

## RCAP jurisdictional assessments: self-reporting monitoring template for RCAP follow-up actions

Jurisdiction: Hong Kong SAR

Status as of: 31 December 2016

With reference to RCAP report(s): Assessment of Basel III risk-based capital and LCR regulations – Hong Kong SAR (March 2015)

### Part A<sup>1</sup>

Post-RCAP follow up: Changes applied to local regulations of the Basel Framework relating to risk-based capital standards (RCAP-Capital)

Table A

(1) Issue and/or relevant Basel paragraph number(s)	(2) Detailed description of finding (please indicate as precisely as possible the finding as identified in the relevant RCAP assessment report)	(3) Detailed reference to the domestic legislation/regulation that addresses the finding	(4) Summary description of amendment or rectification made
1. Credit risk: Standardised Approach  Paragraph 53-56: Claims on sovereigns	Banking (Capital) Rules (BCR) §56(3) allows banks to apply comparatively lower risk weights to sovereign exposures denominated and funded in domestic currencies, in cases where other national supervisory authorities have not exercised the discretion to apply lower risk weights to banks' exposures to their sovereign in terms of paragraph 54 of Basel II.	No longer exist as repealed by Banking (Capital) (Amendment) Rules 2015 (BCAR 2015) clause 11.	BCR §56(3) was repealed on 1 January 2016.
2. Credit risk: Standardised Approach	Under BCR §62, rated Collective Investment Schemes (CIS) investing only in cash or fixed income assets may be risk-	Consultation paper issued by the HKMA in October 2015 on the local	BCR §62 will be replaced by new provisions to be introduced for the implementation of the

<sup>1</sup> To be completed only for those findings where action has been taken or initiated. Any plans for addressing other findings may be indicated in Part B.

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Paragraph 81: Other assets	weighted by reference to the external credit ratings assigned to the CIS instead of receiving the standard risk weight of 100% as required for "all other assets" under paragraph 81 of Basel II.	implementation of the BCBS standard on "Capital requirements for banks' equity investments in funds" issued in December 2013.	BCBS standard. The new provisions are expected to come into effect in 2018.
3. Credit risk: Standardised Approach  Paragraphs 82–89: Off-balance sheet items	Under BCR §74(2)(f), a flat risk weight of 100% is applicable to exposures arising from partly paid-up shares and securities. This would be less stringent than footnote 35 of paragraph 84(i) of Basel II, which requires the exposures to be risk-weighted according to the type of assets.	BCR §74(2)(f) as amended by BCAR 2015 clause 13.	The revised BCR §74(2)(f), which came into effect on 1 January 2016, requires banks to risk-weight the exposures arising from partly paid-up shares and securities by reference to the risk-weight allocated to the relevant shares or securities.
4. Credit risk: Standardised Approach  Paragraphs 145–146 as amended by revised framework: Collateral – Eligible financial collateral	Basel II paragraph 145(d) permits unrated debt securities issued by banks to serve as collateral so long as they satisfy certain criteria. However, BCR §79(1)(m) permits unrated debt securities issued by securities firms (in addition to those issued by banks) to be recognised as eligible collateral.	BCR §79(1)(m) as amended by BCAR 2015 clause 14.	With effect from 1 January 2016, unrated debt securities issued by securities firms are no longer recognisable collateral under the revised BCR §79(1)(m).
5. Credit risk: Standardised Approach  Paragraphs 147–155 as amended by revised framework: Collateral – The comprehensive	Item 7 of Part 1 of the haircut table in BCR Schedule 7 includes debt securities without ECAI issue-specific ratings issued by banks or securities firms. The haircut table included in Basel II paragraph 151 (as amended under Basel III) does not include debt securities issued by securities firms.	BCR Schedule 7 as amended by BCAR 2015 clause 28(2).	Debt securities without ECAI issue-specific ratings issued by securities firms were removed from Item 7 of Part 1 of the haircut table in BCR Schedule 7 on 1 January 2016.

