Consultation Paper

Implementation of Basel III disclosure standards in Hong Kong (for Leverage Ratio, Liquidity Coverage Ratio and Capital Buffers) (D2)

Overview

1. This paper sets out, for comment by the banking industry, the HKMA's proposals for implementing disclosure requirements in relation to the Basel III:

   (a) leverage ratio ("LR");

   (b) liquidity coverage ratio ("LCR"); and

   (c) capital buffers (i.e. the "capital conservation buffer", the "countercyclical capital buffer" ("CCyB") and, for banks considered as "systemically important", the "Higher Loss Absorbency Requirement" ("HLA")).

   Implementation of these disclosure requirements will necessitate amendment of the Banking (Disclosure) Rules ("BDR") and the industry will be consulted shortly on the text of the proposed amendments to the BDR.

2. The HKMA also proposes to take this opportunity to slightly refine the current disclosure framework in Hong Kong in order to align it more closely with some recent updates in prudential reporting requirements ("other disclosures").

3. The relevant amendments to the BDR to implement the above changes are proposed to apply to authorized institutions ("AIs") starting from their first interim or annual financial disclosure in 2015.

Proposed disclosures

Disclosures relating to the Leverage Ratio

4. Under the Basel III implementation timetable, disclosure requirements relating to the LR should take effect from 1 January 2015. Currently a "parallel run" of the LR is in progress during which AIs are required to report their leverage ratios on a quarterly basis to the HKMA as part of the

Basel Committee on Banking Supervision's (BCBS) monitoring process[1]. The parallel run will continue until 1 January 2017 and thereafter any final adjustments considered necessary for the LR definition will be made by the BCBS over the course of 2017, with a view to the LR migrating to a Pillar 1 (minimum capital requirement) standard on 1 January 2018.

5. In January 2014, the BCBS published the *Basel III leverage ratio framework and disclosure requirements*[2] to set out the latest standard for the LR computation methodology and the LR disclosure requirements. Following the approach adopted by the BCBS for the purpose of enhancing the consistency and comparability of bank disclosures in respect of the Basel III risk-based capital standards, the LR disclosure requirements also contain common templates that enable a bank to provide:

   (a) through a "summary comparison table", a comparison of its total accounting assets amounts and its LR Exposure Measure; and

   (b) through a "leverage ratio common disclosure template", a breakdown of the main components of its LR.

6. The templates are required to be supplemented by:

   (a) a qualitative reconciliation that details the source of material differences between the bank's total balance sheet assets in its financial statements and its on-balance sheet exposures in the standard disclosure template; and

   (b) disclosure on the key drivers of material changes in the bank's LR observed from the end of the previous reporting period to the end of the current reporting period.

7. The HKMA proposes to adopt disclosure templates substantially similar in content to those devised by the BCBS (as described in paras 49 to 58 of the January 2014 BCBS document and to require that the information in the templates be supplemented as described in para 6 above.

Disclosures relating to Liquidity

8. In January 2014, the BCBS released the *Liquidity coverage ratio disclosure standards* (revised in March 2014)[3] to set out the disclosure

---

[1] The terms and calculation methodology for the LR are specified in the Quarterly Template on Leverage Ratio issued in May 2014 by the HKMA pursuant to section 63 of the Ordinance for AIs to report their leverage ratio positions.

[2] This paper can be accessed at the BIS website at http://www.bis.org/publ/bcbs270.pdf.

[3] This paper can be accessed at the BIS website at http://www.bis.org/publ/bcbs272.pdf.

requirements associated with the LCR. These include requirements for banks to present information in the form of a common template on their high quality liquid assets ("HQLA") (i.e. the numerator of the LCR) as well as their net cash outflows (i.e. the denominator of the LCR) with a breakdown of individual items of cash outflows and cash inflows. Banks are required to supplement the common template with sufficient qualitative discussion to facilitate understanding of the disclosed information, which could include:

(a) the main drivers of their LCR levels and the evolution of the contribution of inputs to their LCR calculation over time;

(b) intra-period changes as well as changes over time;

(c) the composition of their HQLA;

(d) concentrations of funding sources;

(e) their derivative exposures and potential collateral calls;

(f) the extent of currency mismatch within their LCR;

(g) a description of the degree of centralization of liquidity management within, and interaction between, the banking group's units; and

(h) other inflows and outflows in the LCR calculation that are not captured in the LCR common template but which the institution considers to be relevant for its liquidity profile.

9. As in the case of the Leverage Ratio disclosures, the HKMA proposes to adopt a disclosure template for the LCR that is substantially similar in content to the common template prescribed by the BCBS in their March 2014 document, and to require that the information in the template be supplemented as described in para 8 above. Furthermore, as mentioned in the March 2014 BCBS document, AIs are encouraged to promote market discipline by making additional disclosures (both quantitative and qualitative) to provide market participants with a broader picture of their liquidity risk position and management. The industry will in due course be consulted on the relevant supervisory guidance to be issued by the HKMA to set out our expectations in this regard.

