncovered portion (CRM 不涵蓋部分);

recognized collateral (認可抵押品);

recognized guarantee (認可擔保).

Division 4—Offsetting and Deduction

351. General

For the purposes of calculations under this Part, the valuation of an exposure may be subject to offsetting and deduction in accordance with this Division.

352. Offsetting of positions

(1) A long position and a short position with respect to the same counterparty in an authorized institution's trading book may be offset as follows—

(a) a long position and a short position in the same issue of securities in the trading book may be offset; and

(b) a long position and a short position in different issues of securities in the trading book issued by the same counterparty may be offset, if the long position is senior, or of equivalent seniority, to the short position.

(2) An exposure arising from the holding of securities issued by a counterparty in an authorized institution's trading book may be offset against a credit derivative contract, in the institution's trading book, entered into by the institution to hedge the exposure if the position being hedged is senior, or of equivalent seniority, to the reference obligation of the credit derivative contract.

(3) For subsection (1)(a), 2 issues of securities are treated as the same issue if the following (as applicable) are identical—

(a) the issuer;

(b) coupon;

(c) currency;

(d) maturity; and

(e) priority to claim on the issuer's income or assets.

(4) For determining the relative seniority of a long position and a short position in different issues of securities under subsections (1)(b) and (2)—

(a) the securities may be allocated into broad buckets of different degrees of seniority, including, for example, "equity", "subordinated debt" or "senior debt"; and

(b) if the institution chooses to allocate securities in the way described in paragraph (a), the allocation must be applied consistently across the institution's entire portfolio of positions in its trading book.

(5) A long position with respect to a counterparty in an authorized institution's banking book may be offset against a short position in an option contract with respect to the counterparty in its banking book.

(6) The following is taken to be zero—

(a) a net short position after any offsetting mentioned in subsection (1)(a) or (b), (2) or (5);

(b) a short position not used to offset a long position as mentioned in subsection (1)(a) or (b), (2) or (5).

(7) To avoid doubt, an authorized institution may choose not to do any offsetting mentioned in subsection (1)(a) or (b), (2) or (5).

353. Deduction

In valuing a specified sovereign exposure of an authorized institution, the following amounts are to be deducted—

(a) the amount that is deducted in determining the capital base of the institution in accordance with Part 3;

(b) the amount of specific provisions, made in respect of the exposure, that is not yet considered in the valuation of the exposure;

(c) for an exposure that has been written off in the books of the institution—the amount written off.".

27. Schedule 4D amended (requirements to be met for minority interests and capital instruments issued by consolidated bank subsidiaries and held by third parties to be included in authorized institution's capital base)

Schedule 4D—

(a) section 3(1A)(a) and (b) and (1B);

(b) section 4(1A)(a) and (b) and (1B);

(c) section 5(1A)(a) and (b) and (1B)—

Repeal

"and risk-weighted amount for operational risk" (wherever appearing)

Substitute

", risk-weighted amount for operational risk and risk-weighted amount for sovereign concentration risk".

Part 4

Amendments Relating to Internal Assessment Approach, Domestic Public Sector Entities, Etc.

28. Section 2 amended (interpretation)

(1) Section 2(1), definition of ***ECAI issue specific rating***—

Repeal paragraph (a)

Substitute

"(a) subject to paragraphs (b), (c), (e), (f), (g) and (h), if the exposure is a non-securitization exposure to a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that—

(i) is assigned to the exposure by an ECAI; and

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

(2) Section 2(1), definition of ***ECAI issue specific rating***—

Repeal paragraph (d)

Substitute

"(d) subject to paragraphs (b), (c), (e), (f), (g) and (h), if the exposure is a non-securitization exposure to a person other than a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that—

(i) is assigned to the exposure by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in this subsection; and

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

(3) Section 2(1), definition of ***ECAI issue specific rating***, paragraph (g)—

Repeal

"and".

(4) Section 2(1), definition of ***ECAI issue specific rating***, paragraph (h), after the semicolon—

Add

"and".

(5) Section 2(1), definition of ***ECAI issue specific rating***, after paragraph (h)—

Add

"(i) if the exposure is a securitization exposure, has the meaning given by section 227A;".

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

Repeal paragraph (a)

Substitute

"(a) S&P Global Ratings;".