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approach; Calculation of capital requirement; Own estimates for haircuts			
6. Credit risk: Standardised Approach  Paragraph 182-187: Collateral – the simple approach	BCR §82(4)(c) provides that collateral in the form of gold bullion may be assigned a risk-weight of 0% regardless of the risk-weight floor of 20% imposed by BCR §82(1)(b). However, Basel II has not exempted gold bullion from the risk-weight floor of 20%.	No longer exist as repealed by BCAR 2015 clause 15(3).	BCR §82(4)(c) was repealed on 1 January 2016.
7. Credit risk: Internal ratings-based approach  Paragraph 220: Classification of corporate exposures	Basel II paragraph 220 defines five sub-classes of specialised lending, including HVCRE, for the purposes of categorizing corporate exposures under the IRB approach. The BCR did not categorise assets into HVCRE as the HKMA considered that the criteria set out for the other specialised lending classes, taking into account local underwriting standards on mortgage loans secured by commercial real estate and on lending to finance property development, adequately captured the risks associated with HVCRE.	BCR §§139, 142, 143, 157, 158, 218 and 220 as amended by BCAR 2015.	The BCR sections referred to in column (3) were revised to introduce the HVCRE subclass for corporate exposures under the IRB approach. The amendments came into effect on 1 January 2016.
8. Market risk: Standardised measurement method  Paragraph 701(i):	In addition to the standardised approach and the internal models approach prescribed in Basel II for market risk calculation, BCR §17(1)(c) also permitted an AI to use, subject to the HKMA's approval under §20(2)(a), the approach used by the institution's parent bank ("parent bank approach").	BCR §17(1)(c) of the BCR was repealed by BCAR 2015.	The amendment to withdraw the parent bank approach under the BCR came into effect on 1 January 2016. Prior to this amendment, the HKMA had not granted approval for any AI to use the parent bank approach.

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Methods of measuring market risks			
9. Counterparty Credit Risk framework  Paragraph 92(i)	Under BCR §71(3), an AI is not required to hold regulatory capital in respect of an exchange rate contract (except a contract the value of which is determined by reference to the value of, or any fluctuation in the value of, gold) which has an original maturity of not more than 14 calendar days. However, this exemption is no longer available under Basel II.	BCR §71(2) as amended by BCAR 2015 clause 12.	Paragraph (a) of the definition “excluded exchange rate contract” in Table 11 under BCR §71(2) was removed on 1 January 2016. In other words, the exemption is no longer available under the BCR.
10. Pillar 3  Basel II Paragraph 818: Frequency	Banking (Disclosure) Rules (BDR) do not require (i) quarterly disclosure of Tier 1 and Total capital adequacy ratios, and their components by large internationally active banks and other significant banks, and (ii) semi-annual disclosure of all risk exposures, as required respectively under paragraph 818, and Tables 3 to 14 under paragraph 822 to paragraph 826, of Basel II.	Addressed by the new Part 2A and Part 2B, and the revisions to Part 3 of the BDR as set out in the Banking (Disclosure) (Amendment) Rules 2016 (BDAR 2016).	BDAR 2016 are expected to be tabled in the Legislative Council in January 2017 with a view to the rules taking effect on 31 March 2017 to apply to authorized institutions’ disclosures relating to financial years beginning on or after 1 January 2017.
11. Pillar 3  Basel II Paragraph 825: Table 5 (b, first bullet) Credit risk: Quantitative disclosure	BDR do not require disclosure of outstanding amounts subject to the standardised approach to credit risk by “each risk bucket” (eg 0%, 10% 20% etc) as required in Table 5 (b, first bullet) under paragraph 825 of Basel II although AIs are encouraged to make more detailed or granular disclosures than are required under the BDR pursuant to SPM CA-D-1 §3.2.3.	New BDR §16O as introduced in BDAR 2016 clause 15.	The issue will be addressed in BDAR 2016 for implementing the January 2015 BCBS revised Pillar 3 disclosure requirements which supersede the corresponding requirements issued in 2004 under Basel II (as subsequently enhanced in 2009 under Basel II.5).
12. Pillar 3	BDR §58 and §80 require disclosure of exposures related to counterparty credit risk on a “post-netting” basis, whilst	New BDR §16N and 16R as introduced in BDAR 2016 clause 15.	- Ditto -

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Basel II Paragraph 826: Table 8 (b) Counterparty Credit risk: Quantitative disclosure	Table 8 (b) under paragraph 826 of Basel II explicitly requires disclosure of netting benefits. .		
13. Pillar 3  Basel II.5 Paragraph 826: Table 9 (g and o) Securitisation: Quantitative disclosure	Table 9 (g and o) of Basel II.5 provides disclosure of "The total amount of outstanding exposures securitised by the bank and defined under the securitisation framework (broken down into traditional/synthetic) by exposure type, separately for securitisations of third-party exposures for which the bank acts only as sponsor", divided into banking book and trading book information. The BDR require disclosure for such information, but do not separate the information relating to the banking book and the trading book.	New BDR §16ZF, 16ZG, 16ZH and 16ZI as introduced in BDAR 2016 clause 15.	- Ditto -
14. Pillar 3  Basel II.5 Paragraph 826: Table 9(r) Securitisation: Quantitative disclosure	BDR §60(1)(y) and §82(1)(y) require disclosure of the total amount of underlying exposures in securitisation transactions in relation to which an originating AI has retained some securitisation exposures, but not those in which it does not retain any securitisation exposures for the year of inception as required under Footnote 229 of Basel II.5.  BDR §60(1)(p) and §82(1)(p) require an AI to disclose a summary of securitisation transactions the AI has entered into during the reporting period, and including the amount of underlying exposures that have been securitised and shown separately for exposures in the banking book and trading book. This does not fully address the requirements in Table 9(r) of Basel II.5 which specifies disclosure of	New BDR §16ZH as introduced in BDAR 2016 clause 15.	- Ditto -