10. National authorities are required to give effect to the liquidity disclosure requirements no later than 1 January 2015 and banks should comply from the date of publication of their first set of financial statements relating to balance sheet data on or after 1 January 2015.

11. Consistent with the requirements set out in the Banking (Liquidity) Rules ("BLR")[4], only "category 1 institutions" as defined in the BLR are required to compute the LCR and will hence be subject to the disclosure requirements associated with the LCR. Other AIs (i.e. "category 2 institutions" as defined in the BLR), which are only required to compute the Liquidity Maintenance Ratio ("LMR"), will continue to be subject to existing liquidity ratio disclosure requirements in the BDR modified as necessary to align with the LMR.

Disclosures relating to Capital Buffers

12. The standard templates issued by the HKMA in June 2013 in relation to the disclosure requirements for the composition of capital already contain some provision for disclosure relating to the level of AIs' capital buffers.

13. Additional disclosure requirements associated with the capital buffers, that are yet to be implemented in Hong Kong, relate to the application of:

    (a) the <u>CCyB</u>, as set out in *Basel III: A global regulatory framework for more resilient* banks *and banking systems*[5] issued by the BCBS in December 2010 (revised in June 2011), namely:

        (i) the specific CCyB requirement of a bank calculated by reference to the CCyBs in effect in the jurisdictions in which the bank has private sector credit exposures (as described in para 2.5.2 of the draft SPM module on "Approach to Implementing the Countercyclical Capital Buffer (CCyB)" released in August 2014 by the HKMA for industry consultation). (This should be disclosed with at least the same frequency as the bank's minimum capital requirements); and

        (ii) the geographic breakdown of the bank's private sector credit exposures used in the calculation of its CCyB requirement, and

    (b) the <u>HLA</u> for global systemically important banks ("G-SIBs"), as set out in *Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement* issued by the BCBS in July 2013[6]. Under this standard all banks with an overall size exceeding EUR 200 billion (as measured by the Basel III LR Exposure Measure) and those that (are below the threshold but) have been classified as a G-SIB in the immediately preceding year are

---

[4] The BLR were gazetted on 24 October 2014 and are currently undergoing negative vetting by the Legislative Council.

[5] This paper can be accessed at the BIS website at http://www.bis.org/publ/bcbs189.pdf.

[6] This paper can be accessed at the BIS website at http://www.bis.org/publ/bcbs255.pdf.

required to make publicly available 12 indicators specified in the methodology (under para 19 of the July 2013 BCBS document) for assessing systemic importance in terms of: cross-jurisdictional activity, size, interconnectedness, substitutability/(role in) financial institution infrastructure and complexity. This disclosure ensures that the G-SIB framework remains transparent, and that interested parties are able to anticipate when and how the G-SIB requirements, including additional HLA capital requirements, will be applied.

Although there is as yet no AI, for which the HKMA is the home regulator, falling within the above G-SIB focussed disclosure requirements, the HKMA considers it necessary to incorporate disclosure requirements in respect of the 12 indicators into the BDR. This is to prepare for the case in the future where the need arises to consider whether a locally incorporated AI meets the requirements for designation as a G-SIB.

Although the BCBS has not specified any disclosure requirements for domestic systemically important banks ("D-SIBs") in its *framework for dealing with domestic systemically important banks* issued in October 2012 [7], there is provision for locally incorporated AIs designated as D-SIBs to disclose the level of their specific D-SIB buffer in the standard disclosure template prescribed by the HKMA for the purposes of making disclosures on the composition of capital under the BDR. Currently, no additional disclosure requirements are proposed for AIs designated as D-SIBs on top of those currently required under the BDR. The HKMA, however, plans to review the existing disclosure requirements for D-SIBs, and other AIs more generally, when it comes to consider implementation of the revised pillar 3 disclosure requirements expected to be finalized by the BCBS at the end of this year.

Other disclosures

14. At present, sections 28, 49 and 101 of the BDR require an AI to disclose a breakdown of its material Mainland exposures to non-bank counterparties into the categories in the regulatory return for non-bank Mainland exposures which forms part of the Return of Quarterly Analysis of Loans and Advances and Provisions (MA(BS)2A) (submitted by the institution regularly to the HKMA pursuant to s.63 of the Banking Ordinance). For this purpose, the HKMA has provided guidance to AIs on how their non-bank Mainland exposures should be reported based on the categories of non-bank counterparties set out in a specific section of this regulatory return. As this section will be replaced later this year by a new "Return of

---

[7] This paper can be accessed at the BIS website at http://www.bis.org/publ/bcbs233.pdf.

Mainland Activities", it is consequently necessary to update the relevant sections of the BDR (and related guidance) to align them with the new prudential reporting requirements.