(7) Section 2(1)—

Repeal the definition of *Fitch Ratings*

Substitute

"***Fitch Ratings*** (惠譽評級) means that organization the membership of which consists of companies that—

(a) adhere to a common set of core methodologies, practices and procedures for issuing credit assessment ratings; and

(b) issue credit assessment ratings under the name of Fitch Ratings;".

(8) Section 2(1)—

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

Substitute

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

(a) subject to paragraphs (b) and (c), means an ECAI issue specific rating that is a long-term credit assessment rating;

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

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

(9) Section 2(1)—

Repeal the definition of *Moody's Investors Service*

Substitute

"***Moody's Investors Service*** (穆迪投資者服務) means that organization the membership of which consists of companies that—

(a) adhere to a common set of core methodologies, practices and procedures for issuing credit assessment ratings; and

(b) issue credit assessment ratings under the name of Moody's Investors Service;".

(10) Section 2(1)—

Repeal the definition of *securitization external ratings-based approach*

Substitute

"***securitization external ratings-based approach*** (證券化外部評級基準計算法) means a method, set out in Division 8 of Part 7, of determining the risk-weight of a securitization exposure based on the ECAI issue specific rating, the inferred rating or the internal credit rating, as the case requires, of the exposure;".

(11) Section 2(1)—

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

Substitute

"***short-term ECAI issue specific rating*** (短期 ECAI 特定債項評級) means an ECAI issue specific rating that is a short-term credit assessment rating;".

(12) Section 2(1)—

Repeal the definition of *Standard & Poor's Ratings Services.*

(13) Section 2(1)—

Add in alphabetical order

"***ABCP programme*** (ABCP 計劃) has the meaning given by section 227(1);

approved internal assessment process (經批准內部評估程序), in relation to an authorized institution that has an IAA approval, means the institution's internal assessment process that is the subject of the IAA approval;

eligible ABCP exposure (合資格 ABCP 風險承擔)—see section 15B;

IAA means the internal assessment approach;

IAA approval (IAA 批准) means an approval to use the IAA granted by the Monetary Authority under section 15C(2)(a);

inferred rating (推斷評級) has the meaning given by section 227(1);

internal assessment approach (內部評估計算法) means the method, set out in section 266A, of determining the risk-weight of an eligible ABCP exposure by using the SEC-ERBA based on the internal credit rating of the exposure;

internal assessment process (內部評估程序), in relation to an authorized institution, means a process used by the institution to assess the credit quality of its securitization exposures to ABCP programmes;

internal credit rating (內部信用評級), in relation to an authorized institution that has an IAA approval, means a credit rating which—

(a) is generated by the institution's approved internal assessment process; and

(b) is assigned to a securitization exposure to an ABCP programme;

S&P Global Ratings (標普全球評級) means that organization the membership of which consists of business units within companies that—

(a) adhere to a common set of core methodologies, practices and procedures for issuing credit assessment ratings; and

(b) issue credit assessment ratings under the name of S&P Global Ratings;".

(14) Section 2—

Repeal subsection (5)

Substitute

"(5) If any matter specified in a provision of these Rules is qualified by the word "adequate", "appropriate", "material", "prudent", "qualified", "relevant" or "robust", then, for the purposes of assisting in ascertaining the nature of that qualification insofar as it relates to that matter, regard must be had to any guidelines or codes of practice issued under the Ordinance which are applicable to that provision.".

29. Section 15 amended (authorized institution must use SEC-IRBA, SEC-ERBA, SEC-SA or SEC-FBA to determine risk-weight of securitization exposure)

(1) Section 15—

Repeal subsection (2)

Substitute

"(2) If—

(a) an authorized institution is to determine the risk-weight of a securitization exposure to a securitization transaction; and

(b) the securitization exposure has—

(i) an ECAI issue specific rating issued by an ECAI nominated by the institution for the purposes of section 267(1)(a); or

(ii) if subparagraph (i) does not apply, an inferred rating,

then, subject to subsection (2B), the institution must use the SEC-ERBA to determine the risk-weight of the securitization exposure based on that rating if all of the conditions specified in subsection (2A) are met.".