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	<p>"aggregate amount of exposures securitised by the bank for which the bank has retained some exposures and which is subject to the market risk approach (broken down into traditional/synthetic), by exposure type."</p>		
<p>15. Pillar 3 - additional remuneration and capital disclosure requirements</p> <p>"Composition of capital disclosure requirements" Paragraph 6: Frequency of reporting</p>	<p>Paragraph 6 of "Composition of capital disclosure requirements" under Pillar 3 of the Basel framework requires large banks to make certain minimum disclosures with respect to certain defined key capital ratios and elements on a quarterly basis, regardless of the frequency of financial statement publication. The disclosure of key capital ratios/elements for these banks will continue to be required under Basel III (the revisions as of June 2012).</p> <p>The BDR do not require quarterly disclosure of key capital ratios and elements by large banks. The issue is related to the findings in respect of paragraph 818 of Basel II and hence is not counted as a separate finding.</p>	<p>New BDR §16ZQ as introduced in BDAR 2016 clause 15. See also row #10 above.</p>	<p>- Ditto - (See also row #10 above.)</p>

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Post-RCAP follow up: Changes applied to local regulations of the Basel Framework relating to Liquidity Coverage Ratio (RCAP-LCR)

Table B

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## Part B

(1) Issue and/or relevant Basel paragraph number(s)	(2) Detailed description of finding (please indicate as precisely as possible the finding as identified in the relevant RCAP assessment report)	(3) Plan(s) for amendment/rectification of findings	(4) Expected or tentative time frame
1. Credit risk: Standardised Approach  Paragraph 65: Claims on securities firms	BCR §60 requires claims on securities firms to be risk-weighted similarly to claims on banks. However, the eligibility criteria mentioned in Basel II paragraph 65, including footnote 27, are not required to be fully met with respect to claims on licensed corporations supervised by the Securities and Futures Commission of Hong Kong.	We plan to revisit this issue when implementing the BCBS's revised standard on the Standardised Approach for Credit Risk.	In accordance with the BCBS implementation timetable for the revised standard on the Standardised Approach for Credit Risk.
2. Credit risk: Standardised Approach  Paragraphs 69–71: Claims included in the regulatory retail portfolios	The BCR do not include the granularity criterion for determining whether claims may be included in the regulatory retail portfolio as required under Basel II paragraph 70.	- Ditto	- Ditto
3. Credit risk: Standardised Approach  Paragraph 74: Claims secured by commercial real estate	Basel II paragraph 74 requires a 100% risk weight for claims secured by commercial real estate (subject to meeting criteria under footnote 29, 50% risk-weighting is also possible). The BCR do not contain a similar provision rather, commercial real estate exposures can be treated as corporate exposures, regulatory retail exposures or other exposures.	- Ditto	- Ditto
4. Scope of application  Basel II paragraphs 20-23:	The BCR only require consolidation up to the level of locally incorporated AIs, but do not subject holding companies that are not AIs to capital adequacy requirements.	The HKMA will continue to keep the issue under review. At present, there are only very few AIs, none of which are internationally active, whose holding companies are not subject to supervision by the HKMA or other relevant banking supervisory authorities. In those cases	To be confirmed.



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		where the holding companies are unregulated entities, §70 of the Banking Ordinance (BO) permits the HKMA to impose conditions on the approval of the holding companies as controllers of AIs, and the HKMA uses this power to require these holding companies to comply with the Basel III capital requirements on a consolidated basis as if they were locally incorporated AIs.	
5. Scope of application  Basel II paragraphs 35-36:	BCR §43(1)(n) require the deduction from CET1 capital of any significant investment in a commercial entity that is also a connected company of an AI. (Significant investments in commercial entities that are not connected companies of AIs are risk-weighted at 1250%). Basel III however makes no distinction in terms of treatment between significant investments in commercial entities that are connected to banks and those that are not, requiring all such significant investments to be risk-weighted at 1250%. The deduction approach may not always be the most conservative approach. For AIs with capital levels in excess of the minimum, the deduction approach may result in higher CET1/total capital ratios than the risk-weighting approach.	No AI has reported having to make any such deduction in arriving at its capital position so far. The finding therefore remains immaterial and the HKMA will review the appropriateness of its existing capital treatment when necessary.	To be confirmed.
6. Definition of capital  Basel III paragraphs 62-65:	Under Basel III, surplus minority interest is calculated using the minimum capital requirements plus the capital conservation buffer only.  BCR schedule 4D however includes any Pillar 2 add-on on individual subsidiary AIs as part of minimum capital requirement rather than as surplus capital of such AIs. This	Given that the impact is not material and the issue is still under consideration by the BCBS Working Group on Capital as potential FAQ under the PDG, we intend to keep the existing calculation mechanics for the time being pending further clarification of the BCBS.	To be confirmed.

