

L.N. 222 of 2018

Banking (Capital) (Amendment) Rules 2018

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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) × 10%;
- (g) **5% threshold** (5%門檻) is the amount calculated as follows—
CET1 Capital (post-regulatory deduction) × 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 $\text{Inv}(\text{CET1})$, $\text{Inv}(\text{AT1})$, $\text{Inv}(\text{T2})$ and $\text{Inv}(\text{NvDsg NCLAC})$ —
- (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 $\text{Inv}(\text{CurDsg NCLAC})$, 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—
$$[\text{Inv}(\text{CET1}) + \text{Inv}(\text{AT1}) + \text{Inv}(\text{T2}) + \text{Inv}(\text{NvDsg NCLAC})] - 10\% \text{ threshold};$$
 - (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—
$$\text{Inv}(\text{CurDsg NCLAC}) - 5\% \text{ threshold};$$
 - (ii) zero;

- (h) **CET1 percentage** (CET1百分比) is the percentage calculated as follows—
- $$100\% \times \{ \text{Inv}(\text{CET1}) / [\text{Inv}(\text{CET1}) + \text{Inv}(\text{AT1}) + \text{Inv}(\text{T2}) + \text{Inv}(\text{NvDsg NCLAC})] \};$$
- (i) **AT1 percentage** (AT1百分比) is the percentage calculated as follows—
- $$100\% \times \{ \text{Inv}(\text{AT1}) / [\text{Inv}(\text{CET1}) + \text{Inv}(\text{AT1}) + \text{Inv}(\text{T2}) + \text{Inv}(\text{NvDsg NCLAC})] \}; \text{ and}$$
- (j) **T2 percentage** (T2百分比) is the percentage calculated as follows—
- $$100\% \times \{ [\text{Inv}(\text{T2}) + \text{Inv}(\text{NvDsg NCLAC})] / [\text{Inv}(\text{CET1}) + \text{Inv}(\text{AT1}) + \text{Inv}(\text{T2}) + \text{Inv}(\text{NvDsg NCLAC})] \}.$$
- (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—
- $$\text{Excess}(10\% \text{ threshold})(\text{net long}) \times \text{CET1 percentage}.$$
- (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—
- $$\text{Excess}(10\% \text{ threshold})(\text{net long}) \times \text{AT1 percentage}.$$

- (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—

$$[\text{Excess}(10\% \text{ threshold})(\text{net long}) \times \text{T2 percentage}] + \text{Excess}(5\% \text{ threshold})(\text{gross long}) + \text{Inv}(\text{FmDsg NCLAC}).$$

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—

$$[Inv(CET1) + Inv(AT1) + Inv(T2) + Inv(Non-Alc NCLAC)] - 10\% \text{ threshold};$$
 - (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—

$$Inv(Alc NCLAC) - 5\% \text{ threshold};$$

- (ii) zero;
- (g) **CET1 percentage** (CET1百分比) is the percentage calculated as follows—

$$100\% \times \{ \text{Inv}(\text{CET1}) / [\text{Inv}(\text{CET1}) + \text{Inv}(\text{AT1}) + \text{Inv}(\text{T2}) + \text{Inv}(\text{Non-Alc NCLAC})] \};$$
- (h) **AT1 percentage** (AT1百分比) is the percentage calculated as follows—

$$100\% \times \{ \text{Inv}(\text{AT1}) / [\text{Inv}(\text{CET1}) + \text{Inv}(\text{AT1}) + \text{Inv}(\text{T2}) + \text{Inv}(\text{Non-Alc NCLAC})] \};$$
 and
- (i) **T2 percentage** (T2百分比) is the percentage calculated as follows—

$$100\% \times \{ [\text{Inv}(\text{T2}) + \text{Inv}(\text{Non-Alc NCLAC})] / [\text{Inv}(\text{CET1}) + \text{Inv}(\text{AT1}) + \text{Inv}(\text{T2}) + \text{Inv}(\text{Non-Alc NCLAC})] \}.$$
- (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—

$$\text{Excess}(10\% \text{ threshold})(\text{net long}) \times \text{CET1 percentage}.$$
- (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—

$$\text{Excess}(10\% \text{ threshold})(\text{net long}) \times \text{AT1 percentage}.$$

- (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—

$$[\text{Excess}(10\% \text{ threshold})(\text{net long}) \times \text{T2 percentage}] + \text{Excess}(5\% \text{ threshold})(\text{gross long}).$$

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

$$E(A) = \text{Min} ((S_A \times \text{NAV}_{AI} / \text{NAV}_S), BV)$$

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 tranching 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”.

Norman CHAN
Monetary Authority

12 November 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

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- (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.