(2) After section 15(2)—

Add

"(2A) The conditions specified for subsection (2) are—

(a) the securitization exposure is not a re-securitization exposure; and

(b) either—

(i) the pool of underlying exposures of the securitization transaction is classified as an SA pool; or

(ii) both of the following conditions are met—

(A) the pool of underlying exposures of the securitization transaction is classified as a mixed pool;

(B) the institution is unable to calculate the K_{IRB} in accordance with section 254(1) for at least 95% of the total nominal amount of the underlying exposures.

(2B) If—

(a) an authorized institution having an IAA approval is to determine the risk-weight of a securitization exposure to a securitization transaction; and

(b) the securitization exposure—

(i) does not have an ECAI issue specific rating issued by an ECAI nominated by the institution for the purposes of section 267(1)(a); but

(ii) has an internal credit rating,

then, subject to subsection (2C), the institution may determine the risk-weight of the securitization exposure by using the SEC-ERBA based on the internal credit rating in accordance with section 266A if the securitization exposure is an eligible ABCP exposure and falls within a category of securitization exposures covered by the institution's IAA approval.

(2C) Subsection (2B) does not apply to an authorized institution in determining the risk-weight of a securitization exposure if—

(a) the institution's IAA approval has attached to it under section 33A(1) or (2) any condition that prohibits the institution from using the IAA to determine the risk-weight of the exposure; or

(b) a notice issued by the Monetary Authority under section 15D has the effect of prohibiting the institution from using the IAA to determine the risk-weight of the exposure.".

(3) Section 15(3)(b)(ii)—

Repeal

"; or"

Substitute a semicolon.

(4) Section 15(3)(c)—

Repeal the full stop

Substitute

"; or".

(5) After section 15(3)(c)—

Add

"(d) the institution is required to do so pursuant to a notice under section 15D given to it by the Monetary Authority.".

(6) Section 15(4), after "(2)"—

Add

", (2B)".

(7) Section 15(4)(a)—

Repeal

"; or"

Substitute a semicolon.

(8) Section 15(4)(b)—

Repeal the full stop

Substitute

"; or".

(9) After section 15(4)(b)—

Add

"(c) the institution is required to do so pursuant to a notice under section 15D given to it by the Monetary Authority.".

30. Sections 15B, 15C and 15D added

After section 15A—

Add

"15B. Meaning of *eligible ABCP exposure*

For the purposes of these Rules, a securitization exposure of an authorized institution having an IAA approval (***specified exposure***) is an eligible ABCP exposure if all of the following criteria are met—

(a) the specified exposure is an exposure to an ABCP programme (***ABCP programme***);

(b) one of the following persons is the sponsor of the ABCP programme—

(i) the institution;

(ii) a member of a group of entities of which the ultimate holding company is the same as that of the institution;

(c) the ABCP programme has in place—

(i) adequate and prudent standards on the underwriting and structuring of asset purchase transactions; and

(ii) adequate and prudent policies, processes and structural features for assessing, controlling and mitigating risks associated with underlying exposures and other parties involved such as sellers of the underlying exposures and servicers;

(d) the sponsor of the ABCP programme has an adequate and prudent policy on selecting ECAIs to assign ECAI ratings to debt securities to be issued under the ABCP programme;

(e) there is an ECAI issue specific rating assigned to each of the debt securities with an original maturity of one year or less issued under the ABCP programme by an ECAI that has been nominated by the institution for the purposes of Part 7 in the manner as set out in section 267(1)(a);

(f) the circumstances of the institution and the specified exposure are such that if all of the senior debt securities issued under the ABCP programme were held by the institution—

(i) the debt securities would be required by section 15 to be risk-weighted by the institution by using the SEC-ERBA based on

the ECAI issue specific ratings of the debt securities if section 267(4) did not exist; or

(ii) if the debt securities would overlap with the specified exposure or other securitization exposures of the institution to the ABCP programme—the debt securities would be required by section 15 to be so risk-weighted if sections 239 and 267(4) did not exist;

(g) the specified exposure is not a re-securitization exposure;

(h) the specified exposure is backed by a pool of underlying exposures that is classified as an SA pool;

(i) the institution, if it did not have an IAA approval, would be required by section 15 to determine the risk-weight of the specified exposure by using the SEC-ERBA based on an inferred rating of the specified exposure (if such a rating is available) or by using the SEC-SA;

(j) the initial internal credit rating assigned to the specified exposure by the institution in accordance with the approved internal assessment process is at least equivalent to an ECAI issue specific rating that maps to a long-term credit quality grade of 1, 2, 3, 4, 5, 6, 7, 8, 9 or 10 in Table A in Schedule 11 or a short-term credit quality grade of 1, 2 or 3 in Table B in that Schedule.