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	results in a higher minimum capital requirement when computing the amount of minority interests recognised as capital and thus in a higher capital ratio at the consolidated level compared to the Basel III calculation.		
7. Credit risk: Internal ratings-based approach  Paragraph 231: Classification of retail exposures	Basel II paragraph 231 states that residential mortgage loans are eligible for retail treatment "so long as the credit is extended to an individual". BCR §144(3) allows residential mortgages extended to property-holding shell companies to be classified as retail exposures, the design of which was intended to better reflect the risks associated with such loans vis-a-vis those associated with residential mortgage loans to individuals. In particular, the eligibility criteria for retail treatment set out in the BCR ensure that only those residential mortgage loans to property-holding shell companies that bear comparable risk characteristics to residential mortgage loans to individuals can qualify for retail treatment.	The HKMA plans to revisit this issue when it implements the BCBS's proposed revisions to the IRB framework.	We intend to follow the BCBS's implementation timeline for the revised IRB approach.
8. Securitisation framework  Paragraph 541: Scope and definitions	Paragraph 541 of Basel II states securitisation exposure can include, among other items, interest rate or currency swaps. However, the BCR do not include these two items to be risk-weighted within the securitisation framework. Rather, the BCR require that the capital requirements for the counterparty credit risk arising from such derivative contracts be calculated in accordance with the credit risk capital frameworks for non-securitisation exposures.	The HKMA is in the process of implementing the BCBS's revised securitisation framework issued in December 2014 and updated in July 2016. The capital treatment for interest rate or currency swaps set out in the revised framework will be adopted.	1 January 2018.
9. Securitisation framework  Paragraph 594: Maximum capital requirement	BCR §242(1) caps the capital requirement for securitisation exposures of an originating bank under the standardised approach, which was modelled on the requirements set out in Basel II paragraph 610 in respect of the IRB approach to securitisation. However, paragraph 594 of Basel II does not cap the capital requirement for securitisation exposures of an	This will no longer be an issue upon the local implementation of the BCBS's revised securitisation framework in light that its paragraph 91 extends the Basel II cap on the capital requirements available to IRB banks to an originating or sponsor	1 January 2018.

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	originating bank under the standardised approach except where the bank concerned is subject to the early amortisation treatment.	bank using the standardised approach for credit risk. The HKMA intends to adopt this treatment in the BCBS revised securitization framework.	
10. Operational Risk  Basel II Paragraph 663(f) : The Standardized Approach qualifying criteria	BCR Schedule 4, §1(i) states a bank's operational risk assessment system is subject to validation and regular independent reviews by external auditors or internal auditors. An independent review conducted by internal auditors is not in full alignment with paragraph 663(f) of Basel II which requires the regular review must be done by external auditors and/or supervisors. However, paragraph 2.1.3 of SPM OR-1 stipulates that the HKMA will have particular regard to (among other things) the adequacy and results of the AI's internal review and audit of operational risk.	We plan to revisit this issue when implementing the revised Standardized Approach for Operational Risk.	In accordance with the BCBS implementation timetable for the revised Standardized Approach for Operational Risk.
11. Market risk: Standardised measurement method  Paragraph 711(i): Specific risk for interest rate risk exposures	BCR §287(4)(b) allows securities which are not issued by an MDB or PSE to be rated by fewer than two rating agencies, which is not provided for in Basel II paragraph 711(i). This BCR provision was stipulated in recognition that the solicitation of external credit ratings from two separate rating agencies on the same instrument has not been a widespread practice for local issuers, and that this is not uncommon in jurisdictions with less developed debt markets.	This will no longer be an issue upon the local implementation of the BCBS's revised minimum requirements for market risk issued in January 2016, in view that the use of external credit ratings in the revised framework in respect of interest rate risk calculations are not associated with a requirement on the minimum number of rating agencies involved.	1 January 2019
12. Market risk: Standardised measurement method  Paragraph 718(xLi): Foreign exchange risk	BCR §296(1)(a) and 296(2)(b)(ii) allow an AI to set off its net long or short FX positions against its USD/HKD position where the AI's net open positions in USD and HKD are opposite positions. The BCR provision reflects the operation of the Linked Exchange Rate System (Currency Board) in Hong Kong, which constrains volatility in the exchange rate between the	The HKMA may revisit this issue when it implements the BCBS's revised minimum requirements for market risk issued in January 2016.	1 January 2019

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	USD and the HKD. Over the past 30 years, the average volatility has been 0.46%.		