15. Likewise, sections 25, 46 and 98 of the BDR require an AI to disclose a breakdown of its cross-border claims by major countries or geographical segments in accordance with the type of counterparties, broken down into banks, public sector entities and others. In this regard, the HKMA has advised AIs to make reference to the data reported in the Return of External Positions (MA(BS)9). A new "Return of International Banking Statistics" has however recently been introduced which AIs are required to submit in parallel with the Return of External Positions for the positions of two quarters (viz., ending December 2014 and March 2015) before the latter is superseded by the former. It is therefore necessary to make changes to the sections of the BDR to align the category references more closely to the new return.

Approach to implementation

16. As discussed above, the HKMA intends to fully adopt the disclosure requirements associated with the second phase of Basel III standards as prescribed by the BCBS in their various standards cited above.

17. For the purpose of implementing these standards, the HKMA proposes to follow a similar approach to that adopted in respect of the first phase of Basel III implementation. This will involve amending the BDR to set out the relevant requirements, and provide for the HKMA to specify the "format" of disclosure based on the standard disclosure templates prescribed by the BCBS.

18. The proposed amendments to the BDR, to be set out in a set of Banking (Disclosure) Amendment Rules 2014 ("BDAR 2014") are currently under preparation and will shortly be released for consultation with the industry as required under section 60A of the Banking Ordinance. The areas for amendment in the BDR identified by the HKMA are:

    Leverage Ratio Disclosures

    (a) Incorporate a new section 24A (for interim disclosures) and section 45A (for annual disclosures) into the BDR. These new sections will:

        (i) outline the items that the BCBS requires banks to disclose regarding their LR (see paras 4 to 7 above), including those (in relation to quantitative information) that should be disclosed in standard templates;

(ii) prescribe the means of disclosure and the record maintenance requirements mirroring those for capital disclosures under Section 24(3) and (4); and

(iii) specify the bases of consolidation an AI should use for calculating its LR.

Capital buffer disclosures

(b) Incorporate new sections 24B (for interim disclosures) and 45B (for annual disclosures) into the BDR to reflect the information AIs must disclose in relation to their CCyB requirements (see paras 12 to 13(a) above).

Liquidity disclosures

(c) Repeal the existing Sections 30, 51 and 103 of the BDR on "Liquidity" and substitute each of these sections by a new section to specify the required liquidity disclosures for "category 1 institutions" and "category 2 institutions".

For <u>category 1 institutions</u>, the new section will:

(i) require disclosure of the LCR in respect of the quarter ending on the interim or annual reporting date and the quarter immediately preceding that first-mentioned quarter;

(ii) specify the basis of calculation of the quarterly LCR (which ultimately should be the average LCR calculated based on daily figures for the quarter concerned)[8], and the transitional arrangement (with 1 January 2017 as the cut-off date) for such calculation (as provided by the BCBS in paragraph 13 of the *Liquidity coverage ratio disclosure standards* to ease banks' implementation burden). Under this arrangement, category 1 institutions may, with the prior consent of the Monetary Authority, begin disclosure by reference to month-end figures[9] until January 2017 and thereafter they should use daily figures in calculating their quarterly LCR;

---

[8] In line with the Basel requirement, the quarterly LCR must be calculated as the simple average of the LCR position as at the end of each calendar day in the quarter concerned. In other words, the average is calculated over a period of, typically, 90 days.

[9] This means that the quarterly LCR could be calculated as the simple average of the LCR position as at each month-end in the quarter concerned.

(iii) outline the items that the BCBS requires banks to disclose, including those to be disclosed in relation to the standard template (see paras 8 to 11 above);

(iv) prescribe the means of disclosure and record maintenance requirements that mirror those for capital disclosures under section 24(3) and (4) of the BDR; and

(v) in the case of a locally incorporated AI, specify the bases of consolidation a category 1 institution should use for calculating its LCR.

For <u>category 2 institutions</u>, the new section will set out requirements broadly similar to those under the current section 30, 51 or 103 of the BDR relating to the existing statutory liquidity ratio with necessary changes to align with the LMR.

G-SIB disclosures

(d) Incorporate a new section 45C into the BDR to provide for the new disclosure requirements applicable to any AI which may have the potential in future to be designated by the MA as a G-SIB (due to its systemic importance) (see para 13(b) above).

Other disclosures

(e) Update existing sections 6(8), 6(9), 13(1)(b), 25, 26, 28, 46, 47, 49, 88(7), 88(8), 90(1)(a), 90(1)(b), 98 and 101 of the BDR such that they are in alignment with the current prudential reporting requirements of the HKMA (see paras 14 to 15 above).

19. As with the existing framework, the proposed disclosures in respect of the LR, Capital Buffers and G-SIBs are applicable only to locally incorporated AIs, whereas those in respect of Liquidity and “other disclosures” are applicable to both locally incorporated and overseas incorporated AIs, except for any AIs which meet the relevant exemption criteria specified in Part 1 of the BDR.

20. The HKMA aims to release for industry consultation later this year the standard disclosure templates for the LR and the LCR as mentioned in paragraphs 6 and 8 above. The standard template for disclosures by G-SIBs will be developed and issued for consultation shortly thereafter.