15C. Authorized institution may apply for approval to use IAA to determine risk-weight of eligible ABCP exposure

(1) An authorized institution that has obtained the Monetary Authority's approval under section 8 to use the IRB

approach to calculate its credit risk for non-securitization exposures may make an application to the Monetary Authority for approval to use the IAA to determine the risk-weights of its eligible ABCP exposures (***application***).

(2) Subject to subsection (3), the Monetary Authority must determine the application by—

(a) granting approval to the institution to use the IAA to determine the risk-weights of its eligible ABCP exposures falling within—

(i) the categories of securitization exposures specified in the application; or

(ii) any categories of securitization exposures that the Monetary Authority specifies in the approval; or

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

(3) Without limiting subsection (2)(b), the Monetary Authority must refuse to grant an approval to an authorized institution to use the IAA unless the institution satisfies the Monetary Authority that the institution, and its internal assessment process that is the subject of the application, are subject to an appropriate governance and risk management framework (***framework***) which ensures at all times that—

(a) there is effective oversight of the internal assessment process and other related activities of the institution;

(b) the rating methodologies used for assessing the institution's securitization exposures to an ABCP programme are—

(i) prudent; and

(ii) appropriate to the characteristics of the ABCP programme;

(c) there are adequate and prudent policies, procedures and internal controls for ensuring that—

(i) the internal assessment process is risk-sensitive and robust; and

(ii) requirements under these Rules, for the time being in force in respect of the use of the IAA, are complied with; and

(d) there are regular and independent reviews conducted by qualified persons to assess the adequacy and validity of the internal assessment process and its outputs.

(4) An authorized institution having an IAA approval must not, without the prior consent of the Monetary Authority, make any significant change to the framework in respect of elements that are relevant to ensuring at all times that the descriptions in subsection (3)(a), (b), (c) and (d) are met.

15D. Measures that may be taken by Monetary Authority if authorized institution using IAA no longer satisfies specified requirements

(1) The Monetary Authority may take one or more of the measures set out in this section in respect of an authorized institution that has an IAA approval if the Monetary Authority determines that—

(a) the governance and risk management framework that the institution and its internal assessment process are subject to has ceased to be capable of

ensuring at all times that the descriptions in section 15C(3)(a), (b), (c) and (d) are met, or the institution has contravened section 15C(4);

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

(c) the institution has used the IAA to determine the risk-weight of a securitization exposure—

(i) that is not an eligible ABCP exposure; or

(ii) that is an eligible ABCP exposure but does not fall within a category of securitization exposures covered by the institution's IAA approval.

(2) The Monetary Authority may, by notice in writing given to the institution, require the institution to use the SEC-SA or the SEC-FBA, instead of the IAA, to determine the risk-weights of the securitization exposures or categories of securitization exposures specified in the notice, during the period or beginning on the date or on the occurrence of an event specified in the notice.

(3) The Monetary Authority may, by notice in writing given to the institution, require the institution to adopt one or more than one measure within the period specified in the notice (being a period that is reasonable in all the circumstances of the case) that, in the opinion of the Monetary Authority—

(a) will cause the institution to cease to fall within subsection (1) within a period that is reasonable in all the circumstances of the case; or

(b) will otherwise mitigate the effect of the institution falling within subsection (1).

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

31. Part 2, Division 7A heading amended (attachment of conditions to approvals granted under section 6(2)(a), 8(2)(a), 10B(2)(a), 18(2)(a) or 25(2)(a))

Part 2, Division 7A, heading, after "**10B(2)(a),**"—

Add

"**15C(2)(a),**".

32. Section 33A amended (attachment of conditions to approvals granted under section 6(2)(a), 8(2)(a), 10B(2)(a), 18(2)(a) or 25(2)(a))

(1) Section 33A, heading, after "**10B(2)(a),**"—

Add

"**15C(2)(a),**".

(2) Section 33A(1) and (2), after "10B(2)(a),"—

Add

"15C(2)(a),".

33. Section 34 amended (reviewable decisions)

Section 34(1), after "10B(2),"—

Add

"15C(2),".

34. Section 64 amended (regulatory retail exposures)

Section 64(1)(a)—

Repeal

"section 81(1)(a), (b), (c) or (d) of the Ordinance"

Substitute

"the Banking (Exposure Limits) Rules".

35. Section 76 substituted

Section 76—

Repeal the section

Substitute

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

(1) To avoid doubt, an exposure of an authorized institution to the asset underlying a specified SFT is an exposure subject to the requirements of Part 8 instead of this Part.

(2) In subsection (1)—

specified SFT (指明 SFT), in relation to an authorized institution, means—

(a) a repo-style transaction that is booked in the institution's trading book and falls within paragraph (a) or (b) of the definition of ***repo-style transaction*** in section 2(1); or

(b) a repo-style transaction—

(i) that is booked in the institution's trading book and falls within paragraph (d) of the definition of ***repo-style transaction*** in section 2(1); and

(ii) under which the collateral provided by the institution is in the form of securities.".

36. Section 123 substituted

Section 123—

Repeal the section

Substitute

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

To avoid doubt, an exposure of an authorized institution to the asset underlying a specified SFT, as defined by section 76(2), is an exposure subject to the requirements of Part 8 instead of this Part.".

37. Section 202 amended (securities financing transactions)

Section 202—

Repeal subsection (5)

Substitute

"(5) To avoid doubt, an exposure of an authorized institution to the asset underlying a specified SFT, as defined by section 76(2), is an exposure subject to the requirements of Part 8 instead of this Part.".

38. Section 226S amended (standardized CVA method)

Section 226S(1), Table 23A—

Repeal

"Standard & Poor's Ratings Services"

Substitute

"S&P Global Ratings".

39. Section 227 amended (interpretation of Part 7)

(1) Section 227(1), English text, definition of ***rated***, paragraph (a), after "institution"—

Add

"concerned".

(2) Section 227(1), definition of ***rated***, paragraph (b), after "rating"—

Add

"or an internal credit rating".

(3) Section 227(1), definition of ***synthetic securitization transaction***—

Repeal

"which remain on the balance sheet of the originator in the transaction".

40. Section 227A added

After section 227—

Add

"**227A. Meaning of *ECAI issue specific rating***

(1) An ECAI issue specific rating, in relation to a securitization transaction, means a short-term credit assessment rating or long-term credit assessment rating that—

(a) is assigned by an ECAI (within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in section 2(1)) to—

(i) a specific securitization exposure to the transaction;

(ii) a specific class of securitization exposures to the transaction; or

(iii) the transaction if it is a securities issuing programme (including an ABCP programme) that issues securitization issues; and

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

(2) If—

(a) an ECAI issue specific rating is assigned by an ECAI to an ABCP programme or any other type of securities issuing programme that issues securitization issues (***programme rating***); and

(b) according to the rating definitions, rating criteria or other similar documentation of the ECAI, the programme rating only refers to the creditworthiness of the programme with respect to a specific class of securitization issues issued under the programme,

the programme rating may be treated under these Rules as if it were an ECAI issue specific rating assigned to that specific class of securitization issues.".

41. Section 229 amended (meaning of *eligible securitization transactions*, etc.)

Section 229(1)(a)(i)—

Repeal

"and its"

Substitute

"or its".

42. Section 230 amended (treatment of underlying exposures of eligible securitization transactions: general)

After section 230(5)—

Add

"(5A) The originating institution of a securitization transaction must comply with the requirement of a notice given to it under subsection (5).".

43. Section 235 amended (determination of exposure amount of securitization exposure)

Section 235(3)(b)(i)—

Repeal

"transaction"

Substitute

"securitization transaction concerned".

44. Section 249 amended (supplementary provisions to sections 236 and 245 in relation to tranched credit protection)

Section 249(3)(b)(i)(A)—

Repeal

"or the inferred rating"

Substitute

", the inferred rating or the internal credit rating".

45. Section 266A added

After section 266—

Add

"**266A. Internal assessment approach: determination of risk-weights of eligible ABCP exposures with internal credit ratings**

(1) An authorized institution having an IAA approval must, in determining the risk-weight of an eligible ABCP

exposure by using the SEC-ERBA based on the internal credit rating of the exposure—

(a) map the internal credit rating to an equivalent long-term ECAI issue specific rating or an equivalent short-term ECAI issue specific rating, as the case requires; and

(b) treat the long-term ECAI issue specific rating or short-term ECAI issue specific rating so obtained as that of the exposure and, on that basis, determine the risk-weight of the exposure in accordance with section 265 or 266, as the case requires.

(2) For the purposes of subsection (1)(a), an internal credit rating and an ECAI issue specific rating are considered to be equivalent to each other if both of them represent broadly the same credit characteristics and creditworthiness.".

46. Section 267 amended (use of ECAI issue specific ratings for determination of risk-weights)

(1) Section 267, heading, after "**ratings**"—

Add

"**or internal credit ratings**".

(2) Section 267(2)—

Repeal

"of the transaction"

Substitute

"of a securitization transaction".

(3) Section 267(2), after "specific rating"—

Add

"or the internal credit rating".

(4) Section 267(3)—

Repeal

"the transaction"

Substitute

"a securitization transaction".

(5) Section 267(3), after "rating"—

Add

"or the internal credit rating".

(6) Section 267(4), after "rating"—

Add

"or an internal credit rating".

(7) Section 267(4)—

Repeal

"the transaction is"

Substitute

"a securitization transaction is".

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

Schedule 1, Part 1, after item 11—

Add

"12. HKMC Insurance Limited.

13. HKMC Annuity Limited.".

48. Schedule 6 amended (credit quality grades)

Schedule 6—

(a) Tables A and B;

(b) Table C, Part 1;

(c) Table D;

(d) Table E, Part 1—

Repeal

"Standard & Poor's Ratings Services" (wherever appearing)

Substitute

"S&P Global Ratings".

49. Schedule 7 amended (standard supervisory haircuts for comprehensive approach to treatment of recognized collateral)

(1) Schedule 7—

Repeal

"[ss."

Substitute

"[ss. 2,".

(2) Schedule 7, section 2—

Repeal paragraphs (g) and (h)

Substitute

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

(i) in relation to a debt security (other than a securitization issue) issued by a bank, a securities firm, a corporate incorporated outside India, or any other issuer that is not a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that—

(A) is assigned to the debt security by an ECAI within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in section 2(1) of these Rules; and

(B) is for the time being neither withdrawn nor suspended by that ECAI;

(ii) in relation to a debt security (other than a securitization issue) issued by a corporate incorporated in India, means a short-term credit assessment rating or long-term credit assessment rating that—

(A) is assigned to the debt security by an ECAI; and

(B) is for the time being neither withdrawn nor suspended by that ECAI; or

(iii) in relation to a debt security that is a securitization issue, has the meaning given by section 227A;

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

(i) in relation to a debt security (other than a securitization issue) issued by a sovereign, a sovereign foreign public sector entity, or a multilateral development bank, means an ECAI issue specific rating assigned to the debt security by an ECAI (within the meaning of paragraph (a), (b), (c), (d) or (e) of the definition of ***external credit assessment institution*** in section 2(1) of these Rules) that is a long-term credit assessment rating; or

(ii) in relation to a debt security that is a securitization issue, means an ECAI issue specific rating (within the meaning of section 227A) assigned to the

securitization issue that is a long-term credit assessment rating.".

50. Schedule 8 amended (credit quality grades for specialized lending)

Schedule 8—

Repeal

"Standard & Poor's Ratings Services"

Substitute

"S&P Global Ratings".

51. Schedule 10A amended (requirements supplementary to Schedules 9 and 10)

(1) Schedule 10A, English text, section 2(a)(ii)—

Repeal

"an originating"

Substitute

"the originating".

(2) Schedule 10A, English text, section 2(c), after "securitization issues"—

Add

"concerned".

52. Schedule 11 amended (mapping of ECAI issue specific ratings into credit quality grades under SEC-ERBA)

(1) Schedule 11—

Repeal

"[ss."

Substitute

"[ss. 15B,".

(2) Schedule 11, Tables A and B—

Repeal

"Standard & Poor's Ratings Services"

Substitute

"S&P Global Ratings".

Monetary Authority

2018

Explanatory Note

These Rules amend the Banking (Capital) Rules (Cap. 155 sub. leg. L) (***Principal Rules***). The main objects of the amendments are as explained in the paragraphs below.

Amendments Relating to Holdings of Non-capital LAC Liabilities

2. The Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements—Banking Sector) Rules (Cap. 628 sub. leg. B) (***LAC Rules***) prescribe minimum loss-absorbing capacity (LAC) requirements for authorized institutions and their group companies. Part 2 of these Rules provides for the regulatory capital treatment of holdings by authorized institutions of non-capital LAC liabilities. Some of the terminologies in Part 2 of these Rules follow those in the LAC Rules.

3. Sections 3E and 3F of the Principal Rules are amended so that an authorized institution must take into account its minimum LAC requirements, in addition to its minimum capital requirements, in calculating the CET1 capital available to meet the capital buffer requirement.

4. Currently, sections 43, 47 and 48 of, and Schedules 4E, 4F and 4G to, the Principal Rules provide for the capital deduction framework to reduce the risk of contagion in the banking system by requiring that, in calculating an authorized institution's capital adequacy ratio—

   (a) the institution's holdings of capital instruments issued by financial sector entities must be deducted from the institution's capital base; but

   (b) in the case of insignificant capital investments—

      (i) the holdings, if covered by the existing 10% threshold, are not required to be deducted but are to be risk-weighted in accordance with sections 66, 116, 145 and 183 of the Principal Rules instead; and

      (ii) the holdings, if exceeding the existing 10% threshold, are required to be deducted.

5. These Rules amend the scope and the calculation mechanism of the capital deduction framework—

   (a) to expand the scope of instruments subject to deduction (or risk-weighting) to include holdings of non-capital LAC liabilities of financial sector entities;

   (b) to add a 5% threshold (where insignificant investments of non-capital LAC liabilities by an authorized institution that are not covered by either the existing 10% threshold or this additional 5% threshold are required to be deducted from the institution's Tier 2 capital); and

   (c) to impose additional conditions for applying the 5% threshold, which conditions apply to a resolution entity and, subject to the Monetary Authority's consent to the contrary, a material subsidiary. The terms ***resolution entity*** and ***material subsidiary*** have the meanings given by the LAC Rules.

6. Schedules 4B and 4C to the Principal Rules are amended to incorporate, as part of the qualifying criteria for recognition of instruments as regulatory capital, certain conditions to mirror those forming part of the LAC debt instrument qualifying criteria under the LAC Rules.

7. Obsolete transitional provisions in Schedules 4D and 4H to the Principal Rules (regarding capital deductions, recognition of minority interests, etc.) are repealed.

Amendments Relating to Sovereign Concentration Risk

8. Part 3 of these Rules relates to sovereign concentration risk (definition of the term is added to section 2(1) of the Principal Rules).

9. Under the new Part 10 added to the Principal Rules, an authorized institution must calculate the risk-weighted amount for sovereign concentration risk if the amount of the institution's specified sovereign exposure to a country exceeds the amount of its Tier 1 capital.

10. In addition, the Principal Rules are amended so that the risk-weighted amount for sovereign concentration risk of an authorized institution must be included into the calculation of the institution's capital requirements under the capital framework.

Amendments Relating to Internal Assessment Approach, Domestic Public Sector Entities, Etc.

11. Part 4 of these Rules mainly provides for the determination of the risk-weight of an unrated securitization exposure to an asset-backed commercial paper programme by an authorized institution using the securitization external ratings-based approach based on the internal credit rating generated by the institution's internal assessment process, if the institution has the Monetary Authority's relevant approval.

12. Part 1 of Schedule 1 to the Principal Rules is amended to specify HKMC Insurance Limited and HKMC Annuity Limited as domestic public sector entities.

13. Miscellaneous amendments are made to provisions in the Principal Rules to enhance consistency and clarity.

Banking (Disclosure) (Amendment) (No. 2) Rules 2018

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

1. Commencement

These Rules come into operation on 1 July 2019.

2. Banking (Disclosure) Rules amended

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

3. Section 2 amended (interpretation)

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

Repeal

"or Division 4 of Part 6A"

Substitute

", Division 4 of Part 6A, or Part 10".

Annex D

Monetary Authority

2018

Explanatory Note

Part 3 of the Banking (Capital) (Amendment) Rules 2018 makes changes to the capital requirements applicable to authorized institutions to address concentration risk associated with the institutions' exposures to specified sovereign entities. These Rules make a consequential amendment to the Banking (Disclosure) Rules (Cap. 155 sub. leg